THE INFLUENCE OF CORPORATE GOVERNANCE AND OWNERSHIP STRUCTURE ON PROFITABILITY

Herawanto, ErnieTisnawatiSule, Maman Kusman,Nury Effendi

Abstract: This study aims to examine the influence of Corporate Governance and Ownership Structure on the profitability of Indonesian Banking. The method used is explanatory. The population of this research is banking companies listed on the Indonesian Stock Exchange in 2008-2015. The purposive sampling method is used in the selection of samples to obtain a sample of 28 banking companies with total observations of 224 observational data for 4 years. Based on the hypothesis testing, the result shows that simultaneously Independent Audit Committee, Independent Commissioner and Foreign Ownership affect on profitability (ROA) of the banking industry with the influence 30.25% while the rest of 69.75% influenced by other variable not included in this model. Based on partial hypothesis testing show that partially Independent Audit Committee does not affect on Profitability (ROA) while Independent Commissioner and Foreign Ownership have partial influence to Profitability (ROA) of banking industry.

Keywords: *Corporate Governance, Ownership Structure, Profitability*

Introduction

To invest in industries in Indonesia, the financial performance of a company is generally viewed in terms of profitability. Investors basically seek profit from the increase in investment (capital gains) and from the profit gained from the business, so that the level of profitability makes an industry has a strong appeal to investors.

Profitability of a company is reflected in its return on assets (ROA) ratio. The ROA achieved by the national banking industry has been down to 4.2% (2014) from 4.9% (2013) as reported in LPI 2014 as it is overshadowed by the dynamics of the global economy and slowing domestic economic growth before it becomes 5.3 % (2015) as reported in LKOJK 2015. Although this figure remains relatively high, especially when compared to similar industries in ASEAN and other countries.

Corporate governance explains the relationship between the various participants in the company that determine the direction of the company's performance. According to Nasution and Setiawan (2007), corporate governance is a framework in improving corporate performance through supervision or monitoring of management performance and ensuring accountability of management to stakeholders by basing on the regulatory framework. Corporate governance is realized in order to achieve a more transparent corporate management for all users of financial statements.

Company performance, in this case is profitability, would be good if the company is able to control the behavior of top executives to protect the interests of the company owner (shareholder), one of them through the existence of audit committee. The audit committee is expected to be able to oversee the financial statements, external audits and the internal control system in accordance with the Decree of the Minister of State-Owned Enterprises No. 117 / MMBU / 2002. To meet the Good Corporate Governance guidelines to maintain the independence and effective, appropriate as well as fast decision making, the company must have an independent commissioner at least 30% (thirty percent) of the total members of the board of commissioners (Pratiwi, 2010). As a result, the role of independent board of commissioners can improve the quality of earnings by limiting the level of earnings management through the monitoring function of financial reporting.

According to Wahyudi and Pawesti (2006), ownership structure is able to influence the course of the company which ultimately affects the company's performance in achieving the company's goal that is to maximize the enterprise value. Ownership structure in Indonesia has different characteristics with companies in other countries. Most companies in Indonesia have a concentrated proprietary tendency so that the founders can also sit as boards of directors or commissioners. In addition, agency conflicts can occur between managers and owners and also between majority and minority shareholders. Cibberber & Majumdar (1999), Patibandla (2002), and Douma et al. (2003) examine the effect of foreign ownership on firm performance and found that foreign ownership positively affects the firm's performance, which is reflected in its profitability.

Corporate Governance

The theory of corporate governance comes from the principal-agent problem in the agency theory that generates agency costs. The agency theory is then further developed into stewardship theory and stakeholder theory as well as evolving to resource dependency theory, political theory, legitimacy theory and social contract theory (Yusoff and Alhaji, 2012). Corporate governance is a way to monitor the relationship between the management of the company (agent) with its principals and wider with its stakeholders. The implementation of corporate governance is not standard (not "one-size-fits-all"), but varies widely across countries and companies (OECD, 2000).

The guideline of Indonesian Banking Good Corporate Governance (GCG) according to National Commitee of Corporate Governance Policy states that GCG contains 5 (five) main principles: transparency, accountability, responsibility, independency and fairness. Corporate governance is a guideline for managers to manage companies with best practice. Managers will make financial decisions that can benefit all stakeholders. Managers work effectively and efficiently so as to lower capital costs and to be able to minimize risks. The effort is expected to generate high profitability.

According to Neeshu (2014), there are 3 (three) types of corporate governance mechanisms and controls known in the world. First, the internal mechanisms that comes from internal mechanisms and with function to monitor organizational progress and activities and take corrective action if the organization deviates from the set objectives. These types of mechanisms include internal control by management, independent internal audit, and structure of the Board of Directors. Second, external mechanisms thatcomes from outside the company with the function, among others, for compliance with regulations. This typeof mechanism is in the form of authority / regulator and government. Third, independent audit, which serves to audit financial statements for internal and external stakeholders of the company.

This study uses a measure of corporate governance through the proportion of independent audit committees and the proportion of independent commissioners. In accordance with the Decree of the Minister of State Owned Enterprises No.117 of 2002 and the SOE Act No.19 of 2003 related to the obligation to form audit committee and Decision of Board of Directors of Jakarta Stock Exchange No. Kep-305 / BEJ / 07-2004 relates to the obligation to have an independent commissioner of at least 30% of the total number of commissioners. Many studies in Indonesia use indicators of the proportion of independent audit committees and the proportion of independent commissioners in measuring corporate governance.

Ownership Structure

Meckling and Jensen (1976) examine that the separation between ownership (and shareholders) and control (through management) naturally reduces incentives for management to maximize company efficiency. Ownership structure is often considered as an important instrument for corporate governance to address issues of conflict of interest between shareholders and company management. Policy makers, researchers and companies are concerned with whether and how the ownership structure can affect the company's performance.

Ownership structure has two dimensions: (a) ownership concentration and (b) identity of owner (Chen, 2011; Lee, 2008)). The ownership concentration provides information about the ownership rights of shareholders' capital, while the identity of the owner provides qualitative information about the character of shareholder. As the concentration of ownership (block holders) increases, according to Lee (2008), the incentives to improve the performance of the company and to monitor the running of the company is greater than that of the dispersed shareholders.

This research is based from the concern on the effect of foreign ownership, using the concept of ownership structure based on the identity dimension of the owner. Because what measured is the influence of foreign ownership, the measurement used is how much foreign ownership in the institution.

Profitability

In measuring organizational performance, Kaplan and Norton (1992) use both financial and non-financial indicators as they result in a more thorough assessment of the business of an organization. Traditionally, however, performance measurements using many financial indicators have been carried out by researchers.

The financial performance of the organization, according to Brigham (2007), can be measured by, first, return on investment (ROI) / return on assets (ROA) ie the ratio between net profit after tax and total assets invested. Second, return on equity (ROE) ie the ratio between net profit after tax with total capital stock. Third, return on invested capital (ROIC), ie ratio of net profit after tax to total operating capital. Fourth, economic value added (EVA) is the operating income after tax minus total cost of capital. Fifth, market value added (MVA) is the difference between the stock market value of the company and the number of shares held by the shareholders.

Kwan (2003) mentions that the use of financial indicators in the assessment of banking performance is common for a period of time and the method can be used to compare the performance of one bank with other banks in the industry or with one sector of the industry. One used to measure company performance is profitability. Profitability Ratiois a ratio to assess the ability of companies in seeking profit within a certain period. This ratio also provides a measure of the level of management effectiveness of a company which is shown from the profit generated from the sale or from the investment income, one of which is reflected in the return on assets (ROA) (Kasmir, 2013).

Framework and Hypothesis

- **The Influence of Corporate Governance on Profitability**
  Healthy corporate governance affects the company's performance. Mishra and Mohanty (2014) confirm the positive influence of corporate governance on profitability. Makki and Lodhi (2014) found that corporate governance has an effect on financial performance that is profitability, but the influence is stronger if through the exploitation of intellectual capital resources. Meanwhile, Okiro et al. (2015) found that corporate governance in addition to direct influence on financial performance also influenced through the company's capital structure.

  H1: Corporate Governance influential on profitability

- **The influence of Ownership Structure on Profitability**
  Polovina and Peasnell (2015), Haque and Shahid (2016) and Arouri et al. (2014) found that ownership structure affects on the company's performance of profitability. Similarly Arouri et al. (2014) found that foreign ownership has a significant positive effect on banking performance in Qatar.

  H2: Ownership Structure influential on profitability

Research Methods

The method used is explanatory, iea research that aims to analyze the relationships between one variable with other variables or how a variable affects other variables. This study uses secondary data. The data used comes from the data and annual financial statements of manufacturing companies listed in the Indonesian Capital Market Directory (ICMD), www.idx.co.id and the website of banking companies selected as research samples. The population in this study is a banking company listed on the BEI in 2008-

2015. The purposive sampling method is used in the sample selection so that obtained the sample of 28 banking companies with total observation of 224 data.

Operationalization of Variables

- **Independent Variable**
  The independent variables in this study are corporate governance and ownership structure, as measured by the proportion of independent audit committees and the proportion of independent commissioners for corporate governance variables, and the composition of foreign ownership for ownership structure.

$$\text{Proportion of independent audit committees} = \frac{\text{Numberof independent audit committees}}{\text{Numberof audit committees}} \text{ x } 100\%$$

$$\text{Proportion of independent commissioners} = \frac{\text{Numberof independent commissioners}}{\text{TotalNumberofmembersoftheBoardofCommissioners}} \text{ x } 100\%$$

$$\text{Composition of foreign ownership} = \frac{\text{Theamountofstockownershipbyforeignparty}}{\text{Numberofsharesoutstanding}} \text{ x } 100\%$$

- **Dependent Variable**
  Dependent Variable of the research is profitability that measured by ROA (return on asset).

$$\text{ROA} = \frac{\text{NetIncome}}{\text{Totalassets}}$$

Data Analysis Method

- Classic assumption test which includes normality test, multicollinearity test, heteroscedasticity test, and autocorrelation test.
- Multiple Regression Analysis
- Hypothesis Testing (Test t and Test F)

Result and Discussion

The results of normality testing with Kolmogorov-Smirnov test can be seen in the table below:

Table 1 Kolmogorov – Smirnov test
One-Sample Kolmogorov-Smirnov Test

		Unstandardized Residual
N		224
Normal Parameters[a,,b]	Mean	.0000000
	Std. Deviation	.77062227
Most Extreme Differences	Absolute	.217
	Positive	.217
	Negative	-.111
Kolmogorov-Smirnov Z		1.684

Asymp. Sig. (2-tailed)	.070

a. Test distribution is Normal.

b. Calculated from data.

Source: Data Processing by SPSS 20.00

Based on the output of SPSS version 20.00 presented in table 1 above, it appears that the value of Asymp.Sig> 0.05. It means that if based on criteria, the data in this research is normal distribution.

In this study used the value of Variance Inflation Factors (VIF) as an indicator of the presence or absence of multicollinearity among independent variables. The result of multicolinearity test is the value of Variance Inflation Factor (VIF) <10, and tolerance value> 0.1. The results of multicollinearity testing can be seen in the table below:

Table 2Multicollinearity Test Result

Coefficients[a]

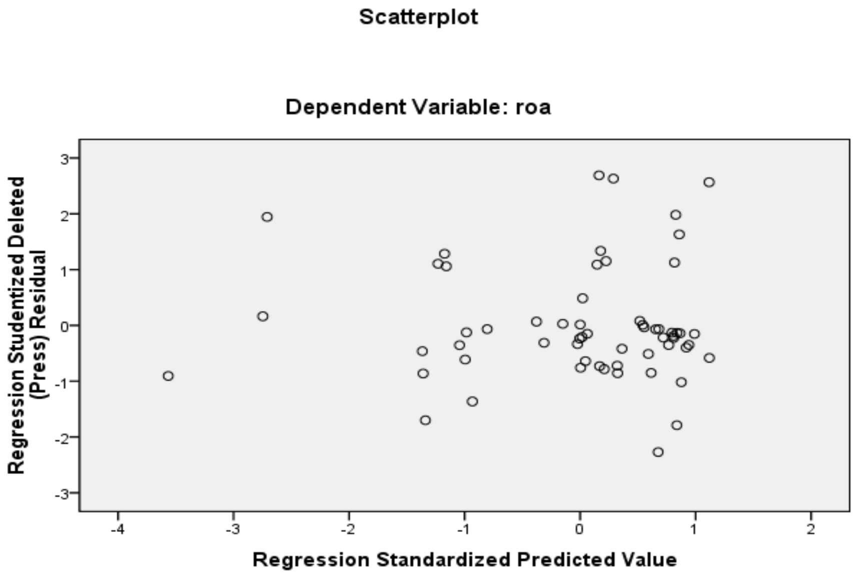
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	,779	4,457		,175	,861		
	Komite Audit Independent	-1,684	3,678	-,033	-,458	,647	,864	1,157
	Komisaris Independent	3,253	7,298	,031	2,446	,656	,940	1,064
	KepemilikanAsing	,362	1,706	,016	2,212	,832	,833	1,200

a. Dependent Variable: Return OnAset

From the table 2 above it can be seen that the VIF value of the three independent variables ie Independent Audit Committee, Independent Commissioner and Foreign Ownership is 1.200, each Independent Audit Committee and Independent Commissioner less than 10 that is 1.157 and 1.064. And the tolerance value for the three X variables is above 0.1. So it can be concluded that there is no multicollinearity between independent variables.

The results of heteroscedasticity testing can be seen in the figure below:

Figure 1 Heteroscedasticity Testing Result



Source: Data Processing by SPSS 20.00

From Figure 1 on the scatterplots chart above shows that the points spread randomly and spread both above and below the number 0 on the Y axis. So it can be concluded that there is no Heteroscedasticity on the regression model, so that the regression model is worthy to be used to predict profitability (ROA) based on input from variable of Independent Audit Committee, Independent Commissioner and Foreign Ownership.

The autocorrelation test results can be seen in the table below:

Table 3 Autocorrelation Test Results

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	,550[a]	,3025	,212	8,97344	,002	,147	3	220	,932	1,327

a. Predictors: (Constant), KepemilikanAsing, Komisaris Independent, Komite Audit Independent

b. Dependent Variable: Return OnAset

Source: Data Processing by SPSS 20.00

Based on table 3 above, seen from the number of Durbin Watson that is equal to 2.007 it can be concluded that there is no autocorrelation due to the DW number.

While the analysis of determination coefficient is used to determine the effect of independent variables on the dependent variable. Coefficient of determination is a squaring of coefficient correlation multiplied 100%, which means percentage contribution of independent variables to the dependent variable.

By using SPSS 20.00 software obtained multiple correlation and coefficient of determination as can be seen in table 3 above which shows the coefficient of determination value R^2 of 0.550, meaning percentage contribution of Independent Audit Committee, Independent Commissioner and Foreign Ownership to Profitability (ROA) is equal to 30.25%, while the remaining 69.75% is influenced by other variables not included in this model .

To know the relationship between the Independent Audit Committee, Independent Commissioner and Foreign Ownership with Profitability (ROA) simultaneously it can also be done a multiple linear regression test as follows:

Based on table 2 above, then obtained the regression equation as follows:

$$\mathbf{Y = 0{,}779-1.684\ X_1 + 3.253\ X_2 + 0.362\ X_3 + e}$$

To know the simultaneous testing of the Independent Audit Committee, Independent Commissioner and Foreign Ownership with Profitability (ROA) can be seen in the table below:

Table 4

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	35,453	3	11,818	3,147	,932 [a]
	Residual	17714,980	220	80,523		
	Total	17750,433	223			

a. Predictors: (Constant), Foreign Ownership, Independent Commissioner, Independent audit commitee

b. Dependent Variable: Return On Asset

Based on the results obtained from the computation of F_{count} with F_{table} is H0 accepted, because F_{count} (3.147) $\geq$ F_{table} (2.26) which means that the Independent Audit Committee, Independent Commissioner and Foreign Ownership have a significant influence simultaneously on Profitability (ROA).

Hypothesis testing of the influence of Independent Audit Committee, Independent Commissioner and Foreign Ownership to profitability (ROA) partially, can be seen in table 2, where the $t_{count}$of Independent Audit Committee on Profitability (ROA) is equal to -0.458 <1.96, so it can be concluded that there is no partial influence from the Independent Audit Committee on Profitability (ROA).

The results of this study are not in line with some previous research results. Mishra and Mohanty (2014) found that from 2 (two) of 3 (three) composite measures the implementation of corporate governance affects the company's financial performance as measured by its profitability (ROA). The two composites are Board Indicators consisting of independent Board of Commissioners, independent commissioners in independent audit committees, and Proactive Indicator in the form of availability of financial information. Meanwhile, Legal Indicator does not affect the financial performance of the company..

Meanwhile, the results of this study is in line with the results of Makki and Lodhi (2014) who found that the existence of corporate governance affect the financial performance through the efficient use of corporate intellectual capital. Moradi et al (2017) found that governance variables in the form of independent commissioners have a significant effect on company performance measured by ROA, ROE and ROS.

The value of t count of Independent Commissioner to Profitability (ROA) is equal to 2.456> 1.96, so it can be concluded that there is partial influence from Independent Commissioner to Profitability (ROA). While t count of Foreign Ownership of 2.212> 1.96, so it can be concluded that there is partially influence from Foreign Ownership to Profitability (ROA). Foreign ownership positively affects the financial performance of banks, especially in the form of profitability. However, the effect will decrease along with the increasing dominance of domestic shareholders in business control at the bank.

Meanwhile, the results of this study are not fully in line with Abraham (2013) who found that foreign ownership in the banking sector in Saudi Arabia affects the aggressiveness of banks in the management of its assets in the form of high levels of leverage as well as the greater lending provided to debtors. The results of this study found that foreign ownership affect the profitability measured by ROA indicates that foreign ownership has an effect on the efficiency of management of all existing assets in generating banking profit.

Conclusion

Based on the results of the discussion it can be concluded that:

1. There is simultaneous influence from the Independent Audit Committee, Independent Commissioner and Foreign Ownership to profitability (ROA), with the influence of 30.25% while the rest of 69.75% is influenced by other variables not included in this model.
2. There is no partial influence from the Independent Audit Committee on Profitability (ROA), whereas Independent Commissioners and Foreign Ownership partially have an influence on Profitability (ROA).

Recommendation

1. Control of concentrated ownership through arrangements can be an effective mechanism for maintaining corporate governance in countries with limited legal protection of investors. The non-

linear effect of the concentration of ownership on the performance of the firm indicates the possibility that the controlling shareholder may take over the wealth of the minority shareholders in the country. This suggests that there should be strict enforcement of regulations to curb the takeover by the controlling shareholder.

2. Companies should increase compliance with the application of governance factors by intensive control, which not only focuses on the independent proportion of audit committees and independent commissioners. Accountability is the key to providing adequate control and discipline for management. In addition it needs a better appreciation of the disclosure needs of the board of directors. The board of directors must ensure disclosure and transparency of information relating to the financial performance of the company, including when the company requires capital for investment or dividends.

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