DOI: 10.7763/IPEDR. 2013. V67. 4

Dead Bank Walking Evidence from Banking Sector in Indonesia

Adrie Putra [1 +] and M. F. Arrozi. A [1]

[1] University Indonusa Esa Unggul, Indonesia

Abstract. This study examines the value of firm in banking industry in Indonesia year 2009 to 2012 from different perspective. By using the Good Corporate Governance (GCG), Earnings Management (EM), Dividend Payout (DP) and Firm Performance (CAMEL) as a proxy measurement of impact on Firm Value (PBV), we investigated 30 commercial Indonesia bank, recorded on the Indonesia Stock Exchange (IDX) for four consecutive years and applied Structural Equation Model (SEM) with Partial Least Square (PLS) path analysis to test the proposed hypothesis. The results indicated that GCG has a direct influence on Earning Management and Dividend Payout. These unique findings opened interesting analysis on banking industry in emerging market.

Keywords: Good Corporate Governance, Earning Management, CAMEL, Dividend Payout, Price to Book Value

1. Introduction

Banking sector has a vital role in supporting economy of a nation, banks is service business, in this case the banks is an institution where to conduct financial transactions, where trust becomes a very important factor in running a banking business. Many global cases occur in the global banking industry, especially after global crisis in 2008, such as Lehman Brothers or Baring Bank, and also cases involving banking in Indonesia such as case in Century Bank recently.

In order for banks to run their business properly, it is necessary to implement Good Corporate Governance (GCG), it is intended to prevent asymmetric information between stakeholders, which between agent as the manager of the company and principal as the owner (investors) companies. Implementations of GCG become a bridge between the two parties in relation to behaviour performed by an agent who sometimes perform earnings management practices for their own benefit. Earnings management behaviour will affect the banks performance directly and also as well as will give effect to the change in value of the firm indirectly.

2. Literature Review

Implementation of good corporate governance in the banking sector especially in Indonesia refers to the rules made by Bank of Indonesia as central bank or regulator of all banks in Indonesia. Along with the demands for good corporate governance on the banking sector, Bank of Indonesia in 2006 initiated the regulations specifically governing the implementation of corporate governance provisions in the Commercial Banks. This study is based on Bank of Indonesia Regulation Number 8/4/PBI/2006 dated January 30, 2006 on the Implementation of Good Corporate Governance for Commercial Banks is again perfected through PBI. 8/14/PBI/2006 dated October 5, 2006 on the amendment of PBI. 8/4/PBI/2006 on Implementation of Good Corporate Governance for listed commercial banks stated that the implementation of GCG is mandatory. GCG implementation in this study based from the financial statements will be undertaken by the banks based on the principle of which 5 pillars of Transparency, Accountability, Responsibility, Independency and Fairness (TARIF).

Many previous studies on corporate governance and corporate values such as those made by Jensen and Meckling [1] which states "nexus of contracts" between principal and agent, or research conducted by Scott [2] the contract between the owners of fund with the company manager. Where between the agent and the principal wants to maximize the utility of each with the information held. On the one hand, agents have more

+ Corresponding author. Tel.: + 62215674223; fax: +62215674248
E-mail address: adrie.putra@esaunggul.ac.id

information (full information) compared with the principal, giving rise to the asymmetry information ". This Asymmetry information caused a conflict of interest. Klapper and Love [3], who argued that the GCG inefficiency and poor implementation of laws relating to the increased risk of investing in emerging market.

The financial statements are often manipulated by the agent for the benefit of the agent itself. Accrual method is often choice by the agent because it is more rational and fair view in reflecting the company's financial condition and overall in real terms, using the accrual basis, the agent can freely choose the method of accounting to be applied at the company as long as what was done does not deviate from the standard or regulation.

There are some patterns that motivate agents to engage the act of earning management; taking bath, income minimization, income maximization and income smoothing. An empirical evidence can be presented in the agent motivation in doing earning management in order to get bonus plan Healy [4]; Mc Nichlos and Wilson [5]; Jones [6]; Holthousen, Larcker, and Sloan [7], another motivation is contracting motivations where enterprises seek to delay or postpone debt due date, Sweeny, [8]; De Angelo, De Angelo and Skinner [9]; Bowen, DuCharme, Shores [10].

Banking performance measurement based on Bank of Indonesia Regulation / 6/10/PBI/2004 on banks performance measurement system, which includes an assessment of the factors CAMEL (Capital, Asset quality, Management, Earnings and Liquidity). Other studies reveal that the banking performance based on CAMEL significantly influence the firm value as seen from increase in stock price (Abdullah, Fariz and Suryanto [11]. From the literature mentioned previously, the hypotheses in this study are as follows:

- H1: CAMEL has significant impact on Dividend Payout (DP)
- H2: CAMEL has significant impact on Price Book Value (PBV)
- H3: Dividend Payout (DP) has significant impact on Price Book Value (PBV)
- H4: Earning Management (EM) has significant impact on CAMEL
- H5: Earning Management (EM) has significant impact on Dividend Payout (DP)
- H6: Earning Management has significant impact on Price Book Value (PBV)
- H7: Good Corporate Governance (GCG) has significant impact on CAMEL
- H8: Good Corporate Governance (GCG) has significant impact on Dividend Payout (DP)
- H9: Good Corporate Governance (GCG) has significant impact on (EM)
- H10: Good Corporate Governance (GCG) has significant impact on (PBV)

3. Research Design and Methodology

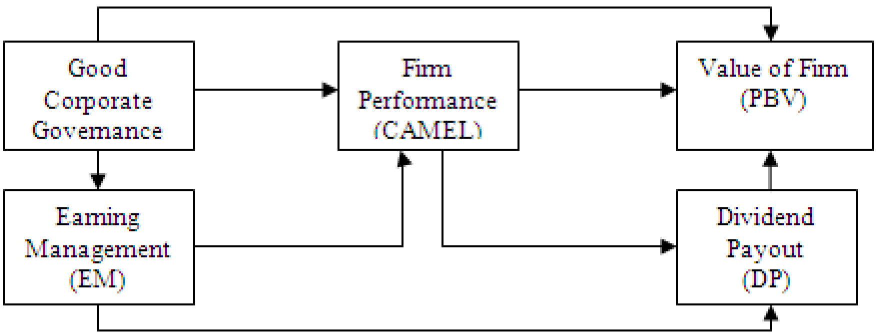

Fig. 1: Research Design

Samples in this study were 30 commercial banks listed on the Indonesia Stock Exchange (IDX) during the years 2009 to 2012; the analysis technique used in this study is path analysis. Reason using path analysis is based on considerations, path analysis has the ability to combine multidimensional simultaneously and efficiently. Using path analysis is a Structural Equation Model (SEM), with Partial Least Square (PLS) technique. Model in this study can be formulated as follows:

$$EM = f(GCG) + \varepsilon \quad \text{(Model 1)}$$
$$CAMEL = f(GCG, EM) + \varepsilon \quad \text{(Model 2)}$$
$$DP = f(CAMEL, EM) + \varepsilon \quad \text{(Model 3)}$$
$$PBV = f(GCG, CAMEL, DP, EM) + \varepsilon \quad \text{(Model 4)}$$

Description:

- Good Corporate Governance (GCG) using Buhiyan and Biswas [12] model measured by:

$$GCG = \frac{\text{Total score itemdisclosed by firm}}{\text{Maximum score that should be disclosed by firm}} \times 100\%$$

- Earning Management (EM) using model Beaver and Engel (1996) measured by:

$$NDA_{it} = \alpha_0 + \alpha_1 C0_{it} + \alpha_2 \, LOAN_{it} + \alpha_3 NPA_{it} + \alpha_4 \, NPA_{it} + \varepsilon$$

$$DAit = TA_{it} - NDA_{it}$$

- DP= Dividend Payout, measured by:
  If Firm pays dividend (cash/stock) = 1, or vice versa
  CAMEL = Firm Performance, According to Indonesia Central Bank, Total Weighted for every Indicator measure by: (C) Capital Adequacy Ratio (A) Asset Quality, (M) Management, (E) Earning, (L) Liquidity
- (C) Capital Adequacy Ratio (CAR), weighted 25% measured by:

$$CAR = \frac{\text{Equity}}{\text{Weighted of risk assets}} \times 100\%$$

- (A) Asset Quality proxy Non Performing Loan (NPL) weighted 25%, measured by:

$$NPL = \frac{\text{Default Loan}}{\text{Total Loan}} \times 100\%$$

- (M) Management proxy Net Profit Margin (NPM) weighted 40%, measured by: Net Income

$$NPM = \frac{\text{Net income}}{\text{Operating income}} \times 100\%$$

- (E) Earning, Return on Assets (ROA) weighted 5%, measured by:

$$ROA = \frac{\text{Net income}}{\text{Total Assets}} \times 100\%$$

- (L) Liquidity, proxy Loan to Deposit Ratio (LDR) weighted 5%, measured by:

$$LDR = \frac{\text{Total loan}}{\text{Total deposit } + \text{Equity}} \times 100\%$$

- PBV = Price to Book Value (Value of Firm), measured by:

$$PBV = \frac{\text{Stock market price}}{\text{Book value of firm}}$$

ε = epsilon

4. Result

Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
PBV	120	.67	16.00	2.2100	1.73624
EM	120	-7E+013	2E+013	-6E+012	1.219E+013
GCG	120	.76	1.00	.9401	.06309
CAMEL	120	.11	.97	.7878	.10701
DP	120	.00	1.00	.5250	.50147
Valid N (listwise)	120				

Source: Proceed

From the descriptive on table 1, it can be seen that the implementation good corporate governance on average in the banking sector in Indonesia is based on the TARIF by 76% with maximum values reaching 100%. While earnings management behaviour performed by the agent showed the banking industry intended to decrease their profit. Company performance as measured by CAMEL method shows that on average banking sector is quite good with the soundness of banks by 78.9%, although it can be seen there is a bank that has a sub-standard performance showed by minimum 11%. While the table above can be seen that 52% in Indonesian banks provide timely dividend payments, which indicates that the bank has sufficient liquidity.

Table 2: Empirical Result

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	Standard Error (STERR)	T Statistics (|O/STERR|)
CAMEL-> DP	-0.1317	-0.1546	0.1001	0.1001	1.3157
CAMEL-> PBV	-0.1254	-0.1145	0.1050	0.1050	1.1941
DP -> PBV	0.0439	0.0499	0.0834	0.0834	0.5261
EM -> CAMEL	-0.0783	-0.0853	0.0767	0.0767	1.0215
EM -> DP	-0.2615	-0.2653	0.0598	0.0598	4.3767 *
EM -> PBV	-0.0021	-0.0089	0.0257	0.0257	0.0816
GCG-> CAMEL	0.1118	0.0848	0.1515	0.1515	0.7379
GCG -> DP	0.0686	0.0838	0.0330	0.0330	2.0790 *
GCG -> EM	-0.3065	-0.3111	0.0436	0.0436	7.0330 *
GCG -> PBV	0.0742	0.0808	0.0835	0.0835	0.8880

Sourced: Proceed

From the results show on table 2, it can be used by researchers to prove the hypothesis. Acceptance of the hypothesis used measure of the significance level of *T-value* table compare to *T-statistic.* If the value of *T-statistic* is higher than the value of *T-table* means that the hypothesis is accepted. For the 95 percent confidence level (alpha 5 percent) the value of the *T-table* for two-tailed hypothesis was > 1.96 and for a one-tailed hypothesis > 1.64 Hartono [13]. Based on the table 2, it can be concluded that the hypothesis H5, H8 and H9 are acceptable.

5. Discussions

The role of banks is very central to the economy of a country, when we look at the results of this study, can provide a picture and evidence that the implementation of good corporate governance is very important for the value of the firm, especially as seen from the 5 pillars of good corporate governance (TARIF). The results also prove that the agency theory where the two parties involved in a company which agent and principal have different interests. In this study also proves that implementing good corporate governance can reduce behavioural earning management (T statistic value 7.0330 > 1.96 and for the original sample value of -0.3065), undertaken by the agent with a variety of motives and goals. Implementation of regulations by the central Bank in Indonesia which stated that implementing good corporate governance is mandatory in the banking industry sector in Indonesia is quite effective. This is evident from effect of corporate governance on dividend payout (2.0790 > 1.96). This will give a good signal to investors and prospective investors to invest their funds in the banking sector, which affects the increase in the stock price due to the high demand of the banking sector stocks.

Financial information as the raw material of this study proved that occurring asymmetric information can be derived by the application of good corporate governance. This is a positive impact for the principal, which is important information for the principal in decision-making and determine what further action, in which the information obtained by the implementation of good corporate governance where the information was reliable and relevant, it can be seen on the reduction of earning management can improve the dividend payout (4.3767 > 1.96).

The role of the Central Bank, (Bank of Indonesia), is needed. It can be seen from the high level of implementation of good corporate governance is seen from the 5 pillars (TARIF). The role of Bank Indonesia through regulations issued also a positive impact on bank performance. Bank Indonesia contributed a great deal as a regulator and supervisor of the banking sector, particularly banks that are owned by public ownership.

6. Conclusion

In this study it can be concluded that there are linkages between Bank Indonesia as the regulator and the bank as an institution in which there are two parties, principal and agent from agency theory perspective. This linkage provides a positive impact for all parties concerned as seen from the impact of the implementation of good corporate governance to value of firm, that indirect impact of implementing good corporate governance has increased the value of firm.

7. Acknowledgements

The authors would like to thank the Central Bank of Indonesia for supporting the study. In addition, the authors grateful for Rector University Indonusa Esa Unggul Dr.Ir.Arief Kusuma. AP MBA, for suggestions and all their help. Finally, I most gratefully acknowledge our parents, family, friends and colleagues for all their support throughout the period of this research.

8. References

[1] Jensen, M., & Meckling, W. (1976) Theory of The Firm; Managerial behavior, agency cost, and ownership structure. Journal of Financial Economics, 3, 305- 360.

[2] Scott, R.W. (2000). *Financial Accounting Theory* 2nd Ed., New Jersey: Prentice Hall

[3] Klapper, L. and Inessa Love (2002), "Corporate Governance, Investor Ptotection, and Performance in Emerging Markets", World Bank Policy Research Working Paper

[4] Healy,P.M., *"The Effect of Bonus Scheme on Accounting Decision";*. Journal Accounting and Economics April, 1985, pp. 85-107.

[5] McNichols, M. and G.P. Wilson," Evidence of Earning Management from the provision for Bad Debt," Journal of Accounting Research (supplement, 1998), pp. 1-31

[6] Jones, J., "Earning Management During Import Relief Investigations," Journal of Accounting research (Autumn,1991), pp.193-228

[7] Holthausen,R.W., D.F. Larcker, and R.G Sloan,"Annual *Bonus Scheme and the Manipulation of Earnings,*' journal of Accounting and Economics, February, 1995, pp.29-74.

[8] Sweeney, A.P.,"Debt-Covenant Violations and Managers' Accounting responses," journal of Accounting and Economics (May,1994), pp.281-308

[9] DeAngelo,H., L.E.,DeAngelo, and D.J. Skinner, *" Accounting Choice in Troubled Companies,"* Journal if Accounting and Economics, January, 1994, pp.113-143.

[10] Bowen,R.M. ,L. DuCharmer, and D. Shores, *"Stakeholders' Implicit Claim and Accounting Methods Choice",* Journal of Accounting and Economics, December, 1995, pp. 225-295.

[11] Abdullah, Fariz dan L. Suryanto. 2004. "Analisis Pengaruh Rasio-Rasio CAMEL sebagai Penilaian Tingkat Kesehatan Bank terhadap Harga Saham Perusahaan Perbankan yang Terdaftar di Bursa Efek Jakarta". Jurnal Studi Manajemen dan Organisasi Vol 1/No/Juli 2004.

[12] Bhuiyan, Md Hamid Ullah and P.K Biswas, " Corporate Governance and Reporting : an Empirical study of The Listed Company in Bangladesh", Journal of Business of Studies, Vol. XXVIII, No.1, 2007

[13] Hartono, J.M Metodologi Penelitian Sistem Informasi, Yoygyakarta, Andi Offset, 2008.