CHAPTER I

INTRODUCTION

1.1 Background

Corporate governance has been one of the most important business parts in this recent era. The existence of governance is not new; in fact it has been widely talked, analyzed, and developed for many decades. Governance itself is the configuration and operation of a corporation in relation to its stakeholders (Banks, 2004). The application of governance in a corporation has been a strong focus for public, especially the corporation's stakeholders as it has a great impact to them. It has been shown that good governance is effective in protecting stakeholder's interests (Dahlsrud, 2006). In the other hand, bad governance can cause to a wide range of problems.

Corporate governance refers to how an institution directs and manages its business and affairs to improve its stakeholders' value by enhancing corporate performance and accountability (Jenkinson & Mayer, 1992). Corporate governance, for its purposes as a mechanism for the corporate runs the business, has many aspects in it. Additionally, according to Bank Indonesia regulation no. 14/08/2006 dated October 5, 2006, there are five basic principles of Good Corporate Governance (GCG). These five principles are transparency, accountability, responsibility, independency, and fairness. The governance aspects distribute rights and responsibilities of many participants in the corporation and enlighten the rules and procedures in decision-makings in the corporation (Banks, 2004). The aspects consisted in the governance spans from ownership structure, size of the board of director, operations, to funding for social activities.

In ownership structure, there is a possibility of what is so named as agency theory to take place. According Jensen and Meckling (1976), agency theory explains that one personnel would put his or her best interest at the top of the list. This list of priorities determines the performance of one personnel within the company. However, one individual might have different set of priorities from the other. Scoot (2000) stated that this difference of interest between parties would trigger conflicts. This conflict or problem is what also known as agency cost. In finance, there are two primary agency relationships: between managers and stockholders, and between managers and creditors (Jensen and Meckling, 1976).

The conflict between managers and shareholders has been studied extensively by researchers seeking to understand the nature of the firm. When shareholders are too diffuse to monitor managers, corporate assets can be used for the benefit of managers rather than for maximizing shareholder wealth (Himmelberg, 1999).

The application of good corporate governance in the company will help to mitigate such conflicts. Some of the good governance that one company can apply includes giving incentive to the agent, having good system of monitoring to its agent, and setting a good management share ownership (Banks, 2004). As a professional individual, one agent with high level of incentive is expected to be highly motivated to work along with the principals' best interest. Good system of monitoring has a great role in aligning the gaps between the principals' interest and the agent. This means that effective corporate governance increase the probability that managers invest in profitable projects (Shleifer and Vishny, 1997). Management share ownership, too, is a part to minimize the problems. This paper will further elaborate the last one: management share ownership.

Stock distribution among stakeholders can have a significant impact on corporate actions that are dependent on shareholders voting (Hutchinson and Gul 2003). By having bigger number of managerial share ownership, the agency problem will be less complicated (Jensen and Meckling, 1976). When managers own stock in a company, they are less likely to make decisions or take actions that are not in the interest of shareholders. Managers who own shares are more likely to use their discretion to improve firm value. In other words, management share-ownership will ensure managers to undertake strategies that will increase firm performance (Hutchinson and Gul 2003).

Another aspect in corporate governance, which also takes part in the corporate governance's reporting, is the size of the corporate board of director or in this case, we use board of commissioner, one part that every public company must have. The number of boards' member determines the size of the board itself. These members are responsible in making decisions on major company issues, representing the stockholders. Several positions available on the board such as: commissioner president, commissioner, independent commissioner, and etc.

Several studies have been conducted regarding to the effects of board of director (BOD) size as a governance mechanism on the performance of firms and have resulted various outcomes. Some researchers like Lipton & Lorsch (1992), Jensen (1993), and Yermack (1996) found that smaller size of boards are more effective than larger ones due to co-ordination problems in larger boards. They suggested limiting the boards' member to ten people, with a preferred size of eight or nine. Jensen (1993) did a research under the same theme and resulted that boards with more than seven or eight people are less likely function effectively and are not easy for the CEO to control. However, some other researchers have also conducted similar researches and found differently. Hermalin & Weisbach (2001), in his research, stated that board composition has no relation to corporate performance and size of BOD is negatively related to corporate performance. These previous researches have, by far, produced mixed results.

One more important aspect, which is also taken into account in governance structure, for one corporation in running the business, is the social aspect of its corporation. Each corporation has their own responsibility to fulfill towards communities in where they operate, which is known as Corporate Social Responsibility. Companies' activities associated with CSR has recently increased significantly and many of CSR advocates confident that taking into account the needs and values of all stakeholders offers strategic advantages.

Corporate Social Responsibility (CSR) has become one crucial part in most of business strategy, as it has also been the new business management paradigm. Companies start to feel the benefits of implementing CSR within their business strategies. In fact, it is no longer about showing off company's generosity, but it is more about how company reacts toward the demanding society. Society these days are more concerned on how company runs their business. As the result, there are more companies are working on winning the game by competing in taking responsibilities toward many level of societies.

In bank industry, any corporate expenditure in regard to fulfill its CSR is disclosed to public along with the corporate governance report. This is in order to fulfill transparency principle to all stakeholder groups on how the corporation spends their fund for CSR. This disclosure comes as a means of understanding and tracking CSR impacts, through creating good dialogue with stakeholders of a company and an effective CSR disclosure is intended to improve stakeholder-related performance (Bayoud, Kavanagh, and Slaughter, 2012). However, not all companies reveal their spending toward this field of activity at the same level. There are still some of the players in the market, which do not disclose their detail of CSR expenses in their annual governance report.

Some of previous researches upon these three aspects of corporate governance report: managerial share-ownership, size of BOC, and CSR disclosure, according to the explanations above, have produced mixed results, while some others have resulted inconclusive outcome. This situation has challenged me to further examine whether managerial ownership, size of BOC, and CSR expenditures disclosure through corporate's annual governance report, respectively, have impacts to corporate performance.

Therefore, the author intends to choose the title "The Effects of Corporate Governance and Corporate Social Responsibility to The Performance of Commercial Banks in Indonesia" to further investigate about the direct impact of corporate governance, through its three aspects mentioned above, towards the performance of the company itself. In this study, Commercial Banks in Indonesia stand as the subject of research.

1.2 Research Problem

Research problems of this study are:

1. Is there any partial direct effect of managerial share ownership towards the performance of the commercial banks in Indonesia?
2. Is there any partial direct effect of size of BOC towards the performance of the commercial banks in Indonesia?
3. Is there any partial direct effect of CSR expenditures disclosure through corporate's annual governance report towards the performance of the commercial banks in Indonesia?
4. Is there any simultaneous direct effect of managerial share ownership, size of BOC, CSR expenditures disclosure through corporate's annual governance report toward the performance of the commercial banks in Indonesia?

1.3 Research Objective

According to the above problem formulation, the objectives of this study are:

1. To examine the partial direct effect of managerial share ownership towards the performance of the commercial banks in Indonesia

2. To examine the partial direct effect of size of BOC towards the performance of the commercial banks in Indonesia
3. To examine the partial direct effect of CSR expenditures disclosure through corporate’s annual governance report towards the performance of the commercial banks in Indonesia
4. To examine the simultaneous direct effect of managerial share ownership, size of BOC, CSR expenditures disclosure through corporate’s annual governance report, toward the performance of the commercial banks in Indonesia

1.4 Research Benefit

This research confers benefits for:

1. Shareholders and Managers
   a) Provide information about the direct effect of managerial share ownership report towards the performance of the Commercial Bank in Indonesia, thus managers and shareholders can apply the best strategy.
   b) Provide information about the direct effect of size of BOC towards the performance of the Commercial Bank in Indonesia, thus managers and shareholders can apply the best strategy.
   c) Provide information about the direct effect of CSR expenditures disclosure towards the performance of the Commercial Bank in Indonesia, thus managers and shareholders can apply the best strategy.
2. Regulator

Provide information about the direct effect of managerial share ownership, BOC size and CSR expenditures disclosure towards the performance of the Commercial Bank in Indonesia, thus regulator can apply the best regulation to improve the performance of banks in Indonesia, which in the end will improve the economic performance of Indonesia.

3. Author

   Provides information about the direct effect of managerial share ownership, size of BOC, and CSR expenditures disclosure through corporate's annual governance report, respectively, towards the performance of the Commercial Bank in Indonesia.

4. Future Researcher

   Provides information about the direct effect of managerial share ownership, size of BOC, and CSR expenditures disclosure through corporate's annual governance report towards the performance of the Commercial Bank in Indonesia.

1.5 Systematic of Thesis Writing

This thesis was prepared with the systematic of writing that consist of five chapters with the following details:

CHAPTER I INTRODUCTION

This chapter describes about background issues that underlying this research, formulation of research problem, and systematic of proposal writing.

CHAPTER II THEORITICAL REVIEW

This chapter describes about previous research, basis theory, framework, and hypothesis of this research.

CHAPTER III RESEARCH METHOD

This chapter describes in detail the research methods of the study design, study limitations, identification of variables, optional definitions and measurement variables, population, sample and sampling techniques, data and data collection methods and data analysis technique

CHAPTER IV DESCRIPTION OF RESEARCH SUBJECT AND DATA ANALYSIS

This chapter describes in detail about the result of the study, both descriptive and statistic analysis. The result is, then, discussed in this chapter.

CHAPTER V CONCLUSION

This chapter is the last chapter in this study, which consists of conclusion, limitation and recommendation of the study.