ECONOMICS FACULTY
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THESIS

BOARD GOVERNANCE AND FIRM'S PERFORMANCE

(The Case of Banking Institution)

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CHAPTER I

INTRODUCTION

1.1 Background

In the wake of the recent corporate scandals, corporate governance practices have received heightened attention. Shareholders, creditors, regulators, and academics are examining the decision-making process in corporations and other organizations and are proposing changes in governance structures to enhance accountability and efficiency (Adams and Mehran 2005).

Countries that suffered dramatic reversals of fortune during the Asian financial crisis have identified weaknesses in corporate governance as one of the major sources of vulnerabilities that led to their economic meltdown in 1997. Indonesia, as one of the countries most affected by the crisis, has been forced to consider corporate governance issues at the forefront of the nation's agenda for corporate and economic policy (Lukviarman 2004).

Corporate Governance generally refers to set of rules that define the relationship between shareholders, managers, creditors, the government employees, and other internal and external stakeholder in respect to their rights and responsibilities, or system by which companies are directed and controlled (Forum Corporate Governance Indonesia 2005).

The role of Good Corporate Governance in recovering the economic crisis in Indonesia is needed absolutely, because as OECD (c.f. Aldridge and Sutojo, 2005) said that "Good Corporate Governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, the managers, shareholders, and other stakeholders. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance of the board and the management's company.

There are two systems adopted by many countries all around the world; Anglo-Saxon system and Continental system (Aldridge and Sutojo, 2005). Anglo-Saxon system also known as unitary board or one-tier board model that is prevalent in the Anglo-Saxon countries. This type of board condenses executive and supervisory responsibilities of the board in one legal entity (Gay 2002). On the other hand, the two-tier board, also called two-board system, is found mostly in Continental European countries, there is a separation of executive and supervisory roles under different boards. Those are the supervisory Board and Management Board. The responsibility of the management board is running the business, while the Supervisory Board controls the management (not the corporation), (Ningsih, 2006).

Recent corporate governance literature has seen the emerge of an extensive body of empirical work on the effectiveness of boards of directors in monitoring managers. Topics covered include the relation between performance and proportion of outside directors (Hermalin and Weisbach. 1991; Bhagat and Black. 2002). Boards size (Yermack. 1996; Eisenberg et al., 1998). Insiders' ownership (Morck et al., 1988; McConnell and Servaes, 1990) and leadership structure (Brickley et al,. 1997). Most of the work has focused on unregulated

CHAPTER V

CONCLUSIONS AND LIMITATION

The preceding chapter has presented the empirical result and this chapter provides a conclusions drawn from the findings and discussions presented in the previous chapter, followed by an assessment of potential limitations present in this study and possible future directions for research.

5.1 Conclusion

This research investigates the significant influence of board governance compliance towards the banks performance. The Board governance compliances are represented by board commissioner's size and proportion of independent commissioner, while bank performance measured by using ROA, NPM and NIM.

In the absence of controlling variables, the statistical testing result accepts the hypothesis showing that the size of board commissioner is having a significant influence towards banking firm performance measured with NPM only. And the proportion of independent commissioner is evidenced of having insignificant influence toward banking firm performance measured with ROA, NPM and NIM.

The inclusion of control variable presented the influence of the size of board commissioners and proportion of independent commissioner toward banking firm performance is only significant for small banks.

This research also proves that there is improvement of board governance compliance in Indonesian Bank listed in Indonesian Stock Exchange comparing several

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