CORPORATE GOVERNANCE AND FINANCIAL DISTRESS, THE CASE OF LISTED MANUFACTURE COMPANIES IN INDONESIA

THESIS
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ABSTRACT

The objective of this research is proving empirically the relationship between corporate governance and financial distress. There are three proxies of corporate governance in this research: supervisory board's size, proportion of independent board, and supervisory board's educational qualification.

Measuring financial distress is using Altman model.The population of this research is manufacture companies listed in IDX from 2004 until 2007. There are 42 companies selected by using purposive random sampling method. Data analysis is done by using regression model to examine the relationship between corporate governance and financial distress.

The result of this reseach shows that supervisory board's size has significant relationship with financial distress, but proportion of independent board and supervisory board's educational qualification have insignificant relationship with financial distress.

CHAPTER I

INTRODUCTION

1.1 PROBLEM BACKGROUND

Economic crisis which faced by most Asian countries since 1997 has resulted to poor financial condition. This condition was indicated by many companies turned to collapse, many banks were liquidated, and great increased in unemployment rate. This crisis catalized by the significant falls of currency exchange rate and the same due date period of a big amount foreign debt, increasing of US Dollar demand and the poor banking system which became major cause of financial crisis in Asia. At the end, many companies had financial distress and predicted to be bankerupt. The meltdown of some big companies in the world collapse, such as Enron Corporation and World Com in USA, HIH Insurance Company Ltd and One-Tell Pty Ltd in Australia and Parmalat in Italy in beginning of 2000.

Indonesia also got huge impact of this economic crisis. Based on BPS data, many sectors of industry got collapsed, especially manufacture sector (about 13%). Several factors pushed manufacture sector to financial distress, decreasing on purchasing power of people, decreasing on domestic economic activities which cause decreasing on aggregate demand of manufacture products, and also decreasing on aggregate supply which caused by high interest rate, limited bank loan, and also high price of raw material (Brahmana, 2006).

Financial distress happened before bankruptcy. Financial distress is defined as a phase of decreasing of financial performance that happened before bankruptcy or liquidation (Plat & Plat on Almilia, 2002). Bankruptcy as a failure is defined as financial failure and economic failure (Adnan and Kurniasih, 2000).

There are three possible reasons why the firm can go bankrupt (Lizal, 2002). The first one, neoclassical, is a result of a state when the allocation of assets is inappropriate. The second reason for bankruptcy might be just financial. The firm has the right structure of assets but its financial structure is bad with liquidity constraint. This means that even if the firm is viable in the long run it has to go to bankrupt in the short run. The last reason of bankruptcy might be that the firm has the proper asset and financial structure but a bad management. The x-inefficiency is then driving the firm out of the market as a consequence of unsolved problems in corporate governance.

Then, among those three reasons, the last reason is the most crucial one to get more focus. It is due to management problem covers all aspects of the company. So, the effective approach to solve the management problem is applying corporate governance (The Committee of the Corporate Governance Forum of Japan, 1997)

Basically, corporate governance is a system (input, process, output) and a set of rules that define a relationship between shareholder, board of commitee, board of director, creditor the government, employees and other internal and external in respect to their and responsibilities. Corporate governance is implemented to control this relationship and to avoid significant errors in corporate strategy and to make sure those errors can be fixed emmidiately (Sutojo & Aldridge, 2005).

CHAPTER 5

CONCLUSION

5.1 Conclusion

The aim of the research is to investigate the influence of the Corporate Governance to the financial distress. The research using 42 samples of manufacture companies listed in Indonesian Stock Exchange with time analysis for 4 years from 2004 until 2007.

Empirical proof of this research supports the hypotheses that board size has significant relationship to Z-score as a proxy of financial distress. It means, a number of supervisory board is proven has positive impact and significant relationship to company financial distress. The result of this research indicates that the larger number of supervisory board is better than lower number of supervisory board.

Empirical proof of this research supports the first hypotheses that board size has significant relationship to Z-score as a proxy of financial distress. It means, the number of supervisory board is proven has positive impact and significant relationship to company financial distress. The result of this research indicates that the larger number of supervisory board is better than lower number of supervisory board.

Meanwhile, the result of that empirical proof does not support the second and the third hypotheses that the proportion of independent board and educational background has no significant relationship toward Z-score as proxies of financial

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