BOARD CHARACTERISTICS AND FINANCIAL PERFORMANCE OF ISLAMIC BANKS: THE CASE OF INDONESIA

THESIS

Submitted In Partial Fulfillment of the Requirement For Undergraduate Degree in Economics

Written By:

PUTRI LENGGOGENI

BP. 05 153 081

ACCOUNTING DEPARTMENT

FACULTY OF ECONOMICS

ANDALAS UNIVERSITY

2010

ABSTRACT

This study includes Independent T-test and Multiple Regressions to analyze the relationship between board characteristics and financial performance of Indonesian Islamic Banks, specifically consist of board of commissioners' size, board independence, board tenure, and board age as independent variable. In measure financial performance, this study use return on equity and BOPO as efficiency ratio. The result indicates that generally the board characteristics insignificance influence toward financial performance of Indonesian Islamic banks according to the correlation between variables in measure the relationship is weak.

Keywords: board characteristics, financial performance, Islamic banks, board of commissioners' size, board independence, board tenure, board age, return on equity, BOPO

CHAPTER I

INTRODUCTION

1.1 Background

Indonesia was deeply affected by the 1997–1998 crises, more than others East Asian country. Its economic contraction was deeper and more prolonged, the only one to experience a (temporary) loss of macroeconomic control, and also suffered "twin crises", in the sense that its serious economic and financial problems were accompanied by Soeharto's regime collapse (Hill & Shirashi, 2007). The recovery was slowly and complex process, as new institutions had to be created, and old ones reformed under successive short-lived administrations. Over the last decade, much has been discussed on how to stimulate economic growth on the continent within the context of a rapidly evolving global economy.

Banks play very important role in the economic life of the nation. The health of the economic is closely related to the soundness of its banking system. Greuning and Iqbal (2007) argued that the growth international financial markets and greater diversity of financial instruments have provided large banks with wider access to fund. Banks have responded to the new challenges by going to new arena. So that, Indonesia is very eager to concern in banking industry in order to recovery its nation economic life.

In developing economic growth, Indonesia adopts several systems of banking; there are conventional system and sharia banking system. Presently there are full-fledged Islamic Bank, Sharia Business Units and Sharia Rural Bank. Indonesia, with the world's largest population of Muslims, has come to Islamic or sharia banking fairly late. Many of Indonesia's Muslim leaders do not believe that commercial interest in its modern form is prohibited, although others do. After some false starts, Islamic financial institutions are developing rapidly and have the enthusiastic support of many young people and intellectuals. The work of the Sharia Bureau of Bank Indonesia demonstrates that Indonesia, especially in particular parts of the country, has considerable unmet demand for Islamic banking (The Blueprint of Islamic Banking Development in Indonesia cited in Timberg, 2003).

Applications of corporate governance in sharia banking become uncomplain certainty. Moreover, sharia banks must be step forward as a leader to implement corporate governance conceptual framework. Sturdy by Islamic Financial Service Board (IFSB) launch Exposure Draft of good corporate governance for Sharia Financing Institution. The difference of corporate governance between sharia and conventional stated at sharia compliance, obedience to shariah it self. Whereas Corporate Governance Principle as we know as fairness, transparency, accountability, responsibility, morality, commitment, and independent, become important principle at activity and existence of a Moslem.

Corporate governance supposed to be implemented in institutions and corporations from whole sectors. Although corporate governance is essential to the success of firms in many industries, the banking sector deserves special attention (UFJI & FCGI, 2005). The banking sector is mainly responsible for the allocation of financial resources to all other sectors of an economy, whose efficiency very much determines the performance of the economy. The

CHAPTER V

CONCLUSION

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

5.1 Research Conclusions

This purpose of this research is to get statistical data that shows whether board characteristics which represent by Board of Commissioners' Size, Board Independence, Board Tenure, and Board Age have significant relationship toward financial performance measure by ROE and BOPO.

This research investigates hypotheses states that there are insignificant influences of the board characteristic variables towards banking financial performance of Indonesian Islamic banks which covers five years data, the results are:

1. There is no significant influence between Board of Commissioners' Size toward financial performance measure by ROE and BOPO.
2. There is no significant influence between Board Independence toward financial performance measure by ROE and BOPO.

REFERENCES

Agarwal, R., & Elston, J. A. (1999). Bank–firm relationships, financing and firm performance in Germany. *Issues in Economics Letters, 72 (2001)*, 225–232.

Anderson, R., Mansi, S., & Reeb, D. (2004). Board characteristics, accounting report integrity and the cost of debt. *Issues in Journal of Accounting and Economics, 37*, 315-342.

Australian APEC Study Centre's Managing Regulatory Change Program. (2004). *Bank Governance Principles and Basel 2: A Best Practice Guide*. Australia.

Australian Stock Exchange. (2003). *ASX Guidance Note 10: Review of Operations and Activities –Listing Rule 4.10.17.* from http://www.asx.com.au/ListingRules/guidance/GuidanceNote10.pdf.

Bacon, J. (1993). *Corporate Boards and Corporate Governance*. New York: The Conference Board.

Bank Indonesia. (2002). *The blueprint of Islamic banking development in Indonesia*. Jakarta.

Basel Committee on Banking Supervision. (2005). *Enhancing corporate governance for banking organizations*. Bank for International settlements.

Beasley, M. (1996). An empirical analysis of the relation between the board of director composition and financial statement fraud. *Issues in Accounting Review, 71*, 443–465.

Beiner, S., Drobetz, W., Schmid, F., & Zimmermann, H. (2003). Is Board Size an Independent Corporate Governance Mechanism?. Retrieved November 11, 2009, from http://papers.ssrn.com

Berger, P. G., Ofek, E., & Yermack, D. L. (1997). Managerial entrenchment and capital structure decisions. *Issues in Journal of Finance, 52 (4)*, 1411-1438.

Bhaghat, S., & B. Black (1999). The uncertain relationship between board composition and firm performance. *Issues in Business Lawyer, 54*, 921-963.

Bhaghat, S., & B. Black (2001). The non-correlation between board independence and long term firm performance. *Issues in Journal of Corporation Law, 27*, 231-274.