CHAPTER I

INTRODUCTION

1.1 Research Background

Corporate Governance plays an important role in the entity and it is always discussed by investors especially in Asia (Perdana, Ramadhan Sukma and Raharja, 2014). Because of the core of corporate governance, investors are willing to pay more to companies that have implemented Good Corporate Governance (GCG). Good Corporate Governance implementation has been seriously occupied by many companies. In 2014, the achievements are reached by one of the company in Indonesia. PT Perusahaan Gas Negara (Persero) Tbk (PGN) that is committed and consistent in implementing the principles of good corporate governance in every aspect of its business, has been re-awarded with international recognition. The award comes from LACP (League of American Communications Professionals) 2013 Vision Award, which PGN was on 4th in the world from the Top 100 of Annual Reports Worldwide Winners. Quoted from the statement of the Director of PGN, Hendi Santoso that in order to achieve the objectives of the company, PGN will always uphold the principles of GCG. This award is also the proof that every company who wants to progress and evolve in the world should pay attention to the importance of implementing good corporate governance in their companies.

Keasey (1993) as cited in Almilia (2006) states that corporate governance is a structure, processes, culture and systems to create the operational conditions of success for an organization. While the State-Owned Enterprises Decision No.

Kep117 / M-MBU / 2002 dated August 1, 2002 on the Implementation of Good Corporate Governance (GCG) in state-owned enterprises, corporate governance is the principles underlying the process and management mechanisms based on legislation and business ethics.

Actually the term corporate governance itself became popular when the Cadbury Committee in 1992 established a report called Cadburry Report (Tjager et.al 2003) as stated by Setyaningrum (2005). This report is considered as decisive corporate governance practices in the world. The practice of good corporate governance continuously developed to obtain the maximum value of the company, by fostering the principles of openness, accountability, and justice for all majority and minority shareholders as stated by Krismatono (2004).

Since the incidents of WorldCom and Enron in the United States has also been assured that the importance of the implementation of GCG. Asian Development Bank has also been reviewing what are the factors that contributed to the crisis in Indonesia. Where these factors are the concentration of ownership is too high, ineffective oversight function of the board of commissioners, inefficiency and lack of transparency regarding to the mergers control procedures and firm acquisitions, and a high dependence on external funding and lack of inadequate supervision by creditors as stated in Kaihatu (2006).

Prolonged crisis in Indonesia since 1998 became one of the proofs on the poor corporate governance that the companies implemented in Indonesia. Herwidayatmo (2000) as cited in Setyanungrum (2005) stated that the poor corporate governance is one cause of the financial crisis in Southeast Asia, and Indonesia were the worst affected due to the crisis. And from that moment on corporate governance to be one concern for investors who want to invest in the company.

Naja (2004) states that many countries are aware regarding to the importance of corporate governance for a company as well as country that has become necessary for survival of the rapid global competition, and avoid bankruptcy. Even in principle, this corporate governance issue has become a necessity, which all lead to the same goal which is to run the business much better, win the competition, and survive from the external onslaught. Lack of factors that related to transparency, accountability, fairness, responsibility and independence of the members of the company (directors, commissioners and shareholders) that led to the decline of most of the businesses in Indonesia.

In the principle of accountability, which it means the clarity of function, structure, system, and accountability so that the company's management element applied effectively. GCG structure in the company is important, because in every structure there is anyone who is involved and what is the inherent responsibilities in accordance with each respective functions. Under the Law Regulations of the Republic of Indonesia No. 40 of 2007 regarding to the Limited Liability Company, the elements of the company shall consist of the General Meeting of Shareholders, the Board of Commissioners and Board of Directors.

Wardhani (2006) in her research consisted of three independent variables, namely the size of board of commissioners, the independence of the board of commissioners and ownership structure. While the dependent variable is a binary variable, which is the companies that have financial distress or good financial condition. In this study led to the conclusion that the increase in the number of commissioners will reduce the possibility of companies experiencing financial distress through better monitoring function, as well as independent commissioners should not only be placed to meet regulatory requirements, but also must perform its functions properly so that the company's financial condition may be much better.

Utama (2004) which resulted in the conclusion of the audit committee be formed to assist the commissioners in the oversight function is mainly related to accounting policies and financial reporting. CG is a set of rules that govern the relationship concerned in it. GCG regulation has an effect on the company's information disclosure mechanism.

Setyaningrum (2005) in which the independent variable is a proxy of the CG and characteristics of the company. For the dependent variable is the bond rating. This study also resulted in a significant effect of structure category and ownership influence, transparency and disclosure of financial information. And for the board of commissioners shows no significant effect.

Financial distress occurs before the company went into bankruptcy. Thus the calculation of financial ratio analysis is required to be able to state that the company is healthy or not can be seen on its financial condition. Foster (1986) as cited in Almilia and Kristijadi (2003) states that to predict specific variables (such as bankruptcy or financial distress) and examine the empirical relationship with financial ratio analysis is needed of financial statements with the financial ratios model. Calculations using financial ratios are expected to help researchers to determine the sample in the form of a company experiencing financial crisis and whom are not experiencing financial crisis.

So in this study, by continuing previous research that the researcher wanted to see how the application structure of CG in a company may be one reason companies are experiencing financial distress, by examining the structure of CG associated with the board, including board size of commissioners, the independence of the commissioner, the ownership structure of the company and the audit committee as an independent variable. Researcher add variable of audit committee, because of a previous study conducted by Utama (2004) states that the existence of significant audit committee involved in the company's performance, because they oversee and assist the commissioners. Therefore, opinions and disclosures made by the audit committee has an effect on the possibility of companies experiencing financial problems.

Meanwhile, to avoid bias, the researcher will insert the control variables, which was in accordance to Pembayun and Januarti (2012), the control variable is inserted so that the relationship of independent variables on the dependent variable is not influenced by the non-examined external factors. Control variables in this research is the size and leverage, where it is believed that a large company has some huge agency problems that require a better governance. The data control is used to see if there is data of the object under study has specific characteristics, and usually "size" variable appears as an explanatory variable due to large enterprise asset value and to avoid bias scale, the amount of assets need to be compressed by using logarithm. Leverage as a control variable used to get a clearer picture of the influence of corporate governance on the possibility of companies experiencing financial distress according to Niarachma (2012). Leverage in this study using the debt to equity ratio, which describes the level of debt of the company, where the level of debt will affect the company's financial condition due to the growing debt levels of the company, the default risk of the company would be even greater, according to Wardhani (2006). This study is also expected to explain the link structure of the CG toward the possibility of companies experiencing financial distress. To see whether the possibility of a company experiencing financial distress or not, so the researcher conducts the analysis on the financial statements using financial ratios.

Thus, the object that will be examined is a manufacturing companies that listed in Indonesia Stock Exchange. The reason of the researcher chose the manufacturing companies as an object of research are as follows:

1. Manufacturing companies that are listed in Indonesia Stock Exchange consists of various sub-sectors of the industry, so it can represent the whole range of the company towards the application of GCG.
2. Manufacturing companies have the largest number of companies that listed in the Indonesia Stock Exchange
3. Manufacturing companies have more complex problems that are expected to describe the company situation in Indonesia.

All of the issues and problems above, the researcher wants to do a research with a title "**The Influence of Good Corporate Governance Structure Towards Company in Experiencing Financial Distress (Empirical Study in Manufacturing Companies Listed in Indonesia Stock Exchange 2012 - 2014)**"

1.2 Research Question

Based on the discussion above, the research problems are formulated in the form of questions as follows:

1. Does size of board of commissioners have significant influence on the possibilities for the companies in experiencing financial distress?
2. Does size of independent commissioners have significant influence on the possibilities for the companies in experiencing financial distress?
3. Does institutional share ownership have significant influence on the possibilities for the companies in experiencing financial distress?
4. Does share ownership of board of directors and commissioners have significant influence on the possibilities for the companies in experiencing financial distress?
5. Does size of board of Audit Committee have significant influence on the possibilities for the companies in experiencing financial distress?

1.3 Research Objectives

The objectives of the research are as follows:

1. To determine whether the size of board of commissioners have significant influence on the possibilities for the companies in experiencing financial distress.
2. To determine whether the size of independent commissioners have significant influence on the possibilities for the companies in experiencing financial distress.

3. To determine whether institutional share ownership have significant influence on the possibilities for the companies in experiencing financial distress.
4. To determine whether share ownership of board of directors and commissioners have significant influence on the possibilities for the companies in experiencing financial distress.
5. To determine whether the size of board of Audit Committee have significant influence on the possibilities for the companies in experiencing financial distress.

1.4 Research Benefits

While the benefits of this research are based on the background described above are as follows:

1. Provide benefits to companies that are experiencing financial distress to consider the application of CG and the appropriate strategies to maximize and enhance the company's financial condition.
2. Provide benefits to investors who want to invest in companies that have implemented CG so be sure and get their rights.
3. Provide information for both internal and external parties in reading whether the financial condition of the company in good health or not (experiencing financial disstress).
4. Be a reference for future research and provide benefits for the development of accounting, particularly in relation to CG.

5. Increase corporate awareness of the importance of CG and its application which became one of the causes of a company's success or failure.

1.5 Writing Systematics

This research consists of five part or chapters as follows:

1. CHAPTER I INTRODUCTION

   This chapter explains about the background, problem definition, research objectives and benefits, and writing systematical.

2. CHAPTER II LITERATURE REVIEW

   This chapter explains about literature review about the influence of good corporate governance to manufacturing company’s financial distress, and review of previous research to develop the hypothesis

3. CHAPTER III RESEARCH METHODOLOGY

   This chapter explains about the research variables and its operational definitions, sampling determination, type and source of data, data collection method, and analysis method.

4. CHAPTER VI ANALYSIS AND RESULTS

   This chapter explains about description of research objects, analysis of data, and discussions.

5. CHAPTER V CONCLUSION

   This chapter explains about conclusion from research result that had been done, research limitations, and research suggestions.