Chapter I

Introduction

1.1 Background

To make profit for shareholder and maximizing shareholder wealth through increasing company value is one of Corporate Governance outcomes expectation. (Brigham and Houston, 2001). High company value could increase its owners wealth, thus making investors invest their money in the company. Complexity of recent competition forcing the owners to select trusted professionals who have knowledges and skills to operates the company and making profit for them. This action is needed for cost effectiveness and efficiency to reach the owner goals. Main concern in this situation is a need for a mechanism to ensure the owners interest align with management interest. Owners called as Principal; who owns the company, and manager called as agent; don't own the company, but manages the whole company. A mechanism to protect them is needed to ensure minimizing conflict of interest between them, principal and agent, and making this whole situation connected to The Agency Problems. (Lukviarman, 2016)

Ownership in current sophisticated corporation is widely held by various owners, differs from manager decision to maximize its owners return, which supporting the agency theory argumentation (Berle and Means 1932; Pratt and Zeckhauser 1985). The agency theory argues that different goals between principal (owners, shareholders) and agent(manager, management Board) will create a conflict that will distort the company goals to maximize its profit, regardless profit for shareholder nor stakeholders. “opportunistic behaviour” indulges the manager to acts differently from the shareholders’ interest, which supports the agency theory (Williamson, 1985). A need for mechanism that works as “disciplinary forces” in order to reduce conflicts between principal and agent is needed in order to reduce the loss for its company or the other stakeholders, this includes employees, creditors, suppliers, consumers, and local community (Alkhafaji, 1989; Ibid, 2005).

This phenomena forces its elements who participated in this system to create a rules and regulations for every elements who interact within this scope to ensure the implementation of the governance. As a whole, every interaction that follows to the accepted rules and regulation will reaches its governance outcomes. Adam Smith, in His books *The Theory of Moral Sentiments*, illustrates the system as a chess board game:

> In the great ‘chessboard’ of human society, every single piece has a principle of motion of its own, altogether different from that whick the legislature might chuse to impress upon it. If those two principles coincide and act in the same direction, the game of human society will go on easily and harmoniously, and is very likely to be happy and successfuk. If they are opposite or different, the game will go on miserably, and the society must be at all times in the highest degree of disorder (p. 234)

Each participant in the chess have its own roles, functions, along with different *motion*. If the participants in the game do not follows the rules and regulation of the game, there will be a disorder that will distrupt the game, thus making the game less exciting and out of control. As the metaphor of chess game by Adam Smith, a set of rules and regulations in the system is needed in order to ensure the *checks and balances* in the system works in the right track, thus reducing the conflict between principal and agent (Ibid, 2016).

A Major mechanism to protect the shareholders and “opportunistic behaviour” of managers is the Board of Directors (BOD). BOD have a roles to oversees and valuating the managerial actions and decisions, in behalf of the shareholders (Donaldson and Davis, 1991). BOD is different from Management, which makes them the governing body of entity, making the position above in the Management. (Ibid, 2016)

Previous studies and research shows BOD and its subfactors (size, activity, proportion) have positive and significant impact to company performance (Nugrahani and Nugroho, 2010; Manik, 2011; Muktiyanto, 2011; Widiawati, 2013; Widagdo and Chariri, 2014)but, some argues that its has negative and not significant impact to company performance (Wulandari, 2006;Dewayanto, 2010; Puspitasari and Ernawati, 2010;Suhardjanto and Anggitarani, 2010, Muktiyanto, 2011; Wijayanti and Mutmainah, 2012). These conclusion of several researches and studies shows inconsistency the outcomes of corporate governance impact to company performance, especially the impact of BOD towards company performance (Dewi, 2006). This research gap interest writer to research the BOD impact to company performance.

Company performance can be measured by using financial ratio. Investors uses one of the ratios, the profitability ratio to decide whether the investors want to invest or not. One of profitability ratio used to measures is Return on Asset (ROA). ROA simplicity and quick results help investor decision to invest their return on investment (Prasinta, 2012). Also, by using ROA investors could examine how the company optimizes its assets in order to reach their profit, along with the purposes of corporate governance to use asset efficiently and effectively (OECD, 2004)

Population of this research in this studies is the listed go-public company in Indonesia Stock Exchange (IDX), with the sample the industry sector company with five year periode, which starts from 2012 to 2016.

In late 2011, goverment of Indonesia agreed to establish a Otoritas Jasa Keuangan (OJK), and in December 2012, OJK replaces the authority of Stock Market Monitoring Body / Badan Pengawas Pasar Modal (Bapepam) and Central Bank of Indonesia to authorize and monitor financial service industry in Indonesia. By establishment of OJK in 2011, it is shown that the importance of financial service sector in Indonesia[1].

From explanation above, it is important how Corporate governance influence the company performance to contribute for the country, thus interest writer to research the corporate governance with specifically focuses on BOD in the company with the

[1] https://ekbis.sindonews.com/read/700589/90/kelahiran-ojk-sejarah-baru-perekonomian-indonesia-1356414181

title **“Board of Director influence on Company Performance in Listed Financial Service Industry in Indonesia Stock Exchange on 2012-2016 Period”**

1.2 Problem Formulation

As the explanation above, the problem formulation in this research can be deducted into:

- Is the supervisory board size has influence in Company performance in listed financial service industry in Indonesia Stock Exchange on 2012-2016 period?
- Is the independent supervisory board proportion has influence in Company performance in listed financial service industry in Indonesia Stock Exchange on 2012-2016 period?
- Is the supervisory board activity has influence in Company performance in listed financial service industry in Indonesia Stock Exchange on 2012-2016 period?

1.3 Research Purpose

Research about supervisory board influence that will be measured by board size, board proportion, and board activity towards company performance has purpose as follows:

1. To know the supervisory board size has influence to company performance.
2. To know the supervisory board proportion has influence to company performance.
3. To know the supervisory board activity has influence to company performance.

1.4 Research Benefit

Expectation of this research result will give benefit towards several users, which:

1. Academics scholar that interest in research the factors that could influence company performance from supervisory board perspective.
2. Knowledge for users to expand their understanding of corporate governance, related to supervisory board influences to company performance.

For next researchers, this research result could expand the research related to supervisory board influences to company performance.

1.5 Writing Systematics

Chapter one is an introduction. This chapter consists explanation of background of related research, problem formulation of the research, purpose of the research, benefit of the research, and writing systematics of the research. Literature review will be explained in chapter two. This chapter consists of review of related research, such as definition, criteria, and detail explanation of supervisory board and company performance. Chapter three is related to research method. This chapter consists of explanation of type and source of the data, method when collecting data, population and sample of the research, variable correlation between independent and dependent variable, and methods used in analyzing the data.

Findings and Analysis can be found in chapter four. This chapter consists of the findings of the data, along with the processed data from analytical software and interpretation of the data. And last, conclusions and suggestions will be explained in chapter five. This chapter consists of conclusion of the research and suggestion based on the findings and analysis of the research.