UNIVERSITAS INDONESIA

THE EFFECT OF BOARD OF COMMISSIONERS ACTIVITY, SIZE AND INDEPENDENCY ON BANK'S NONPERFORMING LOAN

THESIS

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UNIVERSITAS INDONESIA
FACULTY OF ECONOMICS
MAGISTER MANAGEMENT
JAKARTA
JULY 2010

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Submitted to fulfill one of the requirements to obtain degree of Magister Management

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STATEMENT OF ORIGINALITY

This final paper represents my own effort,
Any idea or excerpt from other writers in this final paper, either in form of publication or in other form of publication, if any, have been acknowledged in this paper in accordance to academic standard or reference procedures

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Date	: 2 July 2010

PREFACE

Praise and thanks to Allah SWT because of His grace and guidance, researcher acquire guidance and strength to finalize this thesis. This paper still has many shortcomings and to that end researcher would like to aks forgiveness when there are less acceptable manners during the process of settlement of this writing. On this occasion researcher would like to say gratitude to:

1. Prof. Rhenald Kasali, PhD., as the head of MM-FEUI
2. Dr. Ancella A. Hermawan, as thesis advisor who has been willing to provide her time and share her knowledge for this thesis.
3. My family and Ina Cahyawati for their affection, prayers and never ending support.
4. Friends and colleague for their support and understanding.

Furthermore researcher hope this study can provide scientific contributions to anyone who reads and needs it. Suggestions and constructive criticism as an input for enhancements and improvements for the next writing are welcome.

Jakarta, July 2010

Author

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ABSTRACT

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Study Program | Magister of Management–Master of Business International
Title | **THE EFFECT OF BOARD OF COMMISSIONERS ACTIVITY, SIZE AND INDEPENDENCY ON BANK'S NONPERFORMING LOAN**

This research analyze the effect of board of commissioners characteristic, which represented by board of commissioners meeting frequency in one year, number of board of commissioners members, and percentage of independent commissioners, on bank's nonperforming loan. The use of Big 4 (four) auditors represented the variable control on the regression model. This research used data from year 2008 that collected from bank's annual report and quarterly bank publication report. This research found that independent commissioners percentage indicate significant effect on bank's nonperforming loan, while the other independent variables which are board of commissioners' meeting frequency and size indicate insignificant effect on bank's nonperforming loan.

Key Words:
Good Corporate Governance, Board Meeting, Board Size, Board Independency, Nonperforming Loan.

ABSTRAKSI

Nama	Midian
Program Studi	Magister of Management–Master of Business International
Judul	**PENGARUH AKTIVITAS, UKURAN, DAN INDEPENDENSI DEWAN KOMISARIS TERHADAP KREDIT BERMASALAH PADA BANK**

Penelitian ini menganalisa pengaruh karakteristik dewan komisaris, yang diwakili oleh frekuensi rapat dewan komisaris dalam satu tahun, jumlah anggota dewan komisaris, dan proporsi komisaris independen, terhadap kredit bermasalah pada bank. Penggunaan auditor *Big 4* (auditor 4 besar) digunakan sebagai variabel kontrol dalam model regresi. Penelitian ini menggunakan data tahun 2008, yang dikumpulkan dari laporan tahunan dan laporan publikasi triwulan bank. Penelitian ini menemukan bahwa proporsi komisaris independen mengindikasikan efek signifikan terhadap kredit bermasalah pada bank. Sedangkan veriabel independen lainnya, yaitu frekuensi rapat dan ukuran dewan komisars mengidikasikan efek yang tidak signifikan terhadap kredit bermasalah bank.

Key Words:
Good Corporate Governance, Rapat Dewan Komisaris, Ukuran Dewan Komisaris, Independensi Dewan Komisaris, Nonperforming Loan.

TABLE OF CONTENT

LIST OF TABLES

LIST OF FIGURES

LIST OF APENDIX

CHAPTER 1
INTRODUCTION

1.1 Research Backgrounds

The implementation of good corporate governance has been an important issue in conducting business nowadays. It has evolved from best practice (advisory) into enforcement in most countries. The failure of internal supervisory and risk management within a company will lead to a bad performance, internal and external fraud, even a bankruptcy of that company.

The collapse of Enron, WorldCom, and Baring in the 1990's, Asian Financial Crisis in 1997 and recently, global economic crisis were also caused by the failure to adopt good corporate governance principle.

During the crisis, both 1997 and 2008, government and/or monetary authority in most countries that were affected, provided a huge buffer fund to bailout the financial industry, especially in the banking industry, in order to prevent further collapse. The high degree of government oversight and support is due to the important role of banking industry in the development of a country's economic. As an intermediary institution, banking industry keep the flow of funds from the excess to the shortage accordingly, thus the failure of banking industry could create a systemic effect to country economic system, and in line with globalization, the problem of one country will affect directly or indirectly to the other countries.

Banking industry have 2 (two) characteristics that differentiate it from other industries. Highly regulated is the first characteristic. Almost every aspect of banking operational were regulated and monitored by Bank Indonesia as the regulator. The highly regulated characteristic has a purpose to protect the society as the bank's customer, which lead to the second characteristic, banking industry as business based on trust.

The society as the bank's customer put its fund without full guarantee from the bank. The collected fund will be distributed to the shortage parties in line with bank's essential role in the economic system of a country. In conducting that role, the bank is facing several risks, among others are credit risk, market risk, operational risk and legal risk. Based on those situations, bank should be governed and managed with prudential principle by professional management who has high integrity.

In line with the rapid development in the banking industry nowadays, the complexity in bank's business activities has also increased and sequentially increased bank's risk exposure. Thus, good corporate governance is becoming more important than ever.

A few years before the Asian financial crisis in 1998, Indonesian's economic showed stable growth. Indonesian's Gross National Product (GNP) average within year 1970-1996 was around 6.7% per year. However, behind that stable growth there were weaknesses which potentially distress the national economic stability, especially in financial sector. One of the economic policies that have significant and systemic influence at that time is banking regulation package 1988. The issuance of that regulation package reduce bank establishment requirements, such as minimum capital that only require IDR 10 billion in establishing a bank. Thus, many new banks were established at that time.

However the easiness of bank establishment requirements also had negative impacts, such as cross ownership and cross management issue on Indonesian banking industry. Those two issues lead to the increase of ownership concentration and sequentially cause violation on legal lending limit regulation, especially to the related party.

After the crisis in 1998, a number of commercial bank in Indonesia decrease rapidly, from 237 banks into 130 banks due to bankruptcy, merger & acquisition, and the tightening of bank's requirements.

Based on those experiences, it could be concluded that one of the factor caused the collapse of banking industry is related to bank's governance. The need of improvement in Good Corporate Governance implementation quality is also necessary to be conducted due to the increasing challenge faced by banking industry, both internally and externally. The Board of Commissioners and Board of Directors are expected to be able to act as role models and activators so that Banks will implement optimally the principles of Good Corporate Governance.

Considering the importance of good corporate governance implementation in conducting a business, and the essential role of banking industry within economic system, Bank Indonesia issued Bank Indonesia Regulation (PBI) number 8/4/PBI/2006 regarding Good Corporate Governance Implementation By Commercial Bank in 2006 to enforce implementation of good corporate governance in banking industry, especially for commercial bank.

According to the regulation, the improvement of quality in Good Corporate Governance implementation is necessary to be conducted due to the increasing complexity of risks and challenges faced by banking industry, both internally and externally. Internally, the Board of Commissioners and Board of Directors are expected to be able to act as role models and activator so that Banks will implement optimally the principles of Good Corporate Governance.

The regulation consists of several requirements that should be fulfilled by bank in order to have minimum implementation. The requirements among others minimum number of board of directors and commissioners, percentage of independent commissioners, number of meeting should be held in one year by board of commissioners. The requirements related to board of commissioners were issued after considering the essential role of board commissioners in implementing good corporate governance in bank. By fully complying of those requirements, stated in the regulation, bank's performance is expected to increase.

Bank's nonperforming loan could also represent board of commissioners concern towards bank, by supervising and monitoring bank's credit approval. Lack of monitoring credit approval could cause reckless distribution of fund which sequentially will cause bad debt. In line with the previous research conducted by Reddy (2002), weak corporate governance is one of the causes that generate Nonperforming assets in Japan and sequentially cause poor performance.

Board of commissioners meeting represents board of commissioners' activities. As stated in Bank Indonesia regulation, one of the boards of commissioners' tasks is supervise and monitor loan approval. Thus, by conducting more meeting indicate more monitoring and supervise activities by the board of commissioners, and sequentially will reduce bank's nonperforming loan.

Board of commissioners' size indicates board of commissioners' capabilities to contribute to a bank's performance. By having more members, also mean more experts within the board of commissioners and sequentially will give greater contribution to the bank's performance. Empirical study was conducted by Kiel and Nicholson (2003) that find significant effect of board size on bank's performance.

Previous researches were conducted regarding relationship between company's board composition and company's performances, the result of those researches were varied. Most of the result shows insignificant correlation between the presences of outside director and company's performance. However, research that was conducted by Rosenstein & Wyatt (1990) showed positive significant influence to company's stock price by independent commissioner's proportion on board of commissioners.

The requirements of Bank Indonesia regulation to hold minimum board of commissioners meeting in one year and minimum proportion of independent commissioners are new requirements that should be fulfilled by the banking industry. The effectiveness of those requirements needs to be analyzed in order to identify whether the requirements are already meet the objective of the regulation.

Based on those backgrounds above, this research try to find whether there is an effect of board of commissioners' characteristic, which represent by several proxy variables, on bank's net nonperforming loan.

1.2 Problems Formulation

As mentioned above, corporate governance implementation for commercial bank is intended to improve bank's performance, which represent by bank's nonperforming loan ratio. Bank Indonesia regulation that required the implementation have been issued since 2006, this research assume Indonesian banking industry have implemented the regulation completely.

The research is intended to answer following question:

- Is there any effect of bank's board of commissioners meeting frequency on bank's Net Nonperforming Loan?

- Is there any effect of bank’s board of commissioners size on bank’s Net Nonperforming Loan?
- Is there any effect of bank’s board of commissioners independency on bank’s Net Nonperforming Loan?

1.3 Research Objectives

The objectives of this research are:

- To identify the effect of board of commissioners meeting on bank’s Net Nonperforming Loan.
- To identify the effect of percentage of Bank’s Board of Commissioners size on bank’s Nonperforming Loan.
- To identify the effect of bank’s board of commissioners independency on bank’s Nonperforming Loan.

1.4 Research Contribution

The contribution of these research findings as follow:

- For company these research findings give perspective regarding good corporate governance contribution to bank’s performance, especially net nonperforming loan.
- For regulator this research finding give input concerning essential components of good corporate governance that need to emphasized in order to implement it effectively.
- For public these research findings give point of view regarding good corporate governance implementation on a bank, especially related to bank’s nonperforming loan.

1.5 Research Outline

These research consist of 5 (five) chapters which interrelated one another. The brief contents of each chapter as summarized as follow:

Chapter 1 Introduction

Present background and issues. This chapter discusses problem formulation, and objective of the research. Furthermore, the originality and contribution of this research are also presented in this chapter.

Chapter 2 Literature Review

Present theoretical framework and discusses literature reviews. The important effect in implementing good corporate governance on risk management and bank performance is discussed in this chapter.

Chapter 3 Research Methodology

This chapter presents research methodology which will be uses for this research. The data are collected from bank's annual report or quarterly financial reports and good corporate governance report. This chapter also explains use of SPSS program.

Chapter 4 Research Analysis

This chapter presents research result and reports descriptive and inferential statistical analyses for secondary data. This chapter also provides information about confirming the hypotheses testing. Some rational explanations about the results also discussed in this chapter.

Chapter 5 Conclusion and Recommendation

This chapter presents research conclusion based on previous chapter analysis. Research limitation and recommendations also presented on this chapter.

CHAPTER 2

LITERATURES REVIEW

2.1 Good Corporate Governance

The terminology of good corporate governance first appeared in Cadbury Committee Report on 1992 titled *Financial Aspect of Corporate Governance*. The report sets out recommendations on the arrangement of company boards and accounting systems to mitigate corporate governance risks and failures. According to the committee, the definition of corporate governance as follows.

> *a set of rules that define the relationship between shareholders, managers, creditors, the government, employees and other internal and external stakeholders in respect to their rights and responsibilities, or the system by which companies are directed and controlled. The objective of corporate governance is to create added value to the stakeholders.*

According to Hitt, Ireland and Hoskisson, (2002) corporate governance is relationship between stakeholders that used to determine and control strategic purpose/direction and corporate performance. In another words, corporate governance related with effort to identified methods that ensure strategic decisions has been implemented effectively. Besides that, corporate governance also consider as a tool to control conflict of interest between stakeholders and ensure manager interest in line with owner interest.

Organization for Economic Co-operation and Development (1999) defined corporate governance as follow

> *Corporate governance is the system by which business corporation 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, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provide the structure through*

which the company objectives are set, and the means of attaining those objectives and monitoring performance.

According to Suprayitno, Yasni, Santy and Agus Salim (2007), good corporate governance is a **structure**, **system** and **process** which uses by the company organ for simultaneously added value for the company.

Structure is consisting of board of commissioners, board of director and the stakeholders. System means operational bases for authority check and balance mechanism in order to anticipate potential governance deviation. Process is a method in order to ensure that good corporate governance principle implemented in determine company's targets and goals, realization, performance measurement, and company's performance.

2.2 Good Corporate Governance in Banking Industry

Cadbury Committee Report sets out recommendations for good corporate governance practice in united state, while for the banking industry, Basel Committee on Banking Supervision have issued paperwork on 2006 titled *Enhancing Corporate Governance for Banking Organization* which derived from corporate governance principles that were published earlier by the Organization for Economic Co-operation and Development. The paperwork were consist of 3 (three) main points;

a. Sound corporate governance principles;
b. The role of supervisors; and
c. Promoting an environment supportive of sound corporate governance.

The recommendation was adopted by central bank/monetary authority all over the world, including Indonesia's Central Bank, Bank Indonesia (BI).

In order to follow the recommendations, as already mention in previous chapter, Bank Indonesia issued Bank Indonesia Regulation (PBI) no 8/4/PBI/2006 as amended by Bank Indonesia regulation no 8/14/PBI/2006 year 2006 concerning Good Corporate Governance Implementation by Commercial Bank, as basis law for corporate governance practice in Indonesia Banking Industry. Herewith Good

Corporate Governance definition according to Article 1, Bank Indonesia Regulation no 8/4/PBI/2006;

> *Good Corporate Governance shall be Bank governing procedures through the application of transparency, accountability, responsibility, Independency, and fairness principles.*

Based on above definitions, Susilo and Simarmat (2007) conclude that corporate governance related with following points:

- Relationship which regulated in a structure, process and procedure among corporate organs and other stakeholders.
- This relationship should in line with regulation and sound business practice. There should be check and balance among corporate organs in order to avoid authority misused and deviation in corporate target.
- This relationship regulated according TARIF (transparency, accountability, responsibility, independency, fairness).
- Through this relationship, corporate will be directed by determining corporate target and method to control performance achievement. Corporate governance should also give a proper incentive to corporate board and managements in their effort to achieve corporate target.
- All above processes directed to achieve corporate long-term target which is a sound, strong and competitive good corporate citizen.

Good corporate principles, as mention in Bank Indonesia regulation above, according to Susilo and Simarmat (2007) defined as follow;

a. Transparency

Is openness in conducting decision making and expose relevant and material information regarding company.

Transparency is the most important principle in implementing good corporate governance. Openness in conducting decision making implies that every party who involve in decision making recognizes clearly the judgments and motive in making decision. They also have opportunity in execute objection or give other judgments before the decision was made. The positive and negative result from the decision should also be informed clearly to the stakeholders. Transparency is the platform for fairness condition in conducting transaction.

Expose relevant and material information regarding company is company's accountability to public and stakeholders.

b. Accountability

Accountability is the clarity of function, implementation and responsibility of corporate body, thus corporate management implemented effectively.

The terminology of accountability implies *answerability*, *liability* and *responsibility*, which mean there is a requisite to answer every question about implementation of duty that imposes to a function.

The important meaning of this principle is ability to responsible the implementation of function and main duty of that function to external parties.

c. Responsibility

Responsibility is harmonization of corporation management with prevailing regulation and sound corporate principle.

As mentioned before, responsibility principle close related with accountability principle, since accountability is an expression of responsibility. When a function or task executed in line with prevailing laws and ethics, the result should be easy to responsible.

d. Independency

Independency is a state when corporate managed professionally without conflict of interest occurs and influence from other parties.

Also mention before, implementation of this principle highly related with accountability principle. Accountability principle itself is a consequence from implementation of responsibility and independency principle.

e. Fairness

Fairness is righteousness and equal in fulfill the rights of stakeholders that arise from agreement and prevailing regulation.

There are 3 (three) type of potential conflict in govern a corporate, which are;

- Conflict between management and shareholders;
- Conflict between stakeholders, especially majority shareholder and minority shareholder; and
- Conflict between corporate and stakeholders.

In order to reduce the potential conflict, as mention before, it is important for the corporate organ to implement fairness principle by generate clearness in rights and obligation, and task and responsibilities of corporate organ.

2.3 Corporate Governance and Bank Compliance

Literally, the term "compliance" means obedience or dutifulness, but it has broad scope and various interpretations. Compliance generally covers matters such as observance, application of standards of market conduct and managing conflicts of interests. More recently, Compliance has expanded its scope to cover specific areas such as operations of money laundering and terrorist financing and even tax laws that are relevant to financial services. In brief, the Compliance function should protect the institution against unlawful behavior and strengthen its ethical consciousness. A Board of Directors of any financial institution should approve and oversee the institution's strategic objectives and set a compliance culture. Similarly, the Board should ensure that the financial institution has adequate policies and procedures that enable oversight activities to be carried out on all business lines.

The word "Compliance" has also a connotation of regulatory and supervisory structures, which means that there is an external regulatory or supervisory body to ensure that financial institutions adhere to norms, guidelines and rules set by it. Compliance efforts will be effective and sustainable only in organizations where Compliance emerges from an ongoing board-level engagement. Compliance management therefore is the execution of business processes designed to manage risks and to continuously benchmark against expected parameters/tolerance levels applicable for the entire industry.

Implementation of good corporate governance by banks implies high concern by bank's management and owners toward other stakeholders; in more narrow perspective, it also implies banks concern regarding compliance to prevailing law and regulation. As mention in Basel Committee's Paper titled Enhancing Corporate Governance for Banking Organization (2006)

Also included in BI regulation regarding good corporate governance implementation, bank's compliance is one of the aspects that use to assess bank's good corporate governance implementation.

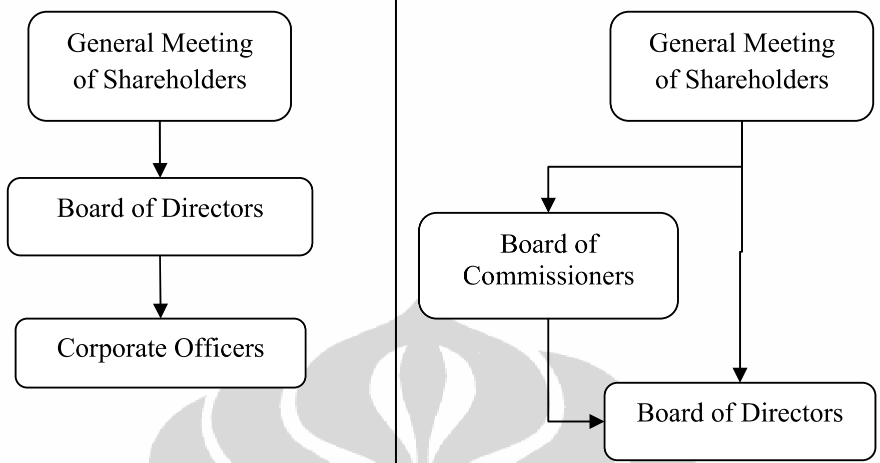
2.4 Company Organs[1]

According to Indonesia Law number 40 year 2007 regarding Limited Liability Company, company organ means the general meeting of shareholders, the board of directors, and board of commissioners. As legal entity, banks conduct legal action through their agent or company's organ. This condition confirms the separation between ownership and management, which defined as ownership positioning or assets partitioning, where there is partition between ownership assets and related legal entity.

There are various types of company's organ based on legal tradition for each country. Based on Anglo-Saxon law tradition (Common-Law), there are two company's organ, which are general meeting of shareholders and board of directors. This model usually described as "one tier board system", referring to company's management which conducted by only one organ.

In case of Indonesia law, company's organs consist of general meeting of shareholders, board of commissioners and board of directors. Since management system according to Indonesia law conducted by two organs, thus the system usually described as "two tiers board system". Following is the comparison between "one tier board system" and "two tiers board system".

[1] Official term that use in Indonesian's Law No. 40 year 2007 regarding Limited Liability Companies



- Board of Director (BoD) shall be headed by Chairman of the Board, who appointed by the shareholders
- Corporate officer appointed by Chief Executive Officer (CEO)
- Chairman and CEO position could be held by one person; good corporate governance advice to separate the position.
- BoD members could hold position as corporate officers.
- BoD member that do not hold position as corporate officer consider as non-executive director and/or independent director.

One tier board system

- Board of commissioners appointed by General Meeting of Shareholders in order to supervise board of director policies in manage the company
- All of the board of commissioners members have equal position and headed by president commissioners
- Board of directors appointed by General Meeting of Shareholders in order to manage the company and represent the company in and out of court.
- All of the board of directors members have equal position and headed by president directors
- Board of commissioners and board of directors could not hold another position

Two tiers board system

Source: Good Corporate Governance pada Bank, Susilo, Simarmata & Karlen (2007)

Figure 2.1 Comparison between "One tier" board system and "Two tiers" board system

In this research, company's organ definitions that refer to Indonesia law regarding limited liability and Bank Indonesia regulation are in line with two tier board system. Howevesr company's organ definitions that refer to Basel committee, OECD papers, or previous research, are in line with one tier board system.

2.5 Board of Commissioners and Board of Directors

The implementation of good corporate governance principles (transparency, accountability, responsibility, independency, and fairness), according to Bank Indonesia regulation should be at least applied on followings:

- Implementation of tasks and responsibilities by the Board of Commissioners and the Board of Directors;
- Completeness and implementation of the tasks of committees and the work unit performing bank internal audit function;
- Performance of compliance, internal auditor and external auditor functions;
- Risk management implementation, including the internal control system;
- Provision of funds to related parties and provision of funds in large amount (large exposures);
- Strategic plan of the Bank;
- Transparency in Bank financial and non financial conditions.

Based on Bank Indonesia requirements above, it can be concluded that board of commissioners and board of director are the one who responsible for the implementation of good corporate governance in the bank. Good Corporate Governance is a top down process; it should be initiated from the management area in order to establish it as a culture within the company.

Stated in BI regulation regarding good corporate governance article 9 number (1);

> *The Board of Commissioners must ensure the implementation of Good Corporate Governance in each of the Bank business activity on all organizational levels or hierarchy.*

Also stated in the same BI regulation, article 26;

The Board of Directors must implement Good Corporate Governance principles in each of the Bank's business activity for all organizational levels or hierarchy.

According to Indonesia Act No. 40 year 2007 regarding Limited Liability Company, board of commissioners means the Company Organ with the task of general and/or specific supervision in accordance with the articles of association and giving advice to the board of directors.

Board of director, according to the same act, means the Company Organ with full authority and responsibility for the management of the Company in the interests of the Company in accordance with the Company's purposes and objectives and to represent the Company in and out of court in accordance with the provisions of the articles of association.

As mentioned on Bank Indonesia regulation implementation of good corporate governance should be applied in board of commissioners' tasks and responsibilities. That requirement implies good corporate governance implementation should initiate from management level or top-down process.

Moreover the board of commissioners' tasks and responsibilities regulate on BI Regulation no. 7/2/PBI/2005 as amended by BI Regulation No. 11/2/PBI/2009 regarding assets quality assessment. This regulation required board of commissioners and board of directors to supervise and maintain asset quality, including loan. As an intermediary institution, generally most of bank's asset quality portfolio is loan. Thus bad quality in loan portfolio will have significant effect to the whole portfolio.

Bad quality in loan portfolio measured by bank's nonperforming loan (NPL) ratio. Board of commissioners responsible to monitor the loan approval by bank and approve related party loan, thus high NPL ratio indicate poor supervisor by board of commissioners.

2.6 Board of Commissioners Meeting

BI regulation regarding good corporate governance requires board of commissioners to have a meeting at least four times a year and physically attended at least two times. The requirement intended to make sure that board of commissioners has conduct active supervision to bank's operational.

The result of the board of commissioners meeting must be recorded into a minute of meeting and documented well. Any dissenting opinions in the board of commissioners meeting must be written clearly in the minutes of meeting along with the reason for the dissenting opinions. Besides that, any recommendation from board of commissioners in the meeting should be exposed on bank's good corporate governance report. This requirement needed in order to ensure the effectiveness of the meeting, thus the number of meeting could be consider as indicator of board of commissioners' supervisory level.

Based on previous research, which conducted by Brick and Chidambaran (2007), board commissioners meeting have significant positive effect on bank's performance, which indicates higher frequency of meeting will increase bank's performance. According to the research, higher meeting implies higher monitoring activities and sequentially will increase bank's performance.

2.7 Board of Commissioners Size

Board of commissioners' size represents board's capabilities to contribute on the bank's performance. Based on previous research which conducted by Kiel and Nicholson (2003), corporate board have significant positive correlation on bank's performance, which mean additional members on the board will increase bank's performance.

The additional member on the board also consider as additional expertise. Thus, the board's capabilities in performing their tasks and responsibilities expected to increase and sequentially give greater contribution on bank's performance

In this research, bank's performance represent by net nonperforming loan ratio. By having additional members, Board of commissioners expected to have more supervisory and monitoring quality on loan approval, thus potential bad debt could be avoided.

In line with those results, Adam and Mehran (2003) also found significant positive effect of board of commissioners on bank's performance. According to that research, bank will have more benefits by increasing the board size compare to the cost of adding more members. The benefit among others is the increase of monitoring capabilities.

2.8 Board of Commissioners Independency

Board of commissioners independency represent by the proportion of independent commissioners within the board of commissioners. Bank Indonesia through Bank Indonesia Regulation required bank to have independent commissioners not less that 50% of the board of commissioners. The requirement indicates the importance of independent commissioners in implement good corporate governance.

In line with that assumption, previous research, which conducted by Rosenstein & Wyatt (1990), found positive significant influence to company's stock price by independent commissioner's proportion.

Fama & Jensen (1983) also found similar result, where independent commissioners have positive effect on company's performance. According to their research, independent commissioners will have incentive to protect shareholders since they have reputation to maintain.

CHAPTER 3
RESEARCH METHODOLOGY

3.1 Research Framework

Based on regulation and literature reviews in the previous chapter regarding good corporate governance and it correlation with bank performance, research framework compose as follow:

- According to Bank Indonesia regulation, good corporate governance principles should be applied on Board of Commissioners task and responsibilities.
- Implementation of good corporate governance could represent by several proxy variables, as follows:
  a. Frequency of Board of Commissioners meeting (BoCMEET): higher number of meetings shows higher activity and effectiveness of bank's board of commissioners.
  b. Board of Commissioners size (BoCSIZE): Higher numbers of board of commissioners' member indicate higher capabilities by bank's board of commissioners to monitor loan approval, since higher number of member indicate more expertise.
  c. Percentage of Independent Commissioners (INDBoC): Higher percentage of independent commissioners shows higher Independency within bank's board of commissioners.

  Those boards of commissioners' characteristics proxy variables theoretically have positive significant effect on bank's loan approval quality, and sequentially will reduce bank's nonperforming loan.
- The uses of Big 4 auditors indicate higher quality on bank's audit and monitoring which sequentially affect bank's loan approval quality.
- Using those variables above, good corporate governance implementation by banks is represent in order to measure the effect on bank's Nonperforming Loan;

Following is the framework that use in conducting this research;

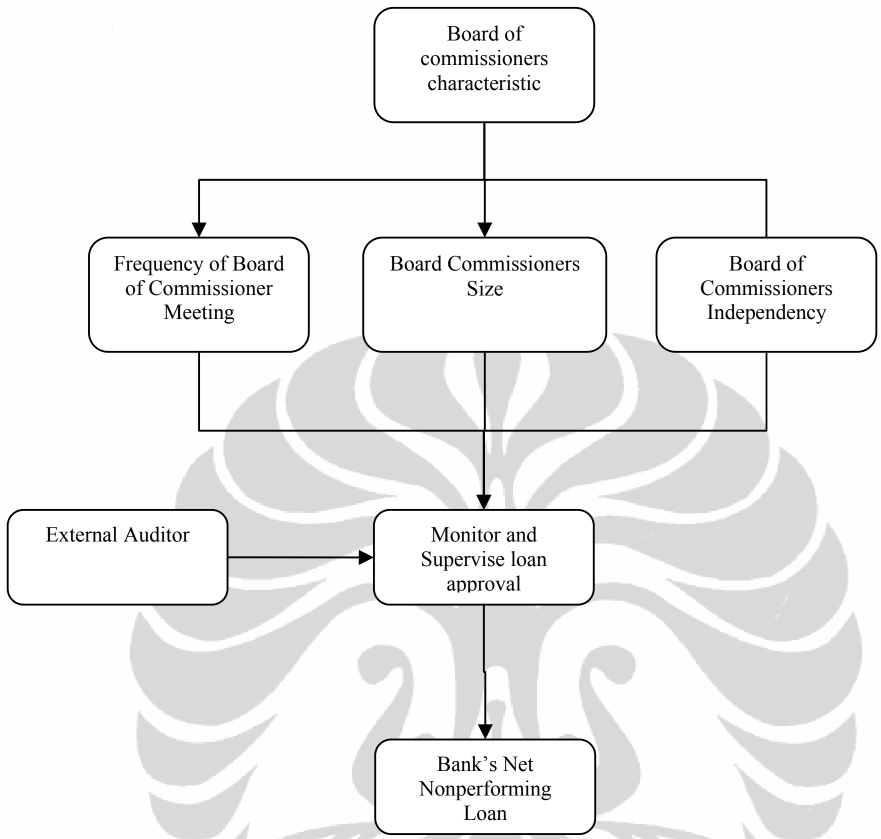


Figure 3.1 Research Framework

Source: processes by researcher

3.2 Research Hypothesis

Number of board of commissioners meeting represent board of commissioners' activities and monitoring process on bank's operational. Bank Indonesia regulation required commercial bank to held board of commissioners meeting at least 4 (four) times in one year, and the result of the meeting should be publish through bank's good corporate governance report. These minimal requirements indicate the importance of board of commissioners meeting variables in implementing good corporate governance.

This paper's argument; higher frequency of meeting indicate better good corporate governance implementation, which will lead to low bank's nonperforming loan.

Based on empirical studied which conducted by Pathan (2007), there is significant positive effect of independent board on bank's performance. This finding implies that independent commissioners has better monitoring on bank's performance since they has market reputation that they need to preserve.

H_{1a} : Higher Frequency of Board of Commissioners meeting will have negative effect on Net Nonperforming Loan

As regulated in Bank Indonesia regulation, bank's board of commissioners composition should be not less than 3 (three) members. This requirement implies the importance of board of commissioners size variables related to corporate governance implementation. Based on previous research which conducted by Kiel and Nicholson (2003), there is significant positive effect of corporate board size on bank's performance.

H_{2a} : Greater Board of Commissioners Size will have negative effect on Net Nonperforming Loan

As regulate in Bank Indonesia regulation, percentage of independent commissioners should be not less than 50% of Board of Commissioners composition. This requirement indicates the importance of independent commissioners related to good corporate governance implementation. According to the arguments, higher number of independent commissioners indicates better corporate governance implementation, which sequentially will lead to a better bank's performance

H_{3a} : Higher Proportion of Independent Commissioners will have negative effect on Net Nonperforming Loan

3.3 Research Model

In order to identify good corporate governance effect on bank performance, equation 3.1 below use in this research

$$\mathbf{NPL_i = \beta_0 + \beta_1 BoCMEET_i + \beta_2 BoCSIZE_i + \beta_3 INDBoC_i + \beta_4 BIG4_i + \varepsilon_i} \quad (3.1)$$

NPL : Net Non Performing Loan, is percentage of bad debt on bank's loan portfolio, which already taking into account the loan Provision.

BoCMEET : Frequency of Board of Commissioners meeting.

BoCSIZE : Bank's board of commissioners' size.

INDBoC : Percentage of Independent Commissioners.

BIG4 : Dummy variable that indicate the use of Big 4 auditors. "1" indicates bank use Big 4 auditors, while "0" indicates bank does not use Big 4 auditors.

ε : error term.

Based on this research hypothesis, bank that have higher board of commissioners meeting frequency, greater size of board of commissioners, and higher percentage of independent commissioner will lead to a low nonperforming loan. Thus, board of commissioners characteristic proxy variables, which are BoCMEET, BoCSIZE and INDBoC expected to have significant negative effect on bank's nonperforming loan.

3.4 Variables Measurement

Variables that used in this research explain as follow:

- Frequency of Board Commissioners meeting (BoCMEET) is the number of board of commissioners meeting that held in one year. It represents board of commissioners concerns and activities towards bank's operation; assume the meetings were effective due to Bank Indonesia's requirement to expose the minutes of meetings.

- Board of commissioners' size is the number of board of commissioners. Bank Indonesia required bank to have board of commissioners member not less than 3 (three) members. Board of commissioners' member that counted for this variable includes commissioners that already acknowledge in bank's article of association.

- Definition of independent commissioners according to Bank Indonesia regarding good corporate governance as follow

  Independent Commissioner shall be a member of The Board of Commissioners without any financial, management, share ownership and/or family relationships with other members of The Board of Commissioners, The Board of Directors and /or Controlling Shareholders or any other relationships that may affect his/her ability to act independently

3.5 Variable Control

BIG4 variable is a variable control within research's model. BIG4 variable is a dummy variable to indicate the use of Big 4 auditors by bank. Those Big 4 auditors consist of Price Waterhouse Coopers, Ernst & Young, Deloitte, and KPMG. Bank that use Big 4 auditors theoretically will have better supervision quality which will lead to lower nonperforming loan. This argument is in line with previous research which conducted by Noghondari and Foong (2009). According to their research finding, there is significant positive effect of the quality of audit on loan decision performance.

3.6 Population and Samples

This research's population data is bank within Indonesia's Banking Industry, specifically commercial bank within year 2008. Foreign commercial banks were excluded from the sample since Indonesian's law regulate their activities differently compare to local bank. They also impose by their head office country's law. Foreign commercial banks are commercial banks that are not registered at Ministry of Law and Human Rights.

Sharia banks also excluded from the sample due to different regulation impose to them. Sharia banks are commercial banks that operate based on sharia principles.

Limitation of data source also influences the sample selection. Since the data source is bank's company website, thus the selected samples are only from banks that have company website.

3.7 Data Gathering

This research use secondary data. The data are collected from following resources:

- Net Nonperforming Loan Ratio and the uses of Big 4 auditors collected from banks annual report 2008 period or Banks' quarterly financial report December 2008 position from bank's company website.
- Number of board of commissioners meeting, board of commissioners' size and number of independent commissioners collected from good corporate governance report

3.8 Descriptive Statistic

This sub-chapter describes the main features of a collection of data in quantitative terms. Each variable's characteristics presented on this sub chapter, such as:

a. Mean (arithmetic mean) or average is the sum of all the value divided by number of the data;
b. Standard Deviation is the square root of its variance. Standard deviation use to measure the variation from the mean/average;
c. Max is the maximum value of the variable;
d. Min is the minimum value of the variable.

In order to avoid outliers in sample data, Winsorizing is use in this research. Followings are the equation to calculate winsorised estimator (Webster, 1998):

Upper bound	=	Mean + (3 x Standard Deviation)	(3.2)
Lower bound	=	Mean - (3 x Standard Deviation)	(3.3)

3.9 Pearson Correlation Test

Pearson coefficient of correlation is a measure correlation between 2 (two) variable, giving a value of measurement between -1 and +1. Following is the equation that uses in order to calculate Pearson coefficient of correlation (Webster, 1998):

$$r = \frac{n\left(\sum xy\right) - \left(\sum x\right)\left(\sum y\right)}{\sqrt{[n\left(\sum x^2\right) - \left(\sum x\right)^2][n\left(\sum y^2\right) - \left(\sum y\right)^2]}} \tag{3.4}$$

r = coefficient of correlation value

n = number of data

In this research, Pearson coefficient of correlation will use to calculate correlation between dependent and independent variables. The calculation will use SPSS program.

3.10 Statistical Test

Model that uses in this research is multiple regression models, which data's assumptions were tested for multicollinearity, autocorrelation, model significancy, and Heteroschedaticity. The tests were performed using SPSS software.

Overall assumptions that uses in this research regression model as follows

a. Error terms (ε_i) is a random variable that have normal distribution;
b. Variance on variable Y (dependent) is equal to X's (independent variable) value. This assumption refer to heteroschedaticity;
c. Error terms are independent. This assumption refer to autocorrelation;
d. Linearity, which assume the equation within linear line;

e. Observation variable (n) is larger than independent variable (k);
f. Independent variables are not linearly connected or in another words there is no multicollinearity.

Multiple regression models, in this research, compose and analyze with classic assumption test through following phases:

1. Data Normality Test
2. Multicollinearity Test
3. Autocorrelation Test
4. Heteroscedasticity Test
5. Hypothesis Test (partially test);
6. Regression Model Test;
7. Interpretation of the model;

3.11 Data Normality Test

Data Normality test conducted in order to determine whether data's probability distribution in line with Normal Probability curve.

In this research, the test will be conducted using SPSS program. The program will generate Normal Probability Plot Figure from the data imputed. If the plot in line with diagonal line in the figure, indicate that the data normality assumption is fullfiled.

3.12 Multicollinearity Test

Multicollinearity test conducted in order to analyze whether there is correlation between independent variables. Sound regression models do not have multicollinearity problem. It will cause the coefficient sign contradictory with the logic.

Multicollinearity analysis that conducted in this analysis uses correlation matrix for every independent variables on the model. The measurement of whether there is correlation or not, were using Z-test

Hypothesis that tested in for multicollinearity test as follows:

H_0 : $\rho_{12} = 0$ (there is multicollinearity in the model)
H_A : $\rho_{12} \neq 0$ (there is no multicollinearity in the model)

"ρ_{12}" is coefficient correlation between independent variable 1 and independent variable 2.

$$t = \frac{r_{12}}{S_t} \tag{3.5}$$

"r_{12}" is correlation between sample, independent variable 1 and independent variable 2.

S_i calculates using following equation (Webster 1998):

$$S_t = \sqrt{\frac{1 - r_{12}^2}{n - 2}} \tag{3.6}$$

H_0 accepted if "t" is inside - $t_{table} < t < t_{table}$ area, and rejected if "t" outside that area.

In this research molticollinearity test will be conducted using SPSS program. The output will be presented on coefficient table, specifically on collinearity statistic column. The column divided into two sub-columns, which are "Tolerance" and "Variance Inflation Factor" (VIF). If the Tolerance value is less than 0.1 and VIF value is greater than 10, it indicate multicollinearity problem.

3.13 Heteroscedasticity Test

As mention above, all residual or error should have the same variance. That condition identify as homoscedaticity. In order to identify whether there is differences between dependent variables' variances (heteroscedasticity) within the model this research will use SPSS program. The output of the program is scatter plot. If the plots are not shows a certain patter, it indicate there is no heteroscedasticity problem in the model.

3.14 Model Significance Test

In order to identify whether the model already explain the data accordingly, following test are needed.

a. Standard error and estimation

Se uses to measure model's goodness fit. Se measure degree of disperse from Y value. Smaller Se indicates the accuracy of model. Standard error calculation uses following equation (Webster, 1998):

$$Se = \sqrt{\frac{\sum \left(Y - \hat{Y}_i^2 \right)}{n - k - 1}} \tag{3.8}$$

n-k-1 is the degree of freedom.

b. Multiple coefficient of determination

Multiple coefficient of determination uses in order to measure correlation between independent variable and dependent or in another word how percentage changes in variable Y (dependent) could be explain by all the independent variable in the model. Multiple coefficients of determination compute by using following equation (Webster, 1998):

$$R^2 = \frac{SSR}{SST} = 1 - \frac{SSE}{SST} \tag{3.9}$$

Variation of variable Y that explained in the model represent by regression sum of square (SSR) and overall variation of variable Y represent by total sum of square (SST).

By adding new variable in the model, theoretically value of R-square should be increase, since the model could explained more changes in variable Y. The values of R-square are from 0 to 1, closer to 1, it means more percentage changes in variable Y that could explained by independent variable.

c. Adjusted multiple coefficient of determination

In order to increase value of R-square, independent variable that do not explain Y variable could be added in the model.

$$\bar{R}^2 = \frac{SSE/(n-k-1)}{SST/(n-1)} \quad (3.10)$$

The additional independent variable will decrease the degree of freedom (n –k – 1). Other equation that uses in calculates adjusted multiple coefficient of determination, as follow

$$\bar{R}^2 = 1-(1-R^2)\frac{n-1}{n-k-1} \quad (3.11)$$

d. Overall model evaluation

In evaluate overall model this research uses analysis of variance (ANOVA). ANOVA test uses in order to indentify whether all the independent variable has correlation with dependent variable. The variable that tested in ANOVA procedure is variance of the variable. If X_1 do not correlated with Y, thus β_1=0. Hypothesis that uses in ANOVA test as follow

H_0 : $\beta_1 = \beta_2 = \beta_3 = \ldots = \beta_k = 0$

H_A : at least one β is not equal to 0

If H_0 is rejected, there is no linear correlation between independent variable and dependent variable. Test that conducted on the ANOVA procedure is F-test, which compares the calculated F and F distribution table taking into account level of significance, regression degree of freedom, and sample degree of freedom. If the calculated F < F distribution table, H_0 accepted (one way ANOVA).

In this research overall model evaluation conducted using SPSS program. The output of the program is Sig. value on model summary table. If the Sig. value is smaller than the critical value, which is $\alpha = 5\%$, H_0 is rejected, which implies the regression model is significant to explain the volatility of dependent variables.

e. Partially coefficient regression test

The test intended to test the coefficient individually, in order to determine the significant coefficient.

H_0 : $\beta_1 = 0$

H_A : $\beta_1 \neq 0$

If H_0 is accepted, the tested independent variables do not contribute or explain the dependent variable.

Hypothesis test in order to identify partially coefficient of regression significance uses t distribution, the calculated t value uses equation as follows;

$$t = \frac{b_1 - \beta_1}{S_{b1}} \tag{3.12}$$

S_{b1} is standard error from coefficient of regression.

This test is a two tailed test compare the calculated t value and t distribution table taking into account the degree of freedom. H_0 rejected if the calculated t value < negative distribution table t value or > positive distribution table t value.

In this research, the test conducted using SPSS program. The output of the program is Sig. value on coefficients table. If the Sig. value is smaller than the critical value, which is $\alpha = 5\%$, H_0 is rejected, which implies the variable is significantly effect the dependent variables. The variable's coefficient sign indicate the effect of independent variable towards dependent variable, whether positive or negative.

CHAPTER 4
RESEARCH ANALYSIS

4.1 Description Research Sample

This research use cross section data within the period of 2008. The data are collected from of 50 commercial banks in Indonesia. The process of data selection is as follow:

Table 4.1 Samples Description

Description	Number of Banks
Number of Commercial Bank	124
Number of Foreign Commercial Bank	(10)
Number of Sample	114
Number of Sharia Commercial Bank	(5)
Number of Sample	109
Number of Bank that have incomplete data	(59)
Number of Sample	50

Source: www.bi.go.id

Foreign Commercial Banks are excluded because of the management structure requirement differences and the law that companies must oblige since they are not Indonesia legal entities. While sharia banks were excluded because of the unique requirements and companies' organ within the organization. Banks that have incompleted data generally because they do not have company's website, thus access to the company's annual report and good corporate governance report were limited.

From the samples that fulfill the criteria above, the followings are the details based on bank's ownership.

Table 4.2 Samples Distribution Based on Ownership

No.	Ownership	Number of Sample	Number of Population	Percentage
1.	State owned/Government	4	5	80%
2.	Foreign/Join Venture	9	16	56%
3.	Local Government or Province	7	26	26%
4.	Private Domestic	29	66	44%
Total		50	124	40%

Source: www.bi.go.id

As presented on table 4.2 above, the highest number of sample comes from Private Domestic owned companies, while the lowest number comes from state owned companies. However the state owned company group is represented by 80% of the population, which is the highest percentage of sample representative.

The local government owned banks only have 26% representative and therefore becomes the second lowest number of sample. One of the reasons for that low number is the lack of banks' website availability.

Table 4.3 Samples Distribution Detail Based on Number of BoC meeting

	Frequency of Meeting in 2008	**Percentage**
Less than 4 times	3	6%
4 times	9	18%
More than 4 times and less than or equal to 12 times	21	42%
More than 12 times	17	34%

Source: Processed by researcher

According to article 15 BI regulation regarding good corporate governance implementation, BoC meeting should be held at least four times in one year, based on the table above, there are 3 (three) banks that do not comply with the regulation, while 18% of the sample held the BoC meeting exactly 4 (four) times in one year, hence fulfilled only the minimum requirement.

Most of the sample shows frequency of BoC meeting more than the minimum requirement, yet 34% of the sample shows more than 12 times of BoC meeting. Or in another words, the BoC meetings were held more than 1 (one) time every month.

Table 4.4 Samples Distribution Detail Based on Percentage of Independent BoC

	Number of Banks	Percentage
Less than required by Bank Indonesia	2	4%
Equal to required by Bank Indonesia	41	82%
More than required by Bank Indonesia	7	4%

Source: Processed by researcher

Table 4.4 shows distribution samples based on the proportion of independent commissioners. According to BI regulation regarding implementation of good corporate governance for commercial bank, proportion of independent commissioners should be not less than 50% of total board of commissioners.

As presented on the table, the number of banks that did not fulfill the requirements are only 2 (two) banks, which indicate that, generally, the requirements have been fulfilled by most of commercial banks in Indonesia.

4.2 Descriptive Statistic

Descriptive statistic is intended to explain each operational variable's characteristics. Descriptive statistic of the samples presented on the table 4.5 below.

Table 4.5 Descriptive Statistic

	Minimum	Maximum	Mean	Std. Deviation
NPL	0.02%	5.73%	1.67%	1.27%
BoCMEET	2	65	16	16
BoCSIZE	2	8	4	2
INDBoC	0%	100%	58.40%	15.93%
BIG4	0	1	0.480	1

Source: Processed by researcher, SPSS output

Mean value of NPL variable, 1.67%, indicates that in average all of the samples have bad loan percentage in their loan portfolio below Bank Indonesia tolerance limit, which is 5%. However the maximum value of NPL variable is 5.73% which was generated by only one sample.

The BoCMEET variable have high variance, where BoCMEET‘s mean is 16, and the standard deviation is 16. The high variance on BoCMEET’s variable also shows by the minimum number the variable, which is 2 (two) times in one year, while the maximum frequency is 65 (sixty five) times in one year.

Minimum value of BoCSIZE variable indicates that there are samples that do not comply with the regulation, such as where Bank Indonesia required bank to have board of commissioners that consist of no less than 3 members.

The INDBoC variable also shows high variance, which can be indicated by the high margin between minimum value and maximum value of the variable. The minimum value of the variable is 0%, which implies incompliance of the sample since there is no independent commissioner within banks’ board of commissioner. According to the respective bank’s annual report, the absent of independent commissioners is due to the fact that some appointed independent commissioner candidates failed to pass Bank Indonesia fit and proper test.

Mean value on BIG4 variable show 0.48, which indicate 48% of the sample using Big 4 auditors, while the 52% using auditors beside the Big 4.

4.3 Pearson Correlation Test

Table 4.6 Pearson Correlation Analysis

	NPL	BoCMEET	BoCSIZE	INDBoC	BIG4
NPL	1.000	0.152	0.143	0.194	0.154
		0.146	0.161	0.088	0.143
BoCMEET		1.000	0.139	-0.029	0.115
			0.168	0.420	0.213
BoCSIZE			1.000	-0.306*	.639**
				0.015	0.000
INDBoC				1.000	-0.203
					0.079
BIG4					1.000

* Correlation is significant at the 0,05 level (1-tailed)
** Correlation is significant at the 0,01 level (1-tailed)

Source: SPSS Output

Pearson Correlation Test is Parametric Correlation test which use in order to identify significance level of correlation between variables. Pearson Correlation between variables shows as follow;

Based on table 4.6 above, there are no independent variables that have correlation with the dependent variable whether in α = 5% or α = 10%, which means nonperforming loan do not have any significant correlation with the frequency board of commissioners meeting, board of commissioners size and proportion of independent commissioners, yet with the control variables, which is big 4 auditor.

Between independent variables, there are two variables that have correlation with the board of commissioners' size variables, those variables are independent commissioners' variable and big 4 auditor variable. The correlation between board of commissioner's size and Big 4 auditor variables shows value of 0.639, which indicate that there could be multicollinearity problems. However the test result for the multicollinearity problem could be seen at sub-chapter 4.4.2.

4.4 Classic Assumption Test

This test is intent to achieve BLUE (Best Linear Unbiased Estimator) category for the regression model. In order to achieve BLUE criteria, there are three requirements that should be fulfilled. Those requirements are Normality, Multicolinearity, and Heteroscedasticity.

4.4.1. Normality Test

In order to identify whether data normality assumption is fulfilled or not, normal probability plot could be used as a benchmark. The dots position that in line with diagonal line on Figure 4.1 indicates the regression model that is used for the research has a sound data normality level.

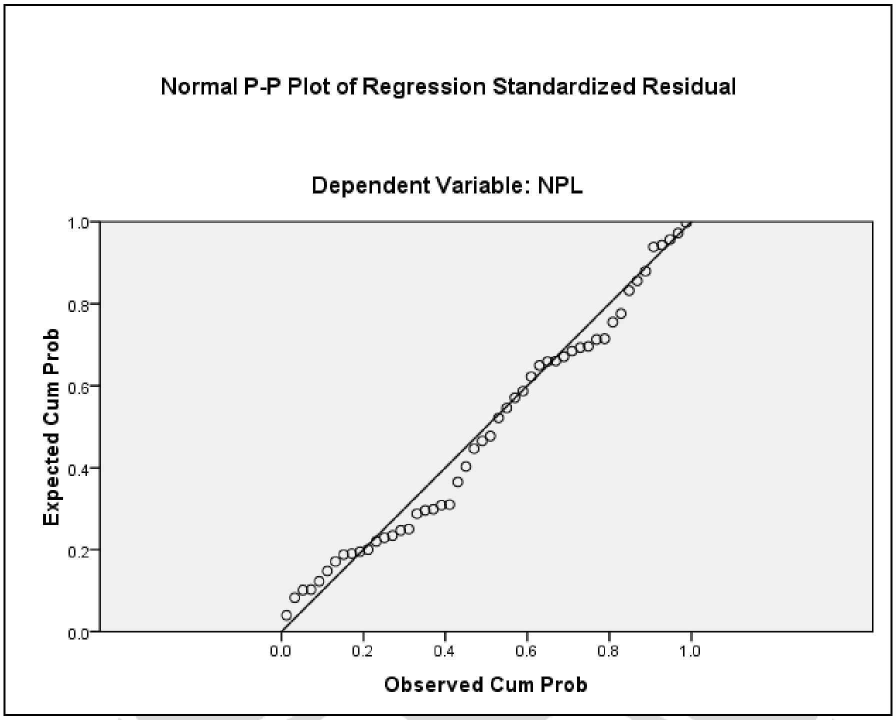


Figure 4.1 Normal Probability Plot

Source: SPSS output

4.4.2. Multicollinearity Test

Table 4.7 Multicolinearity Test Result

$$NPL_i = \beta_0 + \beta_1 BoCMEET_i + \beta_2 BoCSIZE_i + \beta_3\ INDBoC_i + \beta_5 BIG4_i + \varepsilon_i$$

	Collinearity Statistics	
Variabel	Tolerance	VIF
(Constant)		
BoCMEET	0.979	1.021
BoCSIZE	0.555	1.802
INDBoC	0.906	1.104
BIG4	0.591	1.693
Dependent Variable : ROE		

Source: SPSS output

Multicollinearity problem occurs when there is perfect linear correlation or almost perfect between independent variables. This problem should be avoided on regression test. Non multicollinearity assumption test result shows on table 4.7 above.

Multicollinearity test is conducted by interpreting tolerance value and variance inflation factor (VIF). Variable that has tolerance value less than 0.1 and VIF more than 10 could cause multicollinearity problem. Thus, it can be concluded from the table 4.7 above, that there is no multicollinearity problem among independent variables.

4.4.3. Heteroscedasticity Test

There are several methods that could be used in testing heteroscedasticity problem in residual value. Heteroscedasticity occurs when the random variables have different variances. In this research, in testing heteroscedasticity problem, scatter plot is use by viewed the dots pattern on regression figure.

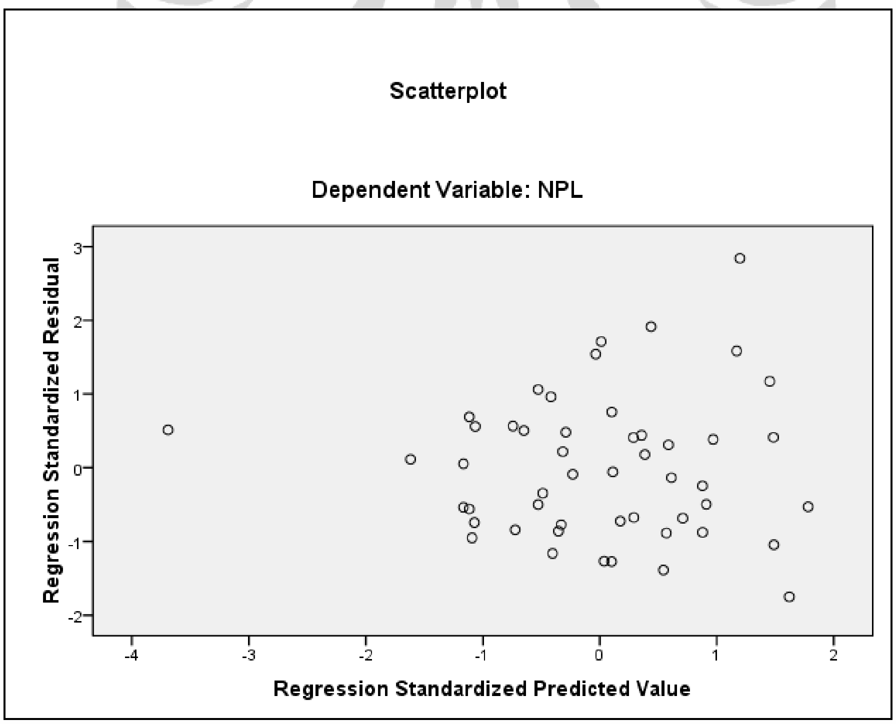


Figure 4.2 Heteroscedasticity Test

Source: SPSS output

According to figure 4.2 above, residual value plots on regression figure does not show a certain pattern, thus it could conclude that there is no heteroscedasticity problem on the regression model.

4.5 Hypothesis Test

Table 4.8 Regression Model Result

$$NPL_i = \beta_0 + \beta_1 BoCMEET_i + \beta_2 BoCSIZE_i + \beta_3\ INDBoC_i + \beta_5 BIG4_i + \varepsilon_i$$

Independent Variable	Expected Sign	Un standardized Coefficients		t	Sig.
		B	Std. Error		
(Constant)		-0.297	0.995	-0.299	0.383
BoCMEET	-	0.010	0.011	0.903	0.186
BoCSIZE	-	0.104	0.141	0.734	0.233
INDBoC	-	0.021	0.012	1.765	0.042**
BIG 4	-	0.260	0.463	0.563	0.288
Observation	50				
R^2	0.326				
Adjusted R^2	0.106				
F-stat	1.334				
Prob (F-stat)	0.272				

*** Significant at the α = 1%
** Significant at the α = 5%
* Significant at the α = 10%
NPL is bank's net nonperforming loan or bad debt percentage on bank's loan portfolio; BoCMEET is Board of Commissioners' meeting frequency in one year; BoCSIZE is the size of BoC member; INDBoC is percentage of independent commissioners on within bank's BoC; BIG4 is dummy variable that represent bank's auditor, whether using big 4 auditor or not ;
Source: SPSS output

After the model already fulfills all the BLUE requirements, the influence and impact pattern test for each variable could be conducted. This research uses multiple regression models with one way test. The test result, which was conducted by SPSS software, is presented on Table 4.8 above.

4.6 Regression Model Test

This test conducted using goodness of fit test. This test intended to identify how independent variables, as a whole, could explain dependent variable on regression model. It shows by coefficient of determination value (R^2) and coefficient of regression (F-Stat). Since in this research the number of data is less than 100, thus this research use adjusted R^2.

As presented on Table 4.8 above, the value of adjusted R^2 is 0.106 which means the regression model that use, where the independent variables are board of commissioners frequency meeting in one year, board of commissioners size, proportion of independent commissioners and Big 4 auditors, could only explain 10.6% of volatility in dependent variable (net nonperforming loan), while 80.4% explain by other variables.

Prob. (F-stat) value shows 0.272, which indicate the regression model, as a whole, is insignificant affecting the dependent variable, or in another words, the independent variables simultaneously could not explain the dependent variables. However considering this research objective, which is partially identify independent variables effect on bank's nonperforming loan, the model insignificancy could be tolerate.

External factor, such as macroeconomic condition could explain the result. Crisis that occurs in 2008 could affect Indonesia's real sector whether direct or indirectly. Thus, in 2008 Indonesia's real sectors have low demand, especially from country that directly have impact from the crisis. Low demand caused Indonesia's real sector to have low income and create bad debt to bank's loan portfolio.

4.6.1. Effect of Frequency of Board of Commissioners Meeting on the Bank's Net Nonperforming Loan

Using significant level $\alpha = 5\%$, the critical value for BoC meeting is α 2 = 0.050. From the SPSS output on table 4.8 shows the significant value for BoC meeting is 0.186, since the significant value is greater than the critical value (0.186 > 0.050), the H_0 is accepted, which mean board of commissioners' characteristic that represent by the Number of Board of Commissioners Meeting in one year (BoCMEET) shows insignificant affect on net nonperforming loan. The positive sign on variable's coefficient shows that the result is not in line with the expected sign and the hypothesis.

Beside macroeconomic factor, bank's internal factor, such as the effectiveness of the meeting could also explain the situation. This argument support by previous research which conducted by Hermalin & Weisbach (1998), where their research found endogenous factor could affect differently on relationship between company's board and performance. Even though minutes of meeting and commissioners recommendation already required being exposed in order to ensure the effectiveness of the meeting, more in depth supervisory by Bank Indonesia is still needed.

4.6.2. Effect of Board of Commissioners size on the Bank's Net Nonperforming Loan

Using significant level $\alpha = 5\%$, the critical value for BoCSIZE is $\alpha = 0.050$. Table 4.8 shows the significant value for BoCSIZE is 0.233. Since the significant value is greater than the critical value ($0.233 > 0.050$), H_0 is accepted, which mean the board of commissioners size shows insignificant affect on net nonperforming loan.

The result is not in line with the hypothesis. As mentioned before, board commissioners' size represents the board capabilities to monitor and supervise bank's loan approval. Different effectiveness of the board members from each bank could explain the result. This argument also support by previous research which conducted by Hermalin & Weisbach (1998), where their research found endogenous factor could affect differently on relationship between company's board and performance.

4.6.3. Effect of Board of Commissioners Independency on the Bank's Net Nonperforming Loan

Using significant level $\alpha = 5\%$, the critical value for percentage of independent commissioners variable is $\alpha = 0.050$. Table 4.8 shows the significant value for independent commissioners variable is 0.042. Since the significant value is less than the critical value ($0.042 < 0.050$), the H_0 is rejected, which mean board of commissioners' characteristic that represent by the percentage of independent commissioner (INDBoC) is a significant variable that influencing net nonperforming loan.

However the variable's coefficient show positive sign, which implies higher independent commissioners percentage will cause higher net nonperforming loan. The same explanation that use for board of commissioners' size variable could also explained the situation. As stated in Kiel and Nicholson research (2003), higher percentage independent commissioners could create ineffectiveness and inefficiency in decision making.

In addition, Bank Indonesia regulation that required bank to have independent commissioners was issued on 2006 and effective on 2007. Based on that situation, most of bank's independent commissioners are new joiners. Thus, lack of in depth knowledge about bank's internal condition and industry insight could also explain the result. Hopefully, in the long term, the effectiveness of bank's independent commissioners could increase in line with the experienced within the bank.

4.6.4. Effect of Variable Control on the Bank's Nonperforming Loan

Using significant level α = 5%, the critical value for BIG4 variable is α = 0.050. Table 4.8 shows the significant value for BIG4 variable is 0.288. Since the significant value is greater than the critical value (0.288 > 0.050), H_0 is accepted, which mean the variable control that represent by the Big 4 auditor shows insignificant affect on net nonperforming loan.

Different audit effectiveness on different country could explain the result. Big 4 auditors are well known auditors around the world. However, different country's policy could affect their effectiveness in influencing bank's performance. That argument supported by previous research, which conducted by Francis and Wang (2006). Based on their findings, different country's policy, especially related to investor protection could highly affect the impact level of using Big 4 Auditors on company's performance.

CHAPTER 5

CONCLUSION AND RECOMENDATIONS

5.1 Conclusion

This research's final chapter consists of conclusion from previous chapter analysis and recommendations for the readers and further research. The followings are several conclusions that generate from this research:

a. Effect of Number of Board of Commissioners Meeting on the Bank's Performance

Bank Indonesia, through BI Regulation, regulates the frequency of board of commissioners meeting, the disclosure of the meeting result, and the attendance of the meeting indicate the important of the variable in regard implementation of good corporate governance principle.

From the result on the previous chapter, there is insignificant positive effect between frequencies of meeting to the bank's net nonperforming loan. According to the result, higher frequency of board of commissioners meetings statistically would not have any effect on bank's net nonperforming loan. This result does not in line with the hypothesis. Thus, it could be concluded that Bank Indonesia requirement regarding minimum frequency of board of commissioners meeting, is not effective, or in another words do not achieve the objective, which is low nonperforming loan.

b. Effect of Board of commissioners size on the Bank's Net Nonperforming Loan

Based on statistical result on previous chapter, board of commissioners' size shows insignificant positive effect on bank's net nonperforming loan, which means the board of commissioners' size, is not significant variable to influence bank's net nonperforming loan.

The positive sign on variable's coefficient statistically implies that greater board of commissioners' size could generate more nonperforming loan. This result does not in line with the hypothesis or expected. Inefficiency of decision making could explain the result.

From the result, it could be concluded that Bank Indonesia requirement regarding minimum board of commissioners size, is not effective, or in another words do not achieve the objective, which is low nonperforming loan.

c. Effect of Board of Commissioners Independency on the Bank's Performance

Through BI regulation, Bank Indonesia also regulated the composition of board of commissioners, especially the number of independent commissioners within the board. An independent commissioner is regulated in order to ensure good corporate governance principles implementation, specifically independency and accountability principle, within bank's organ.

Based on the result of this research, independent commissioner variable indicate significant effect on the bank's performance, which implies higher proportion of independent commissioners within bank's board of commissioners.

From the result, it could be concluded that Bank Indonesia requirement regarding minimum proportion of independent commissioners is not effective, or in other words, it does not achieve the objective, which is low nonperforming loan.

5.2 Research Limitation

There are limitations in this research whether in regard of data or test that was conducted. Following are the limitations that occur in conducting this research.

a. In regards to good corporate governance implementation, there is no standard variable to measure good corporate implementation. Qualitative data needed to have more thorough comprehension on bank's good corporate governance implementation.
b. Bank's GCG rank from GCG self assessment could not be used since it was conducted by the bank itself, thus the objectivity of the result is questionable.
c. In regard to data collecting process, the availability of bank's website also consider as constrain in conducting this research, since banks' website is the main source of data in this research.
d. In this research, board of commissioners independency only represented by 1 (one) variable proxy, which is percentage of independent commissioners on board of commissioners.
e. From the 5 (five) principle of good corporate governance that should be implemented, Transparency, Accountability, Responsibility, Independency and Fairness, only 3 (three) principles that could represent by the proxy variables. Those principles are accountability, responsibility and independency.
f. Samples that are used in this research is a cross sectional data within only one year time period of time, which is the year 2008. Thus the research results are less comparable and less implementable between one period to other period.
g. This research does not take into account the activities of banks' credit committee due to limitation of data source.

5.3 Recommendations

Based on the research result there are several recommendations that could be used by some parties, as follows:

- For Company

  This research findings show insignificant effect of board of commissioners' meeting and percentage on bank's nonperforming loan. It implies ineffectiveness on bank's board of commissioners. Thus, in order to increase the effectiveness of the board, bank could increase commissioners' nomination requirements.

  In support the effectiveness of the board, bank could also increase the board's decision making quality by develop internal information system. Thus information could be delivered in timely manner and high accuracy.

- For regulator (Bank Indonesia)

  The research findings show the ineffectiveness of current regulation on decreasing bank's nonperforming loan. Even though the adaptation period of the regulation could be one of the explanations for the result, constant and active supervision should be conduct by Bank Indonesia in order to increase the regulation's effectiveness and achieved regulation's objectives.

- For public

  The research findings could contribute to public by providing point of view about bank's good corporate governance principle and help to assess the implementation within bank, especially related to board of commissioners' characteristic effect on bank's nonperforming loan.

- For further research

  The research findings show board of commissioners' meeting and size variable has insignificant effect on bank's nonperforming loan. Furthermore, the entire independent variables coefficient does not in line with the hypothesis. For further research, the regression model could be improve by increase the number of data or replace the variables.

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Apendix

Nonperforming Loan and Independent Variables

Bank	BoCMEET	BoCSIZE	INDBoC	BiG 4	NPL
Agroniaga	24	3	66.67%	0	3.59%
Andara	12	3	0.00%	0	0.78%
Antardaerah	2	4	50.00%	0	1.25%
Artha Graha	12	6	50.00%	0	2.70%
BCA	59	5	60.00%	1	0.14%
BII	18	6	50.00%	1	2.37%
BNI	51	7	57.14%	1	1.74%
BPD Bali	9	3	66.67%	0	0.04%
BPD DKI	65	4	50.00%	0	2.05%
BPD Papua	10	4	75.00%	0	0.94%
BPD Riau	10	4	80.00%	0	0.15%
BPD Sultra	16	2	100.00%	0	5.73%
BPD Sulut	20	4	50.00%	0	0.31%
BPD Jambi	5	4	50.00%	0	0.02%
BRI	39	7	57.14%	1	2.80%
BTN	28	4	50.00%	1	2.66%
BTPN	5	6	50.00%	1	0.09%
Bukopin	51	6	50.00%	1	4.14%
Bumi Artha	16	3	66.67%	0	1.46%
Bumi Putera	11	5	60.00%	1	4.25%
Capital	4	3	66.67%	0	0.82%
Chinatrust	5	7	50.00%	1	2.30%
CIMB Niaga	20	6	60.00%	1	1.42%
Commonwealth	4	4	50.00%	1	1.03%
Danamon	7	8	50.00%	1	2.30%
DBS	11	4	50.00%	1	1.81%
Dipo International	4	3	66.67%	0	2.78%
Ekonomi Raharja	7	3	66.67%	1	0.83%
Ganesha	4	2	50.00%	0	1.14%
Hanabank	2	4	50.00%	0	0.51%
Himpunan Saudara	12	3	66.67%	0	0.56%
Index Selindo	4	4	50.00%	0	0.50%
KEBI	4	3	66.67%	1	0.11%
Kesawan	6	4	100.00%	0	3.74%
Mandiri	18	8	62.50%	1	0.97%
Maspion	3	2	100.00%	0	0.93%
Mayapada	4	4	50.00%	0	2.07%
Mega	23	3	66.67%	1	0.79%
Nagari	23	4	50.00%	0	2.03%
OCBC NISP	8	8	50.00%	1	1.75%
Panin	12	4	50.00%	1	2.15%
Permata	12	8	50.00%	1	1.10%
Resona Perdania	12	4	75.00%	1	2.55%
Rabobank	4	6	50.00%	1	3.82%
Indomonex	6	2	60.00%	0	1.93%
Sinarmas	61	3	66.67%	0	1.72%
Swadesi	8	6	50.00%	1	1.64%
UOB Buana	4	5	40.00%	1	2.07%
Victoria	11	3	66.67%	0	0.44%
Windu Kentjana	16	3	50.00%	0	0.29%