UNIVERSITAS INDONESIA

THE EFFECT OF FAMILY OWNERSHIP, GROWTH OPPORTUNITY, AND CULTURE OF THE BOARD OF COMMISSIONERS TOWARDS THE EFFECTIVENESS OF THE BOARD OF COMMISSIONERS

THESIS

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FAKULTAS EKONOMI
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2010

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THESIS

Proposed as one of the requirements for obtaining a degree of Master of Management

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2010

CERTIFICATE OF AUTHORSHIP / ORIGINALITY

I hereby declare that this submission is of my own work, and all sources that are quoted or referred to, has been acknowledged correctly in this thesis.

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ABSTRACT

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Title : The Effect of Family Ownership, Growth Opportunity, and Culture of the Board of Commissioners towards the Effectiveness of the Board of Commissioners

This thesis was made to study the effect of family ownership, growth opportunities of the company, and board member culture of the board of commissioners towards the effectiveness of the board of commissioners. In this research, 199 observations were used as samples from non-financial Indonesian-based companies from the year 2006 and 2007. By using a linear regression statistical analysis with 3 independent variables (the growth opportunity, family ownership of the company, and the culture of the board of commissioners), and 1 dependent variable (board effectiveness), it is concluded that family-ownership has a negative and significant effect towards the effectiveness of the board of commissioners, where the other 2 independent variables do not have a significant effect towards the effectiveness of the board of commissioners. It seems that family-owned firms in Indonesia, although previously were assumed to have a more effective board if its not within a business group, still have an ineffective board of commissioners.

Key Words:
Board of Commissioners, Family ownership, Growth opportunity, Board of Commissioners member culture, Size of the company, Effectiveness, Indonesian-based companies

ABSTRAK

Nama : Muhammad Imam Aulia Akbar
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Tesis ini dibuat untuk mempelajari pengaruh kepemilikan keluarga, peluang pertumbuhan perusahaan, dan budaya dewan anggota dewan komisaris terhadap efektivitas dewan komisaris. Dalam penelitian ini, 199 pengamatan digunakan sebagai sampel dari perusahaan yang berbasis di Indonesia yang termasuk ke dalam *non-financial firms* dari tahun 2006 dan 2007. Dengan menggunakan analisis statistik regresi linear dengan 3 variabel independen (kesempatan pertumbuhan, kepemilikan perusahaan keluarga, dan budaya dewan komisaris), dan 1 variabel dependen (efektifitas dewan), dapat disimpulkan bahwa kepemilikan keluarga memiliki pengaruh negatif dan signifikan terhadap efektivitas dewan komisaris, di mana 2 variabel independen lainnya tidak memiliki pengaruh signifikan terhadap efektivitas dewan komisaris. Tampaknya perusahaan milik keluarga di Indonesia, meski sebelumnya telah diasumsikan memiliki dewan komisaris yang lebih efektif jika perusahaan tidak berada dalam suatu grup usaha, masih memiliki dewan komisaris tidak efektif.

Kata Kunci:
Dewan Komisaris, kepemilikan keluarga, kesempatan pertumbuhan, budaya anggota Dewan Komisaris, Ukuran perusahaan, Efektivitas, perusahaan yang berbasis di Indonesia

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CHAPTER 1

INTRODUCTION

1.1. Background

The board of directors in the company functions as the entity that monitors the behavior of the management on behalf of the shareholders. They keep the management from doing actions of self-interest that is non-beneficial for the company or the shareholders. The performance of a company is more or less depends on the performance of its board of directors. But recently, corporate scandals, bankruptcy and other infamous news of major companies make us think whether the board that is running our company is as effective as it should be, whether we have made a good decision when choosing our directors? Is the board effective? The board of directors is in a way responsible on the corporate governance of the company, even though it's not completely their full responsibility. Corporate governance is the set of process, customs, policies, laws, and institution affecting the way a company is directed, administered and controlled. Ultimately, the role of board of directors in corporate governance is ensuring that the assets are protected in the interests of the shareholders or stakeholders they represent. Failure to do so is the source for the scandals, lawsuits and criminal charges that now dot the corporate landscape.

It is important to understand the different corporate governance structure in Indonesia, compared to most of western nations. Most of the studies were done on the basis that the board of directors is at the highest level of corporate governance in a firm. Different from this, most if not all of Indonesian-based firms adopt the two-tier system, meaning that monitoring the performance of the board of directors, is the board of commissioners. The job of the board of commissioners among other things, are to assist and monitor the board of directors in doing their job. Most of the studies that are to be the background of this research are studies on the board of directors. This paper assumes that the findings that are found in these studies on the board of directors can be applied in the same way in the board of commissioners. This paper will discuss this assumption in further detail in Chapter 2.

How effective the board is can be measured by its performance to uphold the shareholders best interest, actions that benefit the shareholders would increase the board performance and vice versa for the when the board does not. The key problem is what are the factors that make a board to become effective in the company? Identifying these variables would make a future guide line on how a board of director is composed. These factors can come from within the board, such as the values and attributes that each member has, or even from the outside of the board, such as the company's core values and organizational structures. Hopefully these attributes will show us if it have any contribution to the company and can be used as information to help make a good corporate governance from any factors of the board.

In this paper it is defined that an effective board is if the board can perform well, meaning that the board can monitor the management of the firm and prevent the management to take actions that is non-beneficial for the company or the shareholders. Factors such as the a family member inside the company's executive, board members whom are also an executive in a rival company, and so forth, will not be present, or will be in an insignificant proportion in an effective board. Fama and Jensen (1983) note that combining ownership and control allows concentrated shareholders to exchange profits for private rents. Demsetz (1983) argues that such owners may choose nonpecuniary consumptions and thereby draw scarce resources away from profitable projects. These studies show that a family-owned firm is not what you call a good thing, but some other studies also suggest otherwise. Later in this paper, the story of these contradicting theories will be discussed.

Another factor that may have an influence on the board's effectiveness is the growth opportunity of the firm in which the board serves. Studies suggest that having a firm with a high growth opportunity may lead to a stronger board monitoring, and as a result creating an effective board. . Bathala and Rao (1995), notes that firms with more future growth opportunity can be argued to use more outside members in the board to control the higher agency problems inherent in such firms. Even so, there are also several studies that contradict with those finding. Further into this paper, more about this theory will be discussed.

Culture may also contribute to the effectiveness of the board and therefore affect the performance of the firm. Several studies suggest that nationality can affect the effectiveness of a team. Studies also suggest that a hybrid team which is formed from heterogeneously is more effective than teams that are only made up by two subgroups. An earlier research on top management teams, demonstrated that cultural heterogeneity was positively related to team performance and issue-based conflict (Elron, 1997) which was mentioned in the studies of Early and Elaine (2000). But whether these studies can be proven in Indonesia is still in question. There is a possibility that the social structure in Indonesia may influence the disproval of these theories. Later chapters will reveal findings from previous studies in more detail.

The last factor that will be studied is how the size of the company influences the board's effectiveness and hence influences the performance of the company. Previous studies suggest that larger firms have a larger board. Boone, Field, Karpoff and Raheja (2006), notes that as the firm grows and diversify over time, so will the independence and size of the board. This is expansion of board size is probably the board's way to compensate the difficulties for it to have to monitor a wider scope.

The end result is that later hopefully this paper could help us identify what the determining factors are when it comes to building an effective board. Also this paper would help determine whether factors such as the ownership structure of the company, the board's culture, the size of the company, and also the growth opportunity of the company, will be highly related with the performance of the board, or in this case be present in an effective board. This paper will try to identify what makes a good and effective board, and see whether current standards set by the government has room for improvement.

1.2. Problem Identification

There are so many contradicting studies upon the subject of board of directors, and as it is known, these studies are mostly using non-Indonesian companies, and therefore do not capture the economic conditions, among other things. This paper will discuss some of the issues on this topic. The research questions are:

a. Ownership of the company is a major issue that needs to be further discussed. Findings from Mak and Li (2001), indicates that corporate ownership and board structures are related, and that there are significant interrelationship among board structure characteristics. With this in mind, we will then focus our attention towards the relationship between corporate ownership and the company's performance, and finally solve the question of whether ownership of the company affects the performance of the company, and also how much family ownership is good for the company? Will a company of which is run by families have any effect on the effectiveness of the board?
b. Some researchers have hypothesized that firms with greater growth opportunities adopt mechanisms and corporate policies that better control agency problems, and there is substantial empirical support for these predictions (e.g., Smith and Watts, 1992; Gaver and Gaver, 1993). Will the level of growth opportunities have an effect upon the effectiveness of the board?
c. Many previous studies are based upon research on companies that are based in the western world. There are very few studies that focus on Indonesian based companies. This suggests that the studies that have been made in the previous times are not suitable for companies that are based in Indonesia or has a dominant Asian culture influencing the company's direction and restriction. Are having expatriate members in the board of commissioners affects the decisions in the board of commissioners?
d. Usually the bigger the firm is, the better the chance they are of exposure to public. Because of this they are usually more conforming with the

regulations that are given to them. Findings from Boone et al. (2007) suggest that larger, more seasoned, and more diverse firms have larger and more independent boards. Determining whether the financial size of the company affects the board's performance or not will be our guideline of creating the right board for the right company.

1.3. Research Objectives

The target of this research is expected for the following:

a. To understand whether the ownership of the company have any effect on the effectiveness of the board and the performance of the company.
b. To understand how the growth opportunity affects the effectiveness of the board that affects the performance of the company.
c. To see the significance of the culture of members of the board towards the effectiveness of the board and the performance of the company.
d. To recognize how size of the firm affects the effectiveness of the board and the performance of the company.

1.4. Benefits From This Research

Academician

Students and researchers may benefit by having a wider understanding on the dynamics of board effectiveness. Hopefully this paper will give a solid ground for further research to be built upon.

Management

It is understood that the board will be one of the factors that may affect the performance of the company, thus it is quite reasonable for management to get a better look on this subject. Hopefully the results from this research can help management to have a better knowledge on the topic of identifying the right board for the right firm and can give suggestions to the shareholders in what type of board is suitable for effectively heightening the performance of the company.

Investors

For the investors, understanding better how the board works and be able to see and classify which board is effective and which is not, can somehow ensure that their investment to the company is handled by the right people. Recognizing this, investors as a shareholder can identify what type of person is needed in an effective board and then upon the annual shareholders meeting may actually have enough knowledge in choosing the right people to take in charge of their money.

Regulators

As law makers, government institution must have a solid knowledge on the topics they must govern. Also, the demand of higher government involvement and regulations are increasing. Hopefully this paper will give a better insight upon this matter. The laissez-faire attitude of the state toward board composition has permitted substantial compositional diversity (Baysinger & Butler, 1985). Hopefully through this research, the government will have a better understanding in making the right policies and regulations to help aid the growth of companies in Indonesia.

1.5. Report Structures

Chapter 1 Introduction

This chapter will give us an overview of what the research is about and why this topic is discussed in the paper. The current economical environment and also the cultures of the board will be the main focus in this chapter.

Chapter 2 Literature Review

In this chapter, we will discuss briefly on current theories and journals that will be the main groundwork of this research. We will also discuss the current environment of the companies in Indonesia about the characteristics of the board of commissioners.

Chapter 3 Research Methodology

To understand how the report will be done and what types of samples are gathered. The methods of research will be further discussed in this chapter, as will the data that will be acquired. Those data will then be analyzed in the coming chapter.

Chapter 4 Analysis and Discussion

From the samples gathered from various companies listed in the Indonesian Stock Exchange, and other publicized data from the company, we can then peer deeper into the research. A discussion of trends and patterns about the relationship of the board and its determining factors such as family ownership, growth opportunity and culture of the board will give us clues on how these factors relate and affect one another.

Chapter 5 Conclusion and Recommendation

In this chapter we will see what we can conclude from this research and finally answer the questions previously given in Chapter 1. Suggestions on further research on this matter will be discussed in this chapter also.

CHAPTER 2

LITERATURE REVIEW

2.1. The Two Boards

2.1.1. The Board of Directors

Corporate governance is defined in many ways, depending on the disciplines (Turnbull, 2000); for instance in law, psychology, economy, management, finance, accounting, philosophy or even in religious terms. There are several definitions on this term that will be discussed further on this chapter. Sir Adrian Cadbury explains that corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society (Global Corporate Governance Forum – World Bank, 2000). Syakhroza (2002) in the studies conducted by the Bapepam-LK, defines corporate governance as a system that the board uses to direct, control and supervise the management of organizational resources efficiently, effectively, economically and productively (E3P), with transparent, accountable, responsible, independent, and fairness principles (TARIF), in order to achieve organizational goals.

The Indonesian government – through the regulations they issued, the UUPT (*Undang-Undang Perseroan Terbatas*, Law of Limited Liability Company) – enforces the use of the two tier board system, where there is a board of directors that is responsible for the management of the company and represents the company both within and outside the court, and the board of commissioners that oversees and provides advice to the board of directors in carrying out their task. In UUPT Article 56, further stated that once a year the directors shall deliver accountability to shareholders through the annual reports filed in the general meeting of shareholders annually. Reflection for the principle for the fiduciary duties of the board of statutory provisions can be seen in the UUPT Article 85 requires that directors carry out their duties in good faith and full responsibility. In the case of guilty or negligent in doing their duties as directors, every member of the board of directors is held fully accountable personally. It applies also for the board of commissioner according to Article 98.

In Article 82, it is also stated that the board of directors is fully responsible for the management of the company for achieving its interests and goals. In the case of the board acts in a way of illegal acts that harm the Company, shareholders or third parties, then they can be inspected under the UUPT Article 108. It is easy to see how important and critical the role of the board of directors is to the company.

In the sociological and economic literature on organizations, the modem firm is usually seen as a large organization with four main groups of actors: shareholders, boards of directors, top executives and other managers, and workers (Kang & Sorenses, 1999). Shareholders are thought of as "owners"; they provide financial capital and in return receive a contractual promise of economic returns from the operations of the firm. Directors act as fiduciaries of the corporation who may approve certain strategy and investment decisions but whose main responsibility is to hire and fire top managers. Managers operate the firms; they make most business decisions and employ and supervise workers. Workers carry out the activities that create the firm's output. The board of directors can be viewed as a kind of monitoring mechanism.

As previously mentioned, the board is often seen as serving a monitoring function, protecting the interest of various stakeholders against management's self interest (Fama, 1980; Fama and Jensen, 1989). Mainly, the board of directors is invented for controlling agency cost. With that said, it is necessary to see what the board's responsibilities are.

The Business Roundtable (Linck et al., 2008) suggests that the board of directors in a one-tier system has five primary functions:

a. Select, regularly evaluate, and if necessary, replace the chief executive officers, and determine management compensation and review succession planning.
b. Review and where appropriate, approve the financial objectives, major strategies, and plans of the corporation.
c. Provide advice and counsel to top management.
d. Select and recommend to shareholders an appropriate slate of candidate for the board of directors, and evaluate board processes and performance.
e. Review the adequacy of systems to comply with all applicable laws/regulations.

For the purpose, and based on theoretical work, this paper will classify the board's activities into two factors, which is monitoring and advising (Adams and Ferreira, 2007; Raheja, 2005; Linck et al., 2008). In general, the monitoring function is to investigate, scrutinize, and evaluate whether the management are doing a good job in the company and guard against harmful wrong doing that the management might do. The board's advising function is to help the management in order for them to make good decisions for the company. This research focuses on the functions and duties of the board of directors in a one-tier system and later compare it with the board of commissioners in a two-tier system is because the refference that would be used as the foundation of this research are about those two. This is why the this research will not discuss the functions and duties of the board of directors in a two-tier system.

2.1.2. The Board of Commissioners

Mainly, the board of commissioners' role in the firm is to monitor the board of directors. In the UUPT, this is stated in Article 97. Also stated in UUPT, Article 95, members of the board of commissioners are appointed by the Shareholder's Annual Meeting. To sum up, the board of commissioners has three major duties and authority:

a. Perform supervision on the business operation of firm and provide advisory assistance to the directors.
b. In performing their duties, their actions are based upon the best interest of the firm.
c. The board of commissioners can be mandated to take over certain duties of the directors if necessary.

Other than their duties and authorities, the commissioners have the responsibility to monitor and report the performance of the company, the management team, and the also the performance of the board of directors. These reports are usually seen in a firm's Annual Report. The commonality between these two boards is that their main job is to monitor and assist. If the director's job is to monitor and give advisory assistance to the management of the company, the commissioner's job is to monitor and give advisory assistance to the directors.

It was already mentioned that unlike some places, Indonesia adopts the two-tier system in their corporate governance, the difference of which is the existence of the board of commissioners. Many of the studies used in this research are studies from other countries where they applied the one-tier system. This paper assumes that the findings that are found in studies on the board of directors can be applied as the same as in the board of commissioner. This assumption is based on the fact that both of the board mainly has the same job description, which is to monitor, assist and report. Further into this paper, many studies on the board – in this case the board of directors – will also be considered to be applicable to the board of commissioners.

2.2. Agency Problem

An agency relationship arises whenever one or more individuals, called principals, hire one or more other individuals, called agents, to perform some service and then delegate decision-making authority to the agents. The primary agency relationships in business are those (1) between stockholders and managers and (2) between debtholders and stockholders. These relationships are not necessarily harmonious; indeed, agency theory is concerned with so-called agency conflicts, or conflicts of interest between agents and principals. This has implications for, among other things, corporate governance and business ethics. When agency occurs it also tends to give rise to agency costs, which are expenses incurred in order to sustain an effective agency relationship (e.g., offering management performance bonuses to encourage managers to act in the shareholders' interests). Accordingly, agency theory has emerged as a dominant model in the financial economics literature, and is widely discussed in business ethics texts.

Agency theory suggests that, in imperfect labor and capital markets, managers will seek to maximize their own utility at the expense of corporate shareholders. Agents have the ability to operate in their own self-interest rather than in the best interests of the firm because of asymmetric information (e.g., managers know better than shareholders whether they are capable of meeting the shareholders' objectives) and uncertainty (e.g., myriad factors contribute to final outcomes, and it may not be evident whether the agent directly caused a given outcome, positive or negative). Evidence of self-interested managerial behavior includes the consumption of some corporate resources in the form of perquisites and the avoidance of optimal risk positions, whereby risk-averse managers bypass profitable opportunities in which the firm's shareholders would prefer they invest. Outside investors recognize that the firm will make decisions contrary to their best interests. Accordingly, investors will discount the prices they are willing to pay for the firm's securities.

A potential agency conflict arises whenever the manager of a firm owns less than 100 percent of the firm's common stock. If a firm is a sole proprietorship managed by the owner, the owner-manager will undertake actions to maximize his or her own welfare. The owner-manager will probably measure utility by personal wealth, but may trade off other considerations, such as leisure and perquisites, against personal wealth. If the owner-manager forgoes a portion of his or her ownership by selling some of the firm's stock to outside investors, a potential conflict of interest, called an agency conflict, arises. For example, the owner-manager may prefer a more leisurely lifestyle and not work as vigorously to maximize shareholder wealth, because less of the wealth will now accrue to the owner-manager. In addition, the owner-manager may decide to consume more perquisites, because some of the cost of the consumption of benefits will now be borne by the outside shareholders.

Managers can be encouraged to act in the stockholders' best interests through incentives, constraints, and punishments. These methods, however, are effective only if shareholders can observe all of the actions taken by managers. A moral hazard problem, whereby agents take unobserved actions in their own self-interests, originates because it is infeasible for shareholders to monitor all managerial actions. To reduce the moral hazard problem, stockholders must incur agency costs.

Agency costs are defined as those costs borne by shareholders to encourage managers to maximize shareholder wealth rather than behave in their own self-interests. The notion of agency costs is perhaps most associated with a seminal 1976 Journal of Finance paper by Michael Jensen and William Meckling, who suggested that corporate debt levels and management equity levels are both influenced by a wish to contain agency costs. There are three major types of agency costs: (1) expenditures to monitor managerial activities, such as audit costs; (2) expenditures to structure the organization in a way that will limit undesirable managerial behavior, such as appointing outside members to the board of directors or restructuring the company's business units and management hierarchy; and (3) opportunity costs which are incurred when shareholder-imposed restrictions, such as requirements for shareholder votes on specific issues, limit the ability of managers to take actions that advance shareholder wealth.

2.3. Family Ownership

Family businesses can be the source of income of a nation, but also can be a source of unresolved family tensions and conflicts, which can create obstacles to achieving even the most basic goals. When close relatives work together, emotions often interfere with business decisions. Also, unique problems, such as the departure of the founder-owner, develop in family owned firms. When more than one family member is involved, emotions and differing value systems can cause conflicts between members. In fact, most people-related challenges faced by family businesses – small or large – result from interactions of business necessity with family values and relationship.

Occasionally family-run businesses get a bad rap that is totally undeserved. A family member may receive a lot of bad publicity for various reasons, and the public tends to attach a negative feeling toward the family name attached to the small business. Or the company may be part of a scandal that tends to tarnish the family as a whole. These unique problems and quirks make the family owned business very much different from non family-owned firms.

Usually in a family business, a family member is placed and plays the roles of stockholder, board member, working partners, advisors or even employees. The convergence-of-interest hypothesis suggests agency cost decreases as owner-manager's ownership interest increases. Outside investors may perceive that the owner-manager behaves to maximize firm value when the owner-manager's holding is large (Abbott, Parker, & Peters, 2004; Fan & Wong, 2002). In this case convergence of interest between the owner-manager and outside investors occurs (Feldmann & Schwarzkopf, 2003). The higher the owner-manager's ownership stake in the firm means the lesser the divergence-of-interests, therefore, the less likely monitoring needs to occur (Menon & Williams, 1994). There are many factors that influence the behavior of the board and how the board performs. There are possibilities that the ownership of the firm might affect the effectiveness of the board. Sometimes the presence of family in a family owned firm is so overwhelming that it affects the decisions of the board and management altogether.

So then the question arises, if there is more owner-manager ownership in the firm, will the firm have a better performance? How does this relate to the board's effectiveness? If the presence of family-ownership is strong in the company, it may decrease the effect of agency problems because most of the directors, decision makers and owners are synergized with each other, but is this true?

From many studies it seems that that having a large unified ownership of the stock such as from a family-owned business, will cause the firm to profit less than if it does not have a unified ownership. Fama and Jensen (1983) note that combining ownership and control allows concentrated shareholders to exchange profits for private rents. Demsetz (1983) argues that such owners may choose nonpecuniary consumptions and thereby draw scarce resources away from profitable projects. These kinds of findings suggest that family ownership is not a good thing, and so it is commonly perceived as less efficient, or at the very least, less profitable ownership structure than dispersed ownership. But even so, this is not a universal view. Some still believes that family ownership has its upsides as well. Demsetz and Lehn (1985) note that combining ownership and control can be advantageous, as large shareholders can act to mitigate managerial expropriation. For instance, the family's historical presence, large undiversified equity position, and control of management and director posts place them in an extraordinary position to influence and monitor the firm. They also have longer investment horizons, leading greater investment efficiency (James, 1999).

But is creating a better company is only on how much profit the company can make upon each project that it takes? Is it only measured on how much shareholder value it can increase? Diversified shareholders are presumed to evaluate investments using market value rules that maximize the value of the firm's residual cash flow. Large concentrated shareholders however, may derive greater benefits from pursuing objectives such as firm growth, technological innovation, or firm survival than from enhancing shareholder value (Anderson & Reeb, 2003). Further investigation from Anderson and Reeb (2003) suggest that family firms performs at least as well as nonfamily firms, and that the greater profitability in family firms, relative to nonfamily, stems from those firms in which a family member serves as the CEO. One interpretation that they did is that the family understands the business and that involved family members view themselves as the stewards of the firm and therefore identify strongly with the firm and view the firm performance as an extension of their own well-being (Davis, Schoorman and Donaldson, 1997).

These studies that are previously made are taken from samples of companies that are not Indonesian-based companies. The economical environment, culture or many other factors may influence the validity of these studies. Faccio et al. (2001) report that family ownership in East Asia leads to severe conflicts with other claimants and hampers firm performance. Focusing on difference in the rules governing the treatment of minority shareholders, the limited disclosure of firm data in East Asia, and the prevalence of cross-shareholdings, Faccio et al. suggest that the problems faced by East Asia firms are related to corporate governance and the political-regulatory environment.

2.4. Growth Opportunities

The growth opportunities of firms are also a playing factor in the effectiveness of the board and therefore the firm as well. The greater information asymmetry inherent in high-growth firms increases the potential for wealth transfer from potential investors to inside owners (Gaver and Gaver, 1995). Anderson, Francis and Stokes (1993) find that relative expenditure on monitoring from directors is positively related to the availability of growth opportunities. Mak and Roush (2000) argue that proportion of outside directors is positively related to the extent of growth opportunities available to a firm. Also they suggest that firms with relatively more growth opportunities are likely to use dual leadership. Bathala and Rao (1995), notes that firms with more future growth opportunity can be argued to use more outside directors in the board to control the higher agency problems inherent in such firms.

But there are several debates upon this subject. Some researchers have hypothesized that firms with greater growth opportunities adopt mechanisms and corporate policies that better control agency problems, and there is substantial empirical support for these predictions (e.g., Smith and Watts, 1992; Gaver and Gaver, 1993).

There are other studies on the effects of growth opportunities towards the board. Linck et al. (2008) suggest that firm with high growth opportunities are associated with smaller and less independent boards. This study also notes that firms have more independent when insiders have more opportunity to extract private benefits and when the CEO has greater influence over the board. It is possible that from this research one might conclude that the more independent the board is, the more neutral and less influenced the board can be. Both outside directors and a small board are indicative of a stronger board monitoring (Jensen, 1993), this suggest that a small and independent board may lead to an effective board. With this, the question then arises. Will high growth opportunity of a firm lead to the creation of a more effective board of directors, compared to firms with low growth opportunities?

Independence of the board is not positively related to an effective board. Raheja (2005) argues that insiders are an important source of firm-specific information for the board, but they can have distorted objectives due to private benefits and lack of independence from the CEO. Compared to insiders, outsiders provide more independent monitoring, but are less informed about the firm's constraints and opportunities. So then it is understood that the growth opportunities of the firm is somewhat connected to the independence of the board, but the effect of this board independence towards the performance of the company is still in question.

2.5. Board Culture

Many previous studies focuses on companies that have a dominant Western culture influence, there are still so little we can tell about Indonesian based companies. Are having expatriates from a Non-Asian society can create a board that can retain the best of both worlds form each of the culture? How influencing are these cultures towards the decision making actions of the board? What is more challenging is that Indonesia has quite a lot of cultures and traditions. These cultures and tradition can vary even between provinces. Thus, members in a board may have different cultures even if they have the same nationality, and ergo affects the effectiveness of the board.

Is it true that a more diverse board may increase the performance of the company? There are several studies that can contribute to this question at hand. Studies shows that firms with disparate business and geographically dispersed operations or firms with complex operating and financial structures should benefit more from bringing outsiders with a range of expertise, resulting in larger, more independent boards. Lehn, Patro, and Zhao (2004), Boone, Field, Karpoff, and Raheja (2007), and Coles, Daniel, and Naveen (2007) present similar arguments, which some refer to as *the scope of operations hypothesis*. Although monitoring cost naturally increase with a firm's complexity, the benefits from effective monitoring should outweigh the cost on balance (Fama and Jensen, 1983).

An earlier research on top management teams, demonstrated that cultural heterogeneity was positively related to team performance and issue-based conflict (Elron, 1997) that was found in the studies of hybrid team cultures by Earley and Elaine (2000). The moderately heterogeneous groups showed many communication problems, relational conflict, and low level of team identity. These intervening conditions have been found to be dysfunctional for team effectiveness (Jehn, Chadwick & Thatcher, 1997; Thatcher, Jehn & Chadwick, 1998). Studies like these suggest that the more heterogeneous a team is, the more effective it is. Highly heterogeneous group may initially experience disproportionate emphasis on individuality, with team members strongly aware interpersonal differences. Counterbalancing forces may motivate the creation of commonalities among group members, with a hybrid team culture becoming a common identity. A split group may balance individual and team identities, and members are not motivated to adjust this balance. Although this result may satisfy individuals, it blocks team integration and unification. Harstone and Augoustinos (1995) suggested that a third subgroup inside the team may offset the difficulties of two subgroups. Fractionation into three or more subgroups may facilitate hybrid culture creation through greater information sharing about personal traits, backgrounds, and interest.

From this we can understand that it is better to have three or more different cultures in a group of people, rather than having only two where the team will become less effective. This paper assumes that usually inviting expats inside the board, will result having a team with two subgroups. With this given, the question still lingers. Are having expats in the board affects the board's effectiveness?

2.6. Size of the Company

Boone, Field, Karpoff and Raheja (2006), notes that as the firm grows and diversify over time, so will the independence and size of the board. Larger IPO firms facing greater agency problems are more likely to employ boards that are more effective in monitoring managers, however firm size may capture other factors (Mak and Roush, 2000). Findings from Boone et al. (2007) suggest that larger, more seasoned, and more diverse firms have larger and more independent boards. This backs the theory that by having larger firms means that it is much more difficult for the board to monitor the management of the firm if it too does not increase its size, and therefore is countered usually by having a larger board to balance the increase of the managerial size. But by having a larger board means it will be even more difficult to keep the control of the board and further decreasing the performance of the company. So as you can see, there are trade-offs in each both of them. This paper will further investigate which trade-off will be the more dominant in the Indonesia based companies, and which will not.

Another factor that may cause the company's size to maybe influence the board's effectiveness is that larger companies are usually more exposed to the public. This may result in the company to really get together an effective board to be shown to the public, or even to show the public if its compliance with current regulations on board structuring. Back in 1974, Nobel laureate Michael Spence introduced the notion of signaling in economic thinking. According to him, when information is imperfect, individuals who possess strong qualities will send signals to distinguish themselves from the others. Larger companies are somewhat more exposed to the public and the government thus making them having to be more compliant to current regulations than smaller companies. Companies want to make a good impression to the public to attract more investors and thus bringing more money to the company. They can also bring more money to the company by being able to be well trusted by the public. A good company image can go a long way in helping the company in its journey towards reaching their goals and objectives.

Spence (1973) states that information asymmetry exists between company's managers and investors. The company can provide information to the investor in order to eliminate the asymmetry. One of the ways that the company can provide information is through the annual shareholder's meeting that is attended by the corporate shareholder and the board of directors. Thus an effective board comes to play, in which an effective board is also defined as a board that has a good performance and doing its job correctly. But is this true? Is it true that larger firms have better board performance than smaller firms?

CHAPTER 3

REASEARCH METHODOLOGY

3.1. Research Approach

Corporate governance has long been the issue of today's business. How the company is managed is crucial to the company's financial health condition. Knowing that, it is important to understand how the role of the board affects the corporate governance. This thesis will take a look on how some factors would then affect the effectiveness of the board.

The general idea is that the effectiveness of the board is affected by several factors. In this research there are four factors that will be focused on, which are the growth opportunity, board member culture, family ownership and company size. These factors are considered to have influence upon the corporate governance of a company.

The general idea of this research is to analyze each of the independent variable's relation towards the dependent variable. Therefore, using a regression model to would be fit for conducting the research. Regression analysis is widely used for prediction and forecasting. Regression analysis is also used to understand which among the independent variables are related to the dependent variable, and to explore the forms of these relationships. In restricted circumstances, regression analysis can be used to infer causal relationships between the independent and dependent variables.

Further on the research methodology that is used in this research will be discussed more extensively in this chapter. The framework of this research is illustrated in the figure below:

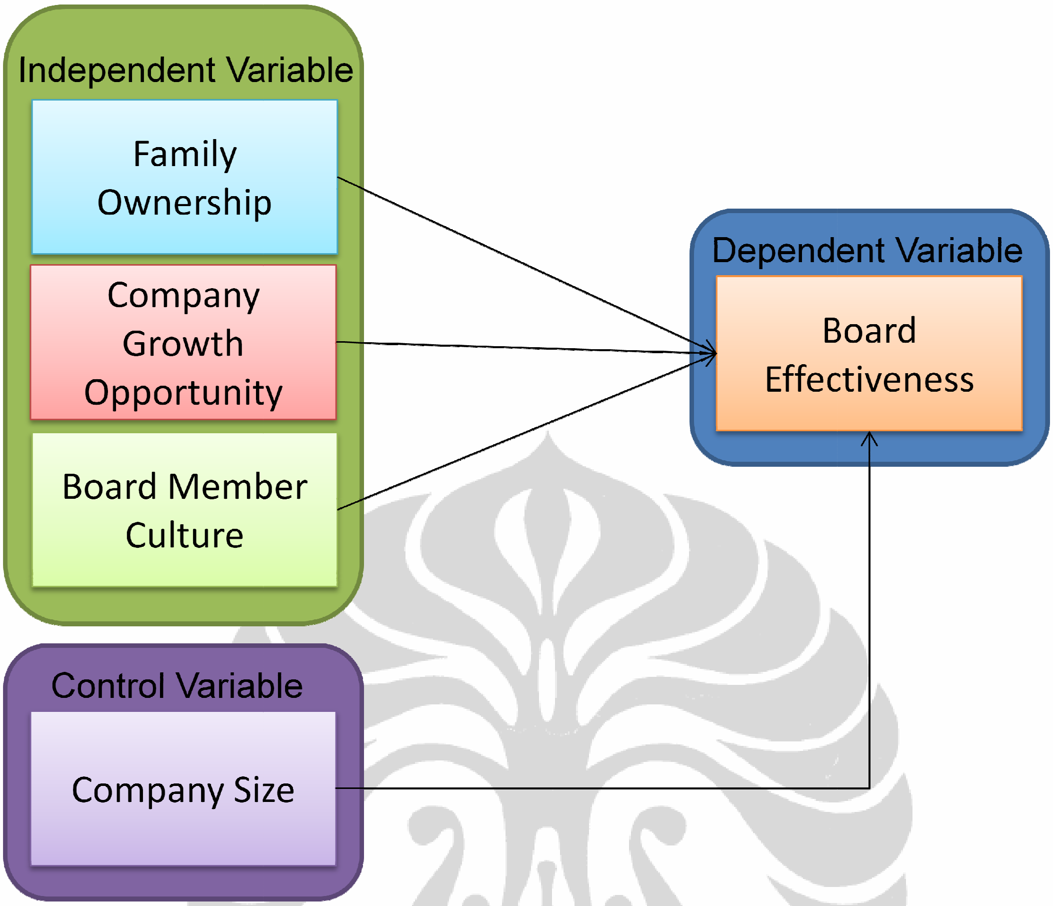

Figure 3.1 Framework

It is clearly shown from the figure above that the basic framework of this research is that the board effectiveness is affected by the company's growth opportunity, the board member culture, the size of the company, and also the presence of a dominant family ownership inside the company.

3.2. Hypothesis Development

In previous chapters it is already been discussed thoroughly these relationships between each independent variables towards the board effectiveness based on previous studies that have been made by researchers.

Family ownership has long been the issue in the corporate world. Some studies suggest that a family presence in the company, or family owned businesses have a better performance. Demsetz and Lehn (1985) note that combining ownership and control can be advantageous, as large shareholders can act to mitigate managerial expropriation. Some also suggest that the large presence of family in the company would result in a have longer investment horizons, leading greater investment efficiency (James, 1999).

But this is not a universal view. Fama and Jensen (1983) note that combining ownership and control allows concentrated shareholders to exchange profits for private rents. In other words, the large family presence would result in some profit from the company is used for personal benefit by the owners itself. Davis, Schoorman and Donaldson (1997) suggested that the success of family owned businesses stems from how the family members in the firm view themselves. Family members that view themselves as stewards of the firm would identify strongly with the firm and view the firm's performance as an extension of their own well-being, thus making them highly dedicated in the performance of the company. This research only evaluates the presence of family ownership of the firm. This means that the firm is flagged a family owned firm if the majority shares are owned by a family or a single entity outside the government, investment group, or public. The assumption is also that a family owned firm outside a business group will have better performance than inside or affiliated with a business group. So the last hypothesis is as follows:

H1a: A family owned firm that is not within a business group will have a higher effectiveness score of the board than other firms.

The growth opportunity of a company is determined by how the market values the company's ability to grow. This ability of growth is determined by the company's performance of investments on good growing projects and investments and decision making. As previously mentioned, this performance is related to the performance of the board, where an effective board will be able to see more growth opportunity for the company, compared to an ineffective board.

Gaver and Gaver (1995) in their studies suggested that the greater information asymmetry inherent in high-growth firms increases the potential for wealth transfer from potential investors to inside owners. They also stated that firms with greater growth opportunities adopt mechanisms and corporate policies that better control agency problems, and there is substantial empirical support for these predictions. These findings were also found by Smith and Watts (1992). Findings like these would be the foundation of the first hypothesis for this paper, which is:

H2a: The growth opportunity value of the company has a positive effect towards the effectiveness score of the board of commissioners.

Studies from Elron (1997) that was found in the studies of hybrid team cultures by Earley and Elaine (2000), suggest that the heterogeneity in the top management teams was positively related to team performance. This proposes that the more diverse a team is, the greater its performance is. Even if that is the case, studies like this have not yet been proven correct in the conditions presented in Indonesia. It is suggested from studies by Lehn, Patro, and Zhao (2004), Boone, Field, Karpoff, and Raheja (2007), and Coles, Daniel, and Naveen (2007), that firms with disparate business and geographically dispersed operations or firms with complex operating and financial structures should benefit more from bringing outsiders with a range of expertise, resulting in larger, more independent boards. The more heterogeneous a team is the more effective it becomes. The moderately heterogeneous groups showed many communication problems, relational conflict, and low level of team identity.

These intervening conditions have been found to be dysfunctional for team effectiveness (Jehn, Chadwick & Thatcher, 1997; Thatcher, Jehn & Chadwick, 1998). In previous chapter it is concluded from studies that suggest three or more different culture is better, compared to only having two where the team becomes less effective. This research will analyze whether diversity is good for the board's performance of Indonesian based companies or not. So the second hypothesis for this paper is:

H3a: The value for the proportion of expatriate members in the board of commissioners has a positive effect towards the effectiveness score of the board of commissioners.

3.3. Research Model

For this paper, to find the relation between each of the independent variables (growth opportunity, culture of board member, company size and family ownership) with the dependent variable (board effectiveness), the multivariate regression model will be used. This method of research is when the focus is on the relationship between a dependent variable and one or more independent variables. The independent variables have been previously mentioned in this chapter, but the dependent variable needs to be discussed further and will be in this chapter.

The control variable used in this model is the size of the company. The control variable is one that must not be changed throughout an experiment because it affects the independent variables and thus affects the outcome of the experiment. Thus the model for this research with the control variable included would be:

$$BSCORE = \beta_0 + \beta_1 DFAMOWN + \beta_2 GWTHOPP + \beta_3 PROPEXPAT$$

$$+\beta_4 \text{SIZE} + \mathcal{E}$$

BSCORE : *Board's Effectiveness Score*

DFAMOWN : *Family Ownership, a dummy variable, if the company have its shares above 50% of its total equity owned by a family or a single entity, and is not within a business group then the score would be 1, and 0 if otherwise*

GWTHOPP : *Growth Opportunity value, the value of which is the value of the firm's market value over its book value for company (i) in period (t)*

PROPEXPAT : *Member Culture, the value shows the proportion of expatriate members inside the Board of Commissioners*

SIZE : *Company Size value, the value of which is the natural log of the company's total market value of equity*

The value of BSCORE would be acquired after previously scoring each of the company's board of director's performance.

3.4. Variable Definition & Measurements

To avoid misinterpretation of each of the variables that are used in this research, this paper will discuss furthermore on the matter of the independent and dependent variable used in this research.

3.4.1. Board Effectiveness Score

Identifying what factors are considered important to have in an effective board must be known first to score the effectiveness of the board,. This research uses a scoring method in determining the effectiveness of the board. Several characteristics those are included in the scoring covers these factors such as independency of the board, activities of the board, number of board member, and the board member's competency. Hopefully this scoring method might illustrate better the strength of corporate governance in the company from the perspective of the board.

This research is based on continuing a previous research that was made by Hermawan (2009). The scoring of the corporate governance by scoring the effectiveness of the board is based on this previous research. In her research, the scoring is based on several factors that are obtained from the company's financial report. In this research, the disclosure of the company's corporate governance will be the basis of the scoring for the corporate governance structure of the company, especially the monitoring role of the board. A checklist will be used to value the board's characteristics which are based on the information given in the financial report of the company. That checklist will also refer to the list made by the Indonesian Institute of Corporate Directorship (IICD) for the scoring done on 2005, although there will be some modification made for the purpose of the research.

Similar to the list made by the IICD, for every question there will be three answers, which are Good, Fair and Poor, and some of the question only having two answer which is Good and Poor. For every Good grade will be given a point of 3, the Fair grade will be given a point of 2, and Poor will be given a point of 1. For every unanswered question due to the lack of information in the financial report, this question will be given a point of 1, similar to the Poor score. The detail of the scoring system is given in Appendix 3.

3.4.2. Family Ownership

Measuring the family ownership of the firm is straight forward. In this paper, if the company has more than 50% of its shares owned by a family, and the company is not within any business group, then the company will be classified as a family owned firm.

3.4.3. Company Growth Opportunity

The growth opportunity is the ability to invest in profitable project. So the company's growth opportunity actually means the company's ability or opportunity to invest in profitable projects and investments. The higher the profitability the company can invest in its investments, the higher the value of its growth opportunity. This paper measures the growth opportunity of a company by first determining the market value of the firm and the book value of the firm. Market value is the firm's worth that is valued by the market, and the book value is the worth of the company valued by the company itself. Collins and Kothari (1989) in the studies from Hermawan (2009) uses the same measurements of growth opportunity when they examined the relationes between ERC and growth opportunity.

The equation below shows the relation between market value, book value and the growth opportunity of a company.

$$Growth\ Opportunity = \frac{Market\ Value\ at\ the\ end\ of\ period}{Book\ Value\ at\ the\ end\ of\ period} = \frac{MV_t}{BV_t}$$

Equation 3.1

In other words, the growth opportunity of a company is how much higher or lower the market is willing to value the company over its actual value. An increase in the growth opportunity value means that the market is willing to value the company higher than its real value. This is probably because the market can see the company has a high ability to grow in the future due to its ability to detect and invest in good projects and investments.

3.4.4. Board Member Culture

This paper will limit the board member culture value by the number of expatriates inside the board. Although there are many other factors, such as the composition of nationalities in the board, this constraint was given to simplify this research. The higher the proportion of expatriate members inside the board, then the higher value for this variable is.

3.4.5. Company Size

The size of the company is measured only through its financial worth. Other measurements of size such as the number of its employee it has, the number of branches it has, and others, will not be measured in this research. To value the company size, Ruland and Zhou (2006) uses market value of equity that is expressed in natural logarithm (ln).

To minimize the scale for the variables measured, the natural logarithm can be transformed into a log, but this research uses natural log instead. So to calculate the size of firms (size) used the equation:

$$Company\ Size = \ln(Market\ value\ of\ equity\ at\ end\ of\ period) = \ln\ (MV_t)$$

Equation 3.2

In this equation, market value of equity is the price of each company shares that has been issued multiplied by the price of each individual share. Market value of equity according to Jones (1993:267) is calculated by multiplying the market price per share by the number of shares outstanding. Market value of equity describes the value of the company in the market. Company value reflects the company's size, whether it is large or small company compared to other firms in the market. Investors can use this value as one of the important variables to determine if it is a good investment or not. Market value of equity reflects the real situation of the shareholders' equity and has the possibility of being higher position or lower than its book value.

3.5. Population and Samples

The population for this research is from the listed companies at BEI. The method of choosing the samples are by using the 'purposive sampling' technique, where the population of the samples chosen for their specific criteria, in this case, from the non-financial fims. These companies that have been chosen will be reviewed from their Annual Reports from the year of 2006, 2007 and 2008. There will be a total of 242 company data that will be analyzed for the purpose if this research. All of the companies which will be reviewed will be Indonesian-based only firms, even if it is a multinational company.

3.6. Statistical Testing

3.6.1. Multiple Regression Analysis

Multiple regression analysis is an analysis to determine the effect of the relationship between a variable against another where there is more than an independent variable that affect a dependent variable. Tests of significance for the model-testing research conducted through the t-test where the samples used in this study limited the population is considered limited by the assumption of dispersion (variance) of data is same. Data processing will be carried out using SPSS software ver.17 to determine whether the research hypothesis accepted or rejected.

3.6.2. Classical Test Assumptions

3.6.2.1. Normality Test

Normality test intended to determine whether or residual variables have normal distribution. As the basis, the t-test and F-test assumes that the residuals follow a normal distribution. If this assumption is violated then the regression model is considered invalid by the number of existing samples. There are two ways commonly used to test the normality of the regression model which are with graph analysis (normal PP plot) and statistical analysis (analysis of skewness and kurtosis Z score) of one sample Kolmogorov-Smirnov test (Ghozali, 2009).

3.6.2.2. Autocorrelation Test

By using the Durbin-Watson value of ‘d’ from the PSAW 18 Output, this test would find out whether there is any autocorrelation occuring in this model. Refferin to the book authored by Gujarati (1992), if the value of ‘d’ is 2, then this means the model has perfectly no autocorrelation occuring. The closer the ‘d’ value comes to 2, the more likely it is not to have any autocorrelation occuring in the model.

3.6.2.3. Multicollinearity Test

Multicollinearity test aims to test whether the regression models found a correlation between independent variable (independent variable). In a good regression model there should not occur correlations between independent variables, because if it happens then these variables are not orthogonal or will will have similarity. Orthogonal variable is an independent variable, where the value of the correlation among the independent variables is zero. This test is to avoid the habit in decision-making process regarding the partial effect of each independent variable on the dependent variable. To detect whether there are problems with multicollinearity, the tolerance value and Variance Inflation Factor (VIF) can be obsererved (Ghozali, 2009).

3.6.2.4. Heteroscedasticity Test

Heteroscedasticity test aims to test whether in the regression model the variance of the residual inequality occurs from one observation to another. If the variance is fixed then it is called homoscedastic and if different then there are problems with heteroscedasticity. A good regression model has a trait of heteroscedasticity. There are several ways to detect whether there is heteroscedasticity, through looking at the scatter plot (predicted values with the residual dependent ZPRED SRESID), Gletjer test, the Park test, and the White test (Ghozali, 2009).

3.6.2.5. Goodness of Fit Test (R^2)

Goodness of fit test aims to measure the coefficient of determination (R^2) as a prediction of 'proximity' between the dependent variable and independent. Through the goodness to fit test it can be stated how much the dependent variable is able to explain the independent variable. The greater the coefficient of determination in the model, illustrates that the more powerful the relationship between independent and dependent variables in the model (Ghozali, 2009).

3.6.2.6. F-test

F-test performed to test the hypothesis of the coefficient (slope) regression simultaneously. The technique is the same way on a simple regression or multiple regressions using ANOVA Table (Analysis of Variance) (Ghozali, 2009).

3.6.2.7. t-test

T-test aims to see the significance in the hypothesis testing. In other words, with the t-test it is easy to see whether the independent variables have significant influence on the dependent variable. This study will be conducted using t-test with a significance level of 5% ($\alpha = 0.05$), where the independent variables is considered affecting the dependent variable significant if a p-value <0.05 (Ghozali, 2009).

3.6.2.8. Winsorising Treatment

The distribution of many statistics can be heavily influenced by outliers. The data samples that would be used in this research would be subjected to the Winsorizing treatment. This treatment for the samples is used to eliminate the existance of outliers in the data by replacing the outliers value with the value of 3 times above the average value and 3 times below the average value (mean $\pm 3\sigma$).

CHAPTER 4

ANALYSIS AND DISCUSSION

4.1. Sample Description

The samples used in this research are taken from the listed company's Annual Reports, Financial Statements, among other sources. These data will then be used to be analyzed together with the BSCORE to find the correlation between these data. Data of the company's ownership structure can be taken from company's stockownership structure and whether the company that is being analyzed is one of the branch companies of a family-owned umbrella corporation. The nationality of the member of the board will produce the data needed for the board member culture side of the research, and from Financial Statements, the growth opportunity and company size can be determined.

The samples that are used in this research are from corporate statements such as Annual Reports, Financial Statements, and also other source from the Indonesian Stock Exchange (IDX). As mentioned before, the method of choosing the samples are by purposive sampling, in which the researcher will choose data that fits the description of an Indonesian-based and listed companies that is also a company that is not in the finance industry, such as banks and investment companies. All of the companies will be from the real and also service industry. There will be a total of 199 company data, ranging from 2006 to 2007. The following Table 4.1 will illustrate the samples used in this research. The details of each of the samples in which this research uses is shown in Appendix 1 and Appendix 2, for samples of 2006 and 2007 respectively.

Table 4.1 Sample Proportion of 2006 and 2007

Company Description	2006		2007	
	Comp. Count	**Percentage**	**Comp. Count**	**Percentage**
Agriculture, Forestry and Fishing	1	0.88%	0	0.00%
Animal Feed and Husbandry	3	2.65%	3	3.49%
Cosntructions	1	0.88%	1	1.16%
Holding and Other Investment Companies	2	1.77%	1	1.16%
Hotel and Travel Services	2	1.77%	1	1.16%
Manufacturing	32	28.32%	15	17.44%
Mining and Mining Services	5	4.42%	4	4.65%
Others	9	7.96%	7	8.14%
Real Estate and Property	35	30.97%	32	37.21%
Securities	1	0.88%	1	1.16%
Telecomunication	3	2.65%	2	2.33%
Transportation Services	6	5.31%	6	6.98%
Wholesale and Retail Trade	13	11.50%	13	15.12%
Number of Companies used in Research	113	100%	86	100%

Source: Author's work

From the 2006 samples, it seems that that the real estate and property industry holds the most proportion of the total samples used in this year, with a total of 35 companies or 30.97% of the total samples used. Next in line is the manufacturing industry, consisting of 32 companies or 28.32% of the total samples used, followed by the wholesale and retail industry with 13 companies or 11.5% of the total samples observed for this research.

From Table 4.1 of the 2007 samples which shows the sample proportion per industry, it seems that that the highest number of companies used recedes in the real estate and property industry, consisting of 32 companies or 37.21% of the total 86 companies being observed. The second largest is from the manufacturing industry with 15 companies or 17.44% of the total number of samples used, and following it is the wholesale and retail trade industry with a total of 13 companies or 15.12% of the total number of samples.

When the samples are viewed as a whole, the distribution of the research can be seen as Table 4.2. From the overall table, it seems that the proportions of companies in their business lines for all of the three years sampled in this research. There is a total of 199 observation used in this research. The table also shows that the highest proportion of the samples used is from the real estate and property industry, a total of 67 company data, or 33.67% of the total samples are used in this research, followed by the manufacturing industry with a total of 47 company data, or 23.62% of the total samples and then from the wholesale and retail trade industry, consisting of 13.07% of the total samples used, or 26 campany data.

Table 4.2 Research Observation (combined)

Company Description	Comp. Count	Percentage
Agriculture, Forestry and Fishing	1	0.50%
Animal Feed and Husbandry	6	3.02%
Cosntructions	2	1.01%
Holding and Other Investment Companies	3	1.51%
Hotel and Travel Services	3	1.51%
Manufacturing	47	23.62%
Mining and Mining Services	9	4.52%
Others	16	8.04%
Real Estate and Property	67	33.67%
Securities	2	1.01%
Telecomunication	5	2.51%
Transportation Services	12	6.03%
Wholesale and Retail Trade	26	13.07%
Number of Observations used in Research	199	100%

Source: Author's work

4.1.1. Analysis BSCORE Variable Results

The table below gives the illustration of the average BSCORE of the samples used in the research. The highest BSCORE average is in 2007 with a score of 43.09 from the highest score of 51. In other words, the performance of the average score form 2007 is 84%, a little bit higher from the 2006 average score of 82%, or a score of 41.83.

Table 4.3 BSCORE Average of Sampled Companies

Year	Average of BSCORE	Maximum	Minimum
2006	41.83185841	51	23
2007	43.09302326	51	22
Avg. on Total Observation	42.46244083	*Max* 51	*Min* 22

Source: Author's work

Note: The lowest score available for the BSCORE is 17 points, and the highest score is 51 points. The lowest point is obtained when each of the list of category are scored with a 1 point, with the highest obtainable score in each 17 category is 3 points.

The list of companies for samples from the 2006 and 2007 are alike with each other. The abundance of data for the 2006 makes it possible for this research to have a high number of companies to be observed. Even though the lists of the companies are the same, the 2007 data have not as much as data as for the 2006.

4.1.2. Analysis of Family-owned Company Results

The table below illustrates the proportion of family owned companies used in the samples observed in this research. Taken from the dissertations of Hermawan (2009), quoted from Arifin (2003), it is mentioned that public companies in Indonesia are mostly originated from family owned companies. Not all of these family owned companies are part of a business group or a conglomeration. The proportion of family owned firms in the 2006 samples are 39 companies of the total 113, or 34.51%, which is also the highest proportion of the observational year from this research. From the total observation of 199 samples, there are a total of 67 samples are considered to be a family owned firm that are not a part of a business group either.

Table 4.4 Observation Distribution Based on Family Ownership of the Company

Year	Number of Family Owned	Total Number of Companies	Percentage
2006	39	113	34.51%
2007	28	86	32.56%
Total Observation	67	199	33.67%

Source: Author's work

4.1.3. Analysis of Size of the Company Results

The table below illustrates the size of the companies that are sampled for this research which ranges from 2006 to 2007. All of which are from the non-financial industry.

Table 4.5 Size of Sample Companies

Year	Average Size of Company	Largest Size	Smallest Size
2006	26.94164755	32.94136779	22.45408563
2007	27.67895869	32.93998103	23.28821519
Avg. on Total Observation	27.31030312	*Max* 32.9407	*Min* 22.8712

Source: Author's work

As can be seen, there are no significant difference of the company size between years. The average size of the company of the total samples being observed, after subjected to natural logarithm, is 27.31. The largest size of 2006 when subjected to natural logarithm is 32.94, and the lowest is 22.45, with an average year of 26.94. At 2007, it seems that that the highest point was also 32.94, and its lowest was 23.28 with an average of 27.68 on that year. As previously mentioned the size of the company is the market value of equity of the company, which is then subjected to natural logarithm.

Data of the size of the company that have been subjected to natural logarithm and further treated to eliminate outliers by Winsorising them. Outlier data will be set to a maximum and minimum that ranges between the mean of the data plus three times its standard deviation, and mean minus three times its standard deviation (mean ± 3σ).

4.1.4. Analysis of Company Growth Opportunity Results

Table 4.6 Growth Opportunity of Samples Used

Year	Average Growth Opportunity	Highest	Lowest
2006	2.858673944	126.0101483	0.102453415
2007	4.197468873	130.583217	0.220002139
Avg. on Total Observation	3.528071409	*Max* 130.583	*Min* 0.10245

Source: Author's work

Table 4.6 gives the illustration of the growth opportunities of the sample companies. Mentioned in the previous chapter of this research, the growth opportunities of the company is obtained from measuring how much the market value of equity is above the book value of equity. In the 2006 batch sample, the highest growth opportunity was over 126 times above its book value of equity, which is a company from the real estate and property sector. The lowest is from 0.102, also from the real estate and property sector, and with an average of growth opportunity on that year as much as 2.858. Reviewing the 2007 batch, it seems that that the highest score is over 130 times its book value of equity, which is from the technology information services, where the smallest is only 0.22, also from the technology information services. The average on that year was higher from the previous year, reaching 4.19. The high multiplication factor is because the market considers the firm to be a good place to invest. In other words, because the high demand of the firm's shares, the price of the shares increased.

4.1.5. Analysis on the Proportion of Expatriate Results

Table 4.7 Distribution of Companies with Expatriates in the Board

Year	Number of Companies With Expats	Total Number of Companies	Percentage
2006	35	113	30.97%
2007	25	86	29.07%
Total Observations	60	199	30.15%

Source: Author's work

For the 2006 batch, there are 35 companies listed to have non-Indonesian or expatriates as members in the board of commissioners, or 30.97% of the total

113 companies being sampled. The 2007 batch tells a similar story, where the total number of companies with expatriates in the board of commissioners are 29% of the total 86 companies being sampled. From all of the observations used in this research, 60 out of 199 samples, or company data, suggest that within their board of commissioners have foreigners as members.

4.2. Descriptive Analysis

As you can see, the BSCORE average point is 42.3, from a maximum point of 51 and a minimum of 17. This means that on average, the boards of commissioners of the companies are performing at an 80% rate of the maximum, if graded by with the current list used in this research. The table also mentioned that market values the companies sampled in this research of almost 3 times its book value. This shows that the market has high expectations on the growth of the companies.

Table 4.8 Descriptive Analysis Output

	Mean	**Std. Deviation**	**N**	**Minimum**	**Maximum**
BSCORE	42.2648	6.09283	199	23.8449	51
DFAMOWN	.3367	.47377	199	0	1
GWTHOPP	2.2699	2.85691	199	0.1	16.1584
PROPEXPAT	.1130	.19868	199	0	0.7187
SIZE	27.2603	2.25621	199	22.4500	32.9400

Source: SPSS Output

4.3. Statistical Testing

4.3.1. Normality Test

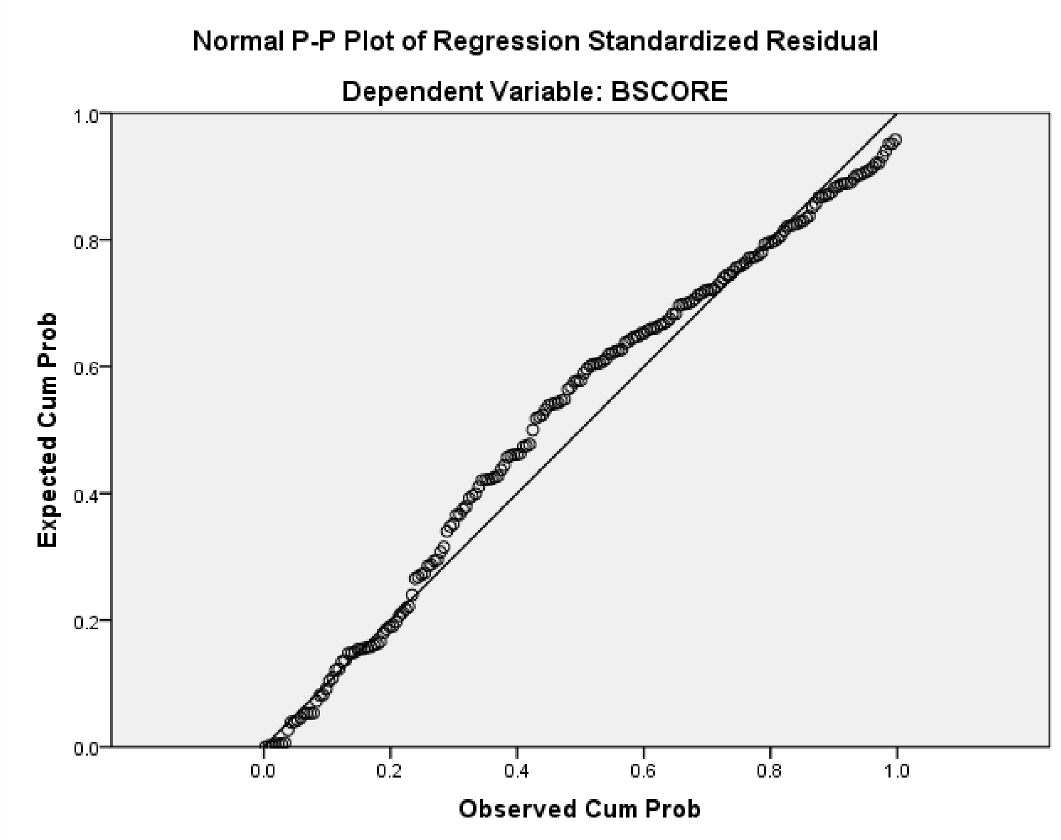

Figure 4.1 Normal P-P Plot

One of the methods to see the normality of residuals is to look at the graph of 'normal probability plot' that compares the cumulative distribution of the normal distribution. If the data are spread around the diagonal line and follow the direction of the diagonal line, then the assumption of normality is met.

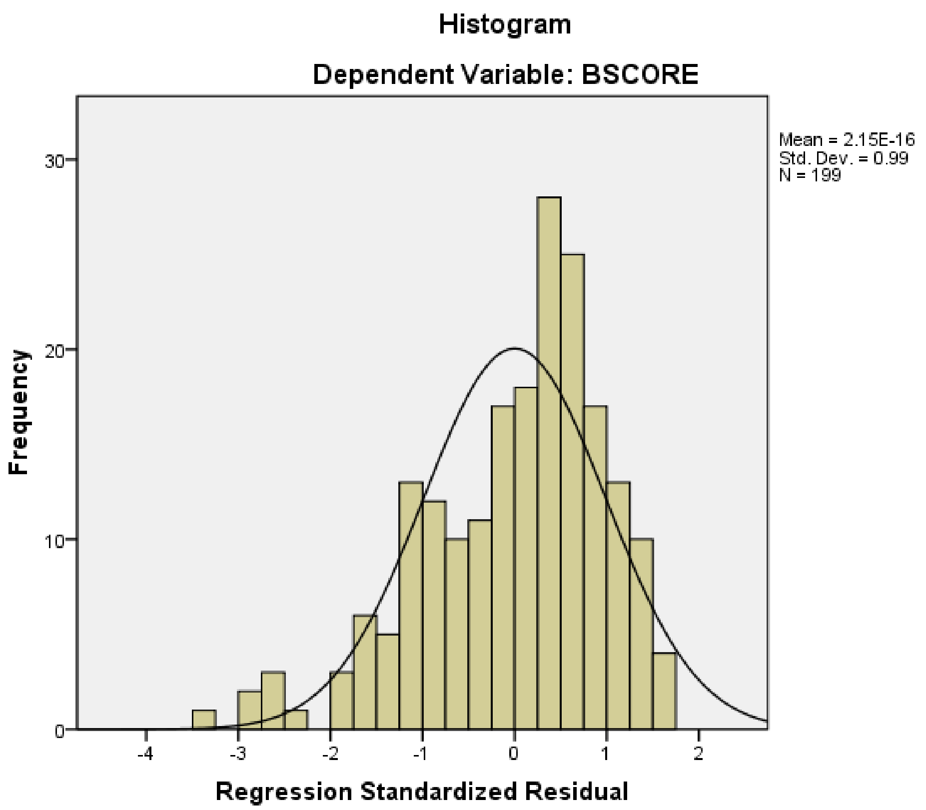

Figure 4.2 Histogram

From the figure above, it seems that the distribution is not symmetrical, in other words, is skewed. There are two peaks that can be seen here in this plot; a taller primary peak and lower secondary peak. But because the large amount of samples used in this research, this anomaly can be waived.

4.3.2. Autocorrelation Analysis

Also in the Table 4.11 below, you can see the Durbin-Watson point for the model. From the model summary table, by using the PASW Statistics 18 program the Durbin-Watson score is 1.805. The frst examination would suggest that because the 'd' value is close to the perfectly no autocorrelation value of 2, meaning that there is no solid evidence that this model have any autocorrelation or not. Later reffering to the book that was authored by Gujarati (1992), from the table below that this value is closer to d = 2 rather than d = 0. This suggested that the this model is inclined towards having no autocorrelation problems occuring.

Finally, with 3 independent variables for this model and using a 5% significance level, it is shown in the Durbin-Watson table, the lower critical value is 1.738, and 1.799 for the upper critical value. This goes to show that the model have no autocorrelation occurring.

Table 4.9 Durbin-Watson Theory of Autocorrelation

Value of ρ	Value of d (approx.)
ρ = -1 (perfect negative correlation)	d = 4
ρ = 0 (no autocorrelation)	d = 2
ρ = 1 (perfect positive correlation)	d = 0

Source: Gujarati, D. (1992). Essentials of Econometrics. *McGraw-Hill*, International Edition.

4.3.3. Multicollinearity Test

By further examining Table 4.10, we can also have a result for the multicollinearity test by looking at the tolerance and VIF score of each variable. In a regression analysis, if the tolerance is above 0.10 and the VIF score is below 10, we can conclude that there is no multicollinearity occurring in the regression model. Now if you look at the table above, all of the variables indicate that there are no multicollinearity occurring between the variables in the model.

Table 4.10 Collinearity

Model	Collinearity Statistics	
	Tolerance	VIF
(Constant)		
DFAMOWN	.819	1.221
GWTHOPP	.753	1.328
PROPEXPAT	.841	1.189
SIZE	.679	1.473

Source: SPSS Output

4.3.4. Heteroscedasticity Test

As previously mentioned, heteroscedasticity test aims to test whether in the regression model the variance of the residual inequality occurs from one observation to another. By looking at the scatterplot of the samples used for this research, we can see whether or not this model has heteroscedasticity problems or not.

Further observation of the scatterplot shows that this research model is free form heteroscedasticity problems, because there are no foreseeable patterns that can be pointed out in the plot.

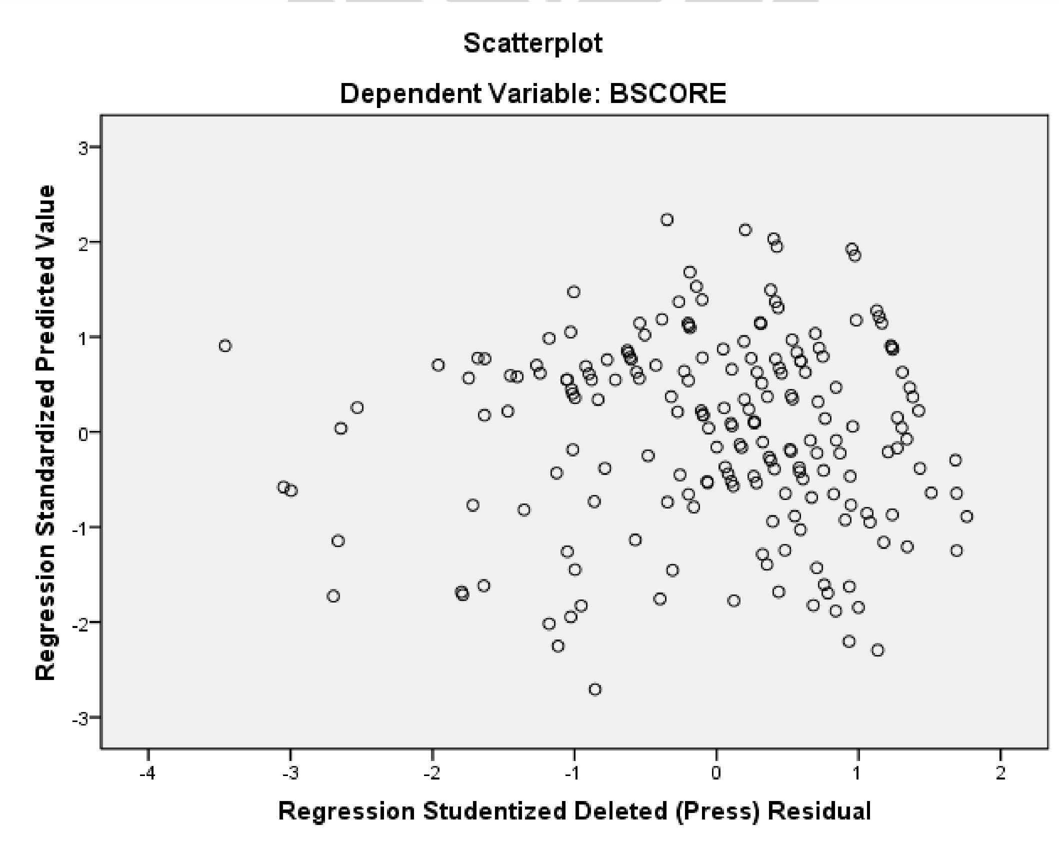

Figure 4.3 Scatterplot

4.3.5. Goodness of Fit Test (Adjusted R^2)

Table 4.11 Models Summary Output

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.276	.076	.057	5.91700	1.805

Source: SPSS Output

From this table, the Adjusted R Square point for the model is 0.035, meaning that the independent variables can explain the BSCORE variable as much as 5.7%, and the other 94.3% can be explained by other variables not mentioned in the model. This goes to show that the BSCORE variable as the dependent variable can be affected by many things outside the mentioned independent variables that are used in the research (family ownership, growth opportunity, company size, and the proportion of expatriate members of the board). With this in mind, it is safe to say that even if the model of this research is significant, or in other words valid, there are still so many factors that can contribute to the performance of the board of commissioners of a company in Indonesia.

4.3.6. Model Significance Test (F-Test)

The statistical analysis is done by using a computer program called PASW Statistics 18. The ANOVA analysis can show if the model is valid statistically or not by examining the significance level of the model.

Table 4.12 ANOVA Output

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	558.147	4	139.537	3.986	.004
Residual	6792.115	194	35.011		
Total	7350.262	198			

Source: SPSS Output

The table above shows that the model has a significance point of 0.004. This is much lower than the required 0.05 point for a model to be valid with a

95% confidence level, which means that the model used in the statistical analysis of this research seems to be valid.

4.3.7. Significance Test (t-Test)

The coefficient table can help to see further into the model and analyze individually each variables. The significance point for each of the independent variables of DFAMOWN (family owned company), SIZE (size of the company), GWTHOPP (growth opportunity of the company), and PROPEXPAT (proportion of expatriate members) are 0.037, 0.020, 0.587, and 0.633 respectively. From this result, we can conclude that in a confidence level of 95%, the SIZE and DFAMOWN variables have a significant affect towards the BSCORE variable. This is because the significance point of the SIZE and DFAMOWN variables are under 0.05, therefore; the other independent variables don't seem to have the same significant affect towards the BSCORE variable.

Table 4.13 Significance of Each Variable

$$BSCORE = \beta_0 + \beta_1 DFAMOWN + \beta_2 GWTHOPP + \beta_3 PROPEXPAT$$

$$+\beta_4 \text{SIZE} + \mathcal{E}$$

Model	Expected Sign	Unstandardized Coefficients	t	Sig.
		B		
(Constant)		28.625	4.74	0.000
DFAMOWN	+	-2.063	-2.1	0.037 **
GWTHOPP	+	-0.092	-0.5	0.587
PROPEXPAT	+	1.103	0.48	0.633
SIZE	+	0.529	2.34	0.020 **

** significant on an $\alpha = 5\%$ (one-tailed)

Source: SPSS Output

4.4. Hypothesis Test Result Analysis

4.4.1. The Effect of Family Ownership towards the Board of Commissioners Effectiveness Score

From the various tests that has been done above, it seems that that with a confidence level of 95%, or an alpha of 5% ($\alpha = 5\%$), it is able to be concluded that with a significance of 0.037, the DFAMOWN variable is significant to the model of this research. This means that family ownership does indeed have an effect towards the effectiveness of the board. By referring to Table 4.13, it is shown that the DFAMOWN variable has Beta (β) of -2.063. This means that the DFAMOWN variable have a negative effect towards the BSCORE variable as much as 2.063, contrast with the hypothesis.

The theory that family ownership has a negative effect towards the performance of the board of commissioner is align with Fama and Jensen's point of view in 1983, where they have mentioned that combining ownership and control allows concentrated shareholders to exchange profits for private rents. The large family presence would result in some profit from the company is used for personal benefit by the owners itself. This finding also suggest that it seems that family-owned firms in Indonesia although it is not in a business group still have an ineffective board, the same as if it is from a business group. One of the possible explanation of why this happens is because the people that were hired to work inside the company would be from the family itself, thus the board of commissioners would have likely neglect its monitoring function because they were also part of the family and have trusted too much on the people managing the company. The higher the owner-manager's ownership stake in the firm means the lesser the divergence-of-interests, therefore, the less likely monitoring needs to occur (Menon & Williams, 1994).

Study also shows that the divergence of interest between owner-managers and outside investors occurs in family owned firms (Feldmann & Schwarzkopf, 2003). It is highly possible that in a family-owned firm, conflicts between the interest of the family and outsiders would occur.

4.4.2. The Effect of Growth Opportunities of Firms towards the Board of Commissioners Effectiveness Score

As previously mentioned, the growth opportunity of a company is the firm's ability or opportunity to invest in projects which is deemed profitable by the market. Several studies suggest that the higher the growth opportunity of the company, the more likely the company will take serious measures to ensure that the corporate governance in that company to be on top notch. Measures such as dual leadership and independent board members were mentioned by Mak and Roush (2000). Other researchers suggest the otherwise. Table 4.13 shows that the GWTHOPP variable has a Significance point of 0.587. Even with a 90% confidence level, this value is still too high. This finding suggests that in Indonesia, the growth opportunity that a firm is subjected to have no effect on the performance of the board. This is also contradictive to the findings of Gaver and Gaver (1993), and the findings of Smith and Watts (1992), where in their research, it was suggested that that firms with greater growth opportunities adopt mechanisms and corporate policies that better control agency problems.

But because this research conclude that there is no significant relationship between the growth opportunity of a company and the performance of the board, this finding is also contradictive to the negative approach of this matter of growth opportunities towards board performance published by Gaver and Gaver, (1995), which suggest that the greater information asymmetry inherent in high-growth firms increases the potential for wealth transfer from potential investors to inside owners. Previous studies suggest that there is a relation, may it be a positive of a negative one. This research has not been able to prove the findings made by previous studies.

4.4.3. The Effect of Proportion of Expatriate Members in the Board towards the Board of Commissioners Effectiveness Score

The question of which was asked on Chapter 2 and 3 was how much influence does culture have towards the performance of the board? In this research, the culture matter boils down to only one thing, which is the presence of expatriates inside the board. By presence this means the proportion of expatriates to the total number of board member. Arguments from Lehn et al. (2004) suggest that a firm with complex operating and financial structures should benefit more from bringing outsiders with a range of expertise, which is referred to *the scope of operations hypothesis*. Nationalities aside, it is crucial to know if the presence of expatriates have any effect towards the performance of the board of commissioner and the corporate governance of the company from the board point of view.

The result from this research suggests that there are no significant effect that the presence of expatriates has on the corporate governance and board performance. This result is contradictive with the arguments of Lehn et al (2004) and other researchers that conclude the existence of a relationship between the presence of expatriates and the board performance. This research does not argue on the matter that cultures have an effect on team performance, it only argues that based by these findings, it is clear that having expatriate members in the board of commissioners in an Indonesian-based company does not have any significant effect to the performance of the board of commissioners.

4.5. The Effect of Control Variable towards the Board of Commissioners Effectiveness Score

From Table 4.13 it is clearly visible that size does matter. Results show that the SIZE variable can be significant on an alpha (α) as low as 5% or a confidence level of 95%. This is aligned with the assumption that as the size of the company increase, it is more likely to have a better board structure and better performing board. Spence (1974) suggested that when information is imperfect, individuals who possess strong qualities will send signals to distinguish themselves from the others. He also states that information asymmetry exists between company's managers and investors. The bigger the company is, the more exposed it is to the public and therefore the more important its corporate governance is to the company.

Table 4.13 shows that there is a positive relation between the size of the company and the performance of the board. It shows that the Beta (β) for the SIZE variable is 0.529. This means that if the BSCORE rises by 1 point, then the SIZE score will rise by 0.529 points. This result is also aligned with the studies conducted by Mak and Roush (2000), which argued that larger IPO firms facing greater agency problems are more likely to employ boards that are more effective in monitoring managers.

CHAPTER 5

CONCLUSION AND RECOMMENDATION

5.1. Conclusion

This research was based on the notion that the application of good corporate governance through an effective working board would lead to a better financial report. It is understood that corporate governance plays a role towards the performance of the company, and that corporate governance are more or less affected by the performance of the board. This paper was to see whether or not the performance of the board was affected towards the company's growth opportunities, the culture in the board, and the existence of family ownership in the company.

This research uses a scoring system to evaluate the performance of the board based on the board's independency, activities, number of member, and its member's competence. These attributes in a board plays a major role in later defining the performance of the board and how effective the board is in doing their job. This paper does not evaluate the relation between the performance of the board and the performance of the company, which is already assumed to be aligned. The board's effectiveness score would then be subjected to another analysis to find out how the three variables (growth opportunities, culture, and family ownership) relates with the board's performance. The size of the company was also used in this research but not as an independent variable, but rather to be the control variable of this research. This research concludes that two variables were significantly affecting the performance of the board, one independent variable and the control variable. Below are the conclusions that can be taken from this research:

1. In the previous chapter, it was shown that the family ownership dummy variable proves to have a significant affect towards the model. This means that family ownership does have an effect with the performance of the

board. Note that the family ownership in this research means that an entity outside the government, an investment group, or public, owns more than 50% of the company's shares, and the firm is not under or affiliated with any business group. Findings from this paper also suggest that the family owned variable have a negative relation with the performance of the board. In other words, the if the firm is a family owned firm, then the board's performance score would be lower than if the firm was not family owned. This finding supports the studies done by Fama and Jensen (1983), where they suggested that combining ownership and control allows concentrated shareholders to exchange profits for private rents. This view of a negative relation is also shared by Demetz (1983) where he argues that such owners may choose nonpecuniary consumptions and thereby draw scarce resources away from profitable projects. Reffering to the studies made by Hermawan (2009), it seems that family-owned firms in Indonesia although it is not in a business group still have an ineffective board, the same as if it is from a business group.

2. The growth opportunity of a company does not have any significant effect to the effectiveness of the board of commissioners. It was not proven that the higher the growth opportunity a company have, the more effective their board of commissioners is. One possible explanation is that unlike most studies, this research uses samples of Indonesian-based companies. Another possibility is that even though a company was forcasted to have a high growth by the market, the board itself does not view this as a reason to do changes that might benefit the effectiveness of the board.
3. The proportion of expatriates do not have any significant effect to the effectiveness of the board. This paper was not able to prove the significance, contradicting with many of the studies. It is possible, that the culture here in Indonesia is too stagnant to budge or be influenced by the presence of foreigners that brought with them their own culture. Another theory is that foreign members was not able to implement their culture into the board because the wrong approach was taken by them. They assumed that only by bringing their knowledge into the team, in this case the board

of commissioners, they would have the ability to change the culture of the team. This conclusion was taken from a disclosed interview with a consultant of a firm.

4. Results from this paper also suggest that size do matter. Reports from the previous chapter tells that size have a significant role in directing the performance of the board. This is aligned with the 'signaling theory' that was presented by Michael Spence. According to him, when information is imperfect, individuals who possess strong qualities will send signals to distinguish themselves from the others. Larger companies are somewhat more exposed to the public and the government thus making them having to be more compliant to current regulations than smaller companies. So the bigger the company, the more exposed there are, and thus the more important the need is to be viewed as a good company with a good corporate governance which is compliant to the current standards set by the regulators. This signaling is done through the Annual Report of the company, where they can provide information to the investor in order to eliminate the information asymmetry. The other two variables, namely the growth opportunity and the proportion of expatriates, do not have any significant effect to the performance of the board. This finding indicates that regardless of findings from other studies, this paper was not able to prove the significance of growth opportunities and expatriates towards the board's performance despite other researches done on this matter. One possible explanation is that unlike most studies, this research uses samples of Indonesian-based companies. In conclusion, all of the hypotheses previously stated in chapter three are all rejected.

5.2. Research Implications

This research concluded that in Indonesia, family ownership and the financial size of the company, in this case the market value of equity, plays a major role in affecting the performance of the board of commissioners. This research emphasizes on the ownership variable where it was found that companies with a dominant family ownership on the stock such as from a family-owned business can cause the firm to have a less effective board of commissioners than other types of firms. Several implications that might have an effect are:

1. Investors should be more aware about the ownership structure of the company, whether the company is a family-owned firm or not. Even though the agency problem of the company between the owners and manager decrease due to the convergence-of-interest in the family owned firms, the issue of agency problem that would occur between the majority shareholders, in this case the family members, and the minority shareholders, in this case the public, will occur in a family-owned firm. Investors that are not part of the family should be more careful in putting their money inside family-owned firms.
2. Bapepam-LK, acting as regulators in Indonesia, should also pay more attention based on this finding. Strict regulations upon a company's ownership structure should be well built in order to sustain a healthy economy in Indonesia. Paying more attention towards the effectiveness of the board of commissioners of family-owned firms, and creating stricter laws that regulate this matter would prove to be helpful in creating a better economical environment.
3. For the companies that are family-owned, they pay more attention to the effectiveness of its board of commissioners and must ensure that their board of commissioners is effective.

5.3. Research Limitations

There are several limitations in this research that needs to be discussed. These limitation majorly affects the outcome of the research and thus crucial to be understood. These limitations are:

a. The number of samples used in this research for the model analysis is finite. This is because the data was limited to only firms that were listed in the Indonesian Stock Exchange (IDX) and are based in Indonesia. The data was also limited to non-banking or financial institutions. All other business sectors beyond it were taken in to account. The limited number of data was also because the limited availability of the data. Samples were also limited to the selected time frame, between 2006 and 2008. The three year span was considered enough to gather corporate information to successfully run the data.

b. This research is constricted to only five variables being analyzed; one dependent variable, three independent variables, and one control variable. The reason behind the selection of the three independent variables is the abundance of studies and reports available to be built upon. The control variable is a variable held constant in order to assess or clarify the relationship between other variables. As illustrated in the previous chapter, there are still many factors that are to be considered in this research model.
c. The scoring of the board's performance is based upon the dissertation of Hermawan (2009). This scoring system stems from regulations and the IICD Checklist (Indonesian Institute for Corporate Directorship). Even though the checklist was stated reliable when tested using the 'cronbach alpha' test, there are always room for further adjustments.
d. The evaluation of a family owned company is limited by its definition of companies where its shares are held by a single entity or a family outside the government, public, and financial institutions, and also not within any business group. Those proxies can be inaccurately depicting the real ownership structure of a company. Another method is by using OSIRIS to gather further information, but even that may lead to a biased classification.
e. The scoring criteria in for the performance analysis of the sampled companies are limited to three scores; good, fair and poor. This scoring technique can have a biased result caused by the inaccurate scoring by the researcher.

5.4. Recommendations for Further Research

Based on the result of this research, a few recommendations could help for further research on this matter:

a. Further research should dig deeper into the relation between the corporate governance of a company towards its financial health and performance. This research have shown that using samples from an Indonesian-based company might prove to have a different result then many studies previously done by samples outside this population.
b. Further research should focus on expanding the board performance scoring system from a three classification per point, to a five classification per point (ex: good, fairly-good, fair, fairly-bad, bad). This might diminish the effects of a biased input and increase the variation of the results. This might help to get a more diverse data to be analyzed.
c. Further research should consider alternate variables to be used, or adding more variables if necessary. Results from this research shows that the current variable's ability to explain the model is low. By placing more variables into account, would help increase the ability to explain the model.
d. Further research should consider adding more data by increasing the time period of the research. This is to increase the diversification of the sample in order to get a more accurate result on this study.
e. Further research should consider using a more current data. Using a longer and more current time period, hopefully the listed companies should already have reported in their latest Annual Reports that are more compliant to the standards set by Bapepam-LK.
f. Further research should do a survey method for determining the culture variable and not depend only on the nationality of the members inside the board of commissioner.

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Appendix 1: Company List of 2006

No.	Code	Company Name
1	**AIMS**	Akbar Indo Makmur Stimec Tbk
2	**AKRA**	AKR Corporindo Tbk.
3	**ALFA**	Alfa Retailindo Tbk.
4	**AMFG**	Asahimas Flat Glass Tbk.
5	**ANTM**	Aneka Tambang (Persero) Tbk.
6	**ARNA**	Arwana Citramulia Tbk.
7	**ASGR**	Astra Graphia Tbk.
8	**ASII**	Astra International Tbk.
9	**AUTO**	Astra Otoparts Tbk.
10	**BAYU**	Bekasi Asri Pemula Tbk.
11	**BHIT**	Bhakti Investama Tbk.
12	**BIPP**	Bhuwanatala Indah Permai Tbk.
13	**BKSL**	Sentul City Tbk.
14	**BLTA**	Berlian Laju Tanker Tbk.
15	**BMSR**	Bintang Mitra Semestaraya Tbk.
16	**BMTR**	Global Mediacom Tbk.
17	**BNBR**	Bakrie and Brothers Tbk.
18	**BUMI**	Bumi Resource Tbk.
19	**CENT**	Centrin Online Tbk.
20	**CKRA**	Citra Kebun Raya Agri Tbk.
21	**CMNP**	Citra Marga Nushapala Persada Tbk.
22	**CMPP**	Citra Marga Nushapala Persada Tbk.
23	**CPIN**	Charoen Pokphand Indonesia Tbk.
24	**CTRA**	Ciputra Development Tbk.
25	**CTRS**	Ciputra Surya Tbk.
26	**DART**	Duta Anggada Realty Tbk.
27	**DAVO**	Davomas Adadi Tbk.
28	**DILD**	Intiland Development Tbk.
29	**DLTA**	Delta Djakarta Tbk.
30	**DNET**	Dyviacom Intrabumi Tbk.
31	**DOID**	Delta Dunia Petroindo Tbk.
32	**DUTI**	Duta Pertiwi Tbk.
33	**DVLA**	Darya-Varia Laboratoria Tbk.
34	**DYNA**	Dynaplast Tbk.
35	**ELTY**	Bakrieland Development Tbk.
36	**EPMT**	Enseval Putra Megatrading Tbk.
37	**FAST**	Fast Food Indonesia Tbk.
38	**FASW**	Fajar Surya Wisesa Tbk.

39	**GGRM**	Gudang Garam Tbk.
40	**GMTD**	Gowa Makassar Tourism Development Tbk.
41	**HERO**	Hero Supermarket Tbk.
42	**HEXA**	Hexindo Adiperkasa Tbk.
43	**HITS**	Humpuss Intermoda Transportasi Tbk.
44	**HMSP**	HM Sampoerna Tbk.
45	**INAF**	Indofarma Tbk.
46	**INCO**	International Nickel Indonesia Tbk.
47	**INDF**	Indofood Sukses Makmur Tbk.
48	**ISAT**	Indosat Tbk.
49	**ITTG**	Leo Investments Tbk.
50	**JIHD**	Jakarta International Hotel & Development Tbk.
51	**JRPT**	Jaya Real Property Tbk.
52	**KARK**	Dayaindo Resources International Tbk.
53	**KIJA**	Kawasan Industri Jababeka Tbk.
54	**KLBF**	Kalbe Farma Tbk.
55	**KPIG**	Global Land Development Tbk.
56	**LAMI**	Lamicitra Nusantara Tbk.
57	**LMAS**	Limas Centric Indonesia
58	**LPCK**	Lippo Cikarang Tbk.
59	**LPKR**	Lippo Karawaci Tbk.
60	**LPLI**	Lippo E-Net Tbk.
61	**LTLS**	Lautan Luas Tbk.
62	**MAMI**	Mas Murni Indonesia Tbk.
63	**MBAI**	Multibreeder Adirama Tbk.
64	**MDLN**	Modernland Realty Tbk.
65	**MDRN**	Modern Internasional Tbk.
66	**MEDC**	Medco Energy Tbk.
67	**MERK**	Merck Tbk.
68	**META**	Nusantara Infrastructure Tbk.
69	**MIRA**	Mitra Rajasa Tbk.
70	**MITI**	Mitra Investindo Tbk.
71	**MLPL**	Multipolar Tbk.
72	**MPPA**	Matahari Putra Prima Tbk.
73	**MTSM**	Metro Supermarket Realty Tbk.
74	**OMRE**	Indonesia Prima Property Tbk.
75	**PBRX**	Pan Brothers Tbk.
76	**PLIN**	Plaza Indonesia Realty Tbk.
77	**PNSE**	Pudjiadi & Sons Estate Tbk.
78	**PTRA**	New Century Development Tbk.

79	**PTRO**	Petrosea Tbk.
80	**PWON**	Pakuwon Jati Tbk.
81	**RALS**	Ramayana Lestari Sentosa Tbk.
82	**RBMS**	Ristia Bintang Mahkota Sejati Tbk.
83	**RIGS**	Rig Tenders Indonesia Tbk.
84	**RIMO**	Rimo Catur Lestari Tbk.
85	**RODA**	Royal Oak Development Asia Tbk.
86	**SDPC**	Millenium Pharmacon International Tbk.
87	**SHID**	Hotel Sahid Jaya Tbk.
88	**SIIP**	Suryainti Permata Tbk.
89	**SIMM**	Surya Intrindo Makmur Tbk.
90	**SMAR**	SMART Tbk.
91	**SMCB**	Holcim Indonesia Tbk.
92	**SMDM**	Suryamas Dutamakmur Tbk.
93	**SMDR**	Samudera Indonesia Tbk.
94	**SMRA**	Summarecon Agung Tbk.
95	**SONA**	Sona Topas Tourism Industry Tbk.
96	**SSIA**	Surya Semesta Internusa Tbk.
97	**TCID**	Mandom Indonesia Tbk.
98	**TGKA**	Tigaraksa Satria Tbk.
99	**TINS**	Timah (Persero) Tbk.
100	**TKGA**	Toko Gunung Agung Tbk.
101	**TLKM**	Telekomunikasi Indonesia (Persero) Tbk.
102	**TMPI**	AGIS Tbk.
103	**TMPO**	Tempo Inti Media Tbk.
104	**TSPC**	Tempo Scan Pacific Tbk.
105	**TURI**	Tunas Ridean Tbk.
106	**UNIC**	Unggul Indah Cahaya Tbk.
107	**UNSP**	Bakrie Sumatra Plantation Tbk.
108	**UNTR**	United Tractors Tbk.
109	**UNVR**	Unilever Indonesia Tbk.
110	**VOKS**	Voksel Electric Tbk.
111	**WAPO**	Wahana Phonix Mandiri Tbk.
112	**WICO**	Wicaksana Overseas International Tbk.
113	**ZBRA**	Zebra Nusantara Tbk.

Appendix 2: Company List of 2007

No.	Code	Company Name
1	**AIMS**	Akbar Indo Makmur Stimec Tbk
2	**AKRA**	AKR Corporindo Tbk.
3	**ALFA**	Alfa Retailindo Tbk.
4	**ANTM**	Aneka Tambang (Persero) Tbk.
5	**ASGR**	Astra Graphia Tbk.
6	**ASII**	Astra International Tbk.
7	**BHIT**	Bhakti Investama Tbk.
8	**BIPP**	Bhuwanatala Indah Permai Tbk.
9	**BKSL**	Sentul City Tbk.
10	**BLTA**	Berlian Laju Tanker Tbk.
11	**BMSR**	Bintang Mitra Semestaraya Tbk.
12	**BMTR**	Global Mediacom Tbk.
13	**BUMI**	Bumi Resource Tbk.
14	**CENT**	Centrin Online Tbk.
15	**CKRA**	Citra Kebun Raya Agri Tbk.
16	**CMNP**	Citra Marga Nushapala Persada Tbk.
17	**CPIN**	Charoen Pokphand Indonesia Tbk.
18	**CTRA**	Ciputra Development Tbk.
19	**CTRS**	Ciputra Surya Tbk.
20	**DART**	Duta Anggada Realty Tbk.
21	**DILD**	Intiland Development Tbk.
22	**DNET**	Dyviacom Intrabumi Tbk.
23	**DUTI**	Duta Pertiwi Tbk.
24	**ELTY**	Bakrieland Development Tbk.
25	**EPMT**	Enseval Putra Megatrading Tbk.
26	**FAST**	Fast Food Indonesia Tbk.
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28	**HERO**	Hero Supermarket Tbk.
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31	**HMSP**	HM Sampoerna Tbk.
32	**INCO**	International Nickel Indonesia Tbk.
33	**ISAT**	Indosat Tbk.
34	**ITTG**	Leo Investments Tbk.
35	**JIHD**	Jakarta International Hotel & Development Tbk.
36	**JRPT**	Jaya Real Property Tbk.
37	**KIJA**	Kawasan Industri Jababeka Tbk.
38	**KLBF**	Kalbe Farma Tbk.

39	**KPIG**	Global Land Development Tbk.
40	**LAMI**	Lamicitra Nusantara Tbk.
41	**LPCK**	Lippo Cikarang Tbk.
42	**LPKR**	Lippo Karawaci Tbk.
43	**LPLI**	Lippo E-Net Tbk.
44	**LTLS**	Lautan Luas Tbk.
45	**MAMI**	Mas Murni Indonesia Tbk.
46	**MBAI**	Multibreeder Adirama Tbk.
47	**MDLN**	Modernland Realty Tbk.
48	**MDRN**	Modern Internasional Tbk.
49	**MEDC**	Medco Energy Tbk.
50	**META**	Nusantara Infrastructure Tbk.
51	**MIRA**	Mitra Rajasa Tbk.
52	**MITI**	Mitra Investindo Tbk.
53	**MLPL**	Multipolar Tbk.
54	**MPPA**	Matahari Putra Prima Tbk.
55	**MTSM**	Metro Supermarket Realty Tbk.
56	**OMRE**	Indonesia Prima Property Tbk.
57	**PLIN**	Plaza Indonesia Realty Tbk.
58	**PNSE**	Pudjiadi & Sons Estate Tbk.
59	**PTRA**	New Century Development Tbk.
60	**PTRO**	Petrosea Tbk.
61	**PUDP**	Pudjiadi Prestige Limited Tbk.
62	**PWON**	Pakuwon Jati Tbk.
63	**RALS**	Ramayana Lestari Sentosa Tbk.
64	**RBMS**	Ristia Bintang Mahkota Sejati Tbk.
65	**RIGS**	Rig Tenders Indonesia Tbk.
66	**RIMO**	Rimo Catur Lestari Tbk.
67	**RODA**	Royal Oak Development Asia Tbk.
68	**SDPC**	Millenium Pharmacon International Tbk.
69	**SIIP**	Suryainti Permata Tbk.
70	**SMDM**	Suryamas Dutamakmur Tbk.
71	**SMDR**	Samudera Indonesia Tbk.
72	**SONA**	Sona Topas Tourism Industry Tbk.
73	**SSIA**	Surya Semesta Internusa Tbk.
74	**TCID**	Mandom Indonesia Tbk.
75	**TGKA**	Tigaraksa Satria Tbk.
76	**TKGA**	Toko Gunung Agung Tbk.
77	**TLKM**	Telekomunikasi Indonesia (Persero) Tbk.
78	**TMPI**	AGIS Tbk.
79	**TMPO**	Tempo Inti Media Tbk.

80	**TURI**	Tunas Ridean Tbk.
81	**UNTR**	United Tractors Tbk.
82	**UNVR**	Unilever Indonesia Tbk.
83	**VOKS**	Voksel Electric Tbk.
84	**WAPO**	Wahana Phonix Mandiri Tbk.
85	**WICO**	Wicaksana Overseas International Tbk.
86	**ZBRA**	Zebra Nusantara Tbk.

Appendix 3: Scoring Method for BSCORE

A. Board Independency

1. The proportion of independent members in the board: the higher the proportion of independent board members will result in a higher monitoring effectiveness of the board, because independent board members are to be more objective in doing the evaluation of the management's performance. BEI (*Bursa Efek Indonesia*, Indonesia Stock Exchange) have defined that the number of independent board member must be the minimum of 30% from the whole number of board member. Then the criteria for this research is:
    a. Good: if the number of independent board member is above 50% of the total number of member.
    b. Fair: if the number of independent board member is between 30% and 50%.
    c. Poor: if the number of independent board member is below 30%.
2. The chairman of the board is independent: as the chairman of the board, he/she will have the authority of making the final decision in the board meeting, so the influence of the chairman is higher compared to other members of the board. Hopefully the decisions that were made by an independent chairman will be more objective and will not side to any party. Then the criteria for this research is:
    a. Good: if the chairman of the board is in fact an independent member of the board.
    b. Poor: if the chairman of the board is in fact not an independent member of the board.
3. Annual Report of the firm reveals the definition of independency for the independent board members: the definition of independent needs to be understood clearly by every company as defined by BEI or Bapepam and LK (*Lembaga Keuangan*, Financial Institution). The criteria for the research is:

a. Good: if the statement of independency of the member of the board are in conformity with the definitions defined by BEI, Bapepam and LK.
b. Poor: if the statement of independency of the member of the board are not in conformity with the definitions defined by BEI, Bapepam and LK.

4. The proportion of board members that works in stock owning companies or affiliated companies: stock owning companies usually chose people who work in the company or its affiliating company to be the board member of the company which is owned by the stock owning company. This can reduce the effectiveness in the board's role of monitoring because that person who was chosen will act upon the interest of the stock owning company and not the company itself. The scoring criteria is:
   a. Good: if the proportion of board members who also works in the stock owning company or affiliating company is no more than 30%. This limit is based from the BEI regulation in which it limits the number of independent board member a minimum of 30%. So if the number of a non independent member, who are also an employee of the affiliating firm is less than 30%, it is considered still good for it does not exceed the proportion of independent board member.
   b. Fair: if the proportion of the mentioned board member is between 30% - 50%. This number illustrates the proportion that is not favorable for the independency of the board, even though it isn't fatal yet because the non independent member does not reach majority.
   c. Poor: if the proportion of the mentioned board member is above 50%, in which it had reached the majority of the board member and drastically reduces the independency of the board.
5. Companies that already have a nomination committee and a remuneration committee in the corporate governance element: in the

conduct of corporate governance, a company is hoped to having several committees that could help the implementation of corporate governance effectively. The presence of a nomination committee is expected to help in the choosing of an independent and professional board member. The remuneration committee has a duty of determining the magnitude of remuneration that is suitable for the board, and is expected to help create an effective and working board of director. Scoring criteria:

a. Good: if the company has a nomination committee and remuneration committee. Companies that already has two of these committees are expected to have a more independent board and effective
b. Fair: if the company has only one of the mentioned committee, the remuneration committee or a nominating committee.
c. Poor: if the company has none of the mentioned committee.

6. Long served as a board of commissioners in the respective companies: the longer board members served on a company can result in the reduction of the objectivity and independence of the board in doing their function. Anderson et al. (2004) found that board tenure which is measured from the average number of board members who served on the board of directors at the company have a positive and significant impact on the cost of debt. Cost of debt is a proxy from the creditor's perception towards the implementation of corporate governance for companies. From this result, we can conclude that the longer the board tenure, the management's ability to influence the opinions board of directors in making decisions increases, so the role of board of directors in corporate governance as increasingly ineffective, and more not independent.

   The serving period of the board member in Indonesia varies, and it depends on the policy of the company. Generally the serving period is between 3 and 5 years. The serving period of 5 years is set for companies conforming to the regulations in Indonesia PP No.12 of 1998. The criteria for scoring:

a. Good: if the average serving period of the members is 5 years.
b. Fair: if the average serving period of the members is from between 5 to 10 years.
c. Poor: if the average serving period of the members is above 10 years.

B. Activities of The Board

7. Companies states clearly the responsibilities of the board: if the duties and the responsibilities of the board are stated clearly, then the board should be able to do their duties better in which is what is hoped for from the company. The scoring criteria:
   a. Good: if the company states clearly the duties and responsibilities of the board.
   b. Poor: if the company didn't state clearly the duties and responsibilities of the board.
8. The number of meetings held in one year: in doing their function the board has to conduct routine meetings, whether with the members of the board of commissioner, or with the board of directors. An active functioning board of commissioners can be shown on the numbers of meetings are held. From the samples gathered, the most frequent meetings held by the board are 6 times in a year, the second most frequent is 4 times in a year. Based of those data, the criteria for the this scoring is:
   a. Good: if the board held meeting for more than 6 times in a year.
   b. Fair: if the board held meetings from between 4 to 6 times in a year.
   c. Poor: if the board held meeting below 4 times in a year.
9. The number of member presence in meetings in a year: the level of presence of the board shows how active the members are in doing their duties as a member. There are many studies that tests the activities of

the board by analyzing only the number of meetings held, but overlooking the level of presence in a meeting. The limitations for this criterion will be based by the criteria used by the IICD. The scoring criteria is:

a. Good: if the level of presence of board member in meetings held in one year averaged more than 80%.
b. Fair: if the level of presence of board member in meetings held in one year averaged from between 70% to 80%.
c. Poor: if the level of presence of board member in meetings held in one year averaged below 70%.

10. The board evaluates the financial report of the company: one of the duties of the board of commissioners is to evaluate how management runs the company. Financial reports is one of the source of information on how the company is performing under the management which is used by public and who are concerned with the company. So the scoring criteria is:
    a. Good: if in the annual report the board of commissioners gave statements about the evaluation of the financial report of the company.
    b. Poor: if in the annual report the board of commissioners didn’t gave statements about the evaluation of the financial report of the company.
11. The board evaluates the performance of the management yearly: the board has duties of monitoring the performance of the management, so the board has to evaluate the performance of the management as the year goes. The scoring criteria is:
    a. Good: if in the annual report the board of commissioners gave statements about the performance of the management.
    b. Poor: if in the annual report the board of commissioners didn’t give any statements about the performance of the management.
12. The board conducts scoring on the business prospect that is proposed by the management: the board must be able to ensure that the

management has done correct strategic planning that will ensure the continuity of the life and long term performance of the company. The scoring criteria is:

a. Good: if in the annual report the board gave statements about the evaluation on the business prospect of the company which is prepared by the management.
b. Poor: if in the annual report the board didn't give any statements about the evaluation on the business prospect of the company which is prepared by the management

C. The Size of the Board of Commissioner

13. The number of members in the board: studies show that the higher the number of board members in the company would result in a lower market value of the company. The less the number of members will push each individual member to be more responsible towards doing their duties (Yermack, 1996). Other studies shows that too few board member also have weaknesses, which is there are too few people to cover the duties of the board. Based on the dissertation of Ancella Hermawan, the scoring criteria is:
    a. Good: if the number of member is from 5 to 10 members.
    b. Fair: if the number of member is between 11 to 15 members.
    c. Poor: if the number of member is from 16 members and above.

D. The Competence of the Board of Commissioners

14. The proportion of competent members with knowledge in finance and accounting: to be able to evaluate and analyze effectively the financial report which was made by the management, there needs to be members if the board which has a sufficient knowledge in accounting or finance. Xie et al. (2003) found a negative relation between the background knowledge of the company and finance which is possessed by the board of directors and earnings management. Chtouro et al. (2001) also found that the capability of the board of directors to limit earnings

management is determined by the competence in finance. Scoring criteria:

a. Good: if the proportion of the board of commissioner which has a background in studying or working in the field of accounting and finance is more than 50%.
b. Fair: if the proportion of the board of commissioner which has a background in studying or working in the field of accounting and finance is from 30% to 50%.
c. Poor: if the proportion of the board of commissioner which has a background in studying or working in the field of accounting and finance is less than 30%.

15. Proportion of the members that has experience in business, which has an experience as a company's board member including the current company, or a CEO in another company: to be able to do their jobs effectively, the members of the board is expected to have a sufficient amount of experience in the business world and corporate governance. Chen et al. (2006) found that chairman of the board which has little previous experience will have little ability to detect fraud. In this research the measurements of experience is expanded and is not applied only for the chairman. The scoring criteria is:
    a. Good: if the proportion of members who have a previous experience as a member of the board of a company, including the current one, or has an experience of being a CEO in another company is more than 50%.
    b. Fair: if the proportion of members who have a previous experience as a member of the board of a company, including the current one, or has an experience of being a CEO in another company is from 30% to 50%.
    c. Poor: if the proportion of members who have a previous experience as a member of the board of a company, including the current one, or has an experience of being a CEO in another company is less than 30%.

16. The proportion of members inside the board which has a adequate knowledge in the business of the company: to be able to monitor and give evaluations for the performance of the management effectively, the board of commissioners must understand the characteristics of the business that the company is involved in. Beasley (1996) found that the longer the period of an outside independent director is a member of the board, there is less chance of a financial fraud to happen. This could be because of the longer the independent outside director serves in the board for the company, the greater the understanding of the business of the company he/she will have. In this research, the understanding of the business of the company is considered a must have for the members of the board to become more effective. The commissioners must understand the business of the company when he/she have been serving in the company for more than 1 year. The scoring criteria:
    a. Good: if the proportion of the board member that have a sufficient amount of knowledge on the business of the company is more than 50% of the total number of members in the board.
    b. Fair: if the proportion of the board member that have a sufficient amount of knowledge on the business of the company is between 30% - 50% of the total number of members in the board.
    c. Poor: if the proportion of the board member that have a sufficient amount of knowledge on the business of the company is less than 30% of the total number of members in the board.
17. The average age of the members of the board: the experience and skill of a person generally depends on the age of the person. Anderson et al. (2004) studies the experience of business of the board member by using the average of age of all the members of the board. In this research, the average age of the members of the board will be used as a

proxy of competence and skill which is possessed by the board of commissioners of the company. The criteria for scoring:

a. Good: if the average age of the board members are above 40 years old.
b. Fair: if the average age of the board members are between 30 and 40 years old.
c. Poor: if the average age of the board members are younger than 30 years old.