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The governance mechanism's influence to fulfill Sharia criteria and the cash placement

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Abstract

This study aims to determine the effect of corporate governance mechanisms on the fulfillment of Sharia stock criteria in companies incorporated in the ISSI as well as on the tendency of corporate cash arrangement at financial institutions via comparative quantitative research methods. The result shows that there is a significant influence on the board of directors on the placement of cash in conventional banks. In conclusion, the board of commissioners should have the same views as the representatives of the owners to place the company's cash on a non-usury-based financial institution.

Keywords: Corporate Governance Mechanisms, Boards Of Commissioners.

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La influencia del mecanismo de gobierno para cumplir con los criterios de la Sharia y la colocación de efectivo

Resumen

El objetivo de este estudio es determinar el efecto de los mecanismos de gobierno corporativo en el cumplimiento de los criterios de acciones de la Sharia en las compañías incorporadas en el ISSI, así como en la tendencia del acuerdo de efectivo corporativo en las instituciones financieras a través de métodos de investigación cuantitativa comparativa. El resultado muestra que existe una influencia significativa en la junta directiva sobre la colocación de efectivo en bancos convencionales. En conclusión, la junta de comisionados debe tener las mismas opiniones que los representantes de los propietarios para colocar el efectivo de la compañía en una institución financiera no basada en usura.

Palabras clave: Mecanismos de Gobierno Corporativo, Juntas de Comisarios.

1.INTRODUCTION

The most frequently discussed study in Islamic finance is about Islamic financial institutions, both in the form of banks and other financial institutions. Very few articles that discuss sharia companies or companies designated as sharia companies by authorized institutions. Given that companies engaged in the real sector have relationships with financial institutions, especially banks, this study raises the issue of corporate governance appointed as a sharia company by the Otoritas Jasa Keuangan (OJK) which subsequently incorporated in Indonesia Sharia Stock Index (ISSI) in the syariah capital market in Indonesia. The issue of corporate governance in Indonesia has only been noticed since the 1997 financial crisis that triggered the establishment of a national committee on Corporate Governance policy in Indonesia in 1999 and later changed to the National Committee on Governance Policy (KNKG), which subsequently published the National Guidelines for Good Corporate Governance in 1999, and revised back in 2001 and 2006, and the KNKG also publishes the Good Governance Guidelines for Sharia Business in 2011 (OJK, 2014).

Corporate governance is needed to encourage the creation of an efficient, transparent and consistent marketplace with applicable regulations and must be implemented by every company in every aspect of business and in all levels of the company, although corporate governance standards cannot be applied consistently to different corporate structures (Abdallah & Ismail, 2016). Corporate governance is very important when there is a separation between ownership and control of the company, especially companies with many shareholders (Rose, 2016). This is understandable given that according to agency theory, there will always be a conflict of interest between management and the owner of the company. Corporate governance serves to try to minimize the conflict of interest between shareholders and managers as a form of protection against shareholders. This study contributes in several aspects. The first aspect, this study seeks to capture how the existing corporate governance mechanisms play a role in meeting the criteria of Shari'a stocks, which are total debt based on usury and unlawful income, which is determined by OJK which so far, to the knowledge of the author, has not been touched by other researchers. This study also tries to see how the role of corporate governance mechanism in choosing the bank used to store the company's cash. This is related to the fulfilment of the second syariah stock criterion, which is unlawful income, which comes from deposits in interest-based banks. The understanding of the role of corporate governance mechanisms, we believe, can provide clues about what is important for a company that is appointed as a sharia company to meet the objectives of sharia companies.

2.LITERATURE REVIEW

Corporate governance relates to the maximization of the general interest of a network of factors that interact with operations, organization and the interrelationship of the goals and objectives of the enterprise (Choudhury & Alam, 2013). The OECD definition states that corporate governance involves a series of relationships between corporate management, the board of directors, shareholders and other stakeholders. Corporate governance also provides the structure, through which such a structure, the company's objectives are established, and the means to achieve the objectives and performance of such monitoring are determined. The design of corporate governance mechanisms is largely focused on mitigating or resolving stakeholder manager conflicts in the context of widely held companies (Aguilera & Crespicladera, 2016). To be able to align the interests of managers and shareholders, shareholders should play an active role. If this is not met, then corporate governance mechanisms are used to reduce the difference in interests between shareholders, who are the owners of the company, with managers, as agents running the operations of the enterprise.

2.1 Board size

The board of commissioners is collectively responsible for supervising and advising the Board of Directors and ensuring that GCG is implemented. Board of commissioners shall not participate in operational decision making. The Board of Directors is collegially responsible for managing the company consisting of management functions, risk management, internal control, communication and social responsibility. The size of the board has an influence on the level of supervision, monitoring, and disclosure. The greater the number of members of the board will benefit the value of the company, because of the combination of members who have their own expertise from various fields. This will provide an opportunity for better corporate governance and increase investor confidence to invest funds in the company. Jaradat states that companies should have effective boards in planning and funding decisions.

It can be argued that the size of a large council will not necessarily add value to the company if the council does not work effectively in planning and funding. Thus it can be said that the size of the board will have a positive influence on the level of debt of the company due to investor security towards the existing council members. Akbari dan Rahmani states that there is a significant negative relationship between the composition of the board and the capital structure. Supervision of the board of commissioners will enable managers to work effectively and efficiently to raise funds at low risk.

2.2 Debt Level

In the capital structure, one of its formers is a debt that can be referred to as funds obtained from other parties, either financial institutions or other related parties, who are willing to invest funds in the company with certain rewards. High debt levels will increase the stock price to a certain point, the increase in debt after passing this point will result in the decreased of company value because the benefits obtained are not balanced with the costs incurred. The owner of the company represented by the board of commissioners will seek to reduce the debt to some extent to increase the value of the company. In the context of sharia companies in Indonesia, the use of debt on a basis of interest, is limited to 45% of its total assets. Thus the owner of the company, with the assumption of knowing and implementing these restrictions, will provide strict supervision of the manager to keep the interest-based debt level held by the company not exceeding that limit.

2.3 Non Permissible Income (NPI)

Spitzer argues that a company's performance appraisal is actually a way of looking at a company's operational results based on a particular point of view. In the view of Islam, companies not only have the goal of making a profit but also have a social purpose and the objectives of the company in gaining profits must be in accordance with the boundaries and rules of sharia and this is a fundamental goal for Muslim entrepreneurs. In this framework, OJK implements rules that limit the amount of non-permissible income, which is income earned by companies derived from unlawful income, such as interest income, amounting to 10% of the total revenue of the company. Interest income will be earned by the company when the company saves its funds in a conventional bank based on interest. In this case, there is no compulsion for the company to keep its funds in a sharia-based bank or financial institution. Thus, the company's fund-storage policy will be the full authority of the company's executive director under the supervision of the board of commissioners. The board of commissioners, as representatives of the owners of the company, will surely oversee the board of directors in order to keep the funds in store not earning interest in excess of 10% of total revenue. The assumption used is that the owner of the company will try to keep his company included in the company that is declared sharia.

2.4 Selection of Bank

Currently, there are two types of banks in Indonesia, namely conventional banks based on interest and Islamic banks that operate according to Islamic rules. The development of sharia banking until now still cannot approach the development of conventional banking (Mursid & Suhartono, 2014). There are fundamental differences in sharia and conventional banking operations. Islamic banking operates on the basis of Islamic principles contained in qur'an and hadith, which in this banking is not allowed to happen riba, while conventional banks operate based on usury-based loans. Based on this principle, if the company keeps the company's cash in conventional banking, the company will earn income based on usury, which means it will increase the unlawful income, whose value is limited to 10% of the total revenue of the company. Conversely, if the company is using sharia banking, the income earned from this deposit will not be included in the unlawful income. Thus, if the company has been established as a sharia company, it will increase the relationship with sharia banking and reduce the relationship with conventional banking. This is logical, given that the addition of conventional banks will increase the company's NPI and vice versa.

2.5 Hypothesis

Based on the above description, the proposed hypothesis is as follows:

H1: All sharia companies have interest-bearing debt at a maximum of 45% of their total assets and have a maximum NPI of 10% of their total revenues.

H2: Board of commissioners and board of directors have an influence on the level of debt and NPI.

H3: The Board of Commissioners and the Board of Directors have an influence on the selection of a depositary bank.

H4: Conventional Banks and Sharia Banks have an influence on NPI.

3. METHODOLOGY

The research approach is quantitative research that is structured research and quantifies data to be generalizable. Based on the level of explanation, this research is associative research, because it is done to know the relationship between two variables or more. The research variables used in this study are the UK (number of boards of commissioners), UD (number of boards of directors), UID (number of independent directors), UIK (number of independent commissioners), TUBTA (ratio of total interest-based debt to total assets), NPI interest income), Bkon (number of conventional banks and Bsya (number of sharia banks). This research contained 970 companies with 194 units incorporated in eight economic sectors, not including financial institutions that conducted for five years from 2012 until 2016. The data source used is the company's annual report. The first hypothesis will be answered by using one sample t-test, by comparing the average TUBTA and NPI against the allowed constraints, ie 45%, and 10% respectively. The second, third and fourth hypothesis will be answered by using panel data regression method with random effects. The equations used are as follows:

$$Y_{it} = \beta_0+\beta_1X_{1it} + \beta_2X_{2it} + \beta_3X_{3it} + \beta_4X_{4it}+\varepsilon \qquad 1)$$

where Yit is the dependent variable, alternately, ie TUBTA, NPI, Bkon and Bsya. The variable X is the independent variable, successively from X1 to X4 are UD UID, UK, and UIK. β is the regression coefficient, i is the notation for the i-th firm and t is the notation for year t.

The fourth hypothesis will be answered by using the following equation:

$$NPI_{it} = \beta_0 + \beta_1 Bkon_{it} + \beta_2 Bsya_{it} + \varepsilon \qquad 2)$$

4.EMPIRICAL RESULT AND DISCUSSION

This section explain the results of descriptive statistical tests and hypothesis testing performe.

Table 1. Descriptive statistic

	UK	UD	UIK	UID	TUBTA	NPI	Bkon	Bsya
Mean	4,31	4,96	1,73	0,40	0,13	0,008	9,86	0,31
Std. Error	0,07	0,07	0,03	0,02	0,00	0,001	0,17	0,03
Std. Deviation	2,22	2,13	1,00	0,55	0,12	0,017	5,40	0,87
Minimum	1,00	1,00	0,00	0,00	0,00	-0,013	1,00	0,00
Maximum	22,00	16,00	8,00	3,00	0,449	0,098	34,00	6,00

UK = number of boards of commissioners, UD = number of boards of directors, UIK = number of independent commissioners, UID = number of independent directors, TUBTA = total ratio of interest-bearing debt to total assets, NPI = interest income divided by total revenue, Bkon = number of banks conventional, Bsya = number of sharia banks.

4.1 Deskriptif

In table 1 there are descriptive statistics for all research variables in general. It appears that the average number of boards of commissioners is 4.31 with a minimum number of 1 and a maximum of 22 persons. The average number of members of the board of directors is 4.95 with a minimum number of 1 and a maximum of 16 persons. In addition, in table 1 it can be seen that not all firms have independent commissioners and directors, where the average number is 1.73 and 0.40 respectively. For total interest-bearing debt, it appears that the average is 0.13 with a minimum value of 0.00 and a maximum of 0.45. The NPI has an average of 0.02 with a minimum value of -0.01 and a maximum value of 0.31. For Bkon, the average value in the can is 9.86, the minimum is 1 and the maximum is 34, while for Bsya, the average value is 0.31, the minimum value is 0 and the maximum value is 6. Based on the results in table 1, it can be said that all the companies that become the sample of this study are feasible to be established into a sharia company because the total debt based on usury and the value of its NPI meets the criteria set by OJK. Conventional banking, still seems to be the choice of companies to save their funds, it can be seen from the average value of conventional banks 9.86, while the average value of Islamic banking is 0.31.

4.2 One-Sample T-Test

Table 2: Result for One-Sample T-test for TUBTA dan NPI

	Test Value = 0.45			
	t	df	Sig. (2-tailed)	Mean Difference
TUBTA	-82.635	970	0.000	-.320567
	Test Value = 0.1			
	t	df	Sig. (2-tailed)	Mean Difference
NPI	-211.535	970	0.000	-.0923926

Table 2 shows the result of the one-sample t-test conducted on TUBTA and NPI. Based on the test results, it appears that all companies have TUBTA and NPI values that are different from their test scores and statistically significant. The average ratio of total debt-based debt to the total asset is lower by 32% compared to defined criteria, while for NPI the difference is 9%. It can be said that the average value of total debt based on usury and NPI that occurred in the field is much smaller than the value that became the criteria for the establishment of sharia companies. Thus it can be concluded that the performance of debt and income unlawfully increased, in the sense that corporate governance is able to meet the criteria required by OJK as a sharia company.

4.3 Panel Data Regression Test

Panel data regression used was a regression with random effect using Eviews 9. Regression test result presented in table 3. It appears that only UID, representing the number of independent directors, has a significant effect on the usury-based debt level. The other three variables have no significant effect on the usury-based debt level. Based on this, there is an indication that when the company is appointed as a sharia company, only independent directors are concerned about the composition of debt held by the company, while other mechanisms have not paid serious attention to the composition of the debt. It deserves attention, given that when the board of directors raises the usury-based debt level beyond the criteria, the company will be scrawled from the list of sharia companies. The board of commissioners should pay serious attention, given that the shares of sharia companies are traded publicly and the owners of the company certainly want the company to remain on the list of sharia companies. For NPI, it appears that none of the variables representing governance mechanisms have a significant effect on NPIs (Anganthi & Uyun, 2019). The absence of significant NPI governance mechanisms does not mean that NPIs have no significance in the criteria of Sharia stocks. One thing worth noting is that the NPI is the result of depositing company funds in conventional banking, where it operates on the basis of returns with pre-determined interest rates. Given that the entire company still keeps its funds in conventional banking, then the NPI will always be found in the company. Based on descriptive data in table 1, it can be said that the tendency is sharia companies still use conventional banking services to store danaya. The size of the interest-based return, of course, follows the bank used. Thus, corporate governance mechanism has no effect on the amount of NPI received. Indirectly, NPI can be regarded as an external factor for sharia companies.

UD, as a variable representing the number of boards of directors, has a significant effect on the selection of conventional banking, while UID, UK, and UIK have no influence on the selection of these conventional banks. As for the selection of sharia banks, it appears that UID has a significant influence, while other variables have no effect. The influence of a significant board of directors on the selection of conventional banking can be said to be the authority of this board member to streamline the company's operations, including the company's risk management. Given that one factor of banking selection is the security of the bank (Ezeh & Nwaizugbo, 2016). The board of commissioners, as representatives of the company owners, does not seem to be paying any serious attention to the placement of the company's funds to a conventional financial institution. This may happen because the value of interest income earned is still much lower than the criteria set by OJK, so the supervision of the selection of financial institutions becomes more negligent than the supervision of usury-based debt. Nevertheless, the control of the owners of the company's management of the face-to-face must be done effectively, in order to avoid asymmetric information related to the appointment of the company as a sharia company. In regression equation (2), it appears that Bkon has a positive and significant effect on NPI, while Bsya has no significant influence. This condition provides an indication that the selection of financial institutions has significance in the fulfillment of financial criteria of sharia companies, namely NPI. The more conventional financial institutions used, the greater the value of interest-based income earned by the company. The role of the board of commissioners becomes very important to oversee this condition.

5. CONCLUSION

This study aims to determine the effect of corporate governance mechanism on the fulfillment of Sharia stock criteria in companies incorporated in the Sharia Sharia Index of Indonesia as well as on the tendency of cash placement companies in financial institutions. Corporate governance mechanisms are represented by the number of boards of commissioners (UK), number of boards of directors (UD), number of independent commissioners (UIK), and number of independent directors (UID). Sharia stock criteria are represented by total usury-based debt to total assets (TUBTA) and non-permissible income (NPI). The cash placement trend is represented by the number of conventional banks and the number of sharia banks

Tabel 3: Panel Data Regression Result (EGLS)

Variabel	TUBTA	NPI	Bkon	Bsya
persamaan (1)				
UD	-0.001261	0.000401	0.21324**	0.00208
	(-0.01544)	(0.000311)	(0.088655)	(0.015091)
UID	0.013358***	0.00007	0.15497	0.058212*
	(0.01251)	(0.000744)	(0.177814)	(0.030907)
UK	0.001302	-0.000535	0.06095	0.00000
	(0.00298)	(0.000383)	(0.113410)	-0.00316
UIK	-0.001064	0.000787	0.157308	(0.019162)
	(0.004112)	(0.000609)	(0.145757)	0.00340
				(0.025186)
Persamaan (2)				
Bkon		0.000282**		
		(0.000115)		
Bsya		-0.000813		
		(0.000687)		

***,**,* significant on α = 1%, 5% dan 10% respectively.

UK = number of boards of commissioners, UD = number of boards of directors, UIK = number of independent commissioners, UID = number of independent directors, TUBTA = ratio of total interest-based debt to total assets, NPI = interest income divided by total revenue, Bkon = number of conventional banks , Bsya = number of sharia banks.

The result of one-sample T-test state that all companies designated as sharia companies do have TUBTA and NPI values in accordance with the criteria set by OJK. The thing to note is that the average TUBTA as a whole is at 13%, while the NPI has an average value of 0.8%. This states that it may be necessary to correct the criteria of sharia stocks stipulated by OJK. Based on the test results using the EGLS panel method there is a significant influence of the board of directors on the placement of cash in conventional banks, while the placement of cash in Islamic banks is influenced by independent directors. Independent directors positively influence TUBTA. For NPI, none of the independent variables has a significant effect. The results of this study indicate the existence of information asymmetry between owners and agents, especially in terms of cash placement in financial institutions. The board of commissioners should have the same views as the representatives of the owners to place the company's cash on a non-usury-based financial institution. Based on the test results using the EGLS panel method there is a significant influence of the board of directors on the placement of cash in conventional banks, while the placement of cash in Islamic banks is influenced by independent directors. Independent directors positively influence TUBTA. For NPI, none of the independent variables has a significant effect. The results of this study indicate the existence of information asymmetry between owners and agents, especially in terms of cash placement in financial institutions. The board of commissioners should have the same views as the representatives of the owners to place the company's cash on a non-usury-based financial institution.

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