DETERMINANT OF CORPORATE GOVERNANCE IMPLEMENTATION QUALITY IN INDONESIA
(Study of Firms Rated by The Indonesian Institute for Corporate Governance)

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Abstract

The purpose of this study is to find empirical evidence whether some variables may affect the quality of corporate governance implementation. This study uses eight independent variables and Corporate Governance Perception Index as dependent variable. The sample used in this research are 189 Indonesian firms rated by the Indonesian Institute for Corporate Governance in the period of 2001-2012 and they must be listed in the IDX. The samples are selected by using nonprobability random sampling (purposive sampling method). This study gives empirical evidence that implementation quality of corporate governance are affected by five variables, the sequencely are the quality of external auditor, regulation factor, firm size, the proportion of independent commissioners board, and profitability. This study enhances some theories related to corporate governance, namely agency theory, agency theory type II, and pecking order theory.

Keywords : Corporate Governance Perception Index, Corporate Governance Implementation, Quality of External Auditor, Regulation, Firm Size, Proportion of Board of Independent Commissioners, Profitability, Leverage, Ownership Concentration, Investment Opportunity Set

Introduction

The limitations of agency theory in solving the agency problem arise the concept of corporate governance which can be seen as the continuation of the agency theory (Ariyoto, 2000 in Darmawati, 2006). Corporate governance is a way to provide confidence in the supplier firm funds for obtaining return on their investment (Shleifer & Vishny, 1997). According to Cadbury (1992), corporate governance is a system for directing and controlling a firm. The Implementation of good corporate governance is further called as Good Corporate Governance.

It is difficult to be denied that over the last ten years, the term Good Corporate Governance (GCG) has gained popularity. It is not only popular but also placed in the top rank due the following reasosn. First, good corporate governance is one of the keys for developing a successful and profitable firm in the long term, as well as for gaining success in the global business competition. Second, the economic crisis in Asia and Latin America are believed to arise due to the failure of the implementation of good corporate governance (Daniri, 2005 in Kaihatu, 2006). Research on Asian financial crisis of 1997-1998 found that weal legal institutions for corporate governance can exacerbate the decline in the stock market in the financial crisis of 1997 (Mitton, 2002). Mitton (2002) found that companies with good corporate governance have better market performance during the Asian financial crisis.

Research on corporate governance suggest that investors have a preference for avoiding companies with poor corporate governance (McKinsey and Co., 2002). Corporate governance has an influence on the operating performance of the firm (Darmawati, 2005) and stock returns (Suranta and Machfoedz, 2003) and is related to the value of the firm (Klapper and Love, 2004). In addition, due to the delegation of authority to management, good corporate governance implementation is favorable to reduce agency cost, i.e. the cost to the shareholders; lower the cost of capital as a result of the healthy and responsible management of the firm, and increase share value, and support for the firm's stakeholders (license to operate) (CGPI, 2008).

Corporate governance issues in Indonesia rose with some recent scandal. One of latest issues is happened in 2012 toward BUMI Plc which owned 25% BUMI resources and 75% Berau Coal Energy. BUMI Plc founded by financier Nat Rothschild and Bakrie company which is the shares is listed in the London Stock Exchange. In 2012, BUMI Plc get reports of serious financial irregularities in the Indonesian operations on the basis of claims made by a whistleblower, major Bumi shareholders were alleged to have siphoned off more than $1bn of assets into other Bakrie family-controlled companies by means of related party transactions. This is cause Bumi's share falling 60% below the IPO price and were suspended from trading in April 2013, following problems in finalising the 2012 accounts. Bumi subsequently reported a pre-tax loss for the year of $2.4bn. (Christopher Thompson and Ben Bland, "Bumi reveals tally for missing payments stands at $201m", *Financial Times*, 31 May 2013). Bumi resources is convicted bankruptly because debt that have to paid and lack of corporate governance implementation.

Meanwhile Corporate Governance Perception Index (CGPI) refers to a ranking of research and implementation of Good Corporate Governance (GCG) to companies in Indonesia through research design that encourages companies improve the quality of the application of the concept of Corporate Governance (CG) through continuous improvement to carry out the evaluation and comparative studies (benchmarking). Research programs and ranking CGPI held since 2001 is an attempt The Indonesian Institute for Corporate Governance (IICG) participation and contribution in promoting good corporate governance practices in Indonesia in order to create ethical, healthy, dignified and sustainable business world.

The companies included in the Corporate Governance Perception Index (CGPI) are companies that have the best quality of corporate governance in Indonesia. The existence of such companies would be an appealing attraction for investors and creditors since the quality of the implementation of GCG has shown to increase the firm's progress through an ever-increasing performance and reliability of the firm. Moreover, implementation of GCG is getting better to remove any suspicion from others as stated in agency theory. In addition, GCG is able to guarantee the company in a sustainabled (preserved) state from an unhealthy business climate (Swa Sembada, 2009:89-104). On the other hand, the companies included in the top ten ranks of the Corporate Governance Perception Index (CGPI) are companies that have the best quality of corporate governance disclosure in Indonesia consisted of 11 CGPI aspects comprising, commitment, transparency. accountability, responsibility, independence, fairness, competence, leadership, strategy, ethics and knowledge management. Results CGPI describes the quality of the implementation of good corporate governance in CGPI participating companies based on the utilization of knowledge and classification of ranked categories wich are very reliable, trustworthy, and fairly reliable.

There are several studies related to the implementation of quality good corporate governance, firm size, leverage, investment opportunities and concentration ownership by using some of the variables of measurement for assessing a firm, among others: Hormati (2009) reveals that firm size affects the quality of corporate governance. Darmawati (2006) discovers the similar findings the same thing that variable firm size has an influence on the quality of corporate governance. This is supported by the research findings of Ulum (2007) which reveals that the firm size positively had significantly influences the quality on the quality of implementation of good corporate governance. Otherwise, Klapper and Love (2004) reveals that the firm size is ambiguous as large firms may have greater agency problems.

A study conducted by Durnev and Kim (2003) shows that leverage has positive influence on the quality of the implementation of goodcorporate governance. Black, et al. (2006) and Gillian, et al. (2003) found the results of different studies that leverage variable negatively affect the quality of corporate governance. Amar and Boujenoui (2007, in Sulyanti, 2011) states similar findings that variable leverage effect negatively towards qualities of good corporate governance. Different finding found by Darmawati (2006) showing that the leverage variable does not affect the quality of corporate governance. Ulum (2009) and Hormati (2009) reveals the similar findings the leverage has no influence on the quality of corporate governance.

Durnev and Kim (2003 in Hormati 2009) state that the investment opportunity has a positive effect on the quality of corporate governance. In contrast, Darmawati (2006) states that the investment opportunity statistics does not affect the quality of corporate governance. This is reinforced by the findings of the study conducted by Ulum (2007) and Hormati (2009) revealing that that investment opportunities do not affect the implementation of good corporate governance.

Darmawati (2009) states that the concentration of ownership variable statistically affect the quality of corporate governance. Amar and Boujenoui (2007) state that ownership concentration negatively affects the quality of corporate governance disclosure. Results of these studies differ from the research findings of Hormati (2009) which reveal that concentration of ownership variable does not affect the quality of corporate governance. It is strengthened by the results carried out by Ulum (2007), and according to the analysis conducted by Barruci and Fallini (2005) that firms having large controlling shareholders, financial holdings, a firm owned by the pyramid group (coalition shareholders) has a low quality of corporate governance.

From above description, it can be seen that some of the previous studies have not yet obtained accurate and consistent evidence dealing with the effect of variable comprimising profitability, leverage, firm size, and the concentration of ownership to implementation corporategovernance. The purpose of this study is to identify the most influencing variable over all of the variable mentioned towards the quality of corporate governance implementation. Another purpose of this study is to give investor prediction about the quality of corporate governace reflected in financial information. Investor also can have consideration about how these influenced factors can predict how good is the implementation of corporate governance based on influenced ranked factors.Then, this study use multiple regression with stepwise method to find out the most influencing variable. On the other hand, there are several other variables that have not been tested further.The formulated research problem of this study is whether firm size, leverage, ownership concentration, profitability, investment opportunities, regulation, quality of external auditor, and the proportion of independent commissioners affect the quality of corporate governance implementation.

Literature Review

Agency Theory

The principles of agency theory particularly related to the perspective of agency relationship which serve as the basis for understanding corporate governance. An agency relationship is a contract between the manager (agent) with the investor (principal) (Jensen and Meckling, 1976). Conflicts of interest between the owner and the agent happen because agents do not always act in accordance with the interests of the principal, thus triggering the agency cost (agency cost). Assumptions: (1) human being, in general, self-serving (self-interest), (2) humans have limited thinking about the future perception (bounded rationality), and (3) humans always avoid risk (risk averse) (Eisenhardt, 1989).

Manager has more knowledge on the internal information and prospects of the firm in the future than the owners (shareholders). Manager has a duty to give signal about the state of the firm to the owner. The signal concerning with the condition of the firm is given through the disclosure of accounting information such as financial statements. The financial statements are important for the users of external information primarily because these groups are in the greatest state of uncertainty. Imbalance information will lead to the emergence of a condition known as asymmetric information. Hence, this situation will provide an opportunity for the manager to manage the earnings (earnings management) in order to mislead shareholders about the firm's economic performance (Haris in Isnanta, 2008).

Another type of agency problem is called agency problem II which major shareholder may act in several ways that he/she will obtain substantial benefitsexploiting his advantage position (brought by owning the majority of the shares) (Madasch, 2010). This agency problem is arised when there is a concentrated owner who try to control the firm to act as behalf on it as the others shareholders/ In addition, the right of majority shareholder can be used to take over the rights of minority shareholders in terms of redistribution assets. Furthermore, Fama & Jensen (1983) also state that higher decisional power given by majority shareholders may lead to an entrechment situation, ending in undertaking actions aiming to expropriate wealth from the rest of the minority shareholders

Corporate governance is a concept that is based on agency theory expected to serve as a tool to provide confidence to investors that they would receive a return on the funds they have invested. Corporate governance is closely related to how investors are confident that the manager will useful. Then investors will feel that the manager will not steal or embezzle or invest in projects related to unfavorable capital funds that have been invested. In addition there is a concern on how to control the managers (Ujiyantho and Nugroho, 2007). In other words, corporate governance is expected to have a role for suppressing or lowering the cost of agency (agency cost).

Corporate Governance

Sutedi (2011) defined that corporate governance is a process and structured used inside firms (shareholders, stakeholders, directors, board of commissioners) to improve bussiness goal and firm accountability. Corporate governance also provice value to long term-shareholders wihout ignore other stakeholders interest. (Indra Surya and Ivan Yustiavandana in Mintara, 2008:12) defined corporate governance as a set pattern of corporate behavior measured through the performance, growth, financial structures, treatment of shareholders and stakeholders. Corporate governance also likely to be normative framework, ie all legal provisions which are derived from the legal system, the judicial system, financial markets, and so forth that affects the behavior of the firm.

According to the Indonesian Institute of Corporate Governance (IICG), GCG is defined as the structure, systems, and processes used by the organs of the firm in an effort to add value to the firm's sustainable in the long term by taking into account the interests of other stakeholders based on laws and norms (IICG, 2009). Corporate governance in addition requires the device structure to achieve the above objectives and monitoring performance.

Cadbury (1992) in his report stated that good corporate governance is aimed to directing and controlling firm in balancing the power and authority of the company. According to the National Committee on Governance (NCG), good corporate governance is one of the pillars of the market economic system. Corporate governance is closely related to the confidence of both the companies that implement them and on the business climate in a country. Implementation of GCG encourages healthy competition and a conducive business climate (NCG in Wardani, 2008). Therefore, the implementation of GCG for companies in Indonesia is very important to support the growth and sustainable economic stability.

Quality of Corporate Governance Implementation

Quality of corporate governance is an assessment of corporate governance which in turn stregthen to the company's predicate (consisting of the predicate "very reliable", "reliable", and "fairly reliable") related to how good corporate governance is implemented by a firm. Rating Corporate Governance Perception Index (CGPI) includes four different weight based on value, including the self-assessment the document completeness, paper , and observation. CGPI value is calculated by adding together the end of the compliance regulations, policies, guidelines, and best practices in the implementation of GCG in Indonesia and other countries. Overall, at least 40 documents are required for public companies and 36 documents for SOEs (IICG, 2006). While the paper is assessed based on the design phase of papers that reflect on the program and the results of the implementation of GCG as a unitary system in CGPI participating companies, themes and principles in the manufacture of paper are determined by IICG. The preparation of papers intended to help the firm to describe its efforts in implementing GCG at the time of observation (IICG, 2006).

Assessment phase observation is direct observation of activities across the firm to ensure whether participants of CGPI implement GCG as a business management system in the firm. Implementation of observations in each firm participant is at most performed once for one working day, which is divided into two sessions, discussion forums, which is a forum for discussion session with the commissioners and directors, and another session of discussion forums with a functional management. Stages of observation has the greatest value by considering the direct review process to ensure that the data, information, and business processes that drive corporate enforcement of GCG (IICG, 2006). The rating level of assessment is as follows:

Table 1
The CGPI rating

Implementation Quality Corporate Governance Criteria	Rating Level CGPI Assessment
Very Reliable	85.00 – 100
Reliable	70.00 – 84.99
Fairly Reliable	55.00 – 69.99

(Source:*Laporan hasil riset dan pemeringkatan corporate governance perception index 2010*)

The Influence of FirmSizeonthe Quality of CorporateGovernanceImplementation

Firm size is a scale or value at which the firm can be classified based on the size of total assets, the log size, the value of stocks and so forth. Large (size) can be expressed in the firm's total assets, sales and market capitalization. The greater the total assets, sales and market capitalization, the greater the size of the firm. These three variables are used to determine the size of the firm because it can represent how big the firm is. The greater the assets, the more capital invested, the more sales, the more the velocity of money the greater the market capitalization, and the greater the firm is known by the public (Virawati, 2009 in Sulyanti, 2011).

Firm size can be expressed in total assets, sales, and market capitalization. The third variable is used because it can represent how big the firm is. The greater the assets, the more capital invested. The greater the sales, the more turnover and market capitalization. Of these three variables, the value of the asset is relatively more stable than the market capitalization and sales in measuring the size of the firm (Sudarmadji and Sularto, 2007).

Based on theory and previous studies, the first hypothesis of this study is as follows:

H_1 : Size affects the quality of the firm's corporate governance implementation.

The Influence of Leverage onthe Quality of CorporateGovernanceImplementation

According to Black etal. (2006), the influence of financial leverage on a firm’s comprimising quality of corporate governance implementation can be viewed from two views on a substitution story and an investor pressure story. The first view (a substitution story) is a firm that has a high level of debt in the capital structure will tend to be subject to scrutiny by creditors who are subject to more stringent and generally expressed in the debt contract made by the parties concerned. Thus, companies are less concerned with the quality of corporate governance implementation, because there has been scrutiny of external parties.

The second view (an investor pressure story) is that creditors are very concerned with the corporate governance practices of debtors and have more power than the shareholders to force the firm to improve the quality of corporate governance implementation (if the firm funds its business with a high proportion of debt in the capital structure). Gillan etal. (2003) conducted a study to find out a negative relationship between leverage and the corporate governanceimplementation. However, on the other hand research conducted by Barucci and Falini failed to find an association between leverage and the quality of corporate governance implementation (Barucci and Falini in Deni Darmawati, 2006).

Based on literature and previous studies, the second hypothesis of this study is as follows:

H_2 : Leverage affecting the quality of the firm's corporate governance implementation.

The Influence of Ownership Concentration onthe Quality of CorporateGovernanceImplementation

Takalamingan (2013) describes that the shareholding structure reflects the distribution of power and influence among its shareholders for the firm's operations. One of the characteristics is the ownership structure or ownership concentration. Ownership concentration of ownership to see the majority ownership of a firm. Majority ownership can be calculated from the percentage of a firm's largest holdings. Companies with a large percentage of ownership indicate that the control over the firm is under the control of shareholder. Durnev and Kim (2003) states that the amount of ownership held by the controlling shareholder will enhance the implementation of quality corporate governance.

Durnev and Kim states that the amount of ownership held by the controlling shareholder will result in the policies and principles of the profitable business which in turn can improve the quality of corporate governance implementation. In addition, the weakness of the legal system or the protection of investors can be overcome with the concentration of ownership which is turn becomes a more important tool to resolve agency problems (Durnev and Kim, 2003). Thus, the concentration of ownership can sometimes raise even degrade the quality of the implementation of corporate governance in a firm. While Barucci and Falini find that ownership of shares by controlling shareholders is negatively related to the quality of corporate governance (Barucci and Falini, 2005). Based on theory and previous studies, the third hypothesis of this study as follows:

H_3 : Ownership concentration affects the quality of the firm's corporate governance implementation.

The Influence of Profitability onthe Quality of Corporate Governance Implemenation

Husnan & Pudji (2007 in Setyaningrum, 2013) state that profitability a ratio to measure how many earned profits are the rights of capital owner. The profitability ratios will give an idea of the effectiveness of the management of the firm. The bigger profitability ratio means better profitability, because the prosperity of the owners of the firm increased by the growing profitability.

In practice, GCG is measured by profitability ratios, namely profit margin (profit margin on sales), Return on Assets (ROA), Return on Equity (ROE), and earnings per share.

In this study, profitability is analyzed by using ROE (Return on Equity), which is the ratio of profit after tax to total equity. Setyaningrum (2013) state that profitability is used by investors to see how firms can provide probability income in the future. Based on theory and previous research, the fourth hypothesis of this study can be formulated as follows:

H_4: Profitability affects the quality of the firm's corporate governance implementation.

The Influence of Investment Opportunities onthe Quality of Corporate Governance Implementation

According to Hormati (2009) Companies that have a high investment opportunity, will require substantial funds, and if the needs of internal funds are not sufficient then the firm will attempt to seek external sources of funding. The third party in this case debt holder would evaluate whether the firm eligible to obtain a loan or not. One of the efforts in which the firm is implementing GCG in to gain the trust of the debtholder. In other hand, pecking order theory popularized by Myers & Majluf (1984) argues that firm prefers internal financing when available, and debt is preferred over equity if external financing is required due to avoid the increasing asymmetric information when the cost of financing is increased.

According Gilian et al. (2003), managers in companies that have high investment opportunities, will have the opportunity to perform discretionary larger project selection, compared to managers in Companies having less investment opportunities. Thus, the firm has an investment opportunity that requires high quality corporate Govérnace. Klapper and Love (2003 in Hormati 2009) find that companies with high investment opportunities will be sought to expand so it will increasingly require external funding. For that purpose, the firm will strive to improve the quality of implementation of GCG for more ease in obtaining external funding sources and lower the cost of capital. Based on theory and previous research, the fifth hypothesis of this study can be formulated as follows:

H_5: Investment opportunities affect the quality of the firm's corporate governance implementation.

The Influence of Regulation on the Quality of Corporate Governance Implementation

Government regulation is any regulation issued by the government to regulate companies. This aspect is very important to be taken by companies, governments and both foreign companies. Some of the literature reveals that regulatory factors have a role on the implementation of GCG. Regulation can have an impact on the structure of corporate governance due to closer scrutiny. Black et al. (2006) states that the banking industry is subject to strict regulation in relation to the application of corporate governance. Regulation in the banking sector contained in the Circular Letter of Bank Indonesia 8/4/PBI/2006 regarding of corporate governance. Firms owned by the government (State Owned Enterprises or SOEs) also get a major concern in the enforcement of corporate governance in Indonesia as stipulated in the regulations KEP-117/M-MBU/2002 on Implementation of GCG of State Owned Enterprises In. So, it is expected that the realization of the above legislation can improve the implementation of corporate governance in Indonesia

But on the other hand, Darmawati (2006) found that state-owned enterprises and the banking regulatory factors have no influence on the quality of corporate governance implementation is tested on a sample of 15 Big CGPI years 2003-2004. Based on theory and previous research, the sixth hypothesis of this study can be formulated as follows:

H_6: Regulation factors affect the quality of the firm's corporate governance implementation.

The Influence of the Quality of External Auditor on the Quality of Corporate Governance Implementation

Hormati (2009) argues that the stigma of society as represented by the stakeholders consider that the Big 4 public accounting firms (PWC, Ernst & Young, Deloitte, and KPMG) have more credibility on performing audit tasks compared to non-big 4 public accounting firms. Thus based this credibility, the Office will consider public accountant in accordance with the opinion that the existing state of the firm's management. Furthermore, companies that want to establish engagement with Big 4 public accounting firms should take into account of the governance of the firm in order to support an unqualified opinion.

Mayangsari (2003 in Hormati 2009) states that the auditor industry specialization has a positive effect on the integrity of the financial statements. The financial statements are informative and meet the principles of disclosure is one component of the implementation of GCG. Ulum (2007) also found that the quality of the external auditors have an influence on the quality of the implementation of corporate governance is supported by the findings of Hormati (2009)

Based on theory and previous research, the seventh hypothesis of this study can be formulated as follows:

H_7 : External auditor affects the quality of the firm's corporate governance implementation.

The Influence of the Proportion of Independent Board Commissioners on the Quality of Corporate Governance Implementation

Dunn (1987 in Cornett et al. 2006) states that commissioners dominated by outsidersare better in monitoring and controlling managers. Board of commissioners consisting of members from outside the firm (independent commissioner) contributes effectively to the trend of earnings management practices. In addition, according to Fama and Jensen (1983), a non-executive director (commissioner independent) can act as a mediator in disputes between internal managers, as a supervisor and manager policy advisers for the manager.

hypothesis of this study can be formulated as follows:

H_8 : The proportion of Independent board of commissioners affects the Quality of corporate governance implementation.

Research Method

Research Type

This research tests several hypotheses to get empirical evidence for factors affecting the quality of corporate governance implementation. Sekaran (2006:162) explained that such kind of research tries to find some relations and effects from variables, and understands difference among groups as well as independency among variables in certain situation.

Population and Sample

Population is a generalization area consisting of the object or subject that has certain qualities and characteristics determined to be studied (Sugiyono, 2008:80). The population of this research is firms rated in CGPI rating in 2001 – 2012.

Meanwhile, Sugiyono (2008:81) stated that sample is a part of amount and characteristic from population. Sampling method used in this research is nonprobability sampling with purposive sampling method. Jogiyanto (2004:79) stated that purposive sampling is used to choose samples based on certain criteria. Sampling criteria in this research are:

1. Firms are listed in *Bursa Efek Indonesia* (BEI) which have financial data in Indonesian Capital Market Directory or have published financial statements in BEI website (www.idx.co.id) or in firm personal website in 2001-2012.
2. Firms are rated in Corporate Governance Perception Index (CGPI) published by The Indonesian Institute for Corporate Governance (IICG) in SWA magazine in 2001-2012.

3. Firms used Indonesian currency (Rupiah) in financial statements.
4. Financial statements do not have deficiency of equity. Anggara (2006) stated that financial statement that have negative equity or profit as denominator is meaningless in financial ratio calculation.
5. Firms have complete data related to variables used in this research, namely total asset, total liability, total equity, number of highest ownership, number of total shares, net profit after tax, market capital information, number of independent board of commissioners, and external auditor information.

Research Data

Based on the samples required, type of data of this research is secondary data. Sekaran (2006:65) stated that data collected in secondary data is collected and processed by other people, thus the researcher may get the data through some media. Secondary data used in this research are:

1. Corporate Governance Perception Index used by The Indonesian Institute fo Corporate Governance in 2001-2012 and published through SWA magazine.
2. Financial ratio and non financial information from firm financial statement in 2001-2012 which are published in The Indonesian Capital Market Directory (ICMD) or *Bursa Efek Indonesia* (BEI) website (www.idx.co.id).

Data Collection Method

Data collection method in this research is documentation study. Sugiyono (2008:422) stated that documentation study is a technique of data collection by taking the data from written media such as books, magazines, documents, regulations, etc. Documents used as data source in this research are firm financial data published on www.idx.co.id which also published on ICMD and also CGPI report published by IICG in 2001-2012.

Definition of Variables and Variable Measurement

The purpose of this research is to analyze factors proxied by indicators that affecting the quality of corporate governance implementation proxied by CGPI. Sekaran (2006:115) explained that variable is anything to distinguish or bring any variation in the value. Variables used in this research are dependent variables and independent variables. The dependent variable is Corporate Governance Perception Index Score as the proxy of the quality of corporate governance implementation. Independent variables are firm size, leverage, ownership concentration, profitability, investment opportunities, regulation factors, external auditor, and proportion of independent board of commissioners.

Dependent Variable

Sekaran (2006:116) explained that dependent variable is the main focus of the researchers and it is affected by another variables (independent variables). Dependent variable in this research is quality of corporate governance implementation. The quality of corporate governance implementation is measured by the rating of corporate governance implementation published by The Indonesian Institute Corporate Governance namely Corporate Governance Perception Index (CGPI). This index is produced by developing methodology and database, publication, program, CGPI candidate confirmation, and self assessment through questionaire conducted by some researchers in corporate governance area.

The index is then called as Corporate Governance Perception Index which entitled very trusted, trusted, and fair trusted according with score range. Thus, the result of CGPI is a measurement used to know how good is the corporate governance implementation of the firms. The formula to calculate CGPI developed throughout 4 assessments namely, Self Assessment, Document Completeness, Paper, and Observation, namely,

CGPI = 17% Self Assessment + 25% Document Completeness + 13% Paper + 35% Observation

The formula above was developed in CGPI 2012 which each year is changed due to consideration from judges in IICG. Besides that, there are some score that already counted in final score (2001, 2002, 2003, 2004, 2005, 2006, 2007, 2008, 2011) and also there are some years that had to be scored manually (2009, 2010, 2012).

There are 8 independent variables used in this research, namely firm size, leverage, ownership concentration, profitability, investment opportunities, regulation factors, external auditor, and proportion of independent board of commissioners.

1. Firm size

Firm size is a scale of firm related to how large the corporation is. According to Black, et al. (2003 in Hormati, 2009), firm size can be measured by Log Natural (Ln) firm total assets. This research uses this measure to avoid extreme value due to the difference of total assets of each firm (Takalamingan, 2013):

Firm Size = Ln Total Assets

2. Leverage

Leverage is a proportion of assets which are not financed by shareholder equity or liabilities. Leverage is measured by using Debt to Equity Ratio (DER). Paranita (2007, in Sulyanti, 2011) explained that DER can describe the structure of business capital. Moreover, DER is capable to describe whether firm capital structure use more liability or capital financing.

$$\text{Leverage} = \frac{\text{Total Liablities}}{\text{Total Assets}}$$

3. Ownership concentration

Ownership concentration is a percentage of the highest capital ownership to total capital ownership. Takalamingan (2013) described that ownership concentration reflects the power of distribution and the effect of shareholder capital over the operational activities. Then, ownership concentration can explain how the highest capital ownership can control the firm. Black et al. (2003: Barucci & Falini, 2004; Drobetz et al., 2004 in Hormati, 2009) measure the highest ownership conentration in the following formula:

$$\text{Ownership Concentration} = \frac{\text{Total highest share ownership}}{Total\ Firm\ Share} \text{X } 100\%$$

4. Profitability

Profitability is an index to describe firm capability to earn profit in certain period. Profitability is also used as a measurement of how effective the management operating activity is. Setyaningrum (2013) stated that profitability is very important for investor as an indicator to measure management effort to earn maximum profit for shareholders. Profitability is measured in the following formula:

$$\text{Profitability} = \frac{\text{Net profit after tax}}{\text{Total Equity}}$$

5. Investment opportunities

Takalamingan (2013) states that investment opportunities is a chance for firm to gain any additional funding. Firm growth will create many investment option in the future which is called as Investment Opportunity Set (IOS). IOS is the proportion of assets currently used and the selection of investment in the future with positive Net Present Value (NPV) (Myers, 1977 in Rokhayati, 2005). This research uses Market to Book Value of Equity (MVE) ratio which describes the firm capital. Systematically, IOS ratio is calculated in following formula (Sulyanti, 2011):

$$\text{Market to Book Value of Equity (MVE)} = \frac{\text{Market Capital}}{\text{Total Equity}}$$

6. Regulation factor

Regulation factor is a strict regulation made by government bodies for Indonesian corporations. In this research, regulation refers to KEP-117/M-MBU/2002 in Indonesia related to particular rule about corporate governance to State-Owned Entreprises (SOE) in Indonesia. The regulation for State-Owned Enterprises is mainly to improve accountability and disclosure. The regulation itself provide guidance about general concept, indicators, supporting bodies, etc.

This regulation also refers to Bank of Indonesia regulation number 8/4/PBI/2006 related to corporate governance implementation for commercial banks which are also used as samples in this research. Darmawati (2006) in her research used dummy variable to measure regulation factor, which is 1 refers to State-Owned Enterprise firm or bank and 0 refer to non State-Owned Enterprise firm or bank. This is due to the fact that State-Owned Enterprise and bank firm already have strict requirement to implement good corporate governance.

7. External auditor

The effect of external auditors on the implementation of corporate governance can be reflected on financial statements. In this case, firms try to implement good corporate governance by having maximum disclosures in financial statements. Thus, when external auditors audit the firms, they try to disclose good corporate governance implementation as much as possible in financial statement during audit session. There is also a belief that firm audited by Big 4 Public Accounting Firms namely Deloitte, Ernst & Young, KMPG, and PWC are more trustable than others (Hormati, 2009). Then, by refering to Hormati (2009), the variable of external auditor in this research is measured using dummy variable, i.e. 1 refers to Big 4 Public Accounting Firm and 0 refers to non Big 4.

8. Proportion of independent board of commissioners

Proportion of independent board of commissioners is a ratio between total number of independent comissioners and total number of comissioners board member. Takalamingan (2013) states that the higher the proportion of independent boards of commissioners, the better the oversight function towards management. Thus, the higher the proportion of independent boards can avoid the earnings management practice and it is an indicator of good corporate governance implementation. The proportion of independent board of commisioners is also based on the requirement of Bapepam regulation KEP-305/BEJ/07-2004 regarding the minimum proportion of independent board which is 30% of total number of board members. Proportion of independent board is calculated in the following formula (Surya and Yustiavananda, 2006:133 in Takalamingan, 2013):

$$\text{Proportion of independent board} = \frac{\text{Number of independent boards of commissioners}}{\text{Total number of bosrds of comissioner}}$$

Descriptive Statistic

Descriptive statistic is intended to give description of any characteristic samples used in this research. Descriptive statistic consists of maximum score, minimum score, mean, and standard deviation from processed data. Ghozali (2006:19) stated that results from descriptive statistic can be used to support data intepretation.

Classic Assumption Test

Classic assumption test is conducted to determine whether the result of multiple regression deviates or not from classical asssumption. The classic assumption test is conducted in following test.

Normality Test

Ghozali (2006:110) stated that normality test aims in testing whether in regression model there are confounding variables that are normally distributed. Furthermore, good regresion has normally distributed data or nearly normal in P-Plot graphic. There are two ways to detect the normally distributed data with graphic analysis and statistic test (Ghozali, 2006:112). This study used both ways to show the normality test

Multicollinearity Test

Multicollinearity test aims to find any correlation in independent variables from regression model. Ghozali (2006:91) states that the good regression model does not have any correlation in independent variables. Multicollinearity test in this study is conducted with tolerance score and Variance Inflation Factor (VIF). If tolerance score ≤ 0,10 or VIF score ≥ 10, there is an indication of multicollinearity.

Heteroskedasticity Test

Heteroskidasity test aims to find any inequality variance from residual one of observation to others observation in regression model. Ghozali (2006:105) mentions that good regression model does not have heteroskedasticity. Heteroskedasticity is a condition when residual variance from observation to observation is different. Otherwise, heteroskedasticity happens when residual variance from observation to observation is similar which indicates good regression model. Glejser test is conducted in this research to determine there is heteroskedasticity or not.

Autocorrelation Test

Autocorrelation test aims to determine whether there is correlation among confounding error in t period with confounding error in t-1 period in regression model (Ghozalli, 2006:95). Autocorrelation happens due to sequential observation over related time which also means when time series data is used. Autocorrelation here is detected with Durbin-Watson (DW) test.

Hypothesis Testing

Data analysis method in this research is multiple regression analysis with stepwise method using Statistical Package for Social Science (SPSS) program version 19.00. Ghozali (2006:7) explains that multiple regression is used when there is one dependent variable and more than one independent variables. The multiple regression equation in this reseach ishowed s as follows:

$$\boxed{Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X6 + \beta_7 X_7 + \beta_8 X_8 + e}$$

Where :

Y : CGPI

α : Constanta

X_1 : Firm size

X_2 : Leverage

X_3 : Ownership concentration

X_4 : Profitability

X_5 : Investment opportunities

X_6 : Regulation factors

X_7 : External auditor

X_8 : Proportion of independent board of commissioners

e : Error

$\beta_1 - \beta_8$: Regression coefficient.

Hypothesisis a expected relationship between two or more variables which is expressed in the form of statement. The relationship isbased on the theoretical framework formulated in the research study (Sekaran, 2006: 123). In testing process, will be found an element of probability or the error that is reflected by the level of significanct level. Therefore, researchers used statistical methods to the level of significance level $\alpha = 0.05$, which means the degree of erroris 5%.

Determination Coefficient (R^2)

Determination Coefficient (R^2) essentially measureshow the regression model explains the variation of dependent variable. The value of determination coefficient is ranged from zero to one. Minimum valueof (R^2) shows that the capability of independent variables to describe the dependent variable is limited. Otherwise, maximum value of (R^2) means that the independent variables provide almost all the information needed to predict the variation of the independent variables (Ghozali, 2006: 127).

RESULTS AND DISCUSSIONS

Sampling Procedure

Population in this research is firms listed in CGPI research started from 2001 until 2012. Sample used in this research is resulted from purposive sampling procedure described in as follow:

Table 2
Purposive Sampling Procedure

No.	Explanation	Amount
1.	Firms rated in CGPI 2001-2012	329
2.	Firms unlisted in BEI 2001-2012	(75)
3.	Firms using dollar currency	(1)
4.	Firms with insufficient data	(3)
5.	Firms with outlier data*	(31)
	Total Sampel	**189**

*Deviated data that far from other data in data set

Descriptive Statistics

Descriptive statistics aims to collect, process, present, and analyze the quantitative data descriptively(Ghozali, 2009). In particular, descriptive statistics is used to present the amount of data and to show the maximum, minimum, average, and standard deviation values of each variable used in this study. The results of descriptive statistics are shown in Table 3.

Table 3
Descriptive Statistic

	N	Minimum	Maximum	Mean	Std. Deviation
Firm Size (X1)	189	319917,00	25211480,00	5365612,0053	5289131,23283
Leverage (X2)	189	,10	,94	,5951	,24351
Ownership Concentration (X3)	189	,24	1,00	,6307	,15588
Profitability (X4)	189	,00	,59	,1913	,11377
IOS (X5)	189	,10	6,90	,6745	,64163
Regulation Factor (X6)	189	,00	1,00	,4233	,49539
External Auditor (X7)	189	,00	1,00	,6984	,46017
Proportion (X8)	189	,00	1,00	,3742	,18267
CGPI (Y)	189	48,94	91,91	78,7599	8,66674
Valid N (listwise)	189				

Based on desrciptive statistics results, there are minimum, maximum, average, and standard deviation values of each variables used in this study.

1. The corporate governance implementation development in Indonesia need to be improved since there is a gap between the highest and lowest score in CGPI.
2. Most firms in this research is financed by debt financing.

3. Most of Indonesian firms are concentrated owned.Therfore,there is a propability the concentrated ownership will control the firms (Hormati, 2009).
4. Firms in average, with available equity funding is good enough to generate revenue by 19,13 per cent.
5. Firms in Indonesia have big opportunity to get additional funding from external funds. In other hand, investors have 67.45 per cent chance to invest their money at firms listed in BEI
6. Regulation related corporate governance in Indonesia only affecting 80 firms (42.33 per cent from 189 firms). In other hand, there is still need of regulation to 109 firms (57.67 per cent from 189 firms) to perform better corporate governance.
7. In average, 69.84 per cent firms in Indonesia using Big Four public accountant services to audit the financial statement. In addition, this result describe that 69.84 per cent firms audited by Big 4 have have better revenue quality of than firms audited non Big 4 (Herusetya, 2009)
8. Firms listed in BEI already fulfill the regulation of BEI, KEP-305/BEJ/07-2004, which is minimum portion of independent commissioners is 30 per cent.

Classic Assumption Test

The result of classis assumption test, which are normality, multicolinearity, heterokeasdicity, and autocorelation tests, are described as under.

Normality Test

PP Plot Graphs and One-Sample Kolmogorov-Smirnov test are used to test the normality.

MulticollinearityTest

From the result, the VIF value of each variable is less than 10 and close to 1. Therefore, it can be concluded that there is no multicollinearity of the data.

Heteroskedasticity Test

Respectively each variable has a significance level greater than α = 0.05. Then, the decision was taken to accept $H_{0,}$ which means that the residual variance is homogeneous.

Autocorrelation Test

Based on Durbin Watson test above, the critical value for n = 189 and k = 8 is du = 1.851 and 4-du = 2.149. Because the value of Durbin Watson lies between du and 4-du, then it can be said that the assumption of non autocorrelation is fulfilled.

Regression Analysis

The linear regression analysis uses stepwise method to obtain the model of the independent variables which have a significant effect only on the dependent variable. Five independent variables are obtained by inputing the variable based on the degree of correlation and significance on the dependent variable sequencely.

Table 4
Variable Added

Model	Variables	Variable added
Model 1	Firm Size (X1)	Firm Size
Model 2	Firm Size (X1) External Auditor (X7)	External Auditor (X7)
Model 3	Firm Size (X1) External Auditor (X7) Regulation Factor (X6)	Regulation Factor (X6)
Model 4	Firm Size (X1) External Auditor (X7) Regulation Factor (X6) Proportion of Independent	Proportion of Independent commissioners board (X8)

	commissioners board (X8)	
Model 5	Firm Size (X1) External Auditor (X7) Regulation Factor (X6) Proportion of Independent commissioners board (X8) Profitability (X4)	Profitability (X4)

Meanwhile, variables X2, X3, X5 are not included because only up to five models that give significant effect partially. Detailed discussion are as follows.

Dominant Test

Variable with dominant influence on Y is the variable that has the greatest regression coefficient. To compare the regression coefficients of each independent variable, ranking tables are presented as follows:

Table 11
Summary of Regression Analysis Model 5

Ranking	**Variable**	**BETA**	**Sig*nificant***	**Influence**
1	X7 (External Auditor)	0.291	0.000	Significant
2	X6 (Reg Factor)	0.280	0.000	Significant
3	X1 (Firm Size)	0.258	0.000	Significant
4	X8 (Proportion)	0.174	0.002	Significant
5	X4 (Profitability)	0.117	0.041	Significant

Based on the above table, it can be seen that the variable X7 (externalauditor) is a variable that has the most standardized Beta coefficient valued 0.291. This indicates that the variable Y (CGPI) is most influenced by variables X7 (external auditor) in the fifth model.

Discussions

This section explains the results of data analysis as described previously. Discussion of research results are arranged sequentially based on the formulation of hypotheses that have been proposed.

Firm Size Influences the Quality of Corporate Governance Implementation

Durnev & Kim (2003) state that corporate governance implementation is better when the firm has a larger size. This is due to the fact that public may pay attention to the operation and financial condition of large firms. The pressure from public motivates the firms to implement better corporate governance. In the other hand, Hormati (2009) states that good corporate governance implementation is an effective way to the complicated systems and problems faced by big firm.

In addition, larger firms have more shareholders. Therefore, agency problems will arise in the same time due to difficulty to monitor them or because of free cash flow argument (Jensen, 1986 in Klapper & Love, 2004). Specifically, Jensen (1986) in his agency theory states that when the organization generates substantial free cash flow, the conflicts of interest between shareholders and managers over payout policies will be severe. As the consequence, large firms try to implement good corporate governance to reduce agency problem in order to make shareholders believe that management is operating on behalf of shareholders.

Leverage Does Not Influence the Quality of Corporate Governance Implementation

Dechow et al. (1996) in Kurniawati (2012) states that firms with high leverage level are motivated to do earnings manipulation. Therefore, creditor uses debt contract to engage monitoring toward firms that have high leverage level. Referring to Table 3, firms tend not to care about corporate governance since there is direct monitoring from creditor due to high level of leverage.

This findings also support Li et al. (2013) who argues that private lenders do more efficient monitors due to their superior access to private information than relying on firms corporate governance. Private lenders, such as banks, are likely to face low monitoring costs and enjoy high monitoring efficiency, due to long term relations they develop with borrowers. Banks, by virtue of their exclusive relationship with borrowers, through prior lending, cash management or advisory activities, have access to private information, and therefore are less exposed to adverse selection and moral hazard problems. This evidence supports that bank lender rely less on the borrower's board governance and shareholder governance. Therefore, leverage does not influence the quality of corporate governance implementation.

Ownership Concentration Does Not Influence the Quality of Corporate Governance Implementation

Barucci & Falini (2005) in their research, The Determinant of Corporate Governance in Italy, show that ownerhsip structure is an important determinant. They also mention the main problem in a system with concentrated ownership is the exploitation of minority shareholders with private benefits for the controlling shareholder. Therefore, a firm with the largest shareholder retaining a large stake is characterized by poor governance. This interpretation is corroborated by the negative effect on the governance quality associated with executive entrenchment and by the negative effect (when it is statistically significant) of variables indicating a wedge between voting rights and cash flow rights (company controlled by a shareholders' coalition, pyramidal group affiliation).

The findings above support the agency theory type II, which is major shareholders act behalf on themselves and try to maximize their benefits as exploiting his advantage position. Shleifer and Vishny (1997) explain that large investor represent their own interest which not need coincide with the interest of other investor. Furthermore, in case of countries with poorer shareholder protection, Porta et al. (1999) explain the controlling shareholder face the strong incentives to monitor manager and maximize profits when they retain substantial cash flow rights in addition of control.

Profitability Influences the Quality of Corporate Governance Implementation

In this research, profitability is defined as a capability of business entity to generate earnings measured by ROE. Higher profitability means that the capability of the firms to get more funding is increasing. The more funding sources from shareholders will increase the number of stakeholders, since high profitability reflects that firms are capable to generate earnings from equity funding. Singhvi & Desai (1971) in Pramono (2011) state that greater income will motivate management to provide extensive information disclosure to provide assurance to investors.

Moreover, Barucci & Falini (2005) show that firm with fund for equity-debt market is more likely to adopt a high-quality governance and a better minority shareholder protection to attract outside investors with a lower cost of capital. Since the higher profitability will attract attention of the investor in equity market, then firms are likely to adopt high-quality governance. Therefore, more profitability will motivate firms to perform better corporate governance due to increasing number of stakeholders (shareholders).

Investment Opportunities Does Not Influence the Quality of Corporate Governance Implementation

The fact that in the Indonesian context the investment opportunities does not influence the quality of corporate governance implementation is supported by pecking order theory popularized by Myers & Majluf (1984). Eventhough firms have high investment oportunities, firms will choose the available funding wisely. Pecking order theory states that a firm in fulfilling the financing need considers the three sources, which are, internal funds, debt, and new equity. Pecking oder theory also argues that firm prefers internal financing when available, and debt is preferred over equity if external financing is required due to avoid the increasing asymmetric information when the cost of financing is increased. The consideration of asymmetric information affects the firm decision whether internal or external funding is used. The asymmetric information is raised due to managers know more about their companies prospects, risks and value than outside investors . Since firms is preferable to internal financing, then there is no need to look after the external funding. Hence, firms tends to ignore corporate governance implementation.

Wah (2009) finds another finding that firms with high investment opportunities are more likely to have more discretionary accruals. However, this relationship is weaker when they have Big 5 auditors. This result suggests that the likelihood of earnings manipulation is higher for firms with high investment opportunities. Furthermore, Taman (2011) explains that there is a possibility that investment opportunity set can be used by managers to manipulate accruals management. The manipulation activities shows that firms ignore governance implementation. Therefore, corporate governance is tend to be ingored eventhough firms have high investment opportunities.

Regulation Factor Influences the Quality of Corporate Governance Implementation

Alexander (2004) states that regulation plays important role to represent the public interest in seeing that firms are regulated efficiently. The regulation enhances firms (banks and financial firms) to the safety and soundness of the banking system and thereby increase economic growth. Alexander (2004) also finds that regulations (FSMA & FSA) in UK addresses the principal-agent problem through enhanced monitoring; improved disclosure and accounting practices; better enforcement of corporate governance rules and the corporate governance framework; and strengthening the institution. Regulations also require banks to establish internal compliance programs to monitor other types of risk arising from the growing problem of financial crime.

Moreover, the Sarbanes-Oxley Act of 2002 (SOX) gives another understanding of how regulations affect the quality of coporate governance implementation. SOX is applied on both private and public companies in the US as an act of major corporate and accounting scandals like Enron and WorldCom. Study conducted by Arping & Sautner (2010) find that cross-listed firms became significantly more transparent following SOX. Therefore, regulations influence the quality of corporate governance implementation.

The Quality of External Auditor Influences the Quality of Corporate Governance Implementation

Dobija (2013) states that external auditor plays a crucial role in helping to promote financial reporting quality by curtailing excessive earnings management practices and serves as an effective monitor to the management. In giving this fairness quality, external auditor gives some rank related to the fairness which are unqualified, qualified, disclaimer and adverse selection. Then, to give this opinion, external auditor has to assess due care since the opinion will affect any decision towards the firm.

Cohen et al. (2009) mentions that auditors place greater reliance on corporate governance in all phases of the audit process. Big four public accounting firms have been trusted to give an opinion based on the real fact and regulation. Public also has an opinion that the big four are trustable to give an opinion. Therefore, when the big four give unqualified opinion then public will trust and rely on it by all means that audited firms have good financial performance and good governance implementation.

Proportion of Independent Board Commissioners Influences the Quality of Corporate Governance Implementation

Gordon (2007) prevails the history of the rise of the independent board which is associated with an increasing orientation of the corporate purpose toward shareholder wealth maximization and with a growing role for the board in mediating between the firm and the stock market. In addition, the growing focus on director independence is stimulated by the desire to enhance the credibility of such decision making to the relevant audiences, particularly increasingly active institutional investors.The board of commissioners is responsible to look after the firm on behalf of the shareholder interest. Then, the independent board of commissioners will act on behalf of shareholder interest and mediating the interest among majority shareholder, minority shareholders, and the management.

Furthermore, the independent board of commissioners will lead to better governance by reducing agency problem type II. As majority shareholders have higher access to information, this will create agency problem type II called as horizontal agency problem where controlling shareholders may seek private benefits at the expense of noncontrolling shareholders (Ali et al., 2007 in Clemente & Labat, 2009). Therefore, to minimize the agency problem type II, independent board of commissioners played important role to act in behalf of any shareholder.

Conclusion

This study provides an empirical evidence of how some factors could inluence the quality of corporate governanece implemention. The top five ranked variables which affects the quality of corporate governance implementation are the quality of external auditor, the regulation factor, firm size, proportion of independent commissioners, and profitability. These variables have been proofed statiscally affecting the quality of corporate governance and supporting the agency theory. This study is able to provide the evidence of how these five factor may indicate whether a firm has a good corporate governance or not. Variable leverage, investment opportunity, and ownership concentration statisticaly do not affect the quality of corporate governance implementation. These three variables streghten the agency theory type II and pecking order theory.

Limitations in this study are the weaknesses recognized during the research. This limitation will provide suggestion to the subsequent research in corporate governance area. 1) The research conducted by IICG is a voluntary participation of any firms. 2) From the sampling procedure, it can be seen that many firms rated by IICG cannot be used as sample because they are not listed in the IDX. 3) The firm size variable in this study is supposed to be transformed to log natural form. But, in order to fulfill the normality assumption, the variable is transformed to inverse form. Because of this, the standar of deviation is large. Based some weaknesess in this study, below are some suggestion for future research related corporate governance. 1) Future research can consider the valuation used by Annual Report Award (ARA). 2) Future research can consider to collect financial data manually and directly from the firms. 3) Another proxy can used to measure firm size, for example using sales record.

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