An Examination of Board Cohesiveness of Initial Public Offering at Indonesian Stock Exchange

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Abstract
We study the financial performance of initial public offerings (IPOs) at Indonesian Stock Exchange. We examine how firm characteristics and board characteristics affects the board cohesiveness. This study attempts to evaluate board cohesiveness of initial Public Offering at Indonesian Stock Exchane during 2000-2008 (119 sample). Our results indicate that among IPO firms, firm characteristics and board characteristics affects the board cohesiveness. These results indicate that board cohesiveness influence by board characteristics and firm perfomance.
Keywords: Board Cohesiveness, Board Characteristics, and Firm Characteristics

1. Introduction

Go Public is an alternative to explore new sources of funding for their investment needs. The reason behind that is uncertainty of business environment and business risk. When a firms goes public, both ownership structure and management structure of the firm change. Although prior to initial public offering (IPO) the board often owns a controlling stake in the firm. Changes in ownership structure occurs because the company is no longer owned by a few people, but it is widely held by the public. This ownership structure changes result in changes in the managerial structure due to changes in the interests of new shareholders to take action against the management or supervision of company managers as well as to anticipate changes in the economic environment as these changes will have an impact on the strategy to be chosen by the company (Rigel 1994)

Conflict of interests between management and owners will pose a problem. Jensen (1976) stated that the problems that arise between management and owners occurs when there is a separation of the functions of decision-making and risk transfer, because the owner is more oriented to the rate of return in the future, while the management over to the achievement of self-interest (Jensen 1986) . Because of this, the owner will try to align the interests and that is costly. Potential conflicts of interest between owners and managers can do to develop good corporate governance. The problems that often arise in corporate governance is when the owners and managers are not able to resolve differences in interests (Hart 1995). Shleifer (1997) suggests the application of corporate governance is one of the functions of monitoring to ensure that the owner will get the desired returns.

Linck (2008) analyze the determinants of firm characteristics that affect the function of monitoring and effectiveness of the board of commissioner. Large companies tend to have more diversified board of commissioners with relatively high amounts. This means that the company will determine the characteristic closeness of the relationship between the commissioners. In addition, the views of free cash flow and leverage characterize personal benefits available to people in the company (Boone 2007). Gillan (2003) states that the cost of monitoring would be higher if the commissioners are not able to function in the mechanism of control and there is no coordination and good communication.

A number of empirical studies (Lehn K 2004, Boone 2007, Coles 2008, Guest 2008, Linck 2008) have examined the determinants of board size. Board size is expected to be greater when the need for information is high. The need is expected to increase along with the increase in the scale and complexity of the problems the company faced by the company. From the results of the above studies concluded that board size is positively related to firm size. Some proxies are used to measure the complexity and proven to positively affect the size of the company, including financial leverage (Coles 2008, Guest 2008), firm age and industry diversification (Boone 2007, Coles 2008, Guest 2008). Means that commissioners must be able to perform the function of monitoring in accordance with the characteristics of the value of the company so that the company could be better.

Research on the board of commissioners based on two events, namely the Asian financial crisis in 1997 and the corporate scandals. The financial crisis that hit Asia in 1997 have an impact on the economic conditions of Thailand, Indonesia, South Korea, Malaysia and the Philippines. The financial crisis has led to a gap between monitoring mechanisms and the implementation of corporate governance (Radelet 1998). The gap between monitoring mechanism and corporate governance will affect the company's financial performance. Daily (2003). Muth (1998) examine aspects of the composition of the board of commissioners, the characteristics, and impact on the value and financial performance. From the results of these studies could be identified that transparency, independence, CEO - Chair separation, diversity commissioners, the number of commissioners, and the activity in the strategic decision-making will improve the company's financial performance .

Previous research that examined the role of the commissioners have been carried out and the study refers to the function of corporate governance, through the ratification of decisions and monitor the implementation of decisions taken by the board of commissioners (Fama 1983, Baysinger 1989, Lorsch 1989, Baysinger 1990, Goodstein 1991, Daily 1994). Different roles of the commissioners is to provide resources through the relationship with the external environment (Boyd 1990, Daily 1994, Gales 1994, Johnson 1996). Resource dependency theory states that the necessary mechanisms are tied to the management of the external environment.

The underlying reason of this research is changes at ownership structure in the Indonesia Stock Exchange. Currently the changes are no longer concentrated ownership but more to the holding ownership. According to Claessens (2001) shareholding owned by the family as much as 60 % and 20 % owned by the state, and the rest is owned by the public. Then in 2002 find that the ownership of the company by the family has resulted in a decrease in the firm performance. The effect of ownership structure like this entrenchment effect and strong alignment. As a result, ownership by a large group of family or pyramid concentrated in ownership will create interest conflict between majority shareholder to minority shareholders. Based on the ownership structure, it appears that the composition of the ownership of shares of 86 companies or 72.27 % is a family company and is the controlling shareholder majority (at least 20 % ownership). Based on the previsious research, the proposed research problem is how to develop a theoretical model to address the effect of the controversy between firm characteristics and the characteristics of the board of commissioners.

2. Literatur Review

2.1. The Relationship Between Firm Characteristics and Board Cohesiveness

Linck (2008) analyze the determinants of firm characteristics that influence the effectiveness of the board of commissioners. Variable size of the firm is recognized as one of the determinants of differences in leverage between firms. Firm size is closely related to the risk and cost of bankruptcy. The larger a company the more the problems faced will be more diverse. Therefore companies with large size tend to have high levels of non-compliance with a low level of profitability as well (Eriotis 2007). Companies with large sizes will more easily attract a debt analyst to provide information to the public about the debt problem. As a result, large companies are usually able to reduce the transaction costs associated with the issuance of long-term debt and could set a lower interest rate.Companies with high profit levels will tend to use lower amounts of debt and the opposite applies. The reason is companies with a high rate of return would be possible to use retained earnings as a source of corporate funding. Kim (1986) concluded that There is a negative impact to the company's profitability leverage corporate scale . This is because companies with high profit levels will tend to use lower amounts of debt. A similar sentiment was expressed by Bennedsen (2000) and Choi (2006) which states that companies with high profit levels tend to use retained earnings as alternative financing, alternative selection is because of the level of risk that must be faced by the company will be lower when compared to the use of the loan .

Companies that have a long standing generally have more stable profitability compared to a new company or who still have a short lifespan. Companies that have a long standing would increase profits due.There is a theoretical ambiguity regarding the relationship between firm age and debt. Some theories postulate that firm age and debt financing are positively correlated. This justification is based on the profits of the company arising from the existence of a strong reputation, the possibility of establishing a relationship lender (Sakai 2010), and lower transaction costs. Older companies have long track record and reputation is stronger and should have better relationships with lenders, lowering the cost of debt.

Petersen (1994) shows that the longer a company must maintain higher leverage implied that given the relatively higher quality. Sakai (2010) illustrates that as the age of the company, relationships with lenders to facilitate various types of exchange of information between borrowers and lenders, reducing information asymmetry and improve the efficiency of credit allocation.

Fama (1983) and Lehn (2004) states that the characteristics driven by the scope and complexity of the company's operations can be partly used by the company size, firm age, the number of the company's business segments and industry concentration . Large companies and companies also tend to have more diversified board of commissioners with relatively high amounts. This means that the company will determine the characteristic closeness of the relationship between the commissioners. In addition, the views of free cash flow and leverage characterize personal benefits available to people in the company (Boone 2007). Firm size plays important role in defining the capital structure of a firm. The big firms have high bankruptcy potential because their business is more varied than the small ones. By virtue of tradeoff theory the bigger firms have higher leverage because their debt cost is lower thanthe small ones.

H1 : There is significant relationship between firm characteristics and board cohesiveness.

2.2. The Relationship Between Board Characteristics and Board Cohesiveness

This study uses a board size and gender as indicators of board charactersitics. The reason is board size have a positive relationship between firm value (Yermarck 1996). Finkelstein (1996) suggest that the number of board make an impact on the strategic direction of the organization. It also indicates that a firm information directly related to the board size (Zahra 1989). Erhardt (2003) found that the diversity of the board is positively related to return on investment and return on assets. Kochan (2003) observed positive and negative effects of gender diversity, and emphasized the important role of the organizational context and the group as a moderator. A positive correlation was found by Adler (2001) who investigated the relationship between the percentage of women and minorities on the board of directors and firm value, positive and significant effects were also found by Carter (2008).

Many studies also define the composition of the board (Peng 2004) found baord size have a positive influence on the financial performance. The resource dependence theory examines the provision of resources as the primary function of the board and then explore the relationship between the board and the capital as antecedents of these functions with firm performance. Provision of resources refers to the ability of board to bring resources to the company.

H2 : There is significant relationship between Board characteristics and board cohesiveness.

3. Methodology

The data required in this study are all secondary data sourced from company reports documented by the Indonesia Stock Exchange. Data are taken from companies that conduct IPOs starting in 2000 through 2008, in a span of five years. In this study using firms that conduct IPOs in the period 2000 to 2008 . As per the data companies doing IPOs in 2000 and 2008 as many as 119 companies. The period of observation in this study of 2000 to 2008 Reasons to use this time span is the study uses panel data which combines cross section data with time series data and to meet the data sufficiency. Thus, the wider the range of time spent. Another reason is the selected time range is able to see the development of the Indonesian capital market ranging from stagnation phase to the recovery phase.

Board cohesiveness refers to Crutchley (2002), the reason is more representative description of the cohesiveness of the board is closeness between the commissioners within a certain time period.

Firm characteristics is a factor that can determine the effectiveness of the control mechanism used to reduce the agency. This study used firm age, risk, and profitability. Profitability is used to measure a company's ability to generate profits. The size of profitability by using the earnings per share (EPS), as done by Jensen (1992), Al Malkawi (2009). Risk is used to measure the low steeper companies face potential bankruptcy. Risk in this study using the Interest coverage ratio is a company's ability to meet obligations on loans by using profits. The measures used in this study is earnings before interest and taxes divided by interest Jensen (1992) , Al - Malkawi (2009). Firm Age, using the size of the number of years since the company was first established (Jensen 1981, Al - Malkawi 2009). The use of this number as a measure of a firm reputation.

Characteristics of the board using board size (Abdullah 2004, Chiang 2005). Board size refers to conducted by Abdullah (2004). In accordance with the suggestion in a study conducted by Burke (1997) and Abdullah (2004).

Model specification

$$Board_{cohesiveness} = a + \beta_1 Firm_{charateristics} + \beta_2 Board_{characteristics} + \varepsilon$$

4. Result and Discussion

Sample of this research were of a group of companies in the category of non-financial industries, namely agriculture industry, mining, basic chemicals, consumer goods, property, property, real estate & building construction, infrastructure, utilities and infrastructure, utilities and transportation, and trade, services and investment. Hypothesis testing using Partial Least Square (PLS).

Table 1 present the result of statistic descriptive

Table 2 present result of outer weights, our result indicate that all indicator (age, size, eps, bc size) valid in model.

Tabel 3 present result of path coefficient

Tabel 4 present result of inner model, this result shows that firm characteristics have positive coefficient (0.373680). This coefficient indicates the effect is positive between the company and the board cohesiveness. It means the higher the risk, the higher the ratio perofitabilitas, and age affects the cohesiveness of the board. Thus the hypothesis that firm characteristics have positive effect on board cohesiveness accepted. Fama and Jensen (1983), Lehn (2004) states that firm characteristics driven by the scope and complexity of the company's operations can be partly used by the company, size of firm age, the number of the company's business segments and industry concentration. Companies that have the complexity of operations tend to have commissioners with relatively high amounts. This means that the company will determine the characteristic closeness of the relationship between board members (Boone 2007). According to the contingency theory that when an organization dealing with turbulent and complex environment the organization responds to the environment (Ashmos P. Donde 2000) . Research conducted by (Demsetz 1985) found that the risk of strengthening the relationship between business performance and corporate value.

Characteristic can be considered as a firm basis for decision making, because the characteristics of the company will affect the effectiveness of management. The results of this study support that company characteristics can be considered as control variables such as the type of industry (Al - Malkawi 2007), profitability (Lee. 2008) Companies that have many departments require more experts who have extensive knowledge and networks (Agrawal 1996). Firm with a high level of profitability resulting from increasingly complex operational activities of firm. Therefore, the necessary control functions of the board, so managers do not act in accordance with their interests. One form of control function performed is to have the board of commissioners from outside the company that would be more objective in decision making.

Hypothesis 2 stated board characteristics positive influence on the board cohesiveness. Our results shows that baord characteristic positive influence on the board cohesiveness. Coeefficient value of 0.177524 and statistical t value of 4.239896 . This indicates that the greater the number of board affects higher level of cohesiveness. The results of this study are consistent with Mizruchi (1983) who provide empirical support for the influence of the company's needs for financial resources and representatives of financial institutions. Many studies also define the composition of the board as one of the determinants of the effectiveness of boards (Goodstein 1991). While other studies have suggested that the composition of the board of commissioners in combination with a board from outside the company will add the ability to net working (Peng 2004). According to resource dependence theory, if the composition of the board of commissioners of the type and composition will be determined after the IPO (Lee 2008). From the perspective of resource dependency, increasing the diversity of the board of commissioners may also provide additional relationships with resources and from the perspective of stakeholders.

From the results proved that the number of board members affect the board cohesiveness, but there is no optimum number of board members. These findings are consistent with research findings Jensen (1988) and Lipton (1992). Additionally Jensen (1988) and Lipton (1992) suggest that the maximum number of board members is 7 or 8 people.

5. Conclusion

This study aims to examine the affect of firms characteristic, board characteristics to board cohesiveness. Object of research is that firms do an IPO on the Jakarta Stock Exchange and the Stock Exchange of Indonesia in 2000-2008, the period of observation for five years beginning at the time of the IPO. Based on purposive sampling method, the company acquired 119 of the 145 companies or 595 units of analysis. Completion estimated using the approach of Partial Least Square (PLS). This study found that firm characteristics and board characteristics affect to board cohesiveness. This suggests that the number of board play an important role in the formation of the relationship and the management of resources.

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Table 1. Descriptive Statistic

	N	Minimum	Maximum	Mean	Std. Deviation
size	119	22,5041	30,5577	26,025118	1,8351000
eps	119	-64,00	2292,00	55,0168	247,26689
age	119	2,0000	44,0000	15,100840	9,4880790
risk	119	,0001	1,9143	,117069	,2527003
bcsize	119	2	7	4,13	1,190
gender	119	,00	,67	,0972	,15788
cohesiveness	119	,5000	3,9792	1,944002	,8031559
Valid N (listwise)	119				

Table 2. Path Coefficients (Mean, STDEV, T-Values)

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	Standard Error (STERR)	T Statistics (|O/STERR|)
BoardCharacteristics->BoardCohesiveness	0,173282	0,169766	0,040292	0,040292	4,300654
FirmCharacteristics -> BoardCohesiveness	0,375855	0,380488	0,045842	0,045842	8,198955

Table 3. Outer Weights (Mean, STDEV, T-Values)

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	Standard Error (STERR)	T Statistics (|O/STERR|)
AGE -> FirmCharactersitics	0,202537	0,194158	0,109514	0,109514	1,849411
BCSIZE -> BoardCharactersitics	1,000000	1,000000	0,000000		
EPS -> FirmCharactersitics	0,575308	0,573037	0,095510	0,095510	6,023544
RISK -> FirmCharactersitics	0,696289	0,679009	0,098481	0,098481	7,070309

Table 4. Hasil Pengolahan Data Inner Model dan t Statistic

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (|O/STERR|)
BoardCharacteristics->BoardCohesiveness	0,177524	0,178182	0,041870	4,239896*
FirmCharacteristics -> BoardCohesiveness	0,373688	0,374334	0,044143	8,465329*

*)sig α = 1%;
**)sig α = 5%
***)sig α = 10%