

## **A STUDY OF CORPORATE GOVERNANCE STRUCTURE, DISCLOSURE AND INFORMATION ASYMMETRY IN INDONESIA BANKING INDUSTRY**

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**Abstract:** The purposes of this study are to find out the effect of corporate governance structure on information asymmetry, to find out the effect of corporate governance structure on disclosure, and to find out the effect of disclosure on information asymmetry in Indonesia banking industry. This study used partial least square/ variance based statistical method. The results of this study found out that good implementation of corporate governance structure will increase disclosure in Indonesia banking industry. The other result implied that the higher implementation disclosure will reduce information asymmetry in Indonesia banking industry (disclosure represented by the indicator of percentage corporate governance items disclosed or as IPCG).

**Keywords:** disclosure, information asymmetry, ownership, audit committee, independent commissioner.

### **INTRODUCTION**

The influence of growing globalization massively impact on investment. Investors need to be convinced that the company where they invested has a standard corporate management and a good reporting standard also the correct implementation and monitoring in order to provide a return as expected by them. Transmission of relevant information on the actual events to the involved various parties in the organization (stakeholders) is very important in order to avoid information asymmetry. The collapse of Enron, Worldcom and some other global as well as local cases has proven the importance of the high quality of information in the company among stakeholders. Disclosure of information is a fundamental principle in the system of good governance in the company, namely transparency. With a good corporate governance, it is expected that disclosure of relevant information will increase and will decrease the information asymmetry, especially among agent and principal.

Agency theory states that the agency relationship arises when one person or more (principals) employs another person (the agent) to provide a service and then delegate decision-making authority to agent. In the management of the company, often there is a separation between ownership and control between the owner as a principal and manager as agent. Agency relationship is a contract in which one or more principal (owners) uses another person as agent (manager) to carry out the activities of the company (Jensen and Meckling 1976). The agency problem often occurs in managerial is "empire building"

which refers to the tendency of managers to run the company beyond their optimal authority or to utilize/use resources in order to increase private utilities, power, compensation, and to increase their prestige (Jensen 1986).

The contractual relationship between the various parties (stakeholders) in the company always happens in the business. And it is very possible impending problems, which is often called the agency problem, because of the diverse interests and because it allows the asymmetry information. In many cases, confidence in the management and reporting of the company was eroded. An increasing number of scandals or problems and the failure of companies to encourage the importance of implementing good corporate governance. The code of ethics is necessary, good governance approach will require the development of corporate performance comprehensively at all levels including revealing events (financial and non-financial) incurred so that the information received by the different parties are the same information or relatively similar.

In practice, disclosure can have a positive impact (gain) as well as negatif or harmful. Competitive disadvantage exists by disclosing segments information (Talha, et al., 2007). Through the public disclosure, investors know the existence of a company and reduces the risk of litigation costs for the company. Disclosure is more often caused by a view to reducing information asymmetry (Buskirk, 2011). There is a negative and strong relationship between the level of voluntary disclosure and information asymmetry (Gajewski & Li, 2015).

Firm size, growth prospects, and independent board members associate positively with recommended disclosure whereas there is a negative relationship between financial leverage and recommended disclosure (Miihkinen, 2008). In Indonesia, regulations on information disclosure standards for publicly listed companies has been regulated in Bapepam Regulation No. VIII.G.7 2012 on guidelines for the presentation of financial statements. Financial Services Authority (OJK) circular letter No. 32 / SEOJK.04 / 2015 also set the annual reporting obligations on annual report for issuers or for public companies. Next perfected in the Regulation of the Financial Services Authority No. 29 / POJK.04 / 2016 annual report 2016 on the issuer or public company (Otoritas Jasa Keuangan, Surat Edaran OJK Nomor 32 /SEOJK.04/2015; Otoritas Jasa Keuangan, Peraturan OJK. No. 29/POJK.04/2016).

Agency relationship defined as a contractual in which one or more persons engage someone else to do something on behalf of those who delegated the authority for decision-making to the agent. Both sides have a relationship of utility maximization and the agent will not always act at the best interest of principal (Jensen and Meckling 1976).

In a contracting schematic of the modern corporation describes the relationship of each parties in the company, and the relationship between the parties describes the contractual relationship that allow for asymmetry information and can eventually lead to a conflict of interest resulting agency problems. Potential conflicts of interest abound, even in a group of owners or shareholders itself (Fred, 2003). Developed corporate governance is as a system which directs all activities within the company can run properly in the interests of stakeholders.

The above descriptions explained that the study about disclosure and asymmetry information becomes very important to do further.

**Good Corporate Governance.** Corporate governance concerns with the relationship between the management, board of directors, controlling shareholders, minority shareholders and other stakeholders. Australian Security Exchange states, Good Corporate Governance as a system used to direct and manage the activities of the company. Corporate governance also have an influence in order to achieve optimal performance, to analyze and control the risks facing by the company (ASX, 2005). Corporate governance is a system in which companies are directed and controlled, it also provides the structure that leads to the company's goals are already set, and the means to achieve those objectives and monitoring performance (Organization for Economic Cooperation and Development, OECD, 2004).

In relation with the presence of board members, then the implementation of corporate governance is often linked to the size of the board, in some circumstances the board can be too small or too large, too small board member will lack of expertise or human power to run the company productively. While greater size will increase more skill and resources availability in the company's Management. Study shown, board size has significant impact on corporate value (Siahaan, 2013).

Study also found that Banks with larger boards have higher efficiency, offer more favorable loan terms to their members, and have easier access do member runding. board size, is an important governance mechanism. (De Lacerda, 2014). While the other study found that board member diversity has an impact on the functions each director successfully provides. Appropriate and necessary board member capabilities differ between small and large firms. Small firms can enhance performance through appropriate member composition in differing ways than large firms (Bendickson et al., 2015). However, that too large board size may not be efficient in making and implementing decisions, and also can be a waste of resources and reduces the productivity of individual.

Another view in respect to board members said that an effective board should be balanced both within the company and outside the company. This ensures that the board remains independent and objective, maximizing the ability to make the best decision for the benefit of the corporation. It is expected that they will provide an independent assessment and monitoring for the better company's performance and that will raise the standard of corporate governance. Yet said board independence has reduced the occurrence of connected transactions and violations such as financial statement fraud, illegal insider trading, and asset misappropriation (Wu, and Li, 2015). Effective independent board will increase the company value (Khosa, 2017). The presence of non-executive directors in corporate boards reduces corporate risk taking practices in financial firms (Akbar et al., 2017).

**Disclosure.** Management as a party to carry out company operational tasks has an obligation to meet the interests of shareholders, but on the other hand the management also have an interest to maximize their welfare. The difference of interests between parties that control company (management as an agent) with the shareholders (principal) would cause a conflict of interest (agency conflict). Agent who has more information about the current conditions and future plan of the company will not provide all the information to principal for various reasons such as cost constraints, a presentation of the report, and the desire to avoid the risk of visible weakness. On the other hand, principals need all the relevant information about the overall condition of the company, but do not have full

access to the company internal information, it raises the asymmetry of information. Seeing the importance of information to minimize the asymmetry of information, disclosure of financial and non financial information is required.

Disclosure of financial statements is a way to convey the information contained in the financial statements, which when talking about full disclosure principles that where management requires the disclosure of all the circumstances and events in the company that makes a difference for users of financial statements in making decisions (Hendriksen et al., 2002). Disclosure comprise of two types, mandatory disclosure and voluntary disclosure. Both mandatory and voluntary disclosure should not be considered as being different, in the sense that both are considered very important (Omar & Simon, 2011).

**Information Asymmetry.** Information asymmetry is a condition where there is an imbalance information between management as an information provider (preparer), with the shareholders and other stakeholders. Or a situation where there is inequality of information (both in quantity and in quality) owned between one party to another party. it is more often concerned that the information held by management as an agent is more complete than the information held by the shareholders (Ujiyantho, 2003; Muller, 2007). Therefore, as an agent it is their obligation to pass information about the current condition and the future plan of the company to the owner, those informations as signal, which can be done through disclosure of financial information (such as financial statements) and even non-financial (eq. the change of leadership of the company).

The state of information asymmetry cause many problems on the players in capital market, including the lack of quantity or quality of the information in making investment decisions (Nikolaou et al., 2013).

Agent in a position has more information capacity, the working environment and the company as a whole compared with the principal. Assuming that individuals act to maximize self-interest, then with its asymmetry of information will encourage agents to conceal some principal's unknown information. Asymmetry between management (agent) and the owner (principal) give an opportunity for managers to act opportunistically and unfavorable for the principals.

**Corporate Governance and Disclosure.** The main purpose of disclosure is to present necessary information in order to achieve the purpose of reporting, to serve the various parties who have interests that differ from one another. From the point of financial statements, the disclosure shall include the components of the financial statements, notes to the financial statements and supplementary information.

Corporate governance is the set of mechanisms that are built to provide protection for the stakeholders, including the minority party in the company (outside inverstors and minority shareholders) from misuse of information delivery conducted by the managers as agent and the controlling shareholders (insiders). Companies that implement good corporate governance should adopt the principles of transparency, which in the sense of providing information to various parties in a timely, accurate, clear, comparable, adequate and easily accessible by the user.

From another side, the application of corporate governance must provide appropriate incentives for management and board in order to achieve the interests of the company and shareholders and should facilitate effective monitoring. An effective corporate governance

system in the companies and the economy as a whole will help provide a level of trust that is needed for a functioning of market economy. Good corporate governance mechanism can increase the level of disclosure in the company and the level of confidence in investing (Zaluki and Hussin, 2009; Wijaya, 2009; Susiyani, 2009).

**Corporate Governance and Information Asymmetry.** In order to reduce management actions that are beneficial for him/ her-self then it is important to implement corporate governance, which include controls and good procedures to ensure that management actions are in accordance with the interests of shareholders. Corporate governance mechanism can also affect the information disclosed by management to the shareholders. The implementation of proper corporate governance mechanism makes the management less likely acts in the interests of their own, further also will be able to disclose relevant information and avoid delivery of inferior information to shareholders.

Quality of information increased after implementation of the corporate governance code code (Machuga and Teitel 2007). Companies that face the information asymmetry will tend to use less intensive monitoring board and will be more lean on or believe in the market discipline and CEO incentive compensation (Cai et al., 2008).

In the previous study indicated when the board act more effectively in monitoring will improve the quality and frequency of information released by management. the publication or issuance of such information does not only include the actual reported earnings, but also in the form of voluntary disclosures such as management estimates and other information release. Further shown, in addition to reducing the accuracy of personal information with the accuracy of public information, the disclosure will also reduce the cost to search information. This suggests that the existance of information asymmetry will be lower in the company whose board members work effectively.

**Disclosure and Information Asymmetry.** Disclosure is an effort to minimize the information asymmetry in the company. Through submission of relevant and credible informations (financial and non-financial) to all parties will expect that the quality of information held by management as an agent will equal or relatively equal (its quality and quantity) compared with the information held by other parties (including investors and creditors). so that the various parties will be assisted in terms of speed and accuracy during their decision-making process (Cormier et al, 2008) and governance disclosure contributes in reducing the stock-market information asymmetry particularly in the country with legally high protection on investor such as Canada.

Generally, disclosure is deemed entirely good and disclosure in large companies as part of efforts to reduce agency problems arise in the company. Indeed this opinion is not completely perfect, because at the better level of disclosure can also exacerbate the agency problem, this is because the costs incurred in the disclosure will also increase, including executive compensation and meeting expenses in connection with the disclosure. Further, pointed out that large companies will adopt strict disclosure rules than smaller firms, and firms with better disclosure would use a more capable power management (Hermalin and Weisbach 2012). More details, the relationships between variables can be seen in a form of matrix table that related to corporate governance, disclosure and information asymmetry (see Table 1).

**Table 1.** Earlier Studies Associated with Corporate Governance, Disclosure and Information Asymmetry

No	Authors, (Year)	Finding (s)	Notes
<b>A. <i>Corporate Governance and Disclosure:</i></b>			
1.	Wijaya, (2009)	Corporate Governance and Financial Distress has significant impact on disclosure level.	This study more looking at voluntary disclosure than mandatory disclosure.
2.	Anyta, (2011)	Public ownership has a significant positive effect on voluntary corporate disclosure (while institutional ownership, the proportion of independent directors and independent audit committee showed no significant effect on voluntary corporate disclosure)	Voluntary corporate disclosure system measured by weighting through 11 categories of the 34 items. Then compiled 34 questioner that represent them, distributed to 100 respondents.
3.	Tsamenyi et al., (2007)	In the developing countries (including Ghana), the level of disclosure is low. ownership structure, dispersion of shareholding, and firm size has a significant impact on disclosure.	Data processed over 22 listed companies on the Ghana Stock Exchange have represented 95% Ghanaian market capitalization.
4.	Aboagye - Otchere et al, (2012).	Although there has been improvement of disclosure practices over the years, the level of disclosure in Ghana was still in moderate. There was a positive relationship between the presence of accounting/ finance expert(s) on the audit committee and corporate disclosure practices.	<p>) Audit committee characteristics are as the governance attributes.</p> <p>) The study follows the trinary procedure of Aksu and Kosedag and uses Standard &amp; Poor's T&amp;D items in the construction disclosure index</p>
<b>B. <i>Corporate Governance and Information Asymmetry:</i></b>			
1.	Kanagaretnam et al., (2007).	Good corporate governance mitigates information asymmetry during quarterly earnings announcements.	Changes in market liquidity around earnings announcement as a proxy for information asymmetry. Board independence, board structure and board activity as indicators for corp. governance.
2.	Cormier et al., (2010).	Formal monitoring (size board and committee size) and the level of voluntary governance disclosure can reduce information asymmetry.	To figure out governance information asymmetry between managers and investors
3.	Tarjo, (2010).	Corporate governance mechanisms will reduce the information asymmetry between managers and owners. Thus the risks of investing in the company is decreased for corporate securities.	Board composition, audit committee and transparency of information used as a measurement of corporate governance mechanisms.

C. *Disclosure and Information Asymmetry:*

1.	Nakhodchari, F. S., & Garkaz, M. (2014).	Voluntary disclosure affects information asymmetry when company with ownership concentration of financial-institutional shareholders.	Study on 140 companies in Teheran.
2.	Cormier et al., (2008).	Governance disclosure contributes to reduce the stock market asymmetry particularly in the legally country on investor protection is high, such as Canada. Voluntary disclosure of corporate governance will be seen as something credible efforts in improving governance.	Web-based disclosure was obtained from the web site. Governance disclosure is measured by indicators of United Nations Guidance on Good Practices in Corporate Governance Disclosure.
3.	Buskirk, A.V. (2011).	The company's decision to disclose financial and non-financial information is more often associated with measures in order to lower the asymmetry of information for investors.	The author uses the bid-ask spreads as a proxy to test the depth of information asymmetry.
4.	Ertimur, Y. (2007).	There is a negative relationship between the overall quality of disclosure (including voluntary disclosure) and the average level of information asymmetry	Evaluation of disclosure using the Association of Investment Management and Research (AIMR)

Sources: earlier studies

It concluded, if companies carry out the principles and mechanisms of good corporate governance than will raise the level of disclosure and will further decrease the information asymmetry. In the direct relationship between corporate governance and information asymmetry it says that companies that implement good corporate governance will mitigate information asymmetry.

The aim of this study are to find out the effect of corporate governance structure on information asymmetry in Indonesia banking industry, to find out the effect of corporate governance structure on disclosure in Indonesia banking industry and to find out the effect of disclosure on information asymmetry in Indonesia banking industry.

Based on the above literatures theories this study constructed hypotheses as:

H1: Corporate governance structure has a significant impact on information asymmetry in Indonesia banking industry.

H2: Corporate governance structure has a significant impact on disclosure in Indonesia banking industry.

H3: Disclosure has a significant impact on information asymmetry in Indonesia banking industry.

## METHOD

The method used in this study is descriptive. Variables are identified, population and sample are the entire Indonesia bank companies listed in Indonesia Stock Exchange. Datas taken from published audited financial statements by an independent auditor for corporate governance variable structure, bloomberg bank data for information asymmetry and for disclosure. All datas are for the period of 31 December 2001 to 2013. This study use partial least square regression approach (PLS) path analysis gives more openness in providing data processing requirements in the sense that the terms classical assumptions and certain distributions as ordinary least squares approach is no longer needed (Latan and Ghozali 2012, Jogianto 2009). A description of the operational variables of the study can be seen in Table 2.

**Table 2.** Description of Operational Variables

Variables:	Definition:	Type of data:
<b>Corporate Governance Structure :</b>		
) Managerial ownership	The percentage of the number of shares in the company owned by managers, directors, and commissioners of all the outstanding share.	Ratio
) Institutional ownership	The percentage of shares owned by all the institutions of the company's shareholders of all the outstanding share capital.	Ratio
) Audit committee member	The number of audit committee members in the company.	Ratio
) Board independen	Number of independent board members divided by all members of the commissioner.	Ratio
<b>Diclosure:</b>		
) Corporate governance disclosure	Total score of items disclosed by the company / the maximum score that should be disclosed by the company (IPCG).	Ratio
<b>Information Asymmetry:</b>		
) Volume of transaction	The number of shares traded on a particular day.	Ratio
) Bid-ask spread	The average percentage of the daily bid-ask spread (the number of trading days) for each type of share studied during the observation period.	Ratio

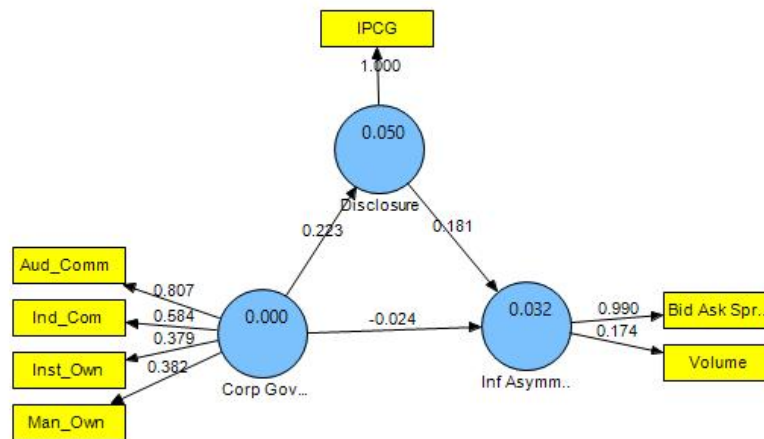
## THE ANALYSIS AND RESULT

There were 38 banks listed on the Jakarta stock exchange, during the the year of 2001-2013, there were 17 new bank entry in the listing on the Jakarta stock exchange and after 31 December 2001 there were 6 banks delisted during the period. So there are 15 banks as sample in this study, with the years of research 2001 up to 2013 then there were 180 year observational datas.



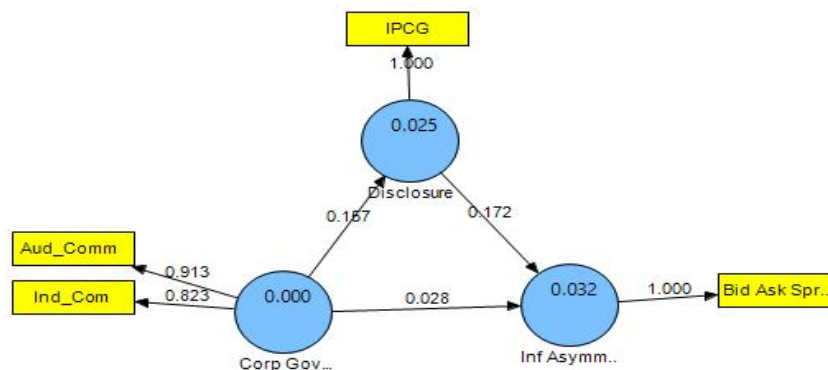
**Outer Model Test (Measurement Model).** The first step outer model test in figure 1 shown that the indicators managerial ownership and institutional ownership for variable corporate governance structure were not meet the validity criteria, also indicator volume for variabel information asymmetry were not meet the validity criteria, it was because of the entire loading

factor for those indicators were below 0.7. By eliminating one by one indicator which does not meet the requirements (from the smallest and so on), then we obtained the final model that deserve to be continued (as it is in figure 2), where that the entire loading factor for each variable has been greater than 0.7.



**Figure 1.** First Step Outer Model Test  
Source: PLS figure output

Figure 2 has shown that there are two reflective indicators for variable corporate governance deserve to be further processed (ie indicator of the audit committee member and independent commissioner), while for information asymmetry variable represented by the indicator of bid ask spread, and for disclosure variable were represented by IPCG indicators (total score of items disclosed by the company / the maximum score that should be disclosed by the company).



**Figure 2.** Last Step Outer Model Test  
Source: PLS figure output

With the value of average variance extracted and Cronbachs Alpha were  $> 0.5$  (see also table 3) confirmed that the model was eligible to be processed further for statistical hypothesis testing. The value of R square are 0.024543 and 0.031944 repectively for disclosure and information asymmetry.

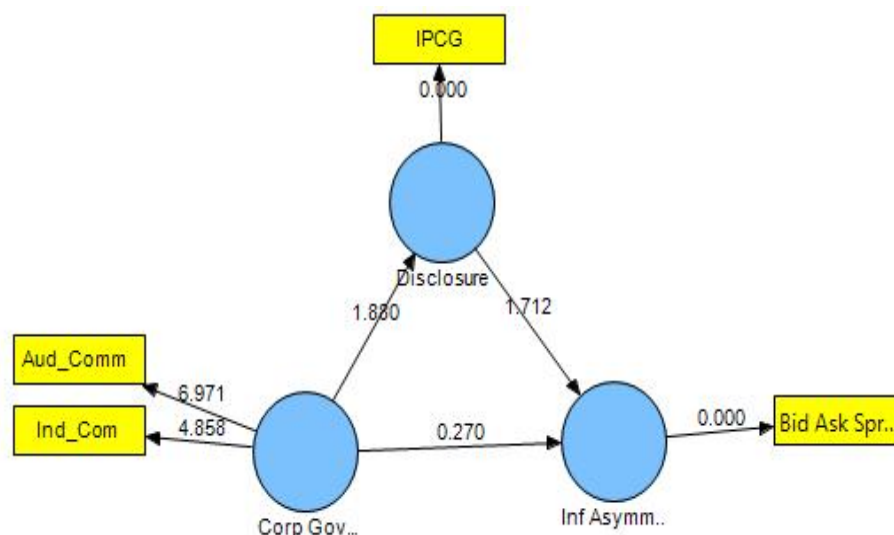
**Table 3.** Overview Result

	AVE	Composite Reliability	R Square	Cronbachs Alpha
Corp. Governance	0.755656	0.860504		0.684261
Disclosure	1.000000	1.000000	0.024543	1.000000
Inf. Asymmetry	1.000000	1.000000	0.031944	1.000000

Source: statistical PLS output

**Inner Model Test (Path Model).** This hypothesis testing using significance level ( ) of 10% and based on the rule of thumb inner evaluation models that the correlational between variables will be declared significant if the t-statistics  $> 1.65$  (Latan and Ghazali 2012). Path testing models with PLS approach resulted that only two hypotheses were accepted, namely:

1. Corporate governance structure has a significant impact on disclosure in Indonesia banking industry (corporate governance structure represented by the indicator of audit committee member and independen board commissioner).
2. Disclosure has a significant impact on information asymmetry in Indonesia banking industry (disclosure represented by the indicator of percentage corporate governance items disclosed or as IPCG).



**Figure 3. Inner Model Test**

Source: PLS figure output

**Table 4.** Path Coefficients (Mean, STDEV, T-Values)

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	Standard Error (STERR)	T Statistics ( O/STERR )	Hypotesis (Accepted/ Rejected)
Corp Governance -> Disclosure	0.156661	0.171066	0.083336	0.083336	1.879874	Accepted
Corp Governance -> Inf Asymmetry	0.027953	0.032643	0.103585	0.103585	0.269859	Rejected
Disclosure -> Inf Asymmetry	0.172205	0.168036	0.100585	0.100585	1.712034	Accepted

Source: statistical PLS output

## CONCLUSION AND MANAGEMENT INTERPRETATION

The transfer of authority from principals to executives through the board for the provision of trust management of funds that have been invested in the enterprise is a form of agency theory, and this theory even thrive in the company formed in the relationship between the various parties. On that authorization relationship may potentially the emergence of agency problems, so that the information held by the agent and the principal can be different at levels and quality, that condition known as information asymmetry. That is why we need good corporate governance that will reduce such problem, the implementation of the principles and mechanisms of good corporate governance can raise the level of disclosure and will further decrease the information asymmetry.

The study results showed that the application of corporate governance in Indonesia banking industry has a significant impact on the level of disclosure, in this study corporate governance reflected by independent of board commissioner and the audit committee member or size. The sufficient information disclosure in Indonesian banking industry is very important to provide guarantees for the investors and creditors that every money they put in the bank is safe and deliver the expected returns. The role of independent board commissioner to oversight or control and to run their advisory function became very determinant point, independent commissioner board that exercises their role and function will encourage and increase the level of good corporate governance disclosure (Zaluki and Hussin, 2009; Richard and Haniffa, 2008).

The audit committee roles to review and evaluate financial statements periodically based on the rules and principles applicable accounting, assessing the implementation and results of the audit, as well as dealing with internal control and corporate governance implementaion, directing the implementation of transparency and good disclosure practices. This study implies the size of audit committee in Indonesia banking became important in enhancing or to deliver the implementation of transparency and to the level of good disclosure practices (Susiyani, 2009).

Disclosure has a significant impact to minimize information asymmetry in Indonesia banking, submission of relevant and credible information from management to stakeholders will deliver the quality of information available to other parties (including

investors and creditors) so that the various parties may be assisted in their decision-making process (Cormier et al, 2008; Buskirk, 2011).

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