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Good Corporate Governance and Firm Size on Cost of Debt: Evidence from Indonesian Listed Companies

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Abstract

The aim of this study was to find out how much influence good corporate governance has in proxy (institutional ownership, managerial ownership, proportion of independent commissioners, number of audit committees) and firm size of the cost of debt. The population of this study is a manufacturing sector company in 2016 - 2017. The sample technique was taken using Slovin which produced 61 companies with 122 data for 2 years of research. The research data is taken from the financial reports found on the IDX website. Data analysis method used with multiple linear regression. The results showed that managerial ownership and the number of audit committees had a significant effect on the cost of debt with a significance level of 10%. Whereas institutional ownership, the proportion of independent commissioners and company size did not significantly influence the cost of debt.

Key words

Institutional ownership, managerial ownership, independent commissioners, Audit Committee, firm size, cost of debt

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1. Introduction

In achieving company goals, the company must be able to manage its finances well, including those related to funding and financing. The company has several alternatives in funding, one of which is using debt. Debt is one way to obtain funds from external parties, namely creditors. Funds provided by creditors in terms of funding of the company incur debt costs for the company, where the cost of debt is the interest rate received by creditors as a suggested rate of return (Ashkhabi and Agustina, 2015). Use of debt to companies tends to increase the value of a company. This happens because debt results in the emergence of interest costs, where the component of interest costs becomes a deduction of profit before tax so that corporate tax becomes lower. In addition, companies with large debt have a large impact. One consequence is that the company is unable to pay its debt so the company needs monitoring of its performance from the management.

The case of a company that has a large debt and has a negative impact on its performance, namely PT Tiga Pilar Sejahtera Food (AISA) in 2017. The financial performance of PT Tiga Pilar Sejahtera Food (AISA) is predicted to decline in 2018. AISA's stock price has fallen since it was caught in a legal case also made analysts not recommend this stock for the long term. Moreover, a lot of homework to overcome debt and make performance improve. Based on the financial report until the third quarter of 2017, AISA's revenue fell 17.5% year on year (yoy) to Rp. 4.1 trillion. The decline also occurred in AISA's net profit of 57% to Rp 176 billion. Now AISA is increasingly depressed because it has a large debt. In April 2018, AISA has been overshadowed by a debt that will mature in value of Rp 900 billion (Investasi.kontan.co.id).

Corporate governance has an important role in organizations. The rules and regulations are made for the internal and external parties which are involved in playing the role in the organization not only from the inside but also the outside of the organization. The decisions are made by the top level management in any organization. And the corporate governance means to control and supervise the issues which relates to the decisions of the organization (Sultan, 2018). In general, it can be described that the mechanism of corporate governance is one of the key elements in improving economic efficiency which includes a series of relationships between company management, board of commissioners, shareholders, audit committees and other stakeholders (Budiharjo, 2019)

According to Asbaugh et al (2004) states that companies with good good corporate governance can have a higher credit rating than companies that are weak in implementing good corporate governance because the application of strong good corporate governance proves that there is good management management so that the risk received by investors and creditors is getting smaller. A high credit rating from good GCG implementation will get a low cost of debt. Good Corporate Governance is a system (input, process, output) and a set of rules that regulate the relationship between various stakeholders, especially in the narrow sense of the relationship between shareholders, board of commissioners, and the board of directors to achieve corporate goals. The application of good good corporate governance is the main aspect in building a strong company, performing well so that business continuity can be maintained.

The measurement of GCG mechanisms by companies can be proxied by several indicators including institutional ownership, managerial ownership, the proportion of independent commissioners and the number of audit committees. Institutional ownership can reduce the cost of corporate debt because of the effective supervision of institutional shareholders, thereby encouraging management to perform well and the risks of the company to be small which ultimately returns expected creditors will be low. Furthermore, managerial share ownership can influence company policy and decision making, one of which is related to funding. Independent commissioners in the organizational structure of the company consisting of a board of commissioners from outside the company function to balance in decision making, especially in the context of protecting non-controlling shareholders and other related parties. The audit committee is an important element of corporate governance and is concerned with building and monitoring the accounting process to provide relevant and credible information to corporate stakeholders (Pincus et al., 1989; Beasley, 1996). The audit committee also functions to monitor the independence of external auditors from senior management which allows debtholders to trust financial information provided. Therefore, the premiums needed for debtholders decrease, and therefore reduce the cost of debt. Large companies also have large assets so that creditors will find it easy to get collateral for their debt. The size of a large company has a small level of business risk so that it will be easier to get trust from creditors regarding funding. Companies that have greater total assets are estimated to have lower equity costs and debt costs (Bhojraj and Sengupta, 2003).

According to the study of Juniarti and Sentosa (2009) that institutional ownership and audit quality affect the cost of debt. While the proportion of independent commissioners and managerial ownership does not have a significant effect on the cost of debt. Kistiah and Mudjiyanti (2014) state that managerial ownership has a significant effect on the cost of debt, while independent commissioners and institutional ownership do not have a significant effect on the cost of debt. According to Adam et al. (2015) managerial ownership and institutional ownership do not affect the cost of debt. Ashkhabi and Agustina (2015) state that institutional ownership and firm size influence the cost of debt while managerial ownership does not affect the cost of debt. According to Meiriasari (2017), institutional ownership and company size negatively affect the cost of debt.

2. Literature review

2.1. Agency Theory

Agency relationship as a contract under which one or more persons (the principal engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. If both parties to the relationship are utility maximizers, there is good reason to believe that the agent will not always act in the best interests of the principal (Jensen and Meckling, 1976). Agency theory also places the application of good corporate governance that can reduce costs resulting from conflicts between managers and shareholders (compensation contracts) and from conflicts between companies and their creditors (debt contracts).

2.2. Good Corporate Governance

National Policy Governane Committee (KNKG) (2013) Corporate Governance as a process and structure used by corporate organs to provide added value to the company on a continuous basis for long-term shareholders, while taking into account the interests of other stakeholders, based on legislation and applicable norms. The mechanism in corporate governance supervision is divided into two groups, namely the internal and exsternal mechanisms. Internal mechanism is a way to control a company by using internal structures and processes such as the board structure, and managerial ownership. While external mechanism is a way of influencing companies in addition to internal mechanisms, such as markets for corporate control, institutional ownership and the level of funding with debt (Barnhart and Rosenstein, 1998).

2.3. Firm Size

Company size is one indicator used by investors in assessing assets and company performance. The size of a company can be seen from the total assets, total sales (netsales) owned by the company (Sudarmadji and Sularto, 2007). The larger the company, the greater the assets owned. Creditors are more trustworthy to give their funds to companies of large size because if in the future the company is unable to pay off its principal debt and interest expense, the company can sell the assets it has to pay off debt to creditors (Lusangaji, 2012).

2.4. Cost of Debt

Cost of debt can be defined as the level that must be received from an investment to achieve the rate of return (yield rate) needed by creditors or in other words is the rate of return needed by creditors when making funding in one company (Fabozzi, 2007). According to Utami (2005) the cost of capital is a dynamic concept that is influenced by several economic factors. The structure of capital costs is based on several assumptions related to risk and tax. The basic assumption used in estimating capital costs is business risk and financial risk is fixed (relatively stable).

2.5. Development of Hypothesis

2.5.1. Institutional Ownership and Cost of Debt

If viewed by using agency theory then with the strict supervision of institutional investors, it will improve management performance to be more optimal to show the performance of a company that is better and can prevent the occurrence of fraud that will be carried out by management.

According to Juniarti and Sentosa (2009), the existence of institutional ownership has a significant influence as an act of monitoring carried out by management. Elyasiani et al. (2010) state that institutional ownership plays an important role in debt costs. This is because institutional investors are in a better position to study the condition of the company and get greater benefits. The attention given by institutional investors can create a better corporate reputation in the capital market, allowing companies to obtain lower debt costs.

H1. Effect of Institutional Ownership On Cost of Debt

2.5.2. Managerial Ownership and Cost of Debt

The existence of managerial share ownership in a company will encourage the unification of interests between agents and principals so that managers will act in accordance with what is expected by shareholders (Jansen and Meckling, 1976). With managerial ownership, the manager's role will be even greater in managing the company, making decisions, preparing financial reports, and using the resources they have to achieve the company's goals. With this, managers will reduce the occurrence of debt transactions to maintain the proportion of ownership in a company. By reducing the amount of debt held by a company, it will make creditors see the company's performance better (Nugroho and Meiranto, 2014).

H2. Effect of Managerial Ownership On Cost of Debt

2.5.3. Independent Commissioners and Cost of Debt

Independent Commissioners are based on the Financial Services Authority regulation number 33/POJK.04/2014 about Directors and Board of Commissioners Issuers or Public Companies are members of the board of commissioners from outside the issuer or public company and fulfill the requirements as independent commissioners. Nugroho and Meiranto (2014) state that independent commissioners have a significant effect on the cost of debt. This can occur because the existence of a board of commissioners can prevent information asymmetry between management and shareholders by conducting routine monitoring by an independent board of commissioners

H3. Effect Proportion of Independent Commissioners On Cost of Debt

2.5.4. Number of Audit Committe and Cost of Debt

The Indonesian Audit Committee Association (IKAI) in Effendi (2016: 48) defines the audit committee as follows: "a committee that works professionally and independently that is formed by the board of commissioners and, thus, its job is to assist and strengthen the function of the board of commissioners (or the board supervisor) in carrying out the oversight function of the financial reporting process, risk management, audit implementation and implementation of corporate governance in companies". To produce an effective audit committee, the company must have an audit committee of at least three in accordance with applicable regulations. The audit committee will be able to supervise the performance of managers to reduce problems in financial reporting so as to make the company's performance better in achieving the desired goals and the cost of debt to be low (Nugroho and Meiranti, 2014).

H4. Effect Number of Audit Committees On Cost of Debt

2.5.5. Firm Size and Cost of Debt

Companies that have greater total assets are estimated to have lower equity costs and debt costs (Bhojraj and Sengupta, 2003). The size of the company will affect the capital structure based on the fact that the larger the size of the company has a high level of sales growth so that the company has a tendency to use the larger number of loans (Ashkhabi and Agustina, 2015). The greater the total assets of the company, the company is expected to provide a more certain level of return to investors so that the risk of the company experiencing a default will decrease. As a result, the cost of the debt borne by the company is lower (Meiriasari, 2017).

H5. Effect Firm Size On Cost of Debt

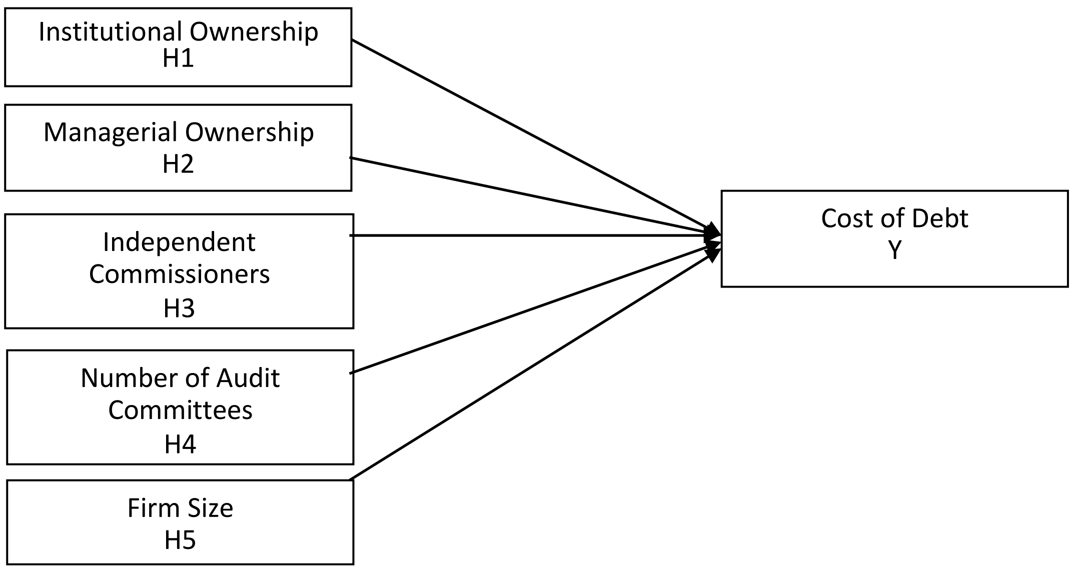

Figure 1. Framework Research

3. Methodology of research

3.1. Types of Research

In this study the type of research used is causal research which explains the effect of an independent variable on the dependent variable. The independent variables in this study include good corporate governance with proxy institutional ownership, managerial ownership, the proportion of independent commissioners, the number of audit committees and company size while the dependent variable is the cost of debt.

3.2. Definition and Operationalization of Variables

Table 1. Operationalization Variables

Variables	Measurement	Scale
Cost of Debt	$\frac{Interest\ Expense}{Average\ Interest\ Bearing\ Debt}$	Ratio
Institutional Ownership	$\frac{share\ ownership\ by\ institutional\ parties}{outstanding\ shares}\ x\ 100\%$	Ratio
Managerial Ownership	$\frac{Shares\ of\ the\ board\ of\ directors\ and\ commissioners}{Outstanding\ shares}\ x\ 100\%$	Ratio
Independent Commissioners	$\frac{independent\ board\ of\ commissioners}{member\ of\ the\ board\ of\ commissioners}\ x\ 100\%$	Ratio
Number of Audit Committees	The number of audit committee members owned by the company	Ratio
Firm Size	Ln (Total Asset)	Ratio

3.3.Population and Sample

The population of this research is manufacturing companies listed on the Indonesia Stock Exchange in 2016-2017. To calculate the number of samples from a particular population, the Slovin formula is used as follows:

$$n = \frac{N}{1 + N\,e^2} \qquad (1)$$

Explanation:
n = Samples
N = Population
e = The level of error or critical value

This sampling is carried out at a confidence level of 90% or a critical value of 10% so that the sample size can be calculated as follows:

$$n = \frac{154}{1 + 154(0{,}1)^2}$$

$$n = 60{,}6$$

Based on the above calculations, the samples taken were 61 (rounded up) issuers per year with 2 years of research conducted so that the total data sampled was 122 data (61 issuers x 2 years).

3.4. Analysis Method

The researcher used a multiple linear regression analysis method because of the relationship between two or more independent variables where the classical assumptions were carried out in the first stage.

COD = α + β1 KEP_INST + β2 KEP_MAN + β3 PROP_IND + β4 NUMBER_AUD + β5 SIZE + e (2)

Explanation:
COD = Cost of Debt

KEP_INST = Intitutional Ownership
KEP_MAN = Managerial Ownership
COMM_IND = Independent Commissioners
NUMBER_AUD = Number of Audit Committees
SIZE = Firm Size

4. Results and discussions

Table 2. Descriptive Statistics

Variables	N	Minimum	Maximum	Mean	Std. Deviation
COD	116	,0000	2,5273	,244878	,4038811
Inst_Own	116	,00	99,43	36,8117	33,27000
Manj_Own	116	,00	57,26	5,0007	10,64258
Comm_Indep	116	20,00	60,00	38,3826	7,78152
Size	116	9,73	18,29	14,6928	1,66152
Number_Aud	116	2	4	3,03	,321

Source : SPSS (2019)

The table above is the result of data after outliers where the initial data amounted to 122 data with the number of issuers per year 61 x 2 years of research. Outlier data is 6 data, including in 2016 ADES, BTON and UNIT while in 2017 BTON, UNIT and WIIM.

1. The mean value cost of debt of the manufacturing company is 0.24%, which means the interest rate that must be paid by the company for loan debt and the rate of return by creditors for the issuance of bonds is relatively small. The maximum value of 2.5% is owned by STAR in 2016. The minimum value of 0.00% is owned by ASII in 2016.
2. The mean value institutional ownership is 36.81% which means the number of shares held by the institution is quite large. The maximum value of 99.43% in TALF companies in 2017 and drinking value of 0.00% is in ALDO, APLI, AUTO and so on in 2016, currently in 2017 there are BUDI, CPIN, EKAD and so on.
3. The mean value managerial ownership is 5.00 which means the number of shares owned by the board of directors and the board of commissioners is very small. The maximum value of 57.26% is owned by SRSN in 2016. The minimum value of 0.00% is owned by AKPI, AMFG, AUTO and so on in 2016 while in 2017 by ADES, BUDI, CPIN and so on.
4. The mean value proportion of independent commissioners is 38.38%, which means that the proportion of independent commissioners owned by manufacturing companies is in accordance with OJK regulations with minimum independent commissioner requirements of 30%. The maximum value of 60% is owned by TSPC in 2016. The drinking value of 20% is owned by KAEF in 2016 and 2017 and SMBR in 2017.
5. The mean value number of audit committes is 3.03 which means the number of audit committees owned by manufacturing companies is 3 people and is in accordance with OJK regulations. The maximum value of 4 people in 2016 is owned by ASII, CPIN, KAEF and 2017 by ASII, CPIN, KAEF, SMGR, TCID. The minimum value of 2 people in 2016 and 2017 is owned by MRAT and PYFA.
6. The mean value of firm size is 14.69% which means that the size of the manufacturing company is small. The maximum value of 18.29% is owned by INDF in 2016. The minimum value of 9.73% is owned by UNVR in 2016.

Table 3. Multiple Linier Regression Result

Model		t	Sig.	Decision
1	(Constant)	1,523	0,131	
	Inst_Own	-0,100	0,921	Rejected
	Manj_Own	-1,864	0,065	Accepted
	Comm_Indep	0,476	0,635	Rejected
	Size	-1,454	0,149	Rejected
	Number_Aud	-2,407	0,018	Accepted

a. Dependent Variable: ln_COD

Institutional Ownership Variables have a t-count value of -0,100 and sig value 0,921 > 0,10. This shows that institutional ownership variables have a positive and insignificant influence. In making a hypothesis, H1 is rejected, which means that ownership does not have a significant effect on the cost of debt. The average share ownership by institutional parties is low at 36.81% so that the control mechanism for management performance is less effective which ultimately impacts on the cost of debt borne by large companies. This is contrary to Meiriasari's (2017) research, institutional ownership has a negative effect on debt costs. Institutional ownership can reduce the cost of debt borne by the company. This is because institutional investors are believed to have a better ability to monitor management actions from opportunistic attitudes. According Budiharjo (2019), institutional ownership makes the management work as well as possible by producing performance in accordance with what the shareholders expect but but this is contrary to the results of this study, namely institutional ownership can not produce performance that is in accordance with the creditor so that it does not affect the cost of debt. However, this research is in line with Adam *et al.* (2015) and Samhudi (2016) which states that institutional ownership does not affect the cost of debt.

Variable managerial ownership has a t value of -1.864 and a sig value of 0.065 < 0.10. This shows that managerial ownership variables have a negative and significant influence with a significant level of 10%. In making a hypothesis, H2 is accepted which means that institutional ownership has a significant effect on the cost of debt. In a company, the manager is involved in determining the amount of the debt borrowing process in a company. With increasing managerial ownership, company managers become more selective in making financing decisions and funding involving high risks that are consistent with the interests of shareholders. This is in line with the research conducted by Kistiah and Mudjiyanti (2014); Wardani and Sari (2018) state that managerial ownership has a significant effect on debt costs. Managers will reduce the occurrence of debt transactions to maintain the proportion of ownership in a company. By reducing the amount of debt held by a company, it will make creditors see the company's performance better (Nugroho and Meiranto, 2014).

The variable proportion of independent commissioners has a t value of 0.476 and a sig value of 0.635> 0.10. This shows that the variable proportion of independent commissioners has a positive and insignificant influence. In making a hypothesis, H3 is rejected, which means that the proportion of independent commissioners does not significantly influence the cost of debt. This is in line with research conducted by Juniarti and Sentosa (2009); Kistiah and Mudjiyanti (2014) which states that the proportion of independent commissioners does not affect the cost of debt. This indicates that independent commissioners have not been able to perform the supervisory function effectively in accordance with their duties and obligations in the regulations contained in the OJK. In addition, it is possible that the existence of independent commissioners is merely fulfilling regulations so that the implementation of GCG has not been maximized and information asymmetry has not been reduced.

Variable number of audit committees has a value having a t value of -2.407 and a sig value of 0.018 < 0.10. This shows that the variable number of audit committees has a positive and significant influence with a significant level of 10%. In making a hypothesis, H4 is accepted which means that the number of audit committees has a significant effect on the cost of debt. The audit committee will be able to supervise the performance of managers to reduce problems in financial reporting so as to make the company's performance better in achieving the desired goals and the cost of debt to be low (Nugroho and Meiranti, 2014). The Audit Committee consists of at least 3 (three) members who come from Independent Commissioners and parties from outside the Issuer or Public Company. The results of this study are in line with Anderson et al (2004); Hashim and Amrah (2016) which states that the size of the audit committee negatively affects the cost of debt.

The variable size of the company has a value that has a t value of -1.454 and a sig value of 0.149> 0.10. This shows that company size variables have a negative and insignificant influence. In making a hypothesis, H5 is rejected, which means that the size of the company does not significantly influence the cost of debt. This is because the average size of companies in the manufacturing sector includes the small category of 14.69%. Companies with a size of company that are valued with greater total assets, are expected to have a great ability to fulfill all of their obligations in the coming period. The greater the total assets of the company, the company is expected to provide a more certain level of return to investors so that the risk of the company experiencing a default will decrease. This is contrary to the Meirisari (2017) study which states that the size of the company influences the cost of debt. Creditors generally trust companies with greater total assets or large companies because large companies are considered more transparent in terms of information compared to small companies. However this is in line with the research conducted by Wardani and Sari (2018) which states that the size of the company does not have a significant effect on the cost of debt.

5. Conclusions

Institutional ownership does not have a significant effect on the cost of debt. The average share ownership by institutional parties is low at 36.81% so that the control mechanism for management performance is less effective which ultimately impacts on the cost of debt borne by large companies.

Managerial ownership has a significant effect on the cost of debt with a significance level of 10%. In a company, the manager is involved in determining the amount of the debt borrowing process in a company. With increasing managerial ownership, company managers become more selective in making financing decisions and funding involving high risks that are consistent with the interests of shareholders.

The proportion of independent commissioners does not have a significant effect on the cost of debt. This indicates that independent commissioners have not been able to perform the supervisory function effectively in accordance with their duties and obligations in the regulations contained in the OJK. In addition, it is possible that the existence of independent commissioners is merely fulfilling regulations so that the implementation of GCG has not been maximized and information asymmetry has not been reduced. The number of audit committees has a significant effect on the cost of debt with a significance level of 10%. The existence of an effective audit committee will result in internal conditions of the company that performs well which leads to improving the reputation of the company. The impact will increase creditor trust and ultimately the cost of debt will be low.

Company size does not have a significant effect on the cost of debt. This is because the average size of companies in the manufacturing sector includes the small category of 14.69%. Companies with a size of company that are valued with greater total assets, are expected to have a great ability to fulfill all of their obligations in the coming period. The greater the total assets of the company, the company is expected to provide a more certain level of return to investors so that the risk of the company experiencing a default will decrease.

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