The influence of Good Corporate Governance on Sukuk Rating

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Article Info:

Abstract:

This objective of this study to determine the influence of sukuk ratings on corporate governance. Proxy of the corporate governance that used is institutional ownership, frequency of board meeting, board size, and audit committee. The population in this study are financial and non-financial companies listed on the Indonesia Stock Exchange (IDX), and issue bonds that are rated by PEFINDO in 2012-2017. The research was conducted with quantitative methods. The analysis methods used in this study is multiple linear regressions and assisted by SPSS version 20. The results of this research indicate that institutional ownership has significantly positive affect on sukuk rating, frequency of board meeting has insignificantly negative affect on sukuk rating and board size has significantly negative affect on sukuk rating and audit committee has significantly positive affect on sukuk rating.

Introduction

One of very important financing sources for company operation is capital market. In Islamic financial system, there are two money concepts and one of them is money as flow concept where it shall be revolved continuously to earn more profit (Soemitra, 2017). Sharia capital market starts growing well despite not as rapid as Sharia banking development. The development of sharia capital market is well supported with strengthened market and various investment instruments. Furthermore, Muslim population in Indonesia that reaches 85% of the total population along with the improvement of public understanding level on Islamic economy become very profound market potential (Winanti, Nurlaela, & Titisari, 2017).
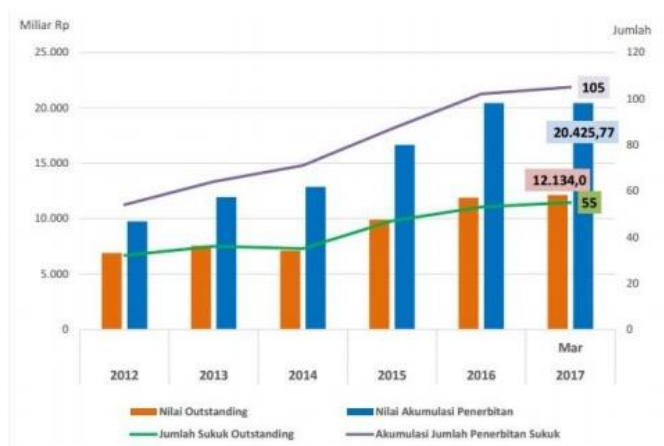

Figure 1.1 The Growth of Corporate Sukuk (Sharia Bonds) 2012 – 2017

According to the Fatwa of National Sharia Board – Indonesian Council of Ulema (DSN-MUI) No. 32/DSN-MUI/IX/2002, Sharia Bond is a long-term financial paper based on sharia principles issued by Issuer to holder of Sharia Bonds that require the Issuer to pay revenue to the holder in the form of profit sharing/margin/fee as well as repay the bond fund on the due date. Based on the data obtained from Financial

Service Authority (Otoritas Jasa Keuangan, 2017), sukuk continues to grow, in December 2017, total issuance of sukuk is Rp20,425.77 billion with Rp12,134 billion outstanding.

One of factors supporting the growth of sharia bond and bond is the implementation of rating. Sukuk rating and bond rating are very substantial to know by company's issuer or investor as measurement of debt failure probability and risk of the issuing company. To measure the level of risk and return on investment in a company, sukuk rating and bond rating are commonly used.

There many factors that can influence the company's bond rating and some studies found that bond rating may be influenced by mechanism or implementation of corporate governance (Lestari & Yasa, 2014). Good Corporate Governance (GCG) is defined as a system that manages and control the company to bring value added to all stakeholders (Monks, A.G., & Minow, 2011). The higher the bond rating is, the lower the risk to face by investor that the return also lower. In contrary, the lower the bond rating, the higher the investor's risk to encounter bad credit that the return also higher (Melzatia & Meiwanto Doktoralina, 2018). Study carried out by Bhojraj & Sengupta (2003) shows elements of corporate mechanism including independent board of commissioner's proportion, institutional ownership percentage, managerial ownership percentage, audit quality and audit committee play significant role in influencing the company bond rating.

Study by Irfandi & Wasilah, (2013)) shows corporate governance mechanism proxied with audit committee brings significant influence. Study by Mariana, (2016) tests the influence of corporate governance mechanism on bond rating result in blockholder, audit quality, and independent board of commissioner proportion bring significant influence to bond rating. Study by Elhaj, Muhamed, & Ramli, (2015) shows that corporate governance proxied with duality of chairperson, the board size, and independent board has positive influence on sukuk rating.

Based on the background, this study formulates the study problems: does GCG (proxied with institutional ownership, independent commissioner's proportion, commissioners meeting frequency and audit committee) have influence on the sukuk rating.

Desk Study, Study Framework, and Hypothesis
Agency Theory

Jensen & Meckling, (1976) defined Agency theory as relation between agent (management) and Principal (company owner) bonded in a contract. The principal assigns tasks to the agent to provide services for principal's interest. In agency theory work contract is introduced to manage the proportion of respective party utility by taking the whole benefits into account. The agency theory or in literature referred to as contracting theory is a theory derived from the theory of firm suggested by Coase (1937).

Signaling Theory

Signaling theory as suggested by Spence (1973) states that company with high performance utilize financial information to fire off signal to the market. Signaling theory explains how the signals of success or failure of management (agent) are delivered to the owner (principal). Signaling theory indicates that company will make effort so show signals of positive information to potential investor through disclosure of financial statement (Miller & Whiting, 2005).

Signaling theory explains the presence of information asymmetry between company management and other parties with interest in certain information (Wolk, Francis, & Tearney, 2001). Bond rating is a published information that can be used as signal on the condition of a company and describe the possibilities with regard to a company's debt, that information asymmetry between investor and bond issuing company can be minimized (Zuhrotun and Baridwan, 2005)

Good Corporate Governance

Good corporate governance is a mechanism used to ensure that financial supplier such as shareholders and bondholders earn return of activities run by the manager with fund they invested/lend or in other words, how company's financial supplier controls the manager (Shleifer and Vishny, 1997). Corporate governance according to Forum for Corporate Governance in Indonesia (FCGI) is a set of regulations governing the relation between shareholders, company management, creditors, government, employees, and other internal and external stakeholders with regard to their rights and obligations, or in other words a system that governs and controls the company.

Sukuk Rating

Sukuk rating is a standardization determined by sukuk rating agency that describes the capability of bond issuer of their willingness to pay the interest and the principal as per the schedule specified. Sukukrating become an important matter to investor before making any investment, since it indicates the risk of payment failure. Indonesia has stock rating agencies and those recognized by Financial Services Authority (OJK) include Fitch Ratings, Moody's Investor Service, Standard and Poor's, Fitch Ratings Indonesia, and Pemeringkat Efek Indonesia.

Term of Reference

Good Corporate Governance (GCG) is defined as system that manages and control the company to bring value added to all stakeholders (Monks et al., 2011). Elements of corporate mechanism including independent board of commissioners proportion, institutional ownership percentage, managerial ownership percentage, audit quality and audit committee play significant role in influencing the company bond rating (Bhojraj & Sengupta, 2003).

Sukuk rating is an indicator of sukuk worthiness issued by issuer and serves as warranty of promptness of bond coupon payment. The higher the bond rating is, the higher the warranty of bond coupon to the investor. The higher the bond rating is, the lower the risk to face by investor that the return also lower. In contrary, the lower the bond rating, the higher the investor's risk to encounter bad credit that the return also higher (Melzatia & Meiwanto Doktoralina, 2018).

Based on review of theories and previous studies, hypothesis of this study are proposed as follows:

H1 = Institutional ownership has positive influence on sukuk rating
H2 = The board of commissioners meeting frequency brings positive influence to sukuk rating
H3 = Independent commissioners proportion has positive influence on sukuk rating
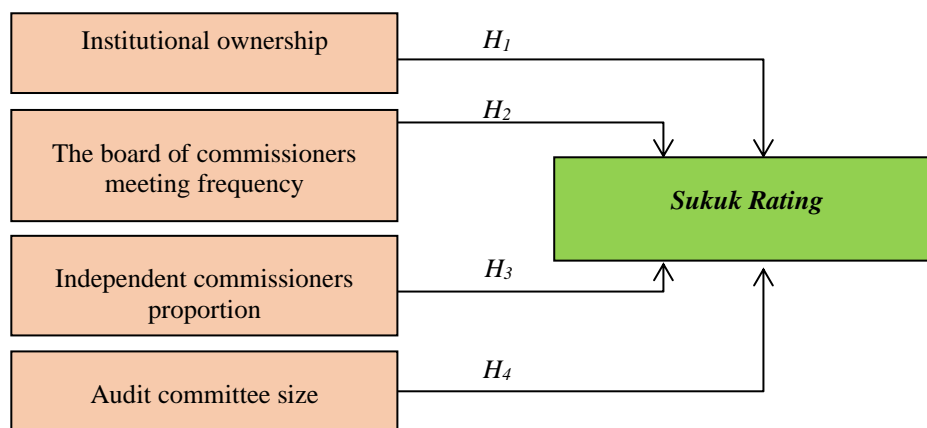H4 = Audit committee size has positive influence on sukuk rating

Figure 2: Research Model

Methodology

The population consists of financial institutions and non-financial institutions. A purposive sampling technique is used with the support of secondary data from the Indonesia Stock Exchange (www.idx.co.id), the securities rating agency (Pemeringkat Efek Indonesia, 2018) during the period from 2012 to 2017 (Sekaran & Bougie, 2013).

In the study, GCG is proxied with institutional ownership, independent commissioner's proportion, commissioners meeting frequency, and audit committee. Institutional ownership is measured using comparison between the numbers of shares owned by the institution with the number of outstanding shares. The board of commissioners meeting frequency is measure using the number of meetings held in a year.Independent board of commissioner's proportion is measured by dividing the number of independent commissioners with total members of the board. Audit committee size is measured by counting the number of audit committee in annual report of a company.

Bond rating falls into two categories i.e. investment grades an speculative grade. Bonds included in investment grade are bonds with symbol of $_{id}$AAA to $_{id}$BBB-, while speculative grade starts from symbol of $_{id}$BB+ to $_{id}$D/$_{id}$SD. The bond rating is first converted to number ranging from 1 to 8. The study data is secondary data collected from annual financial statement of sample corporations, with observation year of 2012-2017.

Result And Discussion
Descriptive Statistics Test Results

Based on the descriptive statistics test result in table 1.1, the number of sample obtained is 73 corporate sukuk from observation year of 2012-2017. Independent variable of Institutional Ownership is minimum of 32.93 and maximum of 100 with average value of 80.389. The level of data variation on institutional ownership is indicated by standard deviation of 19.052. The frequency of the board meeting is minimum 4 times and maximum 48 times with average value of 11.48. The level of variation on meeting board meeting is indicated by standard deviation of 8.997. The board size is minimum 30 and maximum 75 with average value of 44.41. The level of variation on board size is indicated by standard deviation of 13.267. The audit committee has minimum number of 3 and maximum of 5 with average value of 3.48. The level of variation on audit committee is

indicated by standard deviation of 0.747. The independent variable of Sukuk rating has minimum value of 6 and maximum value 8 with average value of 6.78. The level of variation on Sukuk Rating is indicated by standard deviation of 0.886.

Table 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
KEP_INST	73	32.93	100.00	80.3890	19.05200
FREK_RPT	73	4	48	11.48	8,997
PROP_KOM	73	30.00	75.00	44.4104	13.26790
KOM_ADT	73	3	5	3.48	.747
SR	73	6	8	6.78	.886
Valid N (listwise)	73				

Source: Data processed 2019

Normality test result shows that the value of Asymp. Sig. (2-tailed) is higher than the significance level of 0,05 (0.168 > 0.05). Thus, conclusion can be taken that residual data on this regression model is distributed normally.

Classical Assumption Test Results

The result of multicolinearity suggests that each independent variable comes with tolerance value > 0.10 and VIF value < 10. Thus, no multicolinearity occurred with this study's regression model. Durbin Watson autocorrelation test result came with 1.623. This result will be compared to the table score with significance value of 5%, number of sample (n) is 73 and number of independent variable (k) is 4, thus DW table will show dl value of 1.368 and du value of 1.587. Since DW value of 1.623 is higher than the upper limit (du) of 1.587 and less than 4 – du (2.413) it can be concluded that this study's regression model is free of positive and negative autocorrelation. Glejser test result shows no independent variable brings statistically significant influence to dependent variable. This is seen from significance probability that is above trust level of 5%, and can be concluded that the regression model does not have any heteroscedasticities.

Model Feasibility Testing Results

The adjusted R square is 0.587 that means 58.7% of sukuk rating variable can be explained from institutional ownership, board meeting, board size, and audit committee while the remaining 41.3% is explained by model outside of this study. The result of F test came with significance value of 0.00 < 0.05 and calculated F value of 24.152 > F table of 2.75 showing that regression model being tested is all fit, to test the overall significance. Regression model can be employed to predict that Institutional Ownership, Board Meeting, board size, and Audit Committee collectively influence the Sukuk Rating.

t-statistics test result shows that of the four independent variables included in the regression model, Institutional Ownership variable comes with 0.00, board size 0.00 and Audit Committee Size 0.01, and these three variables are far below 0.05. While the Board Meeting variable is 0.091.

Table 2 T test

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	5,614	.426		13,189	.000
	KEP_INST	.025	.004	.538	6,058	.000
	FREK_RPT	-.014	.008	-.145	-1,715	.091
	PROP_KOM	-.041	.006	-.621	-6,719	.000
	KOM_ADT	.334	.095	.281	3,512	.001

Source: Data processed 2019

Hypothesis Test

The result of hypothesis test is shown in table 1.2. In the first hypothesis, the significance value is 0.000 < 0.05 with calculated t of 6.058 and it can be concluded that institutional ownership has positive and significant influence on sukuk rating, thus the first hypothesis is accepted. In the second hypothesis, the significance value is 0.091 > 0.05 with calculated t of -1.715 and it can be concluded that board meeting frequency has negative and insignificant influence on sukuk rating, thus the second hypothesis is rejected. In the third hypothesis, the significance value is 0.000 < 0.05 with calculated t of -6.719 and it can be concluded that board size has negative

and significant influence on sukuk rating that the third hypothesis is rejected. In the fourth hypothesis, the significance value is 0.01 < 0.05 with calculated t of 3.512 and it can be concluded that audit committee has positive and significant influence on sukuk rating, thus the fourth hypothesis is accepted.

Discussion

1. **The Influence of Institutional Ownership to Sukuk Rating**

   The result of multiple linear regression analysis suggests that the institutional ownership has positive and significant influence on sukuk rating indicated with the regression coefficient of 6.058 and significance value of 0.000. It can be concluded that H1 is well-supported that it is accepted. This means the higher the institutional ownership is, the higher the sukuk rating due to more proportion owned by the institution thataccounting information created possibly does not support the shareholders interest. Other possibility is that institutional parties are professional parties who have the ability to evaluate the company's performance; in this regard it improves the company's performance that default risk can be minimized. This study result is consistent with the study by Setyaningrum, (2005) and Bhojraj & Sengupta, (2003) that prove bond rating has positive and significant correlation with institutional ownership percentage. This study result is not consistent with study by Setyapurnama, Santara, & Norpratiwi, (2006), Rinaningsih, (2008) and Mariana, (2016) where institutional ownership variable has negative and significant influence on bond rating.

2. **The Influence of the Board Meeting on Sukuk Rating**

   The result of multiple linear regression analysis suggests that the board meeting has negative and insignificant influence on sukuk rating indicated with the regression coefficient of -1.715 and significance value of 0.091. It can be concluded that H2 is not well-supported that it is rejected. Negative coefficient indicates that the meeting frequency has negative influence on sukuk rating. It means that the higher the meeting frequency is, the lower the corporate sukuk rating. Negative and insignificant result of the study indicates that the more frequent the meeting, the more interference the board makes in the management affairs that its performance is likely less effective, increasing the risk of default.

3. **The Influence of board size on Sukuk Rating**

   Hypothesis 3 states that board size has positive influence on corporate sukuk rating. The result of regression test suggests that board size has coefficient value of -6.719 and significance value of 0.000 < 0.05. This means that the percentage of board size has negative and significant influence on sukuk rating, thus, hypothesis 3 is rejected. The result of descriptive statistics comes with average proportion of independent commissioners of 44.41%, exceeding the percentage required by Capital Market Supervisory Agency and Financial Institution (Bapepam) of which it is at least 30%. Siregar & Bachtiar, (2005) suggests that minimum requirement of 30% for independent commissioners have yet to be sufficiently high to dominate the policy in the board of commissioners. Sari and Murtini (2015) suggest if independent commissioners reach the majority of 50% of the board, the monitoring in the company may run more effective and optimal. This study result is consistent with study by Setyaningrum, (2005) and Prasetiyo (2010) that independent commissioner proportion has negative influence but insignificant on bond rating. Similarly, study by Mariana (2016) found that the percentage of independent commissioners in the board has negative significant on debenture rating. This study is not consistent with the study by Setyapurnama et al., (2006), Ashbaugh, Johnstone, & Warfield (1999), (Bhojraj & Sengupta, 2003) that found that big composition of independent commissioners will significantly increase the bond rating.

4. **The Influence of Audit Committee to Sukuk Rating**

   Hypothesis 4 states that audit committee size has positive influence on sukuk rating. The result of multiple regression analysis shows that the company's audit committee has coefficient value of 3.512 with significance level of 0.01. Thus, it can be concluded H4 is well-supported that it is accepted. Positive coefficient indicates that audit committee size has positive influence on corporate sukuk rating. This means that bigger number of audit committee will increase the sukukrating, the smaller number of the committee will lower the sukuk rating. Audit committee serves a function of supervisory on the preparation of financial statement and internal supervision of a company. Audit committee will improve overall quality of the company's financial reporting and will ensure that the company applies accounting principles to produce accurate and quality company's financial information (Marfuah & Endaryati, 2014). Effective audit committee performance can improve the company's performance and in turn, the company's bond rating will increase (Prasetiyo,2010). This study result is consistent with those of Setyaningrum (2005), Rinaningsih, (2008) and Prasetiyo (2010) that found the proof that the quality of transparency and disclosure of financial information measured with audit committee have significant positive correlation with bond rating.

Conclusion

Based on regression analysis result carried out, the following conclusion can be taken:

1. Institutional ownership has positive and significant influence on sukuk rating. This shows that the higher the institutional ownership is, the higher the sukuk rating.
2. The board of commissioners meeting frequency brings negative and significant influence to sukuk rating. This result shows that the more the meeting frequency is, the lower the sukuk rating.
3. The board of commissioner's proportion brings negative and significant influence to sukuk rating. This shows that the higher the independent commissioner's proportion is, the lower the sukuk rating.
4. Audit committee size has positive and significant influence. This result shows that the bigger the size of audit committee, the higher the sukuk rating.

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