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ANALYSIS OF THE EFFECT OF CORPORATE GOVERNANCE ON YIELD TO MATURITY THROUGH BOND RATING IN INDONESIAN FINANCIAL INSTITUTION

Sasya Sabrina (Accounting Department, Faculty of Economics and Communication, Bina Nusantara University)
Florencia Irena Lawita (Accounting Department, Faculty of Economics and Communication, Bina Nusantara University)

Email: sasyasabrina@gmail.com

Abstract—This research aims to analyze the effect of corporate governance (CG) towards yield to maturity (YTM) with bond rating as the intervening variable. The data of this research are obtained from the official website of IDX, Bank of Indonesia, and Pefindo. This research uses quantitative method by path analysis on the financial institutions that listed on the IDX in 2013-2016. Corporate governance consists of institutional ownership, managerial ownership, audit committee, and board size. The research results indicated that institutional ownership and board size have significant effect on YTM through bond rating, but managerial ownership and audit committee do not, and bond rating itself has significant effect to YTM.

Keywords—Corporate Governance, Yield to Maturity, Bond Rating

I. INTRODUCTION

The ASEAN Economic Community (MEA) is an agreement between ASEAN countries (Association of South East Asia) in order to strengthen various sectors, especially as a form of defense from global shocks. The merging of territorial boundaries can cause business competition to become increasingly tight so that companies must be able to find ways to survive in increasingly fierce competition. In order to survive in competition, companies must strive to increase the value of their companies, such as undertaking business development which will require additional funds, which can be obtained from internal parties (company owners) and from external parties (issuance of shares, bond issuance, and bank loans).

Investment is an alternative for excess fund owners to get a return. Investment can be used to anticipate or to ensure that the company can continue its operations even in difficult conditions (economic recession). When the economy is less profitable, investment can be disbursed, so the company has the availability of funds that can be withdrawn when needed (Hery, 2016).

Foreign investor interest in corporate bonds is higher because corporate bond yields are also high. Bond yield is the rate of return that investors will receive at maturity. Investors measure yields on bond investment using measurements of YTM (Indarsih, 2013). Bond yields are the most important factor as a consideration for investors in purchasing bonds as investment instruments. The risks inherent in bonds are default risk, which is the condition when a bond issuing company does not have the ability to pay a bond coupon and principal.

Investors can use bond rating information as a consideration before buying bonds to avoid the possibility of default risk. PT. PEFINDO assesses the high and low rating of bonds in Indonesia. The higher the company's bond rating, the lower the risk the company is unable to pay off its obligations, so that the YTM received is lower.

Bond ratings are able to mediate the effect of institutional ownership on YTM of bonds (Putri et al., 2017). The greater the number of institutional ownership, the higher the rating the rating agency gives on the bonds issued by the company. The bond rating is able to mediate the influence of the size of the board of commissioners on the YTM of bonds. The greater the size of the board of commissioners, the more parties ensure the quality of company reports and are considered able to run the company better. In addition, the bond rating is able to mediate the influence of the audit committee on YTM of bonds; large audit committee size is considered capable of improving the integrity and credibility of the company's financial statements. Managerial ownership has a significant negative effect on bond yields. Greater managerial share ownership can improve company performance (Hamzah, 2015). Bond ratings have a significant effect on bond YTM because, when the bond rating values increase, it will be followed by a decrease in the YTM of bonds (Saputra & Prasetiono, 2014).

Based on the description above, it can be concluded that research on YTM still gives different results.

Therefore, research on YTM is interesting to do. In addition, the high level of growth and competition in the financial sector industry makes industrial risk important for PT PEFINDO to analyze and assess. In addition, financial institutions are service companies that have responsibilities to the public, so it is important to analyze the risks that exist in financial institutions. In this study, corporate governance, consisting of institutional ownership, managerial ownership, board of commissioner size, and audit committee, will be tested whether it has an influence on YTM with bond ratings as mediation. This research is expected to contribute to investors so that it can be used as an input in making decisions to invest funds in bonds optimally.

II. LITERATURE REVIEW

A. Background Theory

1) Agency Theory

Agency theory describes that there are differences in interests between management (agent) and the owner of the company (principal). Principals are parties who give orders to agents to act on behalf of principals, while agents are parties that are trusted by the principal to carry out company activities (Jensen & Meckling, 1976). A conflict of interest between the principal and the agent occurs because of the possibility of an agent not always acting in accordance with the expectations of the principal. This can cause agency costs. Contract planning must be made as precise as possible in order to harmonize the conflicts of interest of agents and principals. This agency relationship raises two problems, such as: the occurrence of asymmetric information wherein management generally has more information about the actual financial position and operating position of the entity than the owner, and the occurrence of conflict of interest due to inequality of objectives in which management does not always act in accordance with the interests of the owner.

2) Corporate Governance

Corporate governance, according to the Indonesian Institute for Corporate Governance (IICG), is a series of mechanisms that direct and control a company so that the company's operations run in accordance with the expectations of stakeholders. The application of corporate governance in Indonesia is increasing after the crisis along with the demands of the principle of transparency and accountability of the company. The Indonesian government's support for corporate governance is shown through the stipulation of the ministerial regulation of the state-owned enterprise PER-01/MBU/2011 concerning the application of good corporate governance to state-owned enterprises. This regulation requires SOEs to implement corporate governance consistently. The core of the corporate governance policy is that the parties that play a role in the company can understand and carry out their functions and roles in accordance with their duties, authority and responsibilities.

3) Yield-to-Maturity

Before investing in bonds, one of the factors that investors consider that can influence investment decisions is the yield offered. In general, investors will consider the amount of yield they will receive from their investments. One of the factors that makes corporate bonds more attractive than government bonds is that the former offer higher yields. Yield is the result that will be received by investors for the placement of funds in the form of bonds. Bond yields are divided into current yield and YTM. Current yield is the yield that will be received by bondholders calculated based on annual interest per bond price, while YTM is the internal rate of return obtained from bonds held until the due date (BEI). YTM can also be interpreted as a concept used to determine the rate of return received by investors if he invests a long-term loan (bond) associated with the time of maturity. For this reason, the purchase price, repayment value, maturity date, interest rate and time between interest payments must be taken into account.

4) Bond Ratings

Bond ratings are opinions about the credit worthiness of bond issuers based on relevant risk factors. The rating given is not a recommendation for buying, selling, or maintaining a bond. This opinion focuses on the capacity and willingness of bond issuers to fulfill their obligations on time. The level of ability to pay obligations is known as bond rating. Bond ratings are important because low-ranking bonds usually have higher interest costs (Wijayanti, 2014) and because they provide informative statements and give signals about the probability of a company's debt failure (Sunarjanto & Tulasi, 2013). Bond rating is a source of legal insurance for investors in reducing the possibility of default risk by investing only in bonds that have a high rating. The bond rating provides an analysis of the company's creditworthiness so that it can be used for a variety of financial and commercial purposes, such as long-term leasing negotiations or minimizing letters of credit for vendors.

B. Hypothesis Development

1) The Effect of Institutional Ownership toward YTM through Bond Ratings

In accordance with agency theory, institutional ownership is a tool that can be used to minimize agency conflict. Bond ratings are able to mediate the effect of institutional ownership on YTM bonds with the explanation that the greater the number of institutional ownership, the higher the ratings given by rating agencies to bonds issued by companies. A high bond rating is a positive signal and makes investors willing to buy bonds at high prices so that they receive low YTM bonds, and vice versa (Putri et al., 2017).

Based on the explanation above, the first hypothesis of this research is:

H1: Institutional ownership affects YTM indirectly through bond ratings

2) The Effect of Managerial Ownership toward YTM through Bond Ratings

Managerial ownership shows that company managers are the owners and managers of the company, which provides direct benefits and losses to managers for the decisions they make about the company. Managerial ownership has a significant negative effect on bond yields through bond ratings. A greater managerial share ownership can improve company performance. In companies with managerial ownership, managers who are also shareholders will unquestionably align their interests as managers with their interests as shareholders (Hamzah, 2015). The high rating of bonds means the YTM of bonds received by investors will be lower because bond prices will tend to rise with good corporate performance. In contrast, low-ranking bonds show that the bonds are riskier, so investors will get higher yield to bond maturity as a big risk compensation (Putri et al., 2017).

Based on the explanation above, the second hypothesis of this research is:

H2: Managerial ownership affects YTM indirectly through bond ratings

3) The Effect of Board Size toward YTM through Bond Ratings

Article 108 of Undang-undang No. 40 of 2007 stated that a public company must have at least two (2) members of the board of commissioners. Agency problems explain that the higher the number of members of the board of commissioners will mean they experience difficulties in carrying out their roles, including difficulties in communicating and coordinating the work of each member of the board itself, difficulties in monitoring and controlling the actions of management, and difficulties in taking useful decisions for the company.

Based on the explanation above, the third hypothesis of this research is:

H3: Board size affects YTM indirectly through bond ratings

4) The Effect of Audit Committee toward YTM through Bond Ratings

Audit committee is a committee formed by and responsible to the board of commissioners. The audit committee is appointed and dismissed by the board of commissioners and reported in the GMS (General Meeting of Shareholders) of the company. The task of the audit committee is to assist the board of commissioners to fulfill their responsibilities in providing overall supervision. The bond rating is able to mediate the influence of the audit committee on YTM of bonds because the size of a large audit committee is considered capable of improving the integrity and credibility of the company's financial statements. Reliable financial statements will increase company value and increase investor confidence that the risk of bond defaults will not occur. Investors think that corporate bonds are worth investment, so they are willing to buy bonds at high prices and receive low YTM (Putri et al., 2017).

Based on the explanation above, the forth hypothesis of this research is:

H4: Audit committee affects YTM indirectly through bond ratings

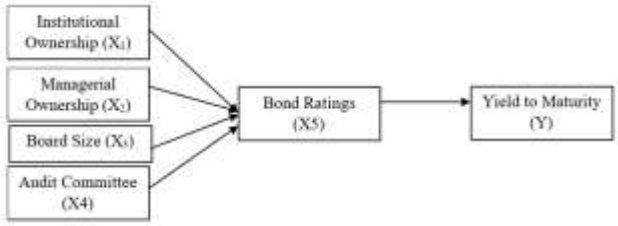

Fig. 1. Research Framework

III. METHODS

A. Sample, Data, and Methods

Sample selection is done by using purposive sampling with the criteria of financial companies that issue bonds listed on the Indonesia Stock Exchange and their bonds rated by PT. PEFINDO in 2013-2016 and paid a fixed amount coupon. All data in this research are secondary data. The data are taken from their financial statements and annual report period of 2013-2016, Bank of Indonesia official website, and Pefindo official website. The data are analyzed using path analysis because this study uses intervening variable (Ghozali, 2016). The hypothesis will be tested using coefficient of determination test, t test, and F test. The regression equation models of this study are:

$$BR = \alpha + \beta.INS + \beta.MGT + \beta.BSIZE + \beta.ACOM + \varepsilon 1 \quad (1)$$

$$YTM = \alpha + \beta.BR + \varepsilon_2 \quad (2)$$

BR : Bond ratings
INS : Institutional ownership
MGT : Managerial ownership
BSIZE : Board size
ACOM : Audit committee
YTM : Yield to maturity

B. Variable Operationalization

The dependent variable of this study is YTM. YTM is measured by (Rahardjo, 2003):

$$YTM = \frac{C + \frac{F - P}{n}}{\frac{F + P}{2}} X\ 100\%$$

The intervening variable of this study is bond ratings. The rating used is the rating given by PEFINDO. The highest ranking will be given a score of 17, while the lowest level will be given a value of 0, so there are 18 variations of data from 0 to 17.

The independent variables of this study are institutional ownership, managerial ownership, board size, and audit committee. Institutional ownership has an important role, because institutional ownership can control management actions (Sari & Murtini, 2015). Institutional ownership is measured by the number of institutional shares divided by the number of outstanding shares (Wida & Suartana, 2014). Managerial ownership is measured by the number of managerial shares divided by the number of outstanding shares (Nasir et al., 2014). Board size is measured by the number of board of commissioner members (Putra, 2013). The audit committee is the total number of members of the internal audit committee and the number of members of the external audit committee (Prasisti & Meiranto, 2013).

IV. Results and Discussion

This study used 72 data and has passed the classic assumptions test. Below is the result of the regression test:

TABLE 1. TEST RESULT OF EQUATION 1

Variables	Coefficient	t-stat
Constant	5,800	4,691*
Institutional Ownership	2,964	2,532*
Managerial Ownership	-3,060	-,591
Board Size	,988	10,224*
Audit Committee	,152	1,008
Adjusted R Square		75,3%
F test		55,009
Sig		0

Dependent Variable: Bond Ratings
*= *significant at 0.05 level*

TABLE 2. TEST RESULT OF EQUATION 2

Variables	Coefficient	t-stat
Constant	14,341	22,495*
Bond Ratings	-,295	-6,748*
Adjusted R Square		38,5%
F test		45,536
Sig		0

Dependent Variable: YTM
*= *significant at 0.05 level*

Based on tables 1 and 2, institutional ownership has a positive coefficient of 2.964 and is significant at 0.05 (5%) and bond ratings have a negative coefficient of 0.295 and are significant at 0.05 (5%), so institutional ownership has a positive and significant effect on bonds ratings and bond ratings have a negative and significant effect on YTM. Institutional ownership is the ownership of shares of companies owned by other institutions or institutions such as companies, insurance, banks and financial institutions. The existence of institutional investors in companies can improve monitoring of the behavior of managers as agents so as to minimize opportunistic actions of managers who act by prioritizing their own interests, such as manipulating financial statements. The greater rate of institutional ownership, the higher rating agencies give to the bonds issued by companies. A high bond rating is a positive signal and makes investors willing to buy bonds at high prices, so that they receive low YTM bonds. The results of this study also support the results of previous research conducted by Tanaka (2014) which state that institutional ownership has a positive and significant effect on YTM through bond ratings because companies with institutional ownership in Japan significantly influence the cost of debt financing and companies with good corporate governance and will produce a low level of YTM. Managerial ownership is not significant at 0.05 (5%) and bond ratings have a negative coefficient of 0.295 and significance at 0.05 (5%), so managerial ownership has no effect on bond ratings. The percentage of managerial ownership in companies in Indonesia is small, so it does not have much influence on company performance. Board size has a positive coefficient of 0.988 and is significant at 0.05 (5%) and bond ratings have a negative coefficient of 0.295 and are significant at 0.05 (5%), so board size has a positive and significant effect on bonds ratings and bond ratings have a negative and significant effect on YTM. Bond ratings are able to mediate the influence of board size on YTM bonds with the explanation that the greater the size of the board of commissioners, the more parties are responsible for ensuring good report quality. Good management will increase company value, the risk of default on corporate bonds will be lower, and the bonds will be given a high rating. This condition will increase the bonds price, so that the YTM of bonds received by investors will be lower (Putri et al., 2017). Audit committee is not significant at 0.05 (5%) and bond ratings have a negative coefficient of 0.295 and are significant at 0.05 (5%), so audit committee has no effect on bond ratings. The existence of an audit committee by the company is only done because of compliance with regulations, but is not intended to enforce good corporate governance in the company. There are still many audit committee members who do not have sufficient knowledge in understanding internal control issues and company risks. In addition, the process of selecting audit committee members is still unclear and transparent so that the members of the audit committee cannot be assured of independence (Hamzah, 2015).

V. Conclusion

Institutional ownership affects YTM indirectly through bond ratings. Institutional ownership has a significant effect on YTM through bond ratings. The

results of this study indicate that institutional ownership can reduce agency conflicts that may arise between managers and investors. High corporate values represent a low investment risk, making investors willing to buy bonds at high prices and receive low YTM bonds. Managerial ownership does not have a significant effect on YTM through bond ratings because of the low rate of managerial ownership in Indonesia companies. Board size has a significant effect on YTM through bond ratings. The size of the board of commissioners is believed to have a better ability to oversee the management of the company and harmonize the interests of investors and management. Larger members of the board of commissioners will also provide more benefits for the company. This will increase the price of bonds, so that the YTM of bonds received by investors will be lower. Audit committee does not have a significant effect on YTM through bond ratings. The existence of an audit committee by the company is only for compliance with regulations and is not certain to enforce good corporate governance.

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