

Corporate Governance with the Institutional Theory Approach on Regional Development Banks in Indonesia

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Abstract. The purpose of this research paper is to analyze the implementation of corporate governance at the Regional Development Banks, or locally known as Bank Pembangunan Daerah, in Indonesia. The focus of this study is on the role and the position of the governing body or board as well as the relations between governance in micro context and macro condition in the framework of institutional theory. The kind of paradigm that is used in this research paper is the post-positivist paradigm by using mixed methods. To analyze the implementation of corporate governance, this research paper is using several key actors: BOD's Size, Board of Commissioners Size, Board of Independent Commissioners Size, Audit Committee's Size, Block-holder Ownership, Risk Monitoring Committee, and Nomination and Remuneration Committee. The results of this research paper indicate that Bank Pembangunan Daerah merely fulfill the requirements of important tools in the implementation of corporate governance. In the end, this will influence the manageability of risk management and compliance process. This condition has positioned the importance of the existence of board in the form of both board of commissioners and board of directors in the management and the achievements of the performance of Bank Pembangunan Daerah (BPDs). In the perspective of corporate governance theorizing that is related to the institutional approach, board can be the balancing power in the context of the diversity of agents that display the relationship patterns not only in the micro-level that involve principal, management, and employees, but also in the macro condition such as legal system in the forms of regulations, social and cultural system, and political system in the form of relations between companies and both legislative and executive institutions. This is related to the strong influence of bureaucracy and political institutions that demonstrate the emergence of conflicting objectives and political interference in the management of Bank Pembangunan Daerah. This condition emerges as the consequences of the existence of Bank Pembangunan Daerah as regional-owned enterprises (BUMDs) that has dual functions, namely as a business enterprise that focuses on making profits as well as an agent of regional development and providing services to the public.

Keywords: corporate governance, institutional theory, conflicting objective, political interference, regional development banks

Abstrak. Penelitian ini menganalisis pelaksanaan corporate governance pada Bank Pembangunan Daerah. Kajian difokuskan pada peran dan kedudukan board serta hubungan antara tata kelola pada konteks mikro dan kondisi makro dalam kerangka pendekatan institutional theory. Penelitian ini menggunakan paradigma post positif dengan menggunakan mixed method. Untuk menganalisis pelaksanaan corporate governance, penelitian ini menggunakan proksi: BOD Size, Board of Commissioner Size, Board of Independent Commissioner Size, Audit Commite Size, Blockholder Ownership, Risk Monitoring Committee, dan Nomination and Remuneration Committee. Hasil penelitian menunjukkan bahwa Bank Pembangunan Daerah baru sebatas memenuhi ketentuan pemenuhan organ-organ penting dalam pelaksanaan corporate governance. Hal ini pada akhirnya mempengaruhi pengelolaan manajemen risiko (risk management) dan compliance process. Kondisi ini memposisikan pentingnya keberadaan board dalam wujud dewan komisaris maupun direksi dalam pengelolaan dan pencapaian kinerja Bank Pembangunan Daerah (BPD). Dalam perspektif teorisasi corporate governance yang terkait dengan pendekatan institusional, board dapat menjadi kekuatan penyeimbang dalam konteks keberagaman aktor (agent) yang menunjukkan pola hubungan tidak saja dalam tataran mikro yang melibatkan pemilik (principal), management, dan pekerja, tetapi juga kondisi makro seperti sistem hukum dalam bentuk regulasi, sistem sosial dan budaya, dan sistem politik dalam bentuk hubungan antara perusahaan dengan lembaga legislatif dan eksekutif. Hal ini berkaitan dengan kuatnya pengaruh birokrat dan institusi politik yang menunjukkan munculnya conflicting objective dan political interference dalam pengelolaan Bank Pembangunan Daerah. Kondisi ini muncul sebagai konsekuensi dari keberadaan Bank Pembangunan Daerah sebagai Badan Usaha Milik Daerah (BUMD) yang memiliki fungsi ganda yaitu sebagai entitas bisnis yang berorientasi pada pencapaian keuntungan dan juga sebagai agent of regional development dan melayani kepentingan masyarakat.

Kata kunci: corporate governance, institutional theory, conflicting objective, political interference, bank pembangunan daerah

INTRODUCTION

In the practical level, the complexity of banking business has made it important for banks to put forward the principles of risk management that is based on the implementation of Good Corporate Governance (GCG).

In addition to the linkage with the complexity and the characteristics of the banking industry that is different from other sectors, the implementation of GCG in the banking sector is also based on the needs to increase the public trust especially in relation to the function of banks as intermediate institutions that collect funds from the

society and redistribute these funds in the form of loans. In addition, the improvement of public trust is the foundation of the improvement of added value for shareholders and guaranteeing the achievement of good banking. This is, naturally, very relevant because the continuity of the operational business of a bank is relying on the public trust, which eventually will be reflected on the improvement of both the performance of the management of the bank that is based on the principles of prudential bank as well as the capability of the bank to manage risks.

De Andres and Vallelado (2008, p.2570) stated that the business complexity of the banking influences the increasing asymmetry information. This, in the end, will reduce the capability of stakeholders in conducting supervisions to the decisions of the leadership of the bank. This condition has led to a need for strict regulations in the banking industry as it is related to the tasks and the responsibility of banks in maintaining the security of public savings, protecting the stability of payment system, and reducing the occurrence of systematic risks (De Andres and Vallelado, 2008, p.2570). In the view of Fama (1980) and Fama and Jensen (1983), the mechanism of supervision that comes from outside of the company (the market, in this case) serves as a mechanism to ensure that the management will act in accordance with existing regulations and procedures in order to achieve the goals of the company.

Corporate governance is a system that is linked to the corporate settings (Blair, 1995, p.3). This is related to the mechanism of power-sharing and regulations toward management activities in achieving the goals of the company. In essence, these goals are related to the process of achieving added value to serve the interests of all stakeholders (Monks and Minow, 2004, p.2). In relation to creating added value, especially for investors, Shleifer and Vishny (1997, p.737) stated that corporate governance is related to the method or the mechanism to convince shareholders in achieving the return of investment that correspond to the money invested in the company. Both of these views put corporate governance in the context of understanding toward values, preferences, responsibility, and orientation toward stakeholders for every decision and policy that is taken in the process of improving the achievements of the goals of the company in the future. In line with the opinions of Monks and Minow (2004), and Shleifer and Vishny (1997), Turnbull (1997, p.181) put the emphasize of the governance within an organization that put the focus on the aspects of control and regulations by paying an attention to the factors that influence the organizational process in order to produce and sell goods and services. In addition to that, the importance substance in establishing corporate governance lies in the aspect of controllers and regulators. Turnbull (1997) placed governance in the context of how an organization can run smoothly in accordance with the purpose that has been determined.

Meanwhile, Lukviarman (2004, p.152) emphasized the aspect of checks and balances in the implementation of corporate governance. Lukviarman (2004, p.141) defined corporate governance as a system that consists of various kinds of device or institutions as well as both the

code of conducts and the law that are required to maintain the checks and balances so that the system can work in an optimal fashion. In this case, Lukviarman (2004, p.141) placed corporate governance as a mechanism that regulate doing the right things right with emphasizing on the meaning of the right things. In the end, from various definitions as mentioned above, it can be concluded that corporate governance is a form of relations and process that implemented by a company to create added value to the shareholders in a long term and sustainable way while still paying attention to the interests of the stakeholders based on existing regulations.

Doowo Nam (2007, p.286) positions corporate governance as the structure, process, or mechanism that represent the interests of all of the stakeholders (majority shareholders, minority shareholders, managers, employee, labor unions, and others) and focuses on board of directors (BOD). In a larger context, this in the end will be related to the strategy, HR policy, organizational management, finances, and decision-making process that involve all of the stakeholders (Doowo Nam, 2007, p.286). Doowo Nam (2007, p.287-289) places the importance of strengthening board of directors, outside directors, strengthening the committees under the coordination of board of directors (committees of the BOD), and Audit Committee.

The above opinions, in essence, positioned the importance of the board's presence including those committees under the board's control in the company management. Busta (2008, p.68) identify the board's presence in the form of board size, the proportion of independent directors, the number of committees, and the frequency of board meetings. In the context of the company's operations, the frequency of board meeting is an important dimension for the accomplishment of board's operations or activities (Vafeas, 1999, p.113), mainly can be used to conduct evaluation toward the implementation of the company's operation activities (Vafeas, 1999, p.140). In relation with the importance of the presence of the committees under the board control, Turlea, Mocanu, and Radu (2010, P.395) put an emphasis on the importance of audit function as part of governance mechanism, which consist of internal audit function, audit committee and external audit. Meanwhile, Tao and Hutchinson (2013), revealed the importance of the role of risk management and compensation committee in reducing the occurrence of asymmetric information, which in the end may reduce risk.

In the context of Indonesia as a country that embraced two-tier system, this research paper emphasizes the importance of the board of directors, the board of commissioner, as well as the committees under the coordination of the board of commissioners (the audit committee, the remuneration and nomination committee, and the risk control committee) as the device of the organization that carries decision-making and decision-control functions. This device of the organization is later composed in a corporate body that consists of: 1) The Annual General Meeting of the Shareholders, 2) the Board of Commissioners (supervisory board), and 3) the Board of Directors. – (see Figure 1).

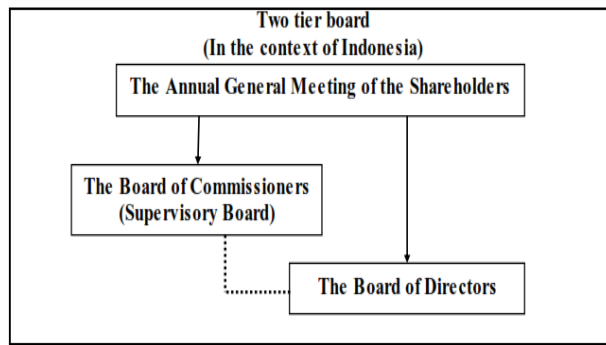


Figure 1. The Structure of Two-Tier Board in Indonesia
 Sources: Law No. 40/2007 on Limited Companies

This research paper analyzes the implementation of corporate governance in the regional development banks in Indonesia, locally known as Bank Pembangunan Daerah (BPD), mainly in relation to the role and the position of the Board of Commissioners as the supervisory board and the Board of Directors as the board of management. This is important because the existence of both the supervisory board and the board of management can be used as a driving force in order to ensure the governance system can run well.

The newness of this research paper lies on two things. First, in the context of the development of the study of corporate governance, this research paper positions the importance of the role of the boards (both the board of commissioners and the board of directors) to strengthen the internal condition of a company. Both the selection and the determination of the composition of the boards have an important meaning because they are related to the management of the company, which in the end will influence the performance of the company. Second, the research paper also examined corporate governance by using the approach of institutional theory. This is a consequence of the form of BPDs as a regional-owned enterprise. This research paper discovers that the variety of actors within the governance structure of BPDs is not only limited to the micro level that involve owners, employees, and managers, but also to the macro level that is related to the system of law and regulations, social and cultural system, as well as political system.

The institutional approach is used to analyze the interconnectedness between the governance that is established in the micro context (the governance in BPDs) and the macro condition (Prasetyantoko, 2008, p.50). Prasetyantoko (2008, p.50) said that the nuance of institutional approach is more leaning toward the study of political economy than the micro study of corporate governance in relation to the classical theorization of company. This means that there is an obvious interconnectedness between the macro-institutional system and the behavior in the micro sector (company). In relation to corporate governance, then this approach is mentioned as the politico-institutional approach that is developed by Mark J. Roe and Masahiko Aoki (in Prasetyantoko, 2008, p.51). Roe (2003) stated that both the success and the failure of a company are also determined by the political and social environment factors that surround the company. In this case, Roe

(2003) argued that the political factor is often invisible and almost never analyzed, but it is actually very influential toward the shape, the structure, and the governance of a company. Prasetyantoko (2008, p.51) stated that a corporation is no other than an economic and law agent so that the economic and law factors within the corporation contains the political elements that cannot be overlooked in the analysis of corporate governance. Meanwhile, Aoki (2001, p.281) stated that corporate governance is a mechanism that control the strategic interactions among actors within the organizational field of a company. In this case, Aoki (2001, p.281) said that corporate governance mechanism is a set of self-enforceable rules (formal or informal) that regulates the contingent action choices of the stakeholders (investors, workers, and managers) in the corporate organization domain. Aoki (2001, p.281) positions 3 (three) main components in the organizational field of a company, namely investors, employees, and managers.

The interaction pattern in the organizational field of a company consists of several basic elements such as ownership rights, control system, supervision, payroll, information, and social relations (Prasetyantoko, 2008, p.53). In the end, corporate governance cannot be separated from the supporting network on a macro level such as law, social, and political systems. Corporate governance occurs on both internal networks (micro level) and external networks (macro level) – (Prasetyantoko, 2008, p.53). Furthermore, Prasetyantoko (2008, p.53) said that in the context of game theory, the relationship patterns in the micro-level networks will generate the same characteristic, but if the complimentary macro factor is also added, then the relationship patterns become unique and depending on the macro context or socio-political context.

Aoki (2001, p.14-15) revealed that in the study of corporate governance, the rules of the game are not only endogenous (only one field), but also exogenous, which involve various fields that in the end will form an equilibrium. Aoki (2001, p.22-25) divided these fields into 6 (six) forms, namely: (1) common domain, (2) trade/economic domain, (3) organization domain, (4) organizational field, (5) political or political economics domain, and (6) social exchange domain. In this context, Prasetyantoko (2008, p.52) said that managers play a central role in managing these complex relations. This central role is related to two respects. First, managers should acknowledge that there are many actors that are involved within the company, so that the equilibrium will not only occur on merely one point but also on various equilibrium points (multiple equilibrium). Second, the external actor determines the form of the equilibrium within the internal environment of the company, so therefore different social, political, and law systems will also generate different patterns of equilibrium (typical equilibrium).

RESEARCH METHODS

This research method used post-positivist paradigm with mixed methods designs. The selection of both quantitative and qualitative research methods is emphasized on the process of data collection and research data analysis.

The quantitative data in the form of numbers that is obtained from the 2007-2013 financial report of Bank Pembangunan Daerah, the 2007-2013 annual report of Bank Pembangunan Daerah, the 2007-2013 GCG performance report of Bank Pembangunan Daerah, and the Indonesian banking statistics in the 2007-2013. Meanwhile, the qualitative data is obtained through document studies on the implementation of GCG on Bank Pembangunan Daerah and interviews that are conducted with several informants that include: (1) Chief Commissioners (BPD East Java, BPD Central Java, Bank DKI), (2) Directors (Bank DKI Managing Director, BPD South Kalimantan Managing Director, Bank DKI Chief Compliance Officer/CCO), (3) Bank Pembangunan Daerah Association Executive Director, (4) Banking practitioners, (5) Financial Services Authority (OJK) Banking Supervision Deputy Commissioner IV, and (6) BUMD Chief of the Regional Financial Directorate at the Ministry of Home Affairs of the Republic of Indonesia.

This research paper selected Bank Pembangunan Daerah as the research object because BPDs belongs to the banking industry with unique characteristic in comparison to other commercial banks. As a commercial bank, Bank Pembangunan Daerah has the characteristic of high regulated industry (Berger and Humprey, 1992; De Andres and Vallelado, 2008; Turlea, Mocanu, and Radu, 2010), opaque industry that is marked with the presence of asymmetric information (De Andres and Vallelado, 2008; Turlea, Mocanu, and Radu, 2010), and high leveraged industry (De Andres and Vallelado (2008, p.2570). However, Bank Pembangunan Daerah is a regional-owned enterprise (BUMD) that has dual function as a business enterprise with the commercial goal of increasing the local revenue as well as a provider of public services that focuses on increasing the local economic and development growth in order to improve the standard of living of the community. This dual function is identified as conflicting objectives in the governance of BPDs, which in the end will influence the capability of BPD to compete with private commercial banks.

Both the population and the sample of this research paper consist of the whole Bank Pembangunan Daerah in Indonesia as many as 26 BPDs. However, during the research, there are three BPDs with incomplete

data, and therefore disqualified as samples, namely (1) BPD Lampung, (2) BPD Bengkulu, and (3) BPD Central Sulawesi. In this research paper, the proxies that are used to measure corporate governance are: (1) BoD_Size (members of board of directors \sum BPDi), (2) BoC_Size (members of commissioners \sum BPDi), (3) BoC_Indp (\sum independent members of commissioners BPDi divided by \sum members of commissioners BPDi), (4) Audit_Size (\sum members of audit committee BPDi), (5) Block_Own (The percentage the number of shares owned by block holder), (6) BoC_Meeting (\sum the meeting of the board of commissioners BPDi in a year), (7) RMC_Size (\sum members of the risk observer committee BPDi), (8) NRC_Size (\sum members of the remuneration and nomination committee BPDi) - Busta (2008), Turlea, Mocanu, and Radu (2010), Tao and Hutchinson (2013), and Vafeas (1999)

In the analysis data, this research used the concurrent triangulation design. The use of the strategy is based on the assumption that the researcher collects both quantitative and qualitative data concurrently, and then compare the two database to find out whether there are convergence, differences, or several combinations (Creswell, 2009, p.213). That is, in this research paper, the author will present statistics results (quantitative data) first, and then followed by the analysis on qualitative data to support or reject the results. The quantitative data analysis is used by utilizing both univariate analysis. Univariate analysis is conducted by using the measure of central tendency and the measure of dispersion in the form of mean, median, modus, and deviation standard. The qualitative analysis data is conducted by utilizing three stages, which are: (1) data reduction, (2) data presentation, and (3) conclusion or verification (Miles and Huberman, 1984).

RESULT AND DISCUSSION

The data in this research paper is obtained from the BPD annual report and the Indonesian banking directory for 2007-2013 period. The following is the descriptive statistics of corporate governance on BPD for 2007-2013 period (see Umanto, Wijaya, and Atmoko, 2015, p.85):

The data on Table 1 as shown above indicated that average number for the members of the Board of

Table 1. Descriptive Statistics for Corporate Governance

	BOD Size	BOC Size	BOC Ind	Audit Size	RMC Size	NRC Size	BOC Meeting	Blockholder
Mean	4.18	3.53	2.36	3.16	3.15	3.39	13.75	.478579
Median	4.00	3.00	2.00	3.00	3.00	3.00	11.00	.449100
Mode	4	3	2	3	3	3	7	.3826a
Std. Deviation	.590	.742	.848	.519	.561	.937	10.260	.1804709
Minimum	2	2	1	2	0	0	2	.1576
Maximum	6	6	4	6	5	6	55	.9994

Sources: Annual Report, GCG Performance Report, and the Indonesian Banking Directory 2007-2013 (compiled)

Commissioners are around 3.53 or 4 (four) people. This means that BPD already meets the minimum requirements for the Board of Commissioners as stipulated on the Bank Indonesia Regulation (PBI) No.8/14/PBI/2006 where board members should be at least 3 (three) people.

The existence of the board of commissioners is very important because it plays a key role in conducting supervision toward the actions or decisions that are made by the directors, as well as advising the directors in the making and the implementation of banking strategy (De Andres and Vallelado, 2008, p.2570). Fama (1980, p.311) and Fama and Jensen (1983, p.332) also stated that the board of commissioners had an important function in ratifying and supervising important decisions that are made by the board of management as the highest leader of the organization. In addition to the fact that, in average, the BPDs that become the samples of this research have already met the requirement of the total number of commissioners in the board, the BPDs that are already in operations have also, in average, fulfilled the requirement as stipulated on PBI No.8/14/PBI/2006. The BPDs that are already established as limited companies should follow the Article 1, Number 6 of the Law No. 40/2007 on Limited Companies. Meanwhile, by the end of 2014, there is still one BPD that is shaped as Regional Company (PD), namely BPD East Kalimantan. In this case, BPD East Kalimantan still followed the provisions under Article 19 of Law No.5/1962 on Regional Companies. Meanwhile, for the BPDs that have already been formed as limited companies should follow Article 1, Number 6 of the Law No.40/2007 on Limited Company.

For the Independent Board of Commissioners, the average total number of independent commissioners is around 2.36 or 2 (two) people. If the members of the board of commissioners are 4 (four) people, then this condition already meets the minimum requirements of the total number of independent commissioners, which is 50 percent of the total number of board commissioners. The independent commissioners are positioned as the members of the Board of Commissioners who do not have connections in terms of finances, management, stock ownership, and/or family relations with other members of board of commissioners, directors and/or the owners of controlling shares or other relations that may influence their ability to act independently. Because of their independent position, the independent commissioners are expected to be able to conduct a more effective supervision toward decisions and actions that are made by directors or management (Hermalin and Weisbach, 2003, p.10; Adam and Mehran, 2012, p.248). In the end, this is expected to contribute to the performance improvement of the company (Saragih, Nugroho, Umanto, 2012, p.52). In Article 120, Law No. 40/2007 it is stated that independent commissioners are selected based on the RUPS decisions from the parties who are not affiliated with the principal shareholder, directors, and/or other board of commissioners. In relation to the data above, then it can be said that BPD

already complied with the regulations on the required total number of independent commissioners who become part of board of commissioners. In addition to the fact that, in average, the BPDs that become the samples of this research paper already meet the requirements of the number of the members of board of commissioners, in average, the BPDs that already in operations have also met the provisions on PBI No.8/14/PBI/2006. In addition to requirements of the existence of independent commissioners, there are three important committees under the control of the Board of Commissioners, namely Audit Committee, Remuneration and Nomination Committee, and Risk Monitoring Committee. These committees have the important role and task to assist the Board of Commissioners in conducting supervision toward decisions that are made by the Directors.

For the Audit Committee, the total number for the members are around 3.16 or 3 (three) people with the composition of one independent commissioner, and 2 (two) other members come from independent parties with expertise on finances/accounting as well as law and banking respectively. This committee is lead by the independent commissioner. The position of the Audit Committee is very important in conducting supervision in relation to the application of internal audit function. Doowo Nam (2007, p.287) stated that the role of an internal auditor include inspecting the legitimacy of the top management and directors, investigating the appropriateness and soundness of financial activities, examining important accounting standads, evaluating the performance of external auditors, etc. Meanwhile, Turlea, Mocanu, and Radu (2010, p.394) placed the importance of the audit function as part of a governance mechanism, that consist of the internal audit function, the audit committee and the external audit. In the perspective of the application of corporate governance in the banking industry, the audit committee has the important role that is mainly connected to the following three: (1) improving the effeciveness of risk management, control, and governance process, (2) assisting the management in identifying and resolving problems that are related to risk management, and (3) providing an objective view in relation to the financial reports of the company (Turlea, Mocanu, and Radu, 2010, p.394-398).

For the Risk Monitoring Committee, the average number of the members is around 3.15 or 3 (three) people with the composition of one independent commissioner while 2 (two) others come from indepenent parties with skills and expertise on finances and risk management respectively. This committee is led by the independent commissioner. The data indicated that the total members of the Risk Monitoring Comittee of each bank is varied from 3 (three) to 4 (four) people. The task of this comittee, in essence, is related to the implementation of supervision toward the risk management that is carried out by Bank Pembangunan Daerah. In the theoretical landscape, Crouhy, Galai, and Mark (2006, p.85) placed the importance of the risk management committees to

conduct the risk management on the banking industry. Crouhy, Galai, and Mark (2006, p.88) encouraged collaboration between BOD and BOC in realizing the integration between corporate governance and risk management as a form of responsibility of the bank in managing market risk, credit risk, operational risk, and business risk. In a wider landscape, the integration between corporate governance and risk management can be used as leverage for the achievement of strategic objectives that are stated on the vision and the mission of the company. In other words, the role of the Risk Monitoring Committee is important in creating key policies and procedures that are related to risk management as well as ensuring that these policies and procedures can be implemented well (Crouhy, Galai, and Mark, 2006, p.90). In the end, this is expected to encourage the realization of risk management that integrates with the application of corporate governance and strategy in order to achieve the goals of the company. Crouhy, Galai, and Mark (2006, p.88) identified four options of actions that are related to risk management, which are (1) avoid risk by choosing not to undertake some activities, (2) transfer risk to third parties through insurance, hedging, and outsourcing, (3) mitigate risk, such as operational risk, through preventive and detective control measures, and (4) accept risk, recognizing that undertaking certain risky activities should generate shareholder value.

For the Remuneration and Nomination Committee, the total number of the members is 3.39 or 3 (three) people with the composition of one independent commissioner, a commissioner, and an executive officer in the field of human resources development. This committee is led by the independent commissioner. The task of this committee is basically related to the remuneration policy of Bank Pembangunan Daerah as well as providing recommendations about the system of the selection and the replacement of the members of the Board of Commissioners and the Board of Directors of BPDs.

For the Board of Directors, the total number of the members for each BPD is as many as 4.18 or 4 (four) people. This indicates that BPDs already meet the minimum requirements of the total number of directors of 3 (three) people. However, it is important to underline that the fulfillment of the completeness of the position of directors on BPDs become a problem that in the end will make the organizational wheel of the BPDs to not be able to run effectively. When analyzing the fulfillment of the required total members for Board of Directors (BOD), then all of the BPDs already meet the requirement for BOD number. In general, the number of BODs on BPDs are between 4 (four) people to 5 (five) people. This is, of course, in line with the scope of business that each BPD runs.

For the Board Meeting Frequency, the average meeting frequency that is conducted by the Board of Commissioners is about 13.57 times or 14 in a year with the mode score of 7 (seven) times. This is, of course, already meet the regulations as stipulated on PBI No.8/14/PBI/2006, Article 15, Paragraph 1-3, and Bank

Indonesia Circular No.9/12/DPNP/2007 that required and obliged the members of the Board of Commissioners to present at the meetings of the Board of Commissioners for at least 4 (four) times in a year. According to Brick and Chidambran (2010), the meetings of the Board of Commissioners are one of the forms of the monitoring task, which later will influence the improvement of the operational performance of the company. In the context of the operations of a company, the board meeting frequency is an important dimension for the implementation of board operations or board activities (Vafeas, 1999, p.113). It is especially used to conduct an evaluation toward the implementation of the operational activities of a company (Vafeas, 1999, p.140).

In this research paper, block holder is related to the number of the majority share ownership from all of the capital that is paid up to the bank. In the period of 2007-2013, the average majority share ownership of the BPD was at 47.86 percent with the mode score of 38.26 percent. The majority share ownership of BPD belongs to the respective provincial governments. This condition generates a quite strong influence from the provincial governments toward the BPD governance, which in the end will trigger the possibility of the emergence of interests that influence the policies of BPDs. This is shown during the selection process of both the Board of Commissioners and the Board of Directors. In certain conditions, the Governors as Local Leaders tend to force their way to place the chosen people that will actually become problematic when these people should follow the fit and proper test that is conducted by Bank Indonesia or the Financial Service Authority (OJK). In the end, this condition hampers the operational activities of BPDs.

Based on the analysis above, it can be said that BPDs already fulfilled the completion of the elements of corporate governance in accordance with requirements from the regulators. However, this research paper has identified that there are still problems during the implementation of Good Corporate Governance in Bank Pembangunan Daerah. First, the weakness in the fulfilment of governance structure in BPDs as the consequence of the failure of the candidates for either directors or commissioners to pass the fit and proper test that is conducted by Bank Indonesia or the OJK. The result of this situation is the phenomenon of vacancies in the Board of Commissioners and the Board of Directors. Bank Pembangunan Daerah is forced to conduct operational activities in a position that is not ideal. This research paper identified that the problem occurs because the Controlling Shareholder tend to generalize the operational activities of the bank with other BUMDs under their control. In fact, the characteristic of governance in a bank is different when compared with other BUMDs. The difference is mainly related to the risk management of a bank that consists of credit risk, market risk, and operational risk (Crouhy, Galai, and Mark, 2006, p.14). The incompleteness of the directors influences the governance of Bank Pembangunan Daerah, which in the end will impact

the performance. PT Bank Pembangunan Jawa Barat-Banten (BJB), which serves the West Java and Banten provinces, has experienced a decrease in profitability as an impact of the incompleteness of its directors (Since May 12, 2014, Bank BJB only has one director). The RUPS of Bank BJB on December 19, 2014 selected 7 commissioners that consist of 3 commissioners and 4 independent commissioners as well as 7 directors). The data from the 2014 annual report of Bank BJB shows that in 2014, Bank BJB recorded a decrease of 18.6 percent in its net profits when compared with a year before. The net profits of Bank BJB in 2013 is Rp 1.376 trillion, which experienced a Rp 256 billion decrease to Rp 1.120 trillion in 2014. This decrease is the impact of the increasing NPL (non-performing loans) of 1.32 percent. The same condition is also happened Bank Sumselbabel, which serves South Sumatra and Bangka Belitung. The shareholders general meeting (RUPS) in 2013 decided to conduct dividend distribution to the local government as the shareholder of Rp 104.4 billion. This number is a 20 percent decrease when compared with a same period in the previous year. The Bank Sumselbabel Managing Director said that the degradation of the business performance of the company happened because of the prolonged vacancies within the board of directors (www.republika.co.id, 19 Mei 2014). The second problem is the emergence of politicization in the governance of Bank Pembangunan Daerah. Local leaders intervene and tend to consider BPDs as their source of income for the interests of the group or even personal interests. This research paper identified that one of the form interventions from the local leaders as the Controlling Shareholder lies on the fulfilment of the organizational structure both on Board of Commissioners and Board of Directors. The selection of managing directors, directors, or commissioners for BPDs tends to be based on political desire of the local leaders. As a result, there is leadership crisis in the BPD governance as well as the emergence of candidates for directors who do not meet the requirements in the fit and proper test that is conducted by Bank Indonesia. In essence, the implementation of Good Corporate Governance on BPDs has already attempted to minimize these interventions through PBI 8/14/PBI/2006 on the Amendment on the Bank Indonesia Regulation No. 8/4/PBI/2006 on the Implementation of Good Corporate Governance on Commercial Banks. The problem that occurs because of this intervention is the failure of a number of BPD directors during the fit and proper test that is conducted by the Financial Services Authority (OJK). In this case, the directors who are nominated to attend fit and proper test are the subordinates of the Controlling Shareholder whose process of selection and appointment is already played by the Remuneration and Nomination Committee.

This intervention appears due to the lack of understanding from the Controlling Share Holders (represented by Governor/Regent/Mayor) on the implementation of GCG on BPD. This condition is in line with the research paper conducted by Arun and Turner (2009, p.101), which stated the main problem

of the management of government-owned bank is the tendency from the bureaucrats to conduct full control on the bank's management. On one hand, the bureaucrats seek to maximize their own interests in relation to consumptions, leisure, and the addition of staff, but on the other hand, bureaucrats tend to avoid unnecessary risk (risk-averse) that they are lack of boldness to take risk in business management. BPD tend to have limited autonomy in conducting bank management (Arun and Turner, 2009, p.102). In the end, Arun and Turner (2009, p.103) said that the government-owned bank's management in developing countries such as Indonesia is very influenced by political considerations. This condition, in the end, lead to bureaucrats (politicians) tend to use government-owned bank to serve their personal interests (La Porta, Lopez-de-Silanes, and Shleifer, 2002, p.266). In this case, government-owned banks became instruments for bureaucrats to provide loans, employment, subsidies, and other benefits for their supporters to back them again in the form of votes, political contributions, and bribes. Shleifer and Vishny (1997, p.768) also stated that bureaucrats have the ability to control state-owned companies and lead these firms to pursue every political goals. This condition, eventually, will create inefficiency in the management of state corporations (Shleifer and Vishny, 1997, p.768). This result is also supported by Mark J. Roe (2003), who stated that political institutions influence the development of corporate governance's institutions (See also Umanto, Wijaya, Atmoko, 2015, p.86).

The patterns of intervention from the officials on BPDs take the form of nepotism when hiring employees, asking for loans, as well as requesting funds from corporate social responsibility programs for political campaign funds (Majalah Infobank No.407, Vol. XXXV, February 2013, p.65). In the context of BPDs as BUMDs, Malang Joedo and Dwijowijoto (2006, p.61) also identified that the problem in the BUMD governance lies on the potential of interventions from the elite in the regions (including local leaders), local bureaucracy, and Legislative Councils (DPRDs). According to Malang Joedo and Dwijowijoto (2006, p.61-62), the political environment that surrounds BUMDs will not allow enough space for BUMDs to develop themselves into companies that are managed professionally. This condition has left BUMDs to be prone to inefficiency, unprofessionalism, and unresponsiveness when following the change and dynamics of the business and management of the BUMDs. On the cultural problem, most BUMDs still tend to apply patriarchalism excessively (Malang Joedo and Dwijowijoto, 2006, p.61). In the end, this will make the decisions to always come from the superiors and thus the integrity and the credibility of the BUMDs are considered to be the responsibility of the superiors. On the leadership problem, the BUMD management tends to be managed by bossy leaders (or, in other words, one man show). In this case, the BUMD leaders are considered to be the controller of both authority and accountability. This condition will later trigger the emergence of bureaucratization

process in the BUMD management, which in the end will slow down the BUMD business process (Malang Joedo and Dwidjowijoto, 2006, p.56). In conclusion, Malang Joedo and Dwidjowijoto (2006, p.62) said that the form of intervention is related to the selection of the candidates for the directors, which mostly are determined by the governmental bureaucracy and thus the determination process will tend to be more political instead of professional.

The statements above basically show that BPDs have merely fulfilled the requirements of the completion of important tools in the implementation of corporate governance. This in the end will influence the governance of risk management and compliance process. The Finance Director said that (based on an interview conducted on October 17, 2014): “The GCG implementation. In terms of the fulfillment of the regulation, this has already been accomplished. However, if we take a closer look, the GCG implementation in BPDs is still far below state-owned banks, other public banks or even private banks”. This opinion is also supported by a statement from the OJK Deputy Commissioner IV for Banking Supervision, who said that (based on an interview conducted on September 22, 2014): “On the governance side, it can be said that BPDs are not professional yet. There is no standard SOP (Standard Operating Procedure) to become modern banks. Owners still consider BPDs are their banks. They forget that the third party funds or the performance is still below expectations. In other words, BPDs are still serving as the cash cow for the Local Governments”.

In order to deepen the analysis, this research paper conducted a study with the use of the theorization perspective of corporate governance that is related with the institutional theory. In the context of BPDs as BUMDs, this research identified that BPD is an entity with dual function. First, a BPD is positioned as a business entity that has the commercial goal to increase the regional revenue. Second, a BPD serves as the provider of public service that is focused on the increasing of economic and regional development growth in order to increase the standards of living of the society (see Article 2, Home Affairs Ministerial Decree No 62/1999 on the Organizational Guidelines and the Work Procedures of Regional Development Banks). This dual function is identified as conflicting objectives in the BPD governance, which in the end will influence capability of BPDs to compete with private commercial banks. Wicaksono (2009, p.149) identified conflicting objectives as one of the problems that is encountered by state-owned enterprises (BUMN) in the world.

The dual function that is attached to BPDs will in turn generate the emergence of a governance structure that is tend to be different when compared to private companies. In a private company, the governance structure consists of three elements, namely RUPS (Shareholders’ General Meeting), Board of Commissioners, and Board of Directors. Meanwhile, the governance structure of a BPD as a BUMD consists of two elements, namely the internal governance structure that consists of RUPS (Shareholders’ General Meeting), Board of

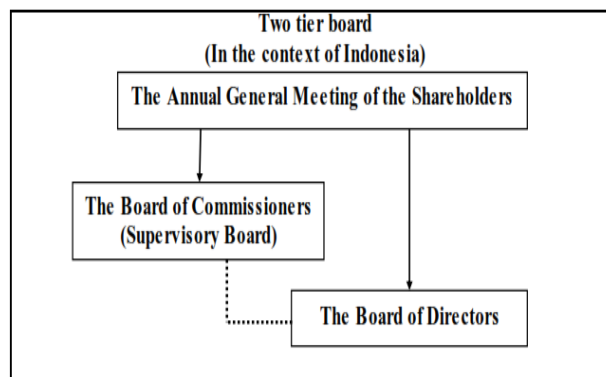


Figure 2. The Governance Structure of Bank Pembangunan Daerah

Sources: Syakhroza (2005), adapted with the BPD Condition

Commissioners, and Board of Directors, as well as the external governance structure that consists of: (1) The Supervising Committee (Board of Commissioners) and the Management of BPD, (2) Regional Legislative Councils (Provincial/Regency/City) as the agent that represent public interests, and (3) Local Governments (Provincial/Regency/City) as well as (Home Affairs Ministry, Finance Ministry, and the Financial Services Authority) as the agent that deal directly with BPDs.

The variety of actors (agents) on regional development banks indicate that the relationship patterns not only happen in the micro level that involve owners (Local Governments in Provinces/Regencies/Municipalities), employees, and managers (directors and commissioners), but also in the institutional condition of the company such as the law system in the form of regulations that are issued by the government (Finance Ministry, Home Affairs Ministry, and the Financial Services Authority), social and cultural system, and political system in the forms of the relations between the company and the legislative and executive institutions. In relation to the political system, in particular, this research paper support the opinion from Roe (2003), who argued that the political factor is often invisible and almost never analyzed, but in fact this factor is very influential toward the form, structure, and the governance of regional development banks. This argument was built based on the results of a study on the ownership structure on many countries in Southeast Asia such as Thailand, Malaysia, and Indonesia, which places the strong position of the majority shareholder (Prasetyantoko, 2008, p.63). The majority shareholder acts as the controlling shareholder with control rights that are more than cash flow rights because of the pyramidal ownership system and the connection between the ownership structure and the selection of the board of supervisors (Prasetyantoko, 2008, p.63). In the context of Bank Pembangunan Daerah, the strong position of the Local Governments (Provincial/Regency/City) as majority shareholders are mentioned on the Home Affairs Ministerial Regulation No. 1/1998, Article 8 (3) that stated that Local Governments have special voting rights in the

Shareholders' General Meetings (see also Umanto, Wijaya, Atmoko, 2015, p.87).

In relation to the key task and function of BPD as stated on the Home Affairs Ministerial Regulation No. 62/1999 on the Organizational Guidelines and Work Procedures of Regional Development Banks, this research paper identified that BPDs are business entities that require political supports from bureaucrats (in this case, the local governments either in the provincial, regency, or the city level) as well as politicians (in this case, DPRD or legislative councils either in the provincial, regency, or the city level). The local governments (either provincial, regency, or city) play the role as shareholders, while DPRD play the role as the partners of local governments in legalizing Local Regulations that are related to Bank Pembangunan Daerah (such as regulations that are related to the capital increase of BPD or the change of the form of legal entity of Bank Pembangunan Daerah). This political support, in the end, can trigger political interference in the governance of Bank Pembangunan Daerah (BPD). This political interference happens especially during the selection of commissioners and directors. The Local Governments, represented by Governors as the majority shareholder put active bureaucrats or former bureaucrats to be one of the commissioners of Bank Pembangunan Daerah. In addition, the Governors also attempt to put their closest people to serve as directors in Bank Pembangunan Daerah. Other problems occur when the achievements of both the tasks and the functions of the BPDs are made to be in accordance with the vision and the mission of the Governors as the representatives of the central government and the society. This means that most of the times there are differences in the directions of the operational governance of BPDs as the result of the differences in the vision and the mission of each Governor that may be changed during elections every five year.

When this is related to the impact, then the variety of actors (agents) on one hand is positive because it will serve as the medium of checks and balances in the governance BPD so that it can be more optimized in implementing the tasks and the functions as stipulated on the Home Affairs Ministerial Regulation No. 62/1999 on the Organizational Guidelines and Work Procedures of Regional Development Banks. On the other hand, however, this will cause conflicts of interests especially among agents who are identified by Aoki (2001) as polity or political domain in the form of Local Governments (Provincial/Regency/City) and DPRD (Provincial/Regency/City). There should be a common political consensus to balance the interests of these two institutions. This is important because the support from both DPRD and Local Governments are very required in the development of Bank Pembangunan Daerah especially in the context of capital increase and the governance of BPD that uphold the principles of corporate governance.

In relation to the results of the study above, this research paper produce several recommendations.

First, There is a need to have an improvement on the understanding as well as conducting socialization towards Controlling Shareholders and Regional Councils in order to strengthen the implementation of governance system on BPD. Both the understanding and the socialization are expected to reduce the appearance of conflicting objectives and political interferences in the management of banking business that is high regulated, high leveraged, opaque, and based on the use of intensive knowledge.

Second, the Financial Services Authority (OJK) encouraging BPD to hold an initial public offering (IPO). The consideration is based on the idea that IPO is not only related with the aspect of capital increase, but also related with the aspect of governance that is both better and more transparent, the improvement of the company growth (corporate value), and the public monitoring which, eventually, will have an impact on the improvement of the banking management in the future. In the context of the existing condition on BPD, this research paper identifies that there are at least three advantages for BPD that already held an IPO, namely: (1) The improvement on financial performance. According to a data from the Indonesian Banking Statistics on September 2014, it is shown that two BPDs that already held an IPO (Bank BJB and Bank Jawa Timur) possess core capital, total assets, total third party funds, and total lending that are higher if compared with other BPDs that are yet to hold on IPO, (2) Clearer in relation with the implementation of GCG, which eventually will influence the improvement of intellectual capital. According to a self-assessment data of GCG BPD, it is revealed that both Bank BJB and Bank Jawa Timur are on the top three. Because BPDs already held an IPO, the wheels of their operational activities will be observed by unlimited parties on the Controlling Shareholder as shareholders.

Third, for the future research. Diverse actors (agents) in the governance structure of BPD shows that the relationship patterns is not only in micro level that involve owners, workers, board (directors and commissioners), but also institutional conditions that is macro level such as legal system in the form of regulation, social and cultural system, and political system in the form of relation between company and legislative and executive institutions. The relation between these various agents result in the complexity of the management of Regional Development Bank (BPD). Aoki (2001) positions this as theoretical game where agents will interact with each other and creating institutionalized linkages between the domain of one organization and the other. In relation to that, this research paper recommends further researches to analyze the context of discussion of corporate governance is focusing on the relation between agents both on micro and macro level. In relation to that, this research paper recommends further research to analyze the context of the discussions on corporate governance in the framework of game-theoretic perspective that is developed by Aoki (2001).

BPD merely complies the provisions of the fulfillment of important aspects in the implementation GCG. However, BPD still experience problems in the fulfillment of governance structure, risk management, and compliance process. This condition puts an emphasis on the importance of the presence of board in the form of board of commissioners and directors in the management and the performance achievement of Regional Development Banks (BPDs).

In the theorization perspective of corporate governance that is related to the institutional approach, board can be the balancing power in the context of the variety of actors (agents) that show the relationship patterns not only on the micro level that involve principals, management, and employees, but also institutional condition that is on the macro level such as law system in the form of regulations, social and cultural system, and political system in the form of relations between companies and both legislative and executive institutions. This is related to the strong influence of bureaucrats and political institutions that show the emergence of conflicting objectives and political interference in the management of Bank Pembangunan Daerah. This condition occurs as a consequence of the existence of Bank Pembangunan Daerah as regional-owned enterprise (BUMD) that has dual function, which means it is a business enterprise that focuses on gaining profits as well as an agent of regional development and serves the community or public interests.

CONCLUSION

BPD merely complies the provisions of the fulfillment of important aspects in the implementation GCG. However, BPD still experience problems in the fulfillment of governance structure, risk management, and compliance process. This condition puts an emphasis on the importance of the presence of board in the form of board of commissioners and directors in the management and the performance achievement of Regional Development Banks (BPDs).

In the theorization perspective of corporate governance that is related to the institutional approach, board can be the balancing power in the context of the variety of actors (agents) that show the relationship patterns not only on the micro level that involve principals, management, and employees, but also institutional condition that is on the macro level such as law system in the form of regulations, social and cultural system, and political system in the form of relations between companies and both legislative and executive institutions. This is related to the strong influence of bureaucrats and political institutions that show the emergence of conflicting objectives and political interference in the management of Bank Pembangunan Daerah. This condition occurs as a consequence of the existence of Bank Pembangunan Daerah as regional-owned enterprise (BUMD) that has dual function, which means it is a business enterprise that focuses on gaining profits as well as an agent of regional development and serves the community or public interests.

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