

The Effect of Local Value on Financial Performance in Digital Society Era

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Abstract—The digital era reduces the boundaries obstacles between societies. However, the local value still has role because the value encourages the management to behave ethically. The aim of this study is to provide empirical evidence about the important role of local wisdom value to encourage the optimal financial company performance. This study uses the local value, such as Islamic Value, that has recognized formally by Indonesia Government as Jakarta Islamic Index. Management considers the Islamic Sharia as local wisdom value of Indonesian to behave ethically. The result shows that local value has significant positive effect to financial performance. The result also supported by the finding that corporate governance score that has formulated globally is insignificant different between the members of Jakarta Islamic Index and Non Jakarta Islamic Index. The result implies that local wisdom can be considered on digital era as the part of corporate governance formulation because it captures the certain region characteristics. This study contributes to agency theory through the awareness of management on local value emerged from local wisdom value to align with shareholder's interest. This study also contributes to the implementation of corporate governance practice, because the local wisdom value can become the social enforcement for management to behave ethically.

Keywords—local value; ethics; digital era; agency theory; financial performance

I. INTRODUCTION

The aim of this study is to examine the important role of local value on management's performance although the digital era has reduced the boundaries between societies. Agency theory predicts that management want to maximize their utilities compare to shareholders' utilities [1]. However, in the digital era, company that want to be the winner in market must implement the appropriate of information technology. The improvement of telecommunication technology may open an opportunity for every people to get information directly from company's web site. Company can offer the products directly to the customer, so company that do not respond the customer's demand appropriately will lost the opportunity to get profit. In the investment perspective, every investor can be the shareholder across the countries. It implies that information technology reduces the obstacles of value and culture between societies in the digital era.

The important question is whether value of the certain society should not be maintained to be the unique characteristic

of that society. Actually, every people from around the world has possibility to be shareholders or customers through the e-trading system. Contrast with study of La Porta et al., the level of investor protection is different between the law families, such as French, Dutch, and United States [2-5]. According to La Porta et al., the difference have effect on the ownership structure and corporate governance implementation that has an effect to the earnings quality [2-5]. The other study reveals that investor protection correlates to auditor [6-8]. The next study also reveal that investor protection correlates to financial performance or management behavior [9-17]. The findings imply the society's value surrounding the company in where operates could encourage management to behave ethically, such as less aggressive to maximize himself/herself interest.

Based on the prior finding, this study examines the role of Jakarta Islamic Index (JII) on company's management. Jakarta Islamic Index enacted by Indonesian Stock Exchange (IDX) is a list of selected company stocks that comply with Islamic Sharia Investment Guidelines. Islam religion is a life guidance for the majority of citizen in Indonesia and it becomes local value of the majority of Indonesia citizen. The management who concern to the value of Islamic will consider it on managing company and as implication, the management will behave ethically, include maximize the shareholder's interest through the company's performance. Other reason, Jakarta Islamic Index formulation shows the recognition from regulator about the Islamic value as Indonesia local wisdom, but the membership of Jakarta Islamic Index is voluntary and there are many other index, such as LQ 45, that shows the liquidity and performance of shares.

This result contributes to the agency theory literature that the local value can encourage management to align with shareholder's interest through maximizing the shareholder's wealth. This study also contributes to the implementation of corporate governance practice that the local wisdom become the social enforcement for management. Corporate governance does not only rely on internal and external control, such as independent commissioner board and audit committee or independent auditor, but also the local wisdom value. Then, the result can contribute to government that has power to formulate policies, regulations, and rules in considering local wisdom value to encourage management behave ethically. The prior studies involve the values of environment, community,

diversity, employee relations, human right, and product and governance to encourage the management's performance, such as Ortas et. al., Gregory et al., Lee et al., and Oikonomou et al. [18-21].

II. METHOD

A. Data and Sample

This study uses financial data and corporate governance data collected from Indonesia Stock Exchange (IDX). The financial data contains assets total, revenue, operating cash flow, ratio of current assets to current liabilities, and ratio debt total to assets total. The corporate governance data includes the number of commissioner board, the number of general meeting of shareholders, the number of committee audit, the meeting number of commissioner board, the meeting number of committee audit, and auditor quality. The part of corporate governance data is also used to measure the monitoring mechanism of the sample companies.

This study uses sample from manufacturing company as the IDX criteria, from 2010 – 2014. The manufacturing companies contains agriculture, mining, chemical, and food industries and the samples must fulfill the financial data and corporate governance data as stated in variable definition. IDX releases 30 companies in every 6 months as Jakarta Islamic Index members. According to the research objective, this study identifies the membership of JII and non-JII for each of industry category, such as agriculture, mining, food, and chemical. This study also identifies the JII members and non-JII members that have same level of asset total. This study also uses age data that starts from IPO until 2014 and the both of categories sample, JII and non-JII, will be compared as assets total data.

B. Research Variables and Model

The examination uses the variables that are detailed below:

- Corporate governance score measured by auditor quality, the percentage of independent commissioner board, the ratio of commissioner board meeting number to commissioner board number, the ratio of audit committee meeting number to audit committee number, the number of shareholders general meeting, and the number of audit committee. Auditor quality is measured by big N (1) and non-big N (0). The score is measured by the value total of each corporate governance proxy and it indicates the commitment of management in order to reduce agency conflict.
- Monitoring score measured by the ratio of commissioner board meeting number to commissioner board number, the ratio of audit committee meeting number to audit committee number, and the number of shareholders general meeting. This study assumes that monitoring score indicates the monitoring mechanism in company that encourages management behave more ethical.

- Financial performance includes the ratio of debt total to asset total, the ratio of current asset to current liabilities, return to assets, and operating cash flow.
- Social value uses proxy of the member of Jakarta Islamic Index: member is 1 and non-Jakarta Islamic Index member is 0.
- There are two variables for identifying the same level sample include asset total and age (month). This study assumes that company that has same level of asset total or age can be compared in order to compare the social value.

The model can be stated in below:

$$FP = \alpha_1 + \alpha_2SV + \alpha_3MSc + \alpha_4CGSc + \alpha_5Age + \alpha_6AT + \epsilon$$

Note:

FP = financial performance;
 SV = social value;
 MSc = monitoring score;
 CGSc = corporate governance score;
 Age = firms age (month);
 AT = assets total.

III. RESULTS

This study uses 57 companies that are the members of Jakarta Islamic Index and 51 companies that are the non-member of Jakarta Islamic Index. The both of member characteristic groups have same level of assets total. Then, this study identifies sample that does not fulfill the variable criteria. Finally, there are 40 companies as sample of Jakarta Islamic Index member and 39 companies as sample of non-Jakarta Islamic Index member. Although the number of sample in each industry categories does not have same number, but both characteristic groups are appropriate for comparing.

There are four financial performance measurements used in this study, such as operating cash flow, ratio of current assets to current liabilities, return on assets, and ratio of debt total to assets total. The operating cash flow of JII members are higher (IDR1.994.770.100.025,7) than non JII members (IDR848.432.378.791,54). The capability of JII members to fulfill the creditor obligation in short term (ratio of current assets to current liabilities) and long term (ratio of total assets to total liabilities) is also higher (0.35 for short term and 3.21 for long term) rather than non-JII members (0.58 for short term and 1.91 for long term). The companies of JII members also have higher return on assets compare to the companies of non JII members (0.13 versus 0.07 consecutively).

However, the corporate governance score and monitoring score between both of category characteristic do not enhance same result as financial performance. The companies of JII members have lower corporate governance score compare to the companies of non JII members (18.22 versus 23.30 consecutively). The monitoring score also state that the companies of JII members have lower monitoring score compare to the companies of JII members (13.40 versus 19.00 consecutively).

The comparison of financial performance, corporate governance, and monitoring score shows that the companies of JII member have higher financial performance than the companies of non-JII member, although the companies of JII member implement weaker monitoring mechanism rather than the companies of non-JII member. According to the management commitment to reduce agency conflict, the companies of JII member also have lower commitment in reducing agency conflict compare to the companies of non-JII member.

This study also involves the survival level of companies measured by the age of company from the date of initial public offering until 2014. The age indicates the ability of company to survive and the result states the age mean of the JII members are longer compare to the non-JII members (239.57 months versus 226.51 months). The age mean contrast to monitoring score and corporate governance score, although the financial performance of the JII members are higher than the non-JII members.

The examination reveals that social value affects significantly negative on the ratio of debt total to assets total (coefficient; 0.23) (see table 1). The result also reveals that social value affects significantly positive on the return on assets (coefficient; 0.04), the ratio of current assets to current liabilities (coefficient; 1.59), and the operating cash flow (coefficient; 6.6) (see table 2).

TABLE I. THE REGRESSION OF LIQUIDITY

	Debt Total to Assets Total		Current Assets to Current Liabilities	
	<i>Coeff</i>	<i>t</i>	<i>Coeff</i>	<i>t</i>
<i>Constant</i>	0.58	5.12	2.83	2.65
<i>Social Value</i>	(0.23)***	(5.00)	1.59***	3.73
<i>Age (Months)</i>	(0.00)**	(2.02)	0.01**	3.24
<i>Monitoring Score</i>	(0.02)	(0.80)	0.60**	2.63
<i>Corporate Governance Score</i>	0.02	0.84	(0.60)**	(2.61)
<i>Assets Total</i>	0.00	0.03	(0.00)	(0.96)
<i>R square</i>	0.32		0.254	
<i>F test</i>	6.911		5.119	

Note: ***) significant < 1%; **) significant < 5%; *) significant < 10%

The monitoring score has significant negative effect to the ratio of return on assets (coefficient; 0.03) and has significant positive effect to the ratio of current asset to current liabilities (coefficient; 0.60). However, the corporate governance score has significant positive effect to the ratio of return on assets (coefficient; 0.03) and has significant negative effect to the ratio of current asset to current liabilities (coefficient; 0.60). The contradiction results between monitoring score and corporate governance score on the its effect to financial performance show that there are inconsistency of the role of control mechanism.

Age as control variable is significantly negative to the ratio of debt total to assets total (coefficient; 0.00) (see table 1). However, age affects significantly positive to the return on assets (coefficient; 0.00), the ratio of current assets to current liabilities (coefficient; 0.01), and the operating cash flow (coefficient; 3.03) (see table 2).

Assets total as a control variable has insignificant correlation with all the proxies of financial performance as predicted in this study that social performance will improve the financial performance, namely short term and long term capabilities and also the wealth of shareholders through return on assets and operating cash flow.

TABLE II. THE REGRESSION OF PROFITABILITY

	Return on Assets		Operating Cash Flow	
	<i>coeff</i>	<i>t</i>	<i>coeff</i>	<i>t</i>
<i>Constant</i>	(0.13)	(2.68)	1.8	2.45)
<i>Social Value</i>	0.04**	2.28	6.6***	2.15
<i>Age (Months)</i>	0.00***	3.76	3.03*	1.83
<i>Monitoring Score</i>	(0.03)**	(2.62)	(2.6)	(1.61)
<i>Corporate Governance Score</i>	0.03**	2.61	2.6	1.61
<i>Assets Total</i>	(0.00)	(0.72)	0.08	9.33
<i>R square</i>	0.333		0.63	
<i>F test</i>	7.498		25.609	

Note: ***) significant < 1%; **) significant < 5%; *) significant < 10%

IV. DISCUSSION

This study examines the important role of social value on financial performance. In this study, the social value uses a proxy: Jakarta Islamic Index enacted by Indonesia Stock Exchange. The Jakarta Islamic Index is a list of selected company stocks that comply with Islamic Sharia Investment Guidelines. The difference of this study from the prior researches is the proxies of social value, such as environment, community, diversity, employee relations, human right, and product and governance [18-21].

The examination of social value on financial performance is important recently because there is no boundary between societies across world in the digital era. Therefore, this study needs to know whether local value can encourage the management to behave ethically.

The companies of Jakarta Islamic Index members have higher financial performance rather than the companies of non-Jakarta Islamic Index members. Although the companies of Jakarta Islamic Index members have same level of monitoring score and corporate governance score with the companies of non-Jakarta Islamic Index members. Therefore, the monitoring score has significant negative correlation with return on assets, so it indicates that higher monitoring implementation will reduce the wealth of shareholders. The corporate governance score also has significant negative correlation with the ratio of current ratio to current liabilities. As consequence, the higher of corporate governance implementation encourages the decreasing ability of sample companies to fulfill the short term obligation from creditor.

The study is important in the digital society era, because the improvement of telecommunication technology open an opportunity for every people to be shareholders, customers, and investors to access information directly from company's web

site. Therefore, the society's value surrounding the company in where operates could encourage management to behave ethically, such as less aggressive to maximize himself/herself interest. Study of La Porta et al. uses the law families on ownership structure and corporate governance implementation [2-5]. As predicted, the social value has significant positive effect to financial performance. However, the study shows that the Jakarta Islamic Index companies have insignificantly mean difference with the non-Jakarta Islamic Index companies on monitoring score and corporate score.

V. CONCLUSION

This study has implication that the implementation of corporate governance practice should involve the local value because management consider the social enforcement rather than the internal and external control, such as independent commissioner board and audit committee or independent auditor. Therefore, government that formulates policies, regulations, and rules for company should encourage company to report the concern of management to the local society as the part of company's report.

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