

Does An IPO Create Better Corporate Governance? (Empirical Evidence from an Indonesian Islamic Bank)

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Abstract—*This research is aimed to serve as an exploratory research on the impact of IPO on corporate governance practices. Drawn from a content analysis using the ASEAN Corporate Governance Scorecard of an Indonesia Islamic Bank as a case study, the findings show significant changes in the governance score of the bank. The changes mainly come from the aspect of the responsibilities of the board and disclosure and transparency. The increasing voluntary disclosure can be explained by the agency theory that the bank is now facing higher agency problem after going public, thus more information is disclosed to reduce the information asymmetry. Even though generalizability is not the main objective of this study, the findings can provide evidence on how a company responds to a greater pressure from stakeholders, especially the shareholders and investors, after an IPO decision.*

Keywords—*IPO, corporate governance, disclosure, Islamic bank*

I. INTRODUCTION

A. Background

A company can raise funds by either adding private issues or public issues by offering new shares. Public issue of new shares from a company which has never publicly issued shares before is called Initial Public Offering (IPO). By offering an IPO, the proportion of the shares will be owned by public shareholders. Hence, the management of the company, or the directors, have then to manage the company responsibly on behalf of shareholder interest, including minority shareholders.

The Shareholders (the principles) trust the management (agents) to run the company on their behalf. However, the Agency Theory argues that management will do their best in the interest of themselves and shape any conflict of interest to fit this theory- the Agency Problem [1]. Agency Problem is the problem when the management act in their best interest, in contrast to the shareholders' interest.

One way to overcome the agency problem is by monitoring the performance of management and directors. An example of monitoring commenced by public shareholders is by nominating shareholder preferred presence within in the management team. They choose their nominee at the Annual General Meeting of Shareholders to choose

independent directors and the other highest body in the board structure. By having their nominee within the structure, management is expected to act in the shareholders' interest. This means that the company will have a better corporate governance according to OECD principles. Nevertheless, in some cases within public companies, many have a poor board structure in place including poor governance implementation in place. For example, the downfall of a giant IT company in India in late 2008 bears evidence of poor governance within a public company.

“Satyam had all the right characteristics associated with good governance, including a distinguished board and a leading international auditor. Satyam had in its basket numerous distinguished corporate awards. Satyam was believed to have the adequate checks and balances required for fraud prevention; however, Raju’s (the CEO) confession letter shattered the myth of good corporate governance in his company [2].”

A Bank has a fiduciary responsibility. According to Law No.10/1998, any bank is an entity that gathers funds from the public in the form of savings, and lends funds to the public in the form of loans and/or in other forms in the objective to improve public welfare. This definition defines that any bank is a ‘public’ company. Banks have a large responsibility to manage people’s money which challenges them to have high degree of governance plus an adequate degree of disclosure to comply with regulations (regulations from OJK, Ministry of Finance, and Bank Indonesia). As stated in PBI 14/14/PBI/2012 that Banks in Indonesia have to publish annual a report containing several items in Article 3 [3]. However, the nature of any business within in a bank requires high degree of governance and so build trust from their customers and to also make sure the corporate structure is protecting the customers from any conflict of interest. Furthermore, to report such items, banks are required to construct acceptable governance to make sure information contained within reports is correct and not misleading. So, by not doing an IPO, banks must have acceptable governance an interesting discussion is whether the banks have better corporate governance after they conduct an IPO.

This research aims to evaluate, discuss, and give the empirical evidence regarding implementation of a company’s (the bank) corporate governance and its compliance to

regulations, especially in the case of a board structure and related disclosure as required by OECD principles and other principles. To evaluate the board structure and disclosure, this research uses the scoring method as released by ACMF, namely ASEAN Corporate Governance Scorecard (ACGS), with modified components in order to make it comparable from the year 2011 to 2015 in PT Bank Panin Syariah Tbk [4]. After evaluating the implementation of CG using ACGS, this paper evaluates the compliance of a company to related regulations.

II. THEORETICAL FRAMEWORK AND LITERATURE REVIEW

This research investigated the corporate governance practices before and after IPO in an Islamic bank. Related theories in this area are discussed below.

A. Agency Theory

The Agency Theory addresses problems that arise due to differences between the goals or desires of the principal and agent. Jensen and Meckling [2] define agency theory as a contract between the owner (the principle) and the agent (management who do the daily activity of the company). This problem is caused by an information asymmetric of the management and the agents resulting in several costs to align the agents' desire and managements' desire. One of which is, as mentioned by Jensen et. al. [2] in Godfrey [5] monitoring cost. Monitoring cost is a cost incurred by the company, which is borne by the principle and to monitor the agents to be aligned with the principles. For instance, audit cost, management compensation, supervising cost, etc.

B. Legitimacy Theory

Legitimation Theory is a concept of social contract that connects people and company, where people give rights and authority to the company for managing resources, either resources or human capital [6]. The company can only be legitimized by the public if the company acts within the social norms and values of society [7]. Thus, companies have to take appropriate action to win the trust and legitimization within the accepted social norms and values of society.

C. Corporate Governance and Effect of IPO

There is no specific definition of Corporate Governance, it is a relatively recent concept [8-10]. Corporate Governance discussed in this paper is as mentioned by Koh & Millstein [7], and corporate governance as the range of institutional policies that are involved in these functions as related to corporations.

Previous studies have returned mixed results on the effect of an IPO on corporate governance. Atinct et.al [11] found that following the changes in ownership structure post-IPO, changes are observed in one of the corporate governance mechanisms, boards of directors, and that there is a negative impact of changes in boards of directors on subsequent performance of young entrepreneurial companies. Krishnan et.al [12] examined the association of a venture capital (VC) firm's reputation with the post-initial public offering (IPO) long-run performance. They found that the more reputable VCs exhibit more active post-IPO involvement in the corporate governance of their portfolio and this continued

involvement positively influences post-IPO company performance. Fan, Wong, and Zhang [13] investigated the corporate governance and post-IPO performance of China's partially privatized companies and found that the three-year post-IPO stock returns underperformed the market by 23%. A significant factor of the underperformance is attributable to politically-connected CEOs, that is, the underperformance of companies with politically-connected CEOs exceeds those without politically-connected CEOs by 37%. Most research focuses on the impact of corporate governance of an IPO [14, 15] and not the opposite. This research tries to fulfill this gap by providing evidence from a case study.

III. RESEARCH METHOD

A. PT Bank Panin Dubai Syariah at a Glance

PT Bank Panin Dubai Syariah (PNBS), 100% owned by PT Bank Panin Tbk, began its business in 2009. By having a stable and reputable performance in sharia banking products, the business growth was good. In 2013, PT Bank Panin Syariah had its Initial Public Offering in the Indonesian Stock Exchange (Bursa Efek Indonesia). Although the offering did not reach the target, PT Bank Panin Syariah was controlled by Dubai Islamic Bank 24.71% at that time and 23.18% of its shares were owned by the public while the majority owner was still PT Bank Panin Tbk. In 2015, Dubai Islamic Bank acquired more PT Bank Panin Syariah Tbk f shares from the public shareholders resulting in two majorities of ownership: PT Bank Panin Tbk and Dubai Islamic Bank PJSC.

B. Scoring

This research use ACG Scorecard released from www.theacmf.org. The ACG Scorecard has some advantages, one of them is easy to understand and practicable. Corporate governance components required in the scorecard are divided into 5 parts:

- Rights of Shareholders
- Equity Treatment of Shareholders
- Role of Stakeholders
- Disclosure and Transparency
- Responsibilities of Board

There are two additional components: Bonuses and Penalties. To make it comparable, this paper modified some components to compose a comparable score both before and after the offering. This research dismisses some of the components from point (a) and (b) simply because the shareholders before an IPO are just the 'original' owners. Furthermore, within banks, the main problem of agency is not on the equity holder, but the debtholder—the savings.

TABLE I. CORPORATE GOVERNANCE-SCORING MATTERS

No	Matters	Maximum Score
1	Equity Treatment of Shareholders	5
2	Role of Stakeholders	9
3	Disclosure and Transparency	22
4	Responsibilities and Board	62
5	Bonus	10
6	Penalty	-14
Total		94

Scoring is focused on 6 components with its maximum score as presented in Table 1. Every answer is scored '1' if it answers 'Yes' to the question and '0' if 'No'. In Penalties, if it is 'Yes', then the score is '-1' and '0' if it is 'No'.

IV. ANALYSIS AND DISCUSSION

A. Overall Scoring

After scoring corporate governance using the ACG Scorecard, this table (Table 2) shows the corporate governance score for PT Bank Panin Dubai Syariah Tbk.

Based on Table 2, the overall (Total) score from year to year is going up. In 2011 to 2012, the score was increased by 2 points. Meanwhile, in 2013 the score rose by 16 points due to the company's public announcement and the registration of the company's equity share to Indonesian Stock Exchange (*Bursa Efek Indonesia*). After the offering, the addition of governance score is decreases from 9 points in 2014 to 2 points in 2015. This may be caused by the adjustment and changes internally to company requirements to meet Corporate Governance as required by the OJK (*Otoritas Jasa Keuangan*, Indonesian Financial Service Authority) as stated in SE 32/SEOJK.04/2015 about five aspects of corporate governance [16].

Although there is no specific guidance mentioned in the regulations regarding corporate guidance, however, the aspects stated in the regulation clearly state that there must be 5 aspects of the listed-companies: (1) Shareholder Treatment, (2) Role and Functions of Board of Commissioner, (3) Role and Functions of Board of Directors, (4) Participation of Stakeholders, and (5) Transparency. These 5 aspects are obviously captured by almost all of the aspects scored in ACG Scorecard. Thus, we can state that the regulation published by OJK is in alignment with ASEAN Corporate Governance, or, ASEAN Capital Market Forum.

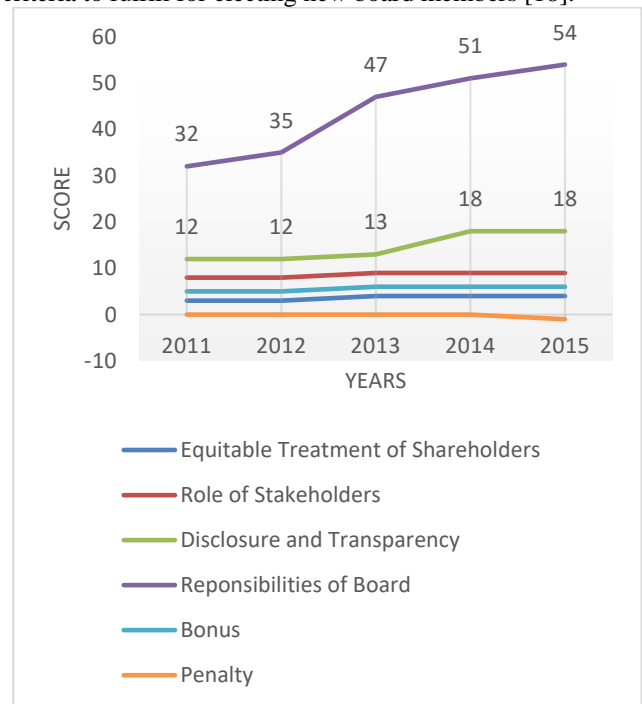
B. Governance Aspects

Table 2 represents the movement of the score between years. Graph 1, as shown below, shows more adequately how the score moves from year to year. The data in Graph 1, shows there is no significant movement from Equitable Treatment, Role of Stakeholders, Bonuses, and Penalties. Nevertheless, in 2013, Responsibilities of Board increased significantly from 35 to 47. This is explained by a major improvement with regards to disclosure related responsibilities of the board. For example, the clearly stated the role of the functions of BOC and BOD, the clear disclosure related to mechanisms of Internal Audit body, the charters of Audit Committee, Remuneration and Nominating Committee, and Risk Committee. Management are now

responsible for compliance with Governance requirements, not only to debtholders but also public shareholders.

One interesting finding is the Responsibilities of the Board. PT Bank Panin Dubai Syariah had no policy regarding time to re-elect both BOD and BOC as stated in the Scorecard for 3 or 5 years even though POJK 33./POJK.04/2014 clearly stated that "1 (one) period of office for members of the Board of Directors shall be no more than 5 (five) years or up to the closing of the annual GMS at the end of 1 (one) period of the said term of office [17]."

This is important information for the public to know because PT Bank Panin Dubai Syariah Tbk has another majority shareholder - Dubai Islamic Bank. So, there is a probability that the board composition in the coming years will contain nominees from Dubai Islamic Bank. Another reason the public should know the re-election policy is how to make a decision regarding the involvement of minority shareholders within the management of the company. Nevertheless, this not easy to achieve. Since the re-election process of the board is strictly regulated by Bank Indonesia (Indonesian Central Bank) so as to ensure the board have the skills and competencies to keep the bank healthy and act in a prudent way. It is stated in PBI 2/27/PBI/2000 that the nomination of directors and commissioners have to take the fit and proper test and there are many requirements and criteria to fulfill for electing new board members [18].



Graph 1. Scoring Results

TABLE II. SCORING RESULTS

No	Matter	Score/Year				
		2011	2012	2013	2014	2015
1	Equitable Treatment of Shareholders	3	3	4	4	4
2	Role of Stakeholders	8	8	9	9	9
3	Disclosure and Transparency	12	12	13	18	18
4	Reponsibilities of Board	32	35	47	51	54
5	Bonus	5	5	6	6	6
6	Penalty	0	0	0	0	-1
	Total	60	63	79	88	90

Another major improvement regarding the responsibilities of the board is the disclosure of boards' performance. Before IPO introduction, there was no clear policy regarding the meeting requirements for the election of boards. For instance, the policy was just 'the directors have a meeting annually to discuss any important matters' this also applies to the commissioners. After the IPO, they disclose the specific times the boards held meetings, the minutes of the meeting must be documented and reported, and also the committees subordinated by the commissioners.

Another interesting matter found in the process of the assessment is the Internal Audit body. Before PNBS had done the IPO, they had no proper internal audit disclosure. Although they have SKAI (*Satuan Kerja Audit Internal*—or Internal Audit body), there was no clear functions, codes, and the position of the Internal Audit in the report. Although PBI 14/14/PBI/2012 did not require the banks to carry out such disclosure, the Bank committed to implement Good Corporate Governance which is an advantage for the bank to voluntarily disclose the Internal Audit function body in the bank to gain trust from the public and society.

V. CONCLUSION

The results show there is a significant change in the governance score of PNBS. There are significant impacts on the banks governance. This mainly comes from the responsibilities of the board and by disclosure and transparency. PNBS now faces higher agency problems as explained by the agency theory. To overcome these problems, PNBS should disclose more information so that the information asymmetry can be reduced. Thus, we can state that the governance of the bank is better after the IPO.

This conclusion is beneficial for regulators since the nature of any bank becoming a 'public' company is compliance of regulations. To regulate with rigor the board should have responsibilities and give full disclosures. It is important for the public and society, to monitor the management in order to keep the bank healthy. Supported by research by Claessens & Yurtoglu [19] that higher quality of governance could lower the cost of debt because easy financing, which can thus improve the company financial performances and economic growth.

VI. LIMITATIONS AND RECOMMENDATIONS

This research has several limitations that could be improved in future research. First, this research is a single case study that only focused on PNBS that offered an IPO in 2013. It is better to enlarge the observation on the banks who had their IPO in 2012 to 2015. The use of larger samples will enable the use of statistic tests to prove whether the change is statistically significant; for instance, by using a Chow test or

another chi-square test to test the significance of different comparisons.

Secondly, this research does not discuss and assess the implementation of Sharia principles in banks. It is suggested that future research discuss 'Sharia Governance' to make sure the implementation of the business is aligned with Sharia principles.

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