CAPITAL STRUCTURE OF INDONESIAN BANKING FIRMS: THE EFFECTIVENESS OF INDEPENDENT COMMISSIONERS

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Submited From 2024-08-10 | Revisions Required 2024-08-11 | Accept Submission 2024-09-09

Abstract **:** This study aims to analyse the effect of family ownership proxied by political connections on capital structure with independent commissioners as a moderating variable in banking companies listed on the Indonesia Stock Exchange from 2018 to 2022. The sampling technique used is purposive sampling, which produces 140 observations. The data analysis technique used is panel data regression model analysis using Stata 17. The results of the preliminary test show that this study uses a fixed effect model. The results of this study found that family ownership has a negative and significant effect on capital structure. In addition, this study found that political connections and independent commissioners have a positive and significant effect on capital structure. Furthermore, the results of the moderation test show that independent commissioners strengthen the negative effect of family ownership and weaken the positive effect of political connections on capital structure. Based on the results of this study, banking companies in Indonesia need to pay attention to political connections and independent commissioners because they have been proven to increase the proportion of company debt, which is considered to reduce agency problems according to agency theory and resource-based view theory.

Keywords: family ownership, political connections, independent commissioners, capital structure

JEL Classification: G21, G23, M41, M42

INTRODUCTION

Indonesia joined the G20 in 1999, triggered by the global economic crisis that also affected Indonesia's economy [1]. The Coordinating Ministry for Economic Affairs stated that Indonesia has a projected annual economic growth rate of 5% in 2024, placing it among the top three countries in the G20. The financial sector, which drives Indonesia's economic growth, is dominated by the banking industry [2]. According to the Fiscal Policy Agency (FPA) of the Ministry of Finance, banking assets reached 60% of Indonesia's total financial assets in 2023. Therefore, the banking sector is considered the core and driver of the economy in Indonesia. The progress of Indonesian banks can be seen from the data released by the Indonesia Stock Exchange regarding market capitalization in 2023 [3]. There are ten major banks in ASEAN, playing a crucial role in supporting and maintaining economic growth while addressing financial inclusion challenges in ASEAN countries. Four of the top 10 banks in ASEAN are dominated by Indonesian banks. This is reinforced by a report from S&P Global Market on the top banks in ASEAN based on market capitalization as of June 2023 [4].

Table 1. Market Capitalization of Top ASEAN Banks

Company	Country	Market Capitalization (US$ Billion)
BCA	Indonesia	73,84
BRI	Indonesia	54,23
OCBC Bank	Singapore	41,68
Bank Mandiri	Indonesia	36,45
UOB	Singapore	35,17
Maybank	Malaysia	29,65
Public Bank (Pbbank)	Malaysia	17,84
CiMB Group	Malaysia	13,17
BNI	Indonesia	11,59
Siam Commercial Bank	Thailand	11,16

The data above shows that Indonesia is able to dominate the capital market and economy of ASEAN countries. This also indicates a competitive competition in the banking industry, which is expected to encourage other banks, especially Indonesian banks, to be more creative and innovative in order to survive in the competition and successfully dominate the ASEAN market [5]. The high market capitalization of companies indicates that the capital structure is dominated by equity with a greater proportion and decreasing debt [6]. This condition makes many global and local investors consider investing in Indonesian banking [7]. Investors can use the capital structure as a basis for investing in companies, as the capital structure defines equity, total debt, and total assets. All three are used to determine risk, return, and income [3].

According to agency theory, independent commissioners are crucial in supervising the work of the board of directors. Because independent commissioners often have the same perspective as the board of commissioners, they recommend the use of high debt in the capital structure [7]. Independent commissioners have the power to restrain opportunistic behavior that prioritizes self-interest from managers, according to agency theory. As a result, the more independent commissioners, the more they will recommend the use of high debt to reduce free cash flow. It will be easier to monitor managerial behavior using debt if there are independent commissioners [8]. Including policies regarding asset ownership. If a company is deemed to have high capital intensity, the company tends to utilize depreciation costs of fixed assets to reduce taxes. High depreciation costs must be ensured not to violate tax regulations. This becomes an assessment that the presence of independent commissioners is able to supervise company activities in investing in fixed assets to remain compliant with applicable regulations [9]. Research by Ghifary & Lastati, Prasetyo & Hadiprajitno, Indrasti states that independent commissioners have a positive effect on capital structur [9], [10], [10]. Meanwhile, research by Tini et al, Rahayu et al, and Indrasti states that independent commissioners have a negative effect on debt. Based on the explanation above, the researcher is interested in analyzing the role of independent commissioners as a moderator of the influence between family ownership and political connections on capital structure. This study develops the research of Setiawan & Kusumawati which examines family ownership, independent commissioners, and capital structure [11]. This study is interested in adding the variable of political connections because previous research found that political connections can increase access to funding [12]

1. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

According to the pecking order theory proposed by Myers , companies prioritize internal funding sources over external ones when financing their investments [13]. This theory suggests that firms initially utilize internally generated funds, such as retained earnings. External funding is sought only when internal resources are insufficient, with debt being preferred over equity [14]. Typically, minority shareholders (non-family members) hold fewer shares than majority shareholders (family members). As a result, majority shareholders possess greater control and can act in their own interests. This phenomenon is referred to as the expropriation of minority shareholders [15].

Barney's Resource-Based Theory (RBT) posits that a firm's ability to sustain and effectively allocate valuable, rare, and non-substitutable resources is crucial for creating sustainable competitive advantages [16]. RBT primarily focuses on the integration of tangible and intangible assets, financial resources, and networking, as well as knowledge and experience, to achieve desired objectives [17]. Social assets, entrepreneurial mindset, and intellectual principles, along with stakeholder monitoring goals, contribute to firm performance (Innayah et al., 2021). Intangible resources, such as political connections and expert skills and experience, are valuable, unique, and complex, making them difficult to replicate and enabling sustainable competitive advantages [18]. These benefits include easier access to domestic funding, facilitating financial managers' investment decisions [19]. Additionally, good government relationships can lead to more lenient regulatory supervision, easier credit approval, and improved access to essential resources and contracts. These advantages enable businesses to operate more efficiently, generating higher revenues [20].

Jensen and Meckling's agency theory posits that the interaction between managers, acting as agents, and shareholders, acting as principals, constitutes an agency relationship [21]. Managers often prioritize their self-interest over the interests of others when making decisions, particularly their own welfare over those of shareholders. Conversely, shareholders seek to maximize their interests. Ultimately, this leads to a conflict of interest between managers and shareholders [22]. A firm's policies are influenced by its shareholder ownership structure. Due to the diverse interests of various shareholders, different ownership arrangements have distinct effects on company policies, which in turn impact the organization's financial performance (agency theory) [23]. This aligns with agency theory, which suggests that a board comprising a large number of independent commissioners can limit the implementation of managerial policies that exploit minority shareholder wealth. Independent commissioners facilitate the resolution of disagreements between managers and residual claimants. A board composed of independent commissioners provides a balance, preventing insiders from exploiting their position and shareholder [11].

According to the pecking order theory, companies tend to prefer internal financing for funding their projects [24]. Family ownership possesses significant influence over administrative positions, enabling cost minimization and profit maximization [25]. The presence of larger family share ownership (represented by managers) can align the interests of family managers and other stakeholders (shareholders), reducing the likelihood of earnings manipulation [26]. Additionally, high debt usage increases the risk of bankruptcy due to fixed interest costs and the relatively long-term nature of debt, making internal financing more preferable [27]. Studies by Wang, Manry, and Rosa , Stryckova et a, Camison et al, and Fausa et al indicate that family ownership has a negative impact on capital structure [28], [29], [30], [31].

H1: Family ownership has a negative effect on capital structure.

The resource-based theory (RBT) posits that companies with political influence can derive benefits in various ways. Business and form partnerships based on shared interests and benefits. Corporate activities that promote government politics objectives and support public policy formulation, including economic interests, benefit the government. Companies gain advantages from these relationships in the form of tax breaks, government project awards, monopoly facilities, and other facilities that support their operations [32]. Companies with political connections often make suboptimal decisions, leading to poor performance. Consequently, these companies are likely to face higher interest rates from lenders. However, companies with political connections have a higher chance of receiving government protection and bailout funds during financial difficulties, making them appear less risky. Commercial banks recognize the benefits of political connections and provide favorable loans to these companies [25]. Studies by Braham et al., Istan & Kamaludin, Ligita & Muazaroh, and Ivonilenia et al. suggest that political connections have a positive impact on capital structure [32], [33], [34], [35].

H2: Political connections have a positive effect on capital structure.

Agency theory posits that corporate governance can alleviate agency problems associated with ownership and control of the company. Independent commissioners, as representatives of corporate governance, play a crucial role in capital structure decision-making. As the number of independent commissioners increases, they are expected to receive greater support in making capital structure decisions, thereby minimizing conflicts of interest as described in agency theory [7]. Improved corporate governance and a higher proportion of independent commissioners facilitate access to external capital, enabling companies to better manage and enhance their financial structure. Furthermore, companies can implement debt policies through corporate governance, as determined by management ownership. As a result, companies are expected to become more adept at managing capital structure due to their ease in adopting debt policies [4].

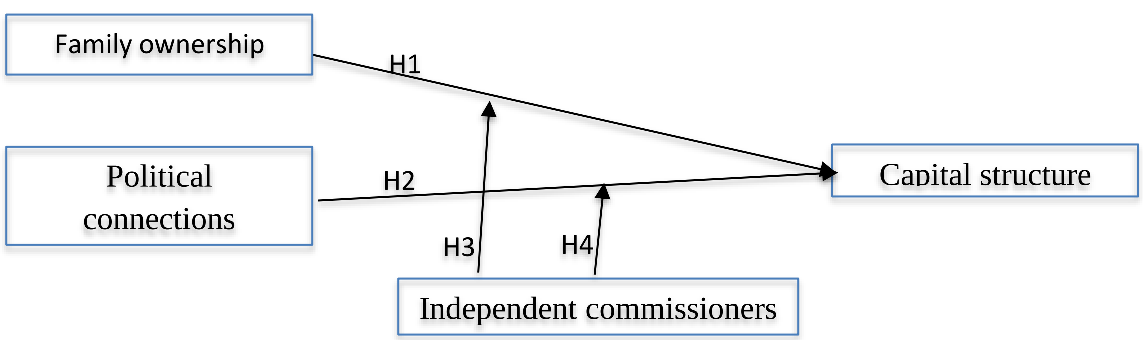
Studies by Setiawan & Kusumawati, Wahidah & Ardiansari, Ghifary & Lastati suggest that independent commissioners mitigate the negative influence of family ownership on capital structure [8], [9], [38].

H3: Independent commissioners weaken the negative influence of family ownership on capital structure.

Companies with strong government ties are characterized by their political connections. Controllers of such companies wield greater power and influence due to these connections. Majority shareholders feel empowered and secure due to their close political ties, which can lead to opportunistic behavior [39]. Companies with political connections can reap various benefits, including reduced debt scrutiny and easier loan approval, which may encourage debt avoidance strategies [12]. Independent commissioners can safeguard shareholder interests by monitoring management actions. As the proportion of independent commissioners increases, companies' ability to avoid debt decreases. Independent commissioners facilitate shareholder oversight of management decisions, promoting transparency and accountability [40]. The presence of independent commissioners enhances oversight of operational activities [41]. Studies by Istan & Kamaludin, Maulana & Wati, Syaputra & Hendrawaty demonstrate that independent commissioners strengthen the positive relationship between political connections and capital structure [32], [42], [43].

H4: Independent commissioners strengthen the positive influence between political connections and capital structure.

Framework Research



H1: Family ownership has a negative effect on capital structure.
H2: Political connections have a positive effect on capital structure
H3: Independent commissioners weaken the negative influence of family ownership on capital structure

H4: Independent commissioners strengthen the positive influence between political connections and capital structure

2. METHODS

This research utilized a quantitative approach to investigate the relationships between variables, leveraging numerical measurements derived from quantitative variable measurements. The study's population comprised 41 banking companies listed on the Indonesia Stock Exchange, yielding a total of 140 observations between 2018 and 2022. Purposive sampling was employed, with selection criteria including financial reports denominated in Indonesian rupiah, banking companies listed on the Indonesia Stock Exchange, and annual reports spanning 2018-2022. Secondary data were compiled, documented, and analyzed through the publication of banking financial reports for 2018-2022 by the Indonesia Stock Exchange.

Table 2. Operational Definition of the Variable

Variable (Symbol)	Operational Definition	Indicators / Measurement Formula	Scale
Capital Structure (MODAL)	The utilization of a combination of debt, preferred shares, and common equity to finance business assets [44]	DAR = Total debt / Total equity	Ratio
Family Ownership (FAMOWN)	The proportion of shares owned by a family [45]	FAMOWN = 1 indicating family ownership and FAMOWN = 0 indicating non-family ownership	Dummy Variable
Political Connection (POLCON)	A company's political affiliation. [45] [46]	POLCON = 1 indicating a political connection and POLCON = 0 indicating no political connection	Dummy Variable
Independent Commissioner (INDEP)	measuring the presence of external board members in the decision-making process [20]	INDEP = number of independent commissioners / total board members	Ratio
Profitability (ROA)	A company's ability to generate profits [47].	ROA = Net Income/ total Asset	Ratio
Tangibility (TANG)	indicating a company's asset structure [47].	TANG = Fixed Asset/ total Asset	Ratio
Company Size (SIZE)	A company's size [47].	the natural logarithm of total assets	Nominal

This study examines the relationship between family ownership, political connection, and capital structure, with independent commissioner serving as a moderating variable. The analysis employs descriptive statistics, classical assumption testing, and panel data regression. Two regression equations are formulated to capture the moderating effect of independent commissioner:

Equation 1: Family ownership and political connection on capital structure.

$$MODAL = \alpha + \beta_1 FAMOWN + \beta_2 POLCON + \beta_3 INDEPCOM + \beta_4 SIZE + \beta_5 TANG + \beta_6 ROA + e \ldots\ldots\ldots\ldots (1)$$

Equation 2: Moderation of independent commissioner on the relationship between family ownership, political connection, and capital structure.

$$MODAL = \alpha + \beta_1 FAMOWN + \beta_2 POLCON + \beta_3 INDEPCOM + \beta_4 FAMOWN*INDEPCOM + \beta_5 POLCON*INDEPCOM + \beta_6 SIZE + \beta_7 TANG + \beta_8 ROA + e \ldots\ldots\ldots\ldots (2)$$

MODAL	= Dependent variable of capital structure
FAMOWN	= Independent variable of family ownership
POLCON	= Independent variable of political connection
INDEPCOM	= Moderating variable of independent commissioner
FAMOWN_INDEPCOM	= Interaction variable between family ownership and independent commissioner
POLCON_INDEPCOM	= Interaction variable between political connection and independent commissioner
SIZE	= Control variable of company size
TANG	= Control variable of tangibility
ROA	= Control variable of profitability
α	= Constant
β1-β8	= Regression coefficients of independent variables
e	= Error term

3. RESULT AND DISCUSSION

Descriptive Statistics Analysis

This section presents a summary of the descriptive statistics, including the minimum, maximum, mean, and standard deviation values of the variables used in this study, which focuses on banking companies listed on the Indonesia Stock Exchange from 2018 to 2022. The results are presented in Table 2.

Table 2. Descriptive Statistic

Variable	Observation	Min	Max	Mean	St. Deviation
MODAL	140	0.04	0.94	0.797257	0.136247
FAMOWN	140	0	1	0.285714	0.453376
POLCON	140	0	1	0.278571	0.449906
INDEPCOM	140	0.3333	1	0.584014	0.113794
ROA	140	0.0002	0.091	0.014107	0.014921
TANG	140	0.002	0.108	0.026136	0.021298

SIZE	140	28.99	35.23	32.01558	1.661371

Source: Stata 17, data processed 2024

Table 3 presents the descriptive statistics for the variables used in this study. The average capital structure (MODAL) of banking companies from 2018 to 2022, measured using the Debt-to-Asset Ratio (DAR), is 0.797257. This suggests that, on average, Indonesian banking companies rely heavily on debt financing, with a debt-to-asset ratio of approximately 0.797257.

The family ownership variable (FAMOWN) ranges from 0 to 1, indicating that the shareholders of banking companies in Indonesia during the observation period are primarily non-family shareholders. The political connection variable (POLCON) has a minimum value of 0 and a maximum value of 1, with an average value of 27.8571%. This implies that a significant proportion of banking companies in Indonesia in this study do not have political connections.

The descriptive statistics for the independent commissioner variable (INDEPCOM) reveal an average of 0.584014 and a standard deviation of 0.113794. This suggests that the majority of banking companies in this study have independent commissioners, in compliance with regulations set by the Financial Services Authority in Indonesia.

Preliminary Test
Chow Test

Table 3. Test Chow test (OLS vs FE)

	Model 1	Model 2
F	25.01	25.75
Prob > F	0.0000	0.0000
Result	FE	FE

Source: Stata 17, data processed 2024

The Chow test was employed to compare the fixed-effect model with the OLS model (Table 3). The results indicate that the chi-square values for models 1 and 2 are 25.01 and 25.75, respectively, with both models having a probability value of 0.0000. This suggests that the fixed-effect model is superior to the OLS model in explaining the relationship between family ownership, political connections, and capital structure, with independent commissioners serving as moderators. The control variables, including profitability, tangibility, and firm size, were also considered in the analysis. The significant result ($p < 0.05$) indicates that the fixed-effect model is more suitable for this study.

Breusch and Pagan Lagrangian Multiplier Test

Table 4. Breusch and Pagan Lagrangian multiplier test (OLS vs RE)

	Model 1	Model 2
Chibar2 (01)	110.05	85.07
Prob > chibar2	0.0000	0.0000
Result	RE	RE

Source: Stata 17, data processed 2024

Furthermore, the Breusch and Pagan Lagrangian Multiplier Test (Table 4) was employed to compare the OLS model with the RE (random effect) model. The test results reveal that the Breusch and Pagan Lagrangian Multiplier Test values for models 1 and 2 are 110.05 and 85.07, respectively, with both models exhibiting a probability value of 0.0000. This finding indicates statistical significance ($p < 0.05$), leading to the rejection of the null hypothesis at a 5% significance level. The results of this study demonstrate that the Ordinary Least Square model is inadequate for assessing the impact of independent variables, including family ownership and political connections, as well as control variables, such as profitability, tangibility, and firm size, on capital structure with independent commissioners serving as moderators. Consequently, the Random Effect model is deemed more suitable.

Hausman Test

Table 5. Hausman Test Result (RE vs FE)

	Model 1	Model 2
Chibar2 (01)	53.88	47.80
Prob > chibar2	0.0000	0.0000
Result	FE	FE

Source: Stata 17, data processed 2024

Thirdly, the Hausman test was conducted to determine the appropriateness of the model selection in choosing between the fixed-effect model and the random-effect model. The results presented in the table indicate that the Hausman test values for models 1 and 2 are 53.88 and 47.80, respectively, with corresponding probability values of 0.0000 and 0.000. These findings suggest statistical significance ($p < 0.05$), leading to the rejection of the null hypothesis at a 5% significance level. Consequently, the fixed-effect model is deemed more suitable for this study. Based on the results of these tests, the fixed-effect model will be employed to examine the relationships between variables.

Diagnostic Tests for Heteroscedasticity and Autocorrelation

Table 6. Test for Heteroscedasticity and Autocorrelation

	Model 1	Model 2
Full Sample	140	140

Heteroscedasticity		
Chi2	7.30E+05	4.50E+06
Prob > Chi2	0.0000	0.0000
Autocorrelation		
F	14.694	18.598
Prob > F	0.0007	0.0002

Source: Stata 17, data processed 2024

Table 6 reports the results of the heteroscedasticity and autocorrelation diagnostics for the regression model. As indicated in Table 6, the results reveal the presence of heteroscedasticity and autocorrelation. To address these issues, the Fixed Effect regression model with clustered sandwich standard errors is employed, thereby ensuring that the model estimates are robust to these problems.

Table 7. Hypothesis Test

	Model 1	Model 2
Data Panel Regression		
Const	0.3194275	0.0968349
	(4.52)**	(0.89)*
FAMOWN	-0.056137	0.1926099
	(-3.3)**	(1.95)*
POLCON	0.045026	0.2147541
	(3.81)**	(4.42)**
Control Variable		
ROA	-0.2563035	
	(-0.92)*	
TANG	0.9864247	
	(3.96)**	
SIZE	0.0122642	
	(4.15)**	
Moderated Regression Analyze		
INDEPCOM		0.2489952
		(3.2)**
FAMOWN*INDEPCOM		-0.3688215
		(-2.85)**
POLCON*INDEPCOM		-0.245895
		(-4.01)**

* indicates significance at the 1% level; ** indicates significance at the 5% level; * indicates significance at the 10% level

Source: Stata 17, data processed 2024

The initial hypothesis test was designed to examine the negative impact of family ownership on capital structure. The test results reveal that family ownership has a statistically significant negative effect on capital structure, with a coefficient value of -0.056137 at a 5% significance level and a t-value of -3.30. Consequently, the hypothesis positing a negative and significant relationship between family ownership and capital structure is supported. This finding aligns with the pecking order theory, which suggests that family ownership tends to avoid high debt risk due to the potential for bankruptcy. As a result, family ownership tends to employ debt reduction strategies to minimize financing and mitigate risks faced by the company. These findings are consistent with prior research conducted by Wang et al, Stryckova et al, Camison et al, and Fausa et al., which similarly suggest that family ownership has a negative impact on capital structure [49] [50] [51] .

The second hypothesis test yielded significant results, indicating a positive relationship between political connections and capital structure, with a coefficient value of 0.045026 at a significance level above 5% and a t-value of 3.81. Consequently, the hypothesis positing a positive impact of political connections on capital structure is supported. The findings suggest that government investment in the banking sector is substantial. Furthermore, the results indicate that companies with higher political connections tend to have higher debt values due to easier access to loans facilitated by these connections. The results of this study are consistent with the Resource-Based Theory, which posits that political connections are a valuable resource for companies. The findings of this study are also in line with previous research conducted by Braham, Peretti, & Belkacem, Istan & Kamaludin, Maulana & Wati, and Syaputra & Hendrawaty, which similarly found a positive relationship between political connections and capital structure [32], [33], [42], [43].

The fourth hypothesis test reveals that independent commissioners strengthen the negative impact of family ownership on capital structure, with a coefficient value of -0.3688215 at a 5% significance level. However, the results do not support the notion that independent commissioners weaken the negative impact of family ownership on capital structure. This finding is consistent with the pecking order theory, which suggests that family ownership prioritizes internal financing over external financing. This result is also in line with the study conducted by Priyanti et al which found that independent commissioners strengthen the negative impact of family ownership on capital structure.

The fifth hypothesis test yields result's indicating that independent commissioners mitigate the positive impact of political connections on capital structure, with a coefficient value of -0.245898 at a 5% significance level and a t-value of -4.01. Contrary to the fifth hypothesis, which posits that independent commissioners strengthen the positive impact of political connections on capital structure, the results do not support this notion. This can be attributed to the role of independent commissioners in banks with political connections, which serves as a monitoring mechanism to oversee bank operations. Consequently, independent commissioners exercise caution when approving debt increases, particularly when the associated risks are excessively high. This finding is consistent with the research conducted by Harijanto & Supatmi [54].

CONCLUSION

This study investigates the impact of family ownership and political connections on capital structure. The empirical findings indicate that family ownership has a negative effect on capital structure, suggesting that family-controlled banks prioritize equity over debt to minimize the risk of bankruptcy. In contrast, political connections have a positive and significant impact on capital structure. The results suggest that Indonesian banking companies have a high level of political connections, as many government institutions invest in the banking sector. This study also examines the impact of independent commissioners on capital structure. The first result shows that independent commissioners have a positive impact on capital structure. The second result indicates that independent commissioners strengthen the negative impact of family ownership on capital structure, consistent with the pecking order theory. The third result reveals that independent commissioners weaken the positive impact of political connections on capital structure, as they are more cautious in approving debt increases when the risks are too high. This study includes three control variables: profitability, tangibility, and firm size. The inclusion of these control variables is used to prevent biased results and ensure the robustness of the findings.

This study acknowledges several limitations in its measurement and variable selection. Specifically, these limitations encompass: (1) the reliance on a single variable, namely independent commissioners, as a proxy for corporate governance mechanisms aimed at mitigating agency problems, (2) the inability to demonstrate a positive impact of family ownership on capital structure, and (3) the utilization of a single measurement for political connections. To address these limitations, future research is recommended to: (1) incorporate additional corporate governance variables, including board size, audit committee, and remuneration committee, (2) employ alternative measurements for assessing family ownership, such as the proportion of family-owned shares to total outstanding shares, and (3) utilize alternative measurements for political connections, including the number of directors with political connections, and conduct a more comprehensive examination of political connection disclosures through various communication channels, including bank websites, sustainability reports, newspapers, and internal magazines used to communicate corporate social responsibility activities.

Acknowledgments

The author wishes to acknowledge and thank himself for his diligent efforts, as well as those individuals who provided invaluable support and encouragement throughout the completion of this work.

Funding

This research was supported by personal funding

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Supervision R.D.C. ; M.N.I; W.P. ; Y. P. A
Validation: R.D.C. ; M.N.I; W.P. ; Y. P. A
Visualization: R.D.C.
Writing – original draft: R.D.C. ; M.N.I.
Writing – reviewing & editing: R.D.C. ; M.N.I.

Conflicts of interest

The author declares no conflict of interest and confirms the originality of their work, with no improper plagiarism.

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