CHAPTER I
INTRODUCTION

1.1 Background of Study

In the modernization era, there could be found lots of company having various business sector. They are competing each other in order to be the best and the top one. Strategies and decisions will be made and implemented in order to achieve the company goals and objective, no exception for the long-term growth of the company.

To keep the existence and the long-life of the company, the daily business and operational activities, company will be in need of capital.

Capital is one of the most important items for the whole process of the company. Without capital, company will not work as well.Capital is aimed to maintain the sustainability of the company as company should always be aware of the amount of capital being used in its operation, either to manufacture goods or in providing services to customer. Without capital itself, it will be hard for company to sustain. Therefore, it is one of the most essential things to be concerned by company in conducting its business activities.

Capital itself is needed by company to finance the operational business and activities. Therefore, deciding on how to earn the capital will become one of the main issues and concerns for company.

There will be a lot of option that could be choosen to fund the company, either by obtaining it internally or externally. However, every single capital that is obtained by company will be charged on the cost, which is known as the cost of capital (Anggraini, 2015). According to Riyanto as quoted by Anggraini (2015), capital cost is a real cost that should be borne by company as the exchange of obtaining capital from the chosen sources.

Thus, it will be important to decide on how to manage the proportion of capital and how to obtain the capital, which can be derived from debts or equities, such as short-term debts, long-term debts, preference shares or even common stocks. As supported by Thesarani (2016) that the decision of determining the optimal capital structure can lead to the efficiency and effectiveness of capital cost for the company.

In order to take on the decision regarding the sources of capital, company will need to decide on the proportion of capital structure. Company settles down the way of financing and chooses which option will best serve the company, whether to use more debt or less equity or even less debt or more equity.

According to Raharjaputra as quoted by Dewi (2018), determining the capital structure could be a challenge for the management, especially for the decision-maker or finance manager to take on the right decision by using minimal capital with an optimal outcome. This argument was also supported by Reminov (2015), saying that company should take an effective and efficient decision regarding capital structure in order to minimize the cost of capital and maximize the value of the company.

A company that has a strong and stable finance could be created by the effectiveness of capital structure. As has been mentioned before, many consideration could be taken, whether to use debt or equity. However, by using debt, there will be the risk, which is the interest rate. While by using equity, there will be the cost of issuing equity (Reminov, 2015). Therefore, Dewi (2018) also stated that the amount of the proportion of funding, both internally or externally should be taken into consideration by management, since the act of using more debt can lead the company to the financial risk such as bankruptcy.

Capital structure's implementation is connected to the stakeholders of the company, where the relationship between capital structure and stakeholders could generate the mechanism to control the act of the management by having the Good Corporate Governance (GCG) (Reminov, 2015).

Besides, the way of deciding the capital structure will also have a link with the agency theory, especially between the principal and agent. Principal is the shareholders or owner of the company, while agent refers to the management, those who are obliged to conduct the business operation. However, issue or conflict can arise between these two parties, when the agent acts not in the interest of principal, which is called as the agency conflict. Hence, according to Muryati and Suardikha (2014), this agency conflict is the background why there is a need to have the implementation of a GCG in a company.

GCG has become an important aspect in a corporation as it reflects the whole package of integrity of a corporation in the eye of public. However, several problems related with good corporate governance still happen in the past until present time. One of the most popular scandals that had ever happened is about the bankruptcy of Enron, where there were many involvement from various parties that led the company to declare a bankruptcy.

In Indonesia, the weakness of the implementation of good corporate governance has been one of the factors that aggravated the financial crisis in 1997, driven by the existence of less transparant management (Setiawan, 2016). Yansyah (2018) also mentioned in the end of 1997, that the concept of governance has become stronger than before, since there was a Letter of Intent (LoI) between Indonesia’s government with International Monetary Fund (IMF) as the donor organization. According to the LoI, there should be an amendment regarding the governance by issuing the organ of governance for corporation.

Based on this problem, there will be a necessity to implement a GCG, such as the regulation and policy regarding GCG which is stipulated by Komite Nasional Kebijakan Governance (here after KNKG). According to KNKG, GCG could be well-implemented and applied if there is a fullfillness of its five principles, which are transparency, accountability, responsibility, independency and fairness.

Thus, in order to create the sustainability of stakeholders, even for both agent and principal, the implementation of GCG by fullfilling the five principals are expected to reduce the agency conflict (Anggraini, 2015).

Other than that, GCG is also expected to encourage management to take the optimal capital structure's decision (Anggraini, 2015). According to Rahadian (2014), GCG can also lead company to the optimization of the capital structure. Moreover, GCG itself can enhance the economic stability of the company.

When discussing about the GCG and the capital structures, there can be a link to the institutional ownership, managerial ownership and board of commissioners. Agoes' explanation as quoted by Supriyadi (2017), said that additional organs such as board of commissioners, commissioner independence, institutional ownership, managerial ownership and audit committee have its own function and responsibility to complete the implementation of GCG.

Another sources could also support this statement as based on *Pedoman Umum* GCG Indonesia arranged and issued by KNKG, the organ of company consists of *Rapat Umum Pemegang Saham* (here after RUPS), Board of Commissioners (BOC) and directors, where they will have an important function in the implementation of GCG effectively.

Moreover, based on the referred journal articles conducted by Beiner et al. as has been quoted by Dewi (2018) in her research before, indicated that there will be two mechanism of corporate governance, which are internal mechanism and external mechanism. Based on the practice, the indicator that could be used for the internal mechanism are BOC, board of directors, independence directors, independence commissioners, managerial ownership and audit committee. Conversely, institutional ownership could be used as the indicator for the external mechanism.

Institutional ownerships themselves can deliver a big impact towards the company position on taking the decisions on the capital structure since management as the agent of the company should act on the behalf of the shareholders. Thus, the total number of institutional ownerships held by certain organizations will become another consideration for management on deciding the best choice of financing for the company. As the institutional ownerships act as the sources or supply of the capital to the company.

Managerial ownership will also become another concern that should be considered, as managerial ownerships held by people who are also taking part on the company's management. Management will try their best to make the best choice of financing from the decision, since they also have the ownership in the company.

The less or the more the number of managerial ownership can reflect the relationship between agent and principal. According to Rahadian (2014), the increase of the number of managerial ownership, will automatically increase the performance of management, which can lead to the prosperity of shareholders as the management act on the behalf and interest of shareholders. The better performance, the better income or profit that could be obtained which can be used as the capital for the sustainability of the company.

Therefore, it is one of the essential factors to be considered, as the GCG can be well-implemented if there is less conflict appears between the agent and principal. The less number of managerial ownership, the greater number of intention of management to take the opportunity for themselves and otherwise.

The size of BOC on the company will be another term of GCG that can be considered. As the board is obliged to observe the performance of the management on handling the whole operation and also decisions being taken. The board can also act as the conselour who gives some advices to the management to ensure management still work on behalf of the principal.

This research itself will uses three variables to determine and proxy GCG, which are BOC, managerial ownership and institutional ownership. On the other side, capital structure will be proxied by debt-to-equity ratio (DER).

The application of the use of BOC, managerial ownership and institutional ownership as the indicator of GCG has been used by a number of researchers. Among others are, Rahadian (2014), Anggraini (2015), Reminov (2015), Kelana (2015), Anizar (2016), Primadhanny (2016), Thesarani (2016), Kusumo (2017), Dewi (2018) and Putri (2018).

Based on those researches, research gap exist and still inconsistent. As found by Putri (2018), she found that institutional ownership has negative but not significant influence on the capital structure. She also found managerial ownership has positive influence but not significant on capital structure.

The result by Putri was supported by Kusumo (2017) who also stated that managerial ownership has a positive but not significant influence toward capital structure and institutional ownership has a negative and not significant influence toward capital structure.

The result obtained by Anizar (2016) indicated that managerial ownership has no significant influence toward the capital structure and size of board of commissioners has positive and significant influence on capital structure. Rahadian (2014) stated that managerial ownership has an influence on capital structure.

However, Anggraini (2015) found that size of BOC has significant negative influence on capital structure, while institutional ownership has positive but not significant influence toward capital structure. Primadhanny (2016) signified that institutional ownership and managerial ownership has effect capital structure partially.

Reminov (2015) found out that managerial ownership has an influence on capital structure, while institutional ownership does not have a significant influence. This research contradicts with the result obtained by Dewi (2018), where managerial ownership has no significant influence and institutional ownership has a positive and significant influence on capital structure.

Another result obtained by Kelana (2015) showed that BOC does not have influence on capital structure. The result was also supported by Thesarani (2016) who mentioned that BOC does not have significant influence on capital structure. Nevertheless, Thesarani (2016) also found that managerial ownership has negative and significant influence while institutional ownership has a negative but not significant influence.

Aside from those variables that will be used in this research, the decision to choose mining companies listed on Indonesian Stock Exchange (IDX) is because mining industry is very sensitive to the fluctuation of the global economic (Kusumo, 2017). Mining sector is the industry that produces and create sales mostly for export country, since Indonesia is rich of natural resources. Besides, mining companies is also the type that will need much sources of capital. Thus, capital structure will be a concern for the company that should be taken on.

Furthermore, Primadhanny (2016) has also stated that mining sector needs a bigger amount and long-term investment. It is vulnerable to the risk and anticipating the fund will be an important issue as it will be required for the development of the company and the exploration of the resources.

Another reason why mining sector has been chosen as the object of the research is because there is a decrease on the growth of mining industry, which is not inline with the economic growth happened in Indonesia in 2017.

As recorded by Badan Pusat Statistik (BPS), mining industry suffered from the negative contraction in the amount of 0.49%, when the economic growth on the first quarter increased to 5.01%. The decline on the growth of mining industry was caused by the decrease on the number of production up to 60% due to the expiration of export license by PT Freeport Indonesia and PT Amman Mineral Nusa Tenggara (Fauzi, 2017).

Thus, the writer is interested to take this sector of industry as the object focus. As the growth of mining industry decreased in 2017 and there was a less number of production. Then, the factors that influenced the capital structure become interesting to be researched. Based on this phenomena and problem that had arisen, the writer concerns to conduct the research about ”The Influence of Good Corporate Governance on The Capital Structure (Study on Mining Companies Listed on Indonesia Stock Exchange 2015-2017)”.

1.2 Problem Limitation

In this research, the problem would be limited to the variable of GCG. As GCG can be measured by abundance of measurements, therefore, this research will just be limited to three kinds of measurements on measuring the GCG. GCG that will be assessed are the institutional ownership, managerial ownership and BOC.

The other limitations are about the sector of industries that will be used as the object of the research. The writer will use mining companies listed on IDX as the sources to obtain and asses the data needed, from year 2015 up to 2017.

1.3 Problem Formulation

Based on the problem and condition, there are certain problem formulations that can be raised in order to narrow the broad problem area. Therefore, the problem formulations could be refined as:

1. Is there influence of managerial ownership on the capital structure?
2. Is there influence of institutional ownership on the capital structure?
3. Is there influence of size of board of commissioners on the capital structure?
4. Is there simultaneous influence of managerial ownership, institutional ownership and size of board of commissioner on the capital structure?

1.4 Objective of the Research

Based on the problem and condition discussed before, the objectives of research that would be determined are:

1. To identify the influence of managerial ownership on the capital structure of mining companies listed on IDX from 2015-2017.
2. To identify the influence of institutional ownership on the capital structure of mining companies listed on IDX from 2015-2017.
3. To identify the influence of size of BOC on the capital structure of mining companies listed on IDX from 2015-2017.
4. To identify the simultaneous influence of managerial ownership, institutional ownership and BOC on the capital structure of mining companies listed on IDX from 2015-2017.

1.5 Benefit of the Research

1.5.1 Theoretical Benefit

Based on thereotical benefit, this research is expected to give the contribution to the development of the study related to the economics, finance and accounting subject. May it hopefully bring an additional benefit to the subject of capital structure and good corporate governance.

Besides, it can also be used as a reference for the future researcher, even for the literature review or as a supporting material. And to complete and add the list of research regarding capital structure, good corporate governance and mining sector in Indonesia.

1.5.2 Practical Benefit

Based on the practical benefit, this research are expected to give benefit for practitioners, such as:

1. For company

   This research is expected to be a recommendation for the company, where company can have more notice on the implementation of the GCG and its impact towards the decision of funding or capital structure. Therefore, it can generate a better capital structure for the company and bring benefit for them as well.

2. For the shareholders

   For shareholders, this research is expected to give an additional information and knowledge regarding capital structure. Moreover, it could be used as a consideration for taking on the right and better decision on the capital structure. Showing how important the decision of capital structure are within the company.

3. For creditors

   This research may be used as the guide for creditors in giving and providing the debt, in which creditors can be more concern in deciding the lending for a company.

4. For the other stakeholders

   For the other stakeholders, such as public, this research is expected to give more explanation and information for those who are (and are not) interested in invesment. The other stakeholders should be at least familiar with the nature of the company and know well about the good corporate governance and its proportion of capital structure of the company before they decide to invest.

5. For readers

   May this research could benefit readers through provided information and knowledge that can be explored deeper. And have a better understanding regarding GCG, BOC, managerial ownership, institutional ownership, capital structure and its relationship.

1.6 System of Writing

System of writing are provided for the easiness to take a look on the overview of content of each chapter of the skripsi.

Chapter I: This chapter will discuss about how the idea of GCG and the way to measure GCG by using managerial ownership, institutional ownership and size of BOC and also capital structure comes from and the fact and reason behind it. It also discusses problem limitation, problem formulatons, objectives of the research, benefit of the research and system of writing.

Chapter II: This chapter will discuss the theoretical side of the grand theory which are agency theory and pecking order theory, GCG, managerial ownership, institutional ownership and also size of BOC. Besides, it includes previous research, hypothesis development, research model and framework of thinking.

Chapter III: This chapter discusses about research design which used quantitative method, population and samples, data collection method, operational variable definition and variable measurement and data analysis method by using the program of SPSS 25.

Chapter IV: This chapter will discuss about general view of research object which is mining sector, data analysis which consists of descriptive statistic, result of data quality testing, result of hypothesis testing and the discussion about the result.

Chapter V: This chapter discusses about the conclusion, implication and recommendation after going through the research.