# FIRM PERFORMANCE, CORPORATE GOVERNANCE, AND EXECUTIVE COMPENSATION IN TOURISM FIRM: EVIDENCE FROM INDONESIA

Te-Kuang Chou*, Agung D. Buchdadi#

*Professor of Finance in College of Business Southern Taiwan University of Science and Technology

#Graduate Student of College of Business Southern Taiwan University of Science and Technology

Abstract

This study determines the effect of corporate governance variables and executive compensation on the firm performance in tourism industry in Indonesia. The corporate governance variables used in this study are proportion of independent and audit commisioner. While the firm performance is measured by return on asset (ROA), stock return, and Tobin's Q variable. The population of this research is Tourism firms listed on Indonesian Stock Exchange between 2009 and 2012. The number of financial firms listed on IDX in that period is 13. The method of analysis used in this research is ordinary least square (OLS) regression. The results show that there is no significant effect corporate governance variables and executive compensation on the firm performance in tourism industry in Indonesia.

Keywords: Corporate Governance, Executive Compensation, Firm Performance, Tourism

**Research Background**

Entity theory considers that the company is an entity that separates responsibilities between the owner of the company and the management. The owner (shareholder) appoints party that can be trusted to run and control the company. Parties are referred to as the management (managers). The problem arises when there is separation between ownership and management (Jensen and Meckling, 1976). The conflict of interests appears between the owners and managers. This problem is known as agency problem. Basically, the shareholders want managers to take appropriate actions on behalf of the interests of shareholders to maximize their wealth. That is what shareholders pay the management so that they always act in accordance with the interests of shareholders. Even the shareholders do not hesitate to give compensation if the company increases profits. The better the performance of the company, the greater the compensation to be received by executives.

Compensation aims to motivate the executives in order to improve their performance. If the performance of the company increases, the value of the company will increase, and shareholders wealth will also increase. Sudarsono (2002) argues that by linking executive compensation with company performance, executives will be more motivated to take more decisions in order to maximize shareholder value. Although previous empirical evidence (e.g. Haid and Yurtoglu, 2006; Nourayi and Mintz, 2008; and also Lazarides, et al. 2009) conclude that the firm performance are positively related to executive compensation, but reality indicates otherwise. Many companies providing a large compensation package for its executives in fact have the company value tend to normal or even worse. For example, Stanley O'Neal, the CEO of Merrill Linch & Co., receive compensation up to 161.5 million U.S. dollars, though company suffers huge losses up to 8.4 billion

U.S. dollars (Prasetyantoko, 2008). This suggests that firm performance does not always determine the amount of compensation they receive.

To avoid the opportunistic behavior of the executives, they should be monitored by shareholders. Kim and Nofsinger (2007) argue that the incentives are not the only way to solve the agency problems, but also needed a scrutiny mechanism called the corporate governance mechanism. Without a corporate governance mechanism, executives are able to freely perform actions that benefit themselves and the profit gained by these executives as the cost will be borne by shareholders. These costs are referred to as agency cost. In the context of executive compensation, corporate governance mechanism is needed to assess the amount of executive compensation and performance monitoring undertaken by management (Prasetyantoko, 2008).

The executive compensation is also influenced by firm size. The larger the company, the larger the executives' responsibility in managing the company. Therefore, not surprised if executives at large companies will get a huge compensation as well. Milkovich et al (2009) reveal that company size is positively related to the level of remuneration. The bigger the company, the bigger the company has the capacity to pay more. Executive compensation has been studied in developed countries since the late 1950s. However, research on executive compensation is rarely conducted in Asia, specifically inemerging market such Indonesia mainly because of data unavailability. Lack of research on executive compensation or remuneration in Indonesia attracts us to further investigate the determinants of executive compensation. Further more, Tourism firm stocks are chosen sector in this research, in order to developing good information to the prospect investor as it is one of important sector in Indonesia income.

**Literature Review**

Parthasarathy et al. (2006) also find that firm size has positive and significant impact on compensation. The results also indicate that the CEO who is also the founder or owner to get bigger compensation than the CEOs who are not owners. Furthermore, institutional ownership has a positive relationship andstatistically significant on the compensation They also find that corporate governance mechanisms are significantly negatively associated with remuneration. Their research period is 2001 to 2006. Conversely, Stone et al (2009) argue that there is no significant relationship among changes in net income and changes in total shareholder return and total compensation. But, they find a significant relationship betweentotal revenue and total compensation. It is also found that in large companies, CEOs receive greater compensation.

In other hand, Fernandes (2005) conducts a study using firms listed on the Portuguese Stock Exchange. He reveals that firm performance does not significantly affect the executive compensation and also finds that there is no relation between the wealth of the stockholders and executive compensation. The results also indicate that company size is a major determinant of compensation. There is a strong relationship between firm size and compensation. CEOs in financial industry receive the highest compensation. Crumley (2008) conduct a study on the relationship between firm performance and CEO compensation in U.S. commercial banking industry. The study uses 36 sample banking companies in the U.S. in period 2001-2003. The results show that there is a weak relationship among the percentage change in stock return and percentage return on assets and CEO compensation. Whereas firm size and CEO compensation have a strong and positiverelationship.

Differences between empirical results and the current reality conveying that corporate performance is not always a determinant of the compensation. Prasetyantoko (2008) argues that concept of agency theory is too ideal. The point is that despite the high executive compensation, financial statements may be still manipulated. Thus, high executive compensation does not necessarily solve the agency problem. Hence, the internal control mechanism is required by a company. Jensen and Meckling (1976) state that the agency problem can be solved not only with compensation but also with the implementation of good corporate governance mechanisms. The introduction of independent commissioners will also increase the effectiveness of the company in creatinggood corporate governance. With an increasing number of independent commissioners, it will tend to increase the decision in accordance with the shareholders (Komari and Faisal, 2007). Core et al (1999) find that firms with weak governance structures have a high level of compensation. They conclude that firms with weak corporate governance that have high agency problem. Their sample comprises 405 big companies in the U.S. during the period 1982 until 1984. Zhu et al (2009) find that the corporate governance mechanisms such as independent directors and the compensation committee have important impacts on CEO incentive system in China

The compensations are also influenced by company size. The larger the company, then managers' responsibility in managing the company would be much greater. Therefore, not surprised if executives at large companies will get a huge compensation as well. Previous empirical evidence supports it. Milkovich et al (2009) argue that firm size may explain executive compensation. Crumley (2008) also argues that a company firm has a significant link with executive compensation. Research on more than 100 companies in the U.S. on executive pay, it is found that company size is a much better predictor for CEO compensation. Size can explain the executive compensation nine times better than the performance of the company. Lazarides et al (2009) also find that size of the firms is positively related to levels of remuneration. The bigger the company, the bigger the company has the capacity to pay more.

**Compensation and Firm performance**

Executive compensation issues are always associated with agency theory. The theory basically assumes that executives always act on its own interests so that need to be created a mechanism that the executives would be subject to the interests of shareholders. One mechanism is to provide compensation to its executives. Agency theory (Jensen and Meckling, 1976) reveals that compensation is a way to unify the different interests between stockholders and managers. One of the factors affecting the compensation is firm performance. Firm performance is an achievement of which is produced by a company based on certain standards within a specific time period. Business performance can be measured with internal or external 4 approach (Sudarsono, 2002). Internal performance measurement is measured with accounting measures obtained in financial ratios. While external performance measurement is usually measured with stock price performance. Internal performance measurement usually uses profitability ratios such as ROA, ROE, and NPM. This is because the company performance is reflected by how large the benefits derived by the company.

Agency theory states that there is a positive relationship between compensation and firm performance. Murphy (1998) links the influence of company performance with executive compensation and the results show that there is positive and significant influence of firm performance on executive compensation. Similarly, Parthasarathy et al. (2006) examines 409 companies listed on Bombay Stock Exchange and finds that corporate performance has positive and significant influence on executive compensation. . Lazarides et al. (2009) conduct research on executive compensation. They find that the company performance and size are positively related to levels of remuneration.

**Methodology**

The population of this research is Tourism firms listed on Indonesian Stock Exchange between 2009 and 2012. The number of tourism firms listed on IDX in that period is 13.

The method of analysis used in this research is ordinary least square (OLS) regression. Software SPSS 17. ver is used to run the data. The regression equation as follows:

$$Performance = \alpha + \beta_1 comind + \beta_2 comaudit + \beta_3 Compensation + Control\ Variable$$

Which:

Compensation = salary, bonus, and allowances given to board of director

Firm Performance = ROA, Stock Reutrn, and Tobin's Q

Comind = proportion of independent commisioners

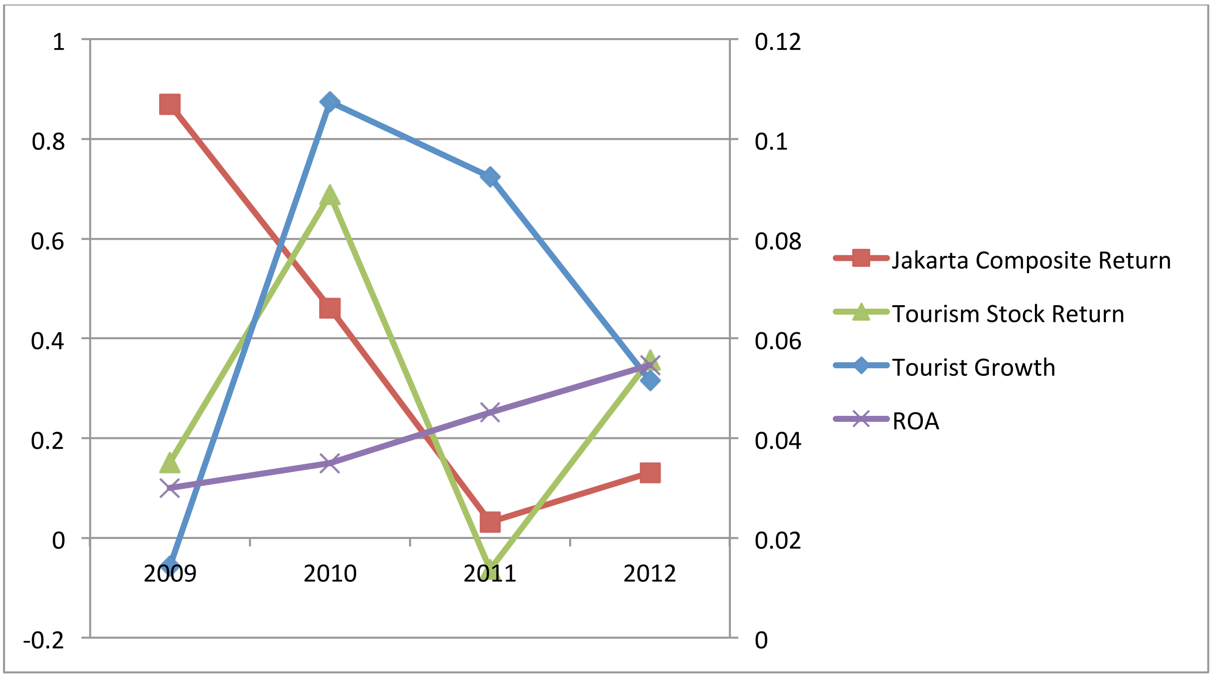
Comaudit = proportion of audit commisioners

Control variable = LNAsset, Leverage variable, and Liquidity variable

**Result and Discussion**

**Data Descriptive**

The graph below provides the historical growth of number of tourist came into Indonesia, the average of ROA of tourism firm, the average stock return in tourism firms, dan Jakarta Composite index Return. It is noted that the ROA and number of tourist are in on direction. During the window priod the ROA and number of tourism are increasing slightly. In other hand, related to the stockmarket value, there was a few fluctuation in both average stock return in tourism firms, dan Jakarta Composite index




Furthermore, in this study the final companies examined are 12 firms which are listed on table below.

| | |
|---|---|
| BAYU | Bayu Buana Tbk |
| PDES | Destinasi Tirta Nusantara |
| GMCW | Grahamas Citrawisata Tbk |
| HOME | Hotel Mandarine Regency Tbk |
| SHID | Hotel Sahid Jaya International Tbk |
| ICON | Island Concept Indonesia Tbk |
| PANR | Panorama Sentrawisata Tbk |
| PGLI | Pembangunan Graha Lestari Indah Tbk |
| PLIN | Plaza Indonesia Realty Tbk |
| PNSE | Pudjiadi and Sons Tbk |
| PSKT | Pusako Tarinka Tbk |
| SONA | Sona Topas Tourism Industry Tbk |

Then, We provides the data descriptive for each variable on the next table

**Descriptive Statistics**

| | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| LNASSET | 48 | 9,34 | 15,30 | 12,2288 | 1,64527 |
| ROA | 48 | -,16 | ,14 | ,0424 | ,06351 |
| Independent | 48 | ,00 | ,60 | ,2972 | ,17386 |
| Audit | 48 | ,00 | 1,33 | ,6451 | ,36500 |
| Compensation | 48 | ,00 | ,11 | ,0201 | ,02003 |
| Leverage | 48 | ,00 | 5,60 | 1,1404 | 1,23104 |
| Liquidity | 48 | ,00 | ,49 | ,1297 | ,11972 |
| StockRet | 48 | -,61 | 3,33 | ,4171 | ,90770 |
| Tobinsq | 48 | ,51 | 16,55 | 2,0774 | 3,14205 |
| Valid N (listwise) | 48 | | | | |

## Result

After preparing the clasic statistical assumption test, including outlier test, muticolinearity test, normality test, and heteroscedastic test, We found the result of each model:

MODEL 1 , Y = ROA

**Model Summary**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | ,770[a] | ,593 | ,534 | ,04337 |

a. Predictors: (Constant), Liquidity, LNASSET, Leverage, Audit, Independent, Compensation

**Coefficients[a]**

| Model | | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | ,005 | ,060 | | ,075 | ,940 |
| | LNASSET | ,001 | ,005 | ,029 | ,252 | ,802 |
| | Independent | ,046 | ,044 | ,126 | 1,057 | ,297 |
| | Audit | ,025 | ,020 | ,146 | 1,299 | ,201 |
| | Compensation | -,305 | ,386 | -,096 | -,790 | ,434 |
| | Leverage | -,025 | ,006 | -,475 | -4,302 | ,000 |
| | Liquidity | ,215 | ,060 | ,406 | 3,584 | ,001 |

a. Dependent Variable: ROA

MODEL 2, Y = Stock Return

**Model Summary**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | ,241[a] | ,058 | -,080 | ,94311 |

a. Predictors: (Constant), Liquidity, LNASSET, Leverage, Audit, Independent, Compensation

**Coefficients[a]**

| Model | | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | ,617 | 1,302 | | ,474 | ,638 |
| | LNASSET | ,007 | ,098 | ,013 | ,074 | ,941 |
| | Independent | -,225 | ,950 | -,043 | -,237 | ,814 |
| | Audit | -,325 | ,427 | -,131 | -,762 | ,450 |
| | Compensation | -6,698 | 8,394 | -,148 | -,798 | ,429 |
| | Leverage | -,046 | ,124 | -,062 | -,368 | ,715 |
| | Liquidity | 1,346 | 1,306 | ,177 | 1,030 | ,309 |

a. Dependent Variable: StockRet

Model 3, Y = Tobin's Q

**Model Summary**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | ,926[a] | ,857 | ,835 | 1,30043 |

a. Predictors: (Constant), Liquidity, LNASSET, Leverage, Audit, Independent, Compensation

**Coefficients[a]**

| Model | | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | 5,347 | 1,815 | | 2,945 | ,005 |
| | LNASSET | -,453 | ,136 | -,236 | -3,323 | ,002 |
| | Independent | ,757 | 1,321 | ,042 | ,573 | ,570 |
| | Audit | -,693 | ,663 | -,077 | -1,046 | ,302 |
| | Compensation | 18,375 | 11,993 | ,117 | 1,532 | ,134 |
| | Leverage | 2,330 | ,201 | ,808 | 11,581 | ,000 |
| | Liquidity | -1,560 | 1,807 | -,059 | -,863 | ,393 |

a. Dependent Variable: Tobinsq

This research, then, supporting Fernandez (2005) work that argues there is no significant effect on proportion of Commisioners and compensation to Firm Performance. However, the model built in this research still need more revision as F test failed on model 2 and model 3.

**Conclusion**

This study in examining the effect of good corporate governance mechanism and commissioners to Firm performance in Tourism Industry in Indonesia provides that there is no significant effect among its variable. It is also supporting one previous research. The limitation on the number of data, and methodology of analysis will encourage us to make more deep clarification and confirmation on this finding.

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