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CORPORATE GOVERNANCE IMPLEMENTATION AND PERFORMANCE ASSESMENT USING THE CGCG's UGM RATING MODEL: COMMERCIAL BANKS IN INDONESIA

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ABSTRACT

The purpose of this research is to examine the implementation of Good Corporate Governance (GCG) in Commercial Banks before and after the policy of The Bank Indonesia Regulation (PBI) Number 8/4/PBI/2006 concerning Good Corporate Governance Implementation for Commercial Banks. Center for Good Corporate Governance Universitas Gadjah Mada (CG CGCG UGM) rating model was employed to measure CG implementation in Commercial Banks which calculate both company organs and Corporate Governance (CG) basic principles in a universal framework. From the company organs perspective, a CG system consists of five (5) organs interacting each others, which are board of directors, board of executives, boards of commissioners/committees, auditors, and stakeholders. Meanwhile, from the CG basic principles perspective, a CG system should fulfill five (5) CG principles, which are Transparency, Accountability & Responsibility, Responsiveness, Independency, and Fairness. Therefore, the CG framework and rating model use The information technology as the main pillar in the application of CG. As for measuring banking performance, CAMEL ratio--which consist of the Capital Adequacy Ratio (CAR), Non Performing Loan (NPL), Management (Man), Net Interest Margin (NIM), and Loan to Deposit Ratio (LDR)--was applied. In conclusion, Using CGCG UGM rating model, it is discovered hat CG implementation at Indonesian banking system was improved subsequently to the issuance of PBI. Whereas on its performance, the significant changes were indicated by only two ratios, i.e. LDR and MAN. This research depicts Bank Indonesia effectiveness as regulator at providing CG implementation guide on PBI. This research reveals for the urge for Indonesian banking industry to boost GCG implementation for their rating and performance improvement.

Keywords: *corporate governance asessment, CAMEL, commercial banks, corporate governance*

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INTRODUCTION

The economic crisis that occurred at the end of 1997 has spurred negative effect towards economic sector in Indonesia, especially for the banking industry. The banking sector has flunk down due to the severe monetary crisis in 1998. The cause of the crisis is not only believed to be proceed from the depreciation of the Rupiah exchange rate, but it is also resulted of the lack of implementation of *Good Corporate Governance* (GCG) in the banking itself (Retnadi, 2004). The 1998 Banking Crisis has also proved that our banking sector has not got a firm banking institutional supported by the good banking infrastructure. By looking through the situation, it is a must that the banking sector has to be reinforced in order to overcome the internal and external fluctuations that could be happened in the future.

Since the crisis, the government of Indonesia and investors has started to give more attention towards Corporate Governance practices. To rehabilitate the banking sector as well as to create a sound, tough, and an efficient Indonesian banking system, Bank Indonesia (BI) as the national banking controller in Indonesia has performed several corrective actions, consider to a good and sound bank for the requirement order in achieving a strong and tough economics. Those corrective actions has started with banking restructurization in 1998 and afterwards continued by the formulation and implementation of a public policy known as Indonesia Banking Architecture (IBA) in 2004 which is further optimized by the issuance of PBI No.8/4/PBI/2006 which regulates GCG practices within the banking sector. The purpose of this issuing of the policy is to encourage the implementation and internalization of GCG practice.

CG for the banking industry will become and continue to be an important issue nowadays and the future, considering of the increasing of risks and challenges faced by the banking industry (Explanation of Bank Indonesia Regulations (PBI) which regulates GCG practices within the banking sector, 2006). The challenges have to be faced by the banking industry eventually led to the banks undertaking operational consolidation, improving human resource quality, enhancing the implementation of GCG, developing banking infrastructure and improving oversight function as well as banking arrangement. Moreover, banking is a highly regulated firm that involves other people's money in its operational, so that is why the implementation of CG is very important in the banking sector.

Therefore, there is so many efforts that can help to rebuild the people's trust in the Indonesian banking sector include committing restructurization and recapitulation that can have a long-term effect, if accompanied by three other important actions namely (i) obedience towards the principle of carefulness, (ii) implementation of CG, and (iii) effective supervision and bank supervisory authority (KNKCG, 2004).

As an intermediary institution, a bank has to embrace the principle of the transparency, possessing a standard performance based on the measurements that are consistent with the corporate values, business objectives and bank strategies as the reflection on the bank's accountability, holding on the prudential banking practices and assuring the implementation of the regulations as a part of its responsibilities, objective and liberated from any party's strain in decision making process, as well as constantly aware on stakeholders interest based on the principle of equality and fairness. Those will be fulfilled if the company's organs can implement connected to the GCG principles.

The official regulations of PBI No.8/4/PBI/2006 has made all the banks must implement GCG principles. This step is very important, which is considering to all regulations issued by Bank Indonesia (BI) in the past, regarding to the implementation of GCG principles were implicitly expressed, and also in an unsystematical order due to the focus on other regulations such as risk management, compliance, audit function setting, and etc (Arafat, 2003).

Therefore, PBI 8/4/PBI/2006 will give CG reforms in the banking sector because it appoint the direction, form, and industry structure in creating a sound, strong, and efficient banking system. It is expected that by issuing PBI, banking sector may achieve its aim as funding institution in order to support the economic growth and national stability.

The aims of this research are to examine and to obtain the empirical evidence regarding the differences in the implementation of GCG and its influence for the banking performance in Indonesia before and after the issuance of PBI No.8/4/PBI/2006. The results of the implementation GCG test showed that a significant difference. Company's organs which consist of Board of Commissioners (BoC), Board of Directors (BoD), Board of Executive (BoE), Auditors, and Stakeholders have been implementing CG's principles better after the policy of PBI No.8/4/PBI/2006. Likewise, the acquirement of CG's principles that consist of the Transparency, Accountability and Responsibility, Responsiveness, Independency, and Fairness, showed a significant difference. In the other hand, the test results on the performance of the commercial banking before and after the issuance of PBI No.8/4/PBI/2006 showed only a significant difference for the liquidity ratio and the assessment of the management. There was an increase in the liquidity ratio and improvement in the management after the issuance of PBI No.8/4/PBI/2006.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

1. Literature Review

1.1. CGCG'S Corporate Governance Assessment Model

Center for Good Corporate Governance Universitas Gadjah Mada (CGCG UGM) has developed a comprehensive model to assess the implementation of CG on a company. In the contrary of the existing assessment tools, the CGCG UGM assesses CG in a more comprehensive way by seeing through the participants' perspectives and the principles of CG. In addition, the calculations are carried out by using a special *software* in order to minimize the bias in the assessment process. The following descriptions will explain about the CGCG UGM Rating Model that is going to be used in this research as the measurement to assess the implementation of CG on Indonesian commercial banks.

1.1.1. Two Main Perspectives of CG CGCG UGM Rating Model

CG CGCG UGM Rating Model is based on two main perspectives, namely the principles of CG and CG participants. The first perspective is the CG principles. By considering the principles offered by many entities and experts, CGCG rely on five principles that should be conducted in implementing GCG, namely:

1. *Transparency*; in order to implement its functions, all participants must submit the information material in accordance with the actual substance, and make that information accessible and easily understood by the other parties concerned.

2. *Accountability & Responsibility*; in order to execute its functions, each CG participant must have an ability to explain the authorization received in accordance with the laws, regulations, standards of moral / ethical and best practices that is generally accepted, as well as setting up the proposed responsibility if the explanation is rejected.

3. *Responsiveness*; with the aim of its functions, each participant must respond to the CG, including anticipatory activity, the demand (requests) and feedback of the parties concerned and changes in the business world which significantly influence the company.

4. *Independency*; with the intention of its functions, each participant must liberate themselves from the interests of other parties which can potentially create the conflicts of interest, and perform its functions according to the competence.

5. *Fairness*; with the purpose of its functions, each participant treat others fairly, based on the general acceptable provisions.

The second perspective is the CG participants. In the early times of CG, those who are considered most responsible for the success of the CG is the board of directors (Leblanc, 2000 and Gillies, 2005), especially in companies listed on U.S. capital markets, which runs the oversight function, enforcement, supervisory, as well as advisory. Along with the increasing complexity and risks, the functions associated with the CG developed, and accomplished by several participants. There are five groups of participants and their respective functions, namely:

1. *Board of Directors* (BoD), especially for the *oversight* function.
2. *Board of Executives* (BoE); primarily on *enforcement* functions.
3. *Board of Commissioner /Committees* (BoC); mainly on *advisory* functions.
4. *Auditors*, including the internal auditors and external auditors; especially for *assurance* functions.
5. *Stakeholders*, including shareholders, creditors, governments, customers, and society and the environment; mainly for *monitoring* functions.

1.1.2. Assessment Matrix

Based on participants' perspectives and CGCG principles, the matrix is formed into (5 x 5) matrix consisting of 25 cells. Each cell is designed according to issues and specific topics to assess the level of achievement of certain principles by a particular participant. Each participant should meet all five principles of CG that has been determined. Each cell specific questions is designed to measure the degree of fulfillment of certain principles by a particular participant.

Table 1: CG CGCG UGM Rating Model Matrix

Participants \ Principles	Transparency	Accountability & Responsibility	Responsi-veness	Indepen-dency	Fairness
BoD (Board of Directors)	7 Issues	6 Issues	2 Issues	2 Issues	2 Issues
BoE (Board of Executive)	2 Issues	7 Issues	6 Issues	2 Issues	2 Issues
BoC (Board of Commissioners/ Committees)	2 Issues	2 Issues	7 Issues	6 Issues	2 Issues
Auditors	2 Issues	2 Issues	2 Issues	7 Issues	6 Issues
Stakeholders	6 Issues	2 Issues	2 Issues	2 Issues	7 Issues

Source: Warsono *et al.* (2010)

Therefore, it is a necessity to define the issues or topics that should be assessed for each cell. Here are the number of issues/topics that are assessed for each cell, adjusted for the main functions of the participants.

1.1.3. Rating Instrument

CG CGCG UGM Rating Model measures the quality of the company's CG by using questionnaires containing a set of questions to assess each participant in implementing GCG practices. To produce an assessment tool that is relevant and reliable, CG CGCG UGM Rating Model has several types of questions as follows:

1. Dichotomy Questions; a question with a Yes/No answer.
2. Discrete Questions; a question with type of answer rank from Very Good to Very Bad.

Furthermore, these questions are classified according to the significance of these questions in the achievement of GCG:

1. The question that should be fulfilled (*Necessary questions*); is the main question that must be asked to rate the quality of CG in the company. Necessary Questions have a more significant value than sufficient questions.
2. The question that ought to be fulfilled (*Sufficient questions*); is a proponent question that need to be asked to confirm the quality of the CG as well as make it more comprehensive.

1.1.4. The Determination of Score

The measurement using should be determined based on the scores of the rating. This research used third-party assessment, with 600 (six hundred) as the total maximum score. The scoring is based on some of the following provisions.

1. The presence of the measuring tool in the assessment matrix. The cells that become the focus of assessment (main cells; 7 and 6 issues). These cells got a higher score than cells that do not become the focus of assessment (the supporting cells; two issues). 5x5 matrix is built based on those describing in the previous section, that there are 10 main cells and 15 supporting cells. Each main cell produces a maximum score of 42 points for the question for discrete and dichotomy questions, so that the maximum score for overall main cells is 420 points. In the meanwhile, each supporting cell produces maximum score of 12 points for discrete and dichotomy questions, so that the maximum score for the entire supporting cells is 180 points.
2. Type of measuring instrument determining scores for each type of question with the following basic provisions:
   a. Dichotomous questions (*Yes*/*No*); Dichotomy questions with answer "*Yes*" will be scored 1 (one) and question with answer "*No*" will be scored 0 (zero).
   b. Discrete questions (*Very poor* to *Very good*); The scores for discrete questions rank from 0, 0.2, 0.4, 0.6, 0.8, and 1.Discrete questions with answer of "*Very Good*" will score 1 (one), while the discrete questions with answer of "*Very Bad*" will score 0 (zero). (Warsono *et al.*, 2010)

1.2. Performance Measurement

According to Bank Indonesia Regulation No. 6/10/PBI/2004 regarding Rating System for Commercial Banks, it is stated that bank rating is the qualitative rating of various aspects affecting the condition or performance of a Bank by means of Quantitative Rating and/or Qualitative Rating of the factors of capital, asset quality, management, earnings, liquidity, and sensitivity to market risk. Quantitative Rating is rating of the position, developments, and projection of the financial ratios of the Bank Then, Qualitative Rating is rating of the factors supporting the results of

Quantitative Rating, application of risk management, and the compliance of the Bank. The process for determining the rating of each factor is done after taking account of judgement based on the materiality ang significance of each rated component and the influence of other factors like condition of the banking industry and the national economy.

This research based on the CAMELS ratios (*capital*, *asset quality*, *management*, *earnings*, *liquidity*, and *sensitivity to market risk*) that is mentioned in PBI No. 6/10/PBI/2004, for assessing bank's performance. The ratios in CAMELS are chosen because they can give a thorough and comprehensive performance measures, in order to measure its soundness. Nevertheless, not all CAMELS ratios are used because the research was not intended to comprehensively assess the performance of the bank according to the pattern of Bank Indonesia. Only 1 (one) ratio is used as a proxy for each aspect. This research also did not assess the *Sensitivity to Market Risk* (S) since the limitations and the availability of existing data to calculate the ratio of *sensitivity to market risk.*

Here is the ratio used to assess banks' performance before and after the implementation of PBI No.8/4/PBI/2006.

1.2.1. Capital ratio (*Capital*)

Capital ratio is a ratio to measure the ability of banks to absorb losses that can not be avoided and used to measure the size of bank assets or property owned by the shareholder. The indicator used is the *Capital Adequacy Ratio* (CAR) which is obtained by comparing its own capital to weighted assets according to the calculated risk.

$$\text{CAR} = \frac{\text{Equity}}{\text{Weighted Average Assets}}$$

1.2.2. Asset Quality Ratios (*Asset Quality*)

This ratio is used to identify quality earning assets, namely bank's investment funds in Rupiah or foreign currency in the form of loans, securities, placements in other banks, and investments. Assessment is required to see whether the assets is used to generate the maximum profit. Beside, asset quality assessment is also intended to assess the condition of the bank's assets, including the anticipation of the risk on financing default. Indicators used to assess the asset quality is *Non Performing Loan* (NPL).

$$\text{NPL} = \frac{\text{Non - Performing Assets}}{\text{Productive Assets}}$$

1.2.3. Management (*Management Assesment*)

The assessment on management is done through the evaluation of several components: general management, the implementation of risk management system, and the bank compliance to the applicable provisions and commitment to Bank Indonesia (BI) and other banks. These components are in accordance with Bank Indonesia Regulation No. 6/10/PBI/2004 concerning Soundness Assessment System for Commercial Banks and also has been included in the CG CGCG UGM Rating Model comprehensively. Therefore, this research will use CG CGCG UGM Rating Model as the tool in assessing the management. Of the five participants in the CG CGCG UGM Rating Model namely BoC, BoD, BoE, Auditors, and Stakeholders, only three participants are taken and considered representative on the management, namely BoC, BoD, and the BoE.

1.2.4. Profitability Ratios (*Earnings*)

Profitability ratio is a tool to analyze or measure the level of business efficiency and the ability of banks in generating profits. The indicator used is the *Net Interest Margin* (NIM) which is obtained by comparing the *Net Interest Income* by *Average Earning Assets*.

$$\text{NIM} = \frac{\text{Net Interest Income}}{\text{Average Earning Assets}}$$

1.2.5 Liquidity Ratio (*Liquidity*)

Liquidity ratios are used to analyze the ability of the bank in fulfilling its obligations or liabilities. The indicator used is the *loan to deposit ratio* (LDR). LDR is obtained by comparing all placements and all funds collected plus its own capital.

$$\text{LDR} = \frac{\text{All Credit Placement}}{\text{All Funds Collected} + \text{its Own Capital}}$$

2. Hypotheses Development

Risks and business characteristics in banking industry have required banks to implement and to comply with the principles of CG. Arun and Turner (2002) stated that there are several reasons why the implementation of GCG in banking industry is very important in developing countries such as Indonesia. **First,** banks hold a dominant position in the financial system of a developing country and possess important role as the driver of the country's economics growth.

Second, capital markets in developing countries are still ineffective, that cause banks to be the prominent funding source for the majority of the developing countries. **Third,** banks in those countries generally have saving and national economic reserve. **Fourth,** most of the developing countries have liberated their banking system through privatization or divestment, and reduce the role of economics regulation. Therefore, the bank management gain freedom in managing their bank, but in this situation may endanger the country's economics condition.

Problems that arose within the banking industry in developing countries like Indonesia, started from the behavioral problems such as the tendency of managers to force expenses on personal needs (*expense-preference behavior*) which can lead to the agency problem (Rose and Hudgins, 2008). In this condition, assymetric information occured, shareholders cannot fully access corporate information so that it is difficult for them to evaluate management's performance and there may be a possibility of management to conduct deviations. This condition may lead the management to do the wrong way. A dispersed bank ownership as well as the domination by individual ownership may also trigger agency conflict. Based on the performance and its their risks, banks are claimed to develop a better supervision system and management compensation system through an effective implementation of CG in order to minimize agency conflict.

CG, seen from a narrow perspective, is a mechanism of corporate management in trying to protect shareholders interest by separating the ownership and control. One of the weakness of this perspective did not consider the human interest on trying to get benefit for oneself so that it may trigger a dereliction by the management which can lead to the expropriation of stakeholders rights (Arun *et al.*, 2002). The separation of ownership and controlling function may also trigger agency problem (Jensen and Meckling, 1976). Other weakness from this perspective is that the structure that based on the narrow *shareholders perspective*, and not from the *stakeholders perspective*.

Shleifer and Vishny (1997) have suggested a broader perspective of CG where CG is seen as a method where funders have an ability in controlling managers to convince that their funds are not being misused by them. This refers to the protection towards depositors and shareholders (*stakeholders approach*), along with the institutional ownership function as the monitoring as well as the controlling function of the company.

Some researches agreed that there are several reasons why banks are recommended to implement CG from broader perspective with the endorsement from the regulations. **First,** banking industry has a unique characteristic, where CG is hoped to have an ability to protect the depositors' interest as well as the shareholders (*stakeholders approach*). Depositors did not know the real value of the bank's loan portfolio as such information is confidential and costly to be disclosed (Bhattacharya *et al*., 1998, p.761). This may trigger an asymmetric information, that the bank managers have an incentive to invest with a higher risk based on the deals. Bank secrecy towards its debt agreement portfolio have conduce management supervision cost to be more expensive. Thus, through the implementation of CG, depositors may gain protection from any irregularity practices as well as the government assurance in form of deposit insurance.

Second, governments of developing countries have proceed from using *economic regulations* to *prudential regulation* (Arun *et al*., 2002), as their effort to reform the banking industry in order to stabilize the state finances and in improving protection towards depositors. *Prudential regulation* included rules for the bank to have a proportionate amount of capital against risk, *early warning system*, and bank inspection by banking supervisors whether *on-site* or *off-site*. Nevertheless, *prudential regulation* has not yet been proven to prevent financial crisis in developing countries because of several reasons: a) banking rules in developing countries require banks to have a larger amount of capital compared to banks in developed countries. However, this has made cost of capital becomes very high which by then made it rarely conducted; b) lack of competent resources to supervise banks; c) bank regulatory agency in developing country is not independent; d) accounting information is incomplete and inaccurate.

Third, bank ownership in developing countries is dominated by state ownership (the government) which can generate conflicts between the government as the owner and the bank managers as the administrator (Arun *et al*., 2002). The opportunistic attitude and *risk averse* managers may affect the decision making process that are inconsistent with the government pretension such as in terms of investment. Therefore, restriction on autonomy upon bank managers such as the requirement to invest on state obligation and *small and medium enterprise* is conducted.

Fourth, *distribution cartels* activities (Oman, 2001) that are implemented by internal parties which have access to the government may endanger the protection credibility towards stakeholders.

The weakness of the implementation of CG on banking in developing countries has shown more urgency on the CG internalization in banking, to achieve bank's aim as a funding institution in promoting economics growth and national stability. Various efforts have been made to formulate policies in order to implement CG in Indonesia. The implementation of CG policies have to be followed by assessment and evaluation in order to support the whole implementation of CG.

One of the weaknesses of the implementation of CG in Indonesia is there is no independent and comprehensive assessment and evaluation of CG, so that the feed back upon the assessment itself cannot be obtained in order to improve the implementation of CG. In spite of that, this research focused on the quality of the implementation of CG in Indonesian banking industry by using the independent and comprehensive corporate governance rating model of the CGCG UGM. The analyses in this paper are based on two dimensions. First dimension is included in principal dimension, consist of; transparency, accountability and responsibility, responsiveness, independency, and fairness. Second dimension is included in participants dimension, consist of Board of Commissioners (BoC), Board of Directors (BoD), Board of Executives (BoE), Auditors, and Stakeholders.

Transparency has a meaning that a bank has to disclose its information punctually, adequately, distinct, accurately, and comparable as well as accessible by the stakeholders. *Accountability* signifies that a bank has to determine distinct responsibilities from each unit of the organization so that they have the same way with the corporate vision, missions, business objectives and corporate strategies. *Responsibility* indicates that a bank has to comply with prudential banking practices and assure that they will ensure the implementation of existing regulations. *Independency* means that a bank has to elude irregular domination by any stakeholders and will be not affected by one-sided interest as well as liberated from any conflict of interest. *Fairness* signifies that a bank has to note all stakeholders interest based on equal treatment.

Based on the importance of implementing CG principles above, the first hypothesis of this research is:

H_{a1}: After the issuance of the Bank Indonesia Regulation (PBI) Number 8/4/PBI/2006, there is an improvement in the implementation of CG principles namely: *transparency, accountability & responsibility, responsiveness, independence,* and *fairness* in commercial banks.

The CG principles are conducted by CG participants of the bank namely *the Board of Commisioners (BoC), the Board of Directors (BoD), the Board of Executives (BoE), Auditors,* and *Stakeholders*. Then, the second hypothesis of this research is :

H_{a2}: After the issuance of PBI, CG participants such as BoC, BoD, BoE, Auditors, and Stakeholders have implemented a better CG for commercial banks.

As the competition is becoming tighter, the national banking industry has undergone rapid changes, dynamic and increasingly integrated in order to create synergy and efficiency in management. This is a good development because the condition of the national banking industry is healthy and strong and have an important role in supporting economic growth and national stability.

This condition is different from the condition in 1998 when some of the banking indicators were in a very bad condition. The performance of the Indonesia national banking industry at that time was worse than the banking conditions in some Asian countries that experienced similar economic crisis such as South Korea, Malaysia, Philippines and Thailand. *Non-Performing Loans* (NPLs) of commercial banks reached 50 percent, the level of the banking industry profits are at the point of minus 18 percent (-18%), and the *Capital Adequacy Ratio* (CAR) was at minus 15 percent (-15%), (Hawkins, 1999). These also show that the poor implementation of CG in the banking sector will also have a negative effect towards the performance which then forced the government to liquidate banks that were considered to be bad and no longer feasible to operate.

Consequently, to develop the national banking and to build public trust towards a better banks, then the implementation of CG is very essential. In the company's managerial level, the bank performance improvement, protection of stakeholders, and the increasing compliance to regulations is an effort to create stakeholders trust as well as the implementation of good corporate governance. In the Bank Indonesia Regulation (PBI) Number 8/4/PBI/2006, all banks are required to accomplish out business activities with guidance on the principles of CG with the aim of improving the performance of banks and protect the interests of stakeholders. Then, the third hypothesis in this research is:

H_{a3}: After the implementation of PBI, the performance of commercial banks that is measured by using CAMEL have better results.

CAMEL ratios used in this research consisted of the *Capital Adequacy Ratio* (CAR), *Non-Performing Loan* (NPL), *Management* (MAN), *Net Interest Margin* (NIM), and *Loan to Deposit Ratio* (LDR).

RESEARCH POPULATION AND SAMPLE

The population of this research is commercial banks that were always listed on the Indonesia Stock Exchange (IDX) from 2004 to 2008. The sampling time span is two years before the implementation of PBI 8/4/PBI/2006, which is in 2004 and two years after the implementation of good corporate governance, which is in 2008. Time span was needed because the implementation of the regulations requires at least one year after the ordinance established. In addition, the year 2008 is also the current period at the time of this research was conduct. This is because the company's data for the year 2009 is not yet fully available. While the year 2004 which is 2 (two) years prior the issuance of PBI 8/4/PBI/2006 was chosen as a sample for the balance the 2008 election. Samples were taken on the basis of purposive sampling, with the following criteria:

1. Commercial banks listed on the IDX from the year 2004 to 2008 and have not delisted during the period.
2. Commercial banks that issue and publish annual reports for the year 2004 and 2008.

Based on the sampling criteria, there are only 22 commercial banks that qualified. However, this study had taken out Century Bank from the research samples, because CG elements analyzed in the annual report did not reflect the actual conditions. It is caused by the extraordinary legal case of Bank Century. Consequently, the total sample of this study is 21 banks.

The data used in this study is the secondary data which is in the form of bank annual reports of 2004 and 2008. They are obtained through a database of the Center for Good Corporate Governance (UGM), the website and its content of each bank, and the Indonesian Stock Exchange (www.idx.co.id). The annual report are then observed. Website content is also one of the sources for the GCG assessment.

The assessment on the implementation of CG in the Indonesian banking industry before and after the implementation of PBI No.8/4/PBI/2006 is performed by using CG CGCG UGM Rating Model where the hypotheses will be tested by using paired t-test. Paired t test is considered applicable because this study used the same object, that is commercial banks in Indonesia. The data comes from two kinds of samples, when the PBI has not been applied which is in 2004 and after the PBI is applied which is in 2008. Paired T test is also conducted to examine the banks' performance before and after the implementation of PBI.

In analyzing the data, this study used .05 significance level or probability. If the significance level or probability is less than .05 then Ho is rejected and Ha is accepted. Shapiro-Wilk test is used to determine the normality of the data. Shapiro-Wilk test was used because the sample size is smaller than 50. If data does not spread normaly then wilcoxon test will be used instead of paired t-test.

EMPIRICAL RESULTS

4. RESULTS OF EMPIRICAL TEST

4.1. Analysis of Hypotheses One and Two

The normality test for the total score of CG showed a normal population spreading, whereas it means that paired t-test can be performed. The average CG scores that is obtained from the software calculation of CG CGCG UGM Rating Model for the year 2008 showed a greater score compare to the year 2004, with the sum of 242.84 in the year 2008 and 109.46 in the year 2004 with level of significance .000. It means that after the issuance of PBI No.8/4/PBI/2006, the implementation of GCG in banking has increased by 121.8 percent (121.8%). The increasing of the implementation of GCG proved that there were concern and improvement on the GCG in banking sector. It proves that banking compliance towards the regulations which have been issued by Bank Indonesia (BI) has been improve significantly.

By using the CG CGCG UGM Rating Model, the total score of CG can be divided by the total score for each CG participants and the CG principles. Therefore, the changes in the internalization and the implementation of CG principles and the concern of CG participants in the implementation of CG can be identified. Prior to conducting paired t-test, each principles and participant has to be tested for their normality. The result showed that all data of principles and participants have a normal spreading except for the auditors. Consequently, paired t-test can not be done for the auditors. Thus, Wilcoxon test was used for the auditors. The result of paired t-test of each basic principles can be seen in Table 3 whereas the result of paired t-test of each CG Participants is shown in Table 4.

Table 3 shows that there are significant differences in all CG principles. It means that there are some improvements for both internalization and implementation of CG principles in each CG participants since PBI No. 8/4/PBI/2006 has been issued. This can be seen from the increase in the average score of CG principles, which increased from 2004 to 2008 with an average increasing of 127.35 percent (127.35%) with the highest score on the principle of Independency with the amount of 171,97 percent (171,97%) and the lowest increase on the principle of Responsiveness which is only 100.85 percent (100.85%). The

Table 2. Paired-t test Result on Total CG Score

Description		Total Score
2004	Mean	109.46
	N	21
	Std Dev	66.53
2008	Mean	242.84
	N	21
	Std Dev	87.2
Probability		0.000
Std Dev		76.94
Description		P<0.05 Significant

Source: Calculated from CGCG UGM's database, 2010

Table 3. Paired-t test Results on Each Principle

Description		Tranparency	Accountability & Responsibility	Respon-siveness	Indepen-dency	Fairness
2004	Mean	29.5	23.67	23.31	18.66	14.32
	N	21	21	21	21	21
	Std Dev	18.97	12.23	18.07	11.51	12.02
2008	Mean	59.55	49.51	46.82	50.75	36.22
	N	21	21	21	21	21
	Std Dev	20.27	15.15	23.58	17.36	17.81
Probability		0.000	0.000	0.000	0.000	0.000
Std Dev		18.00	13.19	21.07	17.62	17.92
Description		P<0.05 Significant	P<0.05 Significant	P<0.05 Significant	P<0.05 Significant	P<0.05 Significant

Source: CGCG UGM's database, 2010

significant increase on the principle of Independency explains that there is a greater attention on this principle caused by the function of independent party, that is assurance function.

Table 4 presents paired-t test results for each participant. It can be seen that there are significant differences between CG scores for each participant in the year 2004 and the year 2008, in which the increasing score is 122.84 percent (122.84%), i.e. 4.51 percent (4.51%) lower than the average increasing average score for each principle of CG. The highest increasing average score is on auditors, which is 169.32 percent (169.32%) and the lowest at 98.58 percent (98.58%) is on stakeholders. As we mentioned before, all of the data of participants showed normal spreading except for auditors. Then it was tested by Wilcoxon test. Paired t-test for auditors is conducted just to be able to compare the test results with other participants. Wilcoxon test for the auditors show a consistent result with the paired t-test. The result can be seen in Table 5.

4.2. Analysis of Hypothesis 3 (Three)

The normality test on CAMEL ratios, showed that the data were not spread normally, except for MAN. Therefore, the paired t-test can only be carried out to test the MAN while the other will be tested with Wilcoxon-test (nonparametric test). However, in order to perform comparisons with the other performance ratios, the MAN is also tested using the paired t-test. The result of Wilcoxon test can be seen in Table 6, while the paired t-test result is presented in Table 7.

Table 4. Paired-t test Result Per Participant

Description		BoD	BoE	BoC	Auditors	Stakeholders
2004	Mean	22.65	22.36	23.73	18.81	21.89
	N	21	21	21	21	21
	Std Dev	17.58	14.57	14.41	14.36	13.88
2008	Mean	48.60	45.61	54.04	50.66	43.47
	N	21	21	21	21	21
	Std Dev	16.56	17.26	19.67	28.03	14.68
Probability		0.000	0.000	0.000	0.000	0.000
Std Dev		19.67	17.57	18.41	23.71	12.99
Description		P<0.05 Significant	P<0.05 Significant	P<0.05 Significant	P<0.05 Significant	P<0.05 Significant

Source: Calculated from CGCG UGM's database, 2010

Table 5. Wilcoxon Test Result for Auditors

Description		N	Mean Rank	Sum Of Ranks
Auditors 2008-Auditors 2004	Negative Ranks	0	0.00	0.00
	Positive Ranks	20	10.50	210.00
	Ties	1	-	-
	Total	21	-	-
	Probability	0.000		
	Asymp.Sig (2-tailed)	P<0.05		
	Description	Significant		

Source: CGCG UGM's database, 2010

Table 6. Wilcoxon Test Result

Description		N	Mean Rank	Sum Of Ranks
CAR 2008-CAR 2004	Negative Ranks	12	11.96	143.50
	Positive Ranks	9	9.72	87.50
	Ties	0	-	-
	Total	21	-	-
	Probability		0.330	
	Asymp.Sig (2-tailed)		P<0.05	
	Description		Not Significant	
NPL 2008-NPL 2004	Negative Ranks	13	10.58	137.50
	Positive Ranks	8	11.69	93.50
	Ties	0	-	-
	Total	21	-	-
	Probability		0.444	
	Asymp.Sig (2-tailed)		P<0.05	
	Description		Not Significant	
MAN 2008-MAN 2004	Negative Ranks	0	0.00	0.00
	Positive Ranks	21	11.00	231.00
	Ties	0	-	-
	Total	21	-	-
	Probability		0.000	
	Asymp.Sig (2-tailed)		P<0.05	
	Description		Significant	
NIM 2008-NIM 2004	Negative Ranks	12	12.96	155.50
	Positive Ranks	9	8.39	75.50
	Ties	0	-	-
	Total	21	-	-
	Probability		0.164	
	Asymp.Sig (2-tailed)		P<0.05	
	Description		Not Significant	
LDR 2008-LDR 2004	Negative Ranks	4	9.63	38.50
	Positive Ranks	17	11.32	192.50
	Ties	0	-	-
	Total	21	-	-
	Probability		0.007	
	Asymp.Sig (2-tailed)		P<0.05	
	Description		Significant	

Source: Calculated from CGCG UGM’s database, 2010

Table 7. Paired-t test Result For MAN

Description		Total Score
MAN 2004	Mean	68.74
	N	21
	Std Dev	41.41
MAN 2008	Mean	148.25
	N	21
	Std Dev	49.03
Probability		0.000
Std Dev		47.11
Description		P<0.05 Significant

Source: CGCG UGM's database, 2010.

Table 6 shows that not only the aspect of capital represented by CAR but also the aspect of asset quality which is represented by NPL and the aspect of rentability which is represented by NIM are not significant. On the other hand, this indicates that there are no significant changes in performance from the aspects of capital, asset quality, and rentability before and after the improvement of CG implementation. In contrast, the score of management (MAN) that measure how the implementation of general management, risk management system, and the bank compliance, has showed significant results of either by using the paired t-test or the Wilcoxon test. Furthermore, the liquidity ratio represented by LDR has also shown significant change.

The insignificant results that occur on three (3) of the five (5) of performance ratios might be caused by the period when the research conducted. It was conducted when the global crisis of 2008 was happening. According to Kusumawati (2009), although the global crisis has not directly shown negative effect on the banking sector as a whole. However, the trend of banking performance since November 2008 decreased gradualy.

CONCLUSIONS AND LIMITATIONS

The results of the analysis concerning the implementation of GCG in commercial banks show that there are significant differences in the implementation of GCG after the issuance of PBI No. 8/4/PBI/2006. PBI No. 8/4/PBI/2006 has successfully made implementation CG better in the banking sector. The implementation quality of CG on CG's principles such as *transparency, accountability & responsibility, responsibility, independency*, and *fairness* is also better compare to the time before the implementation of PBI No. 8/4/PBI/2006. This is also supported by a better implementation of CG by CG participants such as *Board of Directors, Board of Commissioners / Committees, Board of Executives, Auditors,* and *Stakeholders*.

The performance of commercial banks has also increased after the issuance of PBI No.8/4/PBI/2006 in terms of management and liquidity. The PBI has successfully improved the performance of the commercial banks in terms of the management, including the general management, risk management system, and the bank compliance, as well as the liquidity aspects which indicate an increasing ability of banks in fulfilling their liability and lending whereas for the Capital

Ratio, the Asset Quality Ratios, the Profitability Ratios are not significant.

For banking industry, this research accommodates for the evidence that PBI No. 8/4/PBI/2006 is effective to promote the implementation of GCG. This research also provides for the framework of the policy makers in drafting the regulations emphasizing the importance of various company organs to participate in the application of CG through the fulfillment of CG principles. For the practitioners, this paper concede give ideas to implement a comprehensive CG system that still accommodates with the existing CG regulation. GCG implementation should be improved because it can improve the performance of the bank.

For further research, it is expected to use information obtained through direct observation within the commercial banks.

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