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Corporate Governance and Cost of Debt

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Lower asymmetry information reflects the transparency of information and reduce the level of uncertainty due to the lack of information owned by the investor. Through the disclosure indicates a low level of risk of a company. This shows that through the implementation of governance will decrease the cost of debt the company. Companies in Indonesia have a level cost of debt is higher compared to other countries in ASEAN; this condition can be caused by the less optimal of implementing governance in the Indonesian company. This study using company that listed in Corporate Governance Perception Index in Indonesia Stock Exchange period 2011-2015. The result indicate that the company haven't effectively implemented corporate governance and resulting the creditor didn't use corporate governance in the decision of loan granting. Companies have a level of cost of debt that tend to be low and stable, which is likely due to the company has a good performance and has been operating in the long term so it is trusted by the bank.

Keywords: Corporate Governance, Cost of Debt, Corporate Governance Perception Index

1. INTRODUCTION

Companies can use several options of funding sources to meet its operational needs. In general, companies using debt as an option in their capital structure. The main advantage of the use of debt in company's capital structure is the tax advantages of debt interest expense (Fosberg, 2004). Companies that use debt required to pay some compensation to the creditors in return for the funding of the company. This compensation is in the form of interest payable to the lender company for a certain period. The amount of the interest rate is influenced by the level of risk of the company. The lender will take into account the disclosure of information as part of the company's risk, or in other words companies that have a high degree of information asymmetry will be classified into a company with a high level of risk that the lender will charge with a higher interest rate. (Derrien et al, 2016; Wang & Zhang, 2008). Akerlof (1970) called the situation with "lemon problem", which is a condition in which the creditor can not analyze the credit quality of the company due to lack of information. This will result in lenders will charge higher interest rates to compensate for the risk of asymmetry of information.

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The cost of debt is influenced by the availability of company information for creditors. To minimize the risk level, creditors need open and reliable information about the company. The more company disclose their information will reduce the risk and will lower the cost of debt. Armitage & Marston (2007) states that providing complete information may increase the chances of getting a low interest loan. According Bhojraj & Sengupta (2003) cost of debt is influenced by corporate characteristics, agency cost, bankruptcy risk, and asymmetry of information. Barako et al (2006) and Guidara et al (2014) found that there was a negative relationship between voluntary disclosure and cost of debt.

Conditions that occur in Indonesia showed that companies in Indonesia have the cost of debt rate higher than other countries in ASEAN (World Bank, 2015). The interest rate in Indonesia is the second highest after Vietnam, with the high cost of debt, the company is required to continue to pay high interest charges.

It becomes important for companies in Indonesia because according to data from the International Monetary Fund (2015), the ratio of total outstanding loans to total loans to companies in 2014 reached almost 50%. In general, companies in Indonesia use debt as a major source of funding and burdened by high interest rates.

Higher interest rates can be caused by asymmetry of information between the company and creditors (Wang & Zhang, 2008). Implementation of governance can reduce the level of information asymmetry. As a concept that emphasizes the principles of transparent, accountable, responsible, independent, and equality, the implementation of governance has many advantages for the company. One of the advantage is the implementation of good corporate governance will reduce the cost of debt. Previous research by Diamond and Verrecchia (1991); Barth et al. (2013); Habib et al. (1997) suggests that good corporate governance (GCG) will increase the transparency of information and encourage companies to operate effectively and efficiently, so as to lower the company's cost of debt.

2. LITERATURE SURVEY

Research conducted by Chung et al. (2010), Diamond and Verrecchia (1991); Barth et al. (2013); Habib et al. (1997) concluded that companies with good corporate governance has low capital costs and high level of stock liquidity. Cremers et al (2007); Wang and Zhang (2008); Alves (2015) states that corporate governance will reduce information asymmetries and lower cost of debt.

In Indonesia context, Adam et al (2015) conclude that the implementation of good corporate governance and ownership structure through audit quality provides a significant negative effect on the level of cost of debt. Dharmastuti & Wahyudi (2013) states that the role of external parties such as creditors, will perform the function of monitoring is better than internal, so that through the use of debt the company's operations will be run effectively and efficiently and lower the cost of corporate debt.

3. PROBLEM DEFINITION

This study is conducted to answer the following problem formulation:

1. To discover the Implementation of Corporate Governance of companies listed on the Indonesia Stock Exchange in 2011-2015.
2. To discover the level of cost of debt companies listed in Indonesia Stock Exchange in 2011-2015.
3. Test the effect of Good Corporate Governance to cost of debt on companies listed on the Indonesia Stock Exchange in 2011- 2015.

4. METHODOLOGY

In this study, the sample are companies listed in CGPI (Corporate Governance Perception Index) in Indonesia Stock Exchange in 2011-2015.
In this study the variables used are of good corporate governance as an independent variable and the cost of debt as the dependent variable. Measurements were performed for each variable as follows:

1. Good Corporate Governance will be measured by the score of CGPI Index.
2. Cost of debt will be measured by interest expense divided by total debt.

5. RESULT & DISCUSSION

Corporate Governance

Company	Corporate Governance					
	2011	2012	2013	2014	2015	Average
PT. Aneka Tambang	64,61	86,56	88,71	88,92	71,38	80,04
Bank Mandiri	68,77	91,91	91,88	92,37	73,02	83,59
Bank Negara Indonesia	64,91	85,75	86,07	87,19	69,29	78,64
Bank Tabungan Negara	63,11	85,90	85,42	84,94	67,01	77,28
PT. Timah	50,60	75,68	77,81	80,10	64,84	69,81
PT. Bukit Asam	64,06	82,56	83,80	84,09	68,15	76,53
PT. Jasa Marga	61,98	83,66	84,52	85,16	68,28	76,72
Average	62,58	84,57	85,46	86,11	68,85	

The value of corporate governance is derived from the Corporate Governance Perception Index (CGPI) which measured by how many firms perform governance practices. The greater the value of CGPI indicates that the company implements more optimal governance.

On average, the companies perform the highest governance index in year 2014, while the lowest index happen in 2011. The company that have the highest index is Bank Mandiri in year 2014, and the lowest is PT. Timah in year 2011.

The best governance practices was shown by Bank Mandiri with the highest index in all period of observation (2011 – 2015). Bank Mandiri always have governance index higher than average on every year. On the other hand, PT. Timah seems to have the poorest implementation of governance. PT. Timah have the lowest governance index among other companies in every year.

The results show that the average implementation of corporate governance has an increasing trend during the period 2011-2014. However, there is a significant decline in 2015. This decrease is due to the low value of implementation of corporate governance on every company. On average, companies with low governance values are owned by PT Timah (69.81) and the highest is owned by Bank Mandiri (83.59). This lower governance index indicates that the company haven't effectively implementing good governance.

Cost of Debt

Company	Cost of Debt					
	2011	2012	2013	2014	2015	Average
PT. Aneka Tambang	0,006	0,035	0,007	0,013	0,021	0,02
Bank Mandiri	0,033	0,027	0,028	0,032	0,036	0,03
Bank Negara Indonesia	0,029	0,026	0,022	0,033	0,028	0,03
Bank Tabungan Negara	0,047	0,041	0,043	0,056	0,052	0,05
PT. Timah	0,009	0,016	0,010	0,026	0,032	0,02
PT. Bukit Asam	0,002	0,001	0,002	0,008	0,021	0,01
PT. Jasa Marga	0,061	0,062	0,054	0,060	0,058	0,06
Average	0,03	0,03	0,02	0,03	0,04	

The average cost of debt value of the company has a stable trend every year. Year 2013 is the year that has the lowest cost of debt, while in 2015 has the highest cost of debt.

PT. Bukit Asam is the company that has the lowest cost of debt (0.01) and PT. Jasa Marga is the company with the highest cost of debt (0.06).

The cost of debt that tends to be stable every year shows that the company's have a low risk thus the interest rates becomes low and stable every year. This situation can occur because the company has been operating for a long time and has gained the trust of the creditor.

The Influence of Corporate Goverance to Cost of Debt

Regression results show that there is no significant effect of corporate governance to cost of debt. The r square value of 0,036% indicate very little influence from corporate governance to cost of debt.

Fluctuating of governance index does not cause significant change in the cost of debt.

6. CONCLUSION

Analysis of the insignificant effect of governance on cost of debt can be explained as follows:

1) The company listed on the CGPI is a company that has been trusted and established for a long time, thus the creditor has his own judgment against the risk of the company.
2) The lack of concern of investors in Indonesia towards governance so as not to be a concern in making investment decisions
3) The assessment of the governance index that undergoes a change leads to incompatibility when comparisons are made each year.

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