DIPONEGORO JOURNAL OF ACCOUNTING *Volume 10, Nomor 1, Tahun 2021, Halaman 1-7*
http://ejournal-s1.undip.ac.id/index.php/accounting *ISSN (Online): 2337-3806*

THE INFLUENCE OF BOARD INTERLOCKING ON FIRM PERFORMANCE WITH FOREIGN OWNERSHIP AS A MODERATING VARIABLE
(*Evidence from LQ 45 Companies for The Period 2015-2018*)

Ayu Isnaeni, Agung Juliarto[1]

Accounting Department Faculty of Economic and Business Diponegoro University

Jl. Prof. Soedharto SH Tembalang, Semarang 50239, Phone: +622476486851

ABSTRACT

This study aims to examine the influence of board interlocking on firm performance, with foreign ownership as moderating variable. The dependent variable of the study is firm performance (Return On Asset), whereas board interlocking as the independent variable moderated by the foreign ownership variable. The control variables of the study are ownership concentration, institutional ownership, board size, board independence, firm size, firm age and financial leverage. This research used the companies sample that listed in LQ-45 in Indonesia Stock Exchange on 2015-2018 period. This study is a quantitative study using secondary data in the form of annual reports 20 companies for 4 years (80 observations). The sampling method used in the study is purposive sampling. The hypotheses testing used moderated regression analysis with the help of SPSS version 24 software. These results are accordance with Resource Based Theory and Resource Dependence Theory which indicate that board interlocking has a positive effect on firm performance.; However, foreign ownership does not moderate the effect of board interlocking on firm performance.

Keywords: Firm performance, Return on Assets, Board Interlocking, Foreign Ownership

INTRODUCTION

In the modern era, the business world has developed so rapidly that many companies have begun to emerge and also compete fiercely both nationally and internationally. Companies whom firm values are great, can be seen from their own performance and also the number of investors who are fascinated in investing to the company. Of course, attracting investors requires good business practices by prioritizing the company's survival by trying to improve or stabilize performance and also pay attention to the interests of stakeholders. Therefore, a company annually publishes their financial statements with the aim that shareholders or investors can access and know the current state of the company.

The task of issuing company financial reports is indispensable and mandatory for periodic financial performance reports. Managers, investors, the government, business community and other related institutions require measurement and evaluation of the performance of business entities that have gone public, therefore the financial statements very important and crucial. Therefore, the financial statements have special attention to the company with the aim of being able to compete with increasingly stringent business competitors and gain as much profit. Achievement of stable and rising company performance is inseparable from the various strategies made by the company's management. The limited quality of human resources makes the company take an alternative to do board interlocking, so, it can maintain the company's income (it’s performance) (Hamdan, 2017).

Board interlocking happens when an individual is affiliated with one of organizations which also coincides with being a board of directors or commissioners in another organization. This is a

[1] *Corresponding author*

management practice that is most often done and is a practical tool for growing communication in corporate companies by utilizing the experience of board members (Haunchild, 1993). This includes the concurrent positions of directors between a parent company, one board member of the holding company and other board member subsidiaries or other subsidiaries of various holding companies. This circumstances usually arises due to joint ownership and financial linkages (Usman, 2013).

In Indonesia, to achieved desired target, some companies sometimes forget to implement Good Corporate Governance (GCG) which is very important to improve efficiency and economic development as well as investor confidence. The application of GCG in Indonesia is proven by not allowing dual positions in GCG regulations, they are the code of practices made by Bank Indonesia Number 8/4 / PBI / 2006 focusing the practice of Good Corporate Governance for commercial banks in 2006 article 22 (1) and Law of the Republic of Indonesia Number 19 of 2003 focusing State-Owned Enterprises article 33.

The development of a free market in the world makes it easy for investors from various places both domestic and foreign to invest their capital in companies in the country and abroad. By giving companies cross-industry experience and additional filters to monitor company management, foreign ownership promises to reduce agency costs and increase creditor trust. The upward existence of foreign investors could also become a benefit to increase management insistence to attend the benefits of shareholders (Anderson & Reeb, 2003). So, this research is not only continuing previous research in the context that is characterized by Indonesia but also identifying whether the foreign ownership will strengthen and weaken the interrelated effects on performance within the existing of free market implementation which is currently being enhanced by the Indonesian government which is to improve the relationship among other countries, to increase foreign investment. In order to reach the process of research, using findings that come from empirical analysis, criticizes the theoretical components of the board that are interrelated with views to improve the theoretical framework in the study.

This study will focus on the influence of multiple positions held by the Board of Commissioners and Board of Directors on financial performance with the addition of foreign ownership as a moderating variable in Indonesia's companies. This research is based on Hamdan (2017) that examines the influence of board interlocking on firm performance with foreign ownership as moderating variable. In this study, it is different with the research that is conducted by Hamdan (2017). Previous research uses a sample of companies listed in Saudi Arabia while this study takes the sample from Indonesia's companies that listed in LQ45 index from 2015-2018. The use of LQ45 index on this study is because of the existence of this index which can provide objective and reliable tools for financial alysis, investment managers and investors. In addition, this index covers many corporate sectors and has a high level of transactions in the capital market, especially in attracting foreign investors. So that it can make it easier for researchers to analyze study results and make it more efficient in data collection. Based on the description above, then this research entitled The Influence of Board Interlocking On Firm Performance with Foreign Ownership as A Moderating Variable (Evidence from LQ45 Companies Listed from 2015-2018).

THEORETICAL FRAMEWORK AND HYPOTHESES DEVELOPMENT

Board interlocking implementation cannot be separated with agency theory, resource based theory and resource dependence theory. Agency theory is a theory that explains conflicts of interest that arise due to the separation between ownership and control functions (Jensen and Meckling, 1976). This theory can explain the role of board of director and commissioner, such as control and monitor the company's decisions for handling the existence of agency issue among corporate's stakeholders. In resource based theory, companies that utilize variety of intellectual resources enable companies to achieve competitive advantage and added value (Barney, et al., 2011). So, this theory can reveal a dual position performed by company's functionaries, so that a person who does a dual position is considered to have high intellectual value and provide a competitive advantage which will affect the company's performance. Other than that, in resource dependence theory, it can describe the crucial role of firm's superiors as a way to decrease the uncertainty environment (Hermalin & Weisbach, 2003). The company tend to hire professional boards for handling external resources effectively and connecting the company with other players including foreign investors.

The existence of company's board of directors and commissioner can become its' bridge to utilize and reach external resources. To reach that kind of goals, the firm has to own the functionaries who have excellence even advance experiences in this field. However, the limitation quality of human resource that exist is the cause for company cannot reach the corporate's goals (Fama & Jensen, 1983). So, company have a habit to recruit the proficient boards from the other organizations (board interlocking) with aim to achieve the company's objective to increase the financial performance. because board interlocking as an incessant learning method that contributes to increase all members' experience and skill involving informal transfer of knowledge which reflects positively to the performance of company (Ribeiro & Colauto, 2016). the better quality and experience that the boards have, so the higher chance company can develop its performance (Hamdan, 2017). Then, in the context of emerging market countries like Indonesia, the following hypothesis is expected:

H1: There is a Positive Significant Influence of Board Interlocking on Company Financial Performance

Moreover, because business entities face the globalization era which are pushed to compete not only among national competitors but also international companies. So, today many companies try to link their entities to other parties, one of them is foreign investor (Hamdan, 2017). The reason why companies approach foreign investors as their target, because foreign investors usually bring the positive vibes to the corporate governance in the form of presenting the greatest performs into supervision which push the company to improve firm's financial performance (Ahmadjian & Robbins, 2005). In addition, nowadays the government of Indonesia encourages an economical openness policy to increase and attract foreign investment (Sarah, 2019). So, it is the best time to examine whether the foreign ownership can add the benefit for the corporate that simultaneously do interlocking directorate to increase the financial performance. Based on this explanation, the second hypothesis is:

H2: Foreign Ownership Moderate the Influence of Board Interlocking on Firm Performance.

METHODOLOGY

To test the hypothesis, this study uses one dependent variable, one independent variable, seven control variables and moderating variable. The dependent variable used is Return on Asset (ROA), Measuring the ratio between net profit after deducting interest expense and tax (Earning After Taxes / EAT) resulting from the company's main activities with the total assets (assets) owned by the company to carry out the company's overall activities and expressed as a percentage (Hamdan, 2017). ROA will be calculated using the following formula:

$$ROA = \frac{Earning\ After\ Tax}{Total\ Asset} x100\%$$

Then, the independent variable used in this study is board interlocking. Board interlocking is a situation where the same person holds the position of a commissioner and / or board of directors of more than one company. According to Donato, et al. (2009) research, Company carry out interlocking directorate in order to reduce the possibility of information asymmetry in the form of monitoring debtors by providing access to company's internal information.

The moderating variable on this study is foreign investment. Foreign investment is carried out by foreign parties with the aim of making a profit through a production or service. In the Law on investment number 25 of 2007, foreign investment is an investment activity to build and run the corporate in the Republic of Indonesia areas which is carried out by foreign investors, both those who use foreign capital fully or who are joint venture with domestic investors. This variable can be measured by the percentage of shares owned by foreign parties by the number of shares issued (Nugrahanti and Novia, 2012).

$$Foreign\ Ownership = \frac{Total\ Foreign\ Investor's\ Shares}{Total\ Shares\ in\ the\ market}\ x\ 100\%$$

The seven control variables are ownership concentration which measured by fraction of shares owned by the five largest shareholder together, institutional ownership which measured fraction of shares owned by the institutional investors, Board size that measured by size of the board of commissioner, board independence which is the percent of independent on the board, firm size which can be measured by logarithm of the company's total assets, firm age that can be found since establishment till year of the study and financial leverage that can be found by total debt divided by total assets.

Beside the research variable, the other thing that needs to be considered is the population and sample. The population taken in this study are companies listed in the LQ-45 index for the period of 2015-2018, which are the most active transactions on the stock exchange so there will be many analyzes that do more about the company's condition compared to companies outside the LQ-45. The sampling method in this study is a purposive sampling method, sampling is based on considerations in accordance with the purpose of the study, meaning that before the sample is taken, first determine the limits of the sample as to what will be taken (Gendro, 2011). The considerations referred to by researchers are:

1. Companies listed in the LQ-45 index on the Indonesia Stock Exchange. LQ 45 is a stock market index on the Indonesia Stock Exchange (IDX) consisting of 45 companies that meet certain criteria in the 2015-2018 period.
2. Companies that issue financial statements in rupiah.
3. Companies that have the data needed in this study.

By using one dependent variable, one independent variable, seven control variables, and the types of samples previously described, both research hypotheses can be tested. For testing the first and second hypothesis, using Moderated Regression Analysis (MRA), an extraordinary application of linear multiple regression where the regression equation has elements of interaction (multiplication of two or more independent variables) with the following equation (Liana, 2009). The regression model used in the research is as follows:

$$FP = \alpha + \beta_1 \mathrm{ID} + \beta_2 FOx\mathrm{ID} + \beta_3 FO + \beta_4 OC + \beta_5 IO + \beta_6 BS + \beta_7 BI + \beta_8 FS + \beta_9 FA + \beta_{10} \mathrm{FL} + \varepsilon$$

The multiplication variable between FO and ID is also called a moderating variable by describing the moderating effect of the variable foreign ownership on board interlocking and firm performance. While FO and ID are the direct effects of the foreign ownership and board interlocking variables on firm performance.

RESULT AND DISCUSSION

The first and second hypothesis testing used 80 samples selected through purposive sampling and one sample t-test. the results of the purposive sampling and one sample t-test are as follows:

Table 1

Sampling for Testing First and Second Hypotheses

No.	Companies' Criteria	Total
1.	LQ-45 companies listed on the Indonesia Stock Exchange	**45**
2.	The companies were inconsistently consecutively included in the LQ-45 index on the IDX website.	**(16)**
3.	The companies whose foreign ownership structures were not available.	**(4)**
4.	The companies that have outlier data.	**(5)**
	Total companies that fulfill the criteria	**20**
	Years of Analysis	**4**
	Total data sample in four years of analysis from 2015-2018	**80**

Table 2

The Result of First Hypothesis

Model	Unstandardized Coefficients B	Std. Error	t	Sig.
(Constant)	0.872	0.161	5.418	0.000
ID	0.050	0.021	2.351	0.022
BS	-0.003	0.007	-0.453	0.652
BI	0.047	0.012	3.782	0.000
FL	-0.005	0.006	-0.859	0.393
FS	-0.126	0.020	-6.273	0.000
IO	-0.047	0.037	-1.251	0.215
OC	-0.055	0.064	-0.852	0.397
FA	0.037	0.021	1.758	0.083

Data Source: Secondary Data Processing, 2020

Table 2 describes a significant probability value of 0.022 or smaller than 0.05 (0.022 < 0.05) and has a positive direction. Based on the results of hypothesis testing above, the significance value is accepted and the direction is accordance with the hypothesis, it can be concluded that the hypothesis stating "there is a positive significant influence of board interlocking on company financial performance" is accepted.

There are 7 control variables that exist in the study, are board size, board independence, firm leverage, firm size, institutional ownership, ownership concentration and firm age. Board independence and firm size have probability values <0.05 which is 0.00 with the beta coefficient 0.047 and -0.126. This values show that the board independence and firm size variable influence the firm performance. Different from board independence and firm size, board size, firm leverage, institutional ownership, ownership concentration and firm age have p-values that are more than 0.05, mean these variables don’t impact on firm performance.

Table 3

The Result of Second Hypothesis

Model	Unstandardized Coefficients B	Std. Error	t	Sig.
(Constant)	0.851	0.165	5.149	0.000
ID	0.118	0.058	2.017	0.048
BS	-0.009	0.007	-1.299	0.198
BI	0.038	0.012	3.031	0.003
FL	-0.003	0.006	-0.527	0.600
FS	-0.123	0.020	-6.290	0.000
IO	-0.110	0.043	-2.566	0.012
OC	-0.092	0.065	-1.405	0.165
FA	0.039	0.021	1.868	0.066
FO	0.506	0.251	2.014	0.048
ID*FO	-0.398	0.245	-1.625	0.109

Source: Secondary Data Processing, 2020

Based on table 4.14 it can be seen that the significance value is 0.109 or greater than 0.05 (0.109> 0.05) and has a negative direction. Based on the results of testing the hypothesis above, the significance value is not accepted and the direction is not appropriate. Although the hypothesis for board interlocking and firm performance is accepted, it can be concluded that the hypothesis stating "moderate foreign ownership of the influence of board interlocking on firm performance" is not accepted.

In the regression model 2, the control variables that have p- value not more than 0.05 are board independence (p-value: 0.003 and the beta coefficient: 0.038), firm size (p-value: 0.00 and beta coefficient: -0.123) and institutional ownership (p-value: 0.012 and beta coefficient: -0.110). These control variables influence firm performance which measures by Return on Assets. However, board size, firm leverage, ownership concentration and firm age showed the p-value >0.05. So, it can be recapitulated that those control variables don’t have significant effect on the firm performance.

CONCLUSION

This study analyzes the influence of board interlocking toward firm performance with foreign ownership as a moderating variable. The research uses the data from 45 companies (LQ45 index) for four years from 2015-2018 to obtain 180 samples and then reduced by outliers and other company criteria by 100 samples so that the number of samples becomes 80 samples. Based on the analysis of data collected and processed, it can be recapitulated that board interlocking, firm age, board size, institutional ownership, firm size, ownership concentration, board independence, firm leverage, and foreign ownership simultaneously influence firm performance.

From the results of data analysis, the results are known that board interlocking significantly have a positive effect on firm performance. The result of the study prove that the board interlocking has a positive reaction to firm performance. The reason is because board interlocking as a corporate tool to add information channels and transfer important experience and active communication methods to make a positive contribution to the company's operational and financial performance. Other than that, foreign ownership does not moderate the impact of board interlocking on firm performance. Finding shows that there is no different impact connected to board interlocking and firm performance between the company that has high foreign ownership and low ownership.

As a consideration for readers, this study also has several limitations. First, there are 53,4% results affected by outside factors of independent variable, namely board interlocking and control variables, consists of board size, board independence, firm size, firm leverage, firm age, ownership concentration, institutional ownership. Second, the sample size is relatively small, explicitly only 20 companies. The sample used is only companies listed in the LQ-45 index and not all companies on this index meet the criteria for the study sample, which cannot totally reflect the existence of board interlocking in Indonesia’s companies.

Looking up the limitations that exist in this study, some suggestions are recommended to the future research in order to have more development about this topic of research. First suggestion, future research requires to be done on other factors besides board interlocking, foreign ownership and control variables (institutional ownership, board size, board independence, firm leverage. Firm size, ownership concentration and firm age) that can affect firm performance. Second suggestion, next researchers can expand the sample of companies. Further research can use a sample of other companies such as real estate, banking, manufacturing and others or add a sample of countries outside Indonesia, to be able to compare the results of research in several countries.

REFERENCES

Ahmadjian, C. & Robbins, G., 2005. A Clash of Capitalism: Foreign Shareholders and Corporate Restructuring in 1990s Japan. *American Sociological Review,* Volume 70 No. 3, pp. 451-471.

Barney, J., Ketchen, D. & Wright, 2011. The future of resource based theory revitalization or decline?. *Journal of management, 37(5),* pp. 1299-13115.

Fama, E. & Jensen, M., 1983. Separation of ownership and control. *journal law and economics vol 26 No 4,* pp. 301-325.

Hamdan, A., 2017. Board Interlocking and Firm Performance: the role of foreign ownership in Saudi Arabia. *International Journal of Managerial Finance,* p. 270.

Haunchild, P., 1993. Interorganizational imitation: the impact of interlocks on corporate acquisition activity. *Administrative Science QuarterlyVol. 38 No. 3,,* pp. 564-592.

Hermalin, B. & Weisbach, M., 2003. Boards of directors as an endogenously determined institution: a survey of the economic literature. *Economic Policy Review, Vol. 9 No. 1,* pp. 7-26.

Jensen, M. C. & Meckling, W. H., 1976 . Theory of The Firm : Managerial Behavior Agency Costs and Ownership Structure.. *Journal of Finance Economics, 3(4),* pp. 305-360.

Liana, L., 2009. Penggunaan MRA dengan SPSS untuk Menguji Pengaruh Variabel Moderating terhadap Hubungan antara Variabe; Independen dan Variabel Dependen. *Jurnal Teknologi Informasi Dinamik,* Volume XIV, pp. 90-97.

Ribeiro, F. & Colauto, R., 2016. The relationship between board interlocking and income smoothing. *Revista Contabilidade and Finances, Vol. 27 No. 70,* pp. 55-66.

Sarah, 2019. *The Influence of CEO Duality, Interlocking Directorship, Foreign Ownership and Earning Power Towards Earning Management.* [Online]
Available at: http://repository.uinjkt.ac.id/dspace/handle/123456789/45384

Usman, R., 2013. *Hukum Persaingan Usaha di Indonesia.* Jakarta: Penerbit Sinar Grafika.