

# PROCEEDINGS



## 4<sup>TH</sup> GADJAH MADA INTERNATIONAL CONFERENCE ON ECONOMICS AND BUSINESS 2016

“RESEARCH, PRODUCTION, AND BUSINESS MODEL TRILEMMA  
IN THE ASEAN ECONOMIC COMMUNITY”

**VOLUME 4 NO. 1 2016**

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## **PREFACE**

Thanks to God, with the almighty grace.

We are really grateful that the 4<sup>th</sup> Gadjah Mada International Conference of Economics and Business 2016 had been held successfully on November 25-27, 2016 by Faculty of Economics and Business Universitas Gadjah Mada at Jogja Plaza Hotel, Sleman, Yogyakarta. Tokens of appreciation should be rendered to our presenters, participants and all of you that made the event could be organized and carried out with the highest quality, comfort, and precision that we could give. Even though there are some mistakes that we did during the event, we apologize deeply for that. These Proceedings are compiled as a collection of all presenter's research papers. Showing the creativity of ideas that could also be seen as an art inside the field of science.

The theme of this year conference is "Research, Production, in Business Model Trilemma on ASEAN Economic Community," and this theme is manifested in the presented papers that are compiled in these proceedings, comprised of the scholarly work from this global environment and as well as the honorary speakers. Therefore, we would like to express our gratitude and credits to Journal of Indonesian Economy and Business Faculty of Economics and Business Universitas Gadjah Mada.

Professor Christopher Mannings (Crawford Schools, Australia Nationals University), Professor Dr. Mudrajad Kuncoro, M.Soc.,Sc. (Universitas Gadjah Mada), Dr.Satya P.Chattopadhyay Ph.D (University of Scranton) and Arie Setya Yudha (Molay Tacticals) for taking the time to contribute and share their expertise and experiences to the conference that have enriched our knowledge in this field.

All the scientists and researchers that have also contributed their research, ideas, results, and encouraging one another to learn more by sharing, learning, and discussion sessions. There were 119 papers from – different countries presented in the conference. Some of them have agreed to include their full papers in the proceedings.

The proceeding and presentations cover various topics, ranging from economics, marketing management, human resources management, financial management, operation management, supply chains management, and accounting.

We sincerely hope that these proceedings and the conference in particular will grant benefits to all of the participants and also the readers. Especially as a reference for further Economics and Business development in Indonesia and all over the world.

We welcome and will receive any suggestions and constructive feedback to improve the organizing strategy for the betterment and development of Gadjah Mada International Conference of Economics and Business conferences and proceedings. We look forward to see you again in our next event.

Yogyakarta, December 2016.

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**DO BOARD OF COMMISSIONERS AND AUDIT COMMITTEE FUNCTION  
EFFECTIVELY IN THE CORPORATE STRATEGIES?  
STUDY OF REAL ACTIVITIES IN INDONESIA**

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***ABSTRACT***

*We examine board of commissioners and audit committees as a main part of the corporate governance mechanism toward corporate strategies in real activities in public listed companies in Indonesia Stock Exchange (IDX). We measure the effectiveness of the board of commissioners and audit committees using comprehensive scores which is relatively new measures compared to previous studies in Indonesia. On the other hands, real activities are measured using operational activities, which are consisting of sales manipulation, reduction of discretionary expenses, and overproduction. Using our final sample of 265 firm-year observations from manufacturing industries for the period of 2011-2013, we find negative association between board of commissioners and real activities, consistent with our hypothesis and find no evidence on the association between audit committee and real activities. We conclude that real activities as part of the corporate strategies to manage earnings upward, and the board of commissioners function effectively in monitoring these real activities. We also interpret that the function of audit committees are subsumed by the function of the board of commissioners.*

***Keywords:*** *real activities, board of commissioners, audit committee, corporate governance*

**INTRODUCTION**

Past research has documented that companies engage in earning management to increase earnings (Graham, Harvey, & Rajgopal 2005). Past studies also documented that the companies use earning management tools, either accrual based earnings management (AEM) or real based earnings management (REM) (Herusetya 2012; Graham et al. 2005; Chen, Rees, & Sivaramakrisnan 2010). Real earnings management (REM) is an increasingly common method of manipulating financial results (Commerford, Hermanson, Houston, & Peters

2016). Others found that compared to companies with effective internal controls, companies with existing material weaknesses in their internal controls engage in more manipulation of real activities (particularly inventory overproduction) (Järvinen & Myllymäki 2016).

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Sivaramakrisnan 2010). Real earnings management (REM) is an increasingly common method of manipulating financial results (Commerford, Hermanson, Houston, & Peters 2016). Others found that compared to companies with effective internal controls, companies with existing material weaknesses in their internal controls engage in more manipulation of real activities (particularly inventory overproduction) (Järvinen & Myllymäki 2016).

The corporate strategy in the companies' operations are at the top level of management, that include engaging in real activities or real earnings management (REM). Therefore, corporate governance mechanism plays an important role in controlling the company's strategy including real activities done by management. Prior studies that examine the association between corporate governance mechanism and real earnings management were very scarce (e.g., Siregar & Utama 2008; Meidiana & Herusetya 2015).

Many previous studies only examined the relationship between corporate governance mechanism and earnings management using traditional tools, i.e., accrual based earnings management (e.g., Lobo, Zhang, Zhou 2008; Klein 2006; Xie, Davidson, & Dadalt 2001). Corporate governance mechanism is also more done by using traditional measures, such as size or composition of board of commissioners, the existence of independent commissioner and audit committee (e.g., Wedari 2004; Klein 2006; 2002; Meidiana & Herusetya 2015; Hermawan & Adinda 2012). Several studies in Indonesia using an index issued by Indonesian Institute of Corporate Governance (IICD) measuring corporate governance that is more comprehensive, but still in voluntary based because not all listed companies on the Indonesia Stock Exchange (IDX) use these measurements (e.g., Meidiana & Herusetya 2015 ). We investigate the effectiveness of the board of commissioner and audit committee using a relatively new and comprehensive measures as was done by Hermawan (2011) toward real earnings management (REM) or real activities at aggregate level.

## **HYPOTHESIS DEVELOPMENT**

Earnings management occurs when managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting practices (Healy & Wahlen 1999). Management did earnings management to increase earnings, but this earnings management can reduce earnings quality (Levitt 1998).

Earnings management can be done using a variety of tools, either using accrual based earnings management (AEM) or real based earnings management (REM) or real transactions. Roychowdhury (2006) defined real earnings management as the activity that departures from normal operational practices, motivated by manager's desire to mislead at least some stakeholders into believing certain financial reporting goals have been met in the normal course of operations. These departures do not necessarily contribute to firm's value although they enable managers to meet reporting goals. Actually, certain operational activities manipulations are common in certain economic circumstances, such as price discounts and reduction of discretionary expenditures. However, when managers engage in these activities more extensively than is normal given their economic circumstances, with the objective of meeting certain earnings target, they are engaging in real earnings management (Roychowdhury 2006).

Fernando (2009) suggest that corporate governance is typically perceived by academic literature as dealing with problems that result from the separation of ownership and control. From this point of view, corporate governance would focus on the internal structure and rules of the board of directors, the creation of independent audit committees, rules for disclosure of information to shareholders and creditors, and control of the management. Research on the earnings management through

real activities in Indonesia found that manufacturing companies employed overproduction, discounts, credits and allowances as an indication of earnings management, which leads to high production costs, and due to the weak investor protection of public companies in Indonesia, the companies tend to conduct real earnings management (Ratmono 2010).

Corporate governance mechanism has a function in monitoring the company's financial reporting and management strategies. The main function of the corporate governance mechanism can be represented by the role of the board of commissioners as well as the audit committees. Therefore, if the corporate governance mechanism function effectively through the board of commissioners and audit committee, then there is a supervisory of corporate strategy, including real activities employed by the management. Previous research found that the effective board of commissioner can prevent the earnings management practices (Hermawan & Adinda 2012; Klein 2002). Earnings management is less likely to occur in a company whose board consists of both more independent or experienced commissioner (Xie et al. 2001). Consistent with Xie et al. (2001), Beasley, Carcello, Hermanson, and Lapides (2000) suggest that some overall board of directors (or board of commissioner in Indonesia) characteristics have important effect on the quality of financial reporting, thus decreases the likelihood of high earnings management. Further, Fama and Jensen (1983) and Shivadasani (1993) in Klein (2006) show that the independent board members have incentives to develop reputations as experts in decision control and monitoring ability, therefore reduces the likelihood of earnings management, including real earnings management. Based on the above arguments, the hypothesis to be tested is:

**H<sub>1</sub>:** The effectiveness of board of commissioner has negative impact to the real earnings management.

Chtourou, Marrakchi, Bedard, & Courteau (2001) investigate whether the practice of corporate governance has a positive influence on the quality of financial statement. They found that the application of corporate governance will constraints the activity of earnings management. One of the elements of corporate governance mechanism is audit committee. Moreover, the effective audit committee can enhance the earnings quality of company, which means by decreases in earnings management (Xie et al. 2001). Jaggi and Leung (2007) suggest that audit committee can prevent earnings management practices employed by management. Klein (2006) also found evidence that there is a negative relation between effective audit committee and accrual earnings management. With the same thought that earnings management can also be done in real activities, our hypothesis to be tested is:

**H<sub>2</sub>:** The effectiveness of audit committee has negative impact to the real earnings management.

## **RESEARCH DESIGN**

### **Population and Sample Selection**

Population in this research focuses on all manufacture firms which are listed in Indonesia Stock Exchange (BEI) during the period of 2011 – 2013. Our sample selection are performed by purposive sampling method with the criteria as follows: (i) the companies are consistently listed in Indonesia Stock Exchange (BEI) during 2011-2013; (ii) the companies issued and published complete annual report with the year ended December 31st from the 2011-2013; (iii) the companies which are used as sample must be recorded from the year 2009 because to calculate the REM index, we have to use financial data from t-2; (iv) the companies have no negative equity during observation; and (v) use Rupiah as their nominal value.

Based on the criteria above, we found 265 firm-year observations for the year 2011 – 2013. Table 1 shows description of sample selection.

**Table 1:** Sample Selection Descriptions

Description	Total
Number of firm-year observations listed in IDX during 2011 - 2013	423
Number of firm-years that use foreign currencies in 2011 - 2013	(54)
Number of firm-years which do not provide complete data of observation	(104)
Total final samples (firm-years)	265

Observation sample should be recorded since 2009 because data for calculating APROD needs information of sales account from the financial statements in 2009.

**Table 2:** Sub-Sector Sample Descriptions

No	Sectors	Number of firm-year observations	Percentage
1	Basic & Chemical Industry	117	44.15
2	Miscellaneous	67	25.28
3	Consumer Goods	81	30.57
	Total	265	100

Table 2 provides an overview of the sample from the sub-sector in Manufacture Sectors. From Table 2, most of the sampling observations are taken from Basic & Chemical Industry sub-sector, which is 44.15 percent of total sample, followed by Consumer Goods sub-sector for 30.57 percent, and Miscellaneous sub-sector for 25.28 percent.

### Main Regression Model

To test our hypothesis (H1 and H2), we use multivariate regression model in equation (1) as follows:

$$\begin{aligned}
 \text{REM}_{it} = & \alpha_0 + \alpha_1 \text{BOCScore}_{it} + \alpha_2 \text{ACScore}_{it} \\
 & + \alpha_3 \text{BIG4}_{it} + \alpha_4 \text{SIZE}_{it} + \alpha_5 \text{LEV}_{it} \\
 & + \alpha_6 \text{LOSS}_{it} + \alpha_7 \text{SGR}_{it} + \varepsilon_{it}
 \end{aligned}
 \tag{1}$$

Our main variables in equation (1) are BOCScore and ACScore. It is predicted that coefficient of  $\alpha_1$  and  $\alpha_2$  are negative and significant towards the REM index. Some control variables are used to control other factors that can influence the real earnings management, i.e., BIG4, SIZE, LOSS, LEV, and SGR. Companies who are audited by the Big Four

audit firm tends to use real earnings management, so the correlation between BIG4 and REM is positive (Chi et al. 2011). We do not predict the sign of SIZE variable gives since there are some different perspective from prior studies. First, bigger company size can reduce earnings management practices, because bigger companies size tends to have more good internal control, effective corporate governance, and takes into account the reputation costs when engaging in earnings management (Beasley et al. 2000). On the other hand, larger firms are also more likely to manage earnings than smaller firms. Big firms faces more pressure to meet the analysts' expectations than small firms and they also have more bargaining power with auditors. Company with high sales growth (SGR) has a positive correlation with earnings management (Hribar et al. 2006). Companies with higher leverage tend to have higher earnings management (Balsam, Krishnan, & Yang 2003). LEV is predicted to have a positive correlation with REM. The same applied to LOSS, companies that report a loss is predicted to have a correlation with increasing real earnings management.

### Real Earnings Management (REM)

Following Roychowdhury (2006) and Chi et al. (2011), we use real earnings management at aggregate level (REM), i.e., the sum of

standardized abnormal Cash Flow of Operation (CFO), standardized abnormal production, and standardized abnormal discretionary expenses. To find real earnings management at aggregate level are, first, we determine the average normal values from CFO, production cost, and discretionary expenses variables. Then find the abnormal values of each individual level REM, i.e., from the actual values of each variable using their fitted values obtained from the OLS equation. Each specific model was regressed using the linear regression with SPSS ver. 20 software.

To obtain abnormal operating cash flows, first, we use equation (2) to find normal cash flow from operations (CFO) as a linear function of sales and changes in sales in the current period (Dechow, Kothari, & Watts 1998), as follows:

$$CFO_{it} / A_{it-1} = k_1 [1/A_{it-1}] + k_2 [Sales_{it}/A_{it-1}] + k_3 [\Delta Sales_{it}/A_{it-1}] + \varepsilon_{it}$$

(2)

Where:

CFO = cash flow operation

Sales = net sales

$\Delta$  Sales = changes in net sales, calculated from

net sales in year t minus net sales in year t-1

A = total assets

$\varepsilon$  = residual error

Subscript i,t = identification of firm i and year t

From equation (2), we obtain abnormal operating cash flow (ACFO) i.e., the difference between actual operating cash flows less the fitted value from normal operating cash flows calculated using estimated coefficients from equation (2), or a standard error from the regression equation (2). Second, we obtain abnormal discretionary expenses (ADEXP) from equation (3), i.e., the actual value of the operating costs deducted by the fitted value of the estimated coefficient of the normal level of discretionary expense derived from equation (3), or using a standard error from the regression equation (3).

$$DISEXP_{it}/A_{it-1} = k_{1t} [1/A_{it-1}] + k_2 [Sales_{i,t-1}/A_{it-1}]$$

+  $\varepsilon_{it}$

(3)

DISEXP

Sales

A

$\varepsilon$

Subscript i, t = identification of firm i and year

Where:

= discretionary expense

= net sales

= company's total assets

= residual error

t.

Third, to obtain abnormal levels of production cost (APROD), we got from the difference between actual production costs less fitted value calculated using estimated coefficients from equation (4).

$$PROD_{it}/A_{it-1} = k_{1t} [1/A_{it-1}] + [k_2 Sales_{it}/A_{it-1}] + k_3 [\Delta Sales_{it}/A_{it-1}] + k_4 [\Delta Sales_{i,t-1}/A_{it-1}] + \varepsilon_{it} \quad (4)$$

Where:

Prod = production costs, which is cost of

goods sold plus the change of inventories in the current year

Sales = net sales

$\Delta$  Sales = change in net sales in year t, and t-1, respectively calculated from net sales in year t (t-1) reduced with net sales in year t-1 (t-2)

A = total assets

$\varepsilon$  = residual error

Subscript i,t = identification of firm i and year t

Finally, to find the REM index at aggregate level, we have to sum those three variables which have been standardized. The standardized value of each variable ACFO, APROD, and ADEXP can be calculated with the formula = (variable – variable mean) / standard deviation (Chi et al. 2011). The REM index are then calculated by the sum of – (standardized ACFO) + (standardized ADEXP) + (standardized APROD) (Chi et al. 2011; Herusetya 2012).

#### Assessment of the Effectiveness of the Board of Commissioner (BOCScore) and Audit Committee (ACScore)

Board of commissioner is one of the corporate governance elements that functioned to ensure all management actions are for the company's best interest. Based on theory of the board of commissioner and previous studies, the characteristics of board can affect the quality of financial statements measured by earnings management (Hermawan 2011).

To test our hypothesis (H1 and H2), we follow Hermawan (2011) to calculate the score of effectiveness for the board of commissioners and audit committee. The checklist for the effectiveness of the board of commissioner (BOCSCORE) and audit committee (ACSCORE) is provided in Appendix 1 and 2. Each question is assigned with the score of 3, 2, or 1 if the assessment of corporate governance mechanism is good, fair, or poor respectively. The final score of the board of commissioners and audit committee is the total sum of each characteristics based on the checklist. We use 17 questions to assess the effectiveness of board of commissioners, and if the total number of score is 34 or more, we can conclude that the board of commissioners function effectively in monitoring the financial reporting function and management strategies within the firm. This indicates that on average each characteristic on the lists has the value of 2 (Fair). For a complete description on how to operationalize the score of board of commissioners and audit committees effectiveness, please see Hermawan (2011). Thus, BOCSCORE is a dummy variable, given 1 if the score of board of commissioners is equal or more than 34, and 0 if otherwise. The same procedure can be applied in the assessment on how effective the audit committee function in the firm. ACSCORE is a dummy variable, given 1 if the total score of audit committee is equal or more than 22, and 0 if otherwise.

## **RESULTS**

### **Descriptive Statistics and Correlation**

Descriptive statistics and correlation matrix for all variables of main model are presented in Table 3 and Table 4. In Table 3, the variables have a relatively small standard deviation. Mean of REM in aggregate level is -0.008 or less than -

1 percent, represented that on average the public companies involved in real earnings management with the amount of less than -1 percent from total assets. This indicates that even though the aggregate level of REM is quite small, but the company can engage in real activities in the individual level whether in abnormal operating cash flows, abnormal production, or abnormal discretionary expenses<sup>1</sup>. Mean of BOCSCORE and ACSCORE are 0.61 and 0.86 from the scale of 1, respectively. These indicate that on average the board of commissioners and audit committee have scores above the value for Fair assessment respectively.

The variables in correlation matrix (Pearson Correlation) presented in Table 4<sup>2</sup>. In Table 4, BOCSCORE has a negative correlation towards REM variable with the significance level of 1 percent ( $\rho = -0.143$ ), consistent with our previous prediction. ACSCORE has a positive correlation towards REM variable but not significant. Both BIG4 and SGR variables have negative correlations towards REM, significant at 1 percent and 5 percent, respectively. LEV has a positive correlation towards REM with significance level of 5 percent. Other control variables such as LOSS and SIZE do not have significant correlations with REM.

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<sup>1</sup> Mean of individual REM, i.e., abnormal CFO, abnormal production, and abnormal discretionary expenses are -0.9 percent, 13.09 percent, and -15.11 percent respectively.

<sup>2</sup> The correlations among variables do not indicate multicollinearity problem, because the correlation between variables are under 0.80 (Nachrowi & Usman 2006).

**Table 3:** Descriptive Statistics

Variables	Mean	Minimum	Maximum	Std. Deviation
REM	-0.008	-7.452	10.825	2.312
BOCSCORE	0.610	0.000	1.000	0.489
ACSCORE	0.860	0.000	1.000	0.346
BIG4	0.360	0.000	1.000	0.480
LEV	0.540	0.037	3.081	0.435
LOSS	0.140	0.000	1.000	0.351
SIZE	27.765	32.997	32.997	1.887
SGR	0.160	3.533	3.533	0.160

**Variable Definition:**

REM is real earnings management at aggregate level proxied by ACFO, ADISEXP, APROD which are the value of abnormal cash flows from operation, abnormal discretionary expenses, and abnormal production cost, each scaled by total asset t-1 which were calculated using estimation model of real transactions from Roychowdhury (2006). BOCSCORE is dummy variable, equals 1 if the board of commissioners effectiveness score of company is greater than or equal to 34, 0 if otherwise. ACSCORE is dummy variable, equals to 1 if the audit committee effectiveness score is greater than or equal to 22, 0 if otherwise. BIG4 is dummy variable, equals 1 if auditing firm is affiliated with the Big Four firms, 0 if otherwise. LEV is ratio of total debt to total assets. LOSS is dummy variable, equals 1 if company i at year t has a net loss, 0 if otherwise. SIZE is natural logarithm of total assets. SGR is the sales growth for one year, calculated by (Sales t – Sales t-1)/Sales t-1

**Hypothesis Testing Results**

The purpose of our main model is to test hypothesis 1 (H1) i.e., the negative influence of the effectiveness of board of commissioner toward the real earnings management, and hypothesis 2 (H2) i.e., the negative influence of the effectiveness of audit committee toward real earnings management. Results from hypothesis testing are presented in Table 5 with F-test= 4.678 significant at 1 percent. We found that R-squared and adjusted R-squared of the main model (equation (1)) is 11.5 percent and 9.1 percent, respectively.

***The Influence of Board of Commissioners toward Real Activities***

From Table 5, the results show that the coefficient of BOCSCORE has a negative association with REM ( $\alpha_1 = -0.665$ , t-stat = -2.13) significant at 5 percent with two-tailed test. This finding is in line with our early prediction. These findings give an interpretation that governance mechanism through an effective board of commissioner can reduce real earnings management or real activities manipulation in aggregate level. In other words, the higher the score of the board of commissioners, the lower the real earnings management practices. We interpret that the board of commissioners function effectively in controlling the corporate strategy and financial reporting in the firm including the practices of real activities to manage earnings upward that might threads the earnings quality of the firms.

Correlations among Variables

<b>REM</b>	<b>BOCSORE</b>	<b>ACSCORE</b>	<b>BIG4</b>	<b>LEV</b>	<b>LOSS</b>	<b>SIZE</b>
1.000						
-0.143***	1.000					
0.020	0.297***	1.000				
-0.225***	0.294***	0.162***	1.000			
0.110**	-0.242***	-0.182***	-0.161***	1.000		
0.031	-0.153***	-0.115**	-0.101*	0.474***	1.000	
0.045	0.323***	0.151***	0.495***	-0.125**	-0.109**	1.000
-0.104**	-0.004	-0.003	0.087*	-0.026	-0.061	-0.003

ificance at the 1 percent, 5 percent, and 10 percent level for two-tailed test respectively. All variables are defined as in Table 2.

These findings also give interpretation that the board of commissioners also monitored real activities in the individual level in terms of sales manipulation, overproduction, and reduction of discretionary expenses to increase earnings. Our evidence support the previous researches such as Fama & Jensen (1983), Shivadasani (1993), Beasley et al (1996), Xie et al. (2001), and Hermawan (2011), which shows that the effectiveness of the board of commissioner has influence to minimize the real earnings management practices. So our hypothesis of H1 is accepted.

**The influence of Audit Committee toward Real Activities**

In Table 5, we find that the coefficient ACSCORE is not significant at 10 percent with

two-tailed test ( $\alpha_2 = 0.577$ , t-stat = 1.392). Our results are still mixed. Thus, hypothesis H2 is rejected. Hermawan (2011) for example, found that the effectiveness of audit committee does not affect the informativeness of earnings, but further analysis indicates that when the board of commissioner is not effective in its role then the audit committee will function effectively and give positive impact to the informativeness of earnings. Our results also in line with Hermawan and Adinda (2012) who did not find any evidence that the existence of audit committee has significant effect on the Stated-Owned Enterprises' earnings quality. Our alternative explanation of these results are probably that the audit committee roles is subsumed by the effectiveness function of the board of commissioners.

**Table 5:** Hypothesis Testing Results

$$REM_{it} = \alpha_0 + \alpha_1 BOCSCORE_{it} + \alpha_2 ACSCORE_{it} + \alpha_3 BIG4_{it} + \alpha_4 SIZE_{it} + \alpha_5 LEV_{it} + \alpha_6 LOSS_{it} + \alpha_7 SGR_{it} + \epsilon_{it}$$

Independent Variables	Dependent variable: REM				
	Prediction	Coefficient	t-statistic	Sig.	VIF
(Constant)		-7.573	-3.278	0.001	
BOCSCORE	-	-0.665**	-2.130	0.034	1.262
ACSCORE	-	0.577	1.392	0.165	1.120
BIG4	+	-1.423***	-4.251	0.000	1.388
LEV	+	0.455	1.251	0.212	1.360
LOSS	+	-0.199	-0.450	0.653	1.300
SIZE	+/-	0.282***	3.322	0.001	1.394
SGR	+	-0.519	-1.320	0.188	1.015
R-squared	0.115				
Adj. R-squared	0.091				
F-test	4.768				
Sig. F	0.000				
n	265				

\*\*\*, \*\*, \* denote significance at the 1 percent, 5 percent, and 10 percent level for two-tailed test respectively. All variables are defined as in Table 2.

**CONCLUSION**

We investigate the effectiveness of board of

commissioner and audit committee toward real earnings management or real activities manipulation. Our samples are taken from

manufacturing companies that listed in Indonesia Stock Exchange (IDX). With total samples of 265 firm-year observations during the year of 2011-2013, we find evidence that the effectiveness of the board of commissioner has a negative influence on real activities manipulation or real earnings management, consistent with prior researches (e.g., Xie et al. 2001; Hermawan 2011).

We find no evidence that audit committee effectiveness has negative influence on the real earnings management. We interpret that the function of audit committee as part of the internal corporate governance mechanism is subsumed by the function of the board of commissioners (Hermawan 2011; Hermawan & Adinda 2012). Overall, our study find some evidence that the effectiveness of corporate governance mechanism can reduce real transaction manipulation or earnings management practices in Indonesia.

We suggest further studies to explore the role of board of commissioner and audit committee with a case study approach or by direct survey, so that we can directly observe the monitoring activities of the board of commissioners and the audit committee in a company and capture the characteristics that influence the effectiveness of board of commissioner and audit committee. Our study only measured real earnings management practices on the operational activities. In fact, real activities can be classified into operational, investment and finance activities. Future studies are expected to study real activities in investment and finance activities.

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## APPENDIX

### Appendix 1: Score of Effectiveness of Board of Commissioners

No.	Description	Good	Fair	Poor
A.	Board Independence			

1	<p>Among board of commissioners, how many are independent commissioners?  <i>If more than 50% of the board is independent, the company will be given a 'good' score. Firms with 30% to 50% of the board made up of independent commissioners will earn a 'fair' score. If less than 30% of the board is independent, or no information, the company will earn a 'poor' score.</i></p>			
2	<p>Is the chairman an independent commissioner?  <i>If the chairman is an independent commissioner, the firm will earn a 'good' score and 'poor' score otherwise or if no information.</i></p>			
3	<p>Does the company state in its annual report definition of independence?  <i>Firms with a clear definition of independence in the annual report will earn a 'good' score. A 'poor' score will be given if the company does not define independence or if no information.</i></p>			
4	<p>Among board of commissioners, how many are employees of shareholders or affiliated companies owned by shareholders?  <i>If there is more than 50% of the board, or no information, the company will be given a 'poor' score. If there is 30% to 50% of the board, the firm will earn a 'fair' score. If less than 30% of the board, the company will earn a 'good score'</i></p>			
5	<p>Does the company have a nominating committee and remuneration committee?  <i>Firms that have both committees will earn a 'good's score. Firms that have at least one of the two committees will earn a 'fair' score. A 'poor' score will be given to the company that does not have any of these committees or if no information.</i></p>			
6	<p>What is the average years the Board of Commissioner's tenure?  <i>If the average tenure of the board is less than 5 years, the company will receive a 'good' score. If the average tenure of the board is between 5 and 10 years, the score is 'fair' and if the average tenure is more than 10 years, the score will be 'poor'.</i></p>			
<b>B. Board Activities</b>				
7	<p>Does the company clearly describe the board responsibilities?  <i>If the board responsibilities are clearly stated and disclose, the firm will receive a 'good' score. Company that has not defined board responsibilities or no information will earn a 'poor' score.</i></p>			
8	<p>How many meetings were held during the year?  <i>If the board meets more than six times, the firm earns a 'good' score. If 4-6 meeting, the firm is scored as 'fair' while less than four times or no information scored as 'poor'.</i></p>			
9	<p>What is attendance performance of the board members during the year?</p>			

	<i>If the overall board attendance for the year is greater than 80%, the firm earns a 'good' score. If attendance is 70-80% receives a 'fair' score, and less than 70% or no information receives a 'poor' score.</i>			
10	Does the company have a separate board of commissioner's report describing their responsibilities in reviewing firm's financial statement? <i>Firms will receive a 'good' score if they produce a board of commissioner's report as part of the annual report. A score of 'poor' will be awarded if there is no report from the board or no information.</i>			
11	Does the BOC conduct annual performance assessment of the BOD? <i>If the board evaluates the performance of the top executive officer, the company received a 'good' score and 'poor' score otherwise or no information.</i>			
12	Does the board conduct assessment of the business prospects prepared by the BOD? <i>If the board assess the business prospects, the company received a 'good' score and 'poor' score otherwise or no information.</i>			
<b>C. Board Size</b>				
13	What is the size of the board of commissioner? <i>A 'good' score will be given to firm with 5-10 board members. Firm with board size of 11-15 members received a 'fair' score. Boards with size of 16 or more or less than 5 members, or no information will receive a 'poor' score.</i>			
<b>D. Board Expertise and Competence</b>				
14	Does the board member have a sophisticated knowledge about accounting and finance? <i>If there is more than 50% of the board has the knowledge, the company will be given a 'good' score. If there is 30% to 50% of the board, the firm will earn a 'fair' score. If less than 30% of the board, or no information, the company will earn a 'poor' score.</i>			
15	Does the board member have sufficient experience about business (i.e. has the experience as the member of the board commissioners in any company including this company or as a CEO in other company)? <i>If there is more than 50% of the board has the experience, the company will be given a 'good' score. If there is 30% to 50% of the board, the firm will earn a 'fair' score. If less than 30% of the board, or no information, the company will earn a 'poor' score</i>			
16	Does the board member have a sophisticated knowledge about the company's business? <i>If there is more than 50% of the board member has the knowledge, the company will be given a 'good' score. If there is 30% to 50% of the independent board member, the form will earn a 'fair' score. If less than 30% of the independent</i>			

	<i>board member, or no information, the company will earn a 'poor' score.</i>			
17	What is the average age of the board? <i>If the average age of the board is more than 40 years old, the company will receive a 'good' score. If the average age of the board is between 30 and 40 years old, the score is 'fair', and if the average age is below 30 years old, the score will be 'poor'.</i>			
	<b>TOTAL SCORE</b>			

Source: Hermawan (2011)

**Appendix 2: Score of Effectiveness of Audit Committee**

No.	Description	Good	Fair	Poor
<b>A. Audit Committee Activities</b>				
1-5	Assess the responsibilities fulfilled by the audit committee during the year, include the following items: <ol style="list-style-type: none"> <li>1. Evaluating internal control</li> <li>2. Propose auditor</li> <li>3. Financial report review</li> <li>4. Evaluating legal compliance</li> <li>5. Prepare a complete audit committee report for disclosure.</li> </ol> <i>In each category, if the responsibility is fulfilled, firms will received a 'good' score. If the responsibility is not fulfilled, or no information, the company will receive a 'poor' score.</i>			
6	<i>How many meetings held during the year?</i> <i>If the audit committee meets more than six times, the firm will earn a 'good' score. If 4-6 meeting, the firm will earn a 'fair' score, while less than four times or no information will be scored as 'poor'.</i>			
7	What is attendance performance of the audit committee member during the year? <i>If the overall audit committee attendance for the year is greater than 80%, the firm earns a 'good' score. If attendance is 70-80% receives a 'fair' score, and less than 70% or no information receives a 'poor' score.</i>			
8	Does the audit committee evaluate the scope, accuracy, cost effectiveness, independency and objectivity of external auditor? <i>If the audit committee evaluates all of the items, the firm has a 'good' score, If only some part of the items was evaluated, the score will be 'fair'. And if none of the items was evaluated, the score will be 'poor'.</i>			
<b>B. Audit Committee Size</b>				
9	What is the size of the audit committee? <i>If there are 3 people in the audit committee the score will be 'fair', and if there is more than 3 person in the audit committee, the score will be 'good'. If there is no information, the score will be 'poor'</i>			
<b>C. Audit Committee Expertise and Competence</b>				

10	<p>Does the audit committee have an accounting background?</p> <p><i>If the company has more than 1 person with accounting background, the firm will earn a 'good' score. If the company has only 1 person with accounting background, the firm earns a 'fair' score, and if none has accounting background or no information, the score will be 'poor'.</i></p>			
11	<p>What is the average age of the audit committee?</p> <p><i>If the average of the audit committee is more than 40 years old, the company will receive a 'good' score. If the average age of the audit committee is between 30 and 40 years old, the score is 'fair' and if the average age is below 30 years old, the score will be 'poor'.</i></p>			
<b>TOTAL SCORE</b>				

Source: Hermawan (2011)

## **DETERMINANT OF EXTERNAL AUDIT FEE ON PUBLIC CORPORATES IN INDONESIA**

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### ***ABSTRACT***

*This study aims to examine the variables that can affect the external audit fee. Corporate governance should be monitored and controlled to ensure that the governance is done by full compliance with the applicable rules and regulations. The existence of these variables are expected to reduce and control the risk, so that external audit fees will be lowered. The number of corporates sampled in this study were 65 corporates. This study used purposive sampling method and a multiple linear regression analysis. The test results showed that the variable of the independence of audit committees and internal audit have negative significant effect on the audit fee, the variable of audit committee size has negative significant effect on the audit fee, and the intensity of the audit committee meeting has no positive significant effect on the audit fee.*

**Keywords:** *Audit, internal audit, external audit fees, corporate banking*

## **ETHICAL AND LOVE OF MONEY: FRAUD PERCEPTION STUDY ANALYSIS**

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### ***ABSTRACT***

*Recently, the accounting profession is facing many issues which are related to fraud. Enron, WorldCom, and Tyco are the reason behind the birth of the Sarbaney-Oxley Act (SOA), which impose the accountant and auditor obligation over the financial statements. The regulation is being followed by many governments around the world, including Indonesia which enforce UU Akuntan. But the scandals do not stop. American Insurance Group, PT. Kereta Api Indonesia, Tesco, and Toshiba are the current examples of the accounting scandals. The ethics of the accountant then being questioned. The purpose of this study is to investigate the relation between the ethics and the love of money that can drive the fraud, along with the age and gender as other factors.*

*Love of Money is measured using Money Ethic Scale (MES) from Tang (1992) and ethical perception being observed by using four scenarios related to fraudulent act in accounting practices from Elias and Farag (2010). The research method of this study is Path Analysis with decomposition model. The sample of this study consist of 150 accounting students from bachelor and master program, determined by purposive sampling.*

*The result found that there was a positive correlation for gender and love of money to respondents' unethical perception. In this study, male tended to have better ethical perception. Also, this study found that the higher respondents' level of love of money, the higher probability for them to behave unethically.*

**Keywords:** *love of money, age, gender, ethic, ethical perception, fraud*

### **INTRODUCTION**

Recently, the accountant profession is facing many issues which are related to fraud. Enron (2001), WorldCom (2002) Tyco (2002) are accounting scandals happened. The Sarbanes-Oxley (SOX) Act, held by U.S. Congress in July 2002, is a crucial step that will lead to the rules and code of ethic improvemalrest. But fraud actions still happened. American Insurance Group (2005), PT Kereta Api Indonesia (2006), Tesco (2014) and Toshiba (2015) scandals are the example of the most current issue. Therefore, it cannot be denied that the reliability of accountant profession has been declined.

Ethical perception of accountant has become one of most interesting research materials in order to examine what factors that will reduce fraud. This research is conducted to examine the ethical perception of accounting students in Indonesia. Individual behavior is derived from external and internal factors. External factors are factors which come from outside of the individual (cultures, economic and social factors) and internal factors come from the individual itself (knowledge, perception, etc.)

Perception is the way someone look at something and believe that it is the right things to do. Based on expectancy theory, perception can be the basis of someone's motivation to

perform some actions. Money is believed to become an important motivator. In the business, managers frequently use money to control and motivate employees (Milkovich and Newman, 2002). Money is an important aspect of everyday life. Although the money is used universally, the meaning and importance of money is not universally accepted (McClelland, 1967 in Tang, 1992).

Love of money can be explained literally as the individual perception about money; how they respect money. Based on T. L P Tang & Chen (2008) and Elias & Farag (2010), love of money has direct impact related to personal unethical behavior. Money ethics scale (MES) developed by Tang (1992) to measure the individual's love of money.

This research are closely related with Elias & Farag (2010) study with exogenous variable age and gender. The population of this research is undergraduate and graduate accounting students in Universitas Padjadjaran.

## **THEORITICAL FRAMEWORK AND HYPOTHESES DEVELOPMENT**

### **Ethical Perception**

Ethics is derived from Ancient Greek word *ethos*, which means habits or guiding beliefs of person, group, or organization. KBBI (Kamus Besar Bahasa Indonesia) said that ethic is personal knowledge of what is good and bad; while Oxford Dictionary said that it is rules of behavior based on ideas about what is morally good and bad.

Perception is the process of how someone process and organize incoming data in order to form a coherent model which the person could use to solve naturally occurring problems (Hilgard, 2009). Personal perception comes from the process of recognizing situations or problems using five senses. Perception development is an activity-dependent process which is differed for one from another. Normal perception development is affected by nature and nurture factors. The perception about what is right to do (right/wrong) – ethical perception – may differ for each person based on the perceptual learning

along with their life experience. Similar event may be interpreted differently for each person, depends on any distraction or bias in analyzing the event.

### **Love of Money**

Love of money is the new concept from Tang (1992), relates to perception about money, which underlie several desirable and undesirable organizational behaviors, such as employees turnover and job satisfaction (T. L.-P. Tang, Kim, & Tang, 2000). This perception is associated with the concept of “greed” (T. L P Tang & Chiu, 2003) and has been argued that it will lead to unethical behavior (Chen & Tang, 2006).

### **Age and Love of Money**

Furnham (1984) explained that older people have more appreciated their effort and ability (more ethical) to earn money rather than younger ones. Children usually have no idea about the family's financial condition. Parents believe that those are their responsibilities and should not be disclosed to their children. This condition leads younger people to use the money as a means of power and less careful with their money, less able to secure money. In contrast, older people tend to be very conservative and retentive about money.

Based on the explanation above, the hypothesis defined as follows :

*H1 : There is a direct correlation between age and love of money.*

### **Gender and Love of Money**

Furnham (1984) also found that there are differences between male and female according to their perception towards money. The different perception comes from the culture, where male who earns money for the family and female is the one who manage the money for family expenditures. Therefore, female tend to feel inadequate about how much money they possess. This condition also shapes female to be more traditionalist, retentive and precautious in maintaining safety their money rather than male.

Based on the explanation above, the hypothesis defined as follows :

*H2 : There is a direct correlation between gender and love of money.*

#### **Age and Ethical Perception**

Kohlberg's theory explained the moral development is a growing process. There are three big stages of ethical development process (preconventional, conventional, and post-conventional) which are invariant and cannot be bypassed. Gibson's Theory explained that the ethical development is influenced by nature (sense analysis) and nurture (event) in their lives. The increasing in age will also increase the experience (event) happened in people's life. People will have more adequate ways of solving problems in line with the increasing of age.

Based on the explanation above, the hypothesis defined as follows :

*H3 : There is a direct correlation between age and ethical perception.*

*H4 : There is an indirect correlation between age and ethical perception through love of money.*

#### **Gender and Ethical Perception**

Gilligan's theory explained in depth the differences of moral development in males and females. Males are relatively more "fair" and females are relatively more "care". Under ethics of fair, males judge themselves guilty if they do something wrong; under ethics of care, females believe that it is their responsibility for not do something that would hurt others. Individual rights, equality before the law, fair play are the form of ethics of fair. Sensitivity to others, loyalty, self-sacrifice are the form of ethics of care. The difference in ethical perception between genders come from females's femininity identity that needs relationship.

Based on the explanation above, the hypothesis defined as follows :

*H5 : There is a direct correlation between gender and ethical perception.*

*H6 : There is an indirect correlation between gender and ethical perception through love of money.*

#### **Love of Money and Ethical Perception**

Tang & Chiu (2003) theorized that the love of money's construct was strongly related to the concept of "greed". Tang & Liu (2012) also found that it is not the income (money), but the motive (love of money) that cause the dissatisfaction with income which leads to unethical behavior of employees. In business environment, they also found the direct path between the love of money and unethical behavior among employees in Hong Kong. In the academic environment, Tang & Chen (2008) has examined that love of money is directly related to unethical behavior of business and economic students, especially for male students.

Based on the explanation above, the hypothesis defined as follows :

*H7 : There is a direct correlation between love of money and ethical perception.*

### **RESEARCH DESIGN**

#### **Variable Operationalization Ethical Perception**

The endogenous variable in this study is ethical perception of accounting students. The ethical perception in this study is determined from individual's view to accounting fraud that is occurred (Elias & Farag, 2010). In order to measure ethical perception, this study uses the scenarios applied by Elias (2010), consist of four scenarios of fraudulent act.

■ Scenario 1 deals with early recognition of revenues (an example of earnings management).

■ Scenario 2 deals with classifying long-term marketable securities as current, to improve the current ratio.

■ Scenario 3 deals with including some of the consigned inventory as assets.

■ Scenario 4 deals with not reporting contingent liabilities (a violation of the conservatism principle).

This study using Likert Scale, ranging from 1 (strongly agree) to 5 (strongly disagree) because this scale is more common in Indonesia,

so it will help respondents to make a choice easier.

**Age**

Based on Ford & Richardson (1994) and Treviño & Youngblood (1990), age is one of demographic factors which affects ethical perception of people. Even so, there is no specific measurement of age grouping. In this study, age will be in ratio scale.

**Gender**

There is no specific measurement to measure the gender factor. In this study, gender will be determined as dummy variables to separate male and female; male is 0 and female is 1.

**Love of Money**

Love of money measures the value of individual's desire to money, although not for their mutual needs (Arocas & Tang, 2004). In this research, love of money will be measured by using Money Ethics Scale (MES) which is developed by Tang (1992). MES is regarded as the best developed survey to measure individual's attitude towards money; contains 30 items of question which resulted in 6 indicators (good, evil, achievement, respect, budget, and freedom) with regard to the love of money. This study uses Likert Scale, ranging from 1 (strongly agree) to 5 (strongly disagree).

**Population and Sample**

Population in this research is undergraduate and graduate accounting students in Universitas Padjadjaran. Samples are determined using purposive sampling of each grade level students. There are 150 questionnaires distributed. The composition of samples are as follows:

*Table 1 – Respondent (Sample)*

	Batch	Number of Students	Prop or tion	Number of Samples
Under-graduate	2012	206	25%	37
	2013	167	20%	30

	2014	110	13%	20
	2015	127	15%	23
Graduate	2014	222	27%	40
	2015			
Total		832		150

**Source: Research Data**

**RESULTS**

**Descriptive Analysis**

Samples consist of 110 undergraduate students (S1) and 40 graduate students (S2), while there are 65 male and 85 female students whose age are from 17 until 49 years old.

**Table 2 Descriptive Analysis**

	n	Mean	Max	Min	Standard Deviation
<b>Ethical Perception</b>					
Men	65	9.05	16	4	2.509
Women	85	9.73	20	4	3.080
<b>Love of Money</b>					
Men	65	83.31	115	64	10.373
Women	85	83.04	114	58	10.527

**Source: Research Data**

Table 2 presents the difference in ethical perception between male and female students. We can see that females students has mean value of 9.73, which is higher than male student's mean value (9.05). This may indicate that in term of ethical perception, females tend to be more unethical rather than males. Table 2 also indicates a difference level of love of money between male students (mean = 83.31) and female students (mean = 83.04). As we can see, the male students' love of money is higher than female students.

This study also found that for scenario related to changes the earnings directly (scenario 1 and 3), students have better answer (tend to aswer disagree) rather than scenario that not changes the earnings (scenario 2 and 4). Also, undergraduate students have better ethical perception than graduate students.

**Hypothesis Testing – Path Analysis**

**Sub Structure 1 Age (X1) and Gender (X2) on Love of Money**

**Table 3 Coefficient of Sub-Structure 1**

	Beta	T	Sig.
Constant		15.357	0.000
X1	-0.035	-0.417	0.677
X2	0.012	0.144	0.886

Source: Research Data

**Table 4 - Direct & Indirect Effect - Age & Gender to Love of Money**

Variable	Beta	In-direct			Total
		Direct Effect (Beta <sup>2</sup> )	Effect, through(%)	In-direct	
Age	-0.035	0.12	-	0.01	0.12
Gender	0.012	0.01	0.01	-	0.02
Total					0.14

Source: Research Data

As we can see from the Table 3, path coefficient (Beta) for X1 (age) to Y (love of money) is -0.035 and X2 (gender) to Y (love of money) is 0.012. The R Square for this model is 0.14% and the Ftest is 0.107, with the 0,899 significance level. It implied that the age and gender do not significantly affect the love of money.

**Sub Structure 2 Love of Money (Y) on Ethical Perception (Z)**

**Table 5 Coefficient of Sub-Structure 2**

	Beta	T	Sig.
Constant		4.484	0.000
Y	0.139	1.711	0.089***

Source: Research Data

As we can see from the Table 5, path coefficient (Beta) for love of money (Y) to ethical perception (Z) is 0.139. Total influence of love of money to ethical perception is 1.9% (R-square). This result implied that the love of money affected the ethical perception significantly.

**Sub Structure 3 Age (X1) and Gender (X2) on Ethical Perception (Z)**

**Table 6 Coefficient of Sub-Structure 3**

	Beta	T	Sig.
Constant		6.126	0.00
X1	0.110	1.339	0.18
X2	0.135	1.647	0.10***

Source: Research Data

**Table 7 - Direct & Indirect Effect - Age & Gender to Ethical Perception**

Variable	Beta	Direct Effect (Beta <sup>2</sup> )	In-direct Effect, through(%)		Total Effect (%)
			Age	Gender	
Age	0.110	1.21	-	-0.19	-0.19
Gender	0.135	1.83	-0.19	-	-0.19
Total					0.14

Source: Research Data

As we can see from the Table 6, path coefficient (Beta) for age (X1) to ethical perception (Z) is 0.110 and gender (X2) to ethical perception (Z) is 0.135. Total influence of age and gender to ethical perception is 2.7% (R-Square).

Based on Table 8, we can see sig. value of X1 is 0.183 and sig. value of X2 is 0.102. Then, we can conclude that, partially, age (X1) does not significantly affect the ethical perception but gender (X2) significantly affects the ethical perception (significance level is at 10%).

**Decomposition Model**

**Table 8 Coefficient of Sub-Structure 3**

	Beta	T	Sig.
Constant		2.451	0.01
X1	0.115	1.407	0.16
X2	0.113	1.638	0.10***
Y	0.118	1.747	0.08***

Source: Research Data

We can conclude the direct and indirect effect of each exogenous variable as follows:

- Age (X1) does not significantly affect ethical perception (Z) through love of money (Y); as described in Table 8, the p-value (sig.) is 0.161.
- Gender (X2) significantly affects ethical perception (Z) through love of money (Y); as described in Table 8, the p-value (sig.) is 0.10.

## **DISCUSSION**

### **Age to Love of Money**

The Path coefficient of age to love of money is negative, which is -0.035. This negative path coefficient prove that the older people, the less they love money. Age is one of demographic factor that affects personal perspective. Furnham (1984) explains that older people are more appreciate effort and ability to receive money than younger ones. This X1 : Age; X2 : Gender; Y : Love of Money; Z : Ethical Perception condition comes from the fact that older people do not explain clearly how much is their effort to get money. This condition will shape a better perception of how older people value the money rather than younger people. Younger people use the money as a means of power, less careful and less retentive with their money. Therefore, it can be concluded that older people (especially worked people) will have a better perception towards money.

### **Gender to Love of Money**

The path coefficient of gender to love of money is 0.012. From this study, the path coefficient confirms that female students have higher love of money than male students. This result is in accordance with the psychological studies of Furnham (1984). there are differences between males and females according to their perception towards money. The different perception comes from the culture, where males are the one who is responsible to earn money for the family and females are the one who manages the money. The role differences develop different perspective towards money. Females tend to be more traditionalist, retentive, and precautions toward money than males. This result is consistent with Furnham (1984), where females are more precautions and better in maintaining (keep) their money, which will lead them to have higher love of money than males.

### **Age to Ethical Perception**

The path coefficient of age to ethical perception is 0.115. It indicates older people tend to be more unethical rather than younger ones. According to Gibson's Theory about perception developmallest, the ethical developmallest is influenced by nature (sense analysis) and nurture (event) in life. The increasing of

age will also increase the experience (event) happened in people's life. According to Kohlberg's theory, samples in this study are included in the Conventional stage (post-adolescence until adulthood). Kohlberg also explains that most of people end up in this stage which is focusing on how to be approved by others. Common sense (what the community believe as the right to be done) is a must.

The study of Borkowski & Ugras (1992) shows the same result. Comes from Kohlberg's conventional stage reasoning, undergraduate students are more idealistic than graduate students. Undergraduate students believe that what are written in the book or being learned from lecturers are their common sense. While for graduate students, who mostly have practical or job experiences, loyalty – obedience to manager or company's demand become a concern as the right things to be done. Therefore, it is reasonable for younger people to be more ethical compared with older people.

### **Gender to Ethical Perception**

The path coefficient of gender to ethical perception is 0.133, with significant correlation. It means that female students tend to be more unethical rather than male students. Gilligans's theory stated that males are "fair" and females are "care". Under ethics of fair, males judge themselves guilty if they do something wrong; under ethics of care, females believe that it is their responsibility for not do something that would hurt others. Therefore, females will behave in behalf of their parties; they consider the impacts / consequences of their behavior to their coworkers / company. Hence, females will tend to prioritize their parties (in this case is their company), while males prioritize justice and rules enforcement. Then, it is reasonable for males students to be more ethical than females in term of ethical perception.

### **Love of Money to Ethical Perception**

The path coefficient of love of money to ethical perception is 0.141, with Sig. value is 0.083. It means that there is a significant positive correlation between love of money and ethical perception; the higher people's level of love of money, the higher they will behave unethically. Tang & Chiu (2003) explain that love of money was strongly related to the concept of "greed". They also found the direct path between the

love of money and unethical behavior among employees in Hong Kong. Tang & Liu (2012) also found that it is not the income (money), but the motive (love of money) which cause people to behave unethically.

Love of money may cause the dissatisfaction with income which leads to unethical behavior of employees; the more people love money the higher probability of people will be dissatisfied with their income. The higher level of love of money tend to make people to behave more unethically.

## **CONCLUSION AND IMPLICATION**

The purpose of this study is to determine the effect of age, gender, and love of money to ethical perception on accounting students in Universitas Padjadjaran. From this study, only gender and love of money that affect the ethical perception of accounting students. In term of ethical perception, female students tend to be more unethical and the higher students' love of money, the higher probability they will behave unethically.

Considering the fact that this is a very new topic and the research is still rare, hence future research is indispensable. The variables, methods, or population of the study can be expanded. Also, the population can be taken from practical and professional accountants (such as public accountants, governmental accountants, etc.).

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# INFLUENCE OF COGNITIVE MORAL AND LOVE OF MONEY ON UNETHICAL BEHAVIOR AND ACCOUNTING FRAUD TENDENCY: *PANCASILA* AS A MODERATING VARIABLE

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## ABSTRACT

*Phenomenon of accounting fraud that increases in the world, as well as in Indonesia, takes public attention on financial statement reliability. Many studies has examined fraud factors, including concept of Pancasila as an ideology for fraud resistance and moral philosophy in Indonesia. This study aims to analyze moderating effect of Pancasila on relationship between cognitive moral and love of money on unethical behavior and accounting fraud tendencies. Primary data is used using questionnaires that collected in South Sumatera. Sample used are accountants, accounting students who have been worked, professional accounting program students and graduate students as 247 respondents. This study analyzed using Structural Equation Model (SEM) with variance based PLS. The results shows that Cognitive Moral and Love of Money has significant effect on Unethical Behavior but has insignificant effect on accounting fraud tendency. Moreover, Unethical behavior has significant influences on accounting fraud tendency but it does not mediate relationship between Cognitive Moral and Love of Money on accounting fraud tendency. Furthermore, Pancasila does not moderate relationship between Cognitive Moral and Love of Money on Unethical Behaviour.*

**Keyword:** *Cognitive moral, Love of Money, Pancasila, Accounting Fraud Tendency.*

## 1. INTRODUCTION

Fraud and unethical phenomenon both in private and public sectors seems to grow for years, although various efforts to mitigate them both in the world and Indonesia. According Harsanti (2015) in her dissertation entitled Whistleblowing and Fraud in perspective of Theory of Planned Behaviour, the approach of fraud prevention and detection strategies in Indonesia for years merely repressive and less preventative. Recently, various cases of fraud in the world which are done have become the main discussion topic in various media. Results of survey conducted by PWC in 2016 with 6,000 respondents around the world for 24 months, showed that 46% of fraud happens internally rather than externally, meaning that

most of acts of fraud committed by employees of the victim organization. Moreover, results of Integrity survey from KPMG in 2013 which is based on the responses of more than 3500 employees of the United States found that a majority of employees (76%) reported that they find there is something wrong in the previous 12 months.

It is also happen in Indonesia, the survey results PWC (2016), Indonesia is including in developing countries that fraud increased from previous PWC survey, 34% in 2011 to 40% in 2014. Moreover, research of ICW in 2014 using data of law enforcement officers (prosecutors, police and KPK) and ICW network information, there is a trend of increase in number of cases and suspects of

2013 and 2014. In 2013 the number of fraud suspects as 1271 increased to 1328 suspects in 2014. Likewise, the number of cases in 2013 as 560 cases increased to 629 cases with total losses in 2013 as Rp.4,11 trillion to Rp.5,29 trillion in 2014.

The phenomenon of unethical behavior is already ingrained in our nation. Unethical behavior has actually been happening since being in the educational environment. Unethical behavior that occurs varies, ranging from the behavior or actions that are unethical (ethical misconduct) until the case against the law. In Indonesia, there is many ethical scandals in accounting profession that hurt many parties, whether conducted by auditors, company managers, accountants and even civil servant. There is also accountants or auditors influence in some cases. Realizing this issue, Indonesian Accountant Association (IAI) published a code of ethics. Although there has been a code of conduct, but in fact there are still some cases of ethics irregularities committed by accountant lately. Miranda Swaray Gultom, I Wayan Pugeg, Tommy Hendratmo, and Gayus Tambunan is an example of the various accountants who perform deviant acts such thing. They have position in their work and have a chance in behaving unethically.

Many factors that lead fraud occurs, both internal and external. Brass et al. (1998) unethical behavior is caused by two major factors, which are individual factor and organizational factor. Individual factor, for example, consists of locus of control and cognitive moral development which lead to behavior integrity. While organizational factor consists of organization climate, compensation system, codes of conduct, and prevailing norms. According Ludigdo (2012) the most fundamental thing is greediness which is a passion to fulfill the infinite desire (not a requirement) that makes a person take any action. Every human being must have a purpose and needs of each in her life. To achieve the goals or meet their needs, one can use any means, whether honest or dishonest. Therefore, Singleton et al (2006) defines fraud as a strategy to achieve personal or organizational goals and to meet human needs in ways that are not honest.

Accounting fraud is very closely related to ethics. Accounting fraud is an illegal act. Ethics in Indonesia today is effect of economic globalization that causes pressure on the way of thinking in academic, economic, political, social and even cultural aspects of life (Puruhito 2011) in (Ludigdo & Kamayanti, 2012). Unethical behavior and tendency of fraud in financial statement is also caused by attitude and moral responsibility of company. Unethical behavior and tendency of fraud in a company depends on the morality of the management (Gugus et al, 2009).

Misappropriation and fraud and unethical behavior that occurred in Indonesia can not be separated from the world of education today. Education world of education in Indonesia today, especially education in accounting characteristics are influenced from outside, sometimes not in harmony with the values that exist in Indonesia. Accounting education and development of accounting in Indonesia today is still dominated by the positivist paradigm. The development of accounting is still dominated by positive paradigm which is his spirit schools of rationality (Setiawan & Kamayanti, 2012). Accounting and accounting education system to bring the value of secularization which has the characteristics of self-interest that emphasize bottom-line profit and only admit to things that are materialistic (Mulawarman, 2008). Consequences for the education of accountants Indonesia are influenced by the understanding of positivism, rationalism and capitalism above resulted in the phenomenon is not surprising that a lot of fraud involving the accounting profession.

Violations of ethical or unethical behavior that occurs based on various factors such love of money and cognitive moral. Capitalism is very concerned with the increased value of wealth. This affects understanding of importance of money, money has a very important meaning for humans. Working solely for money purpose, will ultimately lead to ethical problems (Fauzi, 2014). Some common belief said that love of money is the root of all evil (Luna-Arocas and Tang, 2004; and (Tang & Chiu, 2003). Money is considered closely related to the concept of greed. (Tang & Chiu, 2003). Ping and Chiu (2003), stated that love of money related to unethical behavior but not

related to income (money). There are several studies showing that higher levels of love of money will have a good ethical judgment/perception according to their level of job satisfaction. This can be seen in research by Luna Arocas and Tang (2005) that examine love of money on ethical considerations have a significant positive relationship.

The other factor that affect unethical behavior is Cognitive moral. As Ramamoorti (2008) stated that behavioral factors are the root of fraud problem. More, Reynolds et al (2007) also stated that moral identity and moral judgement both affect moral behavior. Level of individual cognitive moral will affect person's ability to be ethically or not doing fraud tendencies. Cognitive moral influence ability of an individual solves ethical dilemma. Welton (1994) stated that an individual's ability to resolve ethical dilemma is influenced by the level of cognitive moral. In accounting field, research conducted by Wilopo (2006) found that the higher level of cognitive moral the more likely not to do accounting fraud. Further Shaub et al (1994) stated accounting educators can influence cognitive moral by designing ethical education interventions that would slam accounting students behave in ethical decision making.

According to Forsyth (1980) moral philosophy is controlled by two characteristics of idealism and relativism. Reality on moral philosophy of Indonesian needs our serious attention as a nation. We have Pancasila as moral philosophy, ideology of our nation, and basis for our livelihoods. However, according Ludigdo (2012), the position of Pancasila only as symbol of nationality where an absorption values for everyday life is only symbolic. Links on phenomenon of fraud, ethical problems, and education in Indonesia with existence of Pancasila as philosophy of life is not impossible. Making Pancasila as an ideology to fraud resistance in this country is not impossible, because Pancasila has moral views contained in all its principles. Latif (2011) in Ludigdo (2012) stated Pancasila is identity, personality, morality, and the bow of the safety of the nation. Pancasila has a foundation of strong ontological, epistemological, and axiological. In every

element (sila) has historical justification, rational and actual consistently.

Nowadays, Pancasila such Ivory Tower, Pancasila as state ideology and nationality has no legitimacy and ontology especially when liberalism epistemology has entered into mindset of national scientific (Mulawarman, and Haryono, 2012). Pancasila was never present in practices and technical. Ludigdo (2012) argued that Pancasila can be brought into the realm of various national life media, including professional realm. Asshiddiqie (2011), as recommended on Congress of Pancasila II, efforts to civilizing Pancasila concretely be realized in public life, such as through formulation of a code of ethics and code of conduct as well as the institutionalization of its institutions within government, organizations, NGOs and Enterprises.

Accounting adopted from the West actually can not resolve local problems. The worldview of Pancasila in any situation should be used to build Indonesian accountants personality. Ludigdo (2012) had idea that globalization is a necessity, but Indonesian values should be the cornerstone to enter it. Research on Pancasila values in accounting is mostly conducted by qualitative research, and rarely done empirically. Kamayanti et al (2012) give an opinion on the importance of accounting education based on Pancasila accounting which was revealed in their research that "Ruh" devotion to God, humanity, Indonesianness, unity, and justice will give fundamental consequences on accounting material being taught. Then Setiawan and Kamayanti (2014) stated that through education, it can change the view of prospective accounting profession to balance between the materiality (worldly) and spirituality (hereafter).

Considering this issue, this research is done to analyze the influence of love of money and cognitive moral on unethical behavior and accounting fraud tendency that moderated by Pancasila values. The purpose of this study are; to analyze the influence of cognitive moral and love of money on unethical behavior and accounting fraud tendency; to analyze the influence unethical behavior and accounting

fraud tendency; and to analyze the moderation effect of Pancasila on relationship of cognitive moral and love of money on unethical behavior and accounting fraud tendency.

## **2. Literature and Hypothesis Development**

### **2.1. Agency Theory**

The basic principle of principal-agent theory is the existence of a contract between principal and agent (Jensen and Meckling, 1976). It is basically an effort to maximize profits, every person act in accordance with their own interests and so does agents. In carrying out its functions, agent do not always act to give the best interests for principal.

Agency theory is considered appropriate in describing fraud phenomenon. It is a connector for agent integrity to principal, and is intended to solve two problems that occur in relevant institutions. A problem arises when there is contrary interest or objectives of principal and agent, and when principal have trouble to keep exactly the track what agents do. Both of these problems arise within institution cannot be separated from the opportunistic behavior of agents. At the end the motivation and utilities between agent and principal will be different which can lead to possibility of unethical behavior and accounting fraud tendency committed by agents to the principal resources.

### **2.1. Accounting Fraud Tendency**

Accounting fraud tendency phenomenon seems to grow for years, although various efforts to mitigate either in the world or Indonesia. It is indicated by research PWC, KPMG, and ACFE. Association of Certified Fraud Examiners (ACFE) as one of the associations in the United States categorize fraud in three groups: Fraud Reporting Fraud, Asset Misappropriation, and corruption. Fraud is misstatement occurs from fraud in accounting reporting such as intentionally omit a number or disclosure in accounting report to deceive the report users (IAI, 2001). Moreover, according to Wells (2007), accounting fraud refers to accounting errors were committed intentionally with the intention to mislead readers / users of financial

statements. The purpose of this is done with negative motivation to take advantage of individuals or certain parties.

Fraud also has trickery, using deception regulations for looking for loopholes certain advantages, Albercht (2009) defines it as follows; "Generic term, and embraces all the multifarious means which human ingenuity can devise, which are resorted to by one individual, to get an advantage over another by false representations. No definite and invariable rule can be laid down as a general proposition in defining fraud, as it includes surprise, trickery, cunning and unfair ways by which another is cheated. The only boundaries defining it are those which limits human knavery".

Tendency of fraud can be done in any forms. Wells (2005) stated that misstatement in financial report in form of setting up a higher or lower assets or profit can be done in several schemes that are (1) fraud in assessment of assets, (2) fictitious income, (3) concealing company liabilities and expenditures, (4) difference in income admission, and (5) fraud in revealing financial report information. Furthermore, Indonesian Institute of Accountants (IAI) describes financial statements fraud are: (a) manipulation, falsification or alteration of accounting records or supporting documents; (B) Misstatement of the wrong; (C) One application of the principle of deliberate; and (d) any inaccuracy asset. The explanation above shows that accounting fraud by management can be done using various sources of fraud either forgery or concealment of evidence of transactions, presentation of information and financial reports are not true, or misstatements due to improper treatment of asset.

### **2.2. Unethical Behavior**

Ethics is a science that talks about how and why we follow a certain moral, or how we should take a responsible attitude to deal with various moral (Suseno 1987). Unethical behavior occurs in all areas of society, business, government, education etc. Unethical behavior is something that is difficult to

understand, the answer depends on a complex interaction between the situation and the personal characteristics of the offender.

Unethical behavior is behavior that deviates from the main objectives or tasks that agreed upon (Dijk, 2000). So, unethical behavior should not be morally acceptable to general public because it would be dangerous to others and environment (Beu and Buckley, 2001). In practice unethical behavior has a complex pattern. The complexity symptom of unethical behavior depends on the interaction between personal characteristics with the appearing social phenomena, environmental, and complex psychological factors (Buckley et al., 1998). Therefore, it is sometime difficult to describe the pattern of unethical behavior.

In a previous study noted that unethical behavior consists of abuse of official position, organizational resources, power, and passive behavior towards their position and power (Tang & Chiu, 2003). Dallas (2002) showed that unethical behavior lead to unhealthy climate in workplace and encourage the emergence of accounting fraud tendency (Victor et al, 1993) and interfering performance accountability (Dijk, 2000). As Wilopo (2006) stated unethical behavior regarded as behavior that abuse of office, organizational resources, power, and behaviors that do not do anything in relation to the position and power (Tang & Chiu, 2003). Ethical dilemma often arises when at the same time organization required to increase profit and maximize benefits to be gained consumers through the products. Such circumstances stimulates to unethical behavior and many policies. In practice unethical behavior has a complex pattern.

### **2.3. Love of Money**

Money is something that can not be separated in human life because it is a very important thing. Tang et al. (2005) argues that attitudes toward money are learned through socialization processes established in childhood and maintained through adult life. According to Rubenstein (in Ellias and Farag, 2010) in the United States, a person's success is measured by money and income.

Differences in interpretation of money will eventually find a concept to emerge concept of Tang (2003) which introduced the love of money concept for psychological literature. These concepts are used to measure the person's subjective feelings about money. Luna-Arocas and Tang (2004) summarized the definition of love of money as: 1) measurement of the value of a person, or a desire for money but not their needs; 2) the meaning and importance of money and personal behavior of someone with money.

Later Tang, Chen and Sutarso (2008) defined love of money as a person's behavior toward money; one's understanding of money; one's desires and aspirations of money. Love of money has several meanings. Concept of love of money is related to the concept of greed (Tang & Chiu, 2003). Tang & Chen (2008) examined positive attitude, negative attitude, strength, money management, rewards, and money that was measured in Money Ethic Scale (MES). MES concept is used to measure a person's subjectivity against money.

### **2.4. PANCASILA**

Pancasila as state ideology and nationality has no legitimacy and ontology especially when liberalism epistemology has entered into mindset of national scientific (Mulawarman, and Haryono, 2012). Pancasila was never present in practices and technical. Pancasila values is reduced discharged on behalf of internasionalization accounting to ease the way liberalism and free markets. Pancasila which is ideology of nationality has five principles, namely: (1) belief in one almighty, (2) humanitarian fair and civilized, (3) unity of Indonesia, (4) Democracy, led by the inner wisdom of deliberations of representatives, and (5) social justice for all Indonesian people. According Nataadmaja (1983) in Ludigdo (2012) there are 36 items that reflect all of Pancasila principles.

Pancasila is only written in books, in science studies, however noble values is obeyed, it is merely rhetoric (Maarif, 2011). Ludigdo (2012) argued that Pancasila can be brought into the realm of various national life media, including professional realm. Furthermore,

Asshiddiqie (2011), as recommended on Congress of Pancasila II, efforts to civilizing Pancasila concretely be realized in public life, such as through formulation of a code of ethics and code of conduct as well as the institutionalization of its institutions within government, organizations, NGOs and Enterprises. Pancasila as the philosophy of system is basically a value that is a source of all good norm elaboration of legal norms, moral norms and state norms. It is contained a way of thought that is critical, fundamental, rational, systematic.–Pancasila is an identity, personality, morality, and bow of safety of nation. Pancasila has a foundation of strong ontological, epistemological, and axiological.

## **2.5. Hypothesis Development**

### **2.5.1. Relationships Cognitive moral on Unethical Behavior**

As Ramamoorti (2008) stated that behavioral factors are the root of fraud problem. More, Reynolds et al (2006) also stated that moral identity and moral judgement both affect moral behavior. Level of individual cognitive moral will affect person's ability to be ethically or not doing fraud tendencies. Cognitive moral influence ability of an individual solves ethical dilemma. Welton (1994) stated that an individual's ability to resolve ethical dilemma is influenced by the level of cognitive moral. In accounting field, research conducted by Wilopo (2006) found that the higher level of cognitive moral the more likely not to do accounting fraud. Further Shaub et al (1994) stated accounting educators can influence cognitive moral by designing ethical education interventions that would slam accounting students behave in ethical decision making.

Based on description above, it can be hypothesized as follows:

H1a: Cognitive moral effect on unethical behavior

H1b: Cognitive moral effect on accounting fraud tendency

### **2.5.2. Relationships Love of Money on Unethical Behavior**

Research related to the link Love of Money and Ethical Behavior is still limited and shows mixed results. Tang and Chiu (2003) explains that concept of love of money is related to concept of greed. They found that employees in Hong Kong with a love of money is high less satisfactory in work compared with their peers. Love of Money related to unethical behavior but not related to income or money (Ping & Chiu, 2003). Love of Money is root of evil, but money is not.

Meanwhile, another study conducted by Luna-Aroca and Tang (2004) give different results. They argued that love of money can help to predict and control unethical behavior because of Love of Money someone can predict job satisfaction and possibility of unethical behavior. Chen and Tang (2006) suggested that the relationship may lead to unethical behavior. Furthermore, Tang and Chen (2008), also found that love of money related to corruption and unethical behavior.

Another studies have examined the effect of love of money on ethical considerations. Some research suggests that higher levels of love of money will have a judgment/perception of good ethical according to the level of their job satisfaction. It can be seen in research Luna Arocas and Tang (2005) that examine love of money against ethical considerations have a significant positive relationship. However, according to Elias (2010) the higher love of money on accounting students, the lower the level of ethical considerations accounting student.

Based on this consideration, this issue still need further test. The hypothesis is formulated as follows;

H2a: Love of Money Positive associated with Unethical Behavior

H2b: Love of Money Positive associated with Accounting Fraud Tendency

### **2.5.3. Relationships Unethical Behavior and Accounting Fraud Tendency**

Fraud and unethical behavior just a term that describes non-compliance with regulations in fact. Accounting fraud is very closely related to ethics. However, in social life it is said that

unethical behavior is not necessarily true fraud. Unethical behavior that violates the law is called a fraud (Gugus, 2009). However, the fact that occurs in the various frauds it always starts from unethical behavior (Dallas, 2002). More, Ramamoorti (2008) suggested that behavioral factors are the root of fraud problem. This is also supported by CIMA (2002) as cited by Wilopo (2006) which stated that company with low ethics standard is likely to have high accounting fraud risk.

Further, study of Carpenters and Reimers (2005) also found that unethical behaviors are caused by ourselves, as well as others around us can drive a person to perform acts of fraud. In relation to accounting fraud, research conducted by Calderon and Greenf (1999), Reinstein (1998) showed unethical behavior in form of abuse responsibility and power, position, and company resources, encourage management do accounting fraud. More, Dallas (2002) suggests that unethical behavior resulted in unhealthy climate in the workplace and encourage the emergence of Accounting fraud tendency (Victor et al., 1993), and interfering performance accountability (Dijk, 2000).

This research was supported by Wilopo (2006) which stated that unethical behavior causes accounting fraud tendency and also stated that unethical behavior and accounting fraud tendency can be reduced by increasing the effectiveness of internal control, adherence to accounting rules, morality of management, as well as eliminated the asymmetry of information. Further, Irianto et al (2009) that studied Integrity, unethical behavior, and tendency of fraud stated that fraud tendency can be reduced when a person in ethical environment.

Based on this conception the hypothesis is formulated as follows;

H3a: Unethical behavior is positively related to the accounting fraud tendency

H3b: Unethical behavior mediates relationship between cognitive moral and love of money on accounting fraud tendency

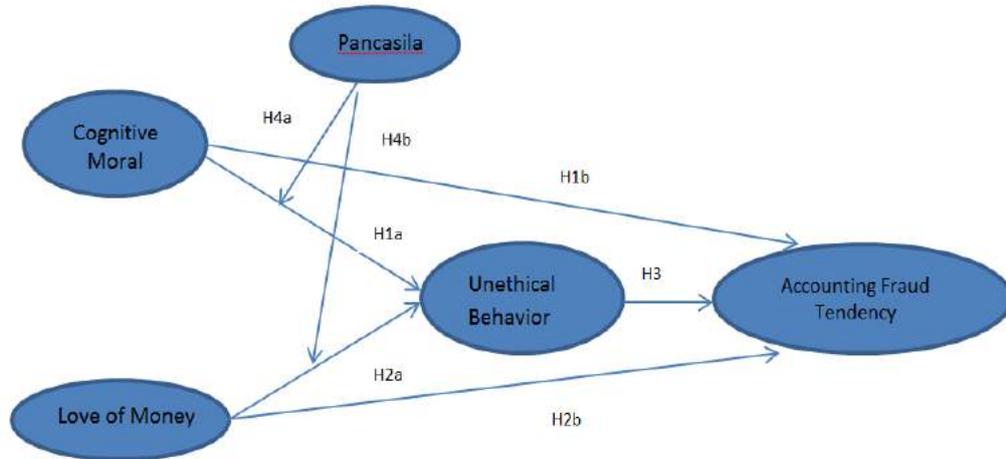
#### **2.5.4. Pancasila moderates the relationship of Cognitive moral and Love of Money on Unethical Behavior**

According to Forsyth (1980) moral philosophy is controlled by two characteristics of idealism and relativism. Study that evaluating elements of Pancasila values in empirical research in conjunction with accounting and accounting ethics education is still limited. Links on phenomenon of fraud, ethical problems, and education in Indonesia with existence of Pancasila as philosophy of life is not impossible. Making Pancasila as an ideology to fraud resistance in this country is not impossible, because Pancasila has moral views contained in all its principles. Latif (2011) in Ludigdo (2012) stated Pancasila is identity, personality, morality, and the bow of the safety of the nation. Pancasila has a foundation of strong ontological, epistemological, and axiological. In every element (sila) has historical justification, rational and actual consistently. Further, ramamoorti (2008) suggested that behavioral factors are the root of fraud problem.

Research on Pancasila values is mostly conducted by qualitative research, and rarely done empirically. Kamayanti et al (2012) give an opinion on the importance of accounting education based on Pancasila accounting which was revealed in their research that "Ruh" devotion to God, humanity, Indonesianness, unity, and justice will give fundamental consequences on accounting material being taught. Then Setiawan and Kamayanti (2014) stated that through education, it can change the view of prospective accounting profession to balance between the materiality (worldly) and spirituality (hereafter). Ludigdo (2012) also argues that Pancasila can be a tool for removing of ethical imperialism. Given how Pancasila values that can be served as moral philosophy and behavior in our country, especially in accounting ethics, it can be hypothesized as follows;

H4: Pancasila value moderates the relationship Love of Money and Moral cognitive on unethical behavior

## 2.6. Research Model



**Picture.1**  
**Research Model**

questionnaires distributed is 300 exemplars, returned is 288 exemplars, while can be processed by 247 exemplars.

## 3. Research Method

### 3.1. Sample and data source

Primary data is used using questionnaires that collected in South Sumatera. Sample used are accountants, accounting students who have been worked, professional accounting program students and graduate students. The

**Data collection technique:** Data used are primary data using questionnaires that collected directly and via email survey to increase response rate of questionnaires.

### 3.2. Variable definition and measurement

Variable definition and measurement can seen from table 1.

**Table 1:** Variable definition and measurement

Variable	Proxy (Acronym)	Measurement	Source
Cognitive moral	Moral	DIT	Rest (1986)
Love of money	L.Money	Money Ethic Scale (MES)	Tang, (2008)
Unethical behaviour	P.TEtis	9 item of Unethical Behavior	Tang et al (2003); Wilopo (2006)
Accounting Fraud Tendency	Kec.Akt	7 item of AFT	IAI (2001); Wilopo (2006)
<i>Pancasila</i>	Pncasila	36 item of Pancasila Value Item	Nataadmaja (1983)

### 3.3. Data Analysis

This study analyzed using Structural Equation Model (SEM) with variance based which is Partial Least Square with WrapPls software.

Model analysis is tested using measurement model (outer model), structural models (inner model), and hypothesis testing.

## 4. Result and Discussion

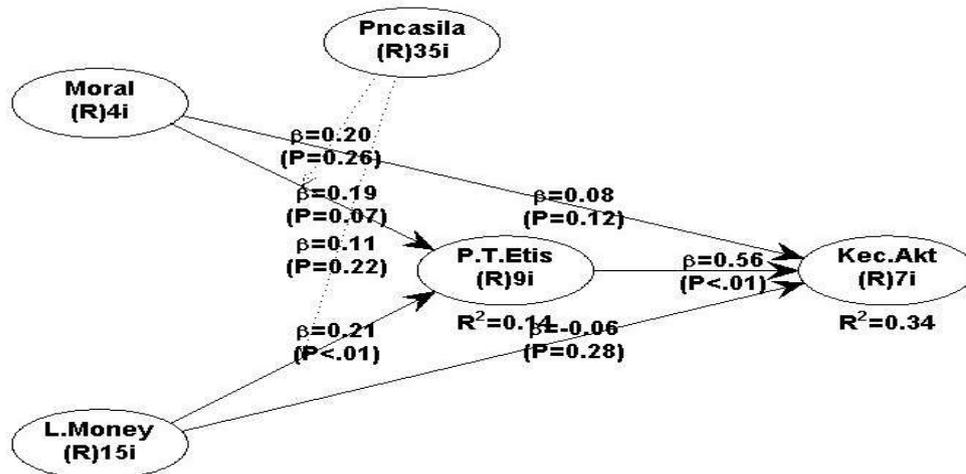
### 4.1. Result

The hypothesis test in this study using Partial Least Square (PLS). It used WrapPLS software program that designed specifically to estimate the structural equations on the basis of the variance, especially for unlinier data.

The result of structural model from WrapPLS is shown in figure 2.

#### 4.1.1 Measurement (Outer) Model Test

##### Validity test



Picture.2  
Structural Model

##### Discriminant Validity

Furthermore, reflective indicators also need to be tested by cross loading discriminant validity. An indicator declared is valid if it has the highest loading factor to intended construct compared to loading factor to other constructs.

##### Convergent Validity

An indicator declared valid if it has a loading factor above 0.5 on the intended construct. Based on the results of combined loadings and cross loading factor loadings, it shows that the indicators of variable value above 0,5 as the recommended value (Ghozali, 2014). The smallest value indicator is 0.534 (LM2) dan the highest value indicator is 0.901 (P30). It means the indicators used in this study is valid or meets the convergent validity. The loading indicator that has a value below 0.5 (M5, M6, L5, L9, and P16) is issued as indicators of variable.

Thus, the latent construct predicts the indicator on their block better than the indicators in other blocks. The result shows that the loading factor in their block is higher that the loading factor in other block.

Another method to see the discriminant validity is to look at value of square root of

average variance extracted (AVE). The recommended value is above 0.5 (Ghozali, 2014).

**Table 2.** Average Variance Extracted

Variabel	Average variance extracted (AVE)
Moral	0.846
L.Money	0.641
P.T.Etis	0.711
Kec.Akt	0.788
Pncasila	0.829

The table above, AVE values above 0.5 for all constructs of the research model. The lowest value AVE is 0,641 on Love of Money variable (L.Money). It means the indicators used in this study is valid or has met the discriminant validity.

**Reliability test**

Reliability testing is done by looking at value of composite reliability of indicator blok that measures the construct. Composite reliability results will indicate a satisfactory score if above 0.6 (Ghozali, 2014). Here is the composite reliability values as follows:

**Table 3:** Composite Reliability & Cronbach’s Alpha

Variabel	Composite Reability	Cronbach’s Alpha
Moral	0.910	0.867
L.Money	0.912	0.896
P.T.Etis	0.901	0.875
Kec.Akt	0.919	0.897
Pncasila	0.987	0.986

The above table shows that the composite reliability for all constructs is above 0.7 indicating that all construct the model estimated meet the criteria of discriminant validity. The lowest composite reability value as 0.910 on Cognitive moral (Moral) construct.

**Table 5.** Hypothesis Test

Hypothesis	Coefficients	P-value	Standard Error	Effect Size
H1a: Moral -> P.T.Etis	0.19*	0.07	0.127	0.039
H2a: L.Money -> P.T.Etis	0.21***	0.001	0.068	0.039
H1b: Moral -> Kec.Akt	0.08	0.12	0.066	0.015
H2b: L.Money -> Kec.Akt	-0.06	0.28	0.112	0.011

This reliability can also be strengthened by Cronbach's Alpha. The recommended value is above 0.6 (Ghozali, 2014). The above table shows that Cronbach's Alpha for all constructs is above 0.6. The lowest

value is 0.867 (Moral) and the highest value is 0.986 (Pancasila).

**4.1.2. Structural Model Test (Inner Model)**

**Adjusted R Square**

Once the model is estimated to meet Outer Model criteria, the subsequent testing is structural models (Inner model). Here are the adjusted R-Square of the constructs:

**Table 4:** Adjusted R-Square

Variabel	R-Square
Moral	
L.Money	
P.T.Etis	0.143
Kec.Akt	0.336
Pncasila	

Adjusted R Square for Accounting fraud tendency is 0.336, it means contribution of cognitive moral, love of money, Unethical Behavior, interaction Pancasila with Cognitive moral, and interaction Pancasila with Love of Money only 33.6%. Furthermore, contribution of cognitive moral, love of money, interaction Pancasila with Cognitive moral, and interaction Pancasila and Love of Money on Unethical behavior is 0.143 or 14.3%.

**Hypothesis testing**

Hypothesis testing results are presented in following table 5.

H3: P.T.Etis -> Kec.Akt	0.56***	<0.001	0.054	0.332
H4a: Pncasila*Moral -> P.T.Etis	0.20	0.26	0.315	0.047
H4b: Pncasila*L.Money -> P.T.Etis	0.11	0.21	0.137	0.018

Note: (\*) significance at level  $\alpha=0.1$ , (\*\*\*) significance at level  $\alpha=0.01$

According to the table above, it shows that there is a significant positive relationship between Cognitive moral on Unethical Behavior with a coefficient of 0.19 at 10% significance. Moreover, Love of Money on unethical behavior has positive significant effect with coefficient 0.21 at 1% significance level. Then, unethical behavior variable is also has a significant positive effect on accounting fraud tendency at 0.56 coefficient at 1% significance level. It can be concluded that hypotheses H1a, H2a, and H3 can be supported.

However, interaction constructs of Pancasila with cognitive moral and love of money on unethical behavior is not significant with coefficient of 0.20 and 0.11 respectively and p-value 0.26 and 0.21 respectively. It means hypothesis H4a and H4b can not be supported. It is similar with hypotheses H1b and H2b which cognitive moral and Love of Money on accounting fraud tendency is not significant, so this hypotheses can not be supported.

Regarding to mediation effect, it is should fulfill in this two criteria; (i) coefficient of path of a direct relationship is significant, and (ii) coefficient of path of indirect relationship (using mediation variable) is also significant too (Sholihin and Ratmono, 2013). Based on PLS result, it shows that cognitive moral and love of money is not significant effect on accounting fraud tendency. It means this relationship is not meet with the first criteria of mediation effect, so unethical behavior cannot mediate cognitive moral and love of money on accounting fraud tendency.

#### Effect Size (F Square)

F square used to assess effect size of models. The effect size of relationship Cognitive moral and Love of Money on unethical behavior is 0.039 and 0.039 respectively (H1a and H2a). It means that this relationship has a medium effect size. Furthermore, relationship unethical

behavior on accounting fraud tendency (H3) has effect size of 0.332, which means it has medium effect size also.

## 4.2. Discussion

### Influence of Cognitive moral on Unethical Behavior and Accounting fraud tendency.

The testing results with PLS indicate that there is a significant positive correlation between Cognitive moral on Unethical Behavior with a coefficient of 0.19 at 10% significance level. Thus this result supports research conducted by Welton (1994), Rest & Narnarz (1994), Aquino (2009), Reynolds (2007) which stated that there was influence between the cognitive moral level of a person with unethical behavior. However, the relationship of Cognitive moral on Accounting Fraud tendency is statistically insignificant, so it can not support research conducted by Wilopo (2006) and Shaub et al (1994) that stated there is relationship between Cognitive moral on Accounting Fraud tendency.

### Influence of Love of Money on unethical behavior and Accounting Fraud Tendency

The relationship of Love of Money on unethical behavior is positive significant with coefficient of 0.21 at 1% significance level. Thus, it supports research conducted by Tang & Ciu (2002), Luna Aroca and Tang (2004), Cheng and Tang (2006) which stated there is relationship between love of money with unethical behavior. However, there is no correlation between Love of Money on Accounting Fraud tendency, so statistically it can not support the previous research.

### Influence of Unethical Behavior on Accounting fraud tendency

Unethical behavior variable has a significant positive effect on accounting fraud tendency with 0.56 coefficients at 1% significance level.

Thus, this result supports research conducted by Wilopo (2006), Toyyibatun (2009), and Calderon and Green (1999) that stated unethical behavior related to accounting fraud tendency.

### **Moderation effect of Pancasila on relationship of Cognitive moral and Love of Money on unethical behavior**

Construct of interaction Pancasila with Cognitive moral and love of money does not affect Unethical behavior. It means statistically it is not significant with coefficient of 0.20 and 0.11 respectively and p-value 0.26 and 0.21 respectively. Thus this result can not support the proposed proposition of Ludigdo (2012) and Setiawan and Ari Kamayanti (2014).

### **5. Conclusion**

- There is a significant positive relationship between Cognitive moral and Love of Money on Unethical Behavior. Unethical behavior is also significant positive on accounting fraud tendency, but it does not mediate relationship between cognitive moral and love of money on accounting fraud tendency.
- Pancasila does not moderate relationship Cognitive moral and Love of money on unethical behavior. Moreover, Cognitive moral and Love of Money on accounting fraud tendency is also insignificant.
- Adjusted R Square for accounting fraud tendency is 0.336 that means contribution of cognitive moral, love of money, unethical behavior, interaction Pancasila with Cognitive moral and Love of Money is 33.6%. Furthermore, contribution of cognitive moral, love of money, interaction Pancasila with Cognitive moral and Love of Money on Unethical behavior is 14.3%.
- Effect size on relationship Cognitive moral and Love of Money on unethical behavior is medium. It is similar with effect size of unethical behavior on accounting fraud tendency.

### **Limitations of study**

- Construct Pancasila value should be explored further in research ethics and accounting by considering Pancasila as identity and values of our nation. Implementation of Pancasila values in our life especially in education of accountants would increase moral values accountants in the future.
- The study only took a limited sample and only in South Sumatra. So for future research it could use more samples with different culture and region.

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**THE ANALYSIS OF SIZE, BOOK TO MARKET VALUE RATIO AND  
MOMENTUM ON STOCK RETURN: A CASE STUDY OF INDONESIAN  
MINING COMPANIES  
2010-2014**

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***ABSTRACT***

*Stock is one of the most attractive ways to increase wealth. An abundance of studies have tried to find out about the predictors of stock return including firm size, book-to-market value ratio and momentum. From the studies conducted, the outcomes are mostly different since different country and industries have different market performance. This research purpose is to find out the correlation of firm size, book-to-market value ratio, and momentum towards stock return. The data taken will be from Indonesian mining Industry for the year of 2010-2014 with IBM SPSS software. Based on the research conducted, it can be found that there is a negative correlation between firm size and stock return, then there is a negative correlation between book-to-market value ratio and stock return. On the other hand, there is a positive correlation between momentum and stock return.*

*Keywords: Firm Size, Book-to-Market Value Ratio, Momentum, Stock Return, Mining Industry*

**INTRODUCTION**

These days people have plenty of options to increase their wealth. The options that can be obtained to increase their wealth such as tangible things and securities. Tangible things referred to gold and etc. On the other hand, some securities here including stock, bonds and mutual funds receives the retribution in three ways which are dividends, interest, or capital appreciation. Dividends are basically the amount of payment made to stockholders from a corporation's earning or profits being paid at certain times often quarterly and each shareholder receives the payment depending on the number of shares they own since dividends are paid as a certain choose the securities which represent ownership of firms' activities under the

amount per share outstanding. Interest is a percentage that is paid based upon the amount of an investment. Meanwhile, capital appreciation is the amount of payment obtained if the investors sell their securities for a higher price than its cost to buy it. (Drake & Dingler, 2001).

The main place investors are able to perform the transactions is the capital market. Fama (1970) declared that the capital market is the market in which prices provide accurate signals for resource allocation or it can be stated as the market where firms can make production-investment decisions and on the other hand, investors are able to

assumption that security prices will fully reflect all information at any time. Based on

Drake & Dingler (2001), there are plenty of factors being considered by investors to make an investment such as its price, minimum investment, interest or yield, risk, timing, and tax incentives or liabilities. One of the main challenges of modern finance these days is measuring risk in the stock market.

As stated by Novak and Petr (2010), there are also plenty arguments of what risk factors should be applied to value asset or determine the cost of capital despite the substantial significance of the topic to investors and market regulators.

As quoted by Agyei-Mensah (2015), financial ratios are able to increase the knowledge of stakeholders since the financial ratios provide a quick and simple tool highlighting firms' performance (Courtis, 1996), the financial ratios enable the comparison of different sizes (Elliot, B. And Elliot, J. 2013), and the information in financial ratios are able to provide users of financial statements with new information that is more useful for ordinary users in evaluating the risk for investment decisions (Watson Et Al, 2002). As quoted by Er & Vuran (2012), there are some factors that found to be significantly affecting the stock returns such as inflation, interest rate, exchange rate, oil price, money supply, GDP, production indice, P/E, E/P, BE/ME, ME/BE, dividend yield, firm size, financial leverage, profitability ratios, and liquidity ratios. As Foroghi and Khorsandifar (2011) cited that size, book-to-market value ratio and momentum are the most important effective factors on stock return, they find out that there are positive effect of book-to-market value in their small-sized portfolio and positive effect on momentum in the small and middle-sized portfolio. Almost the same with Novak and Petr (2010), one of the variable such as momentum is positively associated with stock return but the positive correlation dissapears when it is

combined with the other variables. The same result did not happen to Kassimatis in 2008 since the research find out that all variables are not associated with stock return. Due to the various results from various types of country sample, the motivation to make this research is to analyze the correlation of firm size, book-to-market ratio and momentum on stock return in an emerging market namely Indonesia especially in the mining industries.

According to the Ministry of Energy and Mineral Resources Republic Indonesia, mining trading in Indonesia has been developed since 1602 by the Netherlands who formed an organization to optimize geological and mining research in Indonesia in 1850. In 1942-1945, Indonesia fell to Japan as well as all trading and research in the Indonesian mining industry. In 1945 which is the year of Indonesian independence, the first official organization of mining has been developed named Jawatan Tambang dan Geology. After several changes, the name finally change into Departemen Energy dan Sumber Daya Mineral in 2000.

As stated by Eng (2014), Indonesia is one of the world's leading exporters of copper and nickel ore, refined tin and thermal coal and major producers of natural gas, bauxite, and gold. Similarly Winzenried and Adhitya (2014) stated that mining industry has been one of the key industries encouraging Indonesia's economic growth for several years with significant input in the Indonesian GDP, government revenues, employment, especially the economic development where mining operations are located.

The purpose of this research is to analyze the correlation between firm size, book-to-market value ratio, and momentum towards its stock return.

## **LITERATURE REVIEW**

Kitov (2009) stated that, firm size can be defined as total sales of a firm as expressed in monetary units. It can also be defined by the number of employees. The firm itself as stated by Carrizosa (2007) can be define as the ownership of asset. For the determination of a firm size such as how big or small is a firm, Bernandt and Muller (2000), stated that there are two points of view in this area which are the viewpoint of individual firm, and of the sector in which firms are incorporated. It can be measured by the number of employees, sales, capital or even the average size of the industry and each country has a different scale. There are some reason why firm size is likely to capture the movement of stock return. Chan and Chen (2008) stated that the higher sensitivity of small firms to macroeconomic events is due to many small firms are what they marginal firm. Firms with poor performance might be financially distressed which can be manifested as in high market-imposed financial leverage and cut-downs in dividend payouts. As cited by Hou and Dijk (2014), the size effect in stock return has vanished that small firms did not outperform big firms during 1980s and 1990s in US but from the research they conducted, proved that size effect in expected return exists. Kitov (2009) stated that, firm size can be defined as total sales of a firm as expressed in monetary units. It can also be defined by the number of employees. The firm itself as stated by Carrizosa (2007) can be define as the ownership of asset.. Kruger and Lantermans (2010) stated that firm size is the best variable to predict stock return.

An abundance of studies show that book-to-market value is successful in explaining the cross-section of expected returns. As stated by Fama and French (1992), there is a significant relationship between book-to-

market value ratio and stock return. From the studies conducted, Foroghi and Khorsandifar (2011) stated that the BM ratio might actually reflect some risk factors whose effect may still depend on market value. Specifically, a very low book-to-market value ratio of a firm with small market value proven has higher mean excess return than their medium book-to-market. Ahmad, Mahsa & Gholamreza (2012) found a direct relationship between book-to-market value ratio and its expected return even Cakici, Chan, and Topyan (2011) found that book-to-market ratio has reliable forecast power in China since the differences in raw returns between the highest and lowest stock quintiles are almost positive in all years. On the other hand, Kruger and Lantermans (2010) found out that the correlation between book-to-market value ratio and its stock return is not significant.

According to Chang & Cher (2008), Momentum is the actualization of this law in market is that a price pattern desires to remain until an external blocks it. There are two strategies in trading stocks which are the contrarian strategy and the momentum strategy. The contrarian strategy is more likely suggested by the overreaction hypothesis to grade shares according to their performance before and suggested the purchase of prior losers and the sales of prior winners due to belief that the trend will be reversed in the next period since the prior winners will get loses because it already gain high profit while at the same time, the prior losers will gain profit in the next period. Whereas, it also happened in momentum strategy but suggested the purchase of prior winners and the sale of prior losers due to belief that prior winners will continue to make profit while at the same time, prior losers will continue its

loses (Gunasekarage & Kot, 2007). According to Kandir and Arioglu (2013), momentum refers to the stock price pattern that specifies past winners continue to outperform past losers in the intermediate horizon, leading to a potential investment strategy, which recommends buying past winners and selling past losers. Based on Luxianto's (2009) data processing result, the comparison between no prediction index and index which has 10% accuracy in preventing loss from the beginning of 2000 until the end of 2009 shows that 10% prediction index increases from 100 to 725 in turn 21.92% per year growth which means 10 years practicing prediction with only 10% certainty will be able to make the investors near to twice richer than practicing no prediction at all.

As cited by Banerjee and Hung (2011), for momentum there has been a multitude of extended studies to discover why the momentum strategies of buying the recent winner and selling short the recent loser stocks generate profit (Jegadeesh 1993; Titman 2001). Other research conducted shows that the momentum strategies are not risk-free despite the fact that it is able to decrease the disclosure to the market risk by undertaking the long-short position. As seen from Banerjee and Hung (2011) research, investors who uses momentum strategies tend to get 50% chance of whipping the naive investors. As quoted by Wang, Jang, and Huang (2009), there has been a theoretic model showed investors being overconfident regarding their private information and knowledge directed to the short-term price momentum and long-term price reversal. In general, investors tend to behave differently to new upcoming information because of their self-attribution bias. For instance, if they received inconsistent information compared to their prior previous belief, they tend to relate the disconfirming news to external noise. On the other hand, if they received consistent information that same

as their prior belief, they tend to relate the information to their own competence (Daniel, Hirshleifer and Subrahmanyam 1998). Moreover, Liu and Zhang (2011) found that winners stock mostly have greater expected investment-to-capital growth and expected sales-to-capital which are two major variables of expected marginal benefit and certainly received greater expected return than losers stock. On the other hand, research in China by Cakici, Chan, and Topyan (2011) found that momentum fails to predict the stock return since it is statistically insignificant for small stocks but still significant for large stocks.

Stock can be considered as segment of ownership of public companies where investors might purchase a share of stock for a price in desires that the price will increase in the end. On the other hand, the price decreases below the cost that investor A spent. The stock return consists of the capital gains relative and income on an investment. It is basically gain or loss of a security in a particular period. Dividend is a regular payment received by stockholders for each share that they own. (Frank, Bernanke, Gan, & Kang, 2009) they also stated that an increase in the future dividend or in the future expected stock price rises the stock price today, whereas an increase in the return a saver requires to hold the stock lowers today's stock price. This research will use weighted stock return as a dependant variable. This research will take stock return of each company for 5 consecutive years by adding capital gain yield with dividend yield. Capital gain yield will be determined by finding the movement percentage of stock price by year with the beginning share price and end of year share price for each year.

Whereas, dividend yield will be determined by dividing total cash dividend each year with share price at the beginning of each year. According to Dariush Foroghi, Bahare Khorsandifar(2011),researched on Size, Book-to-Market, and Momentum towards

stock return, the results show non-negative effect of size on weighted stock return of loser portfolio, non-negative effect of momentum stock price on weighted stock return of big-sized portfolio, positive effect of B/M value ratio on weighted stock return of small portfolio and positive effect of momentum stock price on weighted stock return of small-sized and middle sized portfolio

Novak, J., Petr D (2010), studied on CAPM Beta, Size, Book-to-Market, and Momentum on Stock return resulting as none of the established risk factors (beta, size and BE/ME, momentum) seems to be significantly related to the excess stock returns.

The Turkish stock exchange showed different result as momentum is positively related to firm book-to-market and negatively related firm size (Ersan Ersoy, Ulaş ÜNLÜ, 2013).

Based on studied in London Stock Exchange by George Leledakis, Ian Davidson & J. Smith in 2004, firms with smaller equity capitalizations consistently generate higher stock returns on average, is not due to a general relation between expected stock return and actual firm size. The results evidenced that the small and highly leverage companies had an inverse relationship between market equity and stock return.

The study in Teheran stock Exchange by Derestani, Mahboob & Kordestani in 2012, examined 100 companies in Tehran Stock Exchange and relationship between company size and book to market ratio and expected stock returns. The results showed that company size has inverse relationship with expected return while BE/ME ratio has a direct relationship with expected returns.

The market-to-book ratio stands to reveal significant results in terms of predicting stock returns for a one-year period among others for most of the emerging market countries according to researched conducted by Guler Aras, Mustafa Kemal Yilmaz in 2008 regarding the relationship Price-Earnings Ratio, Dividend Yield, Market-to-Book Ratio and stock returns in emerging market countries

Using the Fama and French three factor regression model we confirm that market equity (ME) and the ratio of book equity to market equity (BE/ME) capture much of the cross section of average stock returns in the UK. The worldwide evidence of a negative relation between size and average returns holds and finally, the relation between BE/ME and average return is positive, even though is not very clear for small stocks (Andreas Charitou, Eleni Constantinidi, 2003).

The market-to-book ratio stands to reveal significant results in terms of predicting stock returns for a one-year period among others for most of the emerging market countries according to researched conducted by Guler Aras, Mustafa Kemal Yilmaz in 2008 regarding the relationship Price-Earnings Ratio, Dividend Yield, Market-to-Book Ratio and stock returns in emerging market countries

## METHODOLOGY

The purpose of this research is to contribute to how the firm size, book-to-market and momentum will influence the stock return with reference to mining companies in Indonesia listed in Indonesian Stock Exchange (IDX) for a period of 5 years from 2010 to 2014. The section of the article discusses the firms and variables included in the study, the distribution patterns of data and supplied statistical technique in investigating the relationship firm size, book-to-market and momentum on stock returns.

### 1. Data and Sample

The data used in this study was acquired from Indonesian Stock Exchange (IDX), internet and websites of different firms. Data of firms listed on the IDX for the most recent five years as the basis calculations. The period covered by the study extends to five years starting from 2010 to 2014. The reason for restricting to this period was that the latest data available for the study was available for this period. The sample based on financial statement of selected 5 Indonesian Firms. There are 40 companies inside Indonesia mining industry which are listed on the Indonesia Stock Exchange that will be evaluated using financial statements for the year of 2010 until 2014. From these companies, there are 11 companies that must be disqualified due to be listed on Indonesia Stock Exchange surpassed than 1st January 2010. After that, there will be 20 companies excluded due to incompleteness of data for each variable such as share price and total cash dividend each year. The final disqualification will be 5 companies that has different currencies since USD is the main currency for this research. Therefore, the companies that will be used as sample in this research to analyze the correlation between firm size, book-to-

market value, and momentum towards its stock return.

### 2. Variables

The study implements the issue identifying firm size, book-to market and momentum influencing company stock return of Indonesian firms. Choice of variables is influenced by the previous study on stock return affected by firm size, book-to-market and momentum.

All variables stated below have been used to test the hypotheses of this study. They include dependent and independent variables:

The firm size of Indonesian mining industry for the period of 2010 to 2014 for each month is by multiplying the company share price at the beginning of each month with total

number of outstanding shares from financial statement of each year. This research will rank stocks by market capitalization of each company at the beginning of each month price..

***Market capitalization = total outstanding shares x share price.....(1)***

The book-to-market value ratio (BME) of Indonesian mining industry for the period of 2010 to 2014 for each month by multiplying par value each year which represents book value with share price at the beginning of each month which represents market value (Cakici, Chan, and Topyan, 2011).

***BME = book value of firm / market value of firm.....(2)***

The momentum of Indonesian mining industry for the period of 2010 to 2014 for each month determined by finding the movement percentage of share price month-by-month whether it is increasing or decreasing (Cakici, Chan, and Topyan, 2011).

$$MOM = V - V_x$$

*V is the latest share price,  $V_x$  is the closing share price x number of days ago..(3)*

The dividend yield of Indonesian mining industry for the period of 2010 to 2014 for each year is determined by dividing total cash dividend each year with share price at the beginning of each

$$\frac{D}{P_0}$$

*D is dividend,  $P_0$  is beginning of year share price.....(4)*

To determine the capital gain yield of Indonesian mining industry for the period of 2010 to 2014 for each year. Capital gain yield will be determined by finding the movement percentage of stock price by year with the beginning share price and end of year share price for each year(Frank, Bernanke, Gan, & Kang, 2009).

$$\frac{P_1 - P_0}{P_0}$$

*$P_1$  is end of year share price,  $P_0$  beginning of year share price.....(5)*

To determine the stock return of Indonesian mining industry for the period of 2010 to 2014 for each month

*stock return=dividen yield+capital gain yield.....(6)*

### 3. Hypothesis

Since the objective of this study to examine the relationship between firm size, BME and MOM and stock return. This study makes a set of hypotheses(the Null Hypotheses  $H_0$  Versus the Alternative ones  $H_1$ )

First hypothesis

$H_0$  : There is no significant correlation between the size of a firm and stock return of mining companies in the Jakarta Stock Exchange for the year 2010-2014.

$H_1$  : There is a significant correlation between the size of a firm and stock return of mining companies in the Jakarta Stock Exchange for the year 2010-2014.

Second hypothesis

$H_0$  : There is no significant correlation between BE/ME of a firm and stock return of mining companies in the Jakarta Stock Exchange for the year 2010-2014.

$H_1$  : There is a significant correlation between BE/ME of a firm and stock return of mining companies in the Jakarta Stock Exchange for the year 2010-2014.

Third hypothesis

$H_0$  : There is no significant correlation between momentum and stock return of mining companies in the Jakarta Stock Exchange for the year 2010-2014.

$H_1$  : There is a significant correlation between momentum and stock return of mining companies in the Jakarta Stock Exchange for the year 2010-2014.

Fourth hypothesis

$H_1$  : There is no correlation between the firm size, book-to-market and momentum and stock return of mining companies in the Jakarta Stock Exchange for the year 2010-2014.

$H_0$  : There is a correlation between the firm size, book-to-market and momentum and stock return of mining companies in the Jakarta Stock Exchange for the year 2010-2014.

### 4. Model

Determine the research model for this research

1.  $y = \alpha + \beta_1 \text{firm size} + \epsilon$
2.  $y = \alpha + \beta_1 \text{book-to-market ratio} + \epsilon$       *value*
3.  $y = \alpha + \beta_1 \text{momentum} + \epsilon$

$$4. y = \alpha + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \epsilon$$

Where:  $y$  = stock return

$\alpha$  = fix konstanta

$\beta_1 x_1$  = firm size

$\beta_2 x_2$  = book-to-market value ratio

$\beta_3 x_3$  = momentum

$\epsilon$  = error

### 5. Data Analysis

This research provided two data analysis: descriptive and quantitative. The descriptive analysis is to help to describe relevant aspect of phenomena of company performance and provide detailed information about each relevant variables in this research. In quantitative analysis is uses the pooled regression type of panel data. The pooled regression, also called the constant and the coefficients model is one where both intercepts and slopes are constant. Before the regression analysis is conducted the

classical assumptions are being tested, Classic Assumption is consists of 4 assumptions. They are normality, multicollinearity, autocorellation and heterocedasticity assumptions. The model has to pass this assumption to result in unbiased model. Unbiased model is needed to generalize the result beyond the samples and serve wider population. However, if the model violates the assumption, conclusion still can be made for this sample. It means the research cannot be use for larger population (Field, 2011). Goodness of Fit measures a model validity to explain the phenomenon that becomes purpose of a research. Goodness of Fit is consists of 3 Test, R square, F-test and t-test (Field, 2011). For this purpose of analysis the SPSS 22 software was used to analyzse the financial data especially in the case of panel data.

## DATA AND RESEARCH RESULTS

### 1. Descriptive Statistics

Table 1 Descriptive Statistic

variables	mean	median	minimum	maximum	std. Deviation
firm size	2879683920	2589851211	8,43E+07	1,01E+10	2377203782
BME	0,0368	0,03	0	0,15	0,03094
mom	0,003	-0,1	-0,46	0,53	0,13288
stockreturn	0,0828	-0,08	-0,44	1,53	0,47481

Source: SPSS

As seen on the table 1, the mean value and standard deviation of 300 observations for the firm size is 2879683920 and 2377203782, with the lowest percentage of 8,43E-07% and the highest percentage of 1,01E+10%. The mean value and standard deviation of 300 observations for the book-to-market value ratio is 0.0368% and 0.03094%, with the lowest percentage of 0% and the highest percentage of 0.15%. The mean value and

standard deviation of 300 observations for the momentum is 0.003% and 0.13288%, with the lowest percentage of -0.46% and the highest percentage of 0.53%. The mean value and standard deviation of 300 observations for the stock return is 0.0828% and 0.47481%, with the lowest percentage of -0.44% and the highest percentage of 1.53%. The value of standard deviation indicates the diversity of the data. If the number of the data is

away from 0 or 1, then the data is supposed to be highly variable. On the

other hand, if the data approaching 0 then the data does not vary.

**2. Assumption Test**

The following data is illustrating the assumption test of normality, multicollinearity,

autocorrelation and heterocedascity results for firm size, book-to-market value ratio, momentum and stock return.

**Table 2. Tests of Normality**

Tests of Normality						
	Kolmogorov-Smirnov <sup>a</sup>			Shapiro-Wilk		
	Statistic	Df	Sig.	Statistic	Df	Sig.
Firmsize	,152	300	,000	,918	300	,000
BME	,180	300	,000	,835	300	,000
Mom	,070	300	,001	,976	300	,000
stockreturn	,165	300	,000	,856	300	,000

a. Lilliefors Significance Correction

Source: SPSS

From the result in table 2, it can be concluded that all data for variables passed the normality test since the author used Shapiro-Wilk" indicators as a base. Since

the data quantity is between 0-2000 then significance shows all the values are less than 0,05.

**Table 3 Multicollinearity: Firm Size, Book-to market ratio and Momentum**  
Coefficients<sup>a</sup>

Model		Unstandardized Coefficients		Standardized Coefficients		Sig.	95,0% Confidence Interval for B		Collinearity Statistics	
		B	Std. Error	Beta	t		Lower Bound	Upper Bound	Tolerance	VIF
		1	(Constant)	3422007512	213171585,9			16,053	,000	3002433545
	BME	-.229E+10	4381530333	-,160	-2,304	,025	-2,091E+10	-366427757	,970	1,037
	mom	1423440005	1335235291	,080	1,374	,171	-815332155	346276275	,940	1,064
	stockreturn	-1145245411	292304601,3	-,229	-3,313	,000	-1720534003	-569986879	,925	1,087

a. Dependent Variable: firmsize

Coefficients<sup>a</sup>

Model		Unstandardized Coefficients		Standardized Coefficients		Sig.	95,0% Confidence Interval for B		Collinearity Statistics	
		B	Std. Error	Beta	t		Lower Bound	Upper Bound	Tolerance	VIF
		1	(Constant)	,044	,003			15,416	,000	,038
	firmsize	-2,106E-12	,000	-,762	-2,504	,005	,000	,000	,358	1,043
	mom	-,012	0,4	-,052	-,598	,370	-,039	,015	,937	1,068
	stockreturn	-,012	,004	-,778	-2,397	,003	-,019	-,004	,306	1,103

a. Dependent Variable: BME

Coefficients<sup>a</sup>

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B		Collinearity Statistics	
	B	Std. Error	Beta			Lower Bound	Upper Bound	Tolerance	VIF
1 (Constant)	-.007	.016		-.447	.655	-.039	.025		
firmsize	4,450E-12	.000	.080	1,374	.171	.000	.000	.939	1,064
BME	-.223	.248	-.052	-.898	.370	-.710	.265	.947	1,055
stockreturn	.068	.016	.243	4,172	.000	.036	.100	.931	1,074

a. Dependent Variable: mom

Source: SPSS

From the table 3 above, it can be concluded that firm size, book-to-market value ratio and momentum passed the test as

independent variable since Variance Inflation Factor (VIF) are below 5.

Table 4. Autocorrelation Calculation

Model Summary<sup>b</sup>

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.347 <sup>a</sup>	.120	.111	44757	.302

a. Predictors: (Constant), mom, firmsize, BME

b. Dependent Variable: stockreturn

<i>dL</i>	= 1,79051
<i>dU</i>	= 1,83088
<i>d</i>	= 0,302
<i>(4-d)</i>	= 3,698

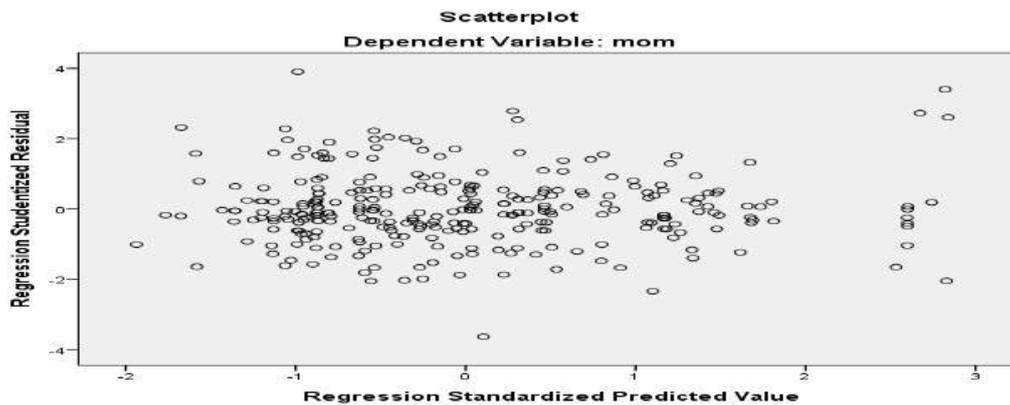
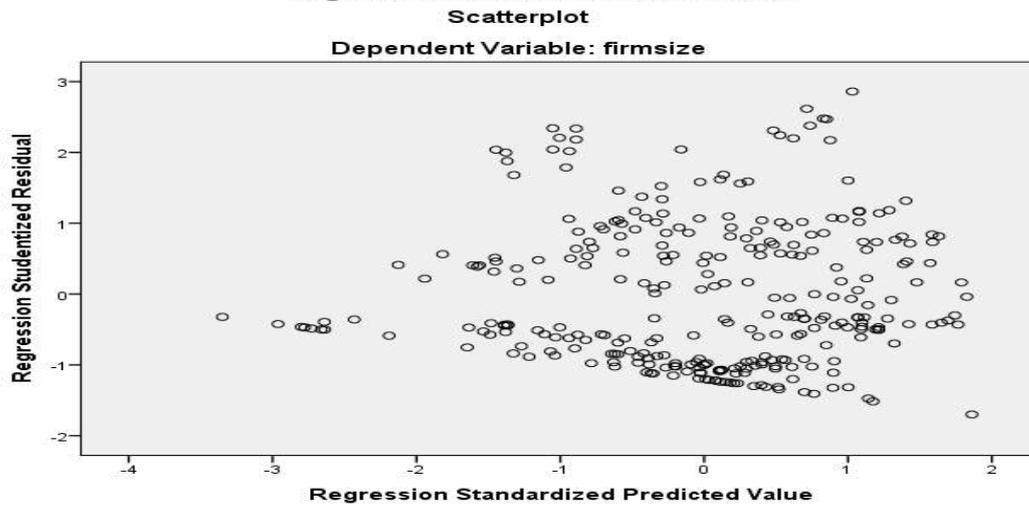
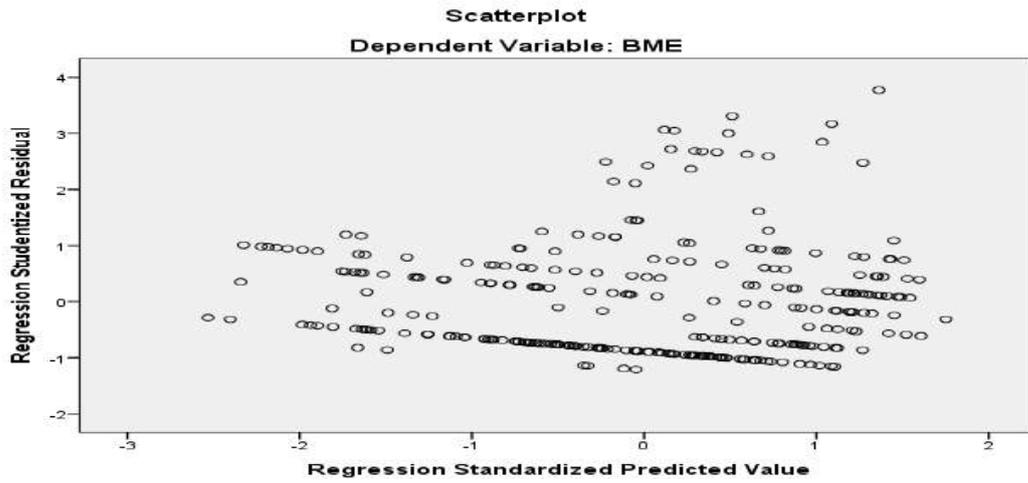
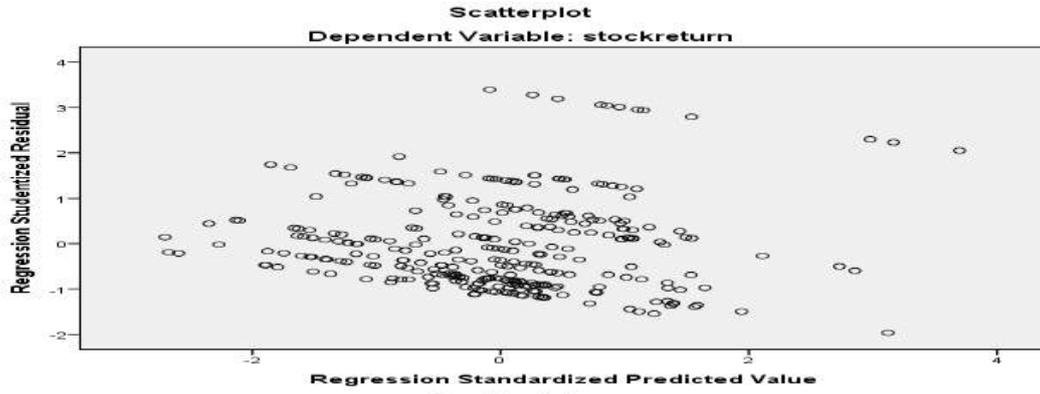
Source: SPSS

Based on Durbin Watson critical values table with 5% significance level, it can be known that the upper critical value is 1,83088 and the lower critical value is 1,79051. From the result above, it can be concluded that there is an indication of positive autocorrelation but since the dependant variable is single, it would not affect the result. However, there is no statistical evidence of negative correlation

happened. Since there is a positive autocorrelation, the sample data taken can only be used for this research and it cannot be generalized for other research.

Firm size, book to market and momentum has heterocedascity tendencies as evidenced on table 5. There is heterocedascity for stock return, firms size, book-to-market value ratio and momentum.

Table 5. Heterocedascity for Stock Return, Firm Size, Book-to-Market Value Ratio and Momentum



Source: SPSS

**3. Research Results**

$$y = 0,189 - 3.681E-11 \text{ firmsize} + \mathcal{E}$$

This formula is able to explain this regression model is able to explain for every

increase in firm size for 1 point, the stock return will decrease by 3.681E-11.

**Table 6. Coefficient, Model Summary, Anova and t-test Hypothesis 1**

**Coefficients<sup>a</sup>**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95,0% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	,189	,042		4,448	,000	,105	,272
	firmsize	-3,681E-11	,000	-,184	-3,237	,001	,000	,000

a. Dependent Variable: stockreturn

**Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,184 <sup>a</sup>	,034	,031	,46747

a. Predictors: (Constant), firmsize

**ANOVA<sup>a</sup>**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2,289	1	2,289	10,475	,001 <sup>b</sup>
	Residual	65,120	298	,219		
	Total	67,409	299			

a. Dependent Variable: stockreturn

b. Predictors: (Constant), firmsize

**Paired Samples Test**

		Paired Differences				t	df	Sig. (2-tailed)	
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower				Upper
Pair 1	stockreturn - firmsize	-2879683920	2377203782	137247924,3	-3149778183	-2609589658	-20,982	299	,000

**Correlations**

		firmsize	stockreturn
firmsize	Pearson Correlation	1	-,184**
	Sig. (2-tailed)		,001
	N	300	300
stockreturn	Pearson Correlation	-,184**	1
	Sig. (2-tailed)	,001	
	N	300	300

\*\* . Correlation is significant at the 0.01 level (2-tailed).

Source: SPSS

From the table 6, it can be concluded that there is a negative correlation between firm size and stock return which are -0,184 or -18,4%. As can be seen in N from the table 4.9, there are 300 samples of data which are being examined to test the correlation between firm size and stock return also in significance level (2-tailed) in the table, it shows 0,001 or 1% significance level. As the correlation result is in the range of -0,1 to -0,3, it can be concluded that there is a

Based on the tests and analysis conducted on hypothesis 1, it can be concluded that H0 is rejected and H1 is accepted since there is a significant correlation between firm size and stock return of mining companies on the Indonesia Stock Exchange for the year of

weak correlation between firm size and stock return as much as -18,4% since the value of -10% to -30% in this test is considered as a weak correlation between dependent variable and independent variable. Since the correlation between firm size and stock return is negative, it means that the variable is moving inversely one to another which means the lower the firm size as concluded will make a greater stock return.

2010-2014. This result is in line with the result from Charitou & Constantinidi (2003) and Darestani, Mahboob & Kordestani (2012) but it has a different result Foroghi & Khorsandifar (2011), Kruger & Lantermans (2010), and Leledakis & Davidson (2004).

$$y=0,173-2,462BME+\varepsilon$$

This regression model is able to explain for every increase in book-to-market value

ratio for 1 point, the stock return will decrease by 2,462.

**Table 7. Coefficient, Model Summary, Anova and t-test Hypothesis 2**

		Coefficients <sup>a</sup>						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95,0% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	,173	,042		4,113	,000	,090	,256
	BME	-2,462	,878	-,160	-2,806	,005	-4,189	-,735

a. Dependent Variable: stockreturn

**Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,160 <sup>a</sup>	,026	,022	,46945

a. Predictors: (Constant), BME

**ANOVA<sup>a</sup>**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1,735	1	1,735	7,872	,005 <sup>b</sup>
	Residual	65,674	298	,220		
	Total	67,409	299			

a. Dependent Variable: stockreturn

b. Predictors: (Constant), BME

**Paired Samples Test**

		Paired Differences				t	df	Sig. (2-tailed)	
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower				Upper
Pair 1	stockreturn - BME	,04600	,48075	,02776	-,00862	,10062	1,657	299	,099

**Correlations**

		stockreturn	BME
stockreturn	Pearson Correlation	1	-,160 <sup>**</sup>
	Sig. (2-tailed)		,005
	N	300	300
BME	Pearson Correlation	-,160 <sup>**</sup>	1
	Sig. (2-tailed)	,005	
	N	300	300

\*\* . Correlation is significant at the 0.01 level (2-tailed).

Source: SPSS

Table 7 represents paired samples test which is two-tailed t-test. This test used to know the position of critical area and null-hypothesis status. From the result above, it can be concluded that H0 is accepted and H1 is rejected since the significance is 0,099 A which is above 0,05. Whereas degree of freedom found to be 299 (N-1) since the population is 300, t-value is 1,657, and “95% Confidence Interval of the Difference” which indicates lower and upper point of the data. Meanwhile, t-value which is 1,657 are outside the loop of upper

and lower point to data which are 0,10062 and -0,00862 indicates the rejecton of null-hypothesis but since the significance 2-tailed value is above the limit, it means that there is no significant correlation between book-to-market value ratio and stock return. Eventhough the result of two-tailed t-test shows that there is no significant correlation between book-to-market value ratio but after some prove and the result of other test, it can be concluded that there is a significant correlation between book-to-market value ratio and stock return.

Based on the tests and analysis conducted on hypothesis 2, it can be concluded that H0 is rejected and H1 is accepted since there is a significant correlation between book-to-market value ratio and stock return of mining companies on the Indonesia Stock Exchange for the year of 2010-2014. This result is in line with the result from AL, Rimziya & Jariya (2013) but it has a different result with Foroghi & Khorsandifar (2011), Darestani, Mahboob & Kordestani (2012), Charitou & Constantinidi (2003), and Aras & Yilmaz (2008).

$$y=0,080+0,845mom+\mathcal{E}$$

This regression model is able to explain for every increase in momentum for 1 point, the stock return will increase by 0,845.

**Table 8. Coefficient, Model Summary, Anova and t-test Hypothesis 3**

**Coefficients<sup>a</sup>**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95,0% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	,080	,027		3,007	,003	,028	,133
	mom	,845	,201	,237	4,202	,000	,449	1,241

a. Dependent Variable: stockreturn

**Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,237 <sup>a</sup>	,056	,053	,46212

a. Predictors: (Constant), mom

**Paired Samples Test**

		Paired Differences				t	df	Sig. (2-tailed)	
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower				Upper
Pair 1	stockreturn - MOM	,07980	,46180	,02666	,02733	,13227	2,993	299	,003

**ANOVA<sup>a</sup>**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	3,770	1	3,770	17,655	,000 <sup>b</sup>
	Residual	63,639	298	,214		
	Total	67,409	299			

a. Dependent Variable: stockreturn

b. Predictors: (Constant), mom

**Correlations**

		stockreturn	mom
stockreturn	Pearson Correlation	1	,237**
	Sig. (2-tailed)		,000
	N	300	300
mom	Pearson Correlation	,237**	1
	Sig. (2-tailed)	,000	
	N	300	300

\*\* . Correlation is significant at the 0.01 level (2-tailed).

Source:SPSS

From the table 8, there is a weak relationship between momentum and stock return with momentum ability as the predictor towards stock return since model summary is measuring how relevant are all the models and how well is the ability of predictor to predict the dependant variable. The coefficient correlation or adjusted R-square shows the number of 0,053 which pointed a weak linear relationship between firm size and stock return. with the adjusted R-square of 5,3%, it means that there is 5,3% opportunity that the formula can clarify the correlation between momentum and stock return since 0,053 from adjusted R-square shows the amount of variance in dependent variable explained by the predictor.

It can be concluded that H0 is rejected and H1 is accepted since the significance is 0,003 which is below 0,05. Whereas degree of freedom found to be 299 (N-1) since the population is 300, t-value is 2,993, and “95% Confidence Interval of the Difference” which indicates lower and upper point of the data. Meanwhile, t-value which is 2,993 are outside the loop of upper and lower point of data which are 0,13227 and 0,02733. It can be stated that companies that have higher momentum, have a greater chance to have higher stock return. the result is in line with the results from Foroghi & Khorsandifar (2011), Novak & Petr (2010), and Ersoy and Unlu(2013).

$$y=0,298+0,817mom-4.305E-11firm\ size-2,541BME+\mathcal{E}$$

This regression model is able to explain for every increase in in momentum by 1 point, it means that dependant variable which is stock return will increase by 0,817. If firm size increases by 1 point, stock return will

decreases by 4.305E-11. If BME increases by 1 point, stock return will decreases by 2,541. If all independent variable is 0, the dependant variable will still be 0,298.

**Table 9. Coefficient, Model Summary & Anova Hypothesis 4**

**Coefficients<sup>a</sup>**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95,0% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	,298	,054		5,533	,000	,192	,404
	mom	,817	,196	,229	4,172	,000	,432	1,203
	firm size	-4,305E-11	,000	-,216	-3,918	,000	,000	,000
	BME	-2,541	,848	-,166	-2,997	,003	-4,210	-,872

a. Dependent Variable: stockreturn

**Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,347 <sup>a</sup>	,120	,111	,44757

a. Predictors: (Constant), BME, mom, firmsize

**ANOVA<sup>a</sup>**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	8,114	3	2,705	13,502	,000 <sup>b</sup>
	Residual	59,295	296	,200		
	Total	67,409	299			

a. Dependent Variable: stockreturn

b. Predictors: (Constant), BME, mom, firmsize

Source: SPSS

The table 9 illustrate the significance is 0 which means that there is a significant correlation between firm size, book-to-market value ratio and stock return since the significance value is below 0,05. It can be proved that investors are able to predict the future stock return using these variables which are firm size, book-to-market value ratio, and momentum since there is a significant correlation between firm size, book-to-market value ratio, and momentum

towards stock return for Indonesian mining industry. Based on the tests and analysis conducted on hypothesis 4, it can be concluded that H0 is rejected and H1 is accepted since there is a significant correlation between firm size, book-to-market value ratio, and momentum towards stock return of mining companies on the Jakarta Stock Exchange for the year of 2010-2014.

## CONCLUSION

There is a significant correlation between firm size and stock return of mining companies on the Indonesia Stock Exchange for the year of 2010-2014 as much as -18,4% since the value is between -10% to -30% which indicates a weak correlation. Since the correlation between firm size and stock return is negative, it means that companies that have lower firm size, have a greater chance to have higher stock return. This result is in line with the result from Charitou & Constantinidi (2003) and Darestani, Mahboob & Kordestani (2012) but it has a different result Foroghi & Khorsandifar (2011),

Kruger & Lantermans (2010), and Leledakis & Davidson (2004). Therefore, hypothesis I H1 is accepted.

The second there is a significant correlation between book-to-market value ratio and stock return of mining companies on the Indonesia Stock Exchange for the year of 2010-2014 as much as -16% since the value is between -10% to -30%. Since the correlation between book-to-market value ratio and stock return is negative, it means companies that have lower book-to-market value ratio, have a greater chance to have higher stock return. This result is in

line with the result from AL, Rimziya & Jariya (2013) but it has a different result with Foroghi & Khorsandifar (2011), Darestani, Mahboob & Kordestani (2012), Charitou & Constantinidi (2003), and Aras & Yilmaz (2008). Therefore, hypothesis 2 reject H0 and accept H1

The third result refers that there is a significant correlation between momentum and stock return of mining companies on the Indonesia Stock Exchange for the year of 2010-2014 as much as 23,7% since the value is between 10% to 30%. Since the correlation between momentum and stock return is positive, it means companies that have higher momentum, have a greater chance to have higher stock return. The result is in line with the results from Foroghi & Khorsandifar (2011), Novak & Petr D (2010), and Ersoy & Ünlu (2013). Therefore, hypothesis 3 accept H1.

The fourth result refers that there is a significant correlation between firm size, book-to-market value ratio, momentum, and stock return of mining companies on the Jakarta Stock Exchange for the year of 2010-2014 as much as 34,7% since the value is between 30% to 50%. The correlation is considered as positive correlation between firm size, book-to-market value ratio, and momentum.

From the result it is recommended to further research on non financial factor such a inflation, interest rate, exchange rate, oil price, money supply, GDP, production indice. In addition to that the possible future research will be conducted in other industry other than mining industries based on the same variables.

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**CONSERVATISM AND EARNINGS QUALITY:  
COMPARATIVE STUDY OF PRINCIPLE-BASED VS RULE-BASED  
ACCOUNTING STANDARDS**

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**ABSTRACT**

*International Financial Reporting Standard (IFRS) develops the principle based accounting standard. Meanwhile, Financial Accounting Standard Board (FASB) which is United States accounting standard setter develops the rule based accounting standard. IASB eliminates the conservatism concept within accounting framework since it can cause the mistatement. Conservatism concept represents a prudent reaction to uncertainty to ensure that uncertainties and risk inherent in business situations are adequately considered. On the contrary, FASB imposes strict regulation in the accounting standards. Some of them employ the conservatism concept. We assume the earnings quality will be affected because of these, even though the IFRS implementation is expected to increase the earnings quality. Objective of this study is to provide the empirical findings about the conservatism and the earnings quality, for the principle-based financial statement compared to the rule-based financial statement.*

*The research is using 70 companies belong to LQ-45 index at Indonesian Stock Exchange (IDX) as the representation of the principle-based accounting standards implementation. Meanwhile, 70 companies belong to S&P 500 index from US capital market are used as the representation of the rule-based implementation. We use the Asymmetric Accrual to Cash-Flow Measure (AACF) as the conditional conservatism proxy; earnings per accrual as the unconditional conservatism proxy; and earnings response coefficient (ERC) as the earnings quality proxy. We use the regression analysis to investigate the empirical data.*

*We concluded that principle-based accounting standard did not always elevate the earnings quality. We found that the earnings quality of the principle-based accounting was not always superior compared to the rule-based accounting earnings quality. We presumed it happened because by using the principle-based accounting standards, the companies had opportunities and flexibilities to imply judgments in presenting their financial statements which not representing the reality of the transactions.*

**Keywords:** *Earnings quality, conservatism, principle-based accounting, rule-based accounting.*

## **INTRODUCTION**

Quality of earnings is an important aspect for external parties especially investors when they are making the decision whether to provide capital for a specific company or not. Its importance is gaining increased attention after the case of Enron and WorldCom on 2001 and significant requests of financial restatements around that period. More recent accounting scandals such as in Toshiba, Olympus, and Tesco during around 2011 to 2014 further clarifies that even the new standards has not been able to fix what is wrong with the previous standard. Poor earnings quality cannot provide reliable information to the financial markets that defraud investors and stake holders (Ismail & Elbolok, 2011). Thus, it is important to understand the process in measuring earnings and all factors that can possibly create distortions during the process (Lyimo, 2014).

As mentioned by Penman & Zhang (2002), quality of earnings refers to reported earnings before extraordinary items that are readily identified on the income statement. Earnings are of good quality if it is a good indicator of future earnings (sustainable earnings), consequently, when an accounting treatment produces unsustainable earnings, those unsustainable earnings are thought to be of poor quality (Ismail & Elbolok, 2011). A firm that wants to provide a strong signal about future earnings should avoid giving negative impression that earnings are low in quality (Ayres, 1994).

Recent shifting from rule-based accounting towards principle-based accounting does affect the way accountants do their job. The way they account for earnings will be different compared with the past, as they have more freedom now in deciding which accounting policy should their company use – thanks to the principle-based standards. Even though the standards still decide which methods are allowed and which are not, at least it becomes not as strict as rule-based standards. As the effect, the quality of accounting will be affected because it is tailored to fulfill specific demand from related parties. The quality of earnings, thus, will also be

affected.

There are differences between rule-based with principle-based accounting standards. One of them is regarding conservatism, which is expressed by early recognition of loss but deferred recognition of profit. Later on when we discuss about the conceptual frameworks that underlie the creation of IFRS and GAAP, we will find that GAAP's framework permits the use of conservatism, whereas IFRS tries to eliminate conservatism in accounting practices. Several people agreed to get rid of conservatism as it is considered to be useless and reduces earnings quality (Penman & Zhang, 2002; Basu, 1997). But some argued that conservatism can be used to prevent overstatement of assets and earnings so that in increase the quality of earnings (Watts, 2003; LaFond & Watts, 2006).

Even though it is already eliminated from present conceptual framework, conservatism is still deserved to be discussed by standard-setters and other related parties. It is important to be discussed because many accountants are still practicing it in professional circumstances (Santi, 2014). Moreover, the standard itself allow accountants to be conservative. For example, the way the standard regulates about fair value usage and recording contingent liabilities provides room for conservative actions. Even though standard-setters worked very hard to improve earnings quality by eliminating conservatism, it is still carried out by companies for their own benefits.

Conservatism can be classified into two major categories, unconditional and conditional. Previously, it is divided into several kinds of classifications such as balance sheet and income statement conservatism, ex-ante and ex-post conservatism, or news dependent and news independent conservatism. For this research we will use terms „conditional“ and „unconditional“, which were popularized by Ball and Shivakumar (2005).

Because this research also puts emphasis on the effect of accounting standard implementation towards conservatism, I am including samples from U.S. companies. As we know, U.S.

companies are still using the rule-based accounting standard, GAAP, for financial reporting purposes. The inclusion of U.S. samples will make it easier to compare the effect of conservatism between companies that use principle-based standard (Indonesian companies) with rule-based standard. It will also be easier for people to evaluate the implementation of principle-based standard, whether it improves the quality of accounting or it is just the same like the old times.

The study aims to obtain empirical findings about the influence of conservatism to earnings quality, for both principle-based accounting standard and rule-based accounting standard.

## **THEORITICAL FRAMEWORK AND HYPOTHESES DEVELOPMENT**

### **Agency Theory**

Agency theory is one of the theories included as a part of a bigger theory – the theory of the firm. Theory of the firm itself consists of stakeholder theory and agency theory. Agency theory itself explains the major organization structure of a business in which there is a principal-agent relationship inside a company. Principle is the entity that holds a specific interest or goal to achieve, and agent is the one who works under the orders of the principle to fulfill the objectives of the principle. An example of this relationship is between airline companies with travel agents. Airline companies want to make as much profit as possible by selling airline tickets to interested passengers. But if all the passengers buy the ticket directly from the airline's office/headquarters, it will very difficult for the office staffs to handle the big volume of transactions. In order to make things easier, airline companies make set up agreements with travel agents. Travel agents are allowed to sell airline tickets from various companies, but the revenues obtained from tickets sales will not be attributed fully to the travel agents. This is because the travel agents are not the owner of the airline business. Travel agents only help airline companies to sell tickets to potential passengers.

Agency theory concerns not only about the principal-agent relationship, but also about the problems that may arise within this relationship. As mentioned by Eisenhardt (1989), the two problems are: (1) conflict of interest between principal and agent and (2) inability of principal to keep an eye on agent's behavior, whether agent is already acting properly or not. Furthermore, difference on each party's view regarding risk is very important, because it can lead to different actions being taken by every party to mitigate the risks (Eisenhardt, 1989).

This principal-agent relationship and all of its problems that may exist should be considered as a basis in creating accounting standards because in the end, the decision of „what must be done“ is all up to the management. No matter how good the standards are, management have the freedom to choose in what way they will do their job. Management may act according to their boss' intentions or be aggressive to satisfy their boss, thus earning bonus payment, even though the real condition is actually adverse. Furthermore, all activities conducted within a company environment are regulated mostly in its own rules or operating procedure standards. Using conservatism as a solution to aggressive accounting can be realized if accounting standards are tailored in a way that makes companies become conservative if the situation requires accountants to become one.

### **Signalling Theory**

Signaling theory suggested a signaling behavior within two or more parties that have access to information. One party sends signal(s) to the other party in exchange for something demanded by the sender. Voluntary disclosure is an example of signaling behavior to attract investors and creditors in providing capital for the demanding company. Companies usually give signals in the form of information that is able to make capital providers appropriate their wealth to support the company's business operation.

The signaling theory of accounting conservatism is first proposed by Wang et al. (2009). In the research, he focused on how

accounting conservatism serves as the signal for lenders in debt markets (the scope is in debt market). By being conservative, companies disclose valuable information about risk to the capital providers. This is done to gain trust from them which in the end will result in a lower interest given by the lender. This also complies with one of Watts' (2003) explanations regarding the existence of conservatism in accounting, which is for debt- contracting purpose.

#### **Unconditional Conservatism**

Accounting conservatism is mainly classified into two types: unconditional and conditional conservatism. This classification is majorly used in a lot of research regarding accounting conservatism, mainly in Beaver and Ryan (2005) and Ball and Shivakumar (2005). Unconditional conservatism is also usually called *ex ante* or news-independent conservatism. It means that the conservatism is performed without any early announcements that suggest upcoming unfavorable circumstances. This kind of conservatism is realized by continually understates book value of net assets relatively to their economic value (Pope & Walker, 2003; Beaver & Ryan, 2005). Because it is independent of news, unconditional conservatism creates a downward bias in book values and earnings (Wang, 2009). It means that, whatever the condition companies are experiencing, the value of asset and earnings will always be reported lower than the usual amount. Examples of unconditional conservatism such as the use of accelerated depreciation method rather than straight-line method, unconditional expensing of R&D cost, immediate expense of the cost of internally generated intangible assets, and so on.

Unconditional conservatism is deemed as „bad conservatism“ because it shows an excessive pessimism of economic reality by accountants (Piot et al., 2010). There is a general acceptance among standard setters that it is a form of „bad“ prudence (EFRAG et al., 2013 in Andre et al., 2013). Also, it is an inefficient way to deal with uncertainties. It is believed that unconditional conservatism is the type of

prudence that IASB wanted to eliminate because it is unnecessary (Andre et al., 2013). Andre et al. (2013) quoted IASB's statement in 2008 regarding the elimination of prudence: “the exercise of prudence does not allow for deliberate understatement of assets or income or overstatement of liabilities or expenses. [...] Introducing bias in understatement of assets (or overstatement of liabilities) in one period frequently leads to overstating financial performance in later periods - a result that cannot be described as prudent” (IASB, 2008).

Unconditional conservatism is also considered to be an inefficient way to enhance contracting efficiency (Ball & Shivakumar, 2005). Watts (2003) believed that conservatism is very useful in contracting purpose to minimize or even prevent overly optimistic actions taken by management – it is highly possible that the conservatism being mentioned here is the unconditional one. But LaGore (2011), citing Ball and Shivakumar (2005), specifically pointed out that “unconditional conservatism is just a downward accounting bias that investors and other contractual parties can adjust for *ex ante*.” Basu (2005) believed that unconditional conservatism exist not to serve for accounting valuation, but more because of contracting, tax, and litigation purposes. Another point that must be mentioned regarding unconditional conservatism is that it is a primary (though not the sole) source of unrecorded goodwill (Andre et al., 2013; Beaver & Ryan, 2005), which establishes a form of “accounting slack” that preempts the application of conditional conservatism unless news is sufficiently bad to use up that slack (Beaver & Ryan, 2005).

#### **Conditional Conservatism**

Conditional conservatism is defined as the conservatism done upon receiving news that may affect the financial aspects of the company, usually regarding to asset and earnings. Because it depends on news, this type of conservatism is sometimes called *ex post* or news-dependent conservatism. When companies receive bad news that will likely affect company's performance, they may decide to adjust the value

of asset or earnings by understating them under the supposed value to be. But when they receive good news, they do not immediately increase the valuation, as they need to verify the news at a higher degree so it can be considered as an “increase” for the company (Basu, 1997). The latter behavior is considered as conservative. The characteristic of needing higher degree of verification is what distinct conditional conservatism from unconditional conservatism. Basu (2005) underlines that timing is a crucial point, because only conditional conservatism that provides new information that could generate contracting response. Also, it is important to note that conditional conservatism involves reducing book value and income if it certain that the current condition is sufficiently adverse (Andre et al, 2013).

Previously we have discussed about unconditional conservatism and we may conclude that unconditional conservatism is bad and inefficient. Maybe we are wondering if conditional conservatism is the same. Even though the core is same, reducing assets or earnings, but as Basu (2005) mentioned timing of reduction is very crucial. It really determines whether conservative act by accountants is just to induce bias in reporting or to improve earnings quality. And in this case it looks like researchers agreed that conditional conservatism is more the beneficial conservatism as it can improve earnings quality (e.g. Ball & Shivakumar, 2005; LaGore, 2011).

### **Quality of Earnings**

Information about earnings is vital for analysts, since that is what the major of investor will look at when making decision. Consequently, the quality of all information in a financial report – earnings included – needs critical attention from reporters. In harmony with the objective of financial reporting stated in the conceptual framework, which is to provide external users with useful information for decision-making purposes, quality of earnings is of interest to those who use financial information for investment purposes (Schipper & Vincent, 2003). Investors and other capital provider

lenders are afraid of misleading information, as it will cause wrongful transfers of wealth. For example, overstated earnings can cause overcompensation to managers. Companies also have the tendency to smooth their income, to make it look good in the eyes of financial report users.

A surprising fact is that accounting standards do not bring definite explanations about quality measurements in general. Conceptual framework does mention about qualitative characteristics that must be satisfied if financial statements are to be classified as fair: relevance, faithful representation, comparability, verifiability, timeliness, and understandability. But still, the standard itself does not contain exact measurements of those characteristics. The lack of coverage regarding measurements prompts researchers to have different concepts of what earnings quality is.

It is common for people – from regular civilians to economy experts – to measure a business performance by using earnings. Therefore, Dechow and Schrand (2004) agreed that good earnings quality should be able to reflect current operating performance. Furthermore, Dechow and Schrand (2004) believed that high earnings quality should be able to indicate future operating performance and accurately capitalize the intrinsic value of the company. This reasoning aligns very well with one of the qualitative characteristics mentioned before: faithful representation. When companies are unable to prove their good performance in the financial numbers, it is possible that a repeat of Enron case will occur in the future.

Similar to the previous opinion, Dechow, Ge, and Schrand (2010) agreed that earnings quality should reflect current operation performance. Specifically, they believe that higher quality earnings should provide information about a company’s financial performance that is relevant for decision-makers when they are making specific decisions. This definition arose based on the reviews done to over 300 studies of earnings quality. Dechow, Ge, and Schrand (2010)

mentioned three features about their definition of earnings quality:

Earnings quality is situational on the decision-relevance of the information. Thus, under their definition, the term “earnings quality” alone is meaningless; earnings quality is defined only in the context of a specific decision model.

Second, the quality of a reported earnings number depends on whether it is informative about the firm’s financial performance, many aspects of which are unobservable.

Third, earnings quality is jointly determined by the relevance of underlying financial performance to the decision and by the ability of the accounting system to measure performance.

Schipper and Vincent (2003) related earnings quality with decision-usefulness and Hicksian income. Earnings quality, as stated by them, is the measurement of how good or bad earnings faithfully represent Hicksian income, which is, conceptually, the change in total wealth. They decided to focus on Hicksian income because it comes from user-decision contexts; from accounting recognition rules, from the effects of management’s judgments and estimates, and from the influence of auditors. Also, according to them, the idea of earnings quality comes from (1) the time-series properties of earnings; (2) selected qualitative characteristics in the conceptual framework; (3) the relations among income, cash, and accruals; and (4) implementation decisions.

All the above concepts of earnings quality have one thing in common. The measurements are based on the qualitative characteristics provided by the conceptual framework and also on other concepts. Ewert and Wagenhorf (2009) also reviewed studies about earnings quality measurement and came up with this definition: “earnings quality is the reduction of the market’s assessment of the variance of the terminal value (liquidating cash flow) due to the earnings report.”

### **Conservatism in Principle-Based Accounting**

Even though it is clear that IFRS really eliminates aspects of conservatism, it does not mean that accountants become unable to act conservatively. It is the space given to the accountants in applying their judgments which causes conservative accounting still exists. For example, the fair value principle itself. Fair value is regulated in IFRS 13 (PSAK 68 in Indonesia). There are three levels of hierarchy mentioned: level 1, level 2, and level 3. The first level is the most prioritized over the other levels, as it is observable and available for many assets and liabilities.

Moving on to the second level, we will start to see how IFRS induce use of judgment from accountants. Some of the level 2 inputs are quoted price for similar assets/liabilities from active or inactive market, observable implied volatility for specified assets or liabilities, etc. The inputs are also adjusted with the condition or the location of asset, the level in which the input is related with items comparable with asset or liabilities, or the volume of activities in the market where input is observable. Notice the word „similar“, it can lead to different judgments by accountants.

Level three inputs are by far the „biggest space“ given for accountants to use their judgments, because they are unobservable. The standard further states that unobservable inputs reflect assumptions, including assumption about risk. This is more or less the same reason used to apply conservative accounting mentioned by FASB. Even the standard permits an entity to develop the unobservable input with their own information. It is quite ironic that the „weapon“ for combating conservatism is the one that opens the way for conservatism instead.

Another example showing room for conservative actions is the IAS 37 „Provisions, Contingent Liabilities, and Contingent Assets“ (SAK 57 „*Provisi, Kewajiban Kontinjensi, dan Aset Kontinjensi*“). The standard clearly displayed reliance on probability – which requires judgment – to recognize provisions

(probability of payment). IAS 37 suggested that risks and uncertainties should be accounted in estimating the provisions – related with conservatism. In addition, the treatment for contingent liabilities and contingent asset is somehow conservative. The standard prioritizes the reporting of contingent liabilities (as provision) that have high percentage of occurrence, compared to contingent assets with high probability of occurrence that only needs to be disclosed.

#### **Relationship between Unconditional Conservatism and Earnings Quality**

Unconditional conservatism is a form of conservatism that accountants perform regardless of what kind of circumstances that they are going to face in the future. It is more likely that accountants become conservative just because they feel that it is much safer to report asset and earnings lower than usual to prepare themselves in facing future uncertainties. Unconditional conservatism does not consider bad conditions or earnings news upon its appliance. Accountants are free to use their judgments in choosing the more conservative accounting policy when they feel it is needed. The absence of “news constraint” enables unconditional conservatism to be performed continuously over the period as long as the business is operating. This means that companies will consistently understate the asset their assets and earnings.

Consistent understatement of asset and earnings will negatively affect the information provided in the financial statements, because it will not reflect the true financial of the reporting company. Hence, the financial statements will not be in good quality because they are not faithfully represented. Investors will lose their interest towards these kinds of companies, as they will be certain that these kinds of companies run their business pessimistically. When the earnings quality is measured with ERC – showing the magnitude of investors’ response based upon earnings information – it will probably show that investors will respond negatively towards unconditionally conservative companies.

It is reasonable that IASB demanded elimination of „prudence“ from accounting conceptual framework. If we assume that unconditional conservatism is the way meant by FASB to face uncertainties prudently, then it can be concluded immediately that prudence unnecessary. Prudence will be unnecessary because it hinders companies from producing quality financial statements, obtaining needed capital for their developments, and it will only hurt companies. Imagine if a company consistently behaving conservative for the last ten years and during the ten years nothing bad that may trigger conservative actions has happened. The company has lost big opportunities to further strengthen its economic position from investors’ fund. The company could have also developed its business operations. But because investors have negatively viewed the conservative actions, they decided to move away and find more promising investees.

Accounting earnings is to be of high quality if it contains minimum amount or even no perception interference and able to reflect true company performance. Lipe (1990) stated that increase in earnings prediction ability can make current earnings information become beneficial to predict future earnings. Hence, investors become more sensitive about earnings information and use present earnings information in investment decision-making.

Kieso and Weygandt (2007) said that earnings quality is tightly related with earnings management, in which higher earnings management leads to lower earnings quality. The same goes with conservatism that affects earnings quality. Several researchers that reject conservatism mentioned that the principle is a problem for earnings quality, as it hinders full disclosure of relevant information. They also argued that earnings under conservatism principle are not good, relevant, and beneficial. As it is pointed out by Klein and Marquardt (2000) that there are two aspects of why conservatism reduces financial statements quality, especially about relevance. The first aspect is that conservatism reports asset or profit

undervalued and it affects relevance and neutrality because of pessimism, thus affecting financial reports. The second aspect, is that conservatism delayed recognition of good news, while quickly account bad news so it causes understatement for now and overstatement in the future. Furthermore, it will cause earnings to become fluctuative and decrease the ability to predict future cash flow. Research by Feltham and Ohlson (1995) also by Penman and Zhang (2002) suggested that conservatism made earnings to be less relevant and low of quality.

The second aspect that becomes the reason why conservatism affects earnings quality by Klein and Marquardt (2000) above shows that the conservatism being discussed is the unconditional one. They argued that conservatism causes earnings to be understated for current period and higher for next periods, in which it will create fluctuation that will lead to distorted earnings.

Different with Klein and Marquardt, Watts (2003) thought that systematic understatement of net asset as a result of conservatism can generate quality earnings. This is because conservatism prevents companies from inflating earnings and helps statements users by providing profit and assets free of overstatements.

The newer IFRS accounting standard has its own underlying conceptual framework, and it is different with FASB's conceptual framework. FASB's version included conservatism as limitation in financial reporting, citing that accountants need to be prudent in facing uncertainties. The newer IFRS conceptual framework completely eliminates conservatism because IFRS think it is unnecessary. Andre et al. (2013) agreed that conservatism – specifically unconditional conservatism – consistently understate the book value of net asset. Further on, this can bias towards reporting lower earnings and stockholders' equity. Andre et al. (2013) believed, citing IASB (2008), that this continuous understatement is the reason why conservatism is eliminated from the conceptual framework.

From the statements above, we can pull out a conclusion that the form of conservatism which will understate companies' asset and profit is unconditional conservatism. This type of conservatism can cause lower earnings reporting for current period and higher earnings for the next period.

Based on the arguments above, the hypothesis that will be tested is (H1): *Unconditional conservatism negatively affects earnings quality.*

#### **Relationship between Conditional Conservatism and Earnings Quality**

Conditional conservatism is the type of conservatism performed based on news received regarding accounting elements such as assets and earnings. Conservative actions are validated through bad news that allows them to report at lower values. Different with unconditional conservatism, the conditional one needs to be preceded by "news" first as a justification. After that, accountants are allowed to proceed with conservative accounting. Because it needs "news", conditional conservatism cannot be performed continuously like it is in unconditional conservatism. We may say that conditional conservatism is a news-dependent conservatism.

One more important thing about conditional conservatism is that it does not allow immediate increase of asset or earnings even though company receives good news related to asset earnings. Accountants may increase values, but only after they can verify that the news is true and the company is in a currently good condition. Conditional conservatism does not allow deliberate understatement in order to increase earnings for future periods – it misses the essence of acting conservative, which is "prudence". Conditional conservatism does not mislead, because it is not earnings management.

Compared with unconditional conservatism, the conditional one has the ability to improve the quality of earnings information. This is because even though the core action is still the same with the previous type of conservatism, conditional conservatism is practiced based upon reliable information

that permits companies to understate their assets or profit. The timing of conservatism prevents companies from recklessly understating important information for decision making necessities. A well-timed conservatism can further improve earnings quality, because not only it reflect true financial performance, it can also show to the investors that the company has already taken preventive actions on upcoming events that negatively affect the company. With that, it is logical to expect positive response from investors which will be shown with high ERC value.

The need of higher degree of verification of good news creates an “asymmetric timeliness” of asset and profit. This is the main trait of conditional conservatism that really distinct it with unconditional conservatism. The need of preceding relevant information before committing conservatism shows that conditional conservatism is the true form of prudence that accountant have to commit. Being prudent is not realized by straightly understate assets and profit for the sake of playing safe. If assets and profits are understated without clear reason, it will create bias of reporting lower than the amount supposed to be. Furthermore, earnings information will not be able to reflect the true financial performance.

Referring to conceptual frameworks, I have previously stated that FASB’s conceptual framework included conservatism as limitations and this is the way they promote prudence. FASB aimed so that earnings information is able to reflect not only financial performance, but also unseen things – risks. IASB eliminated conservatism, but that does not mean IASB stop promoting prudence. If we look at IASB’s older conceptual framework dated on 2010, IASB stated prudence as a characteristic of reliable information. Then in 2013’s conceptual framework, IASB deleted prudence and instead put the phrase „faithful representation” and put „neutrality” as one of the required characteristics. Looking at these developments I conclude that newer conceptual framework still support the need of prudence in

accounting practice.

From all of the statements above, here I hypothesize that conditional conservatism will bring positive effects towards earnings quality because it makes earnings to be able to reflect unforeseen circumstances that are deemed bad by companies. And also, conditional conservatism is not a straightforward kind of conservatism that accountants performed just because they „feel that it is needed”.

The formulation of hypothesis is (H2):

*Conditional conservatism positively affects earnings quality.*

Both hypotheses are contradictive because of a single characteristic that distinct each type of conservatism. As it is said before, conditional conservatism is carried out based on new information about a firm’s value and earnings (Wang et al, 2009). This information is called as „news”. The term „new” information suggests that it is an unexpected shock to the firm’s value (Wang et al, 2009). I believe that the information that underlies decision to report conservatively can improve earnings quality because the earnings are able to reflect uncertainties the company will face in the future. Unconditional conservatism, in the other hand, is carried out independent of any „news”. Basically, companies become unconditional conservative “based on predetermined aspects of the accounting process” (Beaver & Ryan, 2005). Referring to the generally accepted mechanism of conservatism, lowering assets and earnings, the continuous understatement of those elements will result the financial statements become biased in a negative way because of the lack of underlying information, thus leading to worse effect for earnings quality. I decided to observe because both types of conservatism as I believe that firms view both as complements in achieving reporting objectives (Basu, 2005). As Basu (2005) discussed Beaver and Ryan’s (2005) paper, he suggested that the two types of conservatism may have different costs and benefits to different parties, and the cost-benefit tradeoffs influence the choice between the two types of conservatism in different environments.

## **RESEARCH DESIGN**

### **Research Object**

The research objectives that become the interest of me are the magnitude of conservatism and the earnings quality of Indonesian companies and U.S. companies. All the data of Indonesian companies will be taken from Indonesian Stock Exchange, and U.S. companies" data will be taken from U.S. Stock Exchange. Indonesian companies are used to represent companies that use principle-based standard, which is SAK, and the U.S. companies are used to represent entities that use rule-based standard, which is GAAP, in its accounting activities. The scope of this research is limited to the effect of conditional conservatism towards earnings quality before and after the implementation of principle-based accounting.

Data that will be used for this research are taken from financial statements, such as income statement, statement of cash flow, and statement of financial position also the stock prices of companies listed in Indonesia and U.S. Stock Exchange.

### **Research Methodology**

There are three methods that will be used in this research. They are descriptive analysis method, comparative research, and correlation research. The aim of descriptive research is to create description or depiction in a systematic, factual, and accurate manner regarding facts, conditions, and the relation between the examined phenomenon.

Arikunto (2010) states that a comparative study is a research designed to do comparison of conditions exist in two different places, whether the condition is the same or there are differences. And if there are differences, an analysis is done to determine which one is the better condition.

Waters (n.d.) defines a correlational study as a quantitative method of research in which we have two or more quantitative variables from the same group of subjects, and we are trying to

determine if there is a relationship between the two variables. Theoretically, any two quantitative variables can be correlated as long as we have scores on these variables from the same participants.

### **Population and Sample**

The population that is used in this research is companies that fulfill these specified criteria:

- Companies from Indonesia and U.S. listed in related stock exchanges (Indonesian or U.S. Stock Exchange) from 2012 to 2014 and those that published complete financial statements from the specified period.
- Indonesian companies that have fully use principle-based SAK and U.S. companies that use the rule-based GAAP. The criteria that must be fulfilled by the sampled companies are as follows:
- Companies are categorized as the 45 companies with the best stock performances in both countries (45 from Indonesia and 45 from U.S.),
- Companies that published their financial statements in Rupiah or U.S. Dollar currency,
- Companies that have complete data, and
- There is financial report submission date.

Later on, the sample will be classified into two groups based on the origin of the respective companies. The first group will consist of Indonesian companies that are currently using SAK which have accommodated IFRS in its standards. The second group will consist of U.S. companies that are still using GAAP-based accounting standards.

### **Variable Operationalization**

The variables used in this research are:

1. *Conditional conservatism as first independent variable*

The most used measurement for conditional conservatism is Basu's (1997) asymmetric timeliness, using stock price to capture good or bad news. But for this research, I am going to use the Asymmetric Accrual to Cash-flow Measure (AACF) developed by Ball and Shivakumar (2005). This

model is developed at the very first as an alternative to measure conservatism in private companies. But as long as we can obtain information about cash flow, we can use this measurement. The AACF measure is based on the following regression:

$$ACC_t = \beta_0 + \beta_1 DCFO_t + \beta_2 CFO_t + \beta_3 DCFO_t \times CFO_t + \varepsilon_t \quad (1)$$

where

ACC<sub>t</sub>: Accruals measured as Δ inventory + Δ Debtors + Δ other current assets – Δ Creditors

– Δ Other current liabilities – Depreciation

CFO<sub>t</sub>: Cash flow from operation for period t, measured as earnings before exceptional and extraordinary items less accruals

DCFO<sub>t</sub>: Dummy variable that is set to 0 if CFO<sub>t</sub> ≥ 0, and is set to 1 if CFO<sub>t</sub> < 0.

### 2. Unconditional conservatism as second independent variable

The level of unconditional conservatism is measured with accruals proxy or earnings/accrual measures as it is used by Ahmed and Duellman (2012) in their research:

$$UnCon_{it} = N_{it} - C_{fit} \quad (2)$$

where,

UnCon<sub>it</sub> = level of unconditional conservatism

N<sub>it</sub> = net income before extraordinary item

CF<sub>it</sub> = operational cash flow

### 3. Earnings quality as dependent variable (Y)

Earnings quality in this research is measured by using earnings response coefficient (ERC). ERC is a coefficient resulted from the regression between stock price proxy (Cumulative Abnormal Return or CAR) and accounting earnings (Unexpected Return or UE). Cumulative Abnormal Return (CAR) is the stock price proxy that shows the magnitude of market's response towards accounting information published and calculated with market model. CAR is formulated by using this model:

$$CAR_i(t1,t2) = \sum AR_{it} \quad (3)$$

$$AR_{it} = R_{it} - R_{mt} \quad (4)$$

CAR<sub>i(t1,t2)</sub> = i company's CAR during ± 5 days of window period from financial report publication date

(with t = 0 is publication date)

AR<sub>it</sub> = i company's abnormal return at day t

R<sub>it</sub> = real return of i company at day t

R<sub>mt</sub> = market return at day t

Real return is calculated with this formula:

$$R_{it} = (P_{it} - P_{it-1}) / P_{it-1} \quad (5)$$

Where,

P<sub>it</sub> = closing price of i's stock at day t

P<sub>it-1</sub> = closing price of i's stock at day t-1

Meanwhile, market return is calculated with this equation:

$$R_{mt} = (IHS_{gt} - IHS_{gt-1}) / IHS_{gt-1} \quad (6)$$

Unexpected earnings (UE) are the proxy for accounting earnings that shows company's performance result for a certain period of time. UE is the difference between the expected earnings with the actual earnings. UE is calculated as follows:

$$Ue_{it} = (E_{it} - E_{it-1}) / E_{it-1} \quad (7)$$

where,

Ue<sub>it</sub> = i company's unexpected EPS at period t

E<sub>it</sub> = i company's EPS at period t

E<sub>it-1</sub> = i company's EPS at period t-1

## RESULTS

### Model 1 – Indonesian Sample

**Table 1a – Result for Indonesian Sample**

R	0.70
R-squared	0.489
Adjusted R-squared	0.472

**Source: Research Data**

**Table 1b– Result for Indonesian Sample**

Variable	Coefficient	Prob.	Decision
C	0.081	0.000	
X1 Conditional Conservatism			Ho
X2 Un-Conditional Conservatism	0.014	0.033**	rejected
	0.006	0.006***	accepted

**Source: Research Data**

**Model 2 – US Sample**

**Table 2a– Result for US Sample**

R	0.970
R-squared	0.941
Adjusted R-squared	0.940

**Source: Research Data**

**Table 2b– Result for US Sample**

Variable	Coefficient	Prob.	Decision
C	0.14	0.000	
X2 Un-Conditional Conservatism			Ho
	7.49E-005	0.006***	accepted

**DICUSSION**

**Conditional Conservatism in Indonesia and US Companies and the Effects towards Earnings Quality**

The conditional conservatism coefficient for Indonesian sample is 0.014, but there is no value for U.S. sample. This shows that conditional conservatism positively affects earnings quality in Indonesia companies. This also means that investors for Indonesia companies will positively react to conditionally conservative earnings. In the other hand, the nonexistence of this variable in U.S. model may indicate different things: either they are reporting according to the true financial condition of the company, or they are actually being conservative but not according to good or bad news signals.

Empirical evidence from this research shows that Indonesian companies have the tendency to act conditionally conservative when reporting their financial information to the public. In the other hand, U.S. companies are not conditionally conservative,

proven from the results above that conditional conservatism does not affect earnings quality at all. The indicator for conditional conservatism is that if the number is more positive, it means companies are conservative. The value zero means that no matter whether a company is experiencing unfavorable conditions, it will still report financial conditions as it is happening at the current period. The fact that Indonesia decided to converge with IFRS shows that IFRS does trigger Indonesian companies to become conservative. It is quite logical considering that, as we have mentioned in the previous chapters, that IFRS give more freedom to accountants in performing their job.

The shift from rules-based to principles-based accounting shows that accountants become tempted to use their own judgments when performing their accounting responsibilities. Compared to IFRS, U.S. GAAP seems to limit the movements of accountants for at least three years starting from 2014-2015. It is evident that from the data we obtained, all companies from S&P 500 index were currently on “good news period” which is shown from the positive cash flows the companies were generating. This research uses Ball and Shivakumar’s (2005) AACF (asymmetric accruals to cash flows) and this model assumes that “good news” can be reflected from positive operational cash flows.

The hypothesis test shows that conditional conservatism positively affects the earnings quality of companies from LQ45 index, and the effect is significant. This result is the same with our alternative hypotheses which states that conditional conservatism will positively affect earnings quality. From this result, we concluded that investors that invest in LQ45 companies favor conservative reporting. It seems that investors prefer to invest in companies that are able to address bad circumstances earlier so that the managers and other involved parties can take action immediately to mitigate any unfavorable circumstances. This result also strengthens the previous opinions and research regarding conditional conservatism (Ball & Shivakumar, 2005; LaGore, 2011; Basu, 2005; Lyimo, 2014). Assuming that conservatism is related to reporting information with reduced numbers, Basu (2005) firmly stated that the timing of reduction is very essential, as it really determines whether the

reduction is to improve quality or creates bias.

### **Unconditional Conservatism in Indonesia and US Companies and the Effect towards Earnings Quality**

The unconditional conservatism coefficient for Indonesia and U.S. companies are respectively 0.006 and  $7.493 \times 10^{-5}$ . The positive values signal that unconditional conservatism is actually improving earnings quality in the eyes of investors. Furthermore, significance values from statistical tests imply that the effects are significant for earnings quality. These results are completely different with our hypotheses in which we predicted that unconditional conservatism will negatively affect earnings quality. We are basing this opinion from previous research by the likes of Ball and Shivakumar (2005), LaGore (2011), Piot et al (2010), which believed that unconditional conservatism is an inefficient form of prudence.

This research shows that the association between unconditional conservatism and earnings quality is a positive one and significant. Even though this result rejects our alternative hypotheses, it strengthens a previous research conducted by Santi (2014) which studied the effect of unconditional conservatism towards earnings quality. Her research also shows that unconditional conservatism is positively related to earnings quality. The positive effect may occur because even though the understatement is unconditional, but if it is accomplished in a systematic manner and relatively permanent, then unconditional conservatism may be responsible for improvement of earnings quality (Watts, 2003). This constant understatement can smooth net assets and earnings, thus they become less fluctuative. Wang and Williams (2011) found out that stable or nonfluctuative earnings are favored more by the market as they perceived this kind of earnings as less risky. This leads investor to act quicker towards earnings information provided by companies. Share prices starts to rise, so does the company's return. Higher return produces higher earnings response coefficient (ERC). Higher ERC indicates that reported earnings are in high quality – at least, favored by investors.

### **CONCLUSION AND IMPLICATION**

Based on the analysis result from the previous chapter, the conclusions are as follows:

1. There is a positive correlation between conditional conservatism and earnings quality as it shown from the Indonesia model. When companies decided to become more conservative upon the retrieval of bad news, investors are reacting positively, meaning the earnings quality becomes better. The effect is significant.
2. There is a positive correlation between unconditional conservatism and earnings quality for both samples. When companies report their financial information at lower values, as long as it is systematic and relatively permanent, earnings quality will become better. The effect is significant.
3. Change of accounting standards affected the level of conservativeness.
4. Conservatism is favorable in the eyes of investors.

We concluded that principle-based accounting standard did not always elevate the earnings quality. We found that the earnings quality of the principle-based accounting was not always superior compared to the rule-based accounting earnings quality. We presumed it happened because by using the principle-based accounting standards, the companies had opportunities and flexibilities to imply judgments in presenting their financial statements which not representing the reality of the transactions.

### **Suggestions for Future Research**

There are several suggestions that I provide for future researches, such as:

1. Future researchers should use longer observation period in order to generate more convincing results, especially for conditional conservatism, as it includes dummy variables. It needs to be remembered that financial data are somehow very volatile or unpredictable because they are affected by a lot of variables that we may not be able to explain clearly.
2. Future researchers may use other proxies for the variables measurement. For example, future researchers may use other proxy than ERC to measure earnings quality. ERC is

somehow subjective to investors" preferences – from the accounting point view one thing may look bad, but that does not mean investor will hold the same opinion about the specific thing.

3. Future researchers may limit classify their samples based on the industry the companies are competing. By doing this, researchers can identify which industry have the tendency to report their income conservatively.

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## ASSET ALLOCATION STRATEGY UNDER RATE OF RETURN, RATE OF INFLATION AND CREDIT SPREAD RATE IN FINITE-TIME HORIZON

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### **ABSTRACT**

*The global financial crisis has given a very tremendous financial market chaos in the world. Beside the reason that it caused mostly by the bubble economic, it also caused by the ignorance of default risk from bond derivatives such as CDO, CDS and SWAP. Those portfolio of bond ignored the risk of the low rating bonds, which gives a very high risk of having default. This research aims to find an optimal solution for dynamic portfolio in finite-time horizon under defaultable assets. Defaultable assets mean that the assets has a chance to be liquidated in a finite time horizon, e.g stock and corporate bond. The assets that will be used here are limited to the equity, corporate bond and money account. In this study, beside for having the risk of default, the investor will also consider the risk of market such as inflation into her investment. The indirect utility function will be used as the reference for investment decision. Further the asset allocation will be obtained by maximizing the total expected discounted utility in the time span during the investment is executed.*

*To determine the financial defaultable assets, there are two methods that can be used, namely the reduced form and the structural methods. The first method is more applicable because the assets price can be linked with the market risk and credit risk and the latter method. The interest rate and the rate of inflation will be allowed as a representation of market risk, while the credit spread will be used as a representation of credit risk. Furthermore, the dynamic of asset prices can be derived analytically by using Ito Calculus in the form of the movement of the three risk factors above.*

*The dynamic process of investor wealth will be derived from the dynamics of asset prices and budget constraints, which will be linked with portfolio composition. This problem will be solved using the stochastic dynamic programming method. Depending on the chosen utility function, the optimal solution of the portfolio composition can be found explicitly in the form of feedback control. The closed form solution will give the proportion of wealth between bond and money account. Furthermore, the composition of the portfolio will be given as the result. The complicated equation of bond pricing will follow recovery market value (RMV) methods. The finding model is later simulated with different possible values of the parameters. The result shows that the optimal asset allocation will depend on various parameters such as correlation between the risks, the chosen utility function and also recovery rate.*

**Keywords:** *Optimal Portofolio, Defaultable Assets, Dynamic Programming, Optimal Stochastic Control*

## INTRODUCTION

### (1) Background Motivation

In case of Indonesia, investing in financial assets is not yet attractive widely as in other countries. But the trend of the investors are increasing well year by year, since the Indonesian people gain their knowledge and aware about the benefit for having investment in portfolio. The trend for the the price of stock every year is increasing, since there are many companies launching their IPO in the Indonesian financial market. This reason can be explained through Indonesian index of *Indeks Harga Saham Gabungan* (IHSG) or Jakarta Composite Index (JSX) which are representative of all the stocks pricing in Indonesia (see figure (1)), from nine sectorial indices such as agriculture; mining; basic industry and chemicals; miscellaneous industry; consumer goods industry; property and real estate; infrastructure utilities and transportation; finance; and trade, services and investments. It can be seen that the trend of IHSG line shows a promising perspective of stocks performance in Indonesia. It goes increasingly positive through the years. The volume of IHSG index trading in October 2016 is 6.31 billion with mean of Rp. 4,680.043, and volatility of 436.8886. This data is taken from <https://finance.yahoo.com/> for stock index of IHSG from January 2012 to October 2016.

Also many Indonesia Corporates started to launch their corporate bonds lately. According to the report of Asian Development Bank (ADB) in June 2013 (<http://investasi.kontan.co.id>, retrieved in February 5th, 2014), Indonesia Corporate Bond market has reached U.S\$ 20 billion at the end of March 2013. It means growth year of year noted as 26,9%. The Head of Fixed-Income Security of Bank Central Asia (BCA), Herdi Ranu Wibowo, said "it is a very prospecting trend because of the macroeconomic condition in Indonesia is quite good. This will make other corporate bond issuance will be much more interesting to launch rather than to

seek a loan from the bank as a source of funding. This also will bring to a very good prospective of the corporate bond growth in Indonesia". Even though in other point of view the money account which is represented by government bill is also increasing through the time. These phenomenon can be explained through the stylized facts of how the trend of corporate bond index and government bill index go. Those are going increasingly through the time with mean of Rp. 102.597 and volatility of 8. 539745; and mean of Rp. 106.8519 with volatility of 12,66174. The trends are depicted in figure (1) on second and third figures, where the data goes from January 2012 – October 2016. Those data are taken <http://us.spindices.com/indices/fixed-income/sp-indonesia-corporate-bond-index> for corporate bond index and government bill index. For corporate bond index and government bill index show that the trends are monotonically increasing, the interpretation in this situation is that the liquidity in both are very low because the investor tends to hold them to time of maturity. Therefore these three assets in general shows us that the growth of investment in Indonesia are well developed, and as a consequence for a growing investment, the investment risks will also increase.

In other part, after Asian Crisis in 1997-1998 the Central Bank of Indonesia has changed its monetary policy framework from having a multiple ultimate targets as for inflation, economy growth and job creation, into a single ultimate target which is inflation rate. It means that the central Bank of Indonesia has mentioned explicitly that they will always interfere the inflation as the last ultimate target for Indonesian Monetary Policy. To reach this target, central bank will set a short term operational targets that will be adapted to the performance of economy and financial markets Sitorus (2015). This will follow that policy to regulate the inflation will affect the value of assets. This also strengthen the influence of rate of inflation is important to the asset pricing model. Therefore the study in dynamic portfolio under equity, corporate bond and money account is very interesting to do, especially in Indonesia.

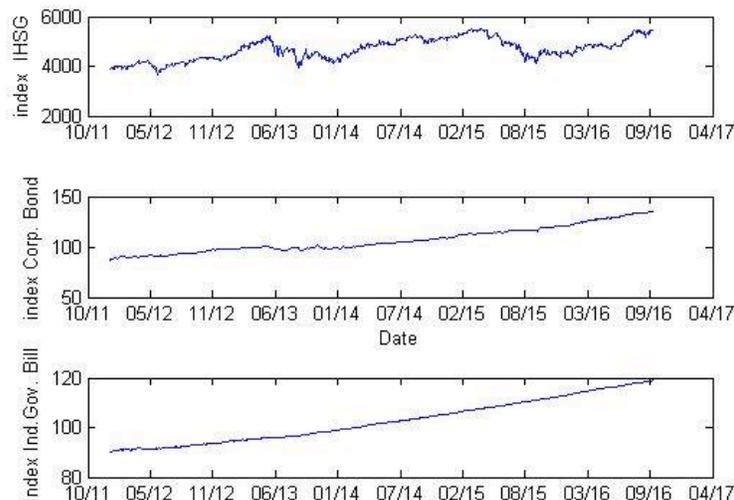


Figure 1: The stylized fact of assets trend in Indonesia, Indonesia index IHSG, Indonesian Corporate Bond Index, and Indonesian Government Bill

## (2) Literature Review

Markowitz (1952) has introduced optimization for static portfolio optimization which based on mean variance from the benchmark risk of an investor in a single period. To solve the problem of maximizing return for a certain risk-level, he also gave a very important contribution into this model, which is to quantify the risk by using variance. This made his work very famous and it becomes the foundation in modern portfolio theory (Markowitz, 1952). However, his model is time independent and cannot link the change in wealth process of investor with the investment.

The work of Markowitz was further extended by Samuelson (1969) using discrete time model by entering the dynamic way and assessing the optimal investment by including the consumption function. Further his works is extended by Merton (1969, 1971) by using continuous time and added discounted utility of terminal wealth. In this model they were able to separate the optimal value function of the portfolio and to make the solutions explicit and time dependent. Their works have given a new perspective of modeling portfolio and it was called dynamic portfolio model.

In modeling portfolio model, first thing to do is to decide the fundamental model of portfolio, between continuous-time model and discrete time model. Next step is to choose the type of

market between complete and incomplete market. For complete market, it is assumed that the trading assets are equal with the traders, so there would be no friction in the market. For incomplete market the trading assets are less than the amount of traders. After the assumption is made then the assets model of pricing will be defined where it will be inbounded with the composition of portfolio. These assets prices will be define as risk-free asset and risky asset. The risky-asset is asset that has a chance to face the risks. Next step is to define the objective of the investor where it is to maximize the investor wealth or to minimize the portfolio risk. These steps are then following with other underlying assumption of parameters such as time-horizon of investment by choosing long life investor or finite-time investor, control variable as the control parameter for investor which are usually asset composition and/or consumption.

After defining the asset pricing model, as already mentioned above, then we have to define the risks that has to be taking care of in order to define the model of portfolio. First of all is the credit risk which is linked with the defaultable asset or defaulty assets. Defaulty asset means that the asset has a chance to be liquidated in finite time horizon. Default value is considered as the main parameter for credit risk when an obligor fails to pay its debt or shows deteriorating its credit worthiness. Since the global financial crisis

occurred in 2008, the credit risk has become an important point of view for investors, countries and also financial researchers. This event has shaken the world until this day. There are many assets of the investment in US had been derived from mortgages securities before the global crisis in 2008. These mortgage securities and credit derivatives, such as Collateralized Debt Obligation (CDO) and Credit Default Swaps (CDS), were failure, and caused the collapse or bankruptcy for several important firms in US, such as Lehman Brothers, AIG, Merrill Lynch, and HBOS. Lehman was the fourth largest US investment bank at the time is collapsed (<http://www.investopedia.com>). They filed for bankruptcy on September 15, 2008 with \$639 billion in assets and \$619 billion in debt. The trigger of the default made Lehman Brothers had to register for Chapter 11 & US Bankruptcy code. Since then there are many studies including the credit risks into their portfolio researches such as Ankirchner et.al (2010) with deterministic interest rate and finite time horizon, under the Quadratic Backward Stochastic Differential Equation (QBSDE); Jiao (2012) under jump diffusion model for the credit risk model and find the solution under Backward Stochastic Differential Equation (BSDE); Bo et al. (2010); and Bo et al. (2013b) use the credit risk as jump diffusion model and find the solution under the Stochastic Differential Equation, they differ only in using the utility of investor. There are two methods used to describe the credit risk into the asset pricing model and determine it into the asset pricing, namely, the reduced form method and the structural method. The first method is more applicable because the assets price can be inbounded with the credit risk, while the second method the asset pricing is linked only with the dynamics inside the firm (Bielecki and Rutkowski, 2002).

Beside credit risk there is also market risk that should be considered, such as the rate of return and the inflation rate. Most of the studies in dynamic portfolio use only deterministic rate of return as market risk, rarely put rate of inflation in their study such as Samuelson (1969), Merton (1969, 1971), Karatzas et al. (1987), Grauer & Hakansson (1999), Campbell et al. (2001), Zariphopoulou (2001), Brennan and Xia (2002), Hou and Jin (2005), Hou (2003), Zhou and Li (2000), Castañeda-Leyva and Hernández-Hernández (2005), Stoikov and Zariphopoulou

(2005), Bielecki and Jang (2006), Dai et al. (2009), Callegaro et al. (2012) and by adding the credit risks in jump diffusion model such as Ankirchner et al. (2010), Jiao et al. (2013) and Bo et al. (2013a). The studies that combine both rate of return and rate of inflation are done by Brennan and Xia (2002) where both risks are under stochastic process in the form of Vasicek Model and Hou and Jin (2005) where the rate of return is deterministic. But in fact risks between the credit risk and the market risk cannot be separated without some assumptions in asset pricing, according to Jarrow and Turnbull (1995). Hou (2003) put this issue to his study in dynamic asset allocation problem at the time when investors meet the credit and market risk only under the rate of return simultaneously.

Of all these aforementioned studies none of them combined market risk and credit risk together which representative by rate of return, inflation rate and credit spread rate into the assets pricing model where the objective is to optimize the portfolio. Therefore, this research will study the optimization of portfolio modeling where the assets are considered as default assets, because the risks of market risks and credit risk are inbounded into the asset model.

## **RESEARCH QUESTION**

Therefore from the side of literature studies and also Indonesian point of view, it is important to understand deeply how the portfolio will be optimal when the assets pricing is assumed as closed enough as the reality where it can be default (representative by credit spread rate) at any time and also to add the influence of inflation rate into the portfolio model together with the credit spread rate. These reasons are made since that in the previous studies there are none of them bring the inflation rate and credit spread rate together in their portfolio model, and also it is important to bring those risks together in order to be implemented in Indonesia, because the Indonesian monetary policy said that the Central Bank of Indonesia has right to control the inflation rate, therefore it will affect the portfolio investment. Furthermore, the assumption in this study is taken as close as the real fact in financial market, e.g such as incomplete market which means that the trading assets are less than the number of investor. In

mathematical model the number of uncertainties in economic model is bigger than the number of assets where the uncertainties are represented by differential of Wiener process. Another addition to use in this study is to take the investment time under finite time horizon. The Research Question of this research will be

**How the portfolio optimization strategy under default assets with finite time horizon will be defined:** where the assets pricing model will be defined as the default assets or defaultable assets. The defaultable asset means that the asset will be modeled under risky asset and those are defined as equity and corporate bond. For other asset such as money account will be used as to compensate the risky assets. The problem of defining the asset model pricing is to define the bond pricing model, because the market risk and credit risk, as for rate of return, rate of inflation and credit spread in the form of Vasicek model will be integrated into this pricing model. This problem has been solved by Rizal (2016) where later in this study we use Rizal (2016) model for the defaultable corporate bond pricing, the equity pricing model and the money account.

**Then, following that the explicit solution of the optimal portfolio composition can be determined by applying stochastic dynamic programming. The optimal solution can be solved explicitly in the form of feedback control by finding the maximal investor-utility. By this, the following research questions will be added with:**

- 1. How the investor utility will be obtained in the time span during the investment?**
- 2. How the composition of assets will be obtained in the time span during the investment?**
- 3. How the optimal portfolio composition will be varied under different correlation of market and credit risks? What is the impact for each asset composition?**

## **RESEARCH METHOD**

This study used the quantitative finance or financial mathematics approach as its

methodology. This method is rather different with the methodology that is often used in the field of management or business. To define the finding model or to build theory in management study, the research is started from the empirical finding or empirical data. (Sekaran and Bougie (2003), Saunders (2011)). In the contrary, for methodology using financial mathematics approach, the mathematical tool is used to draw the model from economic theory, stochastic processes, statistics and probability theory. This approach is also used to build the mathematic model as to describe the intuition that is happened in the reality (Steland (2012)), where the starting point of this method is started from the state of the art in the previous studies. By this reason, the approach that is used in this study will not start from the empirical finding, but well from building mathematical model. After the model is found then it will be calibrated using the previous or simulated data to validate or describe the result and using intuition and comparing with the previous model in the previous study, where also the management finance issues will be discussed further.

## **SAMPLE SELECTION AND DATA COLLECTION**

In this study there are three assets that will be used, defaultable zero coupon bond, equity and money account. For bond data, the value and the parameters that will be used are the one that correlated with the credit spread rate. Credit spread rate data is another issue to be studied. The reason why credit spread rate is another field to study, among other things are:

- a. The problem on how to compare the issue date and maturity date between corporate bond and government bond. Most of these bonds have no similarity on the date of issuing nor the date of maturity. Therefore the "apple-to apple" comparative of the dates is another study to do.
- b. The bond tenor is also hardly to adjust between those bonds. Usually corporate bond has a short time of maturity, but government bond has a long time of maturity.

- c. The trading date among bonds is very unpredictable. Corporate bonds are traded mostly in over-the-counter market (OTC), where the liquidity and the clarity for each bond price are much customized depend on how the obligor and the OTC having their trading agreement. Therefore there is no settlement date for bond market, and the liquidity timing is another issue to be deal with.
- d. The addition of accrued interest on bond pricing when bond trading is done before and after the coupon payment. Accrued interest is the important thing to be add for compensating the coupon payment since the trading is not on the date of coupon payment. Therefore to add the accrued interest to the bond pricing model is also another study to be done.

Therefore based on these reasons, the assumptions for bond data, equity and all parameters included in this study are defined as follows:

- a. The initial data that we use for credit spread parameter is using the data of Bakshi et al. (2001) (which is extend to Bakshi et al. (2006)), this data was used also by Hou (2003) and Hou and Jin (2005). We understand it fully that when we considered about the market, the data from Bakshi et al. (2001) was happened in USA, and the data for rate of inflation and rate of return are taken from Indonesian market, actually cannot be mixed directly. Therefore we use only the number of value for credit spread parameter, where it is used and set as the initial values for the simulation analysis, and later we make the simulation for random values of the initial set to see the sensitivity of our model.
- b. Furthermore, we will take the value of rate of return from Indonesian market, and also the rate of inflation to be used in this portfolio. Taking these two parameters from Indonesian market is to show and validate that the vasicek model which will be founded later, for rate of return and rate of inflation can run smoothly. To find the parameters values for rate of return and inflation rate are processed using Ait-Sahalia model, where the calculation is already given in matlab toolbox

<http://www.princeton.edu/~yacine/ClosedFormMLEUsersGuide.pdf>, where in this toolbox the behavior of maximum likelihood for each data can be taking care of and it can process the values for every parameter that is need such as volatility ( $\sigma$ ), Ornstein Uhlenbeck coefficient ( $\kappa$ ), and long term run value ( $\theta$ ). The data for the inflation rate and rate of return from Indonesian market are justified through the parameter of inflation rate and rate of return that are used in Hou (2003), Hou and Jin (2005) and Brennan and Xia (2002), where the values are quite around the value from those three studies.

- c. The stylized facts of the assets and also the risks that are modeled here are considered in normal distribution, therefore the use of random walk model is presence in this study. By using random walk, the assets and also the risks have expected mean and median value closed to zero.
- d. In real world, the portfolio using bond are usually coming from two bonds one defaultable bond and one is undefaultable bond. To derive the model that using two bond can give a very complex solution. Therefore for the sake of simplicity without loss of generality, we exclude the undefaultable bond in this study and focused only on defaultable bond.
- e. For corporate bond model we will use zero corporate defaultable bond. For the sake of clear intuition, we will assumed that the coupon parameter is not involved in this model. Therefore the defaultable bond is assumed as defaultable zero coupon bond (DZB).
- f. For data of stock we also use simulation data, which the parameter values of stock will be simulated in range of number. This equity value will has volatility value of stock, using rate of return, correlation between the equity and the risks. The initial values for stock parameter are also taken from Brennan and Xia (2002) and Bakshi et al. (2001).
- g. For money account, it will be influenced with the rate of return. The assumption for using money account model is made based on the previous studies Hou and Jin (2005). By using the defaultable bond only with the money account is to see on how the rate of return, the rate of inflation and the credit spread rate will have a connection to the

assets. In other reason is that by using money account it gives less complexity in the derivation than using undefaultable bond. In undefaultable bond we have to face another Brownian derivation in its pricing model.

- h. Further the simulation for the finding model will be simulated for one week trading.
- i. The date of trading for bond transaction in this study will be set on the settlement date so that there is no accrued interest involved in this simulation and the liquidity for other assets are following this settlement date of bond.

For data collection there are several data which are taken from Indonesian data sources such as rate of return, date of inflation, stock and bond. The data of return and rate of inflation (<http://www.bi.go.id>) and (<http://www.tradingeconomics.com/indonesia>), are taken from January 2010 to December 2015. The data of those rates are given in monthly data, therefore the data will be taken as long as possible to have the best information from those values. The other data such as bond pricing, credit spread data the simulating data will be used, since we want to simulate from several aspects regarding the choice of the investor appetite. Also by using simulated data a better insight from the result can be seen.

## MODEL BUILDING

### (1) Market Risk and Credit Risk

From Rizal (2016) it is defined that the rate of return, the rate of inflation and the credit spread rate under vasicek model are respectively equal to:

$$dr = \kappa_r(\theta_r - r)dt + \sigma_r dW_r \quad (1)$$

$$dI = \kappa_I(\theta_I - I)dt + \sigma_I dW_I \quad (2)$$

$$d\delta = \kappa_\delta(\theta_\delta - \delta)dt + \sigma_\delta dW_\delta \quad (3)$$

where:

- $\kappa_r, \kappa_I, \kappa_\delta$  are the coefficient to represent that the Ornstein Uhlenbeck process for respectively rate of return, rate of inflation and credit spread rate which is an elastic random walk process (which possess a stationary distribution, only for  $\kappa_r, \kappa_I, \kappa_\delta > 0$ ),

- $\theta_r, \theta_I$  and  $\theta_\delta$  are respectively the long term mean of return, rate of inflation, and credit spread rate,
- $\sigma_r, \sigma_I$  and  $\sigma_\delta$  are respectively the variance of rate of return, rate of inflation and credit spread rate.
- $dW_r, dW_I, dW_\delta$  are respectively the differential of Wiener process for return, rate of inflation and credit spread rate which have normal distribution.

### (2) Bond Pricing Model

Bond pricing model that will be used here is the corporate bond which is subject to default risk. The defaultable corporate zero coupon bond (DZC) will be used in this study to have clearest intuition and implications. Starting with definition for DZC:

- the maturity date for DZC is  $T_1$  where  $T_1 \in \mathcal{T}$ ,
- the principal of the bond is  $F$ ,
- default time is  $\tau$  where  $\tau \in \mathcal{T}$  that is if  $\tau \in (T_1, \infty)$ ,
- at the time of default the payment would be  $z(\tau)$ , which is recovered in fulfillment of the debt obligation and which is only a fraction of the promised amount will be recovered upon default,
- the coupon process is zero, since defaultable zero coupon bond is used,
- it is defined as a vector DZC  $= (F, z, \tau, T_1)$

The model of DZC bond pricing model which has been derived in Rizal (2016), will be given as follows:

$$\frac{dB(t, T_1)}{B(t, T_1)} = [r + I - \eta]dt + \zeta_r(t, T) \cdot \sigma_r dW_r + \zeta_\delta(t, T) \cdot \sigma_\delta dW_\delta \quad (4)$$

$$\text{for } \zeta_r(t, T) = \frac{\exp(\kappa_r(T_1 - t) - 1)}{\kappa_r} \quad (5)$$

$$\zeta_I(t, T) = \frac{\exp(\kappa_I(T_1 - t) - 1)}{\kappa_I} \quad (6)$$

$$\zeta_\delta(t, T) = \frac{\exp(\kappa_\delta(T_1 - t) - 1)}{\kappa_\delta} \quad (7)$$

where

$r$  is the rate of return,  $\delta$  is the credit spread rate,  $I$  is the rate of inflation,  $\eta$  is the expected recovery rate of defaultable bond until default occurs,  $T_1$  is the default time and  $t$  is time

This expected recovery rate of defaultable bond until default occurs term is happened because of the Recovery Market Value approach consequences that has been used for credit spread approach in Duffie and Singleton (1999). The expected recovery rate  $\eta$  is defined as a function of  $\delta$  and  $\omega$ , where  $\omega$  is defined as write down rate and the value is constant.

$$\eta(t) = \frac{1-\omega}{\omega} \delta(t)$$

(8)

It also indicates that  $\eta$  is also a stochastic process as well as  $\delta$ . Therefore the dynamics of  $\eta$  can be further defined as follows:

$$d\eta = \kappa_\delta(\theta_\eta - \eta)dt + \sigma_\eta dW_\delta$$

(9)

where

$$\theta_\eta = \frac{1-\omega}{\omega} \theta_\delta \text{ and } \sigma_\eta = \frac{1-\omega}{\omega} \sigma_\delta$$

### (3) Equity and Money Account Pricing Model

The equity pricing model is defined as follows:

$$\frac{dS}{S} = r(t)dt + \sigma_s dW_S$$

(10)

where  $dS$  is equal with the delta of stock pricing from today and day before,  $S$  is today stock price,  $r(t)$  is the rate of return,  $\sigma_s$  is the volatility of the stock pricing and  $dW_S$  is the wiener process of the stock pricing. The risk structure of equity is under the risk-neutral probability measure  $Q$ , which is later should be adjusted together with other risk to the same probability measure of  $P$ .

Money account will be defined such that:

$$\frac{dP}{P} = r(t)dt$$

(11)

where  $dP$  is equal with the delta of money account from today and the day before.

### (4) Integrating Risks and Assets Pricing Model to Portfolio Model

Given the risk structures in this study that show in Wiener processes, we have dynamic  $S$ ,  $r$ ,  $\delta$  and  $I$  under the physical measure  $P$  which can be derived given the specifications of the market prices of risks. This transformation can be done since the investor in this study is assumed as risk averse person, and the utility is under the physical measure. Using Girsanov theorem we do the drift adjustment under the risk-neutral probability measure  $Q$  to the physical probability measure  $P$ . This transformation will also give the constant unit risk premium associated with the market, where this haven't associated before when they are defined on each measure probability. This theorem can be applied to the case of independent Brownian motions, given that:

$$dW_S dW_r = \rho_{Sr} dt$$

(12)

$$dW_S dW_I = \rho_{SI} dt$$

(13)

$$dW_S dW_\delta = \rho_{S\delta} dt$$

(14)

$$dW_r dW_I = \rho_{rI} dt$$

(15)

$$dW_r dW_\delta = \rho_{r\delta} dt$$

(16)

$$dW_\delta dW_I = \rho_{\delta I} dt$$

(17)

where  $\rho_{Sr}, \rho_{SI}, \rho_{S\delta}, \rho_{rI}, \rho_{r\delta}$  and  $\rho_{\delta I}$  are respectively the correlation between stock – rate of return, stock- rate of inflation, stock – credit spread rate, rate of return – inflation, rate of return – credit spread rate, and credit spread rate-inflation rate.

Therefore equation in (1), (2), (3) and (10) can be derived to the same physical measure of  $P$ .

$$dS = [r(t) + \sigma_s(\rho_{Sr}\bar{\lambda}_r(t) + \rho_{S\delta}\bar{\lambda}_\delta(t) + \rho_{SI}\bar{\lambda}_I(t) + \bar{\lambda}_S(t))] \cdot S(t) \cdot dt + \sigma_s \cdot S(t) \cdot dW_S^P$$

(18)

$$dr = [\kappa_r(\theta_r - r) + \sigma_r(\bar{\lambda}_r(t) + \rho_{r\delta}\bar{\lambda}_\delta(t) + \rho_{rI}\bar{\lambda}_I(t) + \rho_{Sr}\bar{\lambda}_S(t))] dt + \sigma_r dW_r^P$$

(19)

$$d\delta = [\kappa_\delta(\theta_\delta - \delta) + \sigma_\delta(\rho_{r\delta}\bar{\lambda}_r(t) + \bar{\lambda}_\delta(t) + \rho_{\delta I}\bar{\lambda}_I(t) + \rho_{\delta S}\bar{\lambda}_S(t))]dt + \sigma_\delta dW_\delta^P$$

(20)

$$dI = [\kappa_I(\theta_I - I) + \sigma_I(\rho_{rI}\bar{\lambda}_r(t) + \rho_{\delta I}\bar{\lambda}_\delta(t) + \bar{\lambda}_I(t) + \rho_{SI}\bar{\lambda}_S(t))]dt + \sigma_I dW_S^P$$

(21)

where the terms  $\bar{\lambda}_i (i = S, r, \delta, I)$  are respectively defined as deterministic market price of equity risk (equity premium), deterministic market price of interest rate, deterministic market price of default risk and deterministic market price of inflation rate.

### (5) Portfolio Model

The portfolio can be solved using equation (4), (11), (18) to (20) such as that each of asset has its on weight during the investment time period:

$$\begin{aligned} \frac{dX}{X} &= \frac{dB}{B}\pi_B + \frac{dS}{S}\pi_S + \frac{dP}{P}\pi_P \\ &= \frac{dB}{B}\pi_B + \frac{dS}{S}\pi_S + \frac{dP}{P}(1 - \pi_B - \pi_S) \\ &= \{r(t) + \pi_B[I(t) - \eta(t) + A_1(t)] + \pi_S A_2(t)\}dt + \pi_B \zeta_r \sigma_r dW_r^P + \pi_B \zeta_\delta \sigma_\delta dW_\delta^P + \pi_B \zeta_I \sigma_I dW_I^P \\ &\quad + \pi_S \sigma_S dW_S^P \end{aligned} \quad (22)$$

For

$$A_1 = \sigma_r \bar{\lambda}_r + \zeta_\delta \sigma_\delta \bar{\lambda}_\delta + \zeta_I \sigma_I \bar{\lambda}_I \quad (23)$$

$$A_2 = \sigma_S (\bar{\lambda}_S + \rho_{Sr} \bar{\lambda}_r + \rho_{S\delta} \bar{\lambda}_\delta + \rho_{SI} \bar{\lambda}_I) \quad (24)$$

where  $\pi_B, \pi_S$  and  $\pi_P$  will be defined respectively as the weight of defaultable zero coupon bond, weight of equity, and weight of money account.

Further the utility function has to be defined to solve this optimization problem, using stochastic control method. Recall that  $\omega$  is the write-down rate when default occurred and it gives implication that the expected recovery rate of defaultable bond  $\eta$  will be a state variable in addition to wealth  $X$ .  $\eta$  will be observable since that credit spreads rate are observable in the

market, this is also happened by the implication of assuming that  $\omega$  is constant. Therefore by defining indirect utility (CRRA utility) function from Merton (1971) as also used by Hou and Jin (2005) under Hamilton Jacobi Bellman (HJB) equation, it will be given as follows:

$$J(X, r, \eta, I, T) = \frac{X^{1-\gamma}}{1-\gamma}$$

(25)

this utility is maximum subject to  $D^\pi J(X, r, \eta, I, T) = 0$

Under rigorous calculation using stochastic dynamic programming the utility is found as a function of risks such as:

$$J(X, r, \eta, I, T) = \begin{cases} g(t) \cdot \exp \left[ \begin{aligned} & f(t) \cdot r(t) + k(t) \cdot \eta(t) \\ & + \frac{1}{2} l(t) \cdot \eta(t)^2 \\ & + m(t) \cdot I(t) + \frac{1}{2} v(t) \cdot I(t)^2 \end{aligned} \right] \frac{X^{1-\gamma}}{1-\gamma} & \text{for } \gamma \neq 1 \\ \ln X & \text{for } \gamma = 1 \end{cases} \quad (26)$$

with

$$g(t) = \exp \left( \int_t^T C_0 dt \right) \quad (27)$$

$$f(t) = \begin{cases} 0 & \text{for } \gamma = 1 \\ \frac{1-\gamma}{\kappa_r} (1 - \exp(\kappa_r(t-T))) & \text{for } \gamma \neq 1 \end{cases} \quad (28)$$

$$l(t) = \bar{C}_3 + \frac{\bar{A}}{\bar{C}_4 \cdot \exp(\bar{A}(t-T)) - \bar{C}_2} \quad (29)$$

$$v(t) = \bar{C}_{12} + \frac{\bar{B}}{\bar{C}_{13} \cdot \exp(\bar{B}(t-T)) - \bar{C}_{11}} \quad (30)$$

$k(t)$  and  $m(t)$  will be solved under this equation below

$$\begin{bmatrix} k'(t) \\ m'(t) \end{bmatrix} = \begin{bmatrix} -(\bar{B}_1 + \bar{B}_2 l(t)) & -(\bar{B}_3 + \bar{B}_4 l(t)) \\ -(\bar{B}_6 + \bar{B}_7 l(t)) & -(\bar{B}_8 + \bar{B}_9 l(t)) \end{bmatrix} \begin{bmatrix} k(t) \\ m(t) \end{bmatrix} - \begin{bmatrix} \bar{B}_5 \\ \bar{B}_{10} \end{bmatrix} \quad (31)$$

all the components stated in these equations from (26) to (31) are referred to appendix.

Further after the utility function is defined, then the weight of assets for maximizing utility is also found. The result will be given as follows:

1. Weight of Bond asset

$$\pi_B = \frac{1}{\gamma} [\Omega_1 + \Omega_2(\eta(t) - I(t))] + \frac{1}{\gamma} [\Psi_1 \cdot f(t) + \Psi_2 \cdot (k(t) + l(t)\eta(t)) + \Psi_3 \cdot v(t) \cdot I(t)] \quad (32)$$

2. Weight of Equity (stock)

$$\pi_S = \frac{1}{\gamma} [\Omega_3 + (\eta(t) - I(t))] - \frac{1}{\gamma} [\Psi_4 \cdot f(t) + \Psi_5 \cdot (k(t) + l(t)\eta(t)) + \Psi_6 \cdot m(t) \cdot v(t) \cdot I(t)] \quad (33)$$

3. Weight of Money Account

$$\pi_P = \frac{1}{\gamma} [\Omega_4 + \Omega_5(\eta(t) - I(t))] + \frac{1}{\gamma} [\Psi_6 \cdot m(t) + \Psi_7 \cdot f(t) + \Psi_8 \cdot (k(t) + l(t)\eta(t)) + \Psi_9 \cdot v(t) \cdot I(t)] \quad (34)$$

where:

$$\begin{aligned} \Omega_1 &= \frac{2A_2 C_1 \bar{C}_y}{C_5} & \Psi_2 &= C_1 E_2 + D_3 \\ \Omega_2 &= \frac{4C_1}{\gamma C_5} & \Psi_3 &= \bar{C}_y \\ \Omega_3 &= \bar{C}_y & \Psi_4 &= E_1 \\ \Omega_4 &= \gamma - \Omega_1 + \Omega_3 & \Psi_5 &= E_2 \\ \Omega_5 &= 1 + \Omega_2 & \Psi_6 &= E_3 \\ \Psi_1 &= C_1 E_1 + D_1 & \Psi_7 &= \Psi_4 - \Psi_1 \\ & & \Psi_8 &= \Psi_5 - \Psi_2 \\ & & \Psi_9 &= \Psi_6 - \Psi_3 \end{aligned}$$

for all definition of  $A_2, C_1, C_5, \bar{C}_y, D_1, D_3, E_1, E_2$  and  $E_3$  are defined appendix.

From equation (32) to (34) it can be seen that weight for bond, equity and money can be defined where all of those risks are clearly integrated together the weight models, where it can be seen that the weight are by those risks depend on utility coefficient ( $\gamma$ ), write down rate ( $\omega$ ) and all correlations parameters  $\rho_{Sr}, \rho_{St}, \rho_{S\delta}, \rho_{rI}, \rho_{r\delta}$  and  $\rho_{\delta I}$ .

## RESULT ANALYSIS

Here in this section the theoretical results will be illustrated. The data is taken from Indonesian data for rate of return and rate of inflation, while for credit spread rate the data is taken from Hou and Jin (2005) and Hou and Jin (2005). The values for equity matter is also taken random value that close to the value from Brennan and Xia (2002).

The initial values will be given in table 1. The parameters values for rate of return and rate of inflation in that table below were found using Ait-Sahalia model.

The initial values will be given in table 1. The parameters values for rate of return and rate of inflation in that table below were found using Ait-Sahalia model. The data of rate of return and rate of inflation are processed using Ait-Sahalia tool. <http://www.princeton.edu/~yacine/ClosedFormMLEUsersGuide.pdf>, where in this tool the behavior of maximum likelihood for each data can be taking care of and it can process the values for every parameter that is need such as volatility ( $\sigma$ ), Ornstein Uhlenbeck coefficient ( $\kappa$ ), and long term run value ( $\theta$ ).

The results from equation (26), (32), (33) and (34) will be simulated and varied for all parameters to examine the sensitivity of finding models, which is assumed that the trading is done for weekly trading. This simulations are done using Matlab program, where there are 25 program files that had been made to see the optimization results model clearly. The finding model of weight composition equations (32), (33) and (34), give different perspective from previous studies. The addition of all risks, rate of return, inflation rate and credit spread rate are showed up in all assets composition model. In previous studies there are only rate of return and inflation rate (see Brennan and Xia (2002)) or rate of return and credit spread rate (see Hou (2003) and Hou and Jin (2005)) showed up in their model. Also

if it is compared with the portfolio theory of Markowitz (1952), the additional term to the composition of weight is the time dependency. The assumption that we used here are also fit with the assumption that were made by the aforementioned studies above. The distribution of data that we used here is the normal distribution data, for assets and risks. Therefore the finding values for parameters such as mean, volatility, liquidity and correlations are the same with those previous researches.

Table 1. Initial parameters and the values

Symbol	Definition	Values
$X$	Investment value	1.000.000
$\kappa_r$	Ornstein uhlenbeck coefficient for rate of return	0.379
$\kappa_I$	Ornstein uhlenbeck coefficient for rate of inflation	0.0545
$\kappa_\delta$	Ornstein uhlenbeck coefficient for credit spread rate	0.027
$\theta_r$	Initial rate of return	8.75%
$\theta_I$	Initial rate of inflation	8%
$\theta_\delta$	Initial credit spread rate	30 bps
$\sigma_r$	Long term run for rate of return	0.098
$\sigma_I$	Long term run for rate of inflation	0.038
$\sigma_\delta$	Long term run for credit spread rate	0.012
$\sigma_r$	Rate of return volatility	0.077
$\sigma_I$	Inflation rate volatility	0.014
$\sigma_\delta$	Credit spread rate volatility	0.077
$\omega$	Write down rate	0.56
$\gamma$	The risk aversion coefficient	0.6
$\bar{\lambda}_r$	The deterministic market price of rate of return	-0.209
$\bar{\lambda}_I$	The deterministic market price of inflation rate	-0.0159
$\bar{\lambda}_\delta$	The deterministic market price of credit spread rate	-0.217
$\bar{\lambda}_S$	The deterministic market price of equity (equity premium)	0.450667
$\rho_{Sr}$	Correlation between equity and rate of return	-0.3
$\rho_{SI}$	Correlation between equity and rate of inflation	-0.024
$\rho_{S\delta}$	Correlation between equity and credit spread rate	-0.184
$\rho_{rI}$	Correlation between rate of return and rate of inflation	-0.3
$\rho_{r\delta}$	Correlation between rate of return and credit spread rate	-0.024
$\rho_{I\delta}$	Correlation between rate of inflation and credit spread rate	-0.184
T	Maturity time	1 year

Source: Result from the estimation

There are several practical impact that can be shown by the finding result in this study. It is obvious that in the finding model of weight compositions are determined not only by the risks but also other parameters such as utility coefficient, correlations between the uncertainty risks, write down rate, and volatility of the equity and risks. Different values of those parameters will give different pictures on how the weight of composition will go. The weight compositions are varying with different values of those parameters. By this finding the investor or fund managers can have choices to make the ranges of the parameters values and choose the weight that they desire where those weights will give the optimal result of wealth for the investor.

### (1) Type of Investor

In this study, constant relative risk aversion (CRRA) function is used to describe the investor appetizer. According to Wakker (2008) the type of investor in this utility function is distinguished by the power of utility  $\gamma$ . If  $\gamma$  is equal to 0 the investor is said as the risk neutral investor, and if it is bigger than 0 then it is said as the risk aversion. The bigger value of  $\gamma$  means the more averse the investor. For  $\gamma > 1$  the utility function goes to negative values. Therefore the power of utility  $\gamma$  is limited only to 0 and 1. The utility function for different value of  $\gamma$  is depicted in figure (1) where the utility values are for  $\gamma = 0,4$

(blue line),  $\gamma = 0,6$  (red line), and  $\gamma = 0,8$  (black line) and for optimal choice of weight composition is given in figure (2). In Indonesian case this kind of utility would be fit to the type of Indonesian investor, where most of them are

risk averse type. It can be seen from figure (1) that the more averse the investor the longer time would take the investor to increase her utility see blue line for bigger value of  $\gamma$ .

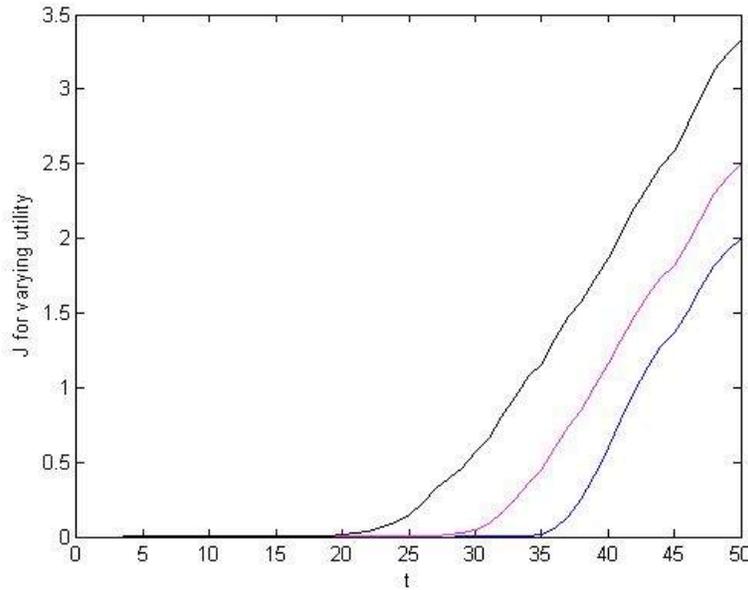


Figure 1. The utility values under varied type of investor,  $\gamma = 0,4$  for blue line,  $\gamma = 0,6$  for red line, and  $\gamma = 0,8$  for black line

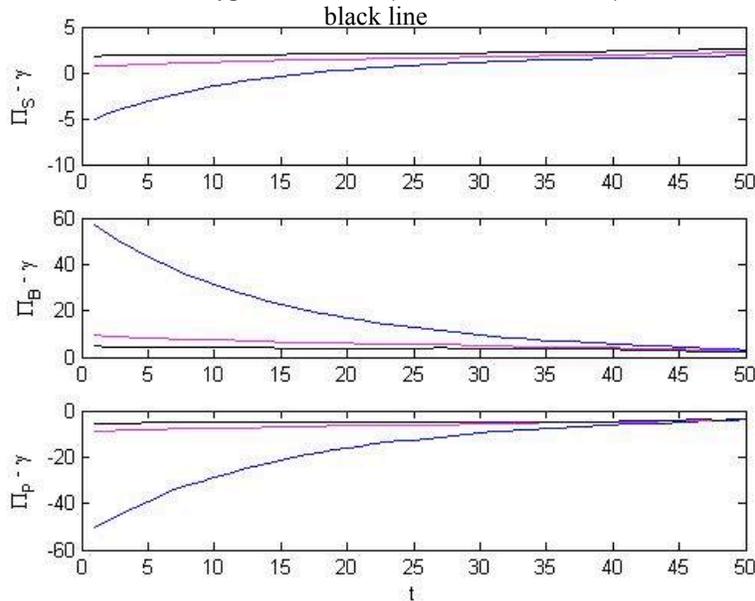


Figure 2. The asset compositions under varied type of investor,  $\gamma = 0,4$  for blue line,  $\gamma = 0,6$  for red line, and  $\gamma = 0,8$  for black line

**(2) Various Value of Correlation**

The correlation between the uncertainty risks from market risk, credit risks and equity are shown in the finding result. As we know from

portfolio theory that mean-variance frontiers are highly sensitive to estimates of means, volatilities and correlations Ang (2014). Poor estimation for correlation also give severe effect on optimizing mean-variance portfolios. Big

swings of portfolio weight can be caused by small changes in correlations Ang (2014). In this study the correlation is not only given through the assets, but more broaden between the risks and asset. The positive value of correlation means that the value between the parameters are going in the same direction, for negative values of correlation means that the value between the parameters are going in different direction or in other meaning the assets will substitute to each other. We use illustration that is happened in Indonesia to make a picture on how the correlation will work.

1. For correlation between risk rate of return and equity risk,  $\rho_{Sr}$

The correlation of rate of return and equity by theory has negative value. This is also happened in Indonesia whenever the Bank of Indonesia increase the rate of return usually due to the high inflation, the stock price is going down. The reason is because the goal of increasing the rate of return is to hold the high value of rate of inflation. When the equity price is going down the investor will sell their equity and adding more in bond or money account. This behavior is depicted in figure (3) where those shows that the more negative value of  $\rho_{Sr}$  the less demand of equity.

2. For correlation between equity risk and inflation risk,  $\rho_{SI}$

It is difficult to say what is the good correlation indicator between rate of inflation and stock price. By empirical findings it is different for every country. It is depend on how the country ability to hedge and also the government monetary policy though by theory of Fama and Gibbons (1982) which is said that the correlation between both parameters should be negative. Usually when rate of inflation is too high, the equity price will go down because the cost of company will increase and that cause the return of equity is going to decrease. The more negative values of correlation between rate of inflation and equity will give the less demand for equity and more demand on bond and money account For all assets again can be seen in figure (4). In Indonesia it is known that when the equity price is going down, it follows that the price of bond is also going down, this can be said that the investor in Indonesia will prefer to hold their investment in saving money rather in other assets.

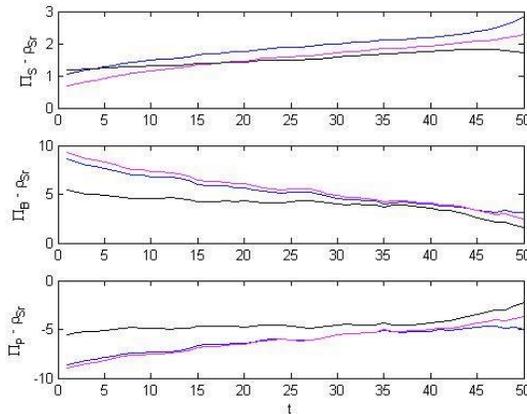


Figure 3. The scenario analysis of asset compositions, under varied  $\rho_{Sr} = -0,8$  (blue line),  $\rho_{Sr} = -0,3$  (red line) and  $\rho_{Sr} = 0,5$  (black line) for 1 year time-maturity bond

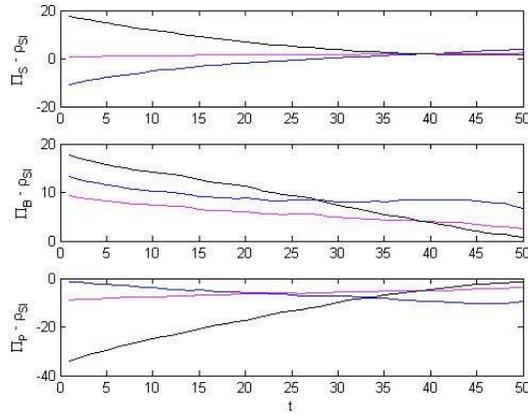


Figure 4. The scenario analysis of asset compositions, under varied  $\rho_{Si} = -0,5$  (blue line),  $\rho_{Si} = -0,02$  (red line) and  $\rho_{Si} = 0,5$  (black line) for 1 year time-maturity bond

3. For correlation between equity risk and credit risk,  $\rho_{S\delta}$

In theory it is said that increasing in bond yield will give decreasing in equity price. In our simulation which is given close to the reality in Indonesia, the data parameter gave different direction of curve compare with the theory. The trend of equity goes in-line with the trend of bond demand. The cause of this relationship is might be because the Indonesian investor is the risk averse type of investor, see figure (5)

rate of return and the yield of bond is usually in the same direction, but the credit spread rate will be the other way around. Therefore the correlation between rate of return and credit spread rate will have negative value. The bond demand will be lower for negative value of  $\rho_{r\delta}$  (see figure (6), stock demand also lower, and less borrowing in money account. From the figure we see that when the value is more negative for  $\rho_{r\delta}$ , the demand for asset is not very aggressive.

4. For correlation between rate of return and credit spread rate  $\rho_{r\delta}$ . The relationship between

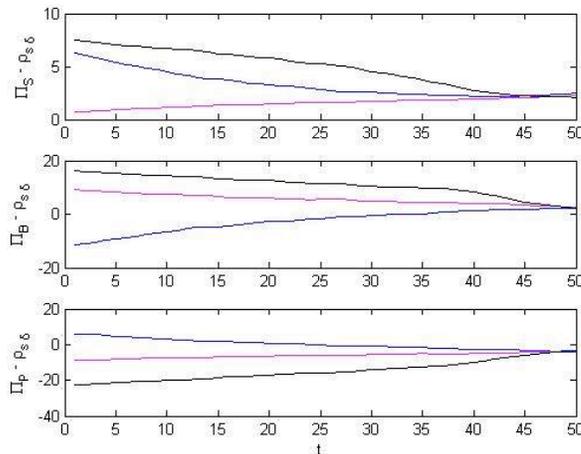


Figure 5.  $\rho_{S\delta}$  The scenario analysis of asset compositions, under varied  $\rho_{S\delta} = -0,5$  (blue line),  $\rho_{S\delta} = -0,01$  (red line) and  $\rho_{S\delta} = 0,5$  (black line) for 1 year time-maturity bond

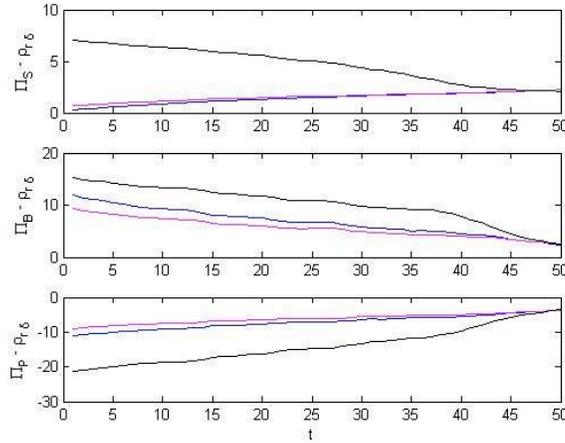


Figure 6. The sensitivity analysis of asset compositions, under varied  $\rho_{r\delta} = -0,5$  (blue line),  $\rho_{r\delta} = -0,02$  (red line) and  $\rho_{r\delta} = 0,5$  (black line) for 1 year time-maturity bond

5. For correlation between rate of return and rate of inflation,  $\rho_{rI}$ .

The central bank will increase the rate of return if the inflation is too high, the higher rate of return will caused the lower value of inflation rate, and therefore the correlation of these parameters should have negative value. We see from the simulation that the equity and bond are decreasing along with the time maturity of investment, but it has lower demand on both of them for more negative value of  $\rho_{rI}$ . In Indonesian case, it can be interpreted as the

typical type of risk averse investor, see again figure (7).

6. For correlation between rate of inflation and credit spread rate  $\rho_{\delta I}$ .

By theory, the increasing value of rate of return will give also the increasing yield of bond and it is expected that the investor should reduce the volume of their investment in equity and switch it to bond, but this is not always happened in Indonesia especially during the crisis, when the price of stock felt down then the bond price was following the same way, see again figure (8).

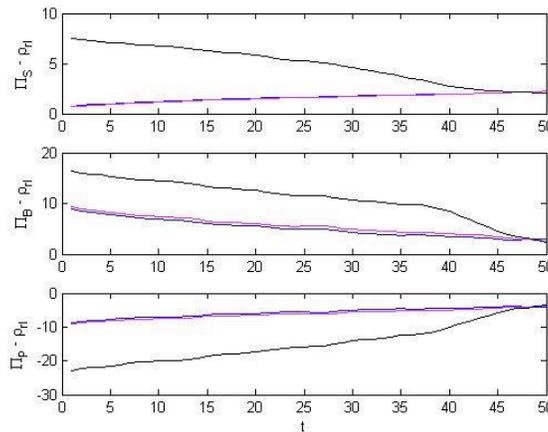


Figure 7. The sensitivity analysis of asset compositions, under varied  $\rho_{rI} = -0,5$  (blue line),  $\rho_{rI} = -0,06$  (red line) and  $\rho_{rI} = 0,5$  (black line) for 1 year time-maturity bond

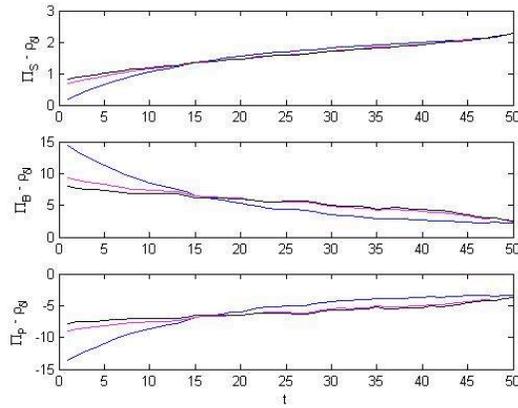


Figure 8. The sensitivity analysis of asset compositions, under varied  $\rho_{\delta t} = -0,5$  (blue line),  $\rho_{\delta t} = -0,02$  (red line) and  $\rho_{\delta t} = 0,5$  (black line) for 1 year time-maturity bond

### (3) Various Value of Down Rate

For various value of down rate  $\omega$  the demand of equity, bond and money account also varied. For more positive value of  $w$  it gives more borrowing money and more short on bond to

balance the optimal values of investment. Therefore the choice of down rate give these kind of possibilities. The simulation is given in figure (9).

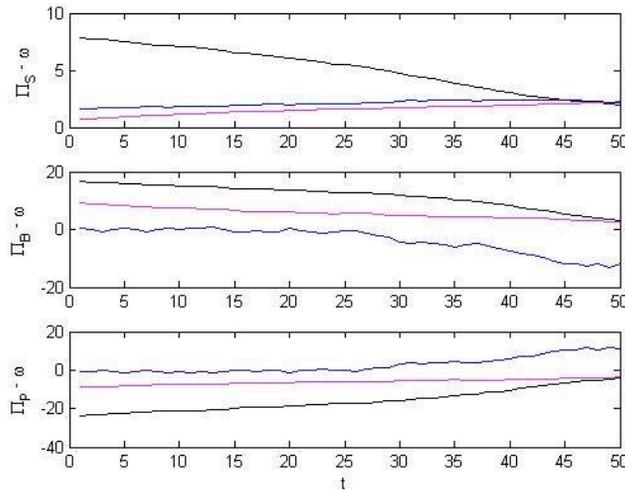


Figure 9. The composition of assets under various value of down rate,  $\omega = 0,1$  (blue line),  $\omega = 0,6$  (red line) and  $\omega = 0,8$  (black line)

### (4) Implementation for Investor and Fund Managers

For practical investor and fund managers this finding result can be used to set their problems regarding the issues on how to capture the risks between rate of return, inflation rate and credit spread rate and also equity. This finding result in this study has already programmed using the Matlab program. All the programs are written in Appendix C. These Matlab program can be used and adjusted directly under different language

such as C++, Visual C and R. The implementation on how the finding model can be used, will be given as follows:

1. From the historical data all of the stylized fact in assets can be defined. In this study we used normal distribution for all assets and risks, therefore the usual method on finding the mean, volatility, correlations can be used for equity, bond and money account.
2. Furthermore from historical data of rate of return ( $r(t)$ ), inflation rate ( $I(t)$ ) and

credit spread rate ( $\delta(t)$ ) between the corporate bond and government bond, the investor knows the parameters each risk following the Vasicek model can be found, such as the volatility ( $\sigma$ ), the Ornstein-Uhlenbeck constant ( $k$ , this constant appears when using Vasicek model), and the long-term run mean ( $q$ ). These parameters can be found using the programming toolbox of Ait Sahalia in Matlab.

3. The prediction of rate of return, rate of inflation and credit spread rate data further can be found and modeled.
4. Next the investor can choose the type of utility ( $g$ ) and write down rate ( $w$ ) that she wishes to have.
5. From equity and risks we can find the correlation values between those four historical data. The amount of correlation will be six correlations ( $\rho_{Sr}, \rho_{St}, \rho_{S\delta}, \rho_{rI}, \rho_{r\delta}$  and  $\rho_{\delta I}$ ).
6. The values from steps number 1 to 5 will be implemented into the weight of assets model (using coding of plot Pi.m in appendix B), then the prediction of having the weight of portfolio under the aforementioned risks can be simulated through the time of bond maturity. Through that prediction the investor can have the right time chosen whenever during the time of investment there is possibility that the credit spread rate (default indicator) and/or the rate of inflation will increase.

## CONCLUSION AND RECOMMENDATION

### (1) Conclusion

This research studied optimal solution for dynamic portfolio in finite-time horizon under defaulty assets. Defaulty assets mean that the assets have a chance to be liquidated in a finite time horizon. Therefore the credit risk are playing a role in this study. The optimal investment are studied here under market risks and credit risk. In addition, inflation rate were integrated in this portfolio. This addition gives another perspective compare to the other previous studies who always separate between credit risk and rate of inflation

The weight of bond, equity and money account are given in this study as the solution for portfolio optimization strategy under defaultable assets, where in each weight model the risks are stated in the closed loop solution. The finding model of investor utility is defined as the indirect utility function or constant relative risk aversion (CRRA). This utility function further is solved for the finding model of portfolio form. This solution gives the form of exponential function where the risks (rate of return, inflation rate and credit spread rate) are hedge-able through the functions that depend on investment time which are given by  $g(t)$ ,  $f(t)$ ,  $k(t)$ ,  $l(t)$ ,  $m(t)$  and  $v(t)$ . These functions are managed to be correlated with the risks inside the utility function. Further numerical exercise are carried to calibrate the optimal asset allocations. Robustness of the model has also been done by varying the values of correlation between those risks and equity risk. It will be proven that when the correlation of the risks are varied it will vary the assets composition. Therefore the simulation for possibilities of correlation are run in this study. Each of correlation gives different meaning for the weight of assets. This explain how the correlation can give a picture on how the behavior of investor will be and also how the phenomena during stable condition or extreme condition such as Indonesian crisis in 1997 can happen. In undefaultable bond we have to face another Brownian derivation in its pricing model. Beside correlation, there are also some insight given to this model, and that is the recovery rate. This came up because the recovery market value from Duffie and Singleton (1999) is used in this study. By having this parameter, it will give insight for the investor to have a flavor to choose the write down rate, which is the variable of recovery market. This also gives some variation for the sensitivity of weight of assets. For practical implication the numerical parameters are depicted from the historical data of assets and risks. Under the assumption of normal distribution then the parameters for those assets and risks such as mean, volatility, correlation can be found and further will be implemented into the finding result.

### (2) Recommendation

The following research is suggested to be done in the future to extend and validate this study:

1. To conduct another research by having empirical studies, to support this finding

models and especially to find the real value for credit spread rate between corporate bond and government bond, and also to find the real number of correlation between equity, rate of return, inflation rate and credit spread rate.

2. To add undeflatable bond into the portfolio as to be close to the reality.
3. In real world the empirical distribution of asset returns deviates from normality, therefore exact models that accurately fit return distributions are essential for the estimation of profit and loss. The use of jump model actually can handle the non-normality of asset pricing. It can capture the effect of volatility smiles and skews in the distribution. To provide the appropriate framework to adequately describe all the real observations the Levy process can be used. Using jump and Levy process means that there will be no closed form solution can be found, as already explained in chapter I and II, this also gives more complex derivation to be met.
4. To add the coupon matter in corporate bond pricing model, since in this study the bond was defined as zero coupon bond.
5. To conduct another mathematical solution to find:
  - a) The utility function by having another options for ansatz function or another form of utility model.
  - b) A better solution for hedging term parameter of credit spread rate and rate of inflation (respectively,  $l(t)$  and  $v(t)$ ).

The finding solutions of weight of assets will help the investor and fund managers to guide for having demand choice to their portfolio where all depend on the choice of parameters such as investor type, correlation for risks and assets, and also to have the choice of having the desired write down rate in order to choose what credit spread that the investors will take. Another point of view they can calculate the correlation of equity and the aforementioned risks, and implement them into the model of weight assets. Therefore the continuity to extend this study is very important.

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Appendix

$\alpha_1 = \frac{A_2\tilde{C}_y}{C_{15y}}$	$\psi_9 = \frac{D_4F_1 + A_1F_3}{C_5}$	$\theta_{15} = \frac{C_1E_2E_3}{C_{15y}^2}$
$\alpha_2 = \frac{A_2}{C_{15y}}$	$\psi_{10} = \frac{1 - D_4\tilde{C}_{15y}}{C_5}$	$\varphi_1 = -\frac{\tilde{C}_yF_1}{C_{15y}}$
$\alpha_3 = \frac{D_1E_1}{C_{15y}}$	$\psi_{11} = \frac{D_6F_1 + A_1F_4}{C_5}$	$\varphi_2 = -\frac{F_1 + \tilde{C}_y\tilde{C}_{15y}}{C_{15y}}$
$\alpha_4 = \frac{D_3E_2}{C_{15y}}$	$\psi_{12} = \frac{1 - D_6\tilde{C}_{15y}}{C_5}$	$\varphi_3 = -\frac{\tilde{C}_{15y}}{C_{15y}}$
$\alpha_5 = \frac{D_5E_3}{C_{15y}}$	$\psi_{13} = \frac{D_2F_3 + D_4F_2}{C_5}$	$\varphi_4 = -\frac{E_1F_2}{C_{15y}}$
$\alpha_6 = \frac{A_2E_1 + D_1\tilde{C}_y}{C_{15y}}$	$\psi_{14} = \frac{D_2F_4 + D_6F_2}{C_5}$	$\varphi_5 = -\frac{E_2F_3}{C_{15y}}$
$\alpha_7 = \frac{D_1}{C_{15y}}$	$\psi_{15} = \frac{D_4F_4 + D_6F_3}{C_5}$	$\varphi_6 = -\frac{E_3F_4}{C_{15y}}$
$\alpha_8 = \frac{A_2E_2 + D_3\tilde{C}_y}{C_{15y}}$	$\theta_1 = \frac{C_1\tilde{C}_y^2}{2C_{15y}^2}$	$\varphi_7 = -\frac{F_2\tilde{C}_y + F_1E_1}{C_{15y}}$
$\alpha_9 = \frac{D_3}{C_{15y}}$	$\theta_2 = \frac{C_1\tilde{C}_y}{C_{15y}^2}$	$\varphi_8 = -\frac{F_2 + E_1\tilde{C}_{15y}}{C_{15y}}$
$\alpha_{10} = \frac{A_2E_3 + D_5\tilde{C}_y}{C_{15y}}$	$\theta_3 = \frac{C_1}{2C_{15y}^2}$	$\varphi_9 = -\frac{F_3\tilde{C}_y + F_1E_2}{C_{15y}}$
$\alpha_{11} = \frac{D_5}{C_{15y}}$	$\theta_4 = \frac{C_1E_1^2}{2C_{15y}^2}$	$\varphi_{10} = -\frac{F_3 + E_2\tilde{C}_{15y}}{C_{15y}}$
$\alpha_{12} = \frac{D_1E_2 + D_3E_1}{C_{15y}}$	$\theta_5 = \frac{C_1E_2^2}{2C_{15y}^2}$	$\varphi_{11} = -\frac{F_4\tilde{C}_y + F_1E_3}{C_{15y}}$
$\alpha_{13} = \frac{D_1E_3 + D_5E_1}{C_{15y}}$	$\theta_6 = \frac{C_1E_3^2}{2C_{15y}^2}$	$\varphi_{12} = -\frac{F_4 - E_3\tilde{C}_{15y}}{C_{15y}}$
$\alpha_{14} = \frac{D_3E_3 + D_5E_2}{C_{15y}}$	$\theta_7 = \frac{C_1E_1\tilde{C}_y}{C_{15y}^2}$	$\varphi_{13} = -\frac{E_1F_3 + E_2F_2}{C_{15y}}$
$\psi_1 = -\frac{\tilde{C}_{15y}}{C_5}$	$\theta_8 = \frac{C_1E_1}{C_{15y}^2}$	$\varphi_{11} = -\frac{E_1F_4 + E_3F_2}{C_{15y}}$
$\psi_2 = \frac{F_1 - A_1\tilde{C}_{15y}}{C_5}$	$\theta_9 = \frac{C_1E_2\tilde{C}_y}{C_{15y}^2}$	$\varphi_{11} = -\frac{E_2F_4 + E_3F_3}{C_{15y}}$
$\psi_3 = \frac{A_1F_1}{C_5}$	$\theta_{10} = \frac{C_1E_2}{C_{15y}^2}$	$v_1 = \frac{2C_x^2F_1^2}{C_5^2}$
$\psi_4 = \frac{D_2F_2}{C_5}$	$\theta_{11} = \frac{C_1E_3\tilde{C}_y}{C_{15y}^2}$	$v_2 = \frac{4C_x^2F_1\tilde{C}_{15y}}{C_5^2}$
$\psi_5 = \frac{D_4F_3}{C_5}$	$\theta_{12} = \frac{C_1E_3}{C_{15y}^2}$	$v_3 = \frac{2C_x^2\tilde{C}_{15y}^2}{C_5^2}$
$\psi_6 = \frac{D_6F_4}{C_5}$	$\theta_{13} = \frac{C_1E_1E_2}{C_{15y}^2}$	$v_4 = \frac{2C_x^2F_2^2}{C_5^2}$
$\psi_7 = \frac{D_2F_1 + A_1F_2}{C_5}$	$\theta_{14} = \frac{C_1E_1E_3}{C_{15y}^2}$	$v_5 = \frac{2C_x^2F_3^2}{C_5^2}$
$\psi_8 = \frac{1 - D_2\tilde{C}_{15y}}{C_5}$		

$$\begin{aligned}
 v_6 &= \frac{2C_x^2 F_4^2}{C_5^2} \\
 v_7 &= \frac{4C_x^2 F_1 F_2}{C_5^2} \\
 v_8 &= \frac{4C_x^2 F_2 \tilde{C}_{15y}}{C_5^2} \\
 v_9 &= \frac{4C_x^2 F_1 F_3}{C_5^2} \\
 v_{10} &= \frac{4C_x^2 F_3 \tilde{C}_{15y}}{C_5^2} \\
 v_{11} &= \frac{4C_x^2 F_1 F_4}{C_5^2} \\
 v_{12} &= \frac{4C_x^2 F_4 \tilde{C}_{15y}}{C_5^2} \\
 v_{13} &= \frac{4C_x^2 F_2 F_3}{C_5^2} \\
 v_{14} &= \frac{4C_x^2 F_2 F_4}{C_5^2} \\
 v_{15} &= \frac{4C_x^2 F_3 F_4}{C_5^2} \\
 K_1 &= \alpha_1 + \psi_3 + \theta_1 + \varphi_1 + v_1 \\
 K_2 &= -\alpha_2 + \psi_2 - \theta_2 - \varphi_2 - v_2 \\
 K_3 &= \psi_1 + \theta_3 + \varphi_3 + v_3 \\
 K_4 &= \alpha_3 + \psi_4 + \theta_4 + \varphi_4 + v_4 \\
 K_5 &= \alpha_4 + \psi_5 + \theta_5 + \varphi_5 + v_5 \\
 K_6 &= \alpha_5 + \psi_6 + \theta_6 + \varphi_6 + v_6 \\
 K_7 &= \alpha_6 + \psi_7 + \theta_7 + \varphi_7 + v_7 \\
 K_8 &= -\alpha_7 + \psi_8 - \theta_8 - \varphi_8 - v_8 \\
 K_9 &= \alpha_8 + \psi_9 + \theta_9 + \varphi_9 + v_9 \\
 K_{10} &= -\alpha_9 + \psi_{10} - \theta_{10} - \varphi_{10} - v_{10} \\
 K_{11} &= \alpha_{10} + \psi_{11} + \theta_{11} + \varphi_{11} + v_{11} \\
 K_{12} &= -\alpha_{11} + \psi_{12} - \theta_{12} - \varphi_{12} - v_{12} \\
 K_{13} &= \alpha_{12} + \psi_{13} + \theta_{13} + \varphi_{13} + v_{13} \\
 K_{14} &= \alpha_{13} + \psi_{14} + \theta_{14} + \varphi_{14} + v_{14} \\
 K_{15} &= \alpha_{14} + \psi_{15} + \theta_{15} + \varphi_{15} + v_{15} \\
 \bar{A} &= -(\bar{C}_1 + 2\bar{C}_2 \cdot \bar{C}_3) \\
 \bar{B} &= -(\bar{C}_{10} + 2\bar{C}_{11} \cdot \bar{C}_{12})
 \end{aligned}$$

$$\begin{aligned}
 C_0 &= \frac{(1-\gamma)}{\gamma} K_1 + \bar{\sigma}_\eta \cdot l(t) + \bar{\sigma}_l v(t) \\
 &+ \left[ \frac{(1-\gamma)}{\gamma} K_4 - \bar{\sigma}_r \right] f(t)^2 + \left[ \frac{(1-\gamma)}{\gamma} K_7 - \bar{\sigma}_{r\theta} \right] f(t) \\
 &+ \left[ \frac{(1-\gamma)}{\gamma} K_5 - \bar{\sigma}_\eta \right] k(t)^2 + \left[ \frac{(1-\gamma)}{\gamma} K_7 - \bar{\sigma}_{\delta\theta} \right] k(t) \\
 &+ \left[ \frac{(1-\gamma)}{\gamma} K_6 - \bar{\sigma}_l \right] m(t)^2 + \left[ \frac{(1-\gamma)}{\gamma} K_{11} - \bar{\sigma}_{l\theta} \right] m(t) \\
 &+ \left[ \frac{(1-\gamma)}{\gamma} K_{13} - D_7 \right] f(t) \cdot k(t) + \left[ \frac{(1-\gamma)}{\gamma} K_{14} - D_8 \right] f(t) \cdot m(t) \\
 &+ \left[ \frac{(1-\gamma)}{\gamma} K_{15} - D_9 \right] k(t) \cdot m(t) \\
 \bar{C}_1 &= 2 \left[ \frac{1-\gamma}{\gamma} K_{10} - K_8 \right] \\
 \bar{C}_2 &= 2 \left[ \sigma_\eta - \frac{1-\gamma}{\gamma} K_5 \right] \\
 \bar{C}_3 &= -2 \frac{1-\gamma}{\gamma} K_3 \\
 \bar{C}_4 &= \frac{\bar{C}_2 \bar{C}_3 - \bar{A}}{\bar{C}_3} \\
 \bar{C}_{10} &= -2 \left[ \frac{1-\gamma}{\gamma} K_{12} + K_l \right] \\
 \bar{C}_{11} &= S - 2 \left[ \sigma_l + \frac{1-\gamma}{\gamma} K_6 \right] \\
 \bar{C}_{12} &= -2 \frac{1-\gamma}{\gamma} K_3 \\
 \bar{C}_{13} &= \frac{\bar{C}_{11} \bar{C}_{12} - \bar{B}}{\bar{C}_{12}} \\
 \bar{\sigma}_r &= \frac{1}{2} \sigma_r \\
 \bar{\sigma}_\eta &= \frac{1}{2} \sigma_\eta \\
 \bar{\sigma}_l &= \frac{1}{2} \sigma_l \\
 \bar{K}_{r\theta} &= K_r \cdot \theta_r \\
 \bar{K}_{\delta\theta} &= K_\delta \cdot \theta_\delta \\
 \bar{K}_{l\theta} &= K_l \cdot \theta_l
 \end{aligned}$$

$$\begin{aligned}
 A_1 &= \sigma_r \lambda_r + \zeta_\delta \sigma_\delta \bar{\lambda}_\delta + \zeta_I \sigma_I \bar{\lambda}_I \\
 A_2 &= \sigma_s (\bar{\lambda}_s + \rho_{rs} \bar{\lambda}_r + \rho_{s\delta} \bar{\lambda}_\delta + \rho_{sI} \bar{\lambda}_I) \\
 A_r &= \sigma_r (\bar{\lambda}_r + \rho_{r\delta} \bar{\lambda}_\delta + \rho_{rs} \bar{\lambda}_s + \rho_{rI} \bar{\lambda}_I) \\
 A_\eta &= \sigma_\delta (\bar{\lambda}_\delta + \rho_{r\delta} \bar{\lambda}_r + \rho_{s\delta} \bar{\lambda}_s + \rho_{I\delta} \bar{\lambda}_I) \\
 A_I &= \sigma_I (\bar{\lambda}_I + \rho_{rI} \bar{\lambda}_r + \rho_{I\delta} \bar{\lambda}_\delta + \rho_{sI} \bar{\lambda}_s) \\
 C_1 &= \sigma_s^2 \\
 C_2 &= \sigma_r^2 \\
 C_3 &= (\zeta_\delta \sigma_\delta)^2 \\
 C_4 &= (\zeta_I \sigma_I)^2 \\
 C_5 &= 2(\rho_{sr} \sigma_s \sigma_r + \rho_{s\delta} \zeta_\delta \sigma_\delta \sigma_s + \rho_{sI} \zeta_I \sigma_I \sigma_s) \\
 C_6 &= 2(\rho_{r\delta} \zeta_\delta \sigma_\delta \sigma_r + \rho_{rI} \zeta_I \sigma_I \sigma_r + \rho_{\delta I} \zeta_\delta \zeta_I \sigma_\delta \sigma_I) \\
 C_x &= C_2 + C_3 + C_4 + C_6 \\
 C_y &= \frac{C_x}{C_5} \\
 C_{15y} &= \frac{1}{2} C_5 - C_1 C_y \\
 \tilde{C}_y &= C_y A_2 - A_1 \\
 \tilde{C}_{15y} &= \frac{C_1}{C_{15y}} \\
 D_1 &= \rho_{sr} \sigma_s \sigma_r \\
 D_2 &= \sigma_r^2 + \rho_{r\delta} \zeta_\delta \sigma_r \sigma_\delta + \rho_{rI} \zeta_I \sigma_r \sigma_I \\
 D_3 &= \rho_{s\delta} \sigma_s \sigma_\delta \\
 D_4 &= \rho_{r\delta} \sigma_r \sigma_\delta \\
 D_5 &= \rho_{sI} \sigma_s \sigma_I \\
 D_6 &= \rho_{rI} \sigma_r \sigma_I + \rho_{\delta I} \\
 D_7 &= \rho_{r\delta} \sigma_r \sigma_\delta \\
 D_8 &= \rho_{rI} \sigma_r \sigma_I \\
 D_9 &= \rho_{\delta I} \sigma_\delta \sigma_I \\
 E_1 &= C_y D_1 - D_2 \\
 E_2 &= C_y D_3 - D_4 \\
 E_3 &= C_y D_5 - D_6 \\
 F_1 &= \frac{C_1}{C_{15y}} \tilde{C}_y + A_2
 \end{aligned}$$

$$\begin{aligned}
 F_2 &= \frac{C_1}{C_{15y}} E_1 + D_3 \\
 F_3 &= \frac{C_1}{C_{15y}} E_2 + D_3 \\
 F_4 &= \frac{C_1}{C_{15y}} E_3 + D_5
 \end{aligned}$$

## **BACKDOOR LISTING STRATEGY: DOES IT MATTER FOR PERFORMANCE IMPROVEMENT?**

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### **ABSTRACT**

*The purpose of this research is to determine the differences of financial performance and market performance of backdoor listing companies. This research uses financial ratios to measure financial performance. To measure market performance, abnormal return is picked as an appropriate indicator. This research picks 36 public companies which have ever performed backdoor listing as samples based on purposive sampling method with several criteria during 2006 – 2015. Method of hypothesis testing uses multivariate analysis of variance and wilcoxon signed rank test with three groups of period, which is before, as at, and after the backdoor listing corporate action period. The results show that the difference of company's current ratio, asset turnover ratio, debt to equity ratio, and return of equity during before, as at, and after backdoor listing corporate action period are statistically insignificant. However, market performance difference test reveals that different result comes from different period. Difference of company's abnormal return is statistically significant during as at and after backdoor listing corporate action period, but it is statistically insignificant during before and as at, also during before and after backdoor listing corporate action period.*

**Keywords:** *Backdoor Listing, Performance Improvement, Indonesia Stock Exchange, Abnormal Return*

### **INTRODUCTION**

A good company will always grow over the time. Company's growth may be done organically and inorganically. According to Drucker (2008), company's organic growth is business expansion level by output and sales increasing. Company's inorganic growth is business expansion by merger or acquisition action. Every growth needs capital. Capital is needed to finance strategic projects that can be done by company to earn more profit. According to Murni and Andriana (2007), capital source may be earned by internal or external. Internal capital's source is retained earnings. External sources are additional shares issued and debts. To fulfill company's capital need, the shareholders prefer to choose debt because it may not reduce shareholder's ownership in the company. With large amount of debt, comes up financial risk of the company itself. Because of that reason, several companies consider

additional share issued as capital source alternative.

In order to looking for capital, company can utilize capital market as external financing source alternative. Capital market provides a lot of opportunities for company to get extra financing. Listed companies are not the only parties which raise the money from capital market. Existing shareholders may alter their ownership through secondary offering. Company may turn its status to a public company and listed its shares on stock exchange by performing Initial Public Offering. Each nation normally has appointed its own capital market regulatory in order to superintend the Initial Public Offering process. It is called Otoritas Jasa Keuangan (OJK) in Indonesia. Before a company performs initial public offering, it has to submit registration statement to the OJK. Once registration statement has been submitted, the company may prepare its prospectus to declare its intention to perform Initial Public Offering.

The company may also organize public expose to introduce its company profile to the potential investors. The OJK may issue an effective statement in forty five days maximum after the last adjusted registration statement is accepted. After effective statement is issued, the company can start to perform Initial Public Offering, list its shares on Indonesia Stock Exchange and its shares are ready for traded by investors. In the IPO process, several vendors get involved to support the company in order to establish successful IPO. They are underwriters, public accountant, notary public, and other supporting institutions.

The entire procedures consume a lot of cost and time. For efficiency reason, several companies take a shortcut to enter the capital market without Initial Public Offering scheme. Backdoor listing is considered to be an easy and instant way for company. Company can enter the capital market by exploit the other listed company using acquisition or merger scheme. Backdoor listing has been performed by several companies around the world, not only in Indonesia. Backdoor listing is considered to be a more efficient way to earn fund from capital market without long track Initial Public Offering process undergoing. Both Initial Public Offering and backdoor listing provide the same access to capital market. Company's decision, whether IPO or backdoor listing is company's right. Each decision comes with its consequences whether positive or negative. Company should consider it carefully which strategy provides better result for its performance.

Backdoor listing is often performed in two schemes. First scheme is private company acquires public company by buying up its majority outstanding shares in capital market. It may perform a tender offer to complete buying process. Second scheme is public company acquires private company. Generally, financial distressed company or bad performance company would be an ideal acquisition target for backdoor listing. According to Andini (2012), benefit of backdoor listing performed company is it does not need to be an interesting prospect company or great financial performance company. Even bad performance company may enter capital market through backdoor listing. It is different with Initial Public Offering. IPO needs better financial performance to attract underwriters and potential investors. The financial distressed company does not need to

improve its performance to enter capital market using backdoor listing. Investors expect company may improve its performance better after perform backdoor listing. As long as, there are several companies have performed backdoor listing corporate action, it is necessary to examine the outcomes of company which performs backdoor listing corporate action in its financial performance and market performance. If backdoor listing brings benefit to public company, there should be a significant difference of its financial and market performances before, as at, and after it performs backdoor listing. If there is no significant difference on them, then there must be a certain reason for company to perform backdoor listing.

## **LITERATURE REVIEW**

### **1. Previous Study**

The previous studies exhibit various findings about company's performance by undertaking merger and acquisition corporate action. Although they are different with backdoor listing, it is still quite relevant in referring on the studies. In fact, not all merger and acquisition corporate action can be categorized as backdoor listing. Previous study agreed that merger and acquisition corporate action drives significant difference on company's financial and market performance. According to Lesmana and Gunardi (2012), there is significant enhancement of financial ratio on both acquiring company and acquired company. Furthermore, there is significant enhancement abnormal return of acquiring company. Otherwise, the abnormal return of acquired company is declining. The study took only a few samples on a narrow period. There is no backdoor listing indication found from its samples.

Several studies show different results. Merger and acquisition may cause significant difference on company's market performance, but not for financial performance. According to Gunawan and Sukartha (2013), there is significant enhancement of company's market performance after having involved in merger and acquisition corporate action. Otherwise, there is no significant enhancement of company's financial performance after having involved in merger and acquisition. Public company target acquired gives better market performance than

private company. It brings the study of backdoor listing closer since acquisition of public company is one of the backdoor listing elements. Otherwise, there is no further reason to explain why the difference did exist only on market performance. According to Novaliza and Djajanti (2013), there is no significant difference of company's financial performance after involved in merger and acquisition corporate action because the main motivation of company to involve in is not financial performance improvement.

Another study mentioned backdoor listing specifically. According to Gleason and Wigginsiii (2005), reverse takeover approach is beneficial for distressed company's shareholders as a way to recover their investment part. According to Brown *et. al.* (2010), the main influenced factors of company which prefers backdoor listing strategy as an alternative to go public rather than Initial Public Offering strategy are company size and transaction settlement of the process. The public company which involve in backdoor listing scheme has certain characteristics. They are less liquid company stock traded and provide less profit than the others which perform Initial Public Offering. Although, backdoor listing is specifically identified, it did not examine what is the effect of backdoor listing to the company's performance. According to Asquith and Rock (2011), status of target public company did not greatly affect market reaction. The decision to pursue reverse takeover is influenced by the fixed costs of being acquired by a shell company are much smaller than the underwriting and other fees of IPO. The study used excess return as main variable. It did not identify financial performance of reverse takeover company.

## **2. Going Public**

According to Geddes (2007), one of the most tested methods of raising cash for business development purpose is through Initial Public Offering. It is the first sale of company's shares

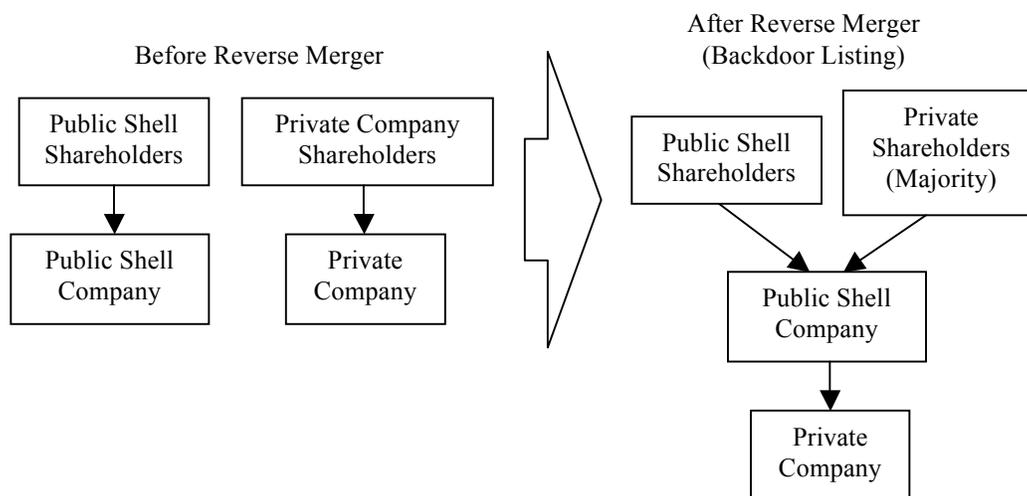
to the public and listing the shares on a stock exchange. The process is arduous, involves significant time commitments from company's management and it takes a lot of cash. Raising cash required at a price that keeps both the vendor and investor happy. By undertaking Initial Public Offering, company wants to maximize its proceeds, build broad ownership base, raise its profile, and facilitate future fund raising. Company may use raised capital from IPO in order to expand the business or reduce debt levels. The decision to go public is a strategic decision, not just a fund raising decision. When considering an IPO strategy, the company has to asses itself critically to determine whether it is really ready to open its ownership for public.

## **3. Backdoor Listing**

According to Brown *et. al.* (2010), backdoor listing is a private company comprehensive action to achieve public company status using public company reverse takeover scheme. The target public company is exploited as a shell company in order to accelerate go public process. According to Malaysian Securities Equity Guidelines, company acquisition may be categorized as backdoor listing corporate action if it fulfills the following criteria:

- The occurrence of public company's core business alteration.
- The occurrence of public company's organizational structure alteration.
- The occurrence of public company's name changing.

According to Feldman (2006), backdoor listing (often known as reverse merger or reverse takeover) gives the private company's shareholders opportunity to allow them a grip of control as they hold majority shares of public company. Reverse merger model in The United States is provided as figure 1.



Source : Vermeulen (2014)  
**Figure 1.** Reverse Merger Model

According United States Securities and Exchange Commission (2011), a reverse takeover, also known as a reverse merger, is a transaction where a public reporting company with few or no operations acquires or being acquired by a private operating company. They seek access to United States capital market. These public companies that have sold certain operations, entered bankruptcy, or simply created with the sole purpose of acquisition. Reverse takeover occurs when private operating company's shareholders accumulate majority of public shell company's outstanding shares. Since they control interest in public shell company, they may replace the management with their own people. The public company's business operations now reflect the formerly private company.

According to Hong Kong Securities and Futures Commission (2014), a transaction is classified as a reverse takeover if it complies with two criteria. First, an acquisition of assets constituting a very substantial acquisition where there is result in control change of the listed issuer. Second, an acquisition of assets from a group of persons or any associates pursuant to an agreement entered into by the listed issuer within 24 months of such group of persons gaining control of the listed issuer.

#### 4. Financial Performance

Financial performance is defined using financial ratio. According to Stickney *et. al.* (2007), financial ratio describes relationship between elements on financial report. Financial

ratio is an effective indicator determining financial performance. Financial ratios which are applied in this research are liquidity ratio, activity ratio, solvability ratio, and profitability ratio.

#### 5. Market Performance

Market performance is defined as abnormal return. According to Jogiyanto (2008), abnormal return is defined as difference between real return with expected return, which is formulated as below.

$$AR_{it} = R_{it} - R_{mt}$$

While:

$AR_{it}$  = abnormal return of company-i at t-period

$R_{it}$  = return of company-i at t-period

$R_{mt}$  = market return of company-i at t-period

Figures and tables are not included in the column. Please place them in the middle of the paper especially when the size is large enough. Do not use any border in the middle of the table. Each figures and table are numbered (with link) and underneath, the source should be mentioned.

#### 6. Theoretical Framework

The two main points of this research are financial performance and market performance of backdoor listing company. It examines the difference of those two main variables in three periods: before, as at, and after performing backdoor listing. Financial performance is defined as four financial ratio variables. Market performance is defined as abnormal return.

Theoretical framework of this research is follow as figure 2.

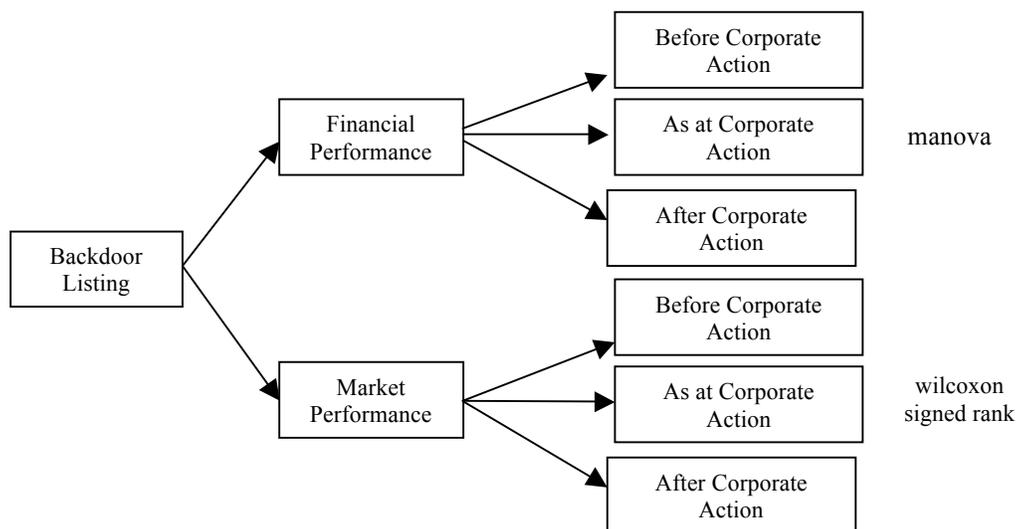


Figure 2. Theoretical Framework

## 7. Research Hypotheses

Previous study reveals various findings about backdoor listing. Backdoor listing is regarded as an alternative strategy to lead private company to capital market access instantly. Logically, company has certain reason when enter the capital market. It may fulfill the company's need to growing up and improve their performance better than before. Every corporate action inflicts responses from investors. It is defined by the stock return. Previous study exhibits the existence of different abnormal return comes from merger, acquisition, and their reverse. Based from the literature reviews, four hypotheses were formulated on this research.

H<sub>1</sub>: There is significance difference of company's current ratio, asset turnover ratio, and return to equity ratio before, as at, and after performed backdoor listing corporate action.

H<sub>2</sub>: There is significance difference of company's abnormal return before and as at performed backdoor listing corporate action.

H<sub>3</sub>: There is significance difference of company's abnormal return as at and after performed backdoor listing corporate action.

H<sub>4</sub>: There is significance difference of company's abnormal return before and after performed backdoor listing corporate action.

## RESEARCH METHODS

### 1. Research Samples

This research used financial report and stock trading report of Indonesia Stock Exchange listed companies on 2005 – 2016 periods as samples using purposive sampling method. This research set the following criteria for samples:

- Companies which have published financial report before, as at, and after perform backdoor listing corporate action.
- Companies which have had complete stock trade report before, as at, and after perform backdoor listing corporate action.

Based on those criteria, 36 public companies are picked as samples.

### 2. Data Sources

This research use secondary data which is acquired from Indonesia Capital Market Directory, company's financial report, company's annual report, and yahoo finance.

### 3. Analysis Method

This research uses statistic analysis method. H<sub>1</sub> argue that there is significance difference of company's current ratio, asset turnover ratio, and return to equity ratio before, as at, and after performed backdoor listing corporate action. The difference of these three periods of financial ratios is tested using

multivariate analysis of variance (manova). Manova is considered as an appropriate method because the research compares financial ratio variable (contains four groups) and period variable (contains three groups). Manova needs several precondition tests, such as: normality test, separate variance homogeneity test, and simultaneously variance homogeneity test in

order to make sure that the model meet several manova assumptions.

H<sub>2</sub>, H<sub>3</sub>, and H<sub>4</sub> are tested using wilcoxon signed rank test. The three hypotheses represent the three types of period comparison. Wilcoxon signed rank test is nonparametric statistic test, so it still can be applied to test H<sub>2</sub>, H<sub>3</sub>, and H<sub>4</sub> although data is abnormal. The research's analysis methods are listed table 1.

**Table 1:** Analysis Method

Hypotheses	Method	Precondition test	Type of test	Precondition test decision making	Hypotheses test decision making
H <sub>1</sub>	MANOVA	Normality	Kolmogorov Smirnov	<ul style="list-style-type: none"> <li>• sig. &gt; 0,05 ; normal distribution.</li> <li>• sig. &lt; 0,05 ; abnormal distribution.</li> </ul>	<ul style="list-style-type: none"> <li>• sig. &lt; 0,05 then H<sub>0</sub> is rejected.</li> <li>• sig &gt; 0,05 then H<sub>0</sub> is accepted.</li> </ul>
		Separate variance homogeneity test	Levene Test	<ul style="list-style-type: none"> <li>• sig. &gt; 0,05 ; equal variance.</li> <li>• sig. &lt; 0,05 ; unequal variance.</li> </ul>	
		Simultaneously variance homogeneity test	Box's M Test	<ul style="list-style-type: none"> <li>• sig. &gt; 0,05 ; equal covariance matrix</li> <li>• sig. &lt; 0,05 ; unequal covariance matrix</li> </ul>	
H <sub>2</sub> , H <sub>3</sub> , H <sub>4</sub>	Wilcoxon signed rank	Normality	Kolmogorov Smirnov	<ul style="list-style-type: none"> <li>• sig. &gt; 0,05 ; normal distribution.</li> <li>• sig. &lt; 0,05 ; abnormal distribution.</li> </ul>	<ul style="list-style-type: none"> <li>• sig. &lt; 0,05 then H<sub>0</sub> is rejected.</li> <li>• sig &gt; 0,05 then H<sub>0</sub> is accepted.</li> </ul>

Source: Hair *et. al.* (2006)

**RESULTS AND DISCUSSION**

**1. Precondition Test**

Precondition test results for manova analysis model are provided on table 2. Precondition test results of manova analysis model show that the model has equal variance with unequal covariance matrix. According to

Gozali (2011), manova analysis model is still robust to be tested, although precondition test results are failed to fulfill normality and variance homogeneity assumptions. Precondition test result shows that data distribution for H<sub>2</sub>, H<sub>3</sub>, and H<sub>4</sub> is abnormal. Although they are abnormal, they still can be analyzed using wilcoxon signed rank test as it is nonparametric statistic test.

**Table 2:** Precondition Test Result

Hypotheses	Method	Type of Test	Result	Explanation		
H <sub>1</sub>	MANOVA	<b>Kolmogorov Smirnov</b>				
		CR	0,000	Abnormal distribution		
		ATO	0,000	Abnormal distribution		
		DER	0,000	Abnormal distribution		
		ROE	0,000	Abnormal distribution		
		<b>Levene Test</b>				
		CR	0,870	Homogeneous variance		
		ATO	0,257	Homogeneous variance		
		DER	0,722	Homogeneous variance		
		ROE	0,391	Homogeneous variance		
		<b>Box's M Test</b>	0,000	Heterogeneous variance		
		H <sub>2</sub> , H <sub>3</sub> , H <sub>4</sub>	Wilcoxon signed rank	<b>Kolmogorov Smirnov</b>		
				Before	0,000	Abnormal distribution
				As at	0,000	Abnormal distribution
After	0,000			Abnormal distribution		

Source : Data processing

**2. MANOVA Analysis**

H<sub>1</sub> is tested using multivariate analysis of variance. The results are provided on table 3. Multivariate analysis of variance results show that H<sub>0</sub> is accepted. It means that there is no significant difference of current ratio, asset turnover ratio, debt to equity ratio, and return to equity ratio before, as at, and after company performed backdoor listing corporate action.

financial ratios which is caused by backdoor listing different period. These results reveal that backdoor listing did not make any significant difference impact on company's financial performance.

Furthermore, test of between subjects reveal that there is no significant difference for all four

**Table 3 : MANOVA Analysis Results**

Effect	Value	F	Sig.	Explanation
Pillai's Trace	0,271	9.456	0,507	H <sub>0</sub> is accepted
Wilks' Lambda	0,729	9.456	0,510	H <sub>0</sub> is accepted
Hotelling's Trace	0,371	9.456	0,514	H <sub>0</sub> is accepted
Roy's Largest Root	0,371	9.456	0,235	H <sub>0</sub> is accepted
Test of Between Subjects				
CR	-	0,034	0,967	H <sub>0</sub> is accepted
ATO	-	0,708	0,495	H <sub>0</sub> is accepted
DER	-	1,708	0,186	H <sub>0</sub> is accepted
ROE	-	1,965	0,145	H <sub>0</sub> is accepted

Sources : Data processing.

### 3. Wilcoxon Signed Rank Test

Wilcoxon signed rank test is applied to test H<sub>2</sub>, H<sub>3</sub>, and H<sub>4</sub>. The results are provided on table 4. Wilcoxon signed rank test analysis results show that only H<sub>3</sub> is accepted. H<sub>2</sub> and H<sub>4</sub> are rejected. They mean that significant difference of abnormal return exists only when comparison period between as at and after company performed backdoor listing corporate action. There is no significant difference of abnormal return before and as at company performed backdoor listing corporate action. Neither it happens before and after company performed

backdoor listing. Since only H<sub>3</sub> is accepted, the significant difference of abnormal return only exists on as at and after company performed backdoor listing. The abnormal return as at company performed backdoor listing is significant higher than after. Although, wilcoxon signed rank test shows the abnormal return before is lower than as at company performed backdoor listing, the difference is not significant. It also happened on before and after periods, although abnormal return before backdoor listing is higher than after, it is not significant.

**Table 4: Wilcoxon Signed Rank Analysis Results**

Hypotheses	Z	Sig.	Explanation	Rank		Explanation
				Negative	Positive	
H <sub>2</sub>	-1,131	0,258	H <sub>0</sub> is accepted	16	20	Before < As at
H <sub>3</sub>	-2,152	0,031	H <sub>0</sub> is rejected	21	15	As at > After
H <sub>4</sub>	-0,911	0,362	H <sub>0</sub> is accepted	20	16	Before > After

Source : Data processing

### 4. Backdoor Listing Company's Financial Performance

Normally, when a company is built, the founder expects the company's business scale will grow over period time. It is also stated in basic underlying assumption in accounting which is going concern. The company will seek strategy to be survived and book better performance than before. As the company growing, it needs additional funding to perform strategic projects. It may look for additional

funding in capital market through Initial Public Offering. Since they performed strategic projects, shareholders and investors expect better performance over period time. According to Amin (2007), there is no significant difference of public company's financial performance before and after perform Initial Public Offering. The company is detected to implement earnings management before and after performing Initial Public Offering as the value of discretionary accrual is positive. Otherwise, under pricing of IPO price is detected as the mean of initial return

of first day trade is positive and it happen in first three months stock trade. Since the company needed to attract investors in order to purchase their share in Initial Public Offering, it implemented earnings management to show up that it was a profitable and promising company. Also they set the price a little bit lower than its market price to pull investors in large amount purchasing. Cooperating with its underwriters, they have to make sure that their shares are in investor's demand, as the company spent considerably cost for Initial Public Offering.

Backdoor listing has similar intention with Initial Public Offering, but in shorter process. The intention of backdoor listing company is to looking for additional funding through capital market. As it does not need to attract investors, it may not need to implement earnings management. Since the IPO performed company made up its financial performance, it might be hard to improve their performance as it managed its earnings before and after Initial Public Offering. If it does happens, there is a great chance and probability for backdoor listing company to show their actual improved performance. When a company decided to perform backdoor listing, it has intention to improve its performance, both financial and market performance. Especially for public company, investors watch its financial performance to make their investment decision.  $H_1$  is formulated as there is significance difference of company's current ratio, asset turnover ratio, and return to equity ratio before, as at, and after performed backdoor listing corporate action.

Manova analysis shows that there is no significant difference of current ratio, asset turnover ratio, debt to equity ratio, and return to equity ratio before, as at, and after company performed backdoor listing corporate action. It is simply stated that there is no significant difference of backdoor listing company's financial performance. It may be simply argued that the main motivation of company performed backdoor listing strategy is not financial performance improvement. Backdoor listing did not make the company book better financial results. These results are in line with Novaliza and Djajanti (2013). Backdoor listing, either on merger and acquisition did not make any impact on financial performance. It may be also argued that backdoor listing can not improve company's financial performance instantly in the short run.

There is possibility that the financial performance improvement will occur in long run. Most of backdoor listing case involved in business turnover. Old unfavorable business is going to be replaced by new prospective business. It will make company's rejuvenation, especially on financial performance. It should be happened, except the public shell company is just an exploited company. Backdoor listing may be performed to earn short term profit from capital market transaction. Most of backdoor listing case in Indonesia is in the form of right issue scheme. Standby buyer which is private company executes all of the other shareholder's right which is not taken in stock purchasing redemption. This action often inflicts financial loss for other investors. The standby buyer next will be a new public company's shareholder and control the company. It is possible that backdoor listing is just a standby buyer scenario to earn profit by its transaction based on its price engineering. There is no intention to improve backdoor listing company's financial performance. To examine this supposition, we used to test  $H_2$ ,  $H_3$ , and  $H_4$ .

## **5. Backdoor Listing Company's Market Performance**

The wilcoxon signed rank test results reveal that the significant difference of abnormal return only exists on as at and after company performed backdoor listing. The abnormal return as at company performed backdoor listing is significant higher than after. If the price engineering of backdoor listing company exists, it might be happened long ago before backdoor listing corporate action is announced to public. It is reflected from the statistics result which shows that there is no significant difference of abnormal return one year before and as at company performed backdoor listing corporate action. It means there is no significant difference in the short term before company performs backdoor listing. After backdoor listing is performed, investors then realized that there is no financial performance improvement. It motivates them to sell the shares and drives the stock price down. It causes the abnormal return after backdoor listing is significant lower than as at backdoor listing performed period.

If the short term profit is the main motivation of backdoor listing cases in

Indonesia, it is different the conclusion of Brown *et. al.* (2010). The company size and settlement process are no longer main motivation of backdoor listing. The need to access capital market may be exist, but the short term return may be the priority. This result is also the opposite with Gunawan and Sukartha (2013). If there is market performance enhancement after merger and acquisition, backdoor listing makes it contrarily. The market performance is declining after backdoor listing. It also means that the new shareholders did not maintain its public company's stock price to attract the investors. It is different with the IPO's company interest. As IPO's company and the underwriters maintain the price to escalate their reputation, the backdoor listing company may do nothing and not care with its reputation. It will not care with the investor's fate. According to Brown *et. al.* (2010), the public company which involve in backdoor listing scheme has certain characteristics. They are less liquid company stock traded and provide less profit than the others. The short term profit motivation argument may be the answer of why bad profile's company is the frequent target of backdoor listing. The reputation may be the motivation difference between Initial Public Offering and backdoor listing. According to Geddes (2007), one of the main motivations of initial public offering performed is to raise company profile. Backdoor listing company does not intend to raise its profile. If it does so, the company should maintain its market price after backdoor listing is performed.

## 6. Why Should Indonesia Regulatory Care About Backdoor Listing?

Since backdoor listing is quite popular on Indonesia Stock Exchange in the last ten years, several companies have performed it. This phenomenon is predicted to be a new trend of going public mechanism. Instant process and low

cost are offered to replace a traditional front door Initial Public Offering. If it happens continuously, there will be less listed company newcomer on Indonesia Stock Exchange than before. Backdoor listing actually does not add new listed company. It just transforms an existing company into a new company by replacing former business, name, or management. The new company that is actually new listed is its new shareholders. It did not change the number of listed company at all. As a developing capital market, Indonesia Stock Exchange needs more listed company for at least being the most listed company number capital market in ASEAN. The government through the regulator has pushed more private companies to go public and listed their shares in Indonesia Stock Exchange. The backdoor listing phenomenon actually is a threat for Indonesia Stock Exchange itself.

If financial performance improvement is not the main motivation and it is not happened on backdoor listing, it will be less benefit to excuse backdoor listing practice. If short term profit is the main motivation of backdoor listing, it just benefits a few certain parties, and inflicts financial loss for a lot of investors. Since backdoor listing is often not excessively regulated by comprehensive listing regulations, it is prone of fraud indicated. This phenomenon should be highlighted by capital market policymakers. It is recommended to formulate special regulations for backdoor listing. In Indonesia especially, the number of backdoor listing case is increased for last several years. There should be special regulations to make sure that backdoor listing is complied with good corporate governance standards in Indonesia. Most of backdoor listing cases in Indonesia applied right issue scheme in enabling new shareholders to acquire a listed company. Actually, OJK has issued several regulations which are concerned about backdoor listing related transactions. They are listed on table 5.

**Table 5:** OJK Regulations about Backdoor Listing.

OJK Regulation	Topic
Number IX.D.1	Preemptive Rights
Number IX.H.1	Takeovers of Listed Companies
Number IX.G.1	Mergers and Consolidations of Listed Companies or Issuers
Number IX.M.1	Disclosure Requirements for Certain Shareholders
Number IX.E.1	Transactions with Affiliated Parties and Conflicts of Interest
Number IX.E.2	Material Transactions and Changes in Core Business

Number IX.J.1	Material Changes in the Articles of Association of Listed Companies
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Source : OJK Regulations.

All of those regulations are related to backdoor listing transactions, but they do not name backdoor listing specifically. They are also insufficient to regulate the backdoor listing transactions happened in Indonesia Stock Exchange so far. It is preferable to design specific regulation concerning backdoor listing to enhance legal certainty about backdoor listing surroundings. The OJK may establish a benchmark from other countries capital market regulator in order to design specific regulations about backdoor listing. Several countries have formulated specific backdoor listing regulations prior from Indonesia. For example, United States through Securities and Exchange Commission (SEC) has set specific regulations about reverse merger. According to SEC (2011) , the regulations prohibit a reverse merger company from applying list until the company has completed a one year seasoning period by trading in United States over the counter (OTC) market and filled all required reports, including audited financial statements. Another regulation example is coming from United Kingdom through Financial Conduct Authority (FCA - formerly known as Financial Services Authority). According to FCA (2012), the FCA may seek to cancel the listing of issuer's equity shares representing equity securities when the issuer completes a reverse takeover, except the issuer has completed several circumstances to satisfied the FCA that cancellation is not required. Once the issuer's listing is cancelled, the issuer may re-apply the shares listing and satisfy the relevant requirements for listing. Australian Securities and Investments Commission may be an interesting sample. Even though, there is no specific regulation about backdoor listing, but it has ruled a significant change to the nature of the listed company. According to Australian Securities and Investments Commission (2013), a listed company involved in a backdoor listing transaction should re-adhered listing requirements under the business nature significant change of listed company regulations. Non-compliance to the regulations could lead to a trade suspension. The purpose is to ensure that company supplied sufficient information about its proposal in changing its nature of business in

the market as a reasonably informed basis. All of those examples may be a good benchmarking for Indonesia in order to design a new specific regulation about backdoor listing which is arose in Indonesia Stock Exchange in last several years. It may reduce fraudulent backdoor listing transactions and give an extra protection for investors.

## CONCLUSION AND RECOMMENDATION

Backdoor listing is expected by investors as a strategy to improve company's performance. This research reveals different things. Since there is no statistical significant difference on financial performance before, as at, and after company performed backdoor listing corporate action, its motivation may not intend to financial performance improvement, at least in short term. The significant improvement of market performance is also undetected. Otherwise, this research shows that backdoor listing company's abnormal return is statistically lower after than as at it is performed. It did not find any statistical difference on other period comparisons. It means that the return after company performed backdoor listing is declining. It is argued that short term profit may be the main motivation of backdoor listing transactions in Indonesia. The new backdoor listing company's shareholders exploited advantage by diluted ownership of other investors who did not execute their right in right issue scheme. Since investors did not see any financial performance improvement in their company, they divested their shares and drove the backdoor listing company's shares price down after backdoor listing is performed. It may be concluded that backdoor listing may be a bad signal for investors. It differs with Initial Public Offering which may be a good signal for investors.

The investors should look out with backdoor listing transactions in Indonesia because they are often not excessively regulated by comprehensive listing regulations and they are prone of fraud indicated. Because of those reasons, it is recommended for investors to avoid investment in backdoor listing company. Another recommendation is advised to

Indonesian capital market regulatory, which is OJK. It is recommended for OJK to design an extra protection for Indonesia Stock Exchange investors in the form of specific regulations concerned backdoor listing formulation. Other country's capital market regulations may be a good benchmarking for OJK. The fact that backdoor listing becomes new trending as an alternative way to go public in last several years may be a good reason for OJK to design the regulations immediately.

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**FACTORS AFFECTING EARNING RESPONSE COEFFICIENT (ERC) WITH  
TIMELINESS AS INTERVENING VARIABLE AT INDONESIA FINANCIAL  
SECTOR COMPANIES**

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***ABSTRACT***

*This study aims to examine and analyze the effect of leverage and the size of the company timeliness, effects of leverage, company size, market risk, the chance to grow and timeliness of the Earning Response Coefficient (ERC), and the effect of leverage and the size of the company Earning Response Coefficient (ERC) through timeliness as an intervening variable. The object of this study was 31 financial sector companies listed in Indonesia Stock Exchange period 2011- 2013. This study used a descriptive statistical tests, test similarity coefficient, the classic assumption, multiple regression analysis and path analysis LISREL. The results obtained from this study is not sufficient evidence that leverage positive effect on timeliness, while the size of the company proved negative influence on timeliness. Company size and timeliness proved negative and positive impact on the ERC, while there is not enough evidence leverage negatively affect the ERC. Market risk and growth opportunities not proven positive effect on the ERC. Timeliness has not been proven as an intervening variable for variable leverage and size of the ERC.*

***Keywords:*** *Earning Response Coefficient (ERC), Systematic Risk.*

**DO THE EFFICIENCY MODELS INCREASE COMPANY PERFORMANCE?  
THE INVESTIGATION OF PRODUCTION COST EFFICIENCY, HUMAN  
CAPITAL EFFICIENCY AND CAPITAL EFFICIENCY**

**Empirical Study on Manufacturing Industry In Indonesia**

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***ABSTRACT***

*Interesting issues are still a concern for academics in the field of strategic management to identify and investigate factors that influence company performance. This study explores company internal resources and knowledge by using two basic grand theories, Resource Based View (RBV) and Knowledge Based View (KBV). Efficiency models are represented by Production Cost Efficiency (PCA), Human Capital Efficiency (HCE) and Capital Efficiency (CE). Meanwhile, the company performances are measured through three approaches based on accounting based (ROA), market value based (Tobin's Q) and sales growth based. By using secondary data of company on 14 sub-sectors of the manufacturing industry in Indonesia during 2010-2014, fixed effect model confirms that the PCA affects ROA and Tobin's Q, the HCE affects ROA and sales growth as well as the CE has an effect on Tobin's Q and sales growth. This study also reveals that the cost advantage can be achieved through the company efficiencies. Conclusions, managerial implications, limitations and suggestions for the future research explained further.*

**Keywords:** *Resource Based View (RBV), Knowledge Based View (KBV), Production Cost Efficiency, Human Capital Efficiency and Capital Efficiency, ROA, Tobin's Q and Sales Growth.*

**ANALYSIS OF LIQUIDITY RATIO, ASSET MANAGEMENT RATIO,  
LEVERAGE RATIO, PROFITABILITY RATIO AND MARKET VALUE RATIO  
ON DIVIDEND POLICY**

**(Empirical Study on Manufacturing Companies Listed in the Indonesia Stock  
Exchange on the Period of 2010 – 2015)**

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***ABSTRACT***

*This research purpose is to examine empirically the influence of financial ratios that consists of Liquidity Ratio, Assets Management Ratio Leverage Ratio, Profitability Ratio and Market Value Ratio to Dividend Policy in Manufacture companies that listed on Indonesia Stock Exchange at 2010-2015. This research using data of Manufacture Companies' financial statements obtained from the Indonesia Stock Exchange and the company's official website from period 2010 to 2015. Purposive sampling technique is used in order to get sample and obtained as much as 20 sample companies. Furthermore, testing of the entire hypothesis in this study using multiple regression analysis by using Eviews 9 software. The result show that financial ratios consists of Liquidity Ratio, Assets Management Ratio, Profitability Ratio, Leverage Ratio, and Market Value Ratio simultaneously not significantly influence dividend policy. Partially, Liquidity Ratio, Assets Management Ratio, Profitability Ratio, Leverage Ratio, and Market Value Ratio also has no effect on Dividend Policy in the 20 sample companies listed in Indonesia Stock Exchange at 2010-2015.*

***Keywords:*** *Dividend Policy, Liquidity Ratio, Leverage Ratio, Assets Management Ratio, Market Value Ratio, Profitability Ratio*

## **THE IMPLEMENTATION OF FISCAL DECENTRALIZATION AND SOCIAL JUSTICE IN REGIONAL DEVELOPMENT IN INDONESIA**

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### ***ABSTRACT***

*This research aims to analyze the implementation of fiscal decentralization and social justice in Indonesia for 2010-2014. This study was conducted at 38 districts in East Java, Indonesia. The data used in this study were equalization fund, employment, poverty, and income equity which were gathered from Statistics Bureau, and Ministry of Finance, Indonesian Republic. This study employs descriptive analysis. The result of this research shows that there is an increase in transferring of equalization fund from central government to regional governments in East Java Province. During the observation, the implementation of fiscal decentralization has increased job opportunities and reduced the poverty level. Although, in the development process, there were income disparity in regional development process for 2014-2015 at East Java Province.*

**Keywords:** *Equalization Fund, Social Justice, Income Equity, Fiscal Decentralization*

## THE LEADING INDICATOR OF FINANCIAL CRISIS PROBABILITY IN 6 ASIAN COUNTRIES AS EARLY WARNING SYSTEM (EWS); PANEL FIXED EFFECT LOGIT APPROACH

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### **ABSTRACT**

*In line with the increasingly integrated economy, the financial crisis in one country can easily spread to other countries and become a global financial crisis. This study will be analyze the leading indicators that influence the exchange rate, banking and debt crisis, in 6 ASIAN countries, using Fixed Effect Panel Logit Model.*

*The results showed the variables that affect the exchange rate crisis are export growth, foreign exchange reserves and the ratio of M2 to foreign reserves. Export growth has a negative impact on crisis, the greater exports growth tend the supply of foreign currency will rise, so reducing the exchange rate pressure. Indonesia suffered the most severe crisis was followed by Thailand and Korea. In the banking crisis, loans, money market rate, and riel interest rates have a positive relationship with the banking crisis, and Thailand performing the deepest. Three factors affecting the debt crisis are the debt rescheduling, the growth of GDP per capita, and the growth of private savings. There are large discrepancies between the rapid growth of domestic investments that can not be offset by the savings of society, so it is still needed foreign debt. Then the debt rescheduling it indicates the financial fragility of a country to meet their debt obligations on a timely basis.*

*The contribution of this paper is to identifying what variables from the external, financial, and the real sectors affecting exchange, banking and debt crisis, so the information can be used as an early warning system of the financial crisis.*

**Keywords:** *Financial Crisis, Exchange Rates Crisis, Banking Crisis, Debt Crisis, Panel Logit, Early Warning System*

## **FOX TAIL THEORY: PRICE WAR AS VARIABLE TO ACHIEVE PERFORMANCE EVOLUTION**

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### ***ABSTRACT***

*Although undesirable, price war have become part of business as we know it today. For many, it is considered to be a strategic means to generate demand in order to achieve market performance, while for some, it becomes their only source of competitive advantage. In its core nevertheless, war in price often brought devastating results for the industry in concern, where price validity become obscured and appreciation of transaction value will be taken for granted. Through exploitation of resource and capabilities, this paper are prepared as an argument of the possibility to use price war as leverage in order to create operational process mutation prior to performance transformation through exaptation. Ultimately in the wake of its aftermath, severe competition in price are seen here as an important aspect of business evolution. Using examples from the Indonesian lighting industry, research in this paper discusses the antecedents of price war and will be organized in conjunction to the author's effort in finding possible solution to the problematic of price war.*

**Keywords:** *Price War, Exaptation, Evolution, Fox-Tail Theory, Survival*

### **INTRODUCTION: THE END OF THE DARK AGES**

We can assume that the world used to be cold and damp, where darkness rule the night with severe cruelty and humanity's last hope hangs in the balance between the hours of twilight. Nighttime become a frightening concept in our days of childhood because we were told that evil lurk in dark places. They feed on our fear and the only way to make them go away is to keep our faith intact through prayers. We were educated through these religious doctrine and become tranced in its virtues that our lives today are dependent so much on a good source of light. It was not until we realize that humanity have the ability to govern darkness through fire, our beliefs begin to change and the idea of fear become a mere complementary factor in the notion of our survival. Following the discovery of electricity, modern lightbulbs was not just considered to be an important achievement in

history, but also as an evidence of humanity's triumph over darkness.

Nowadays we live in a world bathe by the glory of our ancestors, and although many would argue that modern society are too often taking things for granted, we do so because those remarkable moments in history were made available in our daily lives through commercialization. Our fear were made obsolete through the success of economics, and darkness were defeated through a price tag we agreed upon when we decide that lightbulb in the store are worthy of purchase. What before was believed to be a virtue to enlightenment suddenly become a banal precision when the light turns on or off through a single switch on the wall. Light too, in the form of bulbs and other shapes of glass, just like any other products, have become an object of economic commodity, ruled by the market, governed by price.

But if we take a step back for a short while, would it be fair to say that we are taking things for granted when we live in an era of modern

technology made available to make our lives easier? Although in its early commercial days capturing light in a form of a physical product could be considered as an exclusive innovation where its casual acquirement comes through an adequate transactional cost, the development of humanity's social structure demand the product to be made available at an affordable price as the utility it provide was considered to be an essential necessity alongside food and clothes for consumers in general. People are able to extend their activities through prolonged hours of the day and tasks were completed with improved efficiency. In the presence of light as a product, civilization were able to develop, built, and later sustain their existence through its daily utilization.

However as we become dependent on the success of its economic commercialization, could we argue that what once was considered to be a groundbreaking solution to end an era of despair have suddenly become a mere commodity? Light as a marketable product have probably reach the maximum limit of its commercial ability and this phenomenon are apparently have become an occurring trend in the lighting industry, where companies are now struggling to find new sources of future growth. When nowadays consumers are flooded with various lighting brands who offers the same promise of longer lasting brightness, could the world of lighting suddenly become blind and no longer offer a viable business prospect?

## **BACKGROUND: THE INDONESIAN LIGHTING INDUSTRY**

Following the initial success of compact fluorescent bulbs in the early 1990s, the Indonesian lighting industry was certain to experience growth in the scale never before seen by any previous lighting products. The new type of bulbs, dubbed the CFL-i (Compact Fluorescent Lamp – integrated), was a breakthrough in technology since the days of Edison's introduction of his own version of incandescent lamps, back at the end of the 19<sup>th</sup> century. Although at that time it costs the

consumer almost twice or three times than an ordinary lamp, it did not take long for the product to be accepted by the market due to its ability to deliver greater utility with minimum long-term maintenance cost for its users. As one of the biggest countries in Asia, Indonesia suddenly become the industry's fertile ground for future investments.

During the end of 1990s and early 2000s, various companies compete to introduce their brands to the market and endlessly attempt to capture consumer's attention through attractive marketing activities. In some cases the market respond positively, but in most cases complete market capitalization were only achieved by a small number of brands. Seen from the perspective of availability nevertheless, the industry offers consumers from all market segment abundant brand options to choose from, although all of them somehow only provide one utility to derive from: energy-saving lightbulbs. Looking at the industry then, the lighting consumers were segmented through basic utility generalization and mainly served by products that have access to the biggest consumer channel: traditional retail establishment.

However twenty years following the industry's turning point, many companies have voiced their struggle to maintain performance. According to recent observation, several lighting brands have lost market share and entered a declining phase in growth, while the parties responsible for distribution have also expressed their concern in not being able to generate sufficient operational margin due to worsening internal competition among their own respective brands. What was once a promising industry, limitation of product diversification have forced the industry's key players to continuously exploit their resources to the point of zero-sum profit and sometimes at a loss, just to keep the business running.

## **LITERATURE REVIEW: LEVERAGING PRICE WAR**

Within the world of trading, competition in price have become an aspect considered as the

forefront of economic success. Price in its own right have the ability to shape, control, and become the deciding factor that define our future survival. While one can argue that an abundance of related topics other than price itself are worthy to be discussed in great length in regard to firm survival, our business practice relies heavily on how successful price is implemented because it directly represents the value of the transaction itself. As price have again and again prove to us that it possess the power to influence our economic activities, firms from various industries relies heavily on this particular variable and revolve their capabilities around it.

Although the use of price as a variable may not be a new concept, it remains to be a popular short-term strategic choice among firms who believes in the quick need to conquer competition (Garda & Marn, 1993; Rao, Bergen, & Davis, 2000; van Heerde, Gijsbrechts, & Pauwels, 2008). However in conjunction to the future of survival, using price as a variable to capture market attention could bring devastating results to firms who do not possess sufficient resource or capability to escape from price war (Busse, 2000). As majority of firms usually have limited understanding of how price war could erupt, the issue of pricing often used as an excuse to failure in business activities (Bertini, 2014).

Market and industry conditions in their own right are difficult to control. While firms are busy working to create the perfect product, various other aspects such as growth, share, and competition in the market also affect the future of their internal development. Through findings in several literature, combinations between the conditions of market, firms, products, and consumers equally contribute to the likelihood of price war (Heil & Helsen, 2001). Although suggestions on how to manage severe price competition have been previously discussed by several authors, price war remain to be one of the most difficult issue to tackle in real-life business scenarios.

Nevertheless one important aspect interestingly derived from the price war condition is the notion of evolution and survival. When firms operate in an industry where its

market are severely saturated by price, there is little chance that their future development will be facilitated by the same products they previously offered to the customers prior to the eruption of price war. In effort to create successful evolutionary effort, a framework called the *Early Warning Signal* (EWS) proposed by Heil & Helsen (2001) can be used to understand how a firm should manage their competitive positioning during pre-period of price war.

Their framework are used as guidance in this discussion due to its accurate depiction of the price war condition. While it may not offer sufficient suggestion in regard to a firm's future survival, the EWS offers clear description on what signals to look for in all aspect of business operations, seen from the perspective of price war as the dependent variable. When visualized and simplify, the framework can be easily understood using variables presented in table 1.

The framework presented have shown that price war could occur when the market equilibrium shifted and erupt while parties strife to gain share. While price itself was used only as a dimensional aspect of the war's discussion, its flexible nature of application was seen as a crucial business aspect that can lead companies both to success and bankruptcy. Price volatility will not significantly contribute to price war when a market expands (Robinson, 1988), however when industry growth declines or disappears, changes in price can create major structural deviations and competition will resemble a zero-sum game of sales, as firms can only maintain or increase their revenues by capturing customers from rival firms (Heil & Helsen, 2001). In its basic understanding, conditions of growth will likely decrease the likelihood for firms to implement retaliatory price cuts, while on the contrary a decline in the market usually increase the tendency for firms to avoid price corporation among firms (Ramaswamy, Gatignon, & Reibstein, 1994).

Based on various antecedents derived, the use of price as firm's competitive advantage are clearly inevitable and become so powerful that it become one of the most important variable in business survival. While we can argue that ways to avoid severe competition in price are

abundant, feasible solutions remain limited and positive results usually can only be appreciated after a long period of time. However because firms usually do not have long-term planning as their current engagement in price war usually

occupy most of their resources and capabilities, leveraging price as a variable to achieve future business evolution become obscured and overlooked.

**Table 1:** Early Warning Signals – emergence and intensity of price wars (Heil & Helsen, 2001)

EWS Base	Trigger	Hypothesis
Market Conditions	Competitive Entry	As market entry occurs and an entrant gains or is expected to gain a sizable market position, price war becomes likely.
	Excess Capacity	If an industry possesses excess capacity, the emergence of price wars is more likely to occur. Excess capacity will also stimulate the intensity of price war.
	Market Growth, Decline, and Disappearance	Price wars are more likely to occur and to be more intense in markets with marginal or negative growth.
	Market Concentration, or Distribution of Market Power	The incidence of price war is relatively high in markets where power is highly concentrated and fragmented, but low in markets with intermediate levels of concentration.
Firm Characteristics	Exit Costs and Barriers	As exit barriers increase, the likelihood of price war also grows
	Price Leadership	In markets where a single firm is seen as the price leader, price war are less likely to emerge
	Firm Reputation	Price wars are less likely to emerge in markets where one or more firms have established robust reputation by combating past deviations. If price wars emerge in markets with one or more high reputation firms, the resulting price war tends to be more intense compared to other markets.
	Financial Condition and Over-Competition	As financial conditions of at least one firm in an industry worsen, price wars are more likely to erupt.
Product Related	Importance	The higher a product’s strategic importance to a company, the higher the likelihood of a price war.
	Lack of Differentiation and Premium Products	When a product have the tendency to possess a commodity trait, the more likely price war will occur. On the contrary, when a product are premium or only available with certain exclusivity, chances of price war eruption are low.
	Head-To-Head Products	Introduction of head-to-head product with similar or identical qualities and utility will increase the likelihood of price war.
Consumer Characteristics	Brand Loyalty	Lower brand loyalty in the market will contribute to higher likelihood of price war to occur.
	Price Sensitivity	Higher consumer price sensitivity will contribute to higher intensity and likelihood of price war.

**RESEARCH METHODS: MUTATION, EXAPTATION, AND EVOLUTION**

Survival in its own right are a product of evolutionary success. Based on the notion of

sustainability, future success of a business depends on effective management of resources through sufficient and creative use of dynamic capabilities. There is however, another aspect of survival we could derive from the context of

sustainability that often goes unnoticed by various organizations: the concept of performance exaptation.

Exaptation can be referred as a *pre-adaptation* process (Ridley, 1997), and could offer a much more flexible concept for firms to adjust their performance in order to accomplish commercial survival in the long run. While adaptation is defined as a gradual modification of a trait driven by natural selection and assumes continuity in the selected function, exaptation is a discontinuous evolutionary process expressed by functional change of a trait which may open a new evolutionary trajectory (Gould & Vrba, 1982).

While it has probably been receiving little attention, the concept of exaptation remains as one of the most important evolutionary mechanisms in the history of species, ecosystems, and technologies (Andriani & Cattani, 2016). In the natural sciences, various biological traits that were developed for particular functions started as something different. As example, feathers were most likely selected for thermal insulation, bones originated as surplus of calcium deposits, and microwave ovens were initially developed as radar magnetrons. Based on these illustrations, exaptation could be described as a discontinuous evolutionary process that becomes the product of a shift in functionality of an existing trait or technology. In the context of price war, using the concept of exaptation would enable us to improve our own performance prior to achievement of future success.

While we can argue that processes in business and management are formulated or created for a specific purpose and necessary to sustain operational performance, their existence is not immune to transformation and mostly remain dependent to the influence of the environment and ecosystem of its initial establishment. As the establishment of a commercial institution is generally supported by a distinct market trait, sustainability can only be achieved through suitable management process of exaptation. Products (and services) in this sense, can only be offered to the customers under a specific demand

in a specific time frame, under continuous threat of demand extinction.

As business development is usually achieved through incremental changes assisted by innovation, firms could maximize their dynamic capabilities to perform activities with greater efficiency, leading to operational mutation of working process. Under dire market condition where severe competition (such as price war) affects the future livelihood of firms, exaptation might be used to create functional shifts in an existing business trait where its original applicability has been extended to serve customers on a much more complex level, leading to the discovery of new market segments and (possibly) sub-segments. By focusing on the interaction with their surrounding environment, firms may come to realize that new processes could develop and be offered to the market, using previously available resources by adapting to a new selection criteria of a new domain of application.

Within the context of the Indonesian lighting industry, exaptation process could be planned and analyzed using the honeycomb portfolio model. As the industry itself consists of several segments which in itself offers several sub-segments, business evolution could be created and induced through *daily activity mutation* process, where firms focus on continuously to improve its services and expand its product portfolio offering to a larger customer base. The primary center of the model describes a firm's core portfolio selection. It is the base product where revenue is generated and crucial to the firm's current market positioning. While this core center of portfolio generates sales and provides cash flow, it may not necessarily deliver profit or added value to the firm's future evolutionary process. The outer sector of the honeycomb acts as a harmonizing feature to a firm's primary activity, and is described in two different categories: complimentary and secondary. In the sense of operational process mutation and performance exaptation, complimentary sectors can be described as features that support the prolonged survival of the firm's primary portfolio, while the secondary sectors are features created through functional

shifts of the primary portfolio and have the potential to be the firm's future source of profit.

In reality where an industry are plagued by the practice of severe price war, exaptation offers firms with the chance to re-evaluate their competitive positioning through detail product portfolio management. As generally sales are focused on products with the largest amount of revenue and on the largest customer segment, growth opportunities are often overlooked and firms may actually already accumulating hidden knowledge without their anticipation. In some cases, possibility of creative use for alternative and yet unknown applications could be exploited through creative management of firm's dynamic capabilities.

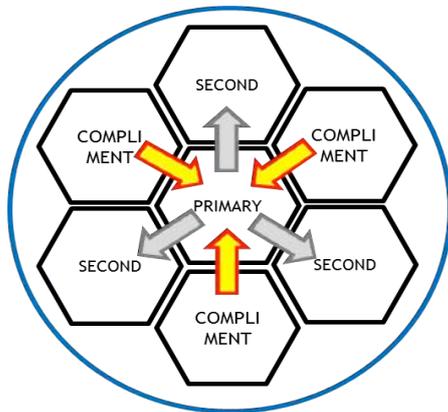


Figure 1

The honeycomb portfolio model, a framework of product development based on resource exaptation

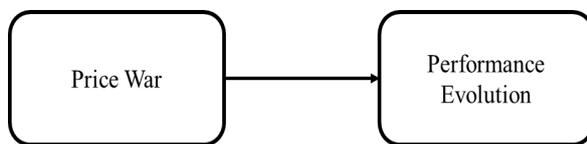


Figure 2

Research Model – Price war as variable to achieve performance evolution

## RESULT AND DISCUSSION: FOX-TAIL THEORY

Especially for the concerned industry discussed in this article, signs of war in price can be seen through the struggle of sellers to move

their fast-moving inventories on a limited time period. In an industry where the market are served through a limited portfolio offering and incremental innovation, one important aspect of long-term sustainability depends on how the ratio between sellers and buyers are maintained. When sellers are limited and buyers are somewhat not, price therefore can be used as a profitable margin-creation tool in order for a firm to ensure future investment in business development are possible. However when sellers (or products) are in excess and buyers are limited, price can only be used as a tool of competitive advantage and the notion of value added traits cannot be exploited to generate sufficient (and profitable) margin.

If the price paradigm remain unchanged and continue to strive as a key aspect in a particular industry, it is probably best to use that exact paradigm as a firm's leading performance characteristics. The core concept here is to create a distraction in order to attract attention of competitors within a specific market to assume that every action made by a firm as an identification of price discount and on par with that particular firm's survival effort. In practice, a firm could act as *the Fox*, where their strategic movement is seen by the industry as threat, despite how well they are doing in the market. If they are successful and able to capture the attention of competitors, price could then be used as a variable to drive them out of the market. However, several key indicators have to be strategically set in the first place to act as the firm's warning sign before the strategy could be executed to avoid operations meltdown and market exit. Such pointers could be set in reality by knowing exactly how big your market size is, who your potential and key customers are, and how well you can survive without them in the long run. Once you know where your sales performance's peak points and resurrection points are, the chasing game can begin. This is the fundamental ideal of *the Fox-Tail Theory*: using price as a variable to capture market attention, annihilate it, and later complete the game through market resurrection – performance evolution through combination of resource

exaptation and dynamic capability redemption (Edwinarto & Pradipto, 2016).

As illustrated in figure 3, points of performance peak and resurrection are indicated with the red circle, used here as an illusion of market size, created through volume increase generated from price undercutting. Company B and C immediately follow the trail left by Company A in effort to regain lost market share, while at the same time Company A are slowing down to the point of resurrection. Once the performance of Company B and C are at its peak, Company A begins to gain new momentum from what was left of Company B and C's exhausted performance, as they unknowingly following the path of Company D, who since the beginning have failed to establish market positioning in the price war environment. If Company B and C fail to recognize their resurrection point in the near future, decline in revenue will eventually lead them to market exit.

As a concept, the Fox-Tail is a method of staying in the game of price by acting one step in advance in comparison to market trend. The

strategy however, offers no chance of market restoration and in order to achieve successful execution, firms are required to gamble away their chances to remain in the industry. Fox-Tail as a strategy are aimed to create long-term market destruction through rapid commoditization and price conflicts.

Although devastating nevertheless, it is worth noting that the Fox-Tail concept can be an effective tool to encourage short-term business process mutation in operations, which if used effectively could lead to medium-term progressive exaptation in business performance. Despite limitation that is set by the firm's position in the industry itself, re-definition of core customers, product portfolio, and key business processes could strengthen the illusion that a firm is moving away (read: dying) due to their inability to compete in price war, when in fact the Fox-Tail strategy are executed to lure competitors into abyss. Once successful, resurrection process can then be initiated through a newly-defined core offering.

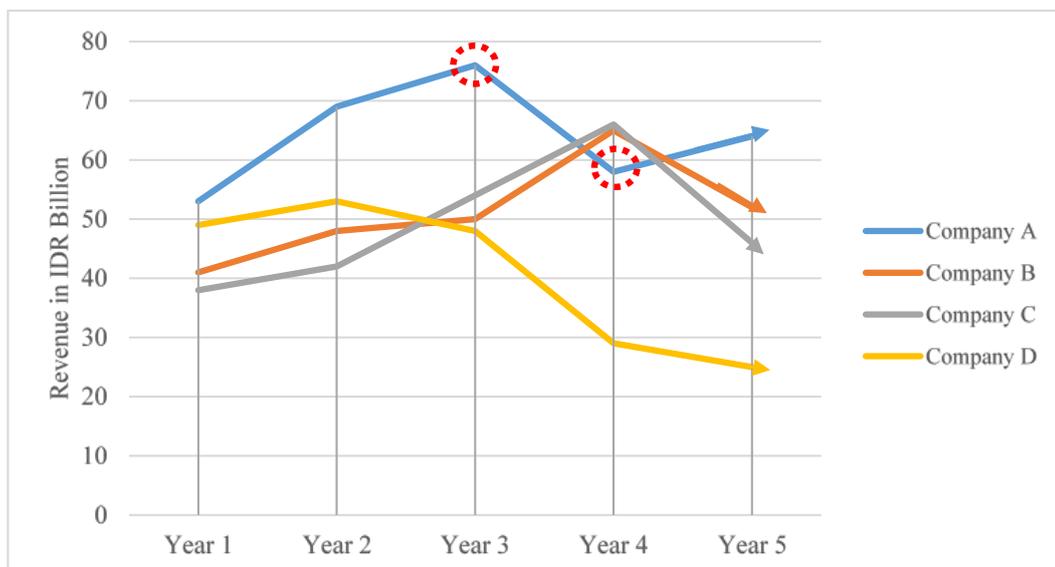


Figure 3

Example of Fox-Tail concept implementation to lure competitors to market exit

## CONCLUSION

Chances of success in using price war as a supporting variable to achieve performance evolution may not be a feasible option for firms with limited resources and insufficient dynamic capabilities, as the concept's decisive execution factor fundamentally depends on creative and sustainable resource management. Nevertheless competition have always been part of business and in that particular sense acquirement and possession of these two important features should be seen as the basic requirement of commercial success. As evolution is a product of successful transformation and transformation are derived from innovation induced by the need of survival, firms must first experience the severity of competition through price war before they prove themselves worthy to serve in their respective industries.

Although most articles discussed price war through the viewpoint of its antecedents and effects, the phenomenon were rarely seen as a decisive aspect of transformation. It is necessary therefore for firms to possess some ability to control its influence on their business performance, as price are universally acknowledged as a crucial revenue-generating element. As a strategy, Fox-Tail remain as a concept in need of much future testing and development, while as a variable, the effects of price war in regard to performance evolution could also be analyzed further using approach from resource-based and dynamic capability theories. Even though the concept at this point are presented as one of many price-control strategies, its destructive nature will bring devastating result for many firms in the industry, and its execution remain questionable through ethical viewpoints.

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## DOES EMPOWERMENT MATTER TO MAINTAIN INTENTION TO STAY OF HOTEL'S FRONT LINERS?

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### ABSTRACT

*Yogyakarta, well known as the center of classical Javanese tradition and culture, has attracted tourists not only the domestic but also the international. Consequently, tourism facilities become focus of business cultivated in this traditional city. Yogyakarta is declared as the city with 1000 hotels at 2016 (Kompas, 2016). Hotel is a service-centered business under the customer satisfaction principle. Therefore, employees working in this business entity are demanded in their excellence in creating satisfaction. The hotel's front liners are employees who are standing in the cross-boarders between company and customers. Their performance in delivering services to customers is a gate of satisfaction toward the hotel. Thus, s/he is demanded to be professional and knowledgably in his/her job responsibility. The competency will minimize inevitable conflict facing by front liners as a representative of company to customers and, oppositely, customers to the company.*

*Studies focusing on competency improvement of hotel's front liners are needed to increase competitive advantage of a hotel based on its human capital. Intention to stay is a considerable construct based on knowledge factor of a front liner. Bartłomiejczuk (2015) notes that tenure drives service quality. Front liner with a long tenure period has higher experiences then drive to higher service quality based on his/her knowledge endowment. However, studies to explore predictors of intention to stay under empowerment literature is limited. Empowerment is predicted to have positive contribution toward intention to stay of a cross-border employee because of the power sharing authority.*

*This research focuses on the impact of empowerment on employee's intention to stay by involving psychological and work related variables those are leadership empowerment behavior, psychological empowerment, job satisfaction, affective commitment, and organizational citizenship behavior. The hypotheses are tested using survey data collected from a sample of 154 front liner hotels located in Yogyakarta. Results showed that the hypotheses are supported, except that of the effect of job satisfaction on intention to stay. The author concludes with discussion of the implications of the findings and directions for future research.*

**Keywords:** *empowerment, intention to stay, hotel front liner*

### INTRODUCTION

Yogyakarta is "a city of 100 hotels"

(Kompas TV, 2016). The Head of Indonesian Hotels and Restaurants

Association, Istijab M. Danunagoro agreed with the statement. He even said that there had been significant addition of hotel rooms by 2015. The great number of hotels in Yogyakarta drives a so tight competition in the industry that in turn forces hotels to give the best services for the sake of the consumers' satisfaction. Consumers' satisfaction is the key to win the competition. In this industry, customers' satisfaction is even used as an indicator to measure the company effectiveness (Schneider et al., 1998).

Fast response is badly needed to increase customers' satisfaction (Kim et al, 2012) because the faster the service is given, the higher the customers' satisfaction will be. Hence, the organization shall hand in more authority to its employees in running their jobs.

Considering that the level of customer satisfaction depends very much on the quality of services by the front liners, this research takes the intention to stay as a variable of result to see what factor can make employees stay still in an organization. This is based on the research of Bartlomiejczuk (2015) stating that services by an employee are determined by the length of working of him/her. The longer s/he works, the more the experience s/he gets and the better the service s/he gives.

Empowering is suspected to be one of the influential factors for the increasing intention to stay. Giving more authority and responsibility to employees is an empowering style of leadership. Some previous researchers have proven the importance of empowerment for the front liners in hotel industry (Kim et al., 2012; Sergeant and Frenkel, 2000). The front liners are chosen for this research since they are the ones serving and interacting directly with consumers, hence, customers' satisfaction depends on how these front liners give their services.

Some previous researches focused on empowering leadership and psychological empowerment to predict the job satisfaction

(Dewettinck and Ameijde, 2011; Lei, 2014). Unlike in the previous research that empowering leadership focused on structural approach, in this research empowering leadership is viewed from two perspectives i.e. structural perspective and emotional perspective. The latter is obtained from employees' experiences and motivations as the impact of the leaders' behaviors reflected in the psychological empowerment variable.

Konczak et al. (2000) tested empowering leadership as a predictor for psychological empowerment and got positive result. Other researchers also have proven that there is a relation between the four dimensions of psychological empowerment and job satisfaction in empowering concept, but it only results in proactive essences in employee empowerment if they work together and support each other (Thomas and Velthouse, 1990; Thomas and Tymon, 1994; Spreitzer et al., 1997). For example, when an employee feels competence in his/her job, s/he will work better and be more patient in dealing with his/her job problems. The better he works, the better performance s/he produces, and this makes someone has influence toward his/her job environment. Therefore, this research treats psychological empowerment variables as one solid variable as previously done by Konczak et al. (2000).

Klidas et al. (2007) has previously studied the relation between empowering leadership and the increase of front liners' positive behavior in hotel industry. The result shows that empowering leadership is positive toward job satisfaction and organizational commitment. This research will also test organizational citizenship behavior because a research by Somech (2005) found out that one of the empowering leadership dimensions was related to organizational citizenship behavior. Therefore, this research will test the effects of empowering leadership on job satisfaction, organizational commitment, and organizational citizenship behavior.

This research aims to analyze the role of empowerment on the front liners' intention to stay in hotel industry in Yogyakarta by involving psychological variables and job results such as psychological empowerment, job satisfaction, affective commitment, and organizational citizenship behavior. The analysis on empowering will refer to its structural level (leadership empowerment behavior) and its motivational level (psychological empowerment). Another reason is that there are only a few researches studying the impacts of empowerment to employees' intention to stay.

## LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

### **Empowerment: Leadership Empowerment Behavior and Psychological Empowerment**

Empowering leadership is a type of leadership willing to hand over more authority to subordinates and facilitate a mechanism for the subordinates to be directly responsible to their job. Arnold et al. (2000) proposes five dimensions of empowering leadership covering up leading by example, involving subordinate to participate in decision-making (participative decision making), training and coaching, providing various relevant information, and showing concern.

Psychological empowerment is a motivational process augmenting self-efficacy to the employees (Kim et al., 2012). According to Thomas and Velthouse (1990), psychological empowerment is an intrinsic motivation to make changes on cognitive variables. Spreitzer (1995) proposes four cognitive dimensions covering up meaningfulness, competence, self-determination, and impact (capability to affect).

A leader behaving in line with the dimension of participative decision-making will give employees a chance to contribute in a team decision making. This will make employee feel trusted and competent to make such decisions. The employees will

then believe that they have competence to give impact to their job environment, and this reflects the impact dimension. At the time a leader gives supervision and support (coaching) or sampling models (leading by example) to his/her employees during their working time, self-confidence grows in them. This reflects the competence dimension (Dewettinck and Amajjde, 2011). Previous findings prove that when leaders apply empowering behaviors, the experience of psychological empowerment on the employees increases (Konczak et al., 2000). Based on the relation between empowering leadership and psychological empowerment, a hypothesis is made as follows:

Hypothesis 1: Empowering leadership positively affects psychological empowerment

### **Psychological Empowerment and Job Satisfaction**

Job satisfaction is to evaluate an employee in relation to her/her job. The evaluation also covers up job characteristics and emotional experience of an employee when s/he is working. Therefore, satisfied employees tend to give positive evaluation to their job more than do the less satisfied ones (McShane and Von Glinow, 2003). Spector (1997) defines job satisfaction as behavior reflecting the feeling of an employee about his/her job entirely or some various aspects of the job.

Herzberg et al. (1959), Hackman and Oldham (1980) argue that when employees feel their jobs give them values and meaning, they tend to have higher job satisfaction than those not feeling values and meaning in their jobs. This accords with Locke (in Dewettinck and Amajjde, 2011) who believes that job satisfaction derives from filled individual values. It is based on the belief that job satisfaction derives from one's perception that is already fulfilled.

Psychological mechanism evolves when employees feel empowered, for example by having job autonomy. They feel

that their leader trusts them and this in turn makes them confident with their competence to have the autonomy. This self-confidence gives more job satisfaction. The hypothesis based on the relationship between psychological empowerment and job satisfaction is as follows:

Hypothesis 2a: Psychological empowerment has positive effects to job satisfaction.

### **Psychological Empowerment and Affective Commitment**

Affective commitment is an emotional relationship between individual and identification on organization. Affective commitment determines employees to stay in an organization by their own will (Qamar, 2012). The commitment also makes employees concerned to the existence of the organization and thus faithful to stay.

The sentiment on the meaningfulness of the job contributes to a higher level of affective commitment (Mento et al., 1980; and Liden et al., 2000). Social exchange theory (Cropanzano and Mitchell, 2005) supports the statement. This theory says that a relationship changes from time to time to become a trust, faithfulness, and mutual commitment. This condition may smoothly run when the two parties i.e. the leaders and the led ones stay in certain norms and obey rules. Cropanzano and Mitchell (2005) explain that norm is a set of rules determining how people have to behave and they have responsibility to conduct reciprocal attitudes.

For example, leaders giving autonomy to employees to participate in decision-making (participative decision-making) will make employees feel they have good competence in the eyes of their leaders and feel trusted. Such a feeling will make the employees encouraged to pay back the goodness of the leaders through being committed to the organization. The commitment appears in the form of both voluntarily staying in the organization and giving the best job performance for the organization.

Meyerson and Kline (2008) in their study believe that psychological empowerment has a relationship with how employees can feel that they are in an empowered environment. Those feeling both confident and competent to be successful in their job will have more satisfaction with their jobs, and be more affectively committed to the organization. Based on the relationship between psychological empowerment and affective commitment, a hypothesis is made:

Hypothesis 2b: Psychological empowerment has positive effects on affective commitment.

### **Psychological Empowerment and Organizational Citizenship Behavior**

Organ (1988) defines organizational citizenship behavior as free-to-do individual behavior and not explicitly realized by formal wage system, but in general this behavior makes organization function effectively. Others say that organizational citizenship behavior consists of some behaviors comprising behavior to help colleagues, voluntarily do tasks out of job description, and obey rules and procedures in the office. These behaviors show the benefit of the employees and become one of the pro social behavior forms such as helpful, positive, and constructive social behaviors (Aldag dan Resckhe, 1997).

When someone is psychologically empowered and consecutively believes in his/her competence, s/he will love the job. When someone loves his/her job, s/he will give the best to accomplish the job even with both efforts and results beyond what is assigned. This is the background of the relationship between in-the-job empowerment and organizational citizenship behavior. In the past, allowing employees to take over responsibility was considered as an increase in the availability of resources and participative decision-making. However, today there is a change in opinion that the organization must empower the employees. This is called psychological empowerment

(Hancer and George, 2003; Conger and Kanungo, 1988). The condition of psychological empowerment is that it increases the intrinsic motivation of the employees and makes them work harder than what is expected (Yen et al., 2004). Because of referring to better performance and stronger determination in task completion, this is thus very important in hotel industry (Yen et al., 2004; Hwang, 2005; Chiang and Jang, 2008). Based on the relationship between psychological empowerment and organizational citizenship behavior, a hypothesis is constructed as follows:

Hypothesis 2c: Psychological empowerment has positive effects to organizational citizenship behavior.

#### **Leadership Empowerment Behavior, Psychological Empowerment, and Job Satisfaction**

The psychological mechanism is constructed in this relationship when a leader empowers his/her employees, for example when giving them opportunity of participative decision-making. This makes employees have role in organization. They will feel that they are psychologically empowered and they can bring effects to their job environment (impact) so that in turn this produces self-satisfaction (Dewwetinck dan Amajjde, 2011). Based on the relationship between empowering leadership and job satisfaction mediated by psychological empowerment, a hypothesis is constructed as follows:

Hypothesis 3a: Psychological empowerment mediates the relationship between empowering leadership and job satisfaction.

#### **Leadership Empowerment Behavior, Psychological Empowerment, and Affective Commitment**

A leader empowering employees by giving more autonomy in their job will make the employees feel respected and trusted, and consecutively this kind of feeling drives self-determination. This self-determination refers to their controlled feeling in their job, indicating that they are psychologically

empowered. (Deci et al., 1989). Besides, the employees feeling more competent and having stronger self-confidence will have more emotional bond to the organization (Meyerson and Kline, 2008). Based on the relationship between empowering leadership and effective commitment mediated by psychological empowerment, the following hypothesis is proposed:

Hypothesis 3b: Psychological empowerment mediates the relationship between empowering leadership and effective commitment.

#### **Leadership Empowerment Behavior, Psychological Empowerment, and Organizational Citizenship Behavior**

The psychological mechanism is constructed in this relationship when a leader is applying empowerment by giving good examples to his/her employees through good behaviors to imitate (Dewwetinck and Amajjde, 2011). This kind of behaviors motivates employees to be responsible for their job and do their job well (Morrison, 1996). When employees already feel empowered, they will have competence to accomplish their assigned job tasks better than what they are supposed to do in that it in turn creates organizational citizenship behavior (Wat and Shaffer, 2005). Based on the relationship between empowering leadership and organizational citizenship behavior mediated by psychological empowerment, a hypothesis is constructed as follows:

Hypothesis 3b: Psychological empowerment mediates the relationship between empowering leadership and organizational citizenship behavior.

#### **Job Satisfaction and Intention to Stay**

Intention to stay is defined as the employee's intention to keep staying in the job relationship s/he has with the employer for a long time (Johanim, 2012). Intention to stay reflects the employee's level of commitment to his/her organization and the

will to keep staying as an employee in the organization (Noraani et al, 2010).

Steers and Mowday (1981) show that values and job expectation influence affective response such as job satisfaction and affective commitment, and this drives individual to stay in the organization, and vice versa (Lee and Mowday, 1987). Satisfaction emerges when job expectation is met, and positive evaluation on the job will be given by the employee. Feeling satisfied, the employee is encouraged to stay in the organization (Lee dan Mowday, 1987).

Igbaria et al. (1994) also found that job satisfaction had significant effect on the employee's will to stay in the organization. This is supported by the finding by Bang (2011) in that the rise of job satisfaction will boost the employee's intention to stay. Based on the relationship between job satisfaction and intention to stay, a hypothesis is constructed as follows:

Hypothesis 4a: Job satisfaction has positive effect on the intention to stay.

### **Affective Commitment and Intention to Stay**

Employees having organizational commitment are willing to contribute what they have to the organization for the sake of the continuing existence of the organization (Mowday et al., 1982). It shows that when someone has affective commitment, s/he tends to willingly sacrifice for the existence of the organization since s/he has deep emotional bond to his/her organization. One of the forms of affective commitment is the intention to stay in the organization (Qamar, 2012).

Igbaria et al. (1994) in his study discovered that organizational commitment had significant effect on the employee's intention to stay in organization. This is because a committed employee has low motivation to change job due to having high intention to keep staying in the organization (Thatcher et al., 2002). Based on the relationship between affective commitment

and intention to stay, a hypothesis is constructed as follows:

Hypothesis 4b: Affective commitment has positive effect on intention to stay.

### **Organizational Citizenship Behavior and Intention to Stay**

According to Chen, Tjosvold, and Fang (1998), organizational citizenship behavior affects the manager's evaluation on the employees. The employees thus feel to be a part of the organization in that it consecutively develops intention to stay. When an employee shows organizational citizenship behaviors, the manager will give a better evaluation on him/her, considering that the behavior is voluntarily conducted and beneficial to the organization. Getting good mark from the leader, an employee will feel accepted and a part of the organization, and consecutively decide to stay in the organization. Based on the relationship between job satisfaction and intention to stay, a hypothesis is constructed as follows:

H4c: Organizational citizenship behavior has positive effects on intention to stay.

Figure 1 shows the research model used in this research.

[Insert Figure 1]

## **METHODS**

### **Research Setting and Respondents**

Disseminating questionnaires directly to respondents is the way to get data. The questionnaires are those already developed by previous researchers, translated into *Bahasa Indonesia*, and confirmed on the contents (back-translation) to get as similar to the original version as possible.

The respondents are a-year-or-more working front liners of hotels in Yogyakarta. The selection is due to the need of the research to study the characteristics of the leaders and the job. Those working for minimally a year are considered having adequate knowledge and information for the research. Front liners such as receptionists, bellboys, doormen, security officers, waiters,

etc. are the employees interacting directly with consumers.

The data collecting took place for a month and 203 data were collected. There were 49 invalid data due to incomplete information and unmatched criteria. Thus, there were 154 data (75.86% response rate) possible to process and used for the research.

All the variables were measured by using Likert scale consisting of five points i.e. 1 = strongly disagree; 2 = disagree; 3 = neutral; 4 = agree; and 5 = strongly agree. The following is the discussion of all the variables used in the research.

*Leadership Empowerment Behavior.* To assess leadership empowerment behavior, this research used the measuring instrument once used in the research by Arnold et al. (2000). The instrument consists of 38 points comprising five dimensions i.e. leading by example, coaching, participative decision-making, information sharing, and showing concern/interacting with team. (point sample: “My leader supports me to undoubtedly proceed my opinions and give inputs”).

*Psychological Empowerment.* The instrument to measure psychological empowerment is the one used by Spreitzer (1995). The instrument consists of 12 points of four dimensions i.e. meaning, competence, self-determination, and impact. (example item: “This job is important for me”).

*Job Satisfaction.* The instrument to measure job satisfaction is MSQ (Minnesota Satisfaction Questionnaire). The instrument consists of 20 points reflecting the level of employee’s satisfaction of the job. (example item: “I am satisfied with my job because I have opportunity to work on my competence”).

*Affective Commitment.* The instrument to measure affective commitment is the one used in a research by Allen and Meyer

(1991). The instrument consists of 6 points reflecting what the respondents feel to their organization. (example item: “I am happy to dedicate my career to this company”).

*Organizational Citizenship Behavior.* The instrument to measure organizational citizenship behavior consists of 5 constructs i.e. altruism, civic virtue, conscientiousness, courtesy, and sportsmanship, using 24 items of question developed by Podsakoff et al., (1990). (example item: “I am willing to help other people who have problems with their jobs”).

*Intention to Stay.* The variable of intention to stay is measured with using 4 items of question developed by Bluedorn (1982). The instrument consists of 4 points reflecting the respondents’ feeling toward their job. (example item: “I will be working in this company for the next 3 or 4 months”).

### **Analytical Procedures**

This research applies structural equation modeling (SEM) technique based on partial least square (SEM-PLS) with Smart PLS 3.0. SEM is a kind of multivariate analysis, which is a statistic method to analyze some research variables simultaneously in social sciences. SEM has two superior abilities, which are ability to test a complex research model simultaneously and ability to analyze unobserved variables by calculating the measurement errors. There are two sub-model steps in running PLS-SEM analysis: measurement model (outer model) and structural model (inner model).

The measurement model will show how observed variables representing latent variables are measured so that they can be used to test the validity construct and reliability construct (Ghozali & Latan, 2012). In SEM-PLS, the validity test is divided into convergent validity test and discriminating validity test. Convergent validity test is conducted to test the validity of every factor of latent variables. The indicator or measuring instruments of a construct shall have high correlation with the

latent variables (Ghozali & Latan, 2012). Convergent validity can be seen through the values of loading factor, Average Variance Extracted (AVE), or communality. An instrument is valid when the loading factor is higher than or equals 0.7 while the AVE and communality are higher than or equals 0.5. A good construct is the one with high loading factor, but mostly the loading factor cannot reach 0.7 especially from the new developed questionnaires, and thus 0.4 – 0.7 are worth considering (Sholihin & Ramono, 2013).

Discriminating validity is obtained through two ways, cross loading and the comparison of AVE root. Cross loading must have number higher 0.7 while the AVE root of a construct must be bigger than the correlation of inter-latent variables. In PLS reliability test can be run by using Cronbach's alpha and Composite reliability. Cronbach's alpha measures the bottom line of a construct's reliability value while Composite reliability measures the real reliability of a construct (Chin, 1995 in Jogiyanto, 2011). The instrument is reliable when the values of Cronbach's alpha and Composite reliability are higher than 0.7, even though 0.6 is worth considering (Hair et al., 2006 in Jogiyanto, 2009).

Structural model or inner model is used to predict the causality relation of inter-latent variables and becomes the next phase after both validity and reliability tests. The test is processed by using a process called bootstrapping in SmartPLS 3.0. Bootstrapping is an estimation practice on estimator value with approximation distribution sampling.

There are three bootstrapping results needing a serious attention: path coefficient ( $\beta$ ) because the value is bigger than the inter latent variables relation, p-value because of showing the significance of inter latent variables relation, R-squares because of showing the level of contribution of certain exogenous variables towards endogenous variables, and f-square effect (effect size) because it is an absolute value of individual contribution of every predicting latent

variable toward R-square value of criterion variable.

The hypotheses of this research are tested by seeing the values of path coefficient and p-value. The hypotheses are supported when having p-value < 0.001 (significant at the level of 1%) and p-value < 0.05 (significant at the level of 5%). Path coefficient value shows the level of relationship between exogenous variables and endogenous variables. The exogenous variable has positive relationship with endogenous variable when path coefficient is positive, and the exogenous variable has negative relationship with endogenous variable when path coefficient is negative. Meanwhile, mediating hypotheses in this research are tested by following causal steps under the terms of Baron and Kenny (1986).

## RESULTS

Table 1 presents the reliability test result referring to the cronbach's alpha values of the variables taken for this research. The indicator is regarded reliable when having Cronbach's Alpha > 0.60 (Sekaran & Bougie, 2010) and composite reliability > 0.70 (Sholihin & Ratmono, 2013). By referring to those two criteria, the indicators used in this research are declared reliable.

[Insert Table 1]

Table 2 show a descriptive statistic about the respondents responses on the question items that reflect the research variables. Descriptive statistic consists of mean value, standard of deviation, and correlation coefficient of inter-variables of the research. The respondents' responses on each question of all the variables engaged in this research tend to be rising, having above 3 in average.

[Insert Table 2]

Figure 2 shows the hypothesis test results. That empowering leadership has positive effect on psychological empowerment is justified ( $\beta = 0.501$ ;  $p <$

0.001;  $R^2 = 0.251$ ). That psychological empowerment has positive relationship with job satisfaction is justified ( $\beta = 0.544$ ;  $p < 0.001$ ;  $R^2 = 0.295$ ). That psychological empowerment has positive relationship with affective commitment is justified ( $\beta = 0.502$ ;  $p < 0.001$ ;  $R^2 = 0.252$ ). That psychological empowerment has positive relationship with organizational citizenship behavior is justified ( $\beta = 0.408$ ;  $p < 0.01$ ;  $R^2 = 0.166$ ). That job satisfaction has positive effect on intention to stay is not justified ( $\beta = 0.100$ ;  $p = 0.177$ ;  $R^2 = 0.280$ ). That affective commitment has positive effect on intention to stay is justified ( $\beta = 0.290$ ;  $p = 0.006$ ;  $R^2 = 0.280$ ). That organizational citizenship behavior has positive effect on intention to stay is justified ( $\beta = 0.259$ ;  $p = 0.016$ ;  $R^2 = 0.280$ ).

Table 3 shows that psychological empowerment mediates the relationship between empowering leadership and job satisfaction is justified (partially mediated) because the path coefficient between empowering leadership variable and job satisfaction variable without mediation is ( $\beta = 0.555$ ;  $p < 0.001$ ;  $R^2 = 0.309$ ), and after being compared to the path coefficient between empowering leadership variable and job satisfaction variable when mediated by psychological empowerment, the value is still significant though having a little decrease  $\beta$  ( $\beta = 0.272$ ;  $p < 0.001$ ;  $R^2 = 0.295$ ).

Table 4 shows that psychological empowerment mediates the relationship between empowering leadership and affective commitment is justified (partially mediated) because the path coefficient without mediation is ( $\beta = 0.572$ ;  $p < 0.001$ ;  $R^2 = 0.327$ ), and compared to the path coefficient with mediation, the value decreases  $\beta$  ( $\beta = 0.251$ ;  $p < 0.001$ ;  $R^2 = 0.252$ ).

Table 5 shows that psychological empowerment mediates the relationship between empowering leadership and organizational citizenship behavior is justified (partially mediated) because the path coefficient without mediation is ( $\beta = 0.466$ ;  $p < 0.001$ ;  $R^2 = 0.217$ ), and compared

to the path coefficient with mediation, the value decreases  $\beta$  ( $\beta = 0.204$ ;  $p < 0.001$ ;  $R^2 = 0.166$ ).

[Insert Figure 2]

[Insert Table 3]

[Insert Table 4]

[Insert Table 5]

## DISCUSSION

This research is to test the relationship between empowering leadership and intention to stay of the employees and the effect of psychological empowerment as mediator variable for the relationship between empowering leadership and other three variables, which are job satisfaction, affective commitment, and organizational citizenship behavior. The relationship among those six variables is represented into ten hypotheses. Based on the hypotheses test results, nine hypotheses are justified while one hypothesis is not justified.

The first hypothesis, that empowering leadership drives psychological empowerment, is justified and in line with the result of the research by Dewettinck and Ameijde (2011). When employees feel their leader conducts empowering leader behavior, they are psychologically empowered. Empowerment makes employees competent and gives them opportunity to plan, implement, and control the implementation of the working plan under either individual responsibility or group responsibility (Nangoi, 2001). This practice corresponds to the definition of psychological empowerment, an employees' belief on their competence and organization capability to deal with obstacles and control occurrences (Behling and McFillen, 1996).

Psychological empowerment has positive relationship with job satisfaction, and it is in line with the research by Dewettinck and Ameijde (2011). Herzberg et al., (1959) and Hackman and Oldham (1980) argue that when employees feel their jobs give them values and meaning, they tend to have higher job satisfaction than those not

feeling values and meaning in their jobs. Besides, job autonomy along with freedom to make decision and self-determination gives an employee a feeling of control over the job. It makes someone do the job for individual's sake rather than for others, and it gives higher satisfaction (Thomas and Tymon, 1994).

This research has also proven that psychological empowerment positively affects affective commitment as found by Dewettinck and Amejide (2011). Mento et al. (1980) and Liden et al. (2000) think that emotion on the meaning of the job contributes to making the level of affective commitment higher. Social exchange theory (Cropanzano and Mitchell, 2005) supports the statement. This theory says that a relationship changes from time to time to become a trust, faithfulness, and mutual commitment. It explains that norm is a set of rules determining how people have to behave and they have responsibility to conduct reciprocal attitudes.

Social exchange occurs when a leader keeps his/her employees by giving examples and supports needed. This strong relationship leads to effective working behaviors and positive employee behaviors such as commitment (Cropanzano dan Mitchell, 2005). It means that empowerment contributes to the existence of affective commitment in an organization through reciprocal processes. That employees respecting the leader's decision feel challenged and responsible for their job is similar to the dimensions of meaningfulness, impact, and self-determination in psychological empowerment. It shows that reciprocated feeling produces stronger commitment in an organization.

Psychological empowerment also has positive relationship with organizational citizenship behavior as found by Morrison (1996). Psychological empowerment creates ambition and motivation of the employees to do the job well and responsibly. Hence, the employees will have competence to carry out their job better than what is already

expected. Therefore, it creates empowering organizational citizenship behavior and job satisfaction to occur directly (Conger Kanungo, 1988).

Furthermore, the hypothesis says that psychological empowerment mediates the relationship between empowering leadership and job satisfaction. As the results shows, it is positive that psychological empowerment partially mediates the relationship between empowering leadership and job satisfaction. This result is in line with the one found by Dewettinck and Amejide (2011). Mediating partially means that the relationship between empowering leadership and job satisfaction can go directly without psychological empowerment, or the relationship can go indirectly through mediation by psychological empowerment. When a leader empowers employees by giving, for example, opportunity to participate in decision-making, the employees feel that they have role in organization. Employees feel psychologically empowered and capable to give impacts to their working environment, and this feeling produces satisfaction (Dewwetinck and Amajjde, 2011).

The hypothesis previously says that psychological empowerment will mediate the relationship between empowering leadership and affective commitment, and the result is positive in that psychological empowerment partially mediates the relationship between empowering leadership and affective commitment. This result accords with the finding by Dewettinck and Amejide (2011). Mediating partially means that the relationship between empowering leadership and affective commitment can go directly without psychological empowerment, or the relationship can go indirectly through mediation by psychological empowerment. When a leader empowers employees, they will feel respected and it drives a feeling of self-determination. This self-determination refers to their controlled feeling in their job, indicating that they are psychologically

empowered (Deci et al., 1989). Besides, the employees feeling more competent and having stronger self-confidence will have more emotional bond to the organization. (Meyerson dan Kline, 2008).

The hypothesis previously says that psychological empowerment will mediate the relationship between empowering leadership and organizational citizenship behavior. As the results shows, it is positive that psychological empowerment partially mediates the relationship between empowering leadership and organizational citizenship behavior. Mediating partially means that the relationship between empowering leadership and organizational citizenship behavior can go directly without psychological empowerment, or the relationship can go indirectly through mediation by psychological empowerment. A leader may show good behaviors to imitate by employees when running empowerment through giving examples to employees (Dewwatinck and Amajide, 2011). This motivates employees to be responsible for their job and do their job well (Morrison, 1996). When employees already feel empowered, they will have competence to accomplish their assigned job tasks better than what they are supposed to do in that it in turn creates organizational citizenship behavior (Wat and Shaffer, 2005).

In this research, the effect of job satisfaction on intention to stay is not justified. Elangovan (2011) in his research states that job satisfaction does not have causal relationship with employee's intention to stay or to resign. This implies that in order to make employees stay, a company must focus more on increasing organizational commitment than "selling" the job attributes and features. According to Melky (2015), there is no correlation between job satisfaction and intention either to stay or to resign. Other factors have more correlating effect on intention either to stay or to resign than job satisfaction. In other words, job satisfaction has minor contribution to the employee's intention to

go. According to Robbins (2001), those other factors affecting the intention to move to another company include job market, alternative job opportunity, perception on organization structure, job stress, job design, performance evaluation system, and too long tenure of working. Besides, job satisfaction variable used in this research is too general to use as an aspect influencing the employee's intention to stay in an organization. Other more specific aspects such as wage, superiors, and working colleagues as variables to test satisfaction are considered more capable to influence the employee's intention to stay.

The researcher also conducted some short interviews with some respondents, and they said that they are comfortable with both the colleagues and the current job environment, but young age employees are in the middle of searching process. They try to seek more and better job experiences. It is in line with the data showing that most respondents aged 21-30 years old seek experience. It is again in line with the data in which most respondents (76.0%) are 21-30 years old.

This research proves that affective commitment has effect on intention to stay as the finding of Qamar (2012), Chen, Tjosvold and Fang (1998). Employees having organizational commitment are willing to contribute what they have to the organization for the sake of the continuing existence of the organization (Mowday et al., 1982). It shows that when someone has affective commitment, s/he tends to willingly sacrifice for the existence of the organization since s/he has deep emotional bond to his/her organization. One of the forms of affective commitment is the intention to stay in the organization (Qamar, 2012).

The hypothesis says that organizational citizenship behavior has relationship with intention to stay. Like the finding of Chen, Tjosvold, and Fang (1998), the hypothesis is proven. They find that organizational citizenship behavior influences the

evaluation of a manager on employees. It encourages employee to feel as a part of the organization so that s/he has intention to stay in the organization. When an employee shows organizational citizenship behaviors, the manager will give a better evaluation on him/her, considering that the behavior is voluntarily conducted and beneficial to the organization. Getting good mark from the leader, an employee will feel accepted and a part of the organization, and consecutively decide to stay in the organization.

### **IMPLICATIONS, LIMITATIONS AND FUTURE RESEARCH**

Only a few researches discuss empowering leadership in relation with intention to stay and organizational citizenship behavior, thus this research result may augment the current references on the related issue. According to Dewettinck and Ameijde (2011) and Seibert et al. (2004), the number of researches on the relationship between empowering leadership and the multidimensional concept of psychological empowerment is still highly limited. This research thus gives contribution to the assessment on empowering leadership construct (structural view) and psychological empowerment (psychological view) by examining the effect of psychological empowerment variables as mediating variables. Besides, this research is expected to augment references on the four dimensions of psychological empowerment that are integrated into one solid variable in the research. Finally, this research is expected to augment references on the effect of empowering leadership on organizational citizenship behavior.

The tight competition in hotel industry in Yogyakarta brings new challenges for business people running this business. They are pushed to have competitive advantages to win the competition. The previous researchers and practitioners have already proven the importance of empowering employees especially the front liners in hotel industry to give the best services to

customers (Kim et al., 2012; Sergeant and Frenkel, 2000).

This research states that empowering leadership gradually increases the employees' intention to stay. Based on the result of the research, the company can apply empowering leadership to increase the employees' intention to stay. It is suggested that organization consider implementing empowering leadership because not only does it increase the employees' intention to stay, but it also increases job satisfaction, affective commitment, and organizational citizenship behavior of the employees. Furthermore, those results can give company competitive advantages to win the competition. Some examples of empowering leadership are showing the importance of employees' job, providing more autonomy in decision-making, showing trust on the employees' competence, removing obstacles in job environment, and letting employees to participate in decision-making concerning their job (Ahearne *et al.*, 2005).

Due to the limited time and fund, this research has thus limitations. Here are some limitations along with the suggestions for further research:

1. The companies were involved only in term of permit processing for data collecting. They did not intensively engage to confirm the front liners on the importance of their being respondents. Hence, there is possibility that some respondents were not committed in data completion. With a total support from the company, it is expected that the research will have more and better data in shorter time.
2. The questioned items are considered too many. There were 104 items to respond. It may distract the respondents focus in completing the data. The researcher suggests that in the next research the data collecting process be conducted through integrated interview process in order that the respondents completely understand the meaning of every construct they are dealing. Interviews

can also build a better interaction between the respondents and the researchers so that the concentration of the respondents in data completion can be consistently maintained.

3. The samples data of this research, by using purposive sampling, are obtained from front liners of some hotels in Yogyakarta. Generalization is limited due to this condition. It is expected that the next researches use different samples and different companies to examine the finding of this research.

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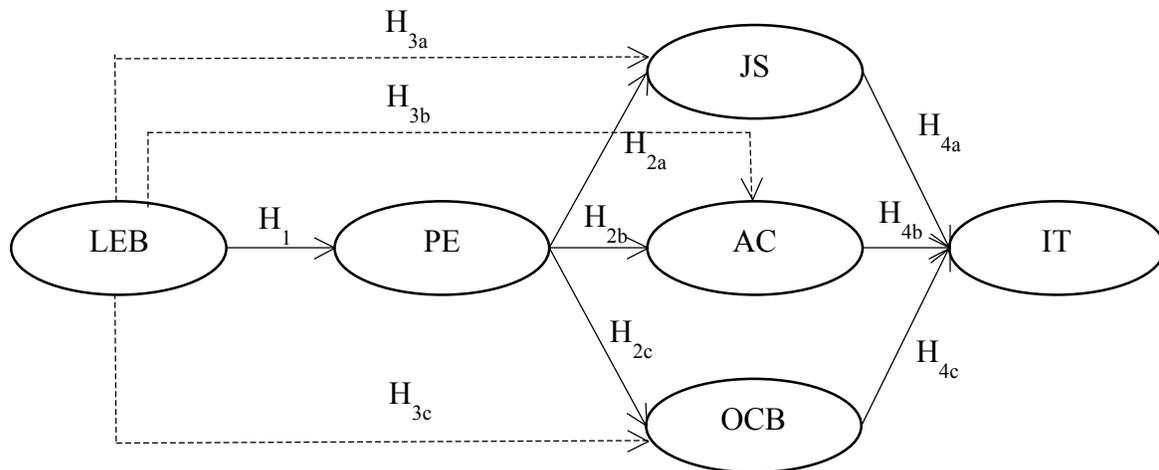
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**Figure 1**  
**Hypothesized Model**



Note:  
LEB: Leadership Empowerment Behavior

PE: Psychological Empowerment  
 JS: Job Satisfaction  
 AC: Affective Commitment  
 OCB: Organizational Citizenship Behavior  
 IT: Intention to Stay

**Table 1**  
**Reliability Testing**

Variable	Cronbach's Alpha	Composite Reliability
Leadership Empowerment Behavior	0,975	0,976
Psychological Empowerment	0,941	0,949
Job Satisfaction	0,950	0,955
Affective Commitment	0,899	0,922
Organizational Citizenship Behavior	0,961	0,964
Intention to Stay	0,931	0,951

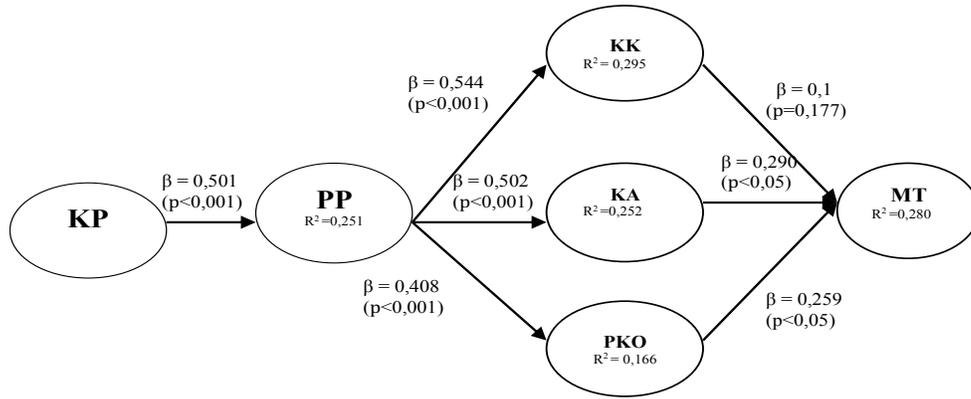
**Table 2**  
**Descriptive Statistics<sup>a</sup>**

Variable	Mean	SD	1	2	3	4	5	6	7
1. Age	2,28	0,66							
2. Tenure	2,20	0,55	0,73**						
3. Leadership Empowerment Behavior	3,84	0,63	0,15	0,10					
4. Psychological Empowerment	3,92	0,64	-0,02	-0,01	0,46**				
5. Job Satisfaction	3,81	0,60	-0,08	-0,09	0,53**	0,54**			
6. Affective Commitment	3,66	0,75	0,02	0,05	0,55**	0,48**	0,56**		
7. Organizational Citizenship Behavior	3,88	0,61	0,04	0,05	0,44**	0,40**	0,44**	0,41**	
8. Intention to Stay	3,80	0,78	0,21**	0,15	0,33**	0,33**	0,38**	0,45**	0,41**

<sup>a</sup>n=154; \*p < 0,05; \*\*p < 0,01

**Figure 2**  
**Structural Equation Modelling Result**

Keterangan  
 KP :  
 Leadership Empowerment Behavior  
 PP :  
 Psychological Empowerment



Information

KP: Leadership Empowerment Behavior

PP: Psychological Empowerment

KK: Job Satisfaction

KA: Affective Commitment

PKO: Organizational Citizenship Behavior

MT: Intention to Stay

**Table 3**  
Test Result of Mediation Hypothesis (H3a)

Hypothesis	Model	Independent	Dependent					
			Job Satisfaction			Psychological Empowerment		
			B	P - value	R <sup>2</sup>	$\beta$	P - value	R <sup>2</sup>
H3a	1	Leadership Empowerment Behavior	0,555	0,000	0,309			
	2	Leadership Empowerment Behavior				0,51	0,000	0,251
	3	Psychological Empowerment	0,544	0,000	0,295			
		Leadership Empowerment Behavior	0,272	0,000	0,295			

**Table 4**  
Test Result of Mediation Hypothesis (H3b)

Hypothesis	Model	Independent	Dependent	
			Affective Commitment	Psychological

						Empowerment		
			$\beta$	<i>p</i> -value	$R^2$	$\beta$	<i>p</i> -value	$R^2$
H3b	1	Leadership Empowerment Behavior	0,572	0,000	0,327			
	2	Leadership Empowerment Behavior				0,51	0,000	0,251
	3	Psychological Empowerment	0,502	0,000	0,252			
		Leadership Empowerment Behavior	0,251	0,000	0,252			

**Table 5**  
**Test Result of Mediation Hypothesis (H3c)**

Hypothesis	Model	Independent	Dependent					
			Organizational Citizenship Behavior			Psychological Empowerment		
			$\beta$	<i>p</i> -value	$R^2$	$\beta$	<i>p</i> -value	$R^2$
H3a	1	Leadership Empowerment Behavior	0,466	0,000	0,217			
	2	Leadership Empowerment Behavior				0,51	0,000	0,251
	3	Psychological Empowerment	0,408	0,000	0,166			
		Leadership Empowerment Behavior	0,204	0,000	0,166			

## **BUSINESS MODEL INNOVATION AS A KEY FACTOR IN ADOPTING EFFECTIVE DIGITAL MARKETING**

### **An Empirical Investigation**

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### ***ABSTRACT***

*A dynamic modern business environment is characterized by frequent and numerous market changes. A significant change in marketing field occurred following the introduction of Internet a few decades ago, in the term of digital marketing. Digital marketing topic has been studied from various perspectives by scholars in the recent years as an effect of Internet usage advances. The Internet has also fundamentally changed the paradigm of today's business communications, altered the way in which information is shared, and set an enormous influence on marketing strategy. There are prior studies on the relationship between new technology adoption and firm performance, as well as business model innovation and firm performance. Most of these studies confirmed that there is a significance correlation between both new technology adoption and business model innovation as well as new technology adoption and firm performance, of which some of them emphasize on the adoption to the Internet or e-commerce. This paper investigates empirically in one integrated research model on the relationship between mentioned variables to firm performance, which the scope of digital marketing includes not only the use e-commerce but also the digital advertising. The survey was undertaken in Greater Jakarta, Indonesia, to 215 firms in the field of consumer shopping goods. The outcome reveals that there is a direct impact of business model innovation to firm performance, but in contrary, the impact of digital marketing adoption on firm performance is not significant. This study also found that the relationship between digital marketing adoption and firm performance is fully mediated by business model innovation. The policy maker, e-commerce platform companies and digital marketing agencies, can use this study to educate and support local businesses for digital marketing usage, in a structured fashion, since it provides the insight on the issues of these firms in adopting it including the requirement to innovate the business model.*

**Keywords:** *Business Model Innovation, Digital Marketing, Digital Marketing, Technology Acceptance.*

## ANALYZING THE INFLUENCE OF TRUST, INFORMATION QUALITY, AND PERCEIVED EASE OF USE ON PURCHASING DECISION ONLINE

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### **ABSTRACT**

*E-commerce is one rapidly growing business in Indonesia. Development of IT, travel, tourism, and hospitality industries in Indonesia encourage Indonesian to change their preference to purchase airlines ticket and hotel online reservation into this e-ticket system. Up to year 2013, there are 71.19 million internet users in Indonesia. With this amount, the internet penetration in Indonesia in 2013 is amounted to 28 percentage. This research aims to investigate how big the influence of trust, information quality, and the perceived ease of use on purchasing decision online is. The respondents are people who used the services of Traveloka, a company that provide services and hotel booking air tickets online with a focus on domestic travel in Indonesia. There are 110 respondents in this research who buy airline tickets through Traveloka during June to July 2015. The data is collected through interview, questionnaire, and documentation study. The data is analyzed using linear regression path analysis. The results showed that trust, information quality, and perceived ease of use simultaneously have significant influence on purchasing decisions. Perceived ease of use is variable that influence most strongly among other independent variables in this study. This shows that the perceived ease of use of reservation, search and transaction is being the main driving factor for someone to decide to purchase online in this research.*

**Keywords:** *Trust, Information Quality, Perceived Ease of Use, Purchasing Decision Online.*

### **INTRODUCTION (HEADING 1)**

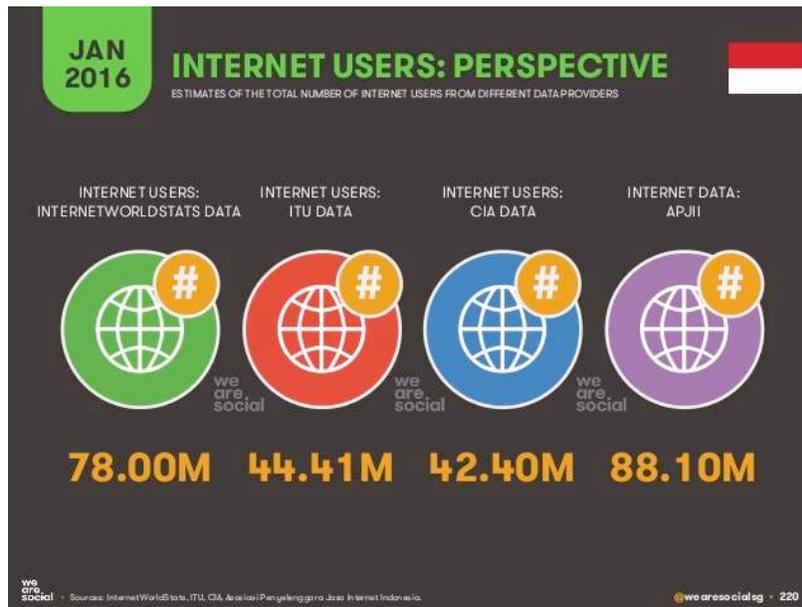
The rapid development of information technology provides impact and changes in various aspects of people's lives, be it in business, socializing and lifestyle. With the development of increasingly sophisticated technology and easily accessible information makes the community living in the world of the all-round practical. Communities now tend to spend more time for activity in virtual worlds using their gadgets as do social networking communications, pay the electric bill and telephone without the need to come and queue up at the payment counters, book a flight ticket online, and other things that is easier because of

the presence of internet. Data obtained from a wearesocial.sg (2016), showed an increase in the number of active internet users in Indonesia by 2016 are 88.1 million or 34% of the population, compared to year 2015 be 45.2 million or 28% of the population compared to 2014 as much as 38.2 million people or 15% of the population. We Are Social is a global agency that launch a comprehensive study of digital, social and media usage around the world, including Indonesia. The increase that took place between 2014, 2015, and 2016 is a significant improvement. We can see that increase to occur by 2016 is more than double the number of active internet users in 2014 (Figure 1 and Figure 2).



Source: wearesocial.sg (2016)

Figure 1. Digital in Indonesia



Source: wearesocial.sg (2016)

Figure 2. Internet Users in Indonesia: Perspective

With the presence of e-commerce, users gain numerous benefits specifically the ease in which transaction can be carried out without the need to come to the brick and mortar store or to meet face-to-face between the seller and the buyer (Nanehkaran, 2013). Electronic commerce or e-commerce is already applied in a variety of fields

and industries, one of which is the tourism industry, particularly reservation of airline tickets and hotel rooms online. The tourism industry in Indonesia is one that has a major contribution to APBN in 2014 of 23% or Rp. 350 trillion. According to Badan Pusat Statistik (2015), the number of foreign tourists who visit

Indonesia in February 2015 is up to 9% over the previous year. Redaksi Bisnis Wisata (2015) noted that the weakening of the rupiah gave a positive impact towards domestic visit, namely the transfer of an overseas visit to be into the country. This can be seen from the decline in the number of passengers of international air transport and an increase in the number of passengers in domestic air transport in January-February 2015 of 13.48% or 10.2 million people compared to the previous year (Badan Pusat Statistik, 2015). A growing number of tourist attractions, will attract more tourist to come to the place, and it will also increase the need for accommodation. Accompanied by the Government's plans to develop more than 560 new tourist destinations in 19 provinces of Indonesia will encourage the growth of the hospitality industry in Indonesia (Alexander, 2015). In addition, with the promulgation of circulars Indonesia Minister of Transportation number HK/213/I/16/PHB/2014, which discusses the increase in public services and requires close ticket sales counters throughout the airport in Indonesia will encourage people to go buy flight ticket online.

According to Boediman (2013), the important thing for the customer trust is guarded against online business run, perceived ease of use, quality of information, the condition of the goods, and also the long delivery time. Trust is a belief of a person related to the competence and integrity of the other party (Rafique, Rizwan, Batool, & Aslam, 2014). Online purchases are done without any face-to-face between buyer and seller using electronic media and the internet. When customers make a purchase online, crime and fraud are common is theft and misused of data privacy when transacting or seller blurred after paid and did not provide the goods or services offered to customers. The quality of the information is related to the number of quality, accuracy, suitability, relevance and form of information about the products and services offered on a site (Alhasanah, Kertabudi, & Riyadi, 2014). In the field of online booking service providers, particularly with regard to airline ticket, the price is dynamic. Change flight prices are dynamic due to several factors, namely in the form of sales time remaining, the remaining seats that haven't sold, the prices of competitors and other things. Other factors that

affect a person for booking tickets online is the perceived ease of use. Perceived ease of use is a measure by which a person believes that an online purchase can be easily understood and used (Wibisono, 2012). Traveloka is accessed by various backgrounds with diverse backgrounds, be it a difference in age, educational background, economic and others, certainly the look of the site and mobile applications, as well as the process of how payments need to be made simple and understandable by many people. The higher a person's perceptions towards ease of use of the system, the higher utilization rate and opportunities of information technology the occurrence of transactions through applications and e-commerce sites the perpetrator (Suhir, Suyadi, & Riyadi, 2014).

Based on the issues and problems that exist, then the purpose of this research is to find out how big the influence of variable trust, quality information, and perceived ease of use on purchasing decision.

## **LITERATURE REVIEW**

Electronic commerce is the buying and selling activities conducted through the internet network and device technologies. According to Alhasanah, Kertabudi, & Riyadi (2014), e-commerce is defined as a set of dynamic between technology, applications and business processes that connect companies, customers and the community via electronic devices. Electronic commerce (e-commerce) is the activity of buying and selling goods or services between buyers and sellers through a computer network (Napitupulu & Kartavianus, 2014). According to Nanehkaran (2013), e-commerce is the interaction between communications systems, data management and security that led to the exchange of information on goods or services sold.

According to Gangeshwer (2013), e-commerce itself is divided into three groups, namely: 1. *Business-to-Business* (B2B)

Buying and selling of goods and services carried out between two or more business or company. In General, transactions that occur is such a transaction between companies with distributors or retail companies.

2. *Business-to-Consumer* (B2C)

Buying and selling of goods and services made between a business or enterprise

with customers directly through the internet and other network technologies.

### 3. *Consumer-to-Consumer (C2C)*

Buying and selling of goods and services that occur between consumer and consumer with a third-party intermediary that provides a site for consumers can directly interact with other consumers. Sites in Indonesia engaged in finger-like tokobagus.com, olx.co.id, bukalapak.com and other sites.

According to the Mahkota, Suyadi, & Riyadi (2014), trust is the willingness of buyers to accept weaknesses in online transactions is based on the belief that he has against the seller and behavioural competencies online. According to Rafique, Rizwan, Batool, & Aslam (2014), the trust is defined as a composition of a person's conviction relates to the competence and integrity of the other party. Research Kedhi (2014) describes the trust would arise if a person has confidence in a deal with a partner who has integrity and can be trusted.

Transactions made in e-commerce generally use internet media where buyer and seller did not meet face-to-face, so from that trust became one of the keys to the success of an e-commerce. Research Broutsou & Fitsilis (2012) stated that the trust is one of the most influential factors in determining the success or failure of an e-commerce business. According to Zendehdel, Paim, Bojei, & Osman (2011), there are three factors that affect the formation of beliefs, namely:

#### 1. Integrity

Integrity in e-commerce can be defined as the perception of internet users regarding the honesty and believe that business in the e-commerce industry will keep their promises. The businessmen are required to act in accordance with that had been promised by their own. Integrity in ecommerce can be defined as the perception of internet users regarding the honesty and believe that business in the e-commerce industry will keep their promises. The businessmen are required to act in accordance with that had been promised by their own.

#### 2. Ability

The ability is defined as the perception of internet users against the skills, capabilities and expertise of business e-commerce in serving customers.

#### 3. Benevolence

Benefits (benevolence) or that can be analyzed as well as the generosity of talking

about how a business person with spirit and his willingness giving advantages to its customers through its products and services with the aim of improving the level of customer satisfaction, but still make a profit. The expected is the maximum profit for the business person, but also a high customer satisfaction. Not only profits but also a business person needs to have a great attention in realizing customer satisfaction.

The higher the value of the perceived benefits of customers, the higher the level of trust of customers against the seller in a transaction that will result in high rates of purchase customers to buy their products (Mahkota, Suyadi, & Riyadi, 2014). Jamaludin & Ahmad (2013) stated that confidence significantly influential in predicting purchase decisions online. The research of Myung-Ja, Namho, & Choong-Ki (2010) stated beliefs also influence purchase decisions online. The indicators used for the variable trust is an indicator used in previous studies, that confidence in the site or application, risk, trust of online vendors and security.

Dewi, Ali & Astuti (2012) defines quality information as a measure of the quality of the data and application system information about things that are important to customers. In e-commerce, buying and selling, promotion and marketing of the product is largely done through the connection of computer devices (Napitupulu & Kartavianus, 2014). The quality of information in e-commerce is defined as the amount relating to the quality, accuracy, suitability, relevance and form of information about the products and services offered on a site (Alhasanah, Kertabudi, & Riyadi, 2014).

In e-commerce, information is one of the factors that have the most powerful influence to affect the behavior of customers in buying an item or service (Rozeqhi, Hussin, & Noor, 2014). This is because the customers cannot see the goods or services offered through the e-commerce site directly. The only way a customer can become a believer and decided to buy an item or service is through the information provided by the seller on online media. When customers make a decision to buy an item or service, they go through a process where customer decisions involving information to evaluate alternative before finally decided (Jie & Cheng, 2012). Research by Alhasanah, Kertabudi, & Riyadi (2014) stated that from the

results of research conducted on 230 respondents shows that the quality of information has an impact on purchasing decisions online. According to Luo, Luo, Schatzberg, & Sia (2013), the quality of information affects customer perception will be the credibility of a goods or services offered by the business of e-commerce which will also influence the decisions of prospective customers to buy or not to buy. The indicators used in this study for the variable quality of information using indicators that are used by Alhasanah, Kertabudi, & Riyadi (2014), i.e. the accuracy, relevance, understandable, and current affairs.

In e-commerce, the first thing seen by the customer no longer physically like goods in shops in General, but the image, display, design, usability and ease of use of a site that sells goods or services (Hendrayana & Santika, 2015). The research of Yolanda & Widijoko (2014) defines perceived ease of use as levels where one believes that technology can be easily understood and used. According to Suhir, Suyadi, & Riyadi (2014), perceived ease of use is defined as the degree to which a person believes that using a technology will be free from effort. According to Cho & Sagynov (2015), perceived ease of use is the perception of belonging to a person that is using the new technology will be free from effort.

Customers consist of many different groups, either based on age, education, social status, economic, and other. Each group has the knowledge, ability, and capture power in using the technology, so that the business needs to create a site or application to access goods and services they offer so that it is easy to use and easy to understand. According to Sukirno & Saputro (2013), the higher a person's perception of the ease of use of the system, the level of utilization of information technology will be increasingly higher. Therefore, if an application or site and selling the more easily understood and used, will be increasingly higher customer perception of ease of use for access and also conduct transactions. The decision-making process involves cognitive attitude or understanding a customer (Nitisusastro, 2012). Cognitive attitudes refer not only on how savvy a person to the information he received, but also how to understand customers against using a technology for the purpose of transacting. The perceived ease of use in conjunction with

purchasing decisions online tickets can be measured using five indicators consisting of booking, search, and transactions (Renny, Guritno, & Siringoringo, 2013).

Purchasing decisions are the result of a process of interaction between cognitive and affective attitude someone with environmental factors that manifest in a real action to buy or not to buy (Nitisusastro, 2012). Cognitive attitudes reflect an understanding and affective attitude reflect the beliefs of a person. Both of these attitudes is the initial stage of the process of purchase decisions are influenced by information received by potential customers when considering and evaluating alternatives.

It has been widely held among researches in the buyer behaviour field, that the consumer's decision to purchase is a multi-staged process (Chon, 1990; Woodside & Lysonski, 1989; Mayo & Jarvis, 1981; Hunt, 1975; Gunn, 1972; Clawson & Knetch, 1966). The classic decision making process, drawn from consumer behaviour literature, as outlined by Kotler (1998), identified that consumers transit the stages of:

1. Need recognition,
2. Information search,
3. Evaluation of alternatives,
4. Choice of product or service, and
5. Post purchase evaluation.

This model outlines the steps involved in purchases that are new and/or complex. It should be noted that not every purchase goes through each step of the model; in routine re-purchase situations such as purchasing low involvement household items, for example milk, the consumer may go straight from need recognition to purchase.

However, this model recognises that the buying decision process may start long before actual purchase and continue long after, signalling that marketers need to focus on the entire buying process rather than just on the purchase decision. (Kotler, 1998) Need recognition is the first stage in the buyer decision process in which the consumer recognises a problem or a need. This need may be triggered by internal stimuli such as hunger or thirst or by external stimuli such as exposure to a new product or advertising message. Following on from need recognition, information search is the stage in the process where the consumer is

aroused to search for more information. This state of arousal may encourage the consumer to go in active search of information or may heighten their attention to relevant information sources including advertising (Kotler, 1998). It is vital marketers understand the sources from which customers draw their information if they are to influence the decision process (Gartner, 1993). Once sufficient information is gathered, the consumer moves into the evaluation of alternatives phase where they evaluate alternative solutions to their needs. The evaluation process is a complex one which varies depending on the buying situation. However, in general terms the consumer will examine the attributes of the product, assign different levels of importance to such attributes, determine the likely level of overall satisfaction with each alternative and derive an attitude toward the different solutions/brands (Kotler, 1998). Marketers need to understand how their customers evaluate alternatives so they may take steps to influence the outcome. For example, the marketing entity could alter the attributes of the product, or inform customers of the benefits of certain attributes or influence the importance rating of particular attributes of the product.

In the evaluation stage, consumers rank brands and form purchase intentions (Kotler, 1998). Generally the consumer's purchase decision will be to buy the preferred brand/solution but two factors can come between the purchase intention and the purchase decision. The first factor is the attitude of other people who influence the purchase decision, for example family members. Marketers must therefore be aware of those who influence the in a buying decision and may use targeted communication to influence their attitudes, as well as those of the purchaser. The second factor is unexpected situational factors such as out-of stock situations, or finding some element of the marketing mix which does not meet their expectation, such as discovering a price increase or finding the service at a distribution outlet unsatisfactory (Kotler, 1998).

The decision process is not complete when the sale has been made as the consumer will either be delighted, satisfied or unsatisfied with the outcome and will engage in post-purchase evaluation (Kotler, 1998). The relationship between consumer expectations and their perception of product performance will determine their satisfaction level. Creating

delighted or at least, satisfied customers is essential as this both assists in customer retention and can lead to new business through satisfied customers becoming advocates for the product and promoting it via word-of-mouth. Marketers therefore must monitor both customer expectations and their satisfaction levels (Lovelock, Patterson & Walker, 2001).

Based on the explanation of the background to the problem and review the literature that has been explained earlier, form the framework of a study describing the direction of the relationship or influence than the variable trust, quality of information, ease of perception as free variables and bound variables as purchasing decisions in this research can be seen in Figure 3.

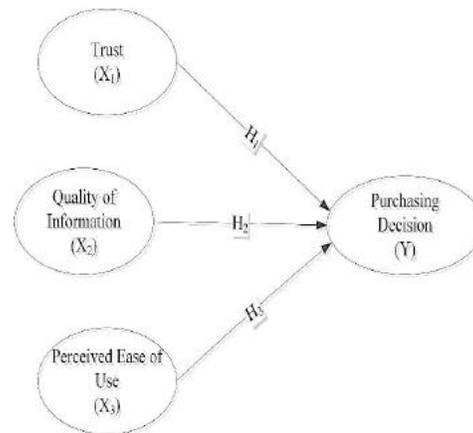


Figure 3. Conceptual Framework

Based on identification problems and conceptual framework above, then the hypothesis formulated in this research are:

H1: Trust has a significant and positive influence on purchasing decision.

H2: Quality of information has a significant and positive influence on purchasing decision.

H3: Perceived ease of use has a significant and positive influence on purchasing decision.

## DATA AND METHOD

The analysis of the data used for this study is descriptive analysis verification. Descriptive analysis is a method used to describe or analyze a research results but is not used to make broader conclusions (Sugiyono, 2012). Verification analysis is a study aiming to find out the

relationship between two or more variables (Sugiyono, 2012). A descriptive verification analysis used in this research is to know the relationship of trust, quality of information, and the perception that the free variable is a variable that is bound against purchasing decisions.

The population in this research is the service users whoever conducted transactions through Traveloka. The sampling method used in this study was a proportionate stratified random sampling. The criteria used for this research method is the person already did transaction through Traveloka with the minimum age is 18 years old, where the age is a requirement of a person are allowed to make a bank account and have a credit/ debit card. Determination of the number of samples is carried out using the help of PHPStat2 with a confidence level of 95%, the rate of errors is limited to 10%, and assuming a 0.5 or 50% of the population have characteristics/criteria in accordance with the research done. Minimum sample size obtained is 97 people. The process of sampling is done by disseminating online questionnaires using GoogleDocs. The questionnaires also distributed on social media sites (Facebook, Twitter, infobandung, gotravelindo, Kaskus, and FUEL) and online travel special forums such as Travel, Indonesia, jalan.com, IndoBackpacker, and Traveller Kaskus that conducted during June 2015.

Operational variables from variable trust, quality of information, perceived ease of use and purchasing decision can be seen in the table below:

**Tabel 2.** Operational Variable

Variable	Concept	Indicator	Scale
Trust (X <sub>1</sub> )	Trust is the willingness of buyers to accept weaknesses in online transactions that based on the belief that he had against the competencies and behaviors of the online sellers (Mahkota, Suyadi, & Riyadi, 2014).	<ol style="list-style-type: none"> <li>1. Trust on site or application</li> <li>2. Risk</li> <li>3. Trust on online vendor</li> <li>4. Security</li> </ol>	Likert
Quality of Information (X <sub>2</sub> )	With regard to the number of quality, accuracy, suitability, relevance and form of information about the products and services offered on a site of trade electronics (Alhasanah, Kertabudi, & Riyadi, 2014).	<ol style="list-style-type: none"> <li>1. Accurate</li> <li>2. Relevant</li> <li>3. Understandable</li> <li>4. Current (Always updated)</li> </ol>	Likert
Perceived Ease of Use (X <sub>3</sub> )	Levels where one believes that technology can be easily understood and used (Yolanda & Widijoko, 2014).	<ol style="list-style-type: none"> <li>1. Reservation</li> <li>2. Searching</li> <li>3. Transaction</li> </ol>	Likert
Purchasing Decision (Y)	The results of the process of interaction between someone's	<ol style="list-style-type: none"> <li>1. Decision to purchase</li> <li>2. Re-purchase</li> </ol>	Likert

	cognitive and affective attitude with environmental factors that manifest in a real action to buy or not to buy (Nitisusastro, 2012).	3. Willing to recommend	
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Source: Mahkota, Suyadi, & Riyadi (2014), Saputro & Sukirno (2013), Alhasanah, Kertabudi, & Riyadi (2014), Yolanda & Widijoko (2014), Renny, Guritno, & Siringoringo (2013), Nitisusastro (2012)

so the research questionnaire can be consider

**DISCUSSION AND ANALYSIS**

The number of samples collected was 110 respondents. Found that from 110 respondents who fill out the questionnaire study was 62% male and 48% female, majority of 71% of the respondents aged 21-69 years of age, 25.9% comes from Bandung city, 50% are still status as students, 34% have an allowance/income every month Rp. 1,000,000-2.499.999, 57% do make payments through wire transfer, 46% bought for 2-3 persons and 47% perform transactions through a smartphone.

Validity test in the research done by KMO and Bartlett's Test. Based on the validity test by using SPSS, shows that value of KMO is 0,858 and sig. value 0.000, where both values were in accordance with the provisions of the test, namely  $KMO > 0.05$  and  $sig. < 0.05$ . This shows that the research questionnaire stated is valid and can be used as a measuring tool to measure the variables in this study.

Adequacy.		0.858
Bartlett's Test of Sphericity	Approx. Chi-Square	1960.578
	Df	378
	Sig.	0

reliable and will provide a consistent result when used repeatedly.

**Table 3.** KMO and Bartlett's Test  
Source: SPSS (2015)

Reliability test results indicate the value of the Cronbach's Alpha of 0.935, where those values in accordance with the provisions of the Cronbach's Alpha  $> 0.60$ ,

**Table 4.** Reliability Statistic

Cronbach's Alpha	N of Items
0.935	28

Source: SPSS (2015)

The variable in this study consists of 3 independent variables, i.e. trust, quality of information, perceived ease of use and 1 dependent variable, i.e. purchasing decisions. The number of statements that are used in the questionnaire study was 28 points based on 14 indicators that have been determined.

**Table 5.** Descriptive Statistic

Variable	N	Minimum	Maximum	Mean	Std. Deviation
Kepercayaan	110	2	5	3.8670	0.6775
Kualitas Informasi	110	1	5	3.8625	0.7158
Persepsi Kemudahan	110	1	5	3.9879	0.6447
Keputusan Pembelian	110	1	5	3.7773	0.9121

Source: SPSS (2015)

The table above shows the variable trust has an average value of 3.8670 or close to 4. When viewed on a Likert scale, where there are 5 classes used from strongly disagree to strongly agree, it shows that 110 of the respondents fill out questionnaires, the majority answered agree to trust variables as a whole. Trust is the willingness of buyers to accept weaknesses in online transactions based on beliefs and behaviour competencies against customers party online sellers (Mahkota, Suyadi, & Riyadi, 2014), it can be drawn the conclusion that the indicator of site application, risk, & online vendors, and security of the majority of the respondents believe the competence, ability and integrity which belonged to Traveloka.

In addition, the average value of the variable quality of the information obtained is 3.8625 or close to 4. When viewed on a Likert scale, where there are 5 classes used from strongly disagree to strongly agree, it shows that 110 of the respondents fill out questionnaires, the majority answered agree. This means the majority of the respondents agreed that the quality of the information provided and displayed on the site and application Traveloka already both in the accuracy, relevance, understandable and up-to-date.

The average value of the perceived ease of use is 3.9879 or close to 4. When viewed on a Likert

scale, where there are 5 classes used from strongly disagree to strongly agree, it shows that 110 of the respondents fill out questionnaires, the majority answered agree. This means the majority of the respondents agreed that in order to make a booking, search and payment is relatively easy to do.

The average value of purchasing decision is 3.7773 or close to 4. When viewed on a Likert scale, where there are 5 classes used from strongly disagree to strongly agree, it shows that 110 of the respondents fill out questionnaires, the majority answered agree. This means the majority of the respondents gave a positive response and will choose to buy, buy and give recommendations to others to purchase flight tickets and hotel rooms reservations through Traveloka.

Multiple regression analysis in this study was performed using the SPSS program to know the great influence of the variable trust, quality of information, and perceived ease of use on purchasing decision. Based on the results, the regression equation can be known for this research is as follows:

$$\text{Purchase Decision} = 0.260 \text{ Trust} + 0.209 \text{ Quality of Information} + 0.375 \text{ Perceived Ease of Use} \quad (1)$$

From equation (1), can be explained as follows:

1. Based on the tables and the equation, the value of regression coefficients of trust is 0.260, where the coefficient is positive. This means that trust was able to influence the purchasing decisions of 26%.
2. Based on the tables and the equation, the value of regression coefficients of quality of information is 0.209, where the coefficient is positive. This means shows that quality of information is able to influence the purchasing decisions of 20.9%.
3. Based on the tables and the equation, the value of regression coefficients of perceived

is of use is 0.375, where the coefficient is positive. This means shows that quality of information is able to influence the purchasing decisions of 37.5%.

The results output from SPSS data processing on the chart above shows the significance value 0000, where smaller significance level of 0.05, then H0 is rejected and the Ha are received. It can be concluded that independent variables of trust, quality of information, and perceived ease of use simultaneously affect dependent variables, i.e. purchasing decisions.

**Table 6.** F Test

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	609.123	3	203.041	38.89	.000 <sup>b</sup>
	Residual	553.432	106	5.221		
	Total	1162.555	109			
a. Dependent Variable: KP						
b. Predictors: (Constant), PK, K, KI						

Source: SPSS (2015)

The result of the SPSS output shows that the magnitude of the Adjusted R<sup>2</sup> is 0.510, which means, 51% variation of the purchasing decisions can be explained by the variation of the independent variables, trust, quality of

information and perceived ease of use. For the remaining 49% purchasing decision variable explained by causes outside of this research model.

**Table 7.** Coefficient of Determination

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.724 <sup>a</sup>	0.524	0.51	2.28496
a. Predictors: (Constant), PK, K, KI				

Source: SPSS (2015)

The results of the analysis above shows that the variable of trust, quality of information, and perceived ease of use of are simultaneously has an influence on purchasing decision. Based on the test results the coefficient of determination, Adjusted R Square value obtained (R<sup>2</sup>) of 0.510. This means that the variables that are used to affect and be able to explain the purchasing decisions as much as 51%, while the remaining 49% are influenced by variables other

than the independent variables used in this study. This is caused because of the many factors that can influence the purchasing decision. As revealed by Nitisusastrio (2012) & Kotler and Keller (2012) that the decision as to decide on buying was also influenced by promotions, advertising, quality of service, cultural factors, demographic, social, and references from other people or families, so the variables used in this study was only able to explain the purchasing decisions of 51%.

The results of regression analysis show that the sig. value of trust is 0.004 ( $< 0.05$ ) with coefficients of 0.260, meaning  $H_0$  is rejected, so that the  $H_a$  is accepted. This means the trust of a customer towards Traveloka can significantly influence customers in taking decisions to buy flight tickets and hotel rooms via the Traveloka amounting to 26%. The results obtained in accordance with research of Renny, Guritno, & Siringoringo (2013), Mahkota, Suyadi, & Riyadi (2014), and Saputro & Sukirno (2013) that trust have significant influence on purchasing decisions. The Trust became one of the things that are important to customers, especially when customers submit financial information and other personal data in conducting transactions online (Mahkota, Suyadi, & Riyadi, 2014). In addition to security, the trust is needed because in the online transaction

the buyer does not really see the products or services offered by seller.

The results of regression analysis show that the sig. value of quality of information is  $0.032 < 0.05$  with coefficient of 0.209, meaning  $H_0$  is rejected, so that the  $H_a$  is accepted. This means that the quality of the information provided by the Traveloka affect customers significantly in the decision to purchase flight tickets and hotels through Traveloka of 20.9%. The results obtained are inconsistent with research Alhasanah, Kertabudi, & Riyadi (2014) which do not affect the quality of information significantly to purchasing decisions. The difference is happen due to the difference of the object of research and the product type, which in this research a product or service that is examined is the airfare and hotels, so the accuracy regarding prices, flight schedules, schedules, and other information is needed. The results of this study mean for the consumers Traveloka, the variable quality of information becomes one of the variables that need to be considered in taking the decision to purchase. The information provided about the product or service being offered is one of the factors that are important to a buyer. This is because in e-commerce buyers do not directly look at the products or services offered on a site, so the only way buyers can know the quality of the goods, price, and other information about the product or service offered is with information provided on the website of the online vendors.

The results of the regression analysis shows that the value of the variable significance of the perceived ease of use is smaller than the value of  $\alpha$  (0.05), so that  $H_0$  is rejected and the  $H_a$  is accepted. This means that perceived ease of use significantly influence purchasing decision with coefficients of 0.375. The results obtained in accordance with the research of Saputro & Sukirno (2013) that perception of the ease is significantly influence the purchasing decision flight tickets and hotel room reservation through Traveloka of 37.5%. According to Saputro & Sukirno (2013), the higher a person's perception of the ease of use of the system, it will increase the level of utilization of information technology. Therefore, if the appearance, function and instructions in running a mobile application or a website getting easier and simpler, it will increase the utilization technology of customers. For example, when there are two flight tickets and hotels booking website and one of them is Traveloka, provide the same deals for the same time and the other website has more complicated stages for the transaction, then the buyer will make the purchase on Traveloka that more simple and easy to use and access. This is because the difference of someone's background will affects that person's ability to use technology. The results of this study indicate that the perception of convenience is a factor to be considered by consumers in purchase decisions.

## **CONCLUSIONS**

The results of multiple regression analysis of 110 respondents Traveloka service users, the conclusion to be drawn as follows:

1. The results of the analysis showed that the confidence effect significantly against the purchasing decisions of 26%. This is in accordance with the research conducted by Renny, Guritno, & Siringoringo (2013); Mahkota, Suyadi, & Riyadi (2014), and Saputro & Sukirno (2013) that beliefs influence on purchasing decisions, so the Trust became one of the things that need to be guarded in transactions conducted online.
2. The results of the analysis showed that the quality of information significantly influence purchase decision amounted to 20.9%. The results obtained are inconsistent with

research conducted by Alhasanah, Kertabudi, & Riyadi (2014) that do not affect the quality of information significantly to purchasing decisions. This is because the difference of the object of research and the product type, which in this research a product or service that is examined is the flight tickets and hotel rooms, so that the quality of information on prices, flight schedules, the schedule of available hotel and other information, is needed for the purchase decision.

3. The results of the analysis show that perceived ease of use significantly influence purchasing decision amounted to 37.5%. The results obtained in accordance with the research conducted by Saputro & Sukirno (2013) that perceived ease of use significantly influence purchasing decision. Perceived ease of use is variable that influence most strongly among other independent variables in this study. This shows that the perceived ease of use of reservation, search and transaction is being the main driving factor for someone to decide to purchase online in this research.

Based on the results of the research that has been done, then the suggestions submitted by the researchers are as follows:

1. The way of Traveloka's effort to continue to maintain and to improve the quality of the site and applications, security systems, and handling the risks already good accepted by the majority of respondents in this study. These things need to be done in order to make sense of trust by Traveloka's customer getting solid. One of the key decisions should be made by Traveloka is the selection of criteria on which the market will be segmented. The superiority of benefit segmentation is primarily due to the causal rather than descriptive nature of the data. It is argued that true market segments are based on the causal relationship between the benefits sought from consumption and future online purchasing behaviour. Grouping travellers based on the benefits sought from the travel experience, along with more traditional segmentation basis such as geographic and demographic profiles is therefore more likely to yield segments that are more useful predictors of online travel behaviour.

2. Based on the descriptive analysis that has been done, the quality of the content of the information as a whole already felt by the majority of respondents. But the latest indicator that is obtained from the variable quality of information has the smallest value compared to other indicators. Therefore, the advice or recommendations for Traveloka is to always improve and update the quality of the content of information, such as the variety of price, hotels, new destinations, the appealing articles, and others.
3. Analysis of the Results obtained shows that the perception of the ease of having the average value of the largest and most powerful influence compared to other free variables. Therefore, suggestions or recommendations that can be given is that the company can continue to maintain and enhance the convenience for the booking process, search, and payments, one of which can be done by keeping the language simple and easily understood by the customer, keep the look of the sites and applications remain simple and easy to understand, and still retain the ability of system and network server so that prospective consumers can access them quickly and easily.
4. The results show that the determination of the coefficient of the variable quality of information, beliefs and perceptions of ease only able to explain variable purchase decisions amounting to 51%, which means, there are 49% of other variables outside of this research model that need to be explored. Therefore, hopefully the next research can develop the research by using variables or other indicators, such as the variables contained in previous research (comfort, perception of usefulness, quality web services interaction, e-commerce and other variables).

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## **DIVIDEND POLICY, CORPORATE GOVERNANCE MECHANISM, PROFITABILITY, SYSTEMATIC RISK, AND FIRM SIZE: APANEL DATA ANALYSIS**

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### **ABSTRACT**

*This study examines the impact of corporate governance mechanism (CGM), profitability, systematic risk (beta) and firm size on the dividend policy in the financial industry, and determines which of those variables having powerful effects to the dividend policy. The study also interested to show the variables that investors rely on to take their investment decisions related to gain from dividends paid by the company. Those variables proposed to develop this research model were formed by a survey of literatures.*

*To achieve the objectives of this study, a total of 18 listed firms of financial industry in Indonesia Stock Exchange was selected using purposive sampling technique from the period of 2009 to 2013. A panel data analysis method has been conducted to explain the impact of corporate governance mechanism (board of director, and institutional ownership), profitability, systematic risk and firm size on the dividend policy. The result shows that systematic risk and board of director have a positive and significant impact on the dividend policy. Firm size has a negative and significant impact on the dividend policy. Meanwhile, profitability and institutional ownership not significantly impact on the dividend policy which is contrary to the theory.*

**Keywords:** *dividend, corporate governance mechanism, profitability, beta, firm size*

### **INTRODUCTION**

Dividend policy is one of very important factor that should be considered by management in managing the company, because the dividend policy influence both of internal companies (corporate financing decisions) and external companies (shareholders and creditors). High dividend distribution can lead to the reduction of internal financing source to carry out investment projects. On the other hand shareholders expect the company to pay cash dividends, especially investors who hold shares for a long time period with the aim to obtain capital gains and dividend yield (Salehi and Biglar, 2009). Therefore, the company's managers should be able to balance the different interests between the

shareholders, so managers can utilize the investment opportunities that are profitable for the company's and pay cash dividends requested by a number of shareholders.

Dividend policy is a sensitive issue and also very important for the company. Dividend policy is often debated in the literature of corporate finance and still controversial. Determinant of dividend policy was proposed by Lintner (1956), which suggests that the company should increase the dividend payment only if the manager believes that a high dividend payment are able to be maintained in the future. There are two important points from the results of the research by Lintner; (1) the company's should emphasize the stable dividend payments, and (2) the company

earning is the main determinant factor in the company's dividend policy (Murhadi, 2008). Lintner's research was followed by Miller and Modigliani (1961) which suggests that the managers do not need to concern themselves with the payment of dividends, the most important things are providing that all of investment projects have a positive NPV, when discounted at the cost of capital, the shareholder wealth can be maximized and any remaining funds should be paid to shareholders as dividends (McLaney, 2009). Lintner research was continued by Fama and Blacomin (1968), and their research result supports his developed model (Murhadi, 2008).

Bhattacharyya (1979), Miller and Rock (1985), John and Williams (1985), John and Lang (1991) in Ahmad and Wardani (2014), argued that dividends can be used as an information from managers who are well-informed to the shareholders that poorly-informed or called as "dividend signaling theory".

Meggison (1997) in Arifin (2007), summarizes the pattern of dividend policy in different countries and found it was different for every country that is influenced by various factors such as the company's dependence on the sources of funds (capital markets or banks), the corporate governance mechanism, company profitable, firm size, industry growth, company growth, investment fund, ownership structure, taxes, and so forth. In addition, the dividend policy can also affected by systematic risk, agency cost and company investment opportunities (Martono and Harjito, 2005).

The corporate governance mechanism is one of the determining factors of corporate dividend policy that is widely discussed by many parties, because it can help to create a conducive relationship and can be accountable among elements within the company (board of directors, board of commissioners, and shareholders) and generally, provide benefits for the companies, investors and public (Sam'ani, 2008).

Shleifer and Vishny (1997), argued that the main purpose of corporate governance is to ensure that investors who invest their money in the company received fair returns of their investment. Furthermore, Kim and Chae Lee (2009), also said that companies with better corporate governance will pay higher dividends if they are not restricted to the external funding. Kowalewski, 2007 found that corporate governance practices are statistically has significant influence in increase the dividend-to-cash-flow ratio. Aydin and Cavdar (2015), show that corporate governance has a relationship with the dividend policy. However, Thanatawee (2014) research results, found that corporate governance (institutional ownership) has a negative correlation with dividend policy. Abdelsalam et. al. (2008) find that corporate governance (board size) does not affect the dividend policy. Yulianto (2014), also find that corporate governances (institutional ownership and board composition) have no effect on the dividend policy.

The company profitability also has relationship with the corporate dividend policy as presented by Lintner (1956). Higgins (1972) in Elston (1996), state that profitability has a positive relationship with the company earning. Furthermore, DeAngelo et.al. (2004), Amidu and Abor (2006), Dennis and Osobov (2008), Moradi et. al. (2010), Ahmad and Wardani (2014), Aydin and Cavdar (2015), and Kajola et al, (2015), found that there is a very close relationship between the company's decisions to pay dividends with the level of a company's profitability. Elmi and Muturi (2016), found different research results and argues that dividend policy is not affected by the company profitability. Systematic risk and firm size also believed to have a relationship with the dividend policy. Generally, found that companies with a higher level of systematic risk tend to pay lower dividends than the companies with a lower level of systematic risk as proposed by Naceur et. al, 2006. Moradi et.all. (2010) and Cheryta, et.al. (2015), found that systematic risk has a negative and

significant relationship with the dividend policy.

Firm size widely discussed as one of the factors that affect company's dividend policy in various countries. According to Megginson (1997), large companies tend to pay greater dividends than small firms (Arifin, 2007). Eriotis (2005), Dennis and Osobov (2008), Ahmad and Wardani (2014), Aydin and Cavdar (2015), Kajola et al, (2015), states that firm size have a relationship with the dividend policy. This opinion is contrary to the results of Moradi et.al. (2010) research who found that firm size does not affect the company's dividend policy.

Based on the above explanation, we conclude that the dividend policy in different industries and countries is very different and the factors that influence dividend policy in each country also differently. Although research on dividend policy has long and widely discussed, but the results still mixed, therefore it is still interesting to discuss the relationship between corporate governance mechanism (CGM), profitability, systematic risk and firm size with dividend policy. This research can contribute to the company and the investor as capital market players that have an interest with the company's dividend policy.

## **LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT**

### **Dividend Policy**

Dividends paid by the company are derived from revenues or profits and distributed in the form of cash dividends and stock dividends to the shareholders (McLaney, 2009). Dividend policy related to the mixed decisions and faced with various options, such as, whether to pay shareholders with cash dividend or capital gain through a share repurchase, how much cash dividends to be distributed, and how frequently it should be distributed in one year (Smart, et al., 2004)

Lintner (1956) said that dividend depends on the income earned by the company at the current time and part of dividend in the previous year. He found that the primary change in the revenue with the existing dividend level is an important determinant factor in the corporate dividend policy. He also found that companies tend to make adjustments to the dividend payments target periodically rather than the dramatic changes. Fama and Babiak (1968), support Lintner model and argue that managers can increase the dividend to a new level when they confident able to maintain permanently (Moradi, et. al., 2009).

Black (1976), states that the dividend policy is like a puzzle in the corporate finance literature. He argues that dividend concept has primarily relied to the agency cost and signaling theory. Agency cost increase when the interests of managers and the interests of shareholders differ. Shareholders prefer the dividends and they tend to appreciate managers who pay regular increasing dividends. Mohanty (1999), said that company adopted dividend policy and bonus depend on the availability of profitability and tend to use a constant dividend payment per share.

### **Corporate Governance Mechanism**

Corporate governance is a process and framework used by the company structure (shareholders or owners of capital, commissioners or board of supervisors, and directors) to increase to increase business success and corporate accountability by taking pay attention to the interests of other stakeholders, based on legislation and ethical values (Sutedi, 2012). Shleifer and Vishny (1997), said that the primary purpose of corporate governance is to ensure that investors supply money to the company and receive a fair rate of return on their investment.

Evidence of an interaction between the dividend policy and governance structures derived from cross-country analysis in which some researcher tries to document

that institutional and legal environment affect dividend policy. Mitton (2004), argues that there is a positive relationship between firm-level corporate governance and dividend payment, especially in the countries that offer strong protection to the shareholder. Adjaoud and Ben-Amar (2010), and Jirapon et. al. (2011), said that companies with strong corporate governance would pay higher dividends. Components of corporate governance mechanism quite a lot and used in this study only board of directors and institutional ownership.

### **Board of Directors**

One of the important mechanisms of corporate governance system is the role of the board of directors. Because the board is seen as the party who runs the primary functions of the company represents the interests of shareholders to carry out control of the top management (John and Senbet, 1998). The board of directors has a duty to determine the overall strategy of the company, and ensure that proper oversight has been implemented to protect the interests of shareholders (Keenan, 2004).

The board of directors is the company organ who is in charge of determining policies and strategies adopted by the company (Rachman, 2015). The boards of directors also have other responsibilities such as financing decisions, investments, and dividends, although in practice the responsibilities delegated to the top management. One of the principles that must be met in the implementation of directors' duties effectively is the composition of the board of directors should be complying with the needs, thereby enabling effective, precise, and fast decision making, and also able to act independently. In accordance to agency theory, the board of directors should be able to perform the duties of the owner and increase the wealth of the owners, one of through the distribution of dividends.

The board of directors has an influence on the company's dividend policy, as stated by Adjaoud and Amar (2010). A similar

argument also presented by Schellenger et. al. (1989), Abor and Fiador (2013), and Roy (2015), has found that the boards of directors affect the dividend policy. Based on the above explanation and theory, the first hypothesis can be formulated as follows:

H1: The Board of Directors has a positive effect on the dividend policy

### **Institutional Ownership**

The empirical evidence on the relationship between dividend payout and corporate ownership structure has been widely discussed in the financial literature by looking for the relationship between ownership structures with the company's dividend policy. Institutional ownership is shares owned by the institution or organization and not individual shares (Yulianto, 2014). The structure of ownership in a company can be divided into two, namely the ownership structure is concentrated and dispersed ownership structure (Saif, et. al., 2013). Each company has diverse ownership structures. Institutional shareholders with a large number of shares have a stronger control of the decisions related to the dividend payout policy. Institutional ownership has an important role in the company corporate governance, especially related to its ability to conduct supervision, gather information, and the impact on the company policies and performance. Based on the theory presented by Allen, Bernardo and Welch in 2000, dividends paid by the company to attract tax, preferred by institutional investors, which gave the signals that the quality of the company good and or efficient (Bichara, 2008).

Kumar (2006), argues that the ownership structure in large numbers has a positive influence on the company's dividend payout policy. Mehrani, et. al., 2011, explains that there is a positive relationship between dividend payments with the institutional ownership concentrated. Triwulan and Wahidahwati (2012), and Saif et. al., 2013

found that institutional ownership has a positive and significant effect on the dividend policy. Different opinion was delivered by Kouki and Guizani (2009), state that there is a significant negative effect of institutional ownership on the dividend policy. Yulianto (2014) suggests that institutional ownership has no effect on the dividend policy. Based on the description above, second hypothesis can be formulated as follows:

H2: Institutional ownership has a positive effect on the dividend policy

### **Profitability**

Company profitability determines firm decision to distribute dividend as proposed by Lintner (1956). Generally, companies with high profit and maturity paid dividends. But it is not mean companies that do not pay dividends is a company that does not make a profit. If the manager believes that the growth opportunities the company is better than the investment opportunities available to the shareholders, the company should keep the profits and reinvesting in profitable business, so it can maximize shareholder value through the distribution of the remaining funds in the form of dividends as proposed by Miller and Modigliani (1961). Companies that manage their cash flow effectively tend to maintain and increase dividend payout over time. Higher earnings growth is usually paid to investors in the form of higher stock prices (Ahmed, 2013).

Fama and French (2001), Booth and Clearly (2001), conduct an empirical analysis and found that the dividend policy of the company is affected by the level of company profits (Ahmed, 2013). Beabczuk 2004 in Morandi et. al. (2010), investigate the dividend policy in Argentina and found that large companies with a large profit level without having a good investment opportunities tend to pay higher dividends. Kania (2005), mentions that the dividend payout ratio is influenced by the level of company profits as measured by return on equity (ROE). Kajola et. al. (2015) found

that the companies dividends policy in Nigeria are influenced by the company profitability. Morandi (2010), found that the corporate dividend policy in Iran has a direct relationship to profitability.

Chhaoti (2015) argues that company's dividend decision in the iron and steel industry in India is greatly influenced by the company's profitability. Biza-Khupe, and Themba (2016) also found that there is a positive relationship between dividend policy and company profits in Botswana. Different opinion proposed by Aydin and Cavdar (2015), found that there was negative and significant relationship between profitability (ROE) and company dividend policy in Istanbul. Elmi and Muturi (2016), also found that profitability was not significant in determining company dividend policy in Nairobi Securities Exchange. Based on the above explanation and theory, the third hypothesis can be formulated as follows:

H3: Profitability has a positive effect on the dividend policy

### **Systematic Risk**

Risk is the differences between the actual return earned with expected return by investors (Tendelilin, 2001). High levels of risk indicate that current and future benefits become less certain. The concept of risk and return explain that if investors faced higher risk, then the return demanded by investors also be higher.

Jogianto (2009), said that the beta is a systematic risk measurement of a security or a portfolio relative to the market returns. Meanwhile, according to Gitman, 2009, beta is a relative risk measurement of non diversifiable index of the return on asset movement in response changes in the market returns. A historical return of assets can be used to find the asset beta coefficient.

The higher of company systematic risk, then the higher of the company's securities return sensitivity to market return change which may result lower company

opportunity getting an external source of funds, so the company should be able to financing need funds through internal sources, consequently, the company will increase retained earnings and reducing the amount of the dividend. This indicates that the higher of company systematic risk, then the lower of company's dividend policy (Tendelilin,2001).

Amidu and Abor (2006), found that the systematic risk has a negative significant effect on the company's dividend policy in Ghana. Moradi, et. al. (2010), also found an inverse relationship between systematic risk and corporate dividend policy in Iran. Adjaoud and Ben-Amar (2010), state that firm risk is negatively related to the firm's dividend payout policy in Canada. Cheryta et.al. (2015), found that systematic risk has a negative effect on the dividend policy in Indonesia. Based on the above explanation and theory, the fourth hypothesis can be formulated as follows:

H4: Systematic risk has a negative effect on the dividend policy

#### **Firm Size**

Company's size describes the size of a company which valued from the total assets owned, average assets, growth of sales, and the average of total sales. Empirical evidence indicates that company size has a positive relationship with the company dividend policy.

The largest size of a company indicates the higher company's ability to maximize company profitability and dividend payout (Arifin,2007).

Reddy and Rath (2006) in Ahmad and Wardani (2014), found that companies paid dividends in the Indian, is a company that has a large size. Adjaoud and Ben-Amar (2010) also found that company's size has a positive influence on company's dividend policy in Canada. Ahmad and Wardani (2014), states that the company's size has a positive and significant effect on the company's dividend policy in the Indonesia Stock Exchange. Roy (2015), also found that

there is a positive relationship between firm size and company's dividend policy in India. Based on the above explanation and theory, the fifth hypothesis can be formulated as follows:

H5: Firm size has a positive effect on the dividend policy

## **RESEARCH METHOD**

### **Population and Sample**

This research used companies in the financial industry listed in Indonesia stock exchange for the period of 2009 – 2013 consist of 79 companies and the companies divide under the categories of bank, financial institution, securities company, insurance, investment fund/mutual fund, and others as population. The samples were taken from 18 companies by using a purposive sampling technique. The criteria used to select the sample were; (1) Companies in Financial Industry listed in Indonesia Stock Exchange for the period 2009 – 2013, (2) Companies paid dividends during the study period, (3) Companies do not perform a stock split during the study period, (4) The companies have the institutional ownership over the study period.

### **Data and Variable**

This study is explanatory research with a quantitative approach and use secondary data. Secondary data is data that is published or utilized by the other organization, not by the user. Secondary data used in this research in the form of documents on financial statements and other related information such as company annual report, and share statistic report. The data were gathered from the official website of Indonesia stock Exchange ([www.idx.co.id](http://www.idx.co.id)) and company annual report. For additional information, the researcher also takes information which has already existed, like articles, journals, text books, and etc. The data used in this research is the combination of time series data and cross section data,

which is known as pooling data/panel data. Panel data give more informative data, more variability, less co-linearity among the variables, more degrees of freedom and more efficiency (Zhao, 2013).

This study analyzed the impact of corporate governance mechanism (CGM), profitability, systematic risk and firm size on the dividend policy (DPR).

The variables observed in this research consist of dividend policy measure by using dividend payout ratio as dependent variable. CGM by using board of directors (BOD) and institutional ownership (IO), profitability by using return on investment (ROI), systematic risk by using beta coefficient (beta), and firm size (size) by using total asset as independent variables. All the variables used in this research and measurements are shown in the table1 below:

**Table 1.** Research Variables and Measurement

Variables	Definition
<b>Independent Variables</b>	
BOD	Ln total board of directors
IO	Share owned by institutional/ number of share outstanding
ROI	Earnings after tax/total assets
Beta	Cov. of share return & market return/var. of market return
Size	Ln total assets
<b>Dependent Variable</b>	
DPR	Dividend per share/earnings per share

**Research Model and Data Analysis Method**

On the way to test the hypothesis in this research used the panel data regression model as used by Kajola et. al. (2015). The regression equation model is presented below:

$$DPR = a + \beta_1 BOD + \beta_2 IO + \beta_3 ROI + \beta_4 BETA + \beta_5 SIZE + e$$

Where *a* was constanta,  $\beta_1, \beta_2, \beta_3, \beta_4, \beta_5$  were regression coefficients, and the variables already being defined in the table 1 above.

The researcher will use eviews version 9 for to run the statistic data and analyze the results. The primary step in conducting panel data regression model is conducted several classical assumption tests. The tests consist of normality, multicollinearity, autocorrelation, and heteroscedasticity test. Normality test is used to test whether the residual is distributed normally in a regression model. There are two ways to find if the residual is distributed normally or not, first by using graphic analysis and second by using statistic test. Normality test used in this research is normality test using Jarque-Bera test.

Multicollinearity test is used in order to find the correlation among the independent variables in a regression model. If the variables are perfectly correlated, then it can

be said as perfect multicollinearity. To detect if the regression model is experiencing multicollinearity, it uses matrix correlation. If the value in the correlation matrix is below 0.8, then there is no multicollinearity among the independent variables, so that it can be used in the analysis.

Autocorrelation test is used to test if the linier regression has a correlation between the errors in the *t* period with *t-1* period. If the correlation occurs, then autocorrelation problem exist. Generally, test that is used in detecting autocorrelation is Durbin-Watson statistic test which developed by J. Durbin and G. Watson in 1951. The Durbin-Watson statistic test or d-statistic can be calculated using this formula (Gujarati, 2004):

$$d = \frac{\sum_{t=2}^{t=n} (\hat{u}_t - \hat{u}_{t-1})^2}{\sum_{t=1}^{t=n} \hat{u}_t^2}$$

Where:

D = Durbin-Watson calculation

U = Error Term

Heteroscedasticity test is used in order to test if there is a difference in variance from the residual form one observation to another observation [20]. According to [19], to detect the heteroskedasticity problem, it can use formal and informal method. Formal method can be done by statistical test including Park Test, White Test, Glejser Test and Breusch Pagan Godfrey (BPG) test. In this research, the research will use the BPG test in detecting the heteroskedasticity problem. The hypothesis used in perform heteroskedasticity test are:

- H0: there is no heteroskedasticity
- H1: there is heteroskedasticity

With the criteria of the test:

- P-value obs\* square <  $\alpha$ , then H0 rejected
- P-value obs\* square >  $\alpha$ , then H0 accepted

Next step was test of the accuracy of the regression model in predicting the value of the dependent variable is determined by the goodness-of-fit (Ghozali, 2013). In measuring the goodness-of-fit, a panel data regression model can be analyzed through F- test. F test is known as Anova test is used to find the relationship between independent variables and dependent variable or to test if the model used is fix or not.

Furthermore, R2 test which is coefficient of determination test to measure the ability of the independent variables used to define changes on the dependent variable. The coefficient determination value is between 0 until 1. Small value  $R^2$  indicates the limitation of the model's ability or the independent variables used in defining dependent variable. If the value of  $R^2$  is close to 1, then it means the independent variables able to define the dependent variable in perfect way or good model's ability.

The last test is t-test or hypothesis test. T-test used to analyze the impact of each independent variable individually toward the dependent variable or to answer all the hypothesis proposed in this research. if  $t_{calculated} > t_{table}$ , dan  $\alpha_{calculated} < 0.05$ , then it means there is a significant impact of

independent variable individually toward dependent variable or hypothesis is received. if  $t_{calculated} < t_{table}$ , dan  $\alpha_{calculated} > 0.05$ , then it means the impact of independent variable individually toward the dependent variable is negative and not significant or hypothesis is rejected.

**ANALYSIS AND DISCUSSION**

The result of normality test using Jarque-Bera test show that Jarque-Bera probability value is  $0.068 > \alpha$  ( $\alpha = 0.05$ ), it can be said that the data are normally distributed. Furthermore, multicollinearity test using correlation matrix for each independent variable resulted through the data processing shows that coefficient correlation are below 0.8, which mean there were no problems with multicollinearity in the model of the study. Autocorrelation test result using Durbin-Watson test shows that the value calculated is 1.6862 and Durbin-Watson table is  $d_L=1,5420$ , and  $d_U = 1,7758$ , it is not showing a certain result because the Durbin-Watson value calculated is between  $d_L$  and  $d_U$ . However, it can be concluded that there is no autocorrelation because the Durbin- Watson calculated is close to 2.

The result of heteroskedasticity using the Breusch Pagan Godfrey (BPG) test resulted in p value-obs\*-square  $0.2397 > 0,05$ , which mean there is no heteroskedasticity among the residuals in the regression model or the variance of the residuals keep staying the same across different observation or different values of independent variables.

The panel data regression results show the coefficient of independent variable, standard error, coefficient of determination, and F test as shown in table 2 below.

**Table 2.** Panel Data Regression Results

Variables	Coefficient	Std. Error
BOD	0.184952	0.058160
IO	0.135588	0.074920
ROI	0.118230	0.461859
Beta	0.049174	0.019508
Size	-0.037691	0.012727

C	0.972983	0.318397
R-squared	0.208234	
F-statistic	4.418400	
Prob(Fstatistic)	0.001275	

Source: The processed using eviews 9

The regression analysis resulted showed that the coefficient of variation ( $\beta$ ) which explains the direction of variability is positive for BOD, IO, ROI and Beta, which mean if BOD, IO, ROI and Beta increase in one unit, then DPR will increase in the amount of coefficient of variation ( $\beta$ ). Meanwhile Size is negative, it's mean, if Size increase in one unit, then DPR will decrease in the amount of coefficient of variation ( $\beta$ ) Size.

F-test results show that  $F_{calculated}$  is 4.418 with  $\alpha_{calculated}$  is 0.001, meanwhile  $F_{table}$  equal to 2.48 with  $\alpha = 0.05$ . It shows that  $F_{calculated} > F_{table}$ , and  $\alpha_{calculated} < 0.05$ . Meaning that independent variables used in this research are able to define dependent variable in a good way or the regression model is fixing.

The model developed for dividend policy is weak, because the coefficient of determination ( $R^2$ ) as shown in table 2 above is 0.2082. It can be said that the variation in the dividend policy in the financial industry listed in Indonesia Stock Exchange can be explained by the variation in BOD, IO, ROI, Beta, and Size by 20.82%, taking into account the sample size and number of independent variables, while the remaining of 79.18% is explained by the variation of other variables outside of the regression model.

**Table 3.** The Result of Hypotheses Test

Variables	t-calculated	$\alpha$ -calculated	t-table	$\alpha$ -table
BOD*	3.1801	0.0021	1,6632	0,05
IO	1.8097	0.0739	1,6632	0,05
ROI	0.2560	0.7986	1,6632	0,05
BETA*	2.5207	0.0136	1,6632	0,05
SIZE	-2.0415	0.06031	-1,6632	0,05

Source: The processed using eviews 9

The first hypothesis is the board of directors (BOD) has a positive effect on the dividend policy. The statistical test shows that the variable has a positive and significant effect to the company dividend policy in the financial industry listed in Indonesia Stock Exchange. Therefore, the first hypothesis is received.

This finding is interesting, because the result indicate that when board of directors of the company's increase, then dividend payout also increase. It does indicate their commitment and responsibilities to increase shareholders wealth through increasing their control, policy and strategy to gather more earning and distribute to the shareholder in the form of cash dividend. This research result align with agency theory that said, the board of directors should be able to perform the duties of the owner and increase the wealth of the owners, one of through the distribution of dividends

Commitment of the board of directors of course will be greeted with delight by shareholders. Shareholders prefer the dividends and they tend to appreciate managers who pay regular increasing dividends as states by Black (1976).

This research finding suitable with the research conducted by Adjaoud and Amar (2010), Schellenger et. al. (1989), Abor and Fiador (2013), and Roy (2015), argue that the boards of directors affect the dividend policy. And contrary with research conducted by Abdelsalam et. al. (2008), and Yulianto (2014) taht found board size does not affect the dividend policy.

Based on data processing result as shown in the table 3 above, the second hypothesis is that Institutional ownership has a positive effect on the dividend policy was rejected. The result indicates that institutional ownership have positive and does not significant effect to the dividend policy. This finding contrary with the agency theory that state institutional ownership has an important role in the company corporate governance, especially related to its ability

to conduct supervision, gather information, and the impact on the company policies and performance.

This research also contrary to the signaling theory, refer to the theory, institutional investors believed able to gave the signals that the quality of the company good and or efficient as state by Bernardo and Welch (2000) in Bichara (2008).

This research finding suitable with research conducted by Kouki and Guizani (2009), state that there is a significant negative effect of institutional ownership on the dividend policy, and Yulianto (2014) who suggests that institutional ownership has no effect on the dividend policy. This research contrary with research conducted by Kumar (2006), Mehrani, et. al., 2011, Triwulan and Wahidahwati (2012), and Saif et. al. (2013), found that institutional ownership has a positive and significant effect on the dividend policy.

The third hypothesis is that Profitability has a positive effect on the dividend policy. The statistical test shows that the variable has a negative and does not significant effect to the dividend policy in the financial industry listed in Indonesia Stock Exchange. This finding indicates that high and low levels of corporate profits not influence the company decision in paid dividend to the shareholders.

This study finding contradictory with the theory proposed by Lintner (1956), state that the company's profitability is the determining factor firm decision to paid dividend. Lintner statement also support by Fama and Babiak (1968). Ahmed (2013), also states that company's which manage their cash flow effectively tend to maintain and increase dividend payout over time. This research result suitable with research conducted by Elmi and Muturi (2016) that found profitability does not significantly determining the company dividend policy in Nairobi Securities Exchange.

The research finding contrary with the research conducted by Fama and French

(2001), Booth and Clearly (2001), Beabczuk (2004), Kania (2005), Morandi (2010), Kajola et. al. (2015), Chhaoti (2015), and Biza-Khupe, and Themba (2016) argue that company's dividend policy influenced by the company's profitability level.

The fourth hypothesis is that systematic risk has a negative effect on the dividend policy. The statistical test shows that the variable has a positive and significant effect to the company's dividend policy in the financial industry listed in Indonesia Stock Exchange. This result indicates that when company's has a higher of beta, then company's decision to paid dividend higher than companies with lower beta coefficient.

This research result contrary with theory proposed by Tendelilin (2001), said that the higher of company systematic risk will be make the higher of the company's securities return sensitivity to market return change which may result lower company opportunities getting an external source of funds, so the company should be able to financing it's self through internal sources of funds, consequently, the company will increase retained earnings and reducing the amount of the dividend. This indicates that the higher of company systematic risk, then the lower of company's dividend policy.

This study finding contrary with research conducted by Amidu and Abor (2006), Moradi, et. al. (2010), Adjaoud and Ben- Amar (2010), and Cheryta et.al. (2015), found that systematic risk has a negative effect on the company's dividend policy.

The fifth hypothesis is firm size has a positive effect on the dividend policy. The statistical test shows that the variable has a negative and significant effect to the firm dividend policy in the financial industry listed in Indonesia Stock Exchange. This result indicate that the largest size of a company will paid lower dividend compared to smallest company which will paid higher dividend.

This research finding contrary with a number of theories and research as state by

Arifin (2007), argue that empirical evidence show that company size has a positive relationship with the company dividend policy. The largest size of a company indicates the higher company's ability to maximize company profitability and dividend payout. This condition occurs because the company observed is financial institutions where the majority of its assets owned by the public are diverse with other industries listed in Indonesia Stock Exchange. Difference in the results of this study can be caused by the limitation number of samples used, and short period of the study.

This study result contrary with research conducted by Reddy and Rath (2006), Adjaoud and Ben-Amar (2010), Ahmad and Wardani (2014), Roy (2015), argues that company's size has a positive influence on the company's dividend policy.

## **CONCLUSION**

The aim of this study was to identify effect of corporate governance mechanism, profitability, systematic risk and firm size on the company's dividend policy, and define which of the most important variables that indicate having powerful effect on the firm dividend policy. The data used for this research was secondary data in the form of documents on financial statements and other related information such as company annual report, and share statistic report, and gather from the official website of Indonesia stock Exchange ([www.ix.co.id](http://www.ix.co.id)) and company annual report.

This research used companies in the financial industry listed in Indonesia stock exchange for the period of 2009 – 2013 which sample were taken from 18 companies based on purposive sampling technique. A panel data regression method has been conducted to explain relationship between dividend policy and board of directors, institutional ownership, return on investment, systematic risk, and firm size variables.

The regression model used in this research has passed from classical assumption tests and the empirical result show that the independent variables used able to describe the dependent variable in a good way and the estimation model is fixing.

Adjusted r square ( $R^2$ ) indicates that 20.82% of independent variables are able to explain the percentage of variation in the dependent variable, while the remaining 79.18% is explained by the variation of other variables outside of the regression model.

Hypothesis test as statistically found there are positive and significant relationship between board of directors and beta with firm dividend policy in the financial industry listed in Indonesia Stock Exchange, and firm size has a negative and significant effect on the firm dividend policy. Meanwhile, institutional ownership and return on investment have a negative and do not significant effect on the dividend firm policy in the financial industry listed in Indonesia Stock Exchange.

There have been several limitations of this research which may affect the research results. First, limitation number of research samples used. In this research, sample used only 18 companies listed in the financial industry that fulfill the criteria which are observed to identify variables that affecting company dividend policy. Thus, the researcher suggest that the future research will use a wider research sample, like more than one industry and longer period of time, so the number of observation is bigger and more accurate.

The second, limited of independent variables used in this research that is only 5 variables. Based on the result of panel data regression methods specifically the adjusted r square ( $R^2$ ), the variation in the independent variables determined 20.82% of the variation in the firm dividend policy, meaning that there are other variables influencing the firm dividend policy, which are not examined in this research. Thus, the researcher suggests that the future research

will add more independent variables by collaborate with more theories.

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## **ANALYSIS OF SHARIA BUSINESS MARKETING AT PT. AL FATIH BANGUN INDONESIA IN BOGOR**

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### **ABSTRACT**

*The background of this study is the researcher had discovered a phenomenon that there is a developer who uses 100% sharia housing schemes, without banks, without penalties, without confiscation and without ceremony, had problems in marketing their products. The purpose of this study is to determine how the application of sharia marketing concepts in sharia business property developer.*

*This study uses qualitative descriptive method which is a research that is directed to provide the symptoms, facts or events systematically and accurately on the nature of the study and analyze the truth based on the data obtained. Data was collected using interview and observation techniques. Discussion is analyzed through the results of the interviews using interpretation. Informants in this study amounted to 7 people. The sampling technique in this research is done by purposive sampling, using 4 informants as key informants, namely the management of PT. Al Fatih Bangun Indonesia and 3 regular consumers of products from PT. Al Fatih Bangun Indonesia.*

*The analysis showed that the application of sharia marketing concepts at PT. Al Fatih Bangun Indonesia has been good but has not been effective overall because PT. Al Fatih Build Indonesia have yet to implement a long-term relationship with the post-purchase consumer products. Also from the marketing side, PT. Al Fatih Bangun Indonesia prefers offline promotion such as an exhibition rather than online promotion, because it is considered more effective. PT. Al Fatih Bangun Indonesia uses a specific strategy in managing its sharia property business, named sky strategy and earth strategy. Both of these strategies are collaborated to get the best results and maximize sales.*

**Keywords :** *Sharia Marketing, Sharia Property Business*

### **INTRODUCTION**

Nowadays, property sector is a sector where its development is quite fast. Property is considered as the sector that brings a great and promising value of investment. It happens in Bogor which is a strategic city for construction growth and development.

The existence of sharia-based developers in Bogor is a new phenomenon that is popular in the world of property. It occurs because recent business and marketing practices start shifting

and transforming from rational to emotional level and in the end to spiritual level. Sharia developers are able to bring unusual innovation and they succeed in breaking doubts of property business actors toward the probability of success in applying Islamic economic concept in business.

PT. Al Fatih Bangun Indonesia or known as ABI Property is one of well-known sharia-based developers in Bogor. PT. Al Fatih Bangun Indonesia proposes 100% sharia concept in managing its business; that is by *muamalah*

without any fine, confiscation, problematic *akad*, and bank KPR. The four concepts are expected to cause PT. Al Fatih Bangun Indonesia as a well-known sharia-based property developer not only in Bogor but also in Indonesia.

Some problems emerged from PT. Al Fatih Bangun Indonesia as a sharia-based property developer are information spread about housing with 100% sharia scheme that has not been comprehensive and rivalry between sharia-based property developers because the emergence of sharia-based property developers has been spread largely in outside Bogor so that companies need to implement accurate strategies to be able to take opportunities to markets.

Based on the explanation above, then the title chosen by the writer in making this research proposal is "Analysis of Sharia Marketing in Sharia Property Business at PT. Al Fatih Bangun Indonesia Bogor".

### Problem Identification

How is marketing sharia concept in sharia property business at PT. Al Fatih Bangun Indonesia Bogor applied?

## I. LITERATURE REVIEW

### 1.1. Sharia Marketing

Sharia marketing is an application of a business strategy discipline that is suitable with *muamalah* values and principles as well as Islamic concept as what The Prophet Muhammad SAW teaches. Hermawan (2006: 26) explains and defines marketing sharia as:

*"a strategic business discipline that directs the process of creating, offering and exchanging values from one initiator to its stake holders and whole process should be in accordance with muamalah principles in Islam."*

Besides, there is a statement from Arham M. (2010) who states that:

*"Islamic marketing may be resolute such as relating all marketing guidelines which are not against the Islamic rules as well as holly Quran. For example, Islam give information to its supporters*

*to get capital on the other hand it stresses that this attainment would not to be present by attain laid-back money through Riba."*

Based on the explanations above, the researcher can conclude that sharia marketing is a whole process either creating, bargaining, or value changing process, none of them should not be contradictory with Islamic *akad* and *muamalah* principles. As long as all processes can be guaranteed and there is no deviation from Islamic *muamalah* principles in any transaction, sharia marketing is allowed. Islam sees marketing as trade which has to show specialty and weakness from a product sold so that buyers are interested to buy.

### 1.2. Sharia Marketing Characteristics

According to Hermawan Kertajaya and Muhammad Syakir Sula (2006: 22), it is stated that sharia marketing has its own characteristics. They are:

#### 1. Theistic (*Rabbaniyah*)

Hermawan Kertajaya and Muhammad Syakir Sula (2006: 28) say that the soul of a sharia marketer believes that theistic (divine) sharia norms is the most fair, perfect, conformable with all forms of kind, the most preventing any kind of damage, the most capable in realizing the truth, disappearing sleaze, and spreading kind. All business activities have to be based on Islamic values assigned in Al Quran.

#### 2. Ethic (*Akhlaqiyyah*)

According to Kertajaya and Sula (2006: 34), there are nine ethics that can be treated as indicators for sharia marketer in executing marketing functions, namely:

- 1) Having spiritual personality (*Taqwa*)
- 2). Kind and sympathetic attitude (*Shidiq*)
- 3). Fair in business attitude (*Al Adil*)
- 4). Serving and humble attitude (*Khidmah*)
- 5). Keeping promises and not cheating
- 6). Honest and believable (*Al Amanah*)
- 7). Disliking prejudice (*Su'uzh-zhann*)
- 8). Disliking mocking (*Ghibah*)
- 9).Undoing bribery (*Riswah*)

#### 3. Realistic (*Al Waqi'iyah*)

Hermawan Kertajaya and Muhammad Syakir Sula (2006: 40) explain that sharia marketer is a flexible marketing concept, as malleability and

adjustability that Islamic sharia bases. Sharia marketers are professional marketers whose simple, neat, and clean appearance, whatever the model or fashion style is, who work by foregrounding religious values, piety, moral aspects, and honesty in all marketing activities.

4. Humanistic (*Al Insaniyyah*)

In Kertajaya and Sula (2006: 44), it is explained that sharia is created for humans so that their level is lifted up, their humanity is maintained and preserved, and their animality can be bridled with sharia guidance. Islamic *shari'a* is created for humans in accordance with their capacity without minding race, sex, skin color, nationality, or status. This is what makes sharia is universal so that it becomes universal humanistic sharia. It can be considered as *ukhuwah insaniyyah* principle (brotherhood between human).

1.3. Sharia Marketing Dimensions

The three dimensions of sharia marketing are explained on the figure below:

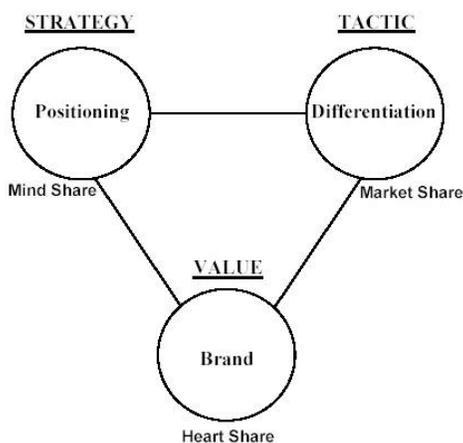


Figure 2.1. Sharia Marketing Dimensions

Source: Alma and Priansa (2006: 352)

1.3.1. Sharia Marketing Strategy

These are the elaboration of Sharia Marketing Strategy indicators:

1).Segmentation

The first basic thing needed to do by a sharia marketer in executing marketing strategy is segmenting market. In which, according to Syafi'i Antonio in Hermawan Kertajaya and Muhammad Syakir Sula (2006: 209), it is

explained that “sharia segmentation has its own unique. Sharia is not only comprehensive but also universal.” What is meant by comprehensive is that Islamic sharia covers all aspects of life either ritual (worship) or social (*muamalah*). While universal in this case is that sharia can be applied in all time and space by each person without differentiating between Moslem or non-Moslem.

2).Targeting

The next step after segmenting market is aiming target market or targeting. Targeting is defined as a strategy that allocates company’s resources effectively due to its limitation (Kertajaya and Sula, 2006: 169).

3).Positioning

Positioning is an action of company to design products and marketing mix in order to create a particular impression in the memory of consumers. Therefore, consumers of segment understand and appreciate what have been done by a company in its relation with the competitors.

4). Differentiation

Sharia companies also need to perform differentiation with similar products. It can be based on what the offer is (content), how to offer (context), and things that cover employees, facilities, and technology (infrastructure).

1.3.2. Sharia Marketing Tactic

Sharia marketing tactic is a strategy used to win market share. When the positioning of sharia marketer has been in the mind of rational market, they have to do differentiation that covers what the offer is (content), how to offer (context), and what infrastructures in offering are. Next, it is necessary to apply differentiation creatively and innovatively by using marketing mix and selling in improving the relationship with customers in order to earn financial profit.

1) Marketing mix in sharia marketing perspective

Abdul Hasan and Abdul Latiff (2008) made an attempt to analyze the five P’s of marketing ethics within the context of marketing as determined by Islamic ethics. The five P’s are: product, price, promotion, place and people.

- a. Product
- b. Price
- c. Place: distribution channel

- d. Promotion
- e. People
- 2) Selling  
In selling, companies do not only deliver offered product features but also the offered products have to give benefit and solution for consumers.

### 1.3.3. Sharia Marketing Value

Sharia marketing value is a strategy used to win heart share (customer's love toward products). All strategies and tactics that have been designed will run optimally if they are accompanied with value improvement from good or service sold. In sharia marketing value, a brand is a good name that becomes identity of a person or a company. Beside brand, the company that applies sharia marketing also needs to concern about service offered in order to maintain customer's satisfaction.

## II. RESEARCH METHODOLOGY

### 2.1. Research Methodology

The research method used in this research is qualitative. The result of qualitative research needed by the researcher is a deep information about condition of a certain object. The type of research used in this research is descriptive analysis research. It aims at describing abstractly and finds the meaning from an event by doing observation and literature study toward related company.

### 2.2. Data Analysis Technique

Data analysis in this research refers to analysis model of qualitative data. Sugiyono (2010: 331) quoting from Bogdan states that data analysis is a process of finding and arranging systematically data gained from interview, field records, and other sources so that they are easy to understand and the finding can be informed to other people. The activities in data analysis are:

- 1) Data Reduction  
The first process of data reduction is summarizing, choosing main things, focusing on important things in order to be able to determine the next theme and pattern. The processes are done so that the researcher can see a real description about the application of sharia marketing in property developer

business at PT. Al Fatih Bangun Indonesia as well as other things related to variables of research. The data assumed unimportant or irrelevant with this research will be reduced or eliminated by the researcher.

- 2) Data Display

After being reduced, the next step is serving the data in order to ease in understanding what really happens in research object. The result of data reduction will yield a deeper explanation in the application of sharia marketing in property developer business at PT. Al Fatih Bangun Indonesia which then will be served in narrative texts, charts, relationship between categories, flowcharts, graphics, matrix, and networks.

- 3) Data Conclusion

Early conclusion that will be delivered is still temporary because it can change if in the future, it is found strongly supporting evidences on the next step of data collection. But, if the conclusion delivered on early step has been supported by valid evidences then the conclusion has been able to be said credible.

## III. FINDING AND DISCUSSION

### 3.1. Sharia Marketing Strategy

#### 3.1.1. Segmenting

PT. Al Fatih Bangun Indonesia or what it is used to call ABI Properti divides markets based on geography, demography, psychograph, and behavior. **Geographical segmentation** chosen is urban areas; that is location for Umami Residence housing located in Nur Amrur, city center of local government Cibinong. **Demographic segmentation** is focused on middle up community groups whose Islam as their religion having encouragement to *muamalah* righteously and highly religious intellectuality. But it is also openly possible for non-Moslem communities to be able to use products from ABI Properti.

**Psychographic segmentation** is focused on communities' life style that is modern. Therefore, ABI Properti designs a

housing with modern, beautiful, and comfortable concept even though it is placed in the middle of hustle and bustle of urban areas. Besides, the location chosen for Ummi Residence housing is strategic; it is close to shopping center, school, office, hospital, and other public places that support communities' daily activities. While **behavior segmentation** is focused on the principle of utility gained by consumers; that is blessing in the world and the hereafter.

### 3.1.2. Targeting

Market target appointed by ABI Properti is middle up Moslem communities whose modern life style but still accentuate Islamic/sharia values. The market target selection is due to offered products are Islamic products. Therefore, the company has to appoint the people whose high Islamic values.

### 3.1.3. Positioning

Positioning applied by PT. Al Fatih Bangun Indonesia is "First Housing in Cibinong with 100% Sharia Concept." The tagline brings the meaning that the company posits itself in the mind of customers as the pioneer of housing with 100% sharia concept in Cibinong. It is also supported by the existence of hashtag #TanpaKPRBank #TanpaSita, and #TanpaAkadBermasalah.

### 3.1.4. Differentiation

The company gives additional attribute hashtag #TanpaKPRBank #TanpaDenda #TanpaSita, and #TanpaAkad as the differentiation from the other sharia property developer services because the hashtags are not only as promotion attribute but also having its own meaning. PT. Al Fatih Bangun Indonesia applies those hashtags into *muamalah* process in order to give the best quality service to consumers.

The use of hashtag #TanpaKPRBank has the meaning that the company cuts all kind of activities with banking chains. PT. Al Fatih Bangun Indonesia earns capital from investors and from the consumers-to-be that in the future will be agreed in *akad*.

Hashtags #TanpaDenda and #TanpaSita have the meaning that when the consumers do not afford to pay mortgage anymore and the mortgage payment has

matured then there is a provision that the company does not apply confiscation and fine to consumers. Islam sees confiscation as *riba* which is *haram* because the excuse that confiscation is considered as indemnity cost for sellers/credit providers and it aims at disciplining buyers/consumers so that they do not underestimate paying mortgage.

The source or reference supporting the statement above is in QS Al Baqarah verse 275 "*dzâlika biannahum qâlû innamâ al-bay' mitslu ar-riba*" which means "That is because they say, 'Trade is just like *riba*'."

## 3.2. Sharia Marketing Tactic

### 3.2.1. Marketing Mix

Marketing mix in sharia marketing according to Abul Hassan and Abdul Lattif (2008) has five contents; those are product, price, place, promotion, and people.

#### 1) Product

The first product launched by PT. Al Fatih Bangun Indonesia is Ummi Residence housing. It is a large type of housing 90/100 as many as 25 units with proposing 100% sharia concept. The reason why choosing housing with large type is adjusting market target appointed; that is middle up Moslem communities with modern life style but still upholding Islamic values.

It is not only housing but PT. Al Fatih Bangun Indonesia also provides additional attributes such as furniture as complementary housing deals. The additional furniture attributes aim for consumers to get extra value from offered products.

#### 2) Price

The determination of price is usually based on three aspects; they are land investment cost, house production cost, and operational cost so that the price can change at any time. Based on the research result, according to the consumers of Ummi Residence, the price determination has been equaled the facilities given so that the consumers satisfy and they do not regret spending much money to get the best result.

#### 3) Place

The location selected for Umami Residence housing is in Nur Amrur, Local Government of Cibinong. Location selection of Nur Amrur for Umami Residence housing is due to its strategic location, its ease for access, and its availability of various public facilities. The determination of location selection is also based on land survey with careful consideration. The developer is required to ascertain the land that will be developed whether it has been on the right track which is in accordance with City Spatial Plan (RKTK) or not so that in the future, the developer will not undergo difficulties in having land utilization permit from the government.

4) Promotion

The form of promotion done by PT. Al Fatih Bangun Indonesia takes two ways, namely online and offline. The media chosen to promote by online is using website, Facebook fan page, Twitter, Google+, Pinterest, and also online property marketing agents. The right word selection or what it is used to call SEO (Search Engine Optimization) also helps the company to promote so that the company site or blog is on the first page/the top position of search engine like Google, Bing, and Yahoo.

Based on the direct observation done by the researcher, offline promotion execution tends to be more effective than online promotion because when offline promotion happens, consumers-to-be that come to ABI Properti booth can do two-ways communication freely with ABI Properti marketers. Offline promotion is done by attending exhibition in malls or Islamic events like Islamic Book Fair.

Management of ABI Properti also states that from a number of online promotion media like website, Facebook fan page, Twitter, Google+, and Pinterest, it is only the website and Facebook that is more update in showing latest information while the other social media only publish some old information. The lack of updated information on social media causes uneven information to the whole areas of Indonesia about housing with 100% sharia scheme.

5) People

PT. Al Fatih Bangun Indonesia uses the spirit of spiritual leadership in managing its human resources in the company realized in the form of routine Al Quran recitation once a week joined by all of management of ABI Properti and the investors. It is also openly possible for other Moslems to attend the Al Quran recitation. It is in a line with the characteristic of sharia marketers which is Al Waqi'iyah or realistic where someone who applies sharia marketing concept works by accentuating religious values, piety, moral aspects, and honesty in all marketing activities.

3.2.2. Selling

PT. Al Fatih Bangun Indonesia succeeds selling 12 units from 25 units during less than three years since the company is established. As the pioneer of *syar'i* housing in Cibinong Local Government, the selling of Umami Residence housing is good enough because to sell a large type of housing 90/100, it certainly needs special marketing strategies. The company names after the marketing strategies as sky strategy and land strategy.

Sky strategy is an indirect strategy used to a place for self-controlling. Sky strategy aims at searching for sincerity from Allah SWT because it is only His sincerity that will bring in the true goodness. Therefore, as His people, we have to assume a good faith to Allah SWT and perform the good practices.

Land strategy consists of nine components. Those are:

1. Price deal strategy
2. Strategy if the land owner asks for down payment
3. Strategy if the land owner asks for booking fee
4. Offer attributes
5. Strategy if the attributes is denied
6. Strategy if the attributes is accepted
7. Offer

3.3. Sharia Marketing Value

3.3.1. Brand

The brand of PT. Al Fatih Bangun Indonesia is more well-known as ABI Properti where the name of Al Fatih is taken from a fighter and a young leader of the best

Islamic troops on the era of re-release of Al Quds in Palestine. The company hopes that the spirit of this figure can get into the spirit of persuasive construction of KPR without *riba* in Indonesia.

The parameter showing that brand ABI Properti is easy to say and to remember is the testimony from consumers who state that brand ABI Properti reflects Islamic nuance which is easy to remember because the name ABI is a nickname for a dad in Arabic language so that it is not something strange to hear.

Besides, the marketing office equipped with calligraphy read the name of Allah SWT also supports the nuance of brand ABI Properti as a sharia-based developer brand. PT. Al Fatih Bangun Indonesia hopes that this brand is not only popular in Bogor area but also in all Indonesia areas. The way executed to improve company's image is by improving the performance of marketing team and giving the best service to the consumers.

### **3.3.2. Services**

Nice sharia-based or conventional marketers have to give the best service to consumers in order to build consumer loyalty and a long term relationship between the company and the consumers. The service in sharia marketing has to be a call from the heart, not just as work, because serving consumers sincerely and wholeheartedly will bring a positive memory and satisfying experience for consumers.

The form of service given to consumers is realized through the attitudes of all management team of PT. Al Fatih Bangun Indonesia which are friendly, humble, honest, and full of patience in giving information about 100% sharia KPR housing scheme and also quick in responding complaints.

### **3.3.3. Process**

The process of transferring service in sharia marketing has the meaning delivering values offered to consumers that is still based on spiritual values. The values in the form of benefit of 100% sharia KPR housing concept are transferred by giving education about the danger of *riba*, problematic transaction, *haram* chain with banking, double *akad*, collateral, and other things related to property

ownership. If the consumers-to-be has really understood 100% sharia housing ownership scheme offered by the company then the consumers-to-be are invited to survey the location to see the condition of offered house land.

To survey location aims at convincing the consumers-to-be that the offered product has been the same as the reality. It is in a line with the characteristic of sharia marketing namely realistic or Al Waqi'ah where the company upholds the principle of honesty. The last step, if the consumers-to-be agree to purchase then the developer will talk about *akad* and it will be made in the form of written statement.

## **IV. CONCLUSION**

Sharia marketing is an application of business strategy within Islamic concept just like what The Prophet Muhammad SAW teaches which aims at reaching a fair and transparent solution for all involved sides. PT. Al Fatih Bangun Indonesia or well-known as ABI Properti is one of companies in the field of sharia-based housing developer service engaging sharia marketing concept in running the business. The applications of sharia business marketing concept are divided into three dimensions, namely:

### **1. Sharia Marketing Strategy**

PT. Al Fatih Bangun Indonesia applies the strategy by segmenting based on geography, demography, psychograph, and behavior. The target appointed by the company are middle up Moslem communities whose modern life style but still accentuating Islamic/sharia values and the company attempts to place the positioning as the pioneer of 100% sharia housing concept in Cibinong.

### **2. Sharia Marketing Tactic**

The product offered by PT. Al Fatih Bangun Indonesia is housing type 90/100 as many as 25 units named Ummi Residence with 100% sharia concept as well as the furniture as the additional value from offered product. The number of units sold from the beginning of PT. Al Fatih Bangun Indonesia was established in 2012 until early 2016 are 12 units from 25 units.

PT. Al Fatih Bangun Indonesia uses unique selling strategies named Sky Strategy and Land Strategy.

3. Sharia Marketing Value

The form of service given to the consumers is realized through the attitudes of all management team of PT. Al Fatih Bangun Indonesia which are friendly and full of patience in giving information about 100% sharia KPR housing scheme and also quick in responding complaints. The steps of process to transfer the service from the company to the consumers are started from educating about 100% sharia KPR housing scheme, surveying the land location, and finally performing *akad*/agreement.

Wholly, PT. Al Fatih Bangun Indonesia has applied the concept of sharia marketing well but there is still miss where the company has not had a long term relationship with the consumers.

## V. SUGGESTIONS

Based on the research result and observation, the suggestions from the researcher for PT. Al Fatih Bangun Indonesia are:

1. The company should apply customer relationship management in order to build a long term relationship by simple ways like holding Al Quran recitation between PT. Al Fatih Bangun Indonesia management and consumers once a month or holding a religious trip like *umroh* program.
2. The company should deliver information about 100% sharia KPR housing scheme by creative ways like through videos, animatic videos, short movies that can be posted on Youtube, Line, or Instagram because today is a digital era, the right time to spread information with low cost yet a large coverage in order to improve promotion by online.
3. The company should perform a cooperation with famous religious figures to help promoting the product because communities have a tendency to imitate what is done by their idols.

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**EVENT STUDY ON THE CRASH OF AIRASIA PLANE: A STUDY ON TRAVEL AND LEISURE COMPANIES LISTED AT MALAYSIAN STOCK MARKET**

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***ABSTRACT***

*This study analyzes the Malaysian stock market reaction in the event of the crash of AirAsia plane on December, 28 2014. The analysis is focused on the travel and leisure industry as the crash would affect more on this type of industry. A total of 15 companies met the selection criteria. The study uses the event study standart procedures in testing the proposed hypotheses. Results show that abnormal returns after the crash tend to decrease, yet no significant abnormal returns were found in the period before and after event. Median abnormal return after the event is significantly higher than before the event at traditional level. Another finding shows that there is no significant different on trading volume activity between before and after the event.*

**Keywords:** *abnormal return, event study, AirAsia plane crash, JELcode; G12, G14*

## IMPACT OF TRANSFORMATIONAL AND TRANSACTIONAL LEADERSHIP STYLES ON ORGANIZATIONAL COMMITMENT AND SMES BUSINESS PERFORMANCE: A COMPARATIVE ANALYSIS

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### ABSTRACT

*The success of SMEs business is contingent upon a number of variables either internal or external. Many studies have been conducted to investigate the success variables, either empirically or theoretically. One of the most essential variables are leadership styles especially transformational leadership and also transactional leadership. This study has investigated the impact of leadership styles on organizational commitment and business performance and organizational commitment on business performance of SMEs in Bali Province Indonesia. Transformational leadership considered relevant in the study were idealized influenced, inspirational motivation, intellectual stimulation, individualized consideration. Transactional leadership were constructive/contingent reward and corrective/management by exception, organizational commitment were affective, normative and continuance commitment and firm performance variables were sales growth, consumer service, success of new product and investment. The study followed a survey design using quitionaire Semantic Differential Scale to 118 manager and assistant manager of 59 SMEs. The research method is quantitative using SEM -PLS. The result showed that leadership styles had significant positive effect on organizational commitment and SMEs business performance. The study concluded that transactional leadership style was more appropriate in inducing performance in small medium enterprises than transformational leadership style and, therefore, recommended transactional leadership style for the small enterprises with inbuilt strategies for transition, the enterprises developed, grew and sustainability.*

**Keywords:** *business performance, organizational commitment, transformational, transactional*

JEL Code; M12 (Personnel Management)

### INTRODUCTION

Studies on leadership, and leadership effectiveness in particular, have extensively been conducted over the last few years. The foci of those studies have varied, related to the purposes of both organization and individuals. One of the aims of the present study was concerned with the significance of improving performance of organization through leadership (Riaz & Haider, 2010). The study conducted by

Jandaghi et al. (2009) discovered that a successful organization is one adopting an appropriate leadership style to influence all elements in the organization. This suggests that appropriate leadership will affect work effectiveness in facing the dynamics of environment both internal and external. Appropriate leadership will help organization understand the challenges faced by the

organization and competitors, as well as appropriately respond to those challenges (Bass et al, 2003). The important role leadership plays in an organization is as a catalyst especially related to human resources, more particularly in managing human capital and intellectual capital.

Of the studies on leadership behavior, transactional and transformational behaviors have received serious attention from researchers in the field of leadership (Stordeur, D'hoore, & Vandenberghe, 2001). According to McColl-Kennedy et al. (2005), transformational leadership refers to ethical leadership style, that is the ability of a leader to promote intellectual stimulus deriving from the employees' inspiration. Stephens et al. (1995) argues that transformational leadership focuses on following the purposes of the organization, and according to Bass (1985) a transformational leader uses and changes the employees' values to promote the organization's vision and purposes. Other researchers, such as Avolio et al (2004), Dvir et al (2002), claim that transformational leadership style is an inspirational method that can motivate and uses such motivation to influence employees. On the other hand, transactional leadership, according to Burns (1978), refers to the exchange of relationship between the leaders and subordinates. The main focus of transactional leadership is to clarify the relationship that exists between the leader and the subordinates wherein the former is supposed to understand the employees' needs that are in accordance with organization's purposes. (Howell and Avolio, 1993). The important role played by transactional leadership concerns the existence of transaction wherein the leader gives rewards to employees with good performance and the leader's ability to achieve the purposes of the organization, as well as giving punishment when the subordinates cannot perform as expected.

In terms of behavioral aspect, leadership also contributes significantly to organizational commitment since leadership has alternative perspectives in promoting commitment. Research has produced inconclusive findings in regard to the effect of transformational and transactional leadership on organizational commitment, and hence further research needs to be carried out. The study conducted by Swanepoel et al. (2000)

found that organizational commitment results from the role played by leadership in the implementation business strategy to achieve the purposes of the organization. Lo et al. (2009) found that transactional and transformational leaderships exert a positive impact on the purposes of the organization.

Studies examining the relationship between transformational leadership and organizational commitment have been carried out by Bycio, 2012; Chen, and Chen, 2010; Hackett, & Allen, 1995. However, studies on the relationship between transformational leadership and organizational commitment have been carried out by Yang et al (2011), Elkhordy (2013), Gumusglou (2013) and also Peachey et al. (2014). Emery and Barker (2007) found a significant positive relationship between transformational leadership and organizational commitment. The present study argues that it is necessary to develop leadership through education and training in order to build a leadership behaviour and skills leading to effective transformational leadership. Avolio et al. (2004) found that transformational leadership significantly influences organizational commitment. The study conducted by Porter (2015) examined the effect of each dimension of transformational leadership on organizational commitment. These studies suggest the significant contribution of transformational leader to motivating employees to work harder, providing opportunities to share the vision, in an attempt to create good organization related to their (employees) personal involvement as well as finishing their work (Shamir et al, 1998; Givens 2008).

While the relationship between transactional leadership and organizational commitment was carried out by Alamir (2010) who found that transactional leadership significantly influences organizational commitment. In a comparison of both types of leadership, transformational leadership is deemed to have a greater influence on organizational commitment than transactional one (Lo, Ramayah, Min & Songan, 2010). Likewise, another study (Marmaya, Torsiman et al., 2011) also found that transformational leadership has a stronger positive influence on organizational commitment than transactional leadership.

Studies conducted by Fernandes et al. (2014), Ejere et al. (2015), Abisilim et al. (2014) and Ojokuku et al. (2012) found that transformational leadership significantly affects the performance of the organization, while the results of research conducted by Obiwuru et al. (2011) showed that transformational leadership does not significant effect organizational performance of SMEs in Nigeria. While the study looked at the relationship transactional leadership with organizational performance conducted by Obiwuru et al. (2011) who found that transactional leadership significantly influence the organizational performance of SMEs elected in Nigeria. But the comparative study on the relationship between both leadership styles conducted by Tahir (2015) found that both leadership styles have a significant effect on organizational performance. Transformational leadership significantly and positively affects organizational performance, while transactional leadership significantly but negatively affects organizational performance.

Empirical studies showing the relationship between organizational commitment and business performance are presented in a study conducted by Puig et al. (2007) who found a positive relationship between organizational commitment on business performance. In the study conducted by Jing and Zhang (2014) the organizational commitment was measured in terms of five (5) dimensions, namely affective, normative, ideal, choice, and economy. From the analysis it was found that the economic commitment does not significant affect organizational performance. Other researchers such as Li (2014) found a positive and significant relationship between organizational commitment and business performance. The variable commitment was measured in terms of three dimensions, namely emotional commitment, ongoing commitment and regulatory commitment, while the organizational performance was measured in terms of four dimensions, namely rational target, open system model, employee relations and internal processes.

## **LITERATURE REVIEW**

### **Transformational Leadership**

Transformational leadership is a leadership style that was originally created by Burns (1978) to map the pattern of leadership

on the political situation at that time and then was specifically developed by Bass and colleagues (1985) leading to the important theory put forth by Avolio and Yammarino (2002). According to Bass (1985), transformational leadership is the type of leader who motivates subordinates through inspiration. Employees are challenged to develop a personality, to concentrate on intangible quality, such as sharing ideas, values and vision in an effort to build good relationships within the organization.

According to Sahgal and Pathak (2007), leaders and employees together share vision of the organization, to help employees develop themselves in order to achieve organizational goals. This means that adherents of this leadership style use the employee as the focus of work, reward and empower employees through development and build employees' motivation and confidence (Boehnke et al, 2003). According to Arachchi (2012), transformational leaders have the courage to take risks, believe in the ability of employees, have clear values, and have the ability to mobilize energy for change. Moreover, Riaz and Haider (2010) suggest that transformational leaders inspire employees and make employees to display their best ability to achieve organizational goals.

Building upon the ideas put forth by Burns (1978) later developed by Bass (1985) as well as other researchers, such as Shibru and Darsan, (2011), Arifin et al (2014), Long et al (2014) argue that transformational leadership has several characteristics (dimensions). In general, there are four (4) dimensions, namely a) idealized influence, b) inspirational motivation, c) intellectual stimulation and d) individualized consideration.

#### a) Idealized influence

This dimension refers to the perspective of employees who believe that the leader has the strength, charisma, confidence, conviction, consistency and ideas that affect the employees, so that employees are able to pull out the best performance and show respect (Mohammad et al, 2011). While Avolio et al (1991) claim that this character is represented by the nature of the sample and is capable of being able to maintain high standards. Meanwhile, according to Northouse (2001), this charismatic character means

that leaders have a special meaning capable of stimulating employees to follow in the leader's perspective.

b) Inspirational motivation.

The second dimension implies that a leader is able to understand the employee with an attitude of understanding through inspiration, persuading and motivating (Arifin et al, 2014). While according to Bruch and Walter (2007) a leader's character creates and attracts future goals and shows an optimistic attitude and enthusiasm. Moghali (2002) more specifically mentions six characteristics of the dimensions of inspirational motivation, namely a) speaking optimistically about the future, b) speaking enthusiastically about what should be done c) expressing the viewpoint that can achieve future d) showing self-confidence on the fact that will be faced, e) describing the exciting future and what must be considered, and f) being able to solve challenging problems.

c) Intellectual stimulation

The third dimension refers to the ability of a leader in answering employee questions, problem solving, and the ability to think about the work in detail and overall responsibility (Omar and Hussein, 2013). Furthermore, following Parrot (2000), a leader with this dimension leads with the best approach, able to face challenges related to the confidence and trust, and helps employees improve leadership capabilities of individual employees and organizations.

d) Individualized consideration

This dimension refers to the ability of a leader in understanding different employees, considering personal motivation, and efforts to improve the motivation of employees, and is capable of transferring responsibility to the employees as a primary goal (Kamali, 2014). On the other hand, Avolio et al (1991) shows that this character is reflected in brevity and being supportive of employees.

### **Transactional Leadership**

Transactional leadership is a leadership style that is used in behavioral sciences. The

originator of this theory is Burns (1978) who referred to this leadership style as an exchange relationship between the leader and the subordinates. Its main focus is the clarity of the role of the leader and subordinates whereby a leader must know the needs of employees in achieving the organizational goals. Bass and Stogdills (1990) and Avolio et al (2004) discuss the transactional leadership attributes in two ways, the first is contingent reward and the other is management by exception.

Hellriegel and Slocum (2006) explain that transactional leadership is based on three main components; contingent reward, management by exception and active management by exception, and passive management by exception. In contingent reward, transactional leaders give rewards in exchange for achieving the targets and the goals are of short-term type and measurable. In active management by exception, leaders monitor the performance of subordinates and subordinates eliminate deviation from the destination path. In passive management by exception, the transactional leader provides an interface when subordinates do not display optimal performance.

Transactional leadership is one that switches the interaction between subordinates for rewards and increase their productivity. In short transactional leadership provides benefits to goal achievement while penalties will be awarded if the employee does not reach the target. Furthermore, Colcuit Piccolo (2006) simply defines transactional leadership as a contractual relationship between leaders and subordinates.

### **Organizational Commitment**

According to Kanter (1968) organizational commitment refers to an attached commitment as a form of individual and emotional feelings of employees on the organization. Meanwhile Buchanan (1974) defines commitment as a partisan, individual feelings in achieving the goals and values of the organization in an organizational relationship. Furthermore, Porter et al, (1974) define organizational commitment as the identification of the strengths of individuals with involvement in any organization. Each commitment can be generalized into three factors, namely;

- a) the strength of the confidence and acceptance of the values and goals of the organization,
- b) the desire to display the best performance for the organization, and
- c) the desire to maintain the sense of being members of the organization.

Other researchers, such as O'Reilly and Chatman (1986) maintain that the organizational commitment is a psychological feeling that is felt by a person for the organization, reflected by the degree to which employees are able to adopt a character and an organizational perspective. Furthermore, Matthieu and Zajac (1990) suggest that the definition of organizational commitment is a line of relationship between employees and the organization.

Furthermore, Meyer and Allen (1984) offer a three-dimensional definition of the concept organizational commitment as follows: affective, continuance and normative.

- 1) affective refers to the emotional state of employees, identification and involvement in the organization,
- 2) continuance refers to the sensitivity to the costs incurred upon leaving the organization, and
- 3) normative refers to the reflection of feelings as an employee.

### **Business Performance**

Performance of business/ organization is a multidimensional variable. Many factors affect the performance of the business so that it makes a difference in both dimension measurement, performance indicators and perspectives. Each functional management area has different proxies to measure the performance of their respective fields. The marketing field is measured by a proxy of market share or sales growth, the financial sector is measured by a proxy of financial performance ratios, while operations are measured by proxy of effectiveness and efficiency and HR are measured through the proxy of the performance of its human resources. Studies examining business performance as associated with factors that influence it have extensively been conducted. Several studies focus on examining the aspects of marketing (Bhuiyan et al, 2005; Lee and Hseh 2010; Nasution et al, 2011). On the other hand, a study linking business performance to aspects

of personnel has been conducted by Selvarajan et al. (2007). A similar study in the fields of finance and operations has been carried out by Aktan and Bullut (2008).

Beer and Frese (2003) maintain that business performance is a subjective measure. Nevertheless, the organizational performance can be measured by using the rate of profit, the return on investment, the level of customer maintenance and sales growth. Meanwhile, according to Tippins and Sohi (2003) business performance can be measured by customer satisfaction with the products offered by a business in the last three years and the quality of the business performance. Pelham (2010) measured the performance of the business based on business efficiency, growth of the market and the ability to make profit. In a general scale, the research on business performance has been conducted by many researchers, including Slate and Nrvr (2000), Shrader (2001), Farrell (2000), Croteu and Bergeon (2001) and Monica (2007). Organizational performance can be measured in terms of return on assets, return on equity, net growth rate, and return on sales while the efficiency and effectiveness is also a measure for the performance of the organization (Lian, 2011).

Meanwhile, if viewed from the subjects in this study, namely SMEs, previous related studies have been conducted by several researchers. According Wiklund (1999), the size of the performance of small businesses used by the researchers is very diverse. Research by Wiklund (1999) deployed such performance indicators as growth and financial performance to measure the performance of small businesses, while research by Frank et al (2010) use the sales growth and cash flow growth relative to competitors as dimensional measurement. Other researchers namely Rauch et al (2005) suggest using employment growth as a proxy of performance for small businesses, because in our view the success of small businesses is more tangibly indicated by the growth of employees. But research by Fairoz et al (2010) preferred to use market share growth as a measure of business performance. The most creative research to date was carried out by Davis et al (2010). Due to the difficulty in collecting the company's business performance data a survey was used to tap on the perception of managers regarding the performance of their

organization in size (net profit) by asking for their opinion about the company's net profit.

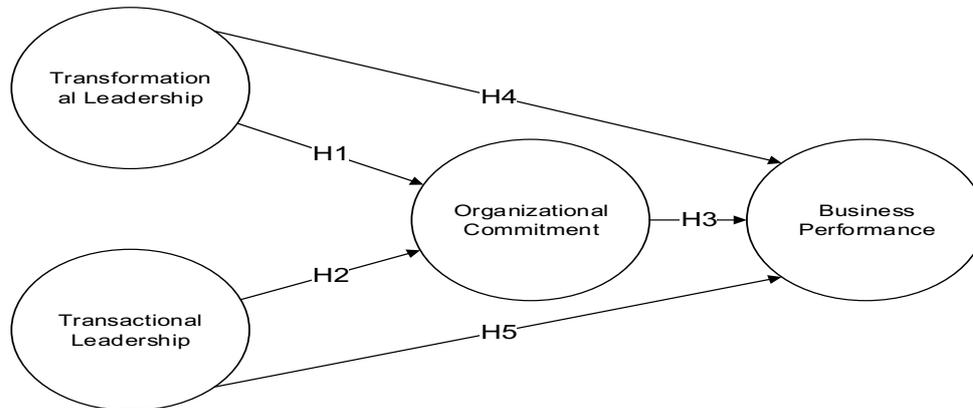
**Research Model Framework and Development of Hypothesis**

Creating a superior organizational performance from changes in an increasingly competitive world demands a different kind of leadership than what was implemented in the past. Because of the global world organizations face a rapidly changing environment and leaders face new realities and challenges.

What is now needed is a leader who can be agents of change and center of gravity, who stays focused on the internal environment and

allows people and organization to adapt and be successful, while at the same time never relinquishes customer focus and an external perspective (Alimo Metcalfe, 1998). Furnham (2002) asserts that the results of precise measurements of the quality of leadership is the effectiveness (reflects success leaders in achieving organizational results, goals, objectives and work needs of the subordinates). Thus, the size of the organizational performance in this study is represented by the extent to which the company achieves its business objectives. The research model is illustrated below:

**Figure 1**  
Research Model Framework



Source: The Research Model Framework Designed by Researcher

Swanepoel et al. (2000) found that organizational commitment results from the role played by leadership in the implementation business strategy to achieve the purposes of the organization. Gumusglou (2013), Peachey et al. (2014), Emery and Barker (2007) found a significant positive relationship between transformational leadership and organizational commitment. According to Alamir (2010) who found that transactional leadership significantly influences organizational commitment. In accordance with the above discussion, the following relevant hypothesis was inferred in this study.

- H1: Transformational Leadership will significantly and positively affect on organizational commitment
- H2: Transactional Leadership will significantly and positively affect on organizational commitment

Kanter (1968) organizational commitment refers to an attached commitment as a form of individual and emotional feelings of employees on the organization. Meanwhile Buchanan (1974) defines commitment as a partisan, individual feelings in achieving the goals and values of the organization in an organizational relationship. Puig et al. (2007) who found a positive relationship between organizational commitment on business performance. In accordance with the above discussion, the following relevant hypothesis was inferred in this study

- H3: Organizational commitment will significantly and positively affect on business performance

In the literature, the role of leadership significantly influences organizational

performance. Studies conducted by Ejere et al. (2015), Abisilim et al. (2014) and Ojokuku et al. (2012) found that transformational leadership significantly affects the performance of the organization. While the study looked at the relationship between transactional leadership and organizational performance conducted by Obiwuru et al. (2011) who found that transactional leadership significantly influence the organizational performance.

H4: Transformational Leadership will significantly and positively affect on business performance

H5: Transactional Leadership is significantly and positively affect business performance

**METHOD**

This study aims to examine the effect of transformational and transactional leadership on organizational commitment and business performance of SMEs. The theoretical relationship between leadership style and commitment, commitment and business performance as well as leadership and business performance is described as a unidirectional relationship tested statistically in a comparative

study between the two styles of leadership and their influence on organizational commitment and business performance.

**Sample and Data Collection**

To determine the sample size in this study, the probability sampling method, more particularly stratified proportional random sampling, was used, i.e. if a sample size of n drawn from a population size of N is based on grade level each unit in the sample has the same opportunities to be selected randomly (Nazir, 2003). Furthermore, according to Singarimbun and Effendi (1995) stratified random sample is proportional to a sample drawn so that each unit of study or elementary unit of the population has equal opportunities to be selected as samples. Based on the assumptions above, the number of samples taken for this study with a quantitative approach as a whole is 59 SMEs. The samples were selected randomly using probability sampling method, that is stratified proportional random sampling (Sugiyono, 2010) whereby the strata were based on the types of business as presented in Table 1

**Table 1**  
Population and Sample

No	Business Field	Number of Population	Sample
1	Fashion Designer and Manufacturer	27	24
2	Furniture and Home Decor	25	22
3	Spa and Aromatic Product	1	1
4	Specialties product	6	4
5	Accessories and jewellery	4	3
6	Service	7	5
	Total	70	59

The respondents in this study were the managers and assistant managers of the company (N = 118). The selection of the sample respondents was conducted using simple random sampling method (Sugiyono, 2010) through the lottery method without recovery (non-replacement) which means that every member of the population had an equal opportunity to be a one-time sample. The collected data were then analysed using SEM-PLS-3.

**Measurement**

As the current research aims to investigate the effects of transformational and transactional leadership on organizational commitment, and their effects on SMEs business performance, through a comparative analysis, the study examined the relationship between variables using multifaceted scales adopted from several previous researches. Furthermore, the positivist philosophy and

deductive approach was deemed to be appropriate for this type of research, and adopted to accomplish the main goal of this study. The basis for data collection and analysis is a field study in which respondents answered all items on a seven-point Semantic differential-scales ranging from “1” meaning “strongly disagree” to “7” meaning “strongly agree”. In addition, elements used to consider each of the constructs were primarily obtained from prior research. These elements provided a valued source for data gathering and measurement as their reliability and validity have been verified through previous research and peer reviews. The analysis in this study was conducted using PLS-3 SEM approach that begins by evaluating the structural equation models for the evaluation of the measurement model (outer model) which aims to determine the validity and reliability of the indicators used and

subsequently the inner model testing through the process of resampling bootstrapping.

**RESULTS**

**Evaluation of Measurement Model (outer model)**

Evaluation of the measurement model in this study aims to assess the indicators (observed variables), reflecting a construct or latent variable. Indicators were tested to give meaning or symbol to the latent variable. Testing measurement model can be explained by Convergent Validity whereby research is the initial stage of development of the measurement scale, where the values of 0.5-0.6 are considered sufficient loading factor (Chin, 1998). The test results and measurements of each study variable and indicator are presented in the table below

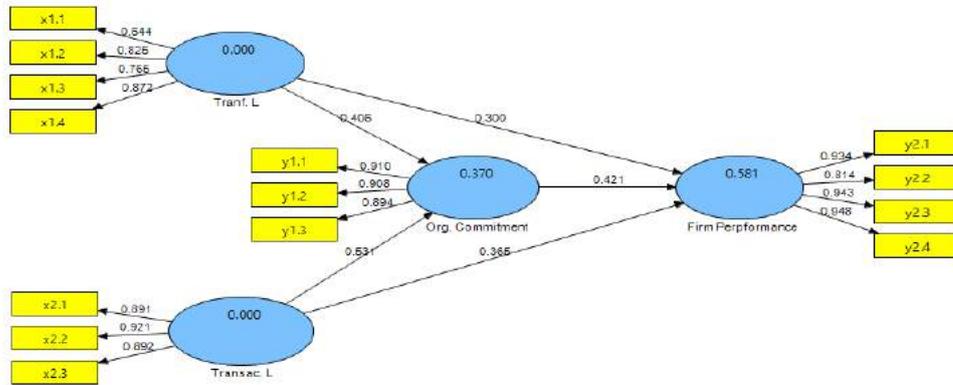
**Table 2**  
Outer Loading for Each Indicator

	<b>BP</b>	<b>OC</b>	<b>Tranf. L</b>	<b>Transc. L</b>
x1.1			0.644	
x1.2			0.825	
x1.3			0.765	
x1.4			0.872	
x2.1				0.891
x2.2				0.921
x2.3				0.892
y1.1		0.910		
y1.2		0.908		
y1.3		0.894		
y2.1	0.934			
y2.2	0.814			
y2.3	0.943			
y2.4	0.948			

From table 2 it can be seen that the values of all indicators were larger than 0.6 so that it can be concluded that the validity criteria were met. Figure 2 presents the results of PLS statistical analysis. Testing the validity of reflective indicators using the correlation between the scores of items with a score of the construct. Suitable reflective indicators used to

measure the perception that this study uses a reflective indicator. The above table shows that the loading factor gives a value above the recommended value that is equal to 0.5. The smallest value is 0.644 for transformational leadership indicator 1 (X1.1) that’s means the indicators used in this study is valid or has met the convergent validity.

**Figure 2**  
Outer Loading and Path Analysis



**Table 3**  
Cross loading

	<b>Business Performance</b>	<b>Org. Commitment</b>	<b>Tranf. L</b>	<b>Transac. L</b>
x1.1	0.187	0.109	0.644	-0.068
x1.2	0.305	0.267	0.825	-0.234
x1.3	0.268	0.196	0.765	-0.235
x1.4	0.348	0.334	0.872	-0.032
x2.1	0.410	0.386	-0.153	0.891
x2.2	0.582	0.428	-0.163	0.921
x2.3	0.336	0.427	-0.163	0.892
y1.1	0.627	0.910	0.388	0.335
y1.2	0.631	0.908	0.286	0.426
y1.3	0.592	0.894	0.168	0.488
y2.1	0.934	0.648	0.291	0.487
y2.2	0.814	0.454	0.307	0.394
y2.3	0.943	0.692	0.370	0.450
y2.4	0.948	0.663	0.365	0.503

Another method used to see the discriminant validity is to look at the value of the square root of average variance extracted

(AVE). Recommended value is above 0.5. Here are the values AVE in the study:

**Table 4**  
Table AVE

	AVE	Akar AVE
Business Performance	0.831	0.911
Org. Commitment	0.818	0.904
Tranf. L	0.610	0.781
Transac. L	0.813	0.902

The table 4 showed AVE values above 0.5 for all constructs contained in the research model. The lowest value AVE is equal to 0.610 in the construct of transformational leadership.

**Test of Reliability**

**Table 5**  
Composite Reliability

	Composite Reliability
Business Performance	0.951
Org. Commitment	0.931
Tranf. L	0.861
Transac. L	0.929

The table 5 shows that the value of composite reliability for all construct is above 0.7, indicating that all construct the model estimated meet the criteria of discriminant validity. Value composite reliability

Reliability testing is done by looking at the value of the block of composite reliability indicator that measures the construct. Composite reliability results will indicate if a satisfactory score above 0.7. Here are the composite reliability values at the output:

the lowest is at 0.861 on the construct transformational leadership style. Test reliability can also be strengthened by Cronbach's Alpha where output SmartPLS- 3 gives the following results:

**Table 6**  
Cronbachs Alpha

	Cronbachs Alpha
Business Performance	0.931
Org. Commitment	0.889
Tranf. L	0.791
Transac. L	0.886

Recommended value is above 0.6 and the table 6 shows that the value of Cronbach's Alpha for all constructs be above 0.6. Value

Lowest amounted to 0.791 on the construct of transformational leadership style. Measurement Commuality and Redundancy program SmartPLS-3 gives the following results:

**Table 7**  
Commuality Redundancy

	Commuality	Redundancy
Business Performance	0.831	0.328
Org. Commitment	0.818	0.072
Tranf. L	0.610	

Transac. L	0.813
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Table 7 shows that all construct communality values above 0.5 are reinforce the results of testing with composite reliability and Cronbach's Alpha. Furthermore, the value is equal to 0.328 business performance

redundancy is high. Once the model is estimated to meet criteria outer model, next step is testing the structural models (inner model). Here are the values of R-Square the construct:

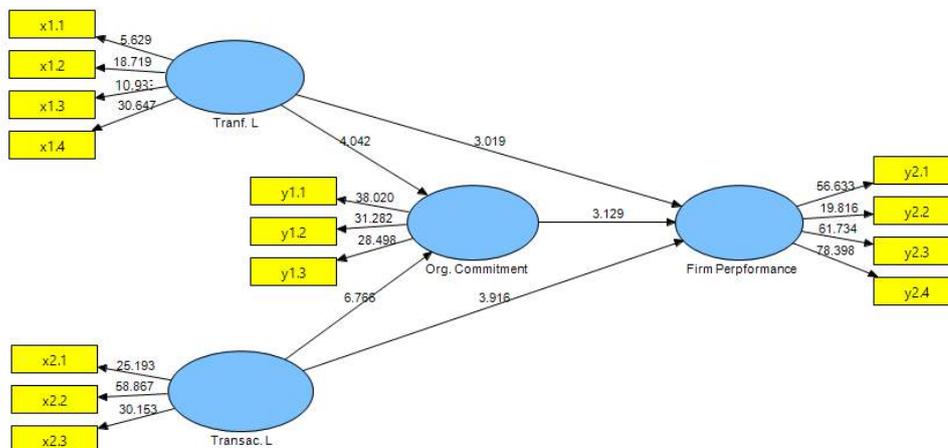
**Tabel 8**  
R square

	R Square
Business Performance	0.581
Org. Commitment	0.370
Tranf. L	
Transac. L	

As can be seen in table 8 above, 58.1% of the total variance of business performance was accounted for by the variable organizational commitment. The R square value of 0.730 for organizational commitment was the collective effect of transformational and transactional leadership. These statistical results indicate that the model was good enough

and had relevan predictive power, that is 58.1% of the total variance of business performance could be accounted for by the research variables, whereas the remaining 41.9% was accounted for by other variables. Subsequent analysis was focused on a series of tests, the results of which are shown in figure 3.

**Figure 3**  
Bootstrapping Model



**Hypothesis Testing**

The present research is a comparative study that examined the effect of transformational and transactional leadership on organizational commitment and business performance of SMEs in the

province of Bali, Indonesia. Therefore, a comparison was made of the path coefficients of the latent variables. The results of the statistical analysis are shown by the table below.

**Table 8**  
Total Effects (Mean, STDEV, T-Values)

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	Standard Error (STERR)	T Statistics ( O/STERR )
Org. Commitment - > Firm Performance	0.421	0.404	0.135	0.135	3.129
Tranf. L -> Firm Performance	0.300	0.300	0.099	0.099	3.019
Tranf. L -> Org. Commitment	0.406	0.397	0.100	0.100	4.042
Transac. L -> Firm Performance	0.365	0.375	0.093	0.093	3.916
Transac. L -> Org. Commitment	0.531	0.527	0.078	0.078	6.766

The above table shows that the relationship between transformational leadership and organizational commitment was significant with a T-statistic of 4.042 ( $> 1.96$ ). The original value of sample estimate was positive, 0.406, which indicates that the direction of the relationship between transformational leadership and organizational commitment is positive. Thus hypothesis H1 in this study which states that 'transformational leadership will significantly and positively influence on organizational commitment' was confirmed. The relationship between transactional leadership and organizational commitment was also significant, with a T-statistic of 6.766 ( $> 1.96$ ). The original sample estimate value was positive, 0,531, which shows that the direction of the relationship between transactional leadership and organizational commitment was positive. Thus hypothesis H2 in this study which states that 'transactional leadership will significantly and positively influence on organizational commitment' was also confirmed.

The relationship between organizational commitment and business performance was significant, with a T-statistics for 3129 ( $> 1.96$ ). The original sample estimate value was positive, 0.421, which indicates that the direction of the relationship between organizational commitment and business performance was positive. Thus hypothesis H3 in this study which states that 'organizational commitment will significantly and positively affect on business performance' was confirmed. The relationship between transformational leadership and business performance was significant, with a T-statistics of 3019 ( $> 1.96$ ). The original sample estimate value was positive, 0.300, which indicates that the direction of the relationship between transformational leadership and business performance was positive. Thus hypothesis H4 in this study which states that 'transformational leadership will significantly and positively affect on business performance' was confirmed.

The relationship between transactional leadership and business performance was significant, with a T-statistic of 3.916 ( $> 1.96$ ). The original sample estimate value was positive, 0,365, which shows that the direction of the relationship between transactional leadership and business performance was positive. Thus hypothesis H5

in this study which states that 'transactional leadership will significantly and positively affect on business performance' was confirmed.

### **Comparative Testing of Variables**

The table 8 above also explains the comparison between the effects of transformational and transactional leadership on organizational commitment and business performance. The path coefficient of direct relationship between transformational leadership and organizational commitment is 0.406, whereas that between transactional leadership and organizational commitment is 0,531. This suggests that transactional leadership exerts greater influence on improving organizational commitment. This is a significant finding for this study. These results disprove the results of previous studies, such as Lo, Ramayah, Min & Songan, (2010) that found transformational leadership is deemed to have a greater influence on organizational commitment than transactional one likewise, and another study (Marmaya, Torsiman and Balakrishnan, 2011) also found that transformational leadership has a stronger positive influence on organizational commitment than transactional leadership.

A direct relationship between transformational leadership and business performance of SMEs is indicated by the path coefficient of 0.300 and the path coefficient of the direct relationship between transactional leadership and business performance is 0,365. It suggests that transactional leadership plays a more important role in improving the business performance of the SMEs adopting transformational leadership. This finding is in direct contrast with the results of the study conducted by Obiwuru et al. (2011) that found transactional leadership was more appropriate in inducing organizational performance than transformational leadership style. In the study of the performance of SMEs, transactional leadership roles have a greater impact because of the nature of the exchange is in this leadership. Business performance is extracted by an exchange in the organization. Subordinates who have good performance will be rewarded, adapted to the performance targets. This confirms the role of social exchange theory in organizations in which elements of the organization obtaining payment from the performance shown.

The direct relationship between organizational commitment and business performance is shown by the path coefficient of 0.421. Statistically, it means that organizational commitment has a more substantive influence than both styles of leadership in this study. This indicates that the organizational commitment brings about a greater impact on business performance. The organizational commitment to contribute more than a leadership role, this is due to the sense of responsibility and a sense of belonging to the organization. They have the intrinsic motivation to do all the work without encouragement from the outside especially the effect of leadership styles.

## CONCLUSION AND DISCUSSIONS

### Conclusion

Transformational leadership and transactional leadership have been discussed extensively in the literature on leadership that both leadership styles have positive impacts on the organization. But partially the two types of leadership can be compared in terms of their function and role. Transformational leadership has the ability to influence subordinates through the power of leadership inspiration by evoking subordinates' emotion, while transactional leadership works through the process of transaction that exists between performance and

organizational objectives. If linked to organizational commitment both leadership styles have a significant impact, but transactional leadership is more effective because of its nature as an exchange relationship. In the context of the present study, organizational commitment is built from such relationship.

If linked to business performance, both leadership styles can also bring about a significant effect. However, transactional leadership plays a more important role since one of its dimensions, contingent reward, dictates the manager to give rewards to those employees having the short-term and measurable target. Thus, transactional leadership is more suitable for SMEs to face transition, develop business, growth and sustainability.

### Study Limitations and Future Research

This study aimed to compare the effect of transformational leadership and transactional leadership on organizational commitment and business performance of SMEs, but the results of this study cannot be generalized to all sectors of SMEs. Future research should use longitudinal data and hence can be applied to all sectors of SMEs so that the results can describe the condition of SMEs and can be applied by managers.

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## DEVELOPING SUSTAINABILITY MANAGEMENT THEORY BASED ON THE PRACTICE OF MULTI-STAKEHOLDERS PARTNERSHIPS MANAGEMENT IN AGRI-FOOD INDUSTRY

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### ABSTRACT

*The complexity of the sustainability management requires a new theory, because the current management theories can not assist individual, organization and societies to start and move toward sustainability effectively and efficiently. A proto theory developed by Starik and Kanashiro which involve multi system (input, process, output and feedback) and multi levels (individual, organization, society) perspective of sustainability management might be able to develop a theory for sustainability management. The paper objective is to propose the antecedents of organizational and inter-organizational sustainability capability to manage partnership at national level. Multi stakeholders partnerships that is usually found in the agro-food will be used as the subject of research, because it can represent the multi system and multi level required by the proto theory. The model is expected to predict that social capital mediated by the knowledge gained in the network and the efficient value chain have influences on the management of multi-stakeholder partnerships. The good management of multi-stakeholder partnership will influence the sustainability performance that consists of environment, social and economic measures. The model will propose the role of ICT as the moderator of the industrial system's life cycle improvement and as enabler in forming the sustainable information society.*

**Keywords:** *sustainability management, agro-food industry, social capital, efficient value chain, ICT*

### INTRODUCTION

#### **2030 Sustainable Development Goals and Its Relation with The Agro-Food Industry**

In 2000, as an act to get rid of poverty and hunger, leaders from 189 countries had signed the agreement to achieve Millennium Development Goals (MDGs) that consisted of 8 goals, 21 targets and 60 indicators. Fifteen years later, in 2015, those countries wanted to continue the successes of the past 15 years and set the new goals, the Sustainable Development Goals (SDGs) which aims to end poverty and hunger by 2030. The goals set reflecting the world leaders' recognition to the importance of people and planet connection which cover the goals for the land, the oceans and the waterways (UNDP, 2015).

The Sustainable Development Goals (SDGs) consists of 17 goals and 6 goals that are closely related with agro-food industry. Those related goals are Goal #2 (End hunger, achieve food security and improved nutrition and promote sustainable agriculture), Goal #8 (Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all), Goal #9 (Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation), Goal #12 (Ensure sustainable consumption and production patterns), Goal #13 (Take urgent action to combat climate change and its impacts) and Goal #15 (Protect, restore and promote sustainable use for terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land

degradation and halt biodiversity loss) (UNDP, 2015).

Indonesia's government has already taken into account the SDGs in the long term development planning. And the six (6) goals that related with Agro-Food Industry are included into 4 (four) of 9 (nine) government planning (Nawacita) (UNDP Indonesia, 2015).

The above data has shown that the industry of Agro-Food has a very important contribution to the welfare and betterment of the live of both Indonesia and the world's population. The improvement in achieving the Agro-Food Industry's sustainability will have a positive impact to the livelihood and the achievement of the SDGs to get rid of poverty in this world. Because of the connectedness of the world currently, to achieve such goals will require the participation of all parties related. The partnerships for sustainable development are multi-stakeholder initiatives voluntarily undertaken by Governments, intergovernmental organizations, major groups and others stakeholders, which efforts are contributing to the implementation of inter-governmentally agreed development goals and commitment. This multi-stakeholder partnerships are recognized in the Goal #17 as important vehicles for mobilizing and sharing knowledge, expertise, technologies and financial resources to support the achievement of the sustainable development goals particularly developing countries.

This type of the partnerships in sustainability management is extended to the cooperation between the private and the public sectors in the form of sustainability roundtables, which usually found in the agro-food and forestry sectors.

### **Sustainability in Business**

More companies are managing sustainability to improve processes, pursue growth and add value to their companies rather focusing on the reputation only (McKinsery Global Survey on Sustainability, 2011). By moving from reputation management to operational improvement, companies have shown that they are more businesslike about their sustainability

agenda. Most companies, however, are still struggling for several areas such as supply chain and the budget, so there is still a lot of potential to drive further integration and increased value creation (Bonini, 2011). Through their sustainability programs, more companies can create value in three areas which are growth, risk management and returns on capital. The value that is strongly related with this research is risk management.

Better management risks that arise from sustainability issues begins with detecting key risks of operational disruptions from climate change, resource scarcity or community issues (Bonini, 2011).

During 20<sup>th</sup> century, food prices fell by average 0.7% a year despite a significant increase in food demand. However, since 2000, food prices (in normal terms) have risen by almost 120 percent due to a declining pace of yield increases, rising demand for feed and fuel, supply side shocks (due to droughts, floods and variable temperatures), decline in global buffer stocks, and policy responses (i.e. governments in major agricultural region banning exports.) (McKinsey Global Initiative, 2013).

The increase food pricing and growth of middle class have forced the food industries organization to secure their food supply chain by increasing their sustainability programs. The sustainability programs can be related with environmental friendly yield increase and traceability

Sustainability program is the next transformation of corporate social responsibility. Porter and Kramer (2011) mention that creating shared value (CSV) is integral to a company's profitability and competitive position. While CSR programs focus mostly on reputation and have only a limited connection to the business, CSV leverages the unique resources and expertise of the company to create economic value by creating social value. Including the poor in the company's value chain is one of the example of CSV which is relevant with the current multi-stakeholders partnerships.

Although sustainability always refers to three pillars of environment, social and economic, more industry players are familiar with the economic responsibility. Corporate sustainability refers to a company's voluntary inclusion of social and environmental concerns in their business operation and interaction with stakeholders (Van Marrewijk, 2003).

Dealing with this unfamiliar territory, many corporate players struggle to match their level of sustainability concern. In order to build their social sustainability, organizations may face conflict in their collaboration and sometimes create paradoxical tensions. Organizations should set up participative settings of action and reflection and build the capacity such as reflexivity and paradoxical thinking to overcome conflict in multi stakeholders processes toward socially sustainable organization (Galuppo, Gorli, Scaratti and Kaneklin, 2014).

In other part, managers are still difficult to seek immediate financial gains from the social and environmental investments (Gao and Bandal, 2013, p. 241). And there are not much empirical studies that examining how firms effectively manage the intersection of social, environmental and economic responsibilities (Van der Byl and Slawinski, 2015).

### **Multi Stakeholders Partnerships in Agro-Food Industry in Indonesia**

One of the sustainability program in agro-food industry is multi stakeholders partnerships which is also known as "stewardship councils" and "sustainability roundtables". The partnerships is actually happened when the public authority is willing to delegate social and environmental regulation to the private sectors. It is often led to the establishment of "voluntary" standards and certification on sustainability. Voluntary means that there are not set in regulation, but in many ways, they are de facto mandatory for producers and other value chain actors if they want to supply the large processors and retailers that are increasingly demanding about certified sustainable products (Ponte, 2013).

Indonesia as one of the commodity producers have developed this kind of roundtable sustainability programs especially for palm oil, cocoa, and coffee. The players in these industries had set up multi stakeholders collaboration to create communication sharing among the members to increase productivity and farmers livelihood, also to secure the continuation of supply. For Palm Oil the collaboration is named as Roundtable on Sustainable Palm Oil (RSPO), for cocoa is Cocoa Sustainability Partnerships (CSP) and for coffee Sustainable Coffee Platform of Indonesia (SCOPI). The collaboration of multi stakeholders (industry, farmers group, government, donor agency, university and researchers) have been practiced for the past 9 years as a wake up calling to the environment degradation and the increase of food price. The main objective of the partnerships mainly is to increase productivity without neglecting the ability for future generation to utilize the benefit of the commodities for their needs.

### **Problem Statement**

Sustainability roundtables have adopted more complex web of institutional and governance of features, developed managerial systems that are time and resource consuming and enacted procedures to meet codes of good practice in standard setting and management. This slow down processes, add costs and in the long run may create stakeholder fatigue. The other negative outcome is when commercially-oriented initiatives are generally less democratic, leaner, quicker and more attuned to the industry interests, but not to the social or environmental interests, become more dominant in the roundtable. The discrimination to smaller players and the domination of bigger players or buyers often exist. The role of NGOs and social movements in roundtable is usually to place pressure for commercially oriented initiatives via retailers and the threat of consumers' boycott. This pressure have pushed the commercially-oriented initiative to adopt the inclusive and institutional features. However, this adoption come up very late (Ponte, 2013)

Because of power and resources differences, most of these programs were funded by the industries and donor agencies. With many

dollars spent in the past years, the results have not been encouraging, because the yield is stagnant and the price of commodity is still high. According to the interview with the Sustainability Head of a prominent palm oil growers (2016), the challenges to get the return of investment back is because no law enforcement to the members who do not comply which create unhealthy competition, some markets do not educate their consumer about the source of the commodity, the internal education about end to end sustainability needs the attention of leaders and lastly transparency on how the players in the value chain contribute in sustainability programs should be available.

With the complexity of the system and the pressure from the buyers, the question from the perspective partnerships' members is ***how to govern a multi stakeholder collaboration effectively and efficiently in order to achieve their sustainability performance.***

The need for a new theory in sustainability is needed because the current management theories such as Institutional Theory, RBT, Natural Resource Based View, Agency Theory, Transaction Cost, Resource Dependency Theory, Stakeholder Theory, Strategic Choice Theory and Social Network Theory can only explain the needs for sustainability. But none of the theory can assist individual, organization and societies to start and move toward sustainability by managing the intersection of those three pillars of sustainability. The complexity of sustainability management is not only a result of the need for multidisciplinary approaches, but also because of many researches are in the initial exploration.

Starik and Kanashiro (2013) mention the need for future research in sustainability management ***are to (1) seek the antecedents and outcomes of organizational and inter-organizational sustainability capability generation at regional, national and global level and (2) understand how social and environmental sustainability phenomena can be integrated for total or holistic sustainability approaches whether through integrated sustainability indicators,***

***approaches, policies, values, strategies, programs or results***

This paper has objective to propose the concept to answer the first questions about the antecedents of organizational and inter-organizational sustainability capability generation at national level. Connecting several researches related to the sustainability, value chain and social entrepreneurship is expected to enlighten the influence of key factors to manage multi stakeholders relationships in order to achieve the sustainability performance.

There are 3 (three) reasons to use agro-food industry as a model for developing sustainability management theory. First, the complexity and interconnected world have increased the inter dependency among stakeholders. On the other hand, conflicts that are happening along the value chain can reduce the effectiveness of partnerships which may influence the sustainability partnerships targets. Second, the voluntary participations and the inexistence of law enforcement can slow down the process of compliance of all members which at the end will influence the achievement of sustainability partnerships targets. Lastly, the power disparity of each members will create a dynamic in the partnerships which will influence the direction of the partnerships.

## LITERATURE REVIEW

### ***Sustainability and Sustainability Management Proto-Theory***

Pojasek (2012) proposed the definition of sustainability is the capability of an organization to transparently manage its responsibilities for environmental stewardship, social well-being and economic prosperity over the long term while being held accountable to its stakeholders and Wilson (2015) confirmed that sustainability has three pillar, economic, social and environment and the term of term of the triple bottom line to represent the three pillar component areas of sustainability : social, environmental and economic or "people, planet, profit". This triple bottom line concepts has been adopted by numerous organizations and agency.

Sustainability has risen as the next development of Resource Base Theory when Hart (1995) introduces the natural resource based view and McWilliam and Siegel (2011) stress the important of CSR as a resource that can lead to competitive advantage. and also in the same time has potential to diminish competitive advantage because of irresponsible behavior. Further, Mc William and Siegel (2011) mention that CSR may not be wholly within the control of the focal corporation, because their sub-contractor partners might not share the same value with them and can create negative CSR behavior. McWilliam and Siegel (2011) found out that it was difficult to measure CSR impact to the value of the company.

Porter and Kramer (2011) mention that creating shared value (CSV) is integral to a company's profitability and competitive position. While CSR programs focus mostly on reputation and have only a limited connection to the business, CSV leverages the unique resources and expertise of the company to create economic value by creating social value. Including the poor in the company's value chain is one of the example of CSV which is relevant with the current multi-stakeholders partnerships.

The current theories of management (Institutional Theory, RBT, Natural Resource Based View, Agency Theory, Transaction Cost, Resource Dependency Theory, Stakeholder Theory, Strategic Choice Theory and Social Network Theory) can only explain the needs for sustainability. But none of the theory can assist individual, organization and societies to start and manage their sustainability program effectively and efficiently. Theory of Sustainability Management may become one of the most holistic, strategic, participatory and time and space related theories that are applicable to a wide range of individual, organizational and societal environmental and socioeconomic opportunities and challenges.

Starik and Kanashiro (2013) suggested that the theory of sustainability management may consists of (1) attention to both natural and socioeconomic environment; (2) describing, predicting and prescribing their system

existence, value and integration (input, process and output and mutual feedback within multiple environment); (3) attention to both environmental and socioeconomic sets of sustainability issues at multiple levels (individual, organization and societal) and multiple contexts (global to local, multiple environmental context, culture, economics and communities); (4) cover many stages (formulation, implementation and evaluation) and three level of individuals, organizational and societal, applying in system analysis and developing conclusions and recommendations; (5) need to account a wide range of quality life phenomena and multiple forms of life and over various time frame; (6) recognize the need for transformational perspectives, decisions, actions and results to begin address looming catastrophes (environmental or socioeconomic or combined) and (7) explore and develop the sustainability solutions that are multilevel, systematically integrated (input, process, output and feedback) and multi stakeholder-oriented. Starik and Kanashiro (2013) has developed a proto theory that cover the multi system and multi level as shown in the Figure 1.

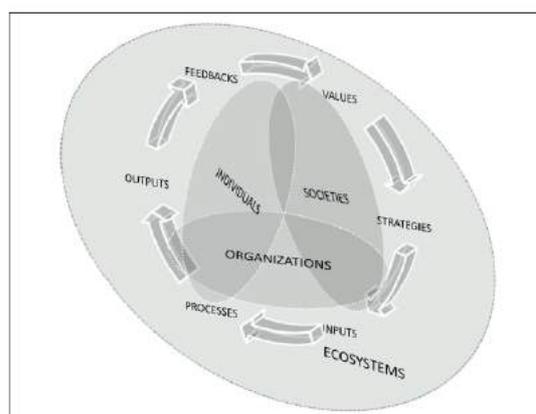


Figure 1. Multi level, multi system perspective of a proto theory of Sustainability Management (Starik and Kanashiro, 2013)

### ***Sustainability Management Antecedents in Agro-Food System : Social Capital and Resource Efficiency***

In order to build their social sustainability, organizations may face conflict in their collaboration and sometimes create paradoxical tensions. Organizations should set up participative settings of action and

reflection and build the capacity such as reflexivity and paradoxical thinking to overcome conflict in multi stakeholders processes toward socially sustainable organization (Galuppo, Gorli, Scaratti and Kaneklin, 2014).

In the agro-food system, the relationship based upon trust and cooperation are critical to the strength and vitality of the networks. This means that exploring and detailing these relationship among the suppliers, producers, workers, processors, brokers, wholesalers and retailers within specific regional geographies of these networks are critical for furthering cooperation and trust. There are two theory explaining this phenomena the social network theory and supply chain management (Jarosz, 2000). The social network theory can be explained through understanding the role of social capital in the network and the supply chain management can be explained by the theory of resource efficiency theory.

Hitt, Lee and Yucel (2002) mention that social capital facilitates the formation of alliances and contributes to the management of relationships in networks. Firms without adequate social capital may experience challenges in gaining access to resources necessary. The future alliance research has put the linkages between alliances and networks as an research opportunity. The study of networks has become a field unto itself that until recently had barely intersected the mainstream alliance literature. From alliance and collaborative perspective, networks can be defined as a set of organization linked by a set of social and business relationships that create strategic interfirm opportunities for the organizations. The social context of networks within firms are embedded, but the alliance literature has not been examined this in any detail (Inkpen, within Freeman et al, 2001).

In today's networked economy, relationships with business partners are essential to a company's survival and growth, yet most companies are struggling to design and manage their key partner relationships for long-term value creation. Most companies approach the design and management of their business partnerships by focusing on optimizing each individual alliance. Typically,

however, a company will be involved with several alliance partners, and sharing of information and knowledge across these alliances is rare. In addition, a company's alliances will often compete with one another and with the internal organization for limited resources.

Although resource efficiency has been seen as part of the overall sustainability research agenda, there is limited research explaining the links of resource efficiency to the supply chain's overall competitive advantage. Matopoulos, Barros and Van der Vorst (2015) show, especially in the agro food industry, the resources efficiency is not the responsibility of one actor but joint responsibility of all actors in the chain. The collaboration on the identification and sparing of potentially scarce materials will help improve chain robustness as well as the management of those scarce resources.

Pattberg and Widerberg (2015) discuss nine conditions for enhancing the performance of multi-stakeholder partnership for sustainable development. Although the multi-stakeholder partnership are widely perceived as a positive contribution, few studies have systematically evaluated the existing evidence for their positive performance. Those nine parameters are optimal partner mix, effective leadership, stringent goal setting, sustained funding, professional process management, regular monitoring, reporting and evaluation to support organization learning, active meta-governance, favorable political and social context and fit to problem-structure.

#### ***The Role of ICT in Sustainability***

The role of information and communication technology in sustainability has been mentioned in several researches in relation with the formation of sustainable information society, sustainability development enabler and the improvement industrial system's life-cycle sustainability.

The role of ICT in formation of sustainable information society is mentioned by Fuchs (2008). According to Fuchs (2008), the relationship of ICT and sustainability is usually related with the ecological perspective only, although the contribution of

ICT to the improvement of environmental perspective is very little and the contribution of sustainability is not limited to environmental only, but to social and economic. A sustainable information society is a society that makes use of ICTs and knowledge for fostering a good life for all human beings of current and future generations by strengthening biological diversity, technological usability, economic wealth for all, political participation of all and cultural wisdom. To achieve a sustainable information society demands a conscious reduction of profit by not investing in the future of capital, but in the future of human, society and nature. Therefore, the utilization of ICT is not limited to the hardware investment, but more to the function of ICT to improve human, society and nature.

The role of ICT in improving manufacturers of industrial systems sustainability is by helping the industrial system to improve their product life cycle approach that enable a more efficient and effective use of limited financial and natural resources. Companies usually use Life Cycle Costing (LCC) and Life Cycle Assessment (LCA) to perform cost and environmental analysis along the whole lifecycle for developing more sustainable product. However, both methodologies have two weaknesses which are limitation in supporting decision when there are a lot of alternatives available and in terms of accuracy of the estimation because the methodologies need real data from the field. Therefore, a tool set utilized ICT is developed and accepts good response from the users. With the limitation because of the span of data collected, an improvement to the tool is proposed. However, the research has shown that ICT has the role in improving the industrial system's sustainability (Cerriand Terzi, 2015). LCC and LCA is the methodologies that are used in evaluating the value chain.

Bull (2014) stated about the role of ICT as enabler for development. The paper shows that ICT can be used to contribute to sustainability through controlling systems more efficiently, facilitating behavioral changes and reducing energy consumption. This statement is consistent with Fuchs (2008). However, Bull (2014) only highlights the role

of ICT to influence environment's related behavior.

#### **PROPOSITION DEVELOPMENT**

Since the objective of this article is to contribute toward the development of the theory of sustainability management, the grand theory is directed to the development of proto- theory of sustainability management in the level of organization where all of the stakeholders of a certain commodity in Agro-Food Industry is organized in a sustainability roundtable. In Indonesia, at least there are 3 (three) roundtable sustainability programs which are for Palm Oil the collaboration is named as Roundtable on Sustainable Palm Oil (RSPO), for cocoa is Cocoa Sustainability Partnerships (CSP) and for coffee Sustainable Coffee Platform of Indonesia (SCOPI).

The conceptual development will use Agro-Food industry as the model to explain the proto theory of Starik and Kanashiro (2013) which involve multi system (input, process, output and feedback) and multi levels (individual, organization, society) perspective of sustainability management. In this research, the level chosen will be organization involved in the multi-stakeholder partnership and involve multi system (input, process, output and feedback) in the organization. The input will be knowledge derived from the interaction in the network (in this case represented by social capital) and the efficient value chain (represented life cycle of production) of each organization. The process will be the multi-stakeholder partnership management and the output will be the sustainability performance. ICT will moderate in the input to process and the process to output.

When discussing the social sustainability and multi stakeholders collaboration, the existence of network has become a critical part in building social sustainability. In relation with social network, an organization's social capital will be a key asset to build social sustainability (Galuppo et al, 2014) and the strengths of social capital can be analyzed through the dimension of the social capital (Hitt et al, 2002). Hitt et al (2002) state that

social capital facilitates the formation of alliances and contributes management of relationships in the networks. Firms without adequate social capital may experience challenges in gaining access to resources necessary. This statement is relevant to the nature of agri-food industry, where each of value chain managed by different actors that build alliances or relationship among them. Hitt et al (2002) proposed that firms with greater social capital are attractive alliance partner candidates, effective in selecting compatible and efficient alliance partners and higher probability of developing successful alliance because of their ability to manage relationships with other firms and are better able to learn from the alliances and to transfer knowledge to their partners than firms with weak social capital. There are three dimensions of social capital according to Yii-Renko, Autio and Sapienza (2001) inside Hitt et al (2002) : social interaction, relationship quality and network ties. Social interaction is necessary to establish the network and the relationship quality will define the strengths of the ties.

*Proposition 1 : the strengths of the social capital dimension of an organization will influence the level of knowledge transfer to the stakeholders*

JiFeng, Gang and Edwin (2008) mention that social capital improves openness between partners. Social capital that is accumulated incrementally through long term on going interaction between firms significantly reduces coordination and interaction costs (transaction costs) in critical information search. Close interaction helps to channel tacit knowledge between different organization members. The importance of social capital build the hypothesis

*Proposition 2 : the knowledge acquired by the network acts as mediator managing multi stakeholder partnerships.*

Fuchs (2008) mentioned that ICT has role in building the sustainable information society which is a society that makes use of ICTs and knowledge for fostering a good life for all human beings of current and future generations

by strengthening biological diversity, technological usability, economic wealth for all, political participation of all and cultural wisdom. The availability of sustainable information society can expedite the knowledge sharing, therefore

*Proposition 1a : ICT moderates the knowledge acquired by the network .*

Resource Base Theory discuss about the capability of company to create competitive advantage from the resources that they own. With the progression of time, the issue of the extinction of natural resources has been related with the sustainability and there is gap about how efficient the supply chain management in the company managed it along the value chain. Matopoulos et al (2015) suggest a framework of Resource Efficient Supply Chain and the supply chain configuration along the value chain will determine the efficiency. Since the responsibility in the value chain is not only one actor 's responsibility, the RESC configuration will influence the rate of conflict between actors. Therefore the hypothesis will be

*Proposition 3 : The more efficient the supply chain configuration along the value chain the more successful the multi-stakeholder partnerships*

Cerri and Terzi (2015) mentioned that ICT can help industry to improve the industrial system's life cycle sustainability by improving the accuracy of the data and making better decision. Since the value chain analysis uses LCA and LLC in the process, the hypothesis will be

*Proposition 3a : The involvement of ICT moderates the value chain system lifecycle to avoid conflict in multi-stakeholders collaboration through a better decision making*

Since the sustainability has three bottom line which are social, economic and environmental (Wilson, 2015), the dependence variables will be the sustainability performance in terms of 3 pillars.

Pattberg and Widerberg (2015) discuss nine condition for enhancing the performance of multi-stakeholder partnership for sustainable development. Although the multi-stakeholder partnership are widely perceived as a positive contribution, few studies have systematically evaluated the existing evidence for their positive performance. Those nine parameters are optimal partner mix, effective leadership, stringent goal setting, sustained funding, professional process management, regular monitoring, reporting and evaluation to support organization learning, active meta-governance, favorable political and social context and fit to problem-structure.

*Proposition 4 : The company that can fulfill nine parameters of multi-stakeholders partnership will have better performance in all sustainability objectives*

ICT acts as enabler in sustainability development (Bull, 2014) through the formation of sustainable information society which is a society that utilizes ICT to achieve their sustainability performance. Therefore, the hypothesis will be

*Proposition 4a : ICT enables the achievement of sustainability performance by forming the organization that use ICT to achieve its sustainability objectives*

## CONCLUSION

The multi stakeholder partnerships in Agro-Food industry can be a model to build the sustainability management theory. This conceptual paper proposes that social capital and resource efficient might be antecedents for sustainability management. With the nature of Agro-Food industry that involves multi level (in this case multi partner in each stage of value chain) and multi system (input , process and output). The input in this model are proposed as the antecedents which are social capital and resource efficient. The model is expected to contribute in building the sustainability management theory.

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## **MEASURING THE PERFORMANCE OF SHARIAH-COMPLIANT COMPANIES: THE RELEVANCE OF EARNINGS MANAGEMENT, FREE CASH FLOW AND INDUSTRY**

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### ***ABSTRACT***

*This study examines the relationship between market performance of Shariah-compliant companies with earnings management, free cash flow and industry. Data from year 2009 to 2011 was used in this study to determine the post financial crisis effect before the introduction of the Malaysia Code on Corporate Governance 2012. This study applied the method by Roychowdhury (2006) in determining the suspected firms engaged in abnormal cost of goods sold (COGS) and abnormal discretionary expenditures (DISEXP), which are the proxies for earnings management. Free cash flow was measured using operating cash flow minus capital expenditures. Linear regression was used in determining the effect of earnings management, free cash flow and industry on performance of Shariah-compliant companies in Malaysia. The results showed that the Shariah-compliant companies were able to enhance its performance through free cash flow as well as through practicing earnings management. It was found that where free cash flow is high, market performance will increase. This contradicts Zhou et al (2012) which indicated that firm performance will decline if companies have more free cash flow. The industry where a company operates in also plays a significant role in influencing performance. However, this study was not able to identify the industry that outperforms other industries as the mean comparison shows very little difference. These findings show no support of the concept that Shariah-compliant companies should fully meet the terms of Shariah principles mainly to keep away from 'gharar' (uncertainties) in business practices.*

**Keywords:** *Shariah-Compliant Companies, Earnings Management, Abnormal Cost of Goods Sold, Abnormal Discretionary Expenditures, Free Cash Flow, Industries*

## **ACCOUNTING STUDENT READINESS FOR THE ASEAN ECONOMIC COMMUNITY: MEET THE NEEDS**

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### ***ABSTRACT***

*The ASEAN Economic Community already established to integrating regional economy. One of the consequence is free movement of skilled labor towards ASEAN countries. This paper compares terms of labor needs in accounting field among ASEAN countries, to indicate opportunities and threats for accounting undergraduates. The qualitative analysis showed that there is a great opportunity for foreign graduates to fill skilled-labor needs in Indonesia. The study also surveyed accounting student AEC readiness, according requisite needed. The results of a survey of 274 accounting students in Semarang shows that the major weakness is lack of proficiency other ASEAN countries languages.*

**Keywords:** *AEC, skilled labor, accounting student, competency*

### **INTRODUCTION**

AEC (Asean Economic Community) is an integrated economic area consists of 10 ASEAN's members. Together, they agree to make an economic policy called the ASEAN Free Trade Agreement (AFTA). It is an economic policy that imposing a free trade between ASEAN countries. (Ph 2014). This program is an ASEAN efforts to save the world economy, nowadays, Europe and several countries in Americas are experiencing a global crisis. Therefore the economy point will shift to Asia, and to be faced for the continuation of the world economy. AEC program is ASEAN's

policy to prepare them self to hold the world economy

Business competition in ASEAN (Association of Southeast Asian Nations) is expected to be intense as ASEAN free market occurred in 2015. Each member of AEC getting ready to face AEC (Pomfret 2013; Suttipun 2014; Moussa & Somjai 2014; Jitpaisanwattana et al. 2015). Five core elements based for a single market and production are free flow of goods, free flow of services, free flow of investment, free flow of capital, free flow of skilled labor (Kusumasari 2015). ASEAN free market allows the product whether it be commodities or services entering Indonesia without

tariff barriers, and it also happened when Indonesia export their products. Therefore, the industries and the small and medium enterprises in Indonesia should prepare itself in order to compete. The Indonesian government has been preparing for this situation by making some policies such as revamping and improvement of infrastructure, connectivity between regions is expected to increase the competitiveness and revamping the goods distribution system becomes more efficient. Indonesia must be ready for this competition, especially Indonesian workers have to be prepared mentally and increase their ability to compete with foreign labor.

There are seven professions were released for free trade in services, because of this situation, workers and job-seekers in Indonesia should begin to worry if they do not have good quality to compete with workers from other countries. If this scenario happened, there will be more unemployment in Indonesia. AEC could be a way for Indonesian workers to develop their careers internationally, but competition with the more developed countries make Indonesian workers must have better value than foreign labor. Accountant is one of the professions that were released so it gets a lot of attention, accountants and prospective accountants in Indonesia must be ready to compete with accountants from other countries.(Steelyana 2015; Suttipun 2014; Kusumasari 2015; Hatta et al. 2016). ASEAN Agreement on the Movement of Natural Persons, ASEAN MRA on Accountancy Qualifications Reference Framework will lead to the movement of job seeker(Fukunaga 2015).

The professional associations both IAI and IAPI focus on improving competence in the accounting profession to face the AEC. Each country has its own standards in accounting, therefore, very important to establish standards and new accounting rules so that it can be used in all ASEAN countries.(Steelyana 2015; Kusumasari 2015). Indonesia has been trying to train accountants be professional in their work and competitive at the global level, by adopting the IES (International Education Standards) standard

learning system, which would create an international standards system. For that, IAI implement International Educational Standards (IES) into standarized Indonesian accounting student's outcome learning in order to get accountng graduates will be standardized internationally(Diyanty & Ghofar 2016).

Students who graduated from the accounting program can obtain their professional competence by continuing professional education or take a certification exam. It is not wrong if we take these steps, but it does not solve the problems. The real problem is most accountant from undergraduate program had not take a professional competence education. Higher education a bit late in applying for undergraduate competency standardization, because AEC started in early 2015, while standardizing competencies for undergraduates set in December 2015. Recently, rules of competency-based curriculum for universities are required to be applied in the academic year 2016/2017. This delay can be circumvented by knowing the market needs for graduates of Accounting in AEC member countries. The aim of this research is to identify the characteristics of the market requirements for bachelor of accounting, then measure the readiness of the final semester students to meet these market needs. Because of that identify the characteristics of the market needs for graduates S1 Accounting becomes an important thing to do. Adequate understanding of the competencies required will help higer education to design curricula.(Tenedero & Vizconde 2015).

Furhermore knowledge about Requirement needs for accounting field will araising awareness for accounting student abaout higher competion in AEC. Araising awareness of student is important expecially for small town accounting student which had minimum awareness about AEC impact. Raising awareness about higer competition will change student perception about what they need to meet the requirement. Challenges will attract people to feel more involved and increase the intrinsic motivation (Dudija et al. 2015). Hezberg dual factor theory states that intrinsic motivation is

motivation that is capable of being a driving force because it is an element of satisfiers for someone (Gibson et al. 2012). Gender performance difference in response in competition (Morin 2015). Competition is useful to get a high performance from male than woman (Migheli 2015; Morin 2015). Therefore they would have a different consideration of importance factors - factors that support the increasing competence of such work. By using the competence factor that has been developed in previous research regarding the readiness of accounting student (Suttipun 2014), this study measures the perceptions of accounting students about the importance of having a specific competence and how prepared the accounting student to face the AEC.

## **LITERATURE REVIEW**

### **(1) Contingency Theory of Action and Job Performance**

AEC makes the competition among jobseekers increased, to win this competition, graduates must have high performance. Therefore, an understanding of how to increase the performance becomes important. This theory is modeled that environment and role in the work is the key to high performance. Organizational performance is predicted to increase when the ability of individuals in accordance with the needs of the work within the organizational environment (Putri 2012). Therefore, an understanding of what is needed in the work environment of an organization becomes important.

### **(2) Readiness**

Readiness according to the dictionary of psychology is the development level of maturity or maturity favorable to practice an activity (Chaplin 2006). Furthermore, Readiness is a condition that must be achieved in the process of individual development in the growth of mental, physical, social and emotional (Hamalik 2008). Readiness includes the ability to prepare our bodies and minds if we want to start a series of motions related to

mental and physical readiness. Readiness that we use in this study has the context of prepare to entering the world of work. According to the dictionary of psychology (Chaplin 2006) job readiness containing two terms : (1) fully alert to react or respond, (2) the development level of maturity or maturity favorable to practice an activity. Hersey and Blanchard defining job readiness as people's ability and willingness to accomplish a specific task given (Gibson et al. 2012).

## **METHODS**

### **(1) Sample**

The population in this research is the students of the Accounting program of Economics and Business Faculty at Soegijapranata Catholic University Semarang. We used final year students of Accounting Program at Soegijapranata Catholic University as a sample because this program get an A for accreditation and has been using the IES as a competency-based curriculum so that graduates students' competency should have been ready to face the AEC. In this study, samples were obtained using judgment sampling with criterias 1) active students, 2) have taken thesis, 3) willing to fill out a questionnaire. By these criterias, we obtained a sample of 274 students. The questionnaire is divided into three parts. The first part all sample get an overview of the work and the requirements that must be met so that they understand the competition that will faced after they graduate. The second part is a questionnaire that is used to identify the important competences to be prepared to deal with this competition. The third Part is a questionnaire that is used to identify how well prepared the students of accounting to enter the AEC.

### **(2) Variables**

*Competency Importance facing the AEC 2015.* Filling out the questionnaire was conducted to determine student's perception about how important the factor of competences needed to face the AEC 2015. The indicators of this variable

using 18 indicators (Suttipun 2014). Likert-type scales (with 5 points) were used to assess all research questions. We categorized all the score that we get from the questionnaire into two. First, if scores lower than the median, we categorized into unimportant and given a code 0. If scores higher than the median, we categorized into important and given a code 1. If scores the same as the median, we do not use it in the analysis.

*Competence readiness to face AEC 2015.* The questionnaire in this study is measuring the perceptions of accounting students about their readiness to compete in the era of AEC 2015. Indicators of these variables using 18 indicators readiness which developed by Suttipun (Suttipun 2014). Likert-type scales (with 5 points) were used to assess all research questions. All scores were categorized into two, first, if scores lower than the median, will be categorized into not ready and given a code 0. If scores higher than the median, we categorized into ready and given a code 1. If scores the same as the median, we do not use it in the analysis.

### **(3) Data Analysis**

After collecting data, the team conduct 2 steps of data analysis, qualitative and quantitative analysis. Here are the details of the qualitative and quantitative analysis.

Quantitative analysis in this study is the exploratory study from some media announcement from newspapers and internet publications about types of jobs that could be filled by undergraduates accounting student identified some jobs which frequently offer was already down in our previous study (Permatahati 2015). The jobs are financial analyst, credit analyst, business analyst, internal audit, financial staff, accountant, financial consultant, account officer, account executive ((Permatahati 2015). This research reclassified requirement to identified most competency needed for accounting student.

In this study, quantitative analysis was conducted to Determine the readiness of accounting student towards the AEC. The analysis based on the respondents answer from questionnaires. The data must pass the validity and reliability test,

before the data were analyzed. Validity test is done to measure the validity of a questionnaire. In other words, the validity test shows how real a test measuring what should be measured and related to the accuracy of measuring devices to perform its duties to reach its goal (Hartono 2013). The method used to test the validity is a product person moment. Reliability indicates the accuracy and precision of measurement (Hartono 2013). Reliability testing is the process of testing a measuring instrument to determine the measure of consistency or stability of the instrument in measuring function. Reliability test equipment is using Cronbach alpha. Data analysis was done using descriptive statistical analysis tools to obtain the readiness of accounting students in the job competition in AEC

### **RESULT AND DISCUSSION**

Financial Analyst, Credit Analyst, Business Analyst, Internal Audit, Financial Staff, Accounting, Financial Consultant, Account Officer, Account Executive require interpersonal skills, English language, skills of analysis, control risk management, financial reports, communication skills, control of financial reporting standards, capability to work independently, capability to work in teams, financial applications such as: SAP. This results showed that the level of preparedness between men and women are different as shown in Table 1.

Women tend to feel ready in all factors to face the AEC compared to men respondents. Female students feel more prepared in proportion than male students. However, there are several factors which the majority of female students feel not fully ready, the factors are readiness of universities, the ability of inter-group cooperation, the ability to operate a computer, knowledge of political issues in AEC member countries, the ability to speak another language (the language of the AEC member countries), knowledge culture, the ability to negotiate, and cooperation with other parties.

The tabulation results about how important the competence to deal with AEC in men and women perception can be seen in table 2. Based on gender

perspective, the majority of male respondents consider that ability to speak English is an important factor that affecting the development of accounting education to face the AEC in 2015 (Table 2) but the majority of male respondents are not ready to face the AEC; while the majority of female respondents who considered that ability to speak English is unimportant feel ready to face the AEC with the English language skills they have (Table 3). This could be happen because the great expectations is giving to men to get the good job both financially and career, so their ability (including the ability to speak English) is regarded as essential to be able to compete, but usually

during the college years, most of the male students do not seriously in the class so that they are not prepared with the skills they have today. This may be different with a woman who think that working is just a self actualization or to help their family economy. Socially, when women get married, they expected to take care of the family, so most women would choose a job that will be able to support her role in the family than looking for a job that has a high income and a brilliant career, although in college most students women have greater success in the study so that the possibility of their capabilities far greater than male students.

**Table 1:** Indonesian Accounting Students Readiness in 2015 AEC Based on Gender

	Readiness	Male		Female	
		Not Ready	Ready	Not Ready	Ready
		%	%	%	%
1	English ability	<b>50.4%</b>	32.4%	49.6%	<b>67.6%</b>
2	Accountant's moral and ethical	<b>55.0%</b>	38.9%	45.0%	<b>61.1%</b>
3	University readiness	39.4%	42.9%	<b>60.6%</b>	<b>57.1%</b>
4	knowledge about IFRS	<b>58.1%</b>	38.1%	41.9%	<b>61.9%</b>
5	Knowledge of accounting work	<b>54.8%</b>	38.8%	45.2%	<b>61.2%</b>
6	Cooperation between groups	40.5%	41.9%	<b>59.5%</b>	<b>58.1%</b>
7	Basic ability to operate computer	42.0%	40.1%	<b>58.0%</b>	<b>59.9%</b>
8	Accounting technology ( <i>accounting software</i> )	<b>53.8%</b>	39.1%	46.2%	<b>60.9%</b>
9	Readiness to managerial system changing	<b>55.9%</b>	37.2%	44.1%	<b>62.8%</b>
10	Competition among accountants	<b>52.6%</b>	39.4%	47.4%	<b>60.6%</b>
11	Knowledge about AEC	48.5%	34.3%	<b>51.5%</b>	<b>65.7%</b>
12	Political issues in AEC member countries	49.0%	39.6%	<b>51.0%</b>	<b>60.4%</b>
13	Knowledge of the culture of AEC countries	<b>55.7%</b>	37.1%	44.3%	<b>62.9%</b>
14	Foreign language skills	47.8%	38.0%	<b>52.2%</b>	<b>62.0%</b>
15	Ability to use communication technology	44.1%	38.4%	<b>55.9%</b>	<b>61.6%</b>
16	The ability to negotiate	39.7%	42.8%	<b>60.3%</b>	<b>57.2%</b>
17	Knowledge about management changing	<b>53.7%</b>	38.2%	46.3%	<b>61.8%</b>
18	Cooperation with other parties	45.3%	37.2%	<b>54.7%</b>	<b>62.8%</b>

Source: Result from the descriptive analysis

**Table 2:** Perception of Importance of Competence for facing AEC Based on Gender

	Readiness	Male		Female	
		Not Ready	Ready	Not Ready	Ready
		%	%	%	%
1	English ability	40.5%	52.9%	59.5%	47.1%
2	Accountant's moral and ethical	45.0%	30.6%	55.0%	69.4%
3	University readiness	42.4%	33.3%	57.6%	66.7%
4	knowledge about IFRS	40.0%	46.3%	60.0%	53.7%
5	Knowledge of accounting work	40.1%	42.3%	59.9%	57.7%
6	Cooperation between groups	42.0%	40.7%	58.0%	59.3%
7	Basic ability to operate computer	41.4%	41.1%	58.6%	58.9%
8	Accounting technology ( <i>accounting software</i> )	46.2%	36.6%	53.8%	63.4%
9	Readiness to managerial system changing	38.5%	42.3%	61.5%	57.7%
10	Competition among accountants	39.2%	42.4%	60.8%	57.6%
11	Knowledge about AEC	41.4%	41.0%	58.6%	59.0%
12	Political issues in AEC member countries	35.2%	42.7%	64.8%	57.3%
13	Knowledge of the culture of AEC countries	35.8%	44.8%	64.2%	55.2%
14	Foreign language skills	39.6%	42.2%	60.4%	57.8%
15	Ability to use communication technology	44.2%	37.8%	55.8%	62.2%
16	The ability to negotiate	44.4%	40.3%	55.6%	59.7%
17	Knowledge about management changing	38.8%	41.8%	61.2%	58.2%
18	Cooperation with other parties	39.9%	43.40%	60.1%	56.6%

Source: Result from the descriptive analysis

**Table 3:** Perception of Importance of competence to deal with AEC

	Faktor	Rangking
1	English ability	1
2	Accountant's moral and ethical	4
3	University readiness	3
4	knowledge about IFRS	2
5	Knowledge of accounting work	7
6	Cooperation between groups	11
7	Basic ability to operate computer	8
8	Accounting technology ( <i>accounting software</i> )	10
9	Readiness to managerial system changing	15
10	Competition among accountants	14
11	Knowledge about AEC	6
12	Political issues in AEC member countries	16
13	Knowledge of the culture of AEC countries	12
14	Foreign language skills	13
15	Ability to use communication technology	9
16	The ability to negotiate	17
17	Knowledge about management changing	18
18	Cooperation with other parties	5

Source: Result from the descriptive analysis

**Table 4:** Indonesian Accounting Student Readiness

	Readiness	Mean	Rank
1	English ability	3,38	8
2	Accountant's moral and ethical	3,38	9
3	University readiness	3,5	1
4	knowledge about IFRS	3,38	10
5	Knowledge of accounting work	3,28	13
6	Cooperation between groups	3,47	3
7	Basic ability to operate computer	3,46	4
8	Accounting technology ( <i>accounting software</i> )	3,36	11
9	Readiness to managerial system changing	3,27	15
10	Competition among accountants	3,41	7
11	Knowledge about AEC	3,36	12
12	Political issues in AEC member countries	3,28	14
13	Knowledge of the culture of AEC countries	3,23	16
14	Foreign language skills	2,96	18
15	Ability to use communication technology	3,49	2
16	The ability to negotiate	3,42	6
17	Knowledge about management changing	3,2	17
18	Cooperation with other parties	3,43	5

Source: Result from the descriptive analysis

The descriptive analysis results gives an overview on the perceptions of respondents about the readiness of Indonesian accounting students to face the AEC in 2015, it shows from the most ready until not ready, the results are displayed in Table 4. Table 4 also shows the sequence of the perception of Indonesian accounting student readiness facing the AEC in 2015, It is seen from the mean value. The highest mean value shows Indonesian accounting students feel ready to face the AEC in 2015, which is owned by the readiness 1 (mean 3.50); while the lowest mean value shows Indonesian accounting students do not feel ready to face the AEC in 2015, which is owned by the readiness of 14 (mean 2.92).

## CONCLUSION

The results showed that all factors are considered essential to prepare the accounting graduates facing the AEC. Factors that are considered most important to enabled the students facing the AEC is primarily English language skills and knowledge of IFRS. University Readiness in establish cooperation with other parties is also considered essential, in order to facilitate the students to do student mobility and obtain an overview of the existing competition. The development of moral character and ethical for accountant is also considered important to make accounting students can compete. In terms of English proficiency, ability to work in a team or mastering of information technology, accounting Students already feel quite ready to compete in the AEC. The weakness are mastering of another language and understanding of culture and managerial patterns that vary between countries. For the next research, researcher can use the sample of undergraduate accounting student to determine the readiness facing the AEC, if we review the conformity with the competence of the graduates formed through the curriculum. Other research could also be developed to compare the readiness among AEC countries.

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## **MOTIVATION FACTORS ON ACADEMIC RESEARCH COMMERCIALISATION**

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### ***ABSTRACT***

*Universities in the 21st century are racing to commercialise their research results, as compared to traditional universities which focused merely in sharing knowledge in their research and development activities. Besides generating income for the university, academics whom involved in research commercialisation activities might gain some portion of the revenues from the research products that had been successfully commercialized. Therefore, it is important to understand the motivation factors of academic researchers because they are the main player in the commercialisation activity. By understanding their motivation factors, the policy makers are able to execute right initiatives in boosting up the commercialisation activities. Many scholars discussed the extrinsic motivation, less discussed about the intrinsic motivation, and even lesser discussed the prosocial motivation in academic research commercialisation. Thus, this study aimed to further understand the role of each motivation factors in accelerating the academic research commercialisation activities. In achieving the study's objective, this study utilised the Self-Concordance Theory as the study's framework and applied a qualitative case study approach. The informants in the study were the academic researchers from four Malaysian technical universities. The study revealed that the academic researchers were motivated by the three motivation factors in supporting their commercialisation activities. This study had found out a new definition of each factor, as compared to previous studies. It shows the type of motivation factors might be bounded by the culture and social environment of the academic researchers. It is hoped that, by knowing the right motivation factors for the academic researchers, the policy makers will execute the best strategy to motivate the novice or unexperienced academic researchers to commercialise their research results as to boost up the research commercialization rate in local universities.*

**Keywords:** *Academic research commercialisation, Extrinsic-intrinsic-prosocial motivation factors, Motivations in Commercialisation, Self-Concordance Theory.*

## **THE 'CORPORATE UNIVERSITY' TRAINING AS A MEANS TOWARDS THE IMPROVEMENT OF COMPETENCE AND PERFORMANCE OF EMPLOYEES**

### **A Case Study of PT PLN Indonesia in South Kalimantan**

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#### ***ABSTRACT***

*Indonesia is facing an era of ASEAN economic community (AEC). Some academics and experts consider AEC is unfair for less fortunate ASEAN countries. An example case is the competence gap between Indonesia and Singapore's human resources. Despite Indonesia having a very big population of 255.5 million people compared to Singapore's smaller 5.31 million people, the quality and competitiveness of Indonesia's human resources are far below Singapore's. At the ASEAN level, Indonesia is ranked number 5, behind Singapore, Brunei Darussalam, Malaysia, and Thailand. Indonesia needs a new model of labor training in order to accelerate the competence and expertise of its workforce. This study aims to look at the effectiveness of the training model i.e. 'corporate university' at the education and training unit of PT PLN in South Kalimantan, Indonesia by using three measurement variables namely 'employee participation', 'employee competence', and 'employee performance'. Structural Equation Modelling (SEM) techniques were used to analyze a sample of 120 employees who had attended the corporate university training. The results show that: 'Employee participation' at PLN Corporate University training affects the 'employee competence' by 43.6%; 'Employee participation' has a direct influence on 'employee performance' by 33% and an indirect influence on 'employee performance' by 15.7% through 'employee competence' as a mediating variable; and 'Employee competence' influences 'employee performance' by 36.1%. Following an in-depth analysis of research results, some recommendations for improving Indonesia's human resources through training programs will also be presented.*

**Keywords:** *ASEAN economic community, human resources, performance, corporate university training*

**THE EFFECT OF COMPETENCE WORKING STUDENTS IN DEALING  
WITH PERSONAL SELF-READINESS AEC (ASEAN ECONOMIC  
COMMUNITY)**

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***ABSTRACT***

*This study aims to investigate and identify the students' competence working in preparation to face AEC (Asean Economic Community) in Economics Education Study Program, Faculty of Economics and Business, Indonesia University of Education. This study is a quantitative empirical approach that involves the use of statistical analysis. This study used primary data. The tool used in this study is multiple regression analysis with SPSS software 20 version. Eighty one Economic students from batch 2014 in Indonesia University of Education are used as the unit analysis of this study. The results showed that the effect of work competence is positive and significant towards the self-readiness students in facing AEC. Based on this study, it is suggested that the students should further improve the ability in international level to be able to compete with other ASEAN countries. This study is to maximize the students' competence working in preparation to face AEC.*

**Keywords:** *Competence, Self-readiness, Student, AEC (Asean Economic Community)*

**ENTREPRENEURSHIP DEVELOPMENT MODEL BASED-ON HUMAN  
CAPABILITY:  
A CASE OF UNIVERSITY STUDENTS IN WEST NUSA TENGGARA, INDONESIA**

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***ABSTRACT***

*University students in Indonesia who are aspired to be entrepreneurs should understand the importance of human capability concept. Delivery of entrepreneurship teaching is usually conducted through transferring business knowledge and skills, which comes from outside of the students (outside-in) for their competency. To build business entrepreneur spirit, efforts to materialize students' human potentials that reflect entrepreneurship aspiration and enthusiasm are required (inside-out) and should be integrated with all competencies of the students. This entrepreneurship development is an endeavour to synergize these two patterns simultaneously to become human capability. A study conducted on university students in some universities in West Nusa Tenggara Province, Indonesia, shows that the spirit to become a business entrepreneur may be built through students' human capability. Egalitarian and sufficient academic climate strengthens the role of human capability to the spirit of becoming a business entrepreneur. The spirit is enriched by creativity to produce new ideas that may be sustainably developed. It is the spirit to make the best innovative creations for customers and related parties and to face challenging business risks and at the same time to anticipate the risks properly. Materialization of many human capabilities does not mean that mastery of competencies and material resources become less important. All needs to be developed synergically to improve entrepreneurship quality and effectiveness of Indonesian students.*

**Keywords:** *Competence, Human potential, Human Capability, Creative, Innovative*

## **INTRODUCTION**

University students in Indonesia need to have high sense of entrepreneurship to face liberalization in ASEAN nowadays. University graduates from various study programs, therefore, will be more prepared to be independent and at the same time be more competitive with universities in ASEAN countries. Among the challenges faced by university graduates in Indonesia is an expectation to be job seekers, instead of job creators. Similar to what happened in Nigeria, in a study (Musa, M.Y. and Adewale, R.S.2015) finds out, "For most graduates of tertiary institutions in Nigeria, government is still the most attractive employer of labour." Lack of job opportunities due to the weakening of real sector and competitiveness, especially in Indonesia, has caused an increase in the number of educated job seekers. This is due to the fact that "many fresh graduates leave universities without the required skills such as attitudes, skills and understanding that is needed to succeed in the working field (Rahim, H.L dan Lajin, N.F.M; 2015). This has certainly caused inconsistency between the skills university graduates have and the criteria required in the job world. This challenge requires special attention from various parties; i.e. the government, universities and students. Mind set informs us how to live this life, which eventually

determines whether or not we will be successful (R. Kasali, 2010).

It is expected that in the future education and teaching process in universities may develop sense of entrepreneurship set to Indonesian students as entrepreneurship is now considered a major contributor to global economic growth (Mc.Stay (2008) in (Ernest,K.; Matthew Somiah, K. and Samuel A,K. 2015). This is in line with experts' opinion that a country will be prosperous if at least two percent of its population are entrepreneurs. Based on its population number, which is 250 million, Indonesia will need 5 million entrepreneurs. Having a dream of a successful future, innovation ability and courage to take calculated risks as capital, an entrepreneur will be able to create and grow a business. An entrepreneur is born through a long learning process in life, which has been experienced since he/she was in school (Ciputra, 2011).

Entrepreneurship education in university is getting popular and is taught in almost all study programs of business and non-business faculties. This is in accordance with an argument (Isaacs et al., 2007) in a study (Enombo, J.P; Hasa, S.L; and Iwu, CG; 2015) stating that "Entrepreneurship education is an acknowledged component of high school curriculum which is supported by a finding of another research (Enombo,

J.P; Hasa, S.L; dan Iwu,CG; 2015), revealing that “The learners and other stakeholders in the Gabonese education system believe in the importance of entrepreneurship education”. It appears that almost 70% of learners think that they cannot open up a business at this stage of their education simply because they do not have the basic skills in entrepreneurship. This finding is relevant because it shows that entrepreneurship is not taught in Gabonese school”. Entrepreneurship has become a pioneer for business success nowadays (Kuratko/Hodgetts, 2007). Entrepreneurship teaching pattern is relatively the same, i.e. transferring elements of competencies, such as knowledge, skills, experience or other abilities. All the competency elements are conveyed through transferring business knowledge from the outside to inside of the students (outside-in). Education and teaching put understanding of entrepreneurship theory as priority (to know) or at the highest, provide entrepreneurship training (to do). Meanwhile, both do not guarantee the building of sense of entrepreneurship that is able to encourage someone to become real entrepreneur. To produce students with sense of entrepreneurship requires an initial step, i.e to grow entrepreneurship spirit from inside of the students (inside-out). “One of the most important functions of an entrepreneur is to bring together the

resources required to start and grow a business. Another key function is to innovate and bring new or different products and services to the market” (Neris F.L. dan Bill O’Gorman; 2011). Thus, entrepreneurship education pattern requires a synergy of the two patterns simultaneously, starting from the students themselves and continued with entrepreneurship materials. These patterns must be supported by academic circles in order to produce students with entrepreneurship concept and at the same time will become entrepreneurs in the future. According to Ciputra (2011), an entrepreneur-minded person is that who has ideas to create opportunities, able to innovate and is courageous to take calculated risks. Thus, entrepreneur-minded university graduates may participate in many fields. Entrepreneurs may become business people (owners), employees or managers (professional entrepreneurs), and may also take part in non-profit sector (social entrepreneurs), teachers or lecturers (academic entrepreneurs), or government employees or officers (government entrepreneurs). In addition, it is necessary to conduct “evaluated effects of entrepreneurship education on the willingness to own personal business by first degree graduates” (Musa, M.Y. and Adewale, R.S.2015).

The challenge faced by related parties in the universities both at present and in the future is to build an academic atmosphere that is able to promote the entrepreneurship spirit and to encourage explicit and implicit knowledge development to all students. It is how to bring out the *embedded* human potentials within the students to emerge through a more effective entrepreneurship education and learning process that is able to respond the current global challenges. Many

### **Entrepreneur Characteristics**

Basically anybody may become an entrepreneur as long as their entrepreneur characteristics are ready and may be materialized. According to experts, generally the characteristics cover ability to create, ability to innovate, and ability and courage to take risks. "Social entrepreneurship is a combination of three main elements namely innovation, pro-activeness and risk talking in seeking fresh opportunities in order to craft positive social impact" (Helm, 2007 in Rahim, H., and Lajin, N.F.M 2015). Private or government employees, teachers, social activities management, may become entrepreneurs as long as they carry out their roles based on the above three characteristics. Thus, university students may become entrepreneurs as long as they understand and develop the three characteristics consistently. The

myths preventing the development of students' human potentials on business must be eliminated and replaced with basic assumption that is able to convince related parties to produce sense of entrepreneurship in universities in Indonesia. Universities management, lecturers, staffs and students need to integratedly create favorable environment to facilitate the development of students' human potential on business maximally.

characteristics may be pushed by the emergence of human potentials which anybody may materialize as long as the individual is willing and determined to utilize them. On the contrary, even a business person may not automatically become an entrepreneur when the aforementioned characteristics are yet built consistently. Becoming a business person may be started instantly, for instance through legacy in a company. Meanwhile becoming a business entrepreneur must be developed through consistency of the three basic characteristics.

Entrepreneur characteristics tend to reflect an individual's spirit to create new or different ideas, and readiness and ability to innovate, to materialize the ideas in the form of works appreciated by people, to carry them out boldly, by calculating the risks. Entrepreneur characteristics indicate high intention to do activities that are useful,

have additional value and in considerative manner. An individual with entrepreneurship mind has the intent to behave to be creative, innovative human being and is bold to take calculated risks. To become university graduates with sense of entrepreneurship, university students need to understand and bring out their business potentials (positive characteristics) and at the same time be able to multiply their competencies and able to become a stimulus to produce a graduate with sense of entrepreneurship.

Entrepreneur characteristics may be developed through maximum actualization process of students' human potentials on business, together with continuous development to their business competence. By the support of favorable academic climate it is expected to expedite and facilitate development of students' entrepreneurship characteristics. It is understood that "entrepreneurship is a process of innovation and new-venture creation through four major dimensions (individual, organizational, environmental, process) that is aided by collaborative networks in government, education and institutions" (Kuratko; 2004 in Siagian, P.J.R and Simatupang, T.M. 2011).

### ***Virtual Capital***

Challenges in global business world nowadays require high, creative and

efficient adaptive ability to develop continuous excellence. Observation on the successes made by business people in overcoming their limitation of physical capital ownership proves that they have exceptional potential power. The potential is basically derived from good values set as examples by Prophet Mohammad (PBUH). The concept of Virtual Capital which is invisible, whose existence, however, is sensed by stake holders, should be utilized. The virtual capital is built from a synergy of students' intellectual capital strengthened by social capital and supported by moral capital. The presence of virtual capital is determined by the presence of business people's human potentials which may be expressed in a strong zeal and aspiration (*azzam*) along with good values. Utilization of human potentials may multiply the competencies of the students to build a robust virtual capital. Virtual capital may overcome limitations or strengthen the physical capital they already have. The utilization of virtual capital is very efficient so that it may build a more competitive and sustainable business ability. Business excellence in this turbulent era will strongly be determined by the existence of virtual capital that may be built and maintained by the ummah (Bagis 2015).

A business entrepreneur automatically becomes a business person, however, a business person may not necessarily be an

entrepreneur. While a business person may be born instantly through asset ownership (shares), it requires certain characteristics to become an entrepreneur. A business person builds material capital while an entrepreneur relies on their characteristics. Through creativity, innovation and courage to take risks, business may be introduced to stakeholders, strengthened by mutual trust, and then it is run. New innovations and ideas may be found through many things, one of which is networking with other entrepreneurs through sharing of problems and mutual learning through sharing of experiences (Welter and Kautonen, 2005 in Nerys, F.L and Bill O’Gorman). This is the essence of virtual capital that may be built by an entrepreneur in this turbulent era, so that the need of additional material capital is relatively easy and at the same time efficient.

### **Paradigm of Human Being with Human Potentials**

Becoming an entrepreneur with consistent characteristics should be started with individual positive attitude. “Entrepreneurial intentions are aimed at either creating a new venture or creating new values in existing ventures” (Vesalainen and Pihkala, 1999 in Musa, M.Y. and Adewale, R.S. 2015). Therefore, it is necessary to have a mind set about elements

of attitude in every human being. The attitude comprises a belief and zeal to struggle as well as high aspiration, as an internal motivation (inside-out) that may strengthen someone's ability (outside-in). Human being is viewed as creature with potentials, which is popularly termed as paradigm of human being with human potentials or resourced human being. This paradigm views humans not only from their competencies (ability) but also from their potentials (willingness), as a unity (human capability) which is inseparable. Thus, the paradigm of human with human ability views human in a more holistic way, and also in a more humanistic way.

To manage more humanistic human beings is not a simple matter. Making complicated matters easy can be done if managers are willing to see their subordinates as human beings with great potentials who are ready to serve for the interests of institutional system and are willing to treat human beings with all rights and obligations attached to them. The implementation of Humanly Potential Human Being Paradigm should treat workers as humanely potential human beings who are the support to develop business excellence both in the present day and in the future. To apply the paradigm, institutions are required to regard and treat their workers as:

1. A member of the institutions who has potentials for the institutions' interests.
2. An independent worker who is able to cooperate in smart ways.
3. Someone who is prepared, willing and able to adapt and develop the job.
4. Someone who is able to manage his/her own works in a responsible manner.
5. A trustworthy person.

A holistic Humanly Potential Human Being Paradigm may be indicated by inter-relatedness between competencies (knowledge, skills, experience, and other abilities) with the spirit to grow and develop the competencies as a smart worker. Humanly Potential Human Being has similar meaning with Human with Resources (Hartanto, 2009). This is because it is relevant with the efforts of empowering university students at both public and business sector in Indonesia, due to the fact that development and utilization of various Human Potentials that they already have as entrepreneurs and prospective business people. Real entrepreneurs are able to build and utilize their human potentials maximally in a conducive working climate, to make it Virtual Capital which is strategic in this era (Bagis, 2014).

## **METHODOLOGY**

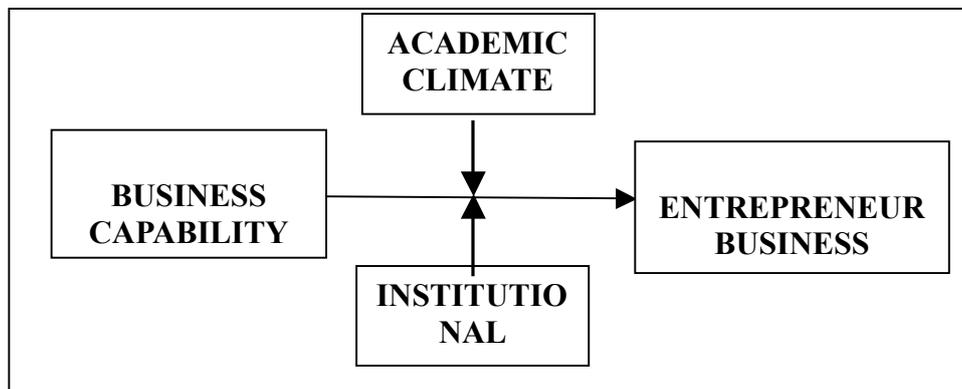
The focus of this research is to develop a business Entrepreneur model with university students as analysis subject. The observation object is students who have completed entrepreneurship subject in their programs respectively. This research was conducted using causative method, by studying unexpected variables that are estimated to be able to develop business sense of entrepreneurship to university graduates. The object of this research was a group of university students in state universities in West Nusa Tenggara. They include students from various study programs who had attended Entrepreneurship subject. The student respondents were assumed to be able to share their perceptions on entrepreneurship issues in universities. The students were also deemed to be able to express their perceptual attitude correctly and objectively. The research took place in state universities in West Nusa Tenggara. Academic population was registered students, meanwhile the respondents were those who were registered and had taken entrepreneurship subject, taken randomly totaling two hundreds students in each study program.

Research measurement objects were attitude and behaviour tendency of students

of Mataram University and Institut Agama Islam Negeri Mataram (State Islamic Institute of Mataram), and students' agreement on the academic climate an institutional support they experienced within their respective campus environment or during daily learning process. Attitude measurement was conducted based on verbal expressions of the students by selecting the statements that best fit their perceptions and feelings. The measurement technique used in this research was the application of *likert scale* with interval measurement scale. The measurement was conducted by observing respondents' data characteristics that met the requirements of interval data processing. Next, construct validation was conducted

using Factor Analysis and causative relation study using Multiple Regression.

Based on the initial concept and entrepreneurship experts support, a hypothesis model was built, depicting two main variables (*independent variable*), covering Human Potentials actualization and students' business Competencies, which was integrated into Human Capability, which was predicted to be able to build Business Entrepreneur. Further, this was strengthened with other moderating variables, i.e. academic climate and institutional support from the State Universities. The basic model of the Business Entrepreneur is described in a diagrammatic model, as follows:



**Figure 1. Research Basic Model**

Business entrepreneurship is an expression of someone's attitude that reflects strong intention to become a real entrepreneur. An intention to behave as a business entrepreneur may be built by first

evoking maximum volition to do business, supported by all understanding and ability of business that someone has (personality). Volition as the basis of building intention to become an entrepreneur may be strengthened by supporting factors, both physically

(means and infrastructure) or non-physical (psycho-social). Students' attitude conceptualized as by business human potential concept and ability is formulated by students' competency level. Both form the concept of Human Capability, which may build business entrepreneur characteristics reflecting an intention to have certain behaviour. Study on academic Environment Variables, both physical in the forms of institutional support and non-physical or conducive environment, may be integrated due to similarity in meaning according to students' perception in teaching and learning process in the university environment. The objectives of this research include: to simultaneously develop a sense of business entrepreneurship of the students based on business human potentials (positive characteristics) and business competencies (knowledge and skills) in the university, which begins with volition to materialize students' entrepreneurship goal and spirit (inside-out), and then followed by the ability to compete (outside-in) in the form of

## **FINDINGS AND DISCUSSION**

Business entrepreneurship in students indicates the level of basic character ownership, especially those who have taken entrepreneurship subject in their study program respectively. Business

up-to-date and contextual business knowledge; to motivate more effective and ethical educational development and entrepreneurship training for students in universities in Indonesia; to develop open cooperation climate and culture for related parties (university graduates, business people, regional government and community), based on mutual trust and to create young entrepreneurs from universities in order to meet the nation's expectation to continue developing excellent competitive human beings. It also aims in a short term to create understanding (*to know*) of up-to-date and contextual entrepreneurship; in a mid term, to create ability to execute (*to do*) ethical business and later ability to create bachelors who (*to be*) are inspired as competitive entrepreneurs; to compile applicative text book and to make an effort to obtain copyright; and to produce scientific publication and social engineering/public policy paradigmatically in order to develop young entrepreneurs in Indonesia.

Entrepreneur characteristics reflect intention to become business entrepreneur, which consist of the main variables, as follows: (1) Students Creative Ability (2) Students Ability to Innovate (3) Courage to take measured risks.

Results of factor analysis for

Business Entrepreneur Characteristics with the three main characteristics may be grouped into two factor solutions, which may be compared and the selected component is the most meaningful to represent the three characteristics attached to each component. In this case it is represented by component (1) which meets all three characteristics of Business Entrepreneur. Thus no new label is required. Reduction of manifest variable occurred in the three Business Entrepreneur characteristics, however, it still reflects the main character of a real business entrepreneur. The Characteristics of Creative Capability are manifested by: item 1.3 of the statement, that the students are determined to create a breakthrough preferred by the market or consumer. Item 1.4, the students are determined to face any obstacles they encounter. Item 1.5, the students are highly motivated to create potential demand. The Characteristics of Innovative Capability, shown in item 2.1 the students are capable of creating or modifying the work into more quality work. Item 2.2, the students are willing to create jobs valuable to the market. Item 2.4, the students are willing to optimally create value added. Item 2.5, the students are determined to build synergy to anybody for the sake of customer. Meanwhile, the courage to take measured risks is manifested

in item 3.3; the students have quality capability in planning correct, rational and intuitive decisions. Item 3.4, the students are highly encouraged to take risks on uncertain challenges. Item 3.5, the students are determined to adapt with uncertain, unplanned and unmeasured matters. All the manifested variables represent the characteristics of a true entrepreneur and satisfy the validation and reliability level of the Creative, Innovative and Courage to take calculated risk owned by the students with sense of entrepreneurship.

Human capability as the combination of business human potential and the students' business competency consists of 7 main variables as follows: (1) Innovative Learning Spirit, (2) Self-efficacy Spirit, (3) Hard Work Spirit, (4) Open Collaboration Spirit, (5) Aspirational Insight, (6) Ethical Insight and (7) Competency representing Knowledge, Skill, Experience and other capabilities. The results of analysis test on Human Capability factor with seven solution factors show reduced manifested variable that satisfy minimum load factor and form group in certain components as well. Based on Rotated Component Matrix (attached), each human capability element can be maintained into 7 components, with changes to content of each component that they need new label. Component (1) reflects the spirit to be

willing to work hard with aspirational and ethical insight in facing highly volatile business challenges. Thereby, its label appropriately changes to the students' "Collaborative Spirit". Component (2) can still reflect the Modernization Spirit to go with the changes. Component (3) remains to reflect the students' self-efficacy spirit. Component (4) contains the element of hard work and knowledge that it can have new label of "Smart Work Spirit". Component (5) represents limited capability that relies only on knowledge obtained from business entrepreneurship class. Component (6) reflects limited Ethical Insight. Component (7) represents limited aspirational Insight. The study result shows different interpretation of questionnaire perceived by students in West Nusa Tenggara.

Academic Atmosphere, representing human relationship between the students and the lecturers and staffs, as well as various forms of institutional support experienced in the course of being academicians, consists of 2 main variables namely: (1) Inter-student relationship, (2) Student-lecturer relationship, (3) Student-staff relationship of which the three relationships reflect academic atmosphere stimulated by psycho-social factor among the students, (4) Institutional support to facilities, (5) Infrastructure support for the students. Variables 4 and 5 reflect academic atmosphere stimulated by institutional support in the form of teaching and learning facilities provision. The results of analysis test on Academic Atmosphere Conduciveness with two solution factors show reduced manifested variable that satisfies minimum load factor and form

group in certain components as well. Based on Rotated Component Matrix, each element of Academic Atmosphere can be maintained into 2 components without undergoing the change on the content of each component, that they can keep using the old label, i.e. Academic Atmosphere that reflects physical satisfaction and Academic Atmosphere that reflects non-physical satisfaction. Component (1) reflects more on non-physical academic situation, or Academic Atmosphere, positively perceived by the students due to physical support from the Institution. Meanwhile, Component (2) reflects more on psycho-socially academic atmosphere perceived by the students as the result of harmonious relationship among the students in campus. Harmonious relationship occurs between the students and the lecturers, between the students and the staffs, and inter-students relationship in campus. The distribution of the component elements also shows similarity in meaning comprehended by the students on the academic atmosphere they perceived. However, both components may show slight differences felt and perceived by the students. Academic atmosphere felt as psycho-social condition and academic atmosphere perceived serve more as technical and management support in their study program. Based on the result of the study on various valid and reliable manifest variables, this serves as the basis for multiple regressions that include independent, dependent and moderate variables. With backward elimination method, the regression in final model shows the following:

**Table 1. Multiple Regression Model**

Independent Variable	$\beta$	eta	B	T	Significance
(Constant)	.78			3.9	.000**
Self-efficacy Spirit	.31	.4		4.9	.000**
Smart Work Spirit	.43	.5		9.9	.000**
Collaborative Spirit	.07	.1		2.7	.006**
Business Competency	-.1	-.1		-2.7	.006**
Modernization Spirit and Institutional Support	.06	.4		6.0	.000**
Self-efficacy Spirit and Academic Atmosphere	-.0	-.1		-4.3	.000**
Business Competency and Academic Atmosphere	.02	.1		2.4	.016**

Significance level:

- \* significance with  $p < 0.10$
- \*\* Significance with  $p < 0.05$
- \*\*\* Significance with  $p < 0.01$

Innovative Learning Spirit showing the spirit to follow the change can only be expressed by the students upon supportive academic atmosphere and is proven to encourage the establishment of strong business entrepreneur characteristics. Innovative learning spirit or modernization spirit of the students can be developed in positive psycho-social atmosphere perceived by the students in campus.

Harmonious relationship between the students and the lectures, the students and the staffs, and among the students themselves has proven to strengthen the impact of modernization spirit on the intention or tendency of the students to behave as business entrepreneur.

Self-efficacy Spirit shows the students' belief to be prepared to become Entrepreneur. This spirit seems to develop as the students' personal attitude that it is sufficient to drive their intention to become entrepreneur. The students' self-efficacy weakens due to academic atmosphere that

they perceived to suppress self-efficacy. The students' self-efficacy spirit is expected to boost the knowledge and entrepreneurship theory learned in class at their respective study program. The analysis study shows that self-efficacy spirit in campus correlates negatively to the students' entrepreneurship development. This can be proven that their confidence in academic environment fails to express positive belief to be prepared for business. It can be expected that what happens in academic environment in fact encourages inferiority to the students. Most of the students in their program study have lack of confidence in becoming business entrepreneur in the future. Thus the verification result shows that the students in both universities have lack of confidence leading to counter-productive effect on developing their determination to become business entrepreneur. The inferiority feeling developed all this time may dominate the spirit of students in Mataram University and Mataram Islamic Institute. This condition is worsened by the students' lack of interest since the beginning of their study and even after they took entrepreneurship class in their respective study program.

The business ethos spirit reflects more on the students' awareness to be prepared to work hard in facing various challenges to become a business

entrepreneur. They realized from the beginning that to become a true business entrepreneur requires preparedness to work hard. The willing to work hard develops not only for material motivation but rather due to positive awareness of the students. To face limited working world challenges is considered the basis of the awareness on the importance of developing early hard work spirit. The preparedness and the spirit to work hard proved that the students are able to develop determination to become a business entrepreneur.

Collaborative Spirit reflects the students' awareness on the importance of synergy collaboration in facing business and work challenges today. The open collaborative spirit is proven to be able to influence the determination of the students to become a business entrepreneur. It should be considered that the students have realized that to become a human who is creative, innovative and dare to take the risks and to become a successful business entrepreneur require collaboration with all parties. The collaborative spirit under the students' awareness expresses the willingness to collaborate with relevant parties. This spirit becomes the students' choice when they have not develop their capability to become business entrepreneur.

Aspirational and Ethical Insights that should show strong expectation and goal to

run business ethically show no contribution to the development of entrepreneurship despite of this study is based with the assumptions that the students basically have potential aspirational and ethical insights, yet they are not shown by the students in West Nusa Tenggara. These findings lead the interpretation that since the beginning, the students do not understand the meaning of goal or expectation as the main element to develop determination to become business entrepreneur. This situation supports the initial condition of students who still are not interested in becoming businessman or entrepreneur. Thus this proves their choice to be not interested in or not ready to becoming business entrepreneur since the start of their study. This turns out to be the major challenge to respond by all parties on what strategy should be taken for early development of interest in business for the students. This include introducing the meaning and benefits of strong and ethical business goal may become proper encouragement in attempt to build students' determination as true business entrepreneur.

Business capability that includes knowledge (theory of business), skill of business and other capabilities may be obtained in class and entrepreneurship practice (transfer of knowledge or skill) coming from outside of the students

(outside-in). Such capabilities are proven to have failed in influencing the development of entrepreneur determination on some students; on the contrary, they bring negative influence. This condition again proves that mastering the theory and practice does not guarantee the students to be determined in becoming business entrepreneurs. On the other hand, the study result find an interesting issue that upon obtaining the knowledge of entrepreneurship, the students are getting demotivated to become a business entrepreneur. The basis of the theory employed in this study shows that business capability will not bring significant benefits without the willingness to run the business. The students should be encouraged to express strong spirit and zeal to become a business entrepreneur. Thus, this finding support the theory that explains the importance of entrepreneurship model development based on the human capabilities of the students all over Indonesia.

The students' business capability will be able to bring actual benefit to the development of their determination to become business entrepreneurs after getting sufficient support for the university. This means that the process of developing the capability to the students requires academic atmosphere support in the form of proper

teaching and learning facilities. Technical and managerial support from the university allows the students' ability to influence the development of their determination in business entrepreneur is necessary. Sufficient academic atmosphere may be perceived as stimulus to develop the students' capability. Sufficient academic atmosphere integrates students' capability and business spirit that it becomes positive business capability as well as developing the determination to become a business entrepreneur. As such, academic atmosphere plays actual role in developing the capability and the willingness that it grows to business capability and build students' determination to become entrepreneurs. Developing Indonesian students' competency or capability to become an entrepreneur is not enough by only providing the business science and knowledge. Even skills, experience and physical ability are not sufficient to the students. Producing scholars that are determined to become a business entrepreneur is not enough only by relying on their intellectual ability. The academicians should take part by providing maximum support for the development of the students' human business potential. The institution should facilitate the students that the intellectual ability the students obtained is integrated with their business intention.

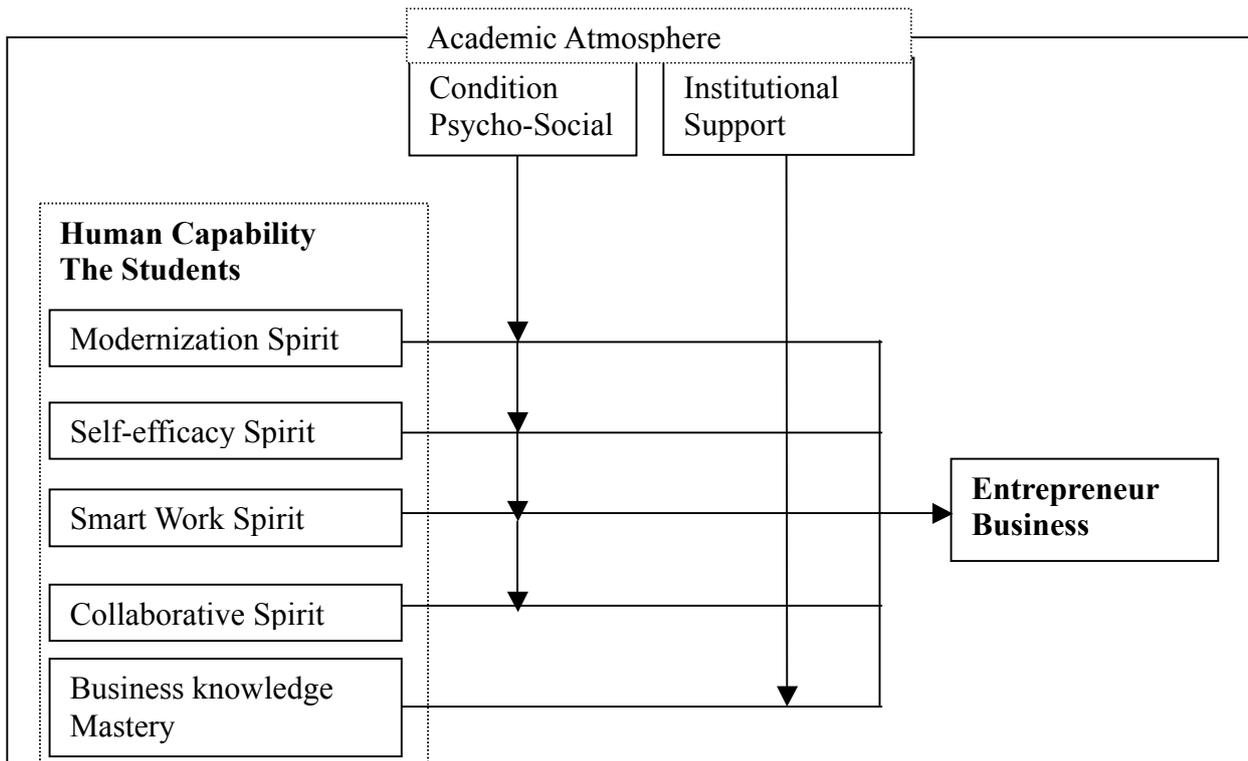
Parties at the universities should institutionally support the students to develop their intellectual, emotional and spiritual abilities in the form of Business Human Capability. Therefore the students who take entrepreneurship training and education need to choose their business interest by materializing their goals and spirit to develop their determination to become business entrepreneur.

Upon various statistical tests, Business Entrepreneur Development has slightly changed to the condition and challenges faced by university students in West Nusa Tenggara. Business Entrepreneur is proven to be significantly developed by Business Human Capability as the synergy of Business Human Potential (Willingness) and Business Competency (Capability). The universities' internal condition that shows favorable academic atmosphere is proven to be able to strengthen the influence of the students' business human capability in developing the determination to become a business entrepreneur.

The fact shows that the elements in Business Human Potential that reflect the willingness level to develop determination as entrepreneur have yet to be maximally actualized by the students in West Nusa Tenggara. Aspirational and Ethical Insight potential that reflect strong ethical goal is still embedded within the students

themselves. They do not thoroughly realize the importance of strong and ethical goal in developing a business entrepreneur determination. This also indicates that the students in West Nusa Tenggara have yet to get used to express their business interest

both verbally and non-verbally. Factual and contextual business entrepreneur development model for the students in West Nusa Tenggara is shown below.



**Figure 2. Business Entrepreneurship Development Model Conclusion**

The business entrepreneur development model is proven to be able to present the entrepreneur phenomenon in university world. The model shows the r square level of 70% meaning it is able to explain different causes and effects that significantly influence the determination to become business entrepreneur.

The result of this study shows the contribution of the students in developing business entrepreneurship shown by their capability to improve their excellence continuously relying on their various business human dan competency potentials. This study leads to the following conclusion: The study on student groups in state universities in West Nusa Tenggara shows that business entrepreneurship built through human capabilities, i.e. the integration of

business human potential and the students' competency is visible from the students' determination to comprehend the direction of business development as well as utilize the business world information. The students' capability will be shown in creativity that results in new ideas and concepts that can be sustainably improved. The students' determination can provide the best service and innovative work to the customers and relevant parties. The determination to create innovative work reflects the business ethos that can increase customers and community appreciation. The students' determination can be in the form of courage to face business risk challenges in a calculated way. It is a risk taking that can be well estimated and anticipated. All these business entrepreneurship characteristics are developed through the students' innovative learning spirit showing their modernization spirit. Competency that shows the students' self-efficacy to face business challenges. Business ethos shows hard and smart work spirit from their belief to create profitable business.

Business entrepreneurship can improve with the students' self-efficacy. This explains the increase in their self-efficacy intensity to be able to overcome any challenges in the working world. The students' knowledge, experience and physical ability form a competency that

can improve their confidence to face actual business challenges. Their confidence may be disturbed in academic atmosphere and inadequate institutional support as experienced by students in West Nusa Tenggara.

Business ethos shows high motivation to run the business and not to be easily discouraged contributes to the improved determination to become business entrepreneur. The ethos is also characterized by their strong motivation and endurance. This condition may result from the students' awareness that the business cannot be run only in a business usual way. This condition is also considered as the reflection of the students' psychological maturity in facing more competitive business world challenges. Collaborative spirit is shown by the students' willingness to have synergy collaboration. Such willingness may come from the awareness on their limited experience in running a business. The willingness to collaborate also shows their awareness on the benefit of the synergy in business collaboration that may exceed the result they make individually.

The capability, obtained by the students in entrepreneurship covers the theory and substantial knowledge on entrepreneurship. Some of study programs provide extra practice class to develop skills in running a business activity. Capability

with knowledge and skills only is proven to be insufficient to develop students' determination to become a business entrepreneur. What happens to students in West Nusa Tenggara is that with capability only they obtained it may lead to counter-productive relation towards the development of entrepreneur determination. Relying only on their capability will isolate their determination to become an entrepreneur. Such capability may bring impact when adequate and conducive institutional support is provided.

Innovative learning spirit illustrates the modernization spirit as important intellectual potential these days where business environment is highly volatile and difficult to pattern. Those with strong business entrepreneurship character should ideally require the materialization of modernization spirit to show their motivation in creating innovative improvement and modernization. Their modernization spirit grows when they experience egalitarian treatment within the university. The intensity of students' interaction with stakeholders is considered an effective organizational learning media for the students. Thus the materialization of the modernization spirit in supportive academic atmosphere convincingly gives positive contribution to developing their determination to become business

entrepreneurs particularly in improving sustainable advantageous knowledge.

It is realized that the students have aspirational and ethical insights for the future, yet often it is not demonstrated in various daily attitude and behavior or when they engage in activities outside the campus. It is assumed that the students face more problems that need quick solutions. In such a situation, business entrepreneurship is usually associated with the ability to solve short-term problems. The absence of aspirational and ethical insights is assumed to be influenced by instant culture of urban society that demands material acquisition more quickly. The determination to become business entrepreneurs is not supported by promising and noble valued future. It is assumed that students with aspirational and ethical insights, with long-term orientation are not considered to directly contribute to the development of business entrepreneurship. It is said that smart students are those who can give solution to the problem they encounter nowadays. The materialization of various human potentials should not mean that competency and physical resources mastery are less important in developing business entrepreneurship. Both of them should be developed simultaneously to improve the students' business entrepreneurship quality and effectiveness.

The study on the influence of human potential and competency or students' human capability on business entrepreneurship is still necessary that it also covers the influence of the students' business human potential completely. This is important since human capability serves as the main basis in business entrepreneurship development of students in Indonesia. People now realize the importance of materializing strong goal and ethics with high motivation as the main power of virtual capital. Such capital is invisible yet its presence can be felt and its benefit is recognized. Holders of virtual capital are believed to be more capable of facing the more volatile business world challenges nowadays, and can also improve physical capital effectiveness that is now getting expensive and limited. It is realized that the students' business entrepreneurship excellence in West Nusa Tenggara is established by their determination particularly their tendency to have certain business behaviors. High business entrepreneurship does not automatically result in high performance or profits but it provides bigger chances to the students to improve their excellence continuously instead. Therefore further study needs to be conducted on the relation between determination as business entrepreneurship with economic performance of a business

activity. Discussion on supportive academic atmosphere cannot be separated from the leadership practice in universities. We need to find out the type of leadership necessary to develop supportive academic atmosphere to raise the students' human potential maximally. To be able to improve well by relying on business capability, the universities should create transformational atmosphere based on trust and honest respect to each other within the program study. Honesty and openness become academic norms respected by all relevant parties. In such an academic atmosphere, the students feel treated as human resources with dignity and respect. Thus the actualization of the student's human potential can grow maximally through more conducive academic atmosphere. With the turbulent business world, the students' role to engage in flexible way is necessary. They should be provided with chance to have more roles in the process of decision-making. All of these can be carried out if the universities in Indonesia can develop more consistent transformational leadership. Bearing in mind that developing a determination to become business entrepreneurship is significantly influenced by actualization of the students' potential and competency, it is suggested that those who have the intention to improve business activity think about the way they behave in

developing the business. Stakeholders' support should be aimed at facilitating the development of innovative learning spirit, competency, work ethos and ethical insight of the students of small and medium business. This study is necessary because we often hear that the development and empowerment of students in the university is not effective. Thus, this is the importance of business entrepreneurship concept outreach for the stakeholders. Stakeholders should support the development of Indonesia university students, universities management, lecturers, staffs, alumni, local government and relevant agencies.

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## ENTREPRENEURSHIP WITHIN EDUCATION IN WEST JAVA: KNOWLEDGE VERSUS APPLICATION

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### **ABSTRACT**

*Today, the application of MEA opportunities for ASEAN country's free trade between countries. It demanded the Indonesian people have an entrepreneurial spirit. It demanded the Indonesian people have an entrepreneurial spirit. Therefore, entrepreneurial incorporated into the educational curriculum to instill the values of entrepreneurship to each learner. The purpose of this study to measure the relationship between the level of understanding of the concept of entrepreneurship to its application in education in West Java. This study used survey method. Research findings showed that the level of understanding of the concept of entrepreneurship in education is quite high but has a low effect on the application. Originality of this study is the object of study that focuses on the world of education that is represented by a college student in West Java, who has contracted an entrepreneurial course.*

**Keywords:** *Entrepreneurial Knowledge, Application, Entrepreneurship*

### **INTRODUCTION**

Existence of SMEs is undoubtedly because it proved able to survive and become a cog economy, especially after the economic crisis. On the other hand, SMEs also face a lot of problems, namely lack of working capital, low human resources, and lack of mastery of science and technology (Sudaryanto dan Hanim, 2002).

Other obstacles for SMEs are the relationship with prospects less clear and the planning, the vision and mission that were not

steady. This happens because most SMEs are gathering income of raising revenue, with the following characteristics: a family-owned business, using technology that is still relatively modest, lack of access to capital (bankable), and there is no separation of venture capital to individual needs (Bos-brouwers, 2010).

Small and Medium Enterprises (SMEs) are the backbone of the Indonesian economy. Global competition makes companies must be able to fight to preserve the sustainability of its business (Machmud & Sidharta, 2014) and has

a sustainable competitive advantage to be able to achieve positive growth performance (Miraza, 2015) as experienced by SMEs in developing countries. Sustainable competitive advantage occurs when an organization acquires or develops an attribute or combination of attributes that allow it to outperform competitors. MSME in the midst of globalization and high competition makes SMEs must be able to face global challenges, such as improving product and service innovation, human-resource development and technology, as well as the expansion of the marketing area (Sudaryanto, 2011).

With the entry of Indonesia into the MEA, the entire community to prepare your sue themselves in competition not only with the local community but also to the global community. Joining Indonesi into the MEA can be positive as well as negative impacts. Plus the public has the opportunity to develop business broadly through the easiness that is provided MEA. However, the negative impact is that people do not have the competence, and competitiveness will be left far behind. This competition requires people to have creative and innovative in order not lagging far behind

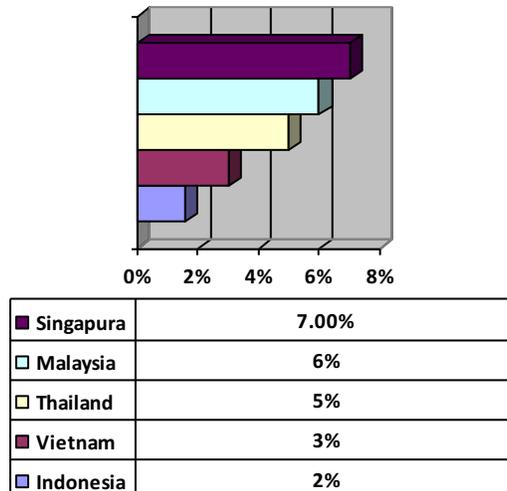
other countries, because despite the imposition of new MEA specified but many countries have prepared in advance.

It is required of every citizen to be able to prepare themselves facing rivalries in the world of MEA. One of them is to be an entrepreneur. However, the entrepreneur is not just a passion but must be based on knowledge, skills and professionalism in the run. Not just for the public to prepare, but the government also plays an important role in preparing people to become entrepreneurs who have the competence and high professionalism in order to compete. To support sustainable business growth then there should be entrepreneurial development efforts undertaken by the government and the world of education (Ardianti & Indriyani, n.d.).

**FINDINGS**

Currently, Indonesia only has the number of entrepreneurs is 1.6% of the total population of Indonesia, is still far when compared to other ASEAN countries.

Picture 1.1  
The percentage of the number of entrepreneurs in ASEAN Countries



Resource : Association of HIPMI/www.hipmi.org

Table above shows the country in ASEAN has the highest percentage of the number of entrepreneurs, taken from the site Association seeks. It is known that in the ASEAN countries which have the highest number of entrepreneurs is Singapore, which is 7% 6% followed by Malaysia, then Thailand by 5%, followed by Vietnam at 3% and Indonesia ranks only fifth at 1.6% of the total population. Indonesia should have at least 1.7 to 5.8 million new entrepreneurs to be able to catch up. Governments are therefore flocked create policies to increase the percentage of the number of Indonesian businessmen as it relates to the country's income level. One of the government's effort is to make entrepreneurship as a discipline of applied science into the curriculum.

Almost all levels of education, especially the upper middle and colleges have special knowledge about the discipline of entrepreneurship. This paper examines the application of this entrepreneurship curriculum, especially in college, how effective. It does merely understand the theory and concepts alone or have an impact on implementation in the life of a student..

## **DISCUSSION**

Entrepreneurship is a way of managing and exploiting opportunities without regard to resources currently owned (Sahlman & Stevenson, 1992), which is the result of a disciplined, systematic application of processes and innovation creativity in meeting the needs and opportunities in the marketplace (Zimmerer, 2007). Drucher (1996) stated entrepreneur is a passion, attitude, behavior; one's ability to handle the effort aimed at the effort, search, create, implement, ways of working, technologies, and new products to

improve efficiency in order to provide better service and gain greater.

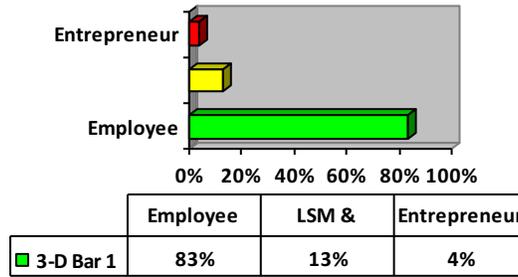
While the entrepreneur is someone who specializes in taking responsibility and make judgments that affect the location, shape, and use of goods, physical or non-physical resources more (Hébert & Link, 1989).

Initially, entrepreneurship is only considered as an inborn talent that cannot be learned. However, over the times and change the paradigm of thinking, entrepreneurship made an important thing to learn. Thus becoming its own discipline, which has been studied in every school.

Entrepreneurship education has a high priority on the policy agenda in Europe and the United States, but little research has been conducted to assess the impact of application (von Graevenitz, Harhoff, & Weber, 2010). Some previous studies found the positive impact of the program at the university on the perceived attractiveness and feasibility of the initiation of new business or even the actual startup activity or entrepreneurial education program (Fayolle, Riot, Landström, Berglund, & Gartner, 2013). However, there are also studies that found no evidence that entrepreneurship education negatively affecting the application (Oosterbeek, van Praag, & Ijsselstein, 2010).

Effects derived from entrepreneurship education is still lacking for its implementation in the real world. Kids just understand the theory and concepts alone but still not able to implement it. As shown in the table below, taken from a survey conducted by the Association seeks profession expected by students after they graduate:

Picture 1.2  
Students Desired Profession

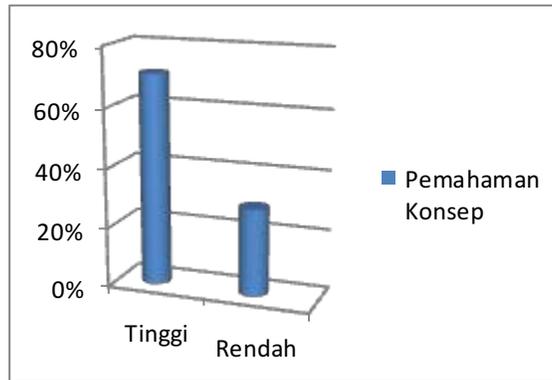


Resource : Association of HIPMI/www.hipmi.org

The above data shows that only 4% of students who have the desire to become entrepreneurs, but the government hopes is to encourage as many students to become young entrepreneurs by implementing entrepreneurship curriculum. In addition to seeing the extent to which the effectiveness of the application of the discipline of entrepreneurship in education, especially in

college in West Java then we conducted a survey to several universities in West Java. Data taken by 200 respondents who are students who have contracted entrepreneurship courses. Research instrument used in the form of a written test containing 10 pertanyaan the concept of entrepreneurship obtained the following results:

Picture 1.3  
Concept Training Level Students



Resource : Entrepreneurial Concept Knowledge Test to 200 college student in West Java

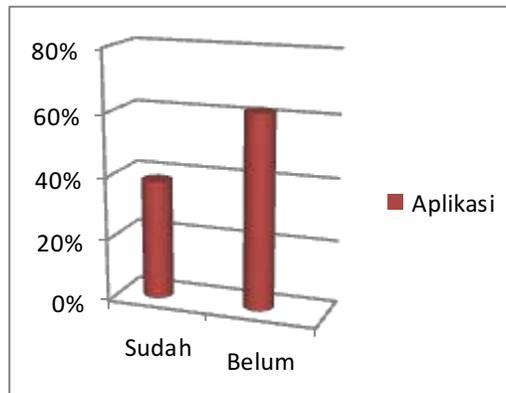
Data are the result of tests conducted on students who have contracted entrepreneurship courses. Samples represented by 200 respondents on average third-level students in several universities in West Java. That after the students in the given test understanding of concepts of entrepreneurship, the results showed that 71% of respondents, or as many as 142 students scored above 75, and the

remaining students who score below 75 is 29% or as many as 58 students.

The above results indicate that the students understanding of the concept of entrepreneurship is high means that students understand the urgency, the benefits, how to

apply and another knowledge about entrepreneurship. The next step is to give the questioner second on the application of entrepreneurship in their lives, and the results obtained are as follows:

Picture 1.4  
Enterprise Application Level



Resource : Questioner to 200 college student in West Java

From the above data, is the result of a questionnaire given to students who have already contracted entrepreneurship courses to see if the concept in understanding the students have been applied properly or otherwise. Samples represented by 200 respondents on average third-level students in several universities in West Java. Results showed that there are 38% of students who have applied entrepreneurship in his life, as many as 76 students. And there are 62% of students who have not applied entrepreneurship in his life, as many as 124 students. The above results indicate that the students understanding of the concept of entrepreneurship is inversely proportional to its application.

## CONCLUSION

The government's aim to make entrepreneurship as one of the disciplines in the curriculum of schools and universities is to cultivate the entrepreneurial spirit in children so that they understand to be a good entrepreneur. In the cognitive aspect of interest is said to be nearly successful because the level

of understanding of the concept of children is high. However, in this aspect of the application of theory and concepts of entrepreneurship in children activity is still relatively low. One reason may be that the knowledge of the risks faced to make the child more alert and cautious about run a business..

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## **A STUDY OF THE CONSUMER MOTIVE: WHY DO INDONESIAN CONSUMERS BUY PIRATED CD?**

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### ***ABSTRACT***

*The spreads of illegal music through internet received harsh criticism from musicians and record label companies. Piracy certainly has a devastating effect to the music industry; CD sales continue to decreasing globally and numerous recording companies are going bankrupt, leaving only a few big label companies. Since 2012 there are 3 major labels companies remain in the world which consists of Universal Music Group (UMG), Warner Music Group (WMG), and Sony Music Entertainment (SME), obviously it is a very small quantity compared to the past.*

*Music piracy has deeply rooted in Indonesia, leaving only 4.3 percent of legal music sales in the industry. Indonesian Songwriter and Singer Association (PAPRI) recorded in 2013 that piracy had caused loss of up to Rp4 trillion losses per year. Same thing happens in film industry where, based on Indonesian Film Producers Association (APROFI), piracy on a single film would cause around Rp4.3 billion of loss.*

*The objective of the research is to identify why people in Indonesia tend to buy pirated CD. In order to understand this, we conduct interview with 500 consumers of pirated CD live in Jakarta, Indonesia who are selected by purposive sampling method. To understand relation among variables, primary data analyzed by Path Analysis.*

*The research reaches a conclusion that Consumer motive has a significant role to form Consumer Purchase Intention; and consumer motive influenced by consumer moral judgment and consumer moral intensity but not consumer risk perception.*

**Keywords:** *Purchase intention, Moral judgment, Consumer motive, Moral intensity, Risk perception*

## INSTITUTIONAL ENTREPRENEURSHIP IN CREATIVE INDUSTRIES IN EMERGING MARKETS: A LITERATURE REVIEW

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### ABSTRACT

*In a condition when creative industries in emerging markets experience a high level of uncertainty and low level of institutionalization, the roles of institutional entrepreneurs are required. Conducting a study regarding institutional entrepreneurship in creative industries in emerging markets could reveal the detailed roles of institutional entrepreneurs in this sector, their strategies and the resulted institutions. Before organizing this study, a review is arranged to seek the discussions on institutional entrepreneurship in creative industries in emerging markets as well as to offer directions for the further institutional entrepreneurship research.*

*A narrative literature review is a method used by this study. A database search was conducted through ABI/INFORM Complete. There were 23 papers reviewed after a screening process from 205 papers. More than half of these papers analyze the roles of the institutional entrepreneurs. Albeit there are only three particular creative industries studies in emerging markets from the institutional entrepreneurship perspective, social relationship or social linkages are gathered as the important factor to cope the institutional environment. Moreover, spanning the institutional voids is the most analyzed institutional entrepreneurship strategy while the company is found as the most dominant institutional entrepreneur in this review.*

**Keywords:** *institutional entrepreneurship, creative industries, emerging markets, narrative review.*

### INTRODUCTION

Creative industries are growing rapidly nowadays. Creative industries emerge for the end of mass production and a rise in cultural consumption (Connor, 2007). The term of creative industries is used more commonly after UNESCO and UNCTAD merged the cultural industries and creative industries concept (Pratt, 2008). The official creative industries' concept which found in the decision in 1997 by the UK government was followed by the UK DCMS (Department for Culture, Media and Sport) Creative Industries Mapping Document in 1998 (Flew, 2011). The world's trade of creative goods and services reached more than double from 2002

to 2011 while the average rate of growth during this period was 8.8 percent (United Nations, 2013). These conditions were relevant with Landry (2005) who emphasizes that the creative economy grows so impressively.

The development of creative industries occurs in emerging markets as well. The creative industries' contribution to GDP and employment in one emerging market, Indonesia, reach almost the same value as UK and US albeit it happened in different years. Figure 1 shows the comparison of GDP's contribution and employment in several countries within various periods. This figure intends to prove the growth of creative industries in several emerging markets despite they were

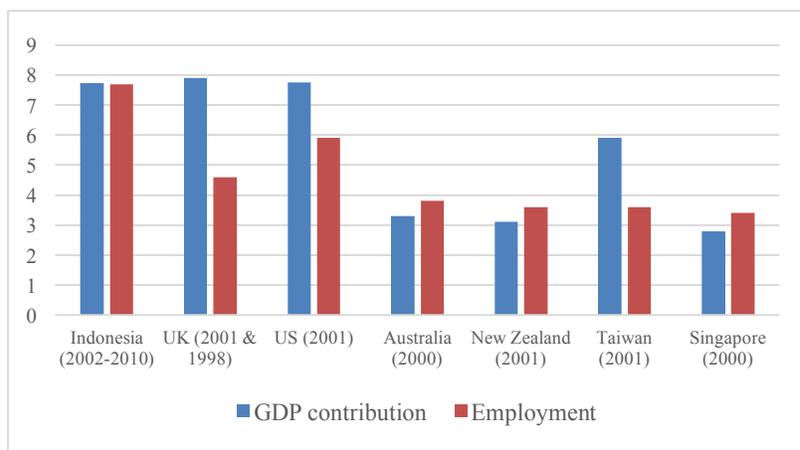
late to start which is seen in the different comparison years.

Creative industries in emerging markets experience a low level of institutionalization and high level of uncertainty which will drag the opportunities (Tracey and Phillips, 2011). Furthermore, low-level institutionalization opportunities are the exploitation area for entrepreneurs (Smallbone and Welter, 2008). Creative industries' uncertainty (De Vany, 2004; Pratt, 2008; Dempster, 2008; Peltoniemi, 2015) will lead to the entrepreneurial reaction as Dempster (2008) thought. When creative industries are developed in emerging markets, there will be processes of shaping the institutions in dealing with the commercial aspects. The act of institutionalization is a key role of institutional entrepreneurs (DiMaggio, 1988; Maguire et al., 2004; Dorado, 2005).

Institutional entrepreneurship is defined by Maguire et al. (2004) as "the activities of actors who have an interest in particular institutional arrangements and who leverage resources to create new institutions or to transform existing ones". While creative industries are defined as "those industries which have their origin in individual creativity, skill, and talent and which have a potential for wealth and job creation

through the generation and exploitation of intellectual property". UK DCMS published the Creative Industries Mapping Document specifying the 13 sectors i.e. advertising; architecture; the art and antique market; crafts; design; designer fashion; film; interactive leisure software; music; the performing arts; publishing; software and computer services; and television and radio (DCMS, 2001).

The preparatory literature search shows that Tracey and Phillips (2011) suggest investigating the formation of the field in emerging markets and the entrepreneurs' role in the institutional process. There is also a recommendation from Zahra and Wright (2011) to pay more attention to the institutional context in entrepreneurship research. Wright et al. (2005) aware the beneficial of institutional theory's utilization in emerging markets' conceptualization, but there is still a small number of studies on local start-up in emerging economies. In connection with the stated conditions and the preparatory literature search, the purpose of this study is to investigate the discussions on institutional entrepreneurship in creative industries in emerging markets. The result of this review offers directions for the institutional entrepreneurship research as well.



Source: Simarmata et al. (2011)

Figure 1. Creative Industries' Contribution to GDP and Employment (in percentage)

## METHODS

This study applies narrative literature reviews method. According to Green et al. (2006), this

variety is helpful in presenting a broad perspective on a topic and often describe the history or development of it. The first step in this study was selecting the source of information.

Starting the literature search through the electronic database is considered as the most efficient way. Hence, this review started from an electronic database and the chosen database was ABI/INFORM Complete. ABI/INFORM contains a wide variety of business information, from scholarly journals and dissertations, to company, industry, and market focused trade news. There are over 30,000 business-related dissertations and over 10,000 business cases and case studies in full text (Proquest, 2016).

The second step was defining the search terms and delimiting. In this phase, it is important to set the specific parameters by preparing several keywords as the boundaries. These boundaries can keep the relevancy of the generated literature. The keywords used in this research were the phrases “institutional entrepreneurship”, “creative industry” and “emerging market”. The searching process utilized Boolean logic in order to build a search string of the synonyms and connected concepts. The search string might look like: (institutional entrepreneurship OR institutional entrepreneur) AND (creative industries OR creative industry) AND (emerging market\* OR emerging econom\*). These phrases were searched in ‘Anywhere’ from the title, abstract to the full text of the paper. The type of the selected paper was limited to the papers that posted in the full text and peer-reviewed papers. The limitation was applied to the paper’s publication time as well. The UK DCMS firstly published the Creative Industries Mapping Document in 2001 and after that, the development of creative industries was spreading to the emerging markets until now. Hence, the searching period of the papers’ publication date started from 1 January 2001 until 14 March 2016 when this review was started.

Applying the selection criteria was the next step. The filters or criteria have the same function with the keywords. They keep the focus of the searching for the relevant papers. The first filter

was language and author only chose English for the papers searched. Location of the study as the second filter was limited only to emerging markets such as all countries in Asia except Japan, all countries in Africa, all countries in Latin America and all countries in Eastern Europe. The last filter is the subject which was limited to entrepreneurship OR entrepreneurs OR developing countries--ldcs OR emerging markets OR small & medium sized enterprises-sme OR culture OR small business. There were 205 papers generated after applying these three filters.

The next step of this study was manually screening the titles and abstracts of the retrieved papers. The screening process searched for the most relevant to the topic and had resulted in 22 papers. These selected papers at least contain ‘institution’ and ‘entrepreneur’ phrase or its extension in the paper’s title or abstract or content. Before gathering those 22 papers, the author had found one paper of Tracey and Phillips (2011) as cited in the introduction section which was examined in this study as well.

## FINDINGS

As this study uses narrative overview type, it reports author’s finding by summarizing the contents of each paper (Green et al., 2006). The synthesis went from 205 keyword-generated hits to 22 papers. Including one paper found earlier, a total of 23 papers met the inclusion criteria.

There are various methodological approaches applied by the reviewed papers. The majority of the papers are categorised as qualitative research. There is a dominant usage of case study approach while documentary analysis and interviews are also found as the dominant methods. Only four papers are categorised as quantitative research by conducting a survey and two papers organize mixed methods approach. All of these papers’ research design and their purposes can be seen in Table 1 below.

**Table 1:** Paper’s Research Purpose and Design

Study	Reference	Purpose	Research Design
1	Gibb (2006)	Analyse the design of effective support systems for MSMEs development	Qualitative Research. Documentary analysis method
2	Kalantaridis et al.	Examine the distinctiveness of rural	Mixed Method Research.

	(2007)	entrepreneurship upon institutional setting and its implications in post-socialist countries	3 case studies in 3 different areas use 2 stratified random sampling surveys to 900 general respondents and to 300 entrepreneurs
3	Kshetri (2007)	Examine the influence of institutional change to the entrepreneurship promotion in China	Qualitative Research. Documentary analysis method
4	Roxas et al. (2007)	Propose conceptual framework of institutional factors in shaping entrepreneurial climate for MSMEs in city scope	Qualitative Research. Documentary analysis method
5	Roxas et al. (2008)	Propose conceptual framework that shows the relation between institutions and strategic choice of MSMEs	Qualitative Research. Documentary analysis method
6	Miller et al. (2009)	Compare the relationships of community and connection in family businesses and non-family businesses and their impact on the performance of the emerging market of high-technology sectors	Mixed Methods Research. Questionnaires distribution and interviews with 170 CEOs of high-technology firms
7	Mair and Marti (2009)	Examine institutional voids and the institutional entrepreneurs' activities in addressing the voids and to advance theory on institutional entrepreneurship	Qualitative Research. Case study with 40 semi-structured interviews (as primary data source), observations and documentary analysis
8	Tracey and Phillips (2011)	Analyse the relationship between institutional uncertainty and entrepreneurship in emerging markets	Qualitative Research. Documentary analysis method
9	Liu (2011)	Investigate the influence of institutional voids toward high-tech ventures' innovation and the strategies of high-tech entrepreneurs deployed in coping their encountered institutional environments	Qualitative Research. Case study uses in-depth interviews with 9 CEOs of high-tech ventures and some additional interviews with government officials, associations, and investors
10	Jurse and Lejko (2012)	Examine the internationalization of SMEs in Slovenia and explore the institutional mechanism to support it	Qualitative Research. Explorative approach uses interviews with 125 SMEs
11	Arasti et al. (2012)	Identify the effective normative institutional factors on entrepreneurial intention in Iranian context	Qualitative research. Semi-structured interviews with 10 entrepreneurs
12	Brundin and Wigren-Kristoferson (2013)	Investigate the strategy of family business' owner in combining traditional heritage and new competition changes	Qualitative Research. Interviews with 6 key persons of family business
13	Pinto and de Souza (2013)	Analysis of the evolution of apparel industry in Brazil regarding the impact of global sourcing to value upgrading and the impact of creative industries phenomenon to the apparel production	Qualitative Research. Case study by interviews and documentary analysis.
14	Yu and Dong (2013)	Deal the problems and challenges of e-commerce innovation in Chinese SMEs	Qualitative Research. Multiple case studies in 12 firms by interviews, field visit and documentary analysis
15	Wahid and Sein (2013)	Study the interrelationship between the mechanisms of institutionalization in information system (IS) implementation	Qualitative Research. Case study by interviews with 11 key persons
16	Ntayi et al. (2013)	Examine institutional framing for entrepreneurship in a sub-Saharan	Quantitative Research. Random sample survey to 659 SMEs in 2

		context and give solution to the start-up problem in Uganda	districts.
17	Ntayi et al. (2014)	Provide suggested policy and managerial actions required in solving the existing low entrepreneurial capital problem in Uganda	Quantitative Research. Cluster and simple random sampling survey which results in 4498 questionnaires to be analysed from 11,105 SMEs
18	Cao et al. (2014)	Examine the role of institutional entrepreneurship in opportunity formation and opportunity exploitation in developing strategic new industries	Qualitative research. Historical case studies use documentary analysis
19	Almeida et al. (2014)	Present an analytical narrative of the Brazilian functional yogurts market's construction	Qualitative research. Exploration of factual evidence and combined with documentary analysis
20	Gupta et al. (2014)	Explore institutional environment for entrepreneurship in emerging economies	Quantitative Research. Survey to 809 business major students
21	Aggestam (2014)	Analyze entrepreneurial capital based on institutional change	Qualitative Research. Case study in 3 medium-sized companies by ethnography
22	Urban (2014)	Study the influence of institutional logic on social outcomes	Quantitative Research. Survey to 165 respondent
23	Kshetri (2014)	Compare and contrast the key indicators related to impacts, performance measures and determinants of entrepreneurship between two countries	Qualitative research. Multiple case studies use documentary analysis

Table 1 shows the development of study regarding institution and entrepreneurship up until the present. The variety of methodology used, the field of business, units of analysis and location of study from these twenty-three papers provide a challenging area for the author to review. This review concentrates on four main parts. First, institutional entrepreneurship in creative industries in emerging markets analysis. The second part is the institutional entrepreneurship. The third section covers the creative industries while the emerging market is explained in the last part.

**(1) Institutional entrepreneurship in creative industries in emerging markets**

This is the most important part of the review since it covers all the phrases discussed. From all 23 examined papers, there is only one paper studies institutional entrepreneurship in creative industries, as its main field of study, in emerging markets. A study from Liu (2011) explicitly states institutional entrepreneur. Nine software and application firms in China which their CEOs had been interviewed in this study are categorized as creative industries sub-sector. This paper discovers that institutional voids give negative

and positive impacts to the high-tech ventures' innovation. Moreover, *guanxi*<sup>1</sup> and government involvement help the firms to face the negative impacts of the institutional voids. On the other hand, institutional voids offer the opportunity to the firms for developing innovative business models. When the entities of *guanxi*, government bodies or firms in individual or group fill the institutional voids, they play the roles of institutional entrepreneurs.

It is found other two papers study institutional entrepreneurship in creative industries, as one of their several fields of study, in emerging markets. Miller et al. (2009) note 30.6 percent of their samples are the computer and related firms (where software and computer services are most probably included). They compare family business and non-family business technology firms as institutional entrepreneurs in institutional voids fulfillment. Community and connection are agreed as beneficial aspects to fill the institutional voids. Another study, Tracey and Phillips (2011) give an example of clothing retail when explaining the institutional strategies.

<sup>1</sup> Chinese' social relationship that brings family norms in business setting.

Clothing retail discussed is shown as an example of the implementation of bridging institutional distance strategy. Fields examined in these two papers are categorised as creative industries sub-sector.

## **(2) Institutional Entrepreneurship**

From selected 23 papers, 13 papers examine institutional entrepreneurship. Seven papers explicitly state the term and six papers are in an implicit way. Those who clearly state the term 'institutional entrepreneurship' or 'institutional entrepreneur(s)' are Mair and Marti (2009), Tracey and Phillips (2011), Liu (2011), Wahid and Sein (2013), Cao et al. (2014), Almeida et al. (2014) and Urban (2014). These seven papers investigate the roles of the institutional entrepreneurs. Albeit institutional entrepreneurs are dominated by companies or firms, there are seen other type of institutional entrepreneurs such as Non-Governmental Organization (NGO), social entrepreneurs and government. These findings prove that institutional entrepreneurs can be anyone or any organization. Debates regarding the roles of government agencies in institutionalization occur in several papers. Besides playing the roles of institutional entrepreneur, government agencies could act as supportive institutionalization actor. There is also found that spanning institutional voids is the most analyzed strategies among those papers. These seven papers realize and emphasize the importance of local context in discussing institutional entrepreneurship.

Other six papers which implicitly study institutional entrepreneurship are Brundin and Wigren-Kristoferson (2013), Aggestam (2014), Gibb (2006), Yu and Dong (2013), Miller et al. (2009) and Kshetri (2014). When Miller et al. (2009) investigates institutional void, the actors who deal with institutional void can be categorized as institutional entrepreneurs. The institutionalization of the family firms in Brundin and Wigren-Kristoferson (2013), actions taken regarding institutional change in Aggestam (2014), the process of repositioning policy in the making markets (Gibb, 2006), the readiness for e-commerce innovation in Yu and Dong (2013) and

the entrepreneurial ecosystem development in Kshetri (2014) involve the roles of institutional entrepreneurs as well. It can be seen from these six papers that institutional aspects have a close relation and affect entrepreneurship.

Ten other papers (Kalantaridis et al., 2007; Kshetri, 2007; Roxas et al., 2007; Roxas et al., 2008; Jurse and Lejko, 2012; Ntayi et al., 2013; Ntayi et al., 2014; Gupta et al., 2014; Pinto and de Souza, 2013; Arasti et al., 2012) study the relation between institutional aspects and entrepreneurship.

## **(3) Creative Industries**

This study found five papers study the creative industries. The examined sub-sectors are fashion (Tracey and Phillips, 2011; Pinto and de Souza, 2013) and software and computer services (Miller et al., 2009; Liu, 2011; Arasti et al., 2012). Tracey and Phillips (2011) show the successful adoption of bridging institutional distance strategy by the specialized menswear entrepreneur in Russia. Pinto and de Souza (2013) examine the development of fashion industry that considers institutional factors in Brazil. The computer and related firms in South Korea were taken by Miller et al. (2009) as some of their samples in a spanning of institutional voids strategy study. Liu (2011) investigates the influence of institutional voids to the software and applications firms' innovation in China. The last, Arasti et al. (2012) identify the influence of normative institutional factor toward the entrepreneurial intention in Information Technology sector where software is included as its sub-sector.

Some other papers study different field of business i.e. Cao et al. (2014) in solar energy industry, Almeida et al. (2014) in yogurt production, Brundin and Wigren-Kristoferson (2013) in vineyard business, Aggestam (2014) in maritime transport services industry, steel distributor and ice-cream producer, Yu and Dong (2013) in chemical and gardening, Mair and Marti (2009) in microfinance sector, Wahid and Sein (2013) in government sector and Urban (2014) in social entrepreneurship.

On the other hand, other ten papers (Gibb, 2006; Kalantaridis et al., 2007; Kshetri, 2007; Roxas et al., 2007; Roxas et al., 2008; Jurse and Lejko, 2012; Ntayi et al., 2013; Ntayi et al., 2014; Gupta et al., 2014; Kshetri, 2014) do not particularly study one or several fields.

#### **(4) Emerging Markets**

All the 23 papers discuss their topic in the emerging markets context. 17 papers particularly examine the topic in a country, four papers in more than one country and two papers in the continent context. These two papers are Roxas et al. (2007) who create the framework of entrepreneurial climate in the context of Asia Pacific's developing countries and Roxas et al. (2008) who develop the institution-strategic choice relationship framework for developing countries in Asia.

China was discovered as the most discussed country by seven papers (Gibb, 2006; Kshetri, 2007; Liu, 2011; Tracey and Phillips, 2011; Yu and Dong, 2013; Cao et al., 2014; Gupta et al., 2014). The second most discussed country is Brazil by four papers (Tracey and Phillips, 2011; Pinto and de Souza, 2013; Almeida et al., 2014; Gupta et al., 2014). South Korea is discussed by three papers (Miller et al., 2009; Gupta et al., 2014; Kshetri, 2014). Countries which are studied by two papers are Russia (Kalantaridis et al., 2007; Tracey and Phillips, 2011), India (Tracey and Phillips, 2011; Gupta et al., 2014), Bangladesh (Mair and Marti, 2009; Tracey and Phillips, 2011), Uganda (Ntayi et al., 2013; Ntayi et al., 2014) and South Africa (Brundin and Wigren-Kristoferson, 2013; Urban, 2014). Countries which are discussed by only one paper are Ukraine (Kalantaridis et al., 2007), Poland (Aggestam, 2014), Slovenia (Jurse and Lejko, 2012), Indonesia (Wahid and Sein, 2013), Estonia (Kshetri, 2014) and Iran (Arasti et al., 2012).

#### **DISCUSSION**

The roles of institutional entrepreneurs, which are found as the major discussion in this review, are seen in many fields of business in emerging markets. Besides these roles, some of

the reviewed papers also present the institutional strategies. However, there are only three papers analyze these roles in creative industries. The existence of institutional entrepreneurs and their roles are inevitable since the emerging markets experience a low level of institutionalization and high level of uncertainty (Tracey and Phillips, 2011).

As the papers which study institutional entrepreneurship in creative industries in emerging markets, it is found that Liu (2011) and Miller et al. (2009) observe the similar field of business i.e. technology and also examine the same topic i.e. institutional voids. Where Liu's voids are intellectual property rights protection, regional policy priority, marketization development and individual capabilities, Miller's voids are more general such as lack of capital, product, and labor institutional infrastructures. The attractive point from these two papers is they both agree that social relationship is beneficial to deal the institutional voids in emerging markets. Social relationship or social linkages may include firm, employee, government, university, other company, research organization, consultant, legal expert and technical expert. The suggestion to test the proposition regarding social relationship by a survey in quantitative research (Liu, 2011) was already conducted by Miller et al. (2009) who apply mixed method research. The main difference between these two papers is the form of the firms examined. Liu examines high-tech ventures but Miller compares between the family business and non-family business. There is only institutional brokering strategy which is not discussed by any papers regarding creative industries in emerging markets if referring to the three institutional strategies mentioned by Tracey and Phillips (2011). From these three strategies, the most examined strategy is spanning the institutional voids while bridging the institutional distance is less analyzed.

The limitation of this review is only one database employed, the ABI/INFORM Complete. Another limitation is the characteristic of the narrative review used by this study. Although narrative review provides the topic's update, continue the education credits or challenge the

author's way of thinking, this method just deals more with broader issues rather than any focused problems.

## **CONCLUSION**

Albeit there are only a few studies of institutional entrepreneurship in creative industries in emerging markets, social relationship or social linkages is gathered as the important factor to anticipate the institutional environment. The papers which cover institutional entrepreneurship topic dominantly discuss the roles of institutional entrepreneurs while others just analyze the relation between institutional factors and entrepreneurship. The institutional strategies are also discussed in some papers which spanning the institutional voids strategy is found as the most examined strategy. In the context of the actor, company or firm is the most dominant institutional entrepreneur. However, institutional entrepreneurs are not only the company or firm but could be other entities such as social entrepreneur, government or Non-Governmental Organization. The reviewed papers adequately represent the world's emerging markets context referring to their various research locations.

A small number of particular creative industries studies from the institutional entrepreneurship perspective is the opportunity for further study. As this review frequently found the discussion of the roles of institutional entrepreneurs and their strategies, there will be an advantage to create the framework of the institutional entrepreneurship in the specific field of business such as creative industries in emerging markets. This framework will clearly visualize the roles of institutional entrepreneurs, their strategies and the institutions made. Further research is also encouraged to utilize other databases such as Scopus, Business Source Premier, Science Direct Business and JSTOR. The usage of other databases is beneficial to compare as well as increase the variety of examined papers. It is also suggested to conduct qualitative systematic literature reviews for a more detailed result.

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## **IMPRESSION MANAGEMENT IN INDONESIAN CORPORATIONS: A STUDY OF CEO LETTER IN ANNUAL REPORT**

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### ***ABSTRACT***

*This research aims to examine corporate narrative in the form of the CEO Letter of listed companies in Indonesia Stock Exchange (IDX). The effect of firm characteristics on impression management strategies by means of concealment and attribution are investigated. In doing so, this study examines impression management strategies using narratives text length, thematic and rhetoric tone that are measured using language analytic software, DICTION 7.0.*

*The research population for this study is the Indonesian Corporations listed on Jakarta Stock Exchange during the period of 2012-2014. Hence, this study attempts to expand the research empirical evidence in the field, particularly in emerging economies country.*

*The findings in this study conclude that high performing companies has less verbosity in text length, more Certainty and less Optimism in their corporate disclosures compare to poor performing companies. This result contrasts with impression management behaviours framework constructed by Merkl-Davies and Brennan (2007). It implies that Indonesian corporations relatively does not use CEO letter as impression management vehicles to make impression on their performances. However, larger companies contain more text length and optimism, but less certainty tone. Thus, larger firms reflecting impression management behaviours framework as they tend to utilise annual report i.e. CEO Letter as impression management vehicles by exposing the best part of themselves into readers' perspectives.*

**Keywords:** *Corporate Narratives, Firm Performance, Firm Size, Impression Management*

## LONG-RUN IPO INVESTMENTS, IS IT RISKY?

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### ABSTRACT

*Most investors suggest that the stock investment in the short-run will run a lower risk than in the long run. This point of view is not necessarily true. The uncertainty/volatility of economic circumstances will decrease probability of risk. The longer the period of investment is the lower probability the uncertainty of economic circumstances-run. This research purpose is to provide information about the pattern of risk and return of IPO securities which invested in three year period. Researcher suggest that the IPO securities in the long-run will result lower risk and return. By looking into the stocks performance of the IPO securities. This research adopt BHAR model to represent the holding period return, CAPM to predict the yields in risky assets and Fama-French Three Factor model to measure the systematic risk which cannot be prove by CAPM model. The population is BEI listed companies. The sample of the research is the companies which carried out IPO from 2008-2010 and the companies restate from BEI listed companies with closest market capitalization. Data processing using IBM SPSS 20.0 for Windows. The empirical results shows that market risk premium, firm size and book-to-market value significantly impact to higher volatility of IPO stocks return within three year period after the first offerings.*

**Keywords:** Risk of the long term investments; CAPM; Fama-French Three Factor Model; Long-run IPO investments

### INTRODUCTION

Investors acknowledge that the securities investments in the long-run will yield uncertainty return and pose high risk. This believe is based on technical experiences. The uncertainty of market conditions which poses risk is still controversial in terms of risky assets investment. Bodie (1995) suggest that the insurance cost of the decrease in securities profit to risk-free-assets will increase along with the longer period of investments.

Consequently, the investments risk will increase along with the longer period of investments, on the contrary the conventional wisdom states that a well diversified portfolio will run during acceptance period (Ferguson dan Leistikow, 1996:67). This research is aim at investigating the perspective by comparing IPO securities with matched firms securities, will along term investments lower risk and reduce return.

### LITERATURE REVIEW

#### Risk and Return in The Long-Run

Investors must be aware of the volatile risk and return while analyzing historical data to draw up in their investment in the future. According to Siegel (2013:94), securities are riskier than bonds within a one – two year period of investments. Within a ten year period

the performance of securities is better than that of bonds. Within a twenty year period of investments the return of securities are never lower than the inflation rates. Low risk long term investments must diversify a portfolio of equity. The holding period of a relevan of

portfolio allocation is referred to as the length of the period, in which investors hold their securities. It is not affected by how many times the composition of individual securities are change altered. The historical data also indicates that the return of investment (return of securities) will be lower than that of T-bills. The high probability of higher return of T-bills makes investors reluctant to keep their stocks.

Risk are define as standard deviation of the average of real annual return. Based on the portfolio and assets allocation model theory, standard deviation is a proxy to measure risk. The deviation standard of the securities return is higher than that of the bonds return in the short-run. But when the period of the investments is fifteen to twenty years the risk of stocks will be lower than bonds (Siegel, 2013:97).

The concept used to measure the risk in the long-run is shortfall. Shortfall accrues when the rate of return of stocks portfolio is lower than that risk-free-assets. Bodie (1995) says that the risk free assets used as a logical benchmark to measure the risk of stock is zero coupon bonds. In indonesia, the risk-free assets referred to as zero coupon bonds is saving deposit. The researcher will use the rate of interest of saving deposit as the interest rate of risk-free-assets (Bodie, 1995:51). Bodie, Kane, Marcus (2011:177) says that shortfall is not appropriate tool to measure the risk of investment because it is not refer to size of potential of losses. The appropriate approach to quantified risk in the long-run is using market price. Insurance premium refer to the probability and the magnitude of losses.

### Capital Asset Pricing Model (CAPM)

Capital Assets Pricing Model (CAPM) used for predict equilibrium expected return on risky assets. There are several basic assumption in CAPM basic model but rationally it were not applicable, then some assumptions were developed,

1. Investor choose to hold risky assets portfolio at the right proportion to market portfolio.
2. Not only market portfolio which were at efficient frontier but also every investor

assets / optimal capital allocation line (CAL).

3. Risk premium in market portfolio would be proportional to risk.
4. Risk premium individual stocks would be proportional to risk premium market portfolio and beta coefficient relative to market portfolio.

Expected return beta relationship is one of the most attractive factor in CAPM for practitioner. Well-diversified portfolio will reduce firm-specific risk and market risk. Beta coefficient relative to market so its suitable for risk measured (Bodie, Kane, Marcus, 2011:310).

### Fama French Three Factor Model

Market index in Fama French Three Factor Model would explore systematic risks of macroeconomic factors. There are two variables of firm specific, firm size (Small Minus Big) based on market capitalization and book-to-market value (High Minus Low), both of them capture average of deviation of stocks return. Small stocks sensitive to business economic condition, while the higher book to market ratio shows that company is in bad condition, like financial distress. Fama and French prove that the model is predicting average return on varieties of time period and market, and preventing data-snooping (scan and rescan database security return for searching variables) (Bodie, Kane, Marcus, 2011:363).

## DATA AND METHODOLOGY

### Data

This research adopt a quantitative method with the aid of SPSS IBM 20.0 for Windows. The population is BEI listed firms. Sample is divided into the two groups. The first group is refer to as the companies which carried out initial public offering in 2008, 2009 and 2010 and they did not belong to banking and property industry. The seconds group (matched firms) is refer to those listed on BEI with closest market capitalization and in the same industry (Septina, 2013:35). The observation of holding period return is three year period after first offerings. Data mining are from summary of company's performance

on BEI website and trading-day of securities on Yahoo Finance.

**Hypotheses**

Is market risk premium and firm specific variables (firm size and book-to-market value) affects securities return on IPO securities portfolios and matched firms portfolios significantly?

H<sub>0</sub>: Market risk premium, firm size and book-to-market value affects securities return.

H<sub>1</sub>: Market risk premium, firm size and book-to-market value not affects securities return.

**Variables**

The Observation of risk and return of securities is divided into three steps,

1. BHAR (Buy and Hold Return) as a proxy of securities return, after keep the securities in certain period. Barber and Lyon (1997; in Wu dan Kwok, 2007), Kothari and Warner (1997, in Wu dan Kwok, 2007) says that buy and hold return is measure investors experience and the appropriate performance estimator in the long-run.

$$BHAR_{(T_1, T_2)} = \left[ \prod_{t=T_1}^{T_2} (1 + r_i) \right] - \left[ \prod_{t=T_1}^{T_2} (1 + R_m) \right]$$

.....equation 1.1

$r_i$  is monthly trading-day securities return,

$R_m$  is return index market (IHSG) in the same period, the starting period after first offerings ( $T_1$ ).

2. CAPM (Capital Asset Pricing Model) as a proxy of risk and return of securities compared to market portfolio.

$$r_p = R_f + \beta_i (R_m - R_f) + \epsilon_t \text{ .....equation 2.1}$$

$$(r_i - R_f) = \alpha_i + \beta_i (R_m - R_f) + \epsilon_t$$

.....equation 2.2

$r_p$  is required return of securities,

$r_i$  is monthly trading-day securities return,

$\beta_i$  is securities risk measure,

$(R_m - R_f)$  is excess returns market portfolio, calculated from return-market (return IHSG) minus interest rate of risk-free-assets,

$R_f$  is interest rate of risk-free-assets,

$R_m$  is return index market (IHSG) in the same period,

3. Fama French Three Factor Model as a proxy of risk and return securities of firm specific and market portfolio. The model is investigating the variables which can not capture by CAPM and BHAR.

$$(r_i - R_f) = \alpha_i + \beta_m (R_m - R_f) + \beta_s SMB_t + \beta_h HML_t + \epsilon_t$$

.....equation 3.1

$r_i$  is monthly trading-day securities return,

$\beta_m, \beta_s, \beta_h$  are securities risk measure,

$(R_m - R_f)$  is excess returns market portfolio, calculated from return-market (return IHSG) minus interest rate of risk-free-assets,

$SMB_t$  (Small Minus Big) is return small minus big securities, classified by market capitalization, grouping by weighted-average of market capitalization,

$HML_t$  (High Minus Low) is return high minus low book-to-market value (B/M value) of securities portfolio, grouping by weighted-average of book-to-market value.

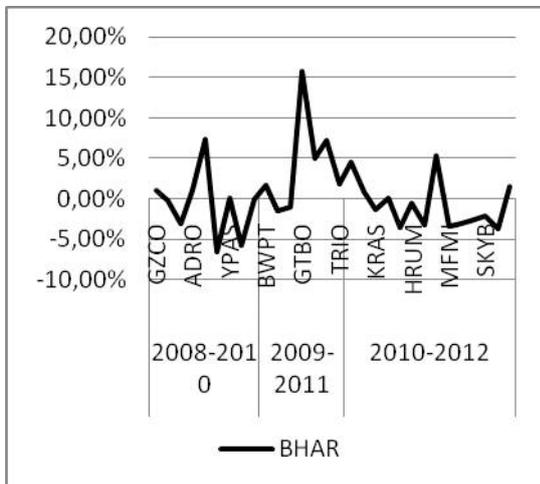
**Hypotheses Testing**

Tools for analyze using multiple regression with software SPSS-IBM 20.0 for Windows.

1. Classic assumption testing
2. Hipotesis testing
  - a. Coefficient regression one testing (F-Test)
  - b. Coefficient regression partial testing (t-Test)
  - c. Coefficient determinant testing ( $R^2$ )

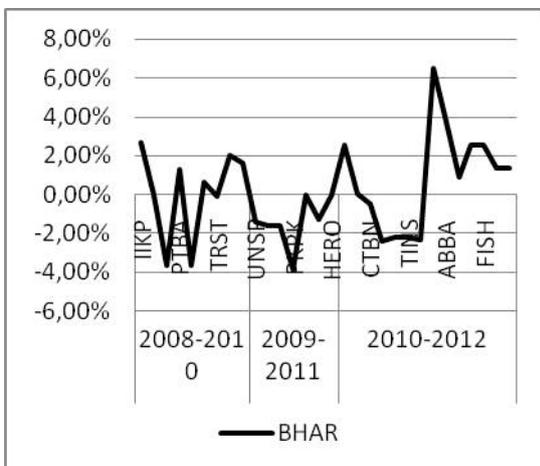
**FINDINGS AND DISCUSSION**

**1. Buy and Hold Return (BHAR)**



Source: Yahoo Finance, Analyzed by Researcher

**Figure 1.1** Buy and Hold Return (BHAR) IPO stocks



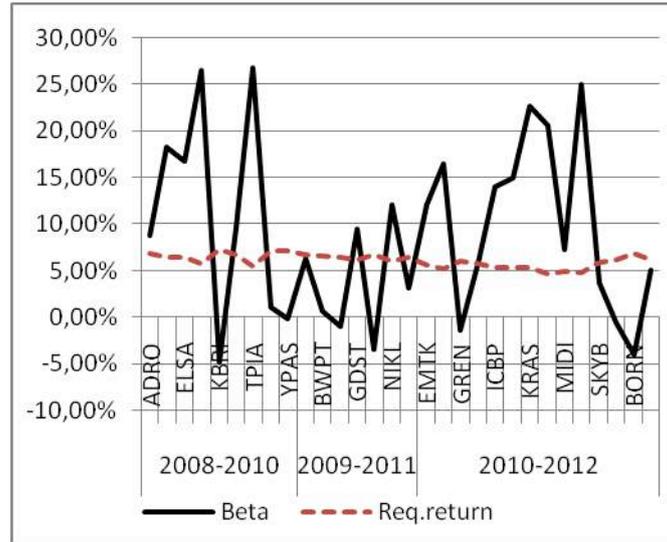
Source: Yahoo Finance, Analyzed by Researcher

**Figure 1.2** Buy and Hold Return (BHAR) Matched firms stocks

Buy and hold return approach is the most relevant method for investors. Return of securities using equal 1.1 are describe in figure 1.1 and figure 1.2. Return of IPO securities tend to increase and positive. Return of matched firms securities shows more stability condition. This perspective provide that higher investors expectations to return of securities in initial public offerings rather than non-IPO securities.

**2. Capital Asset Pricing Model (CAPM)**

CAPM is still to be populare approach to measure risk of securities investments because of its simplification. Jeremy Stein (1996) in Bodie, Kane Marcus (2011:319) says that if investors are irrational, then beta is still right measure, its captures assets fundamental risk. Equation 2.1 calculate the return of securities and beta coefficient which describe in figure 2.1 and figure 2.2. Return in this equations also called as required return. Required return of IPO securities and non IPO securities show the stability pattern. The volatility of beta coefficient of IPO securities is tend to higher and positive, its indicate higher risk of investing on IPO securities within three year period after first offerings. The volatility of beta coefficient of matched firms securities is tend to high and negative, then the lower risk of investing on matched firms securities. Ritter (1991) says from investors perspective, the pattern of securities price's volatility describe chance of active trading strategies to produce superior return.



Source: Yahoo Finance, Analyzed by Researcher  
**Figure 2.1** Beta Coefficient and Required Return of IPO Securities

### 3. Multifactor Regression for CAPM and Fama-French Three Factor Model

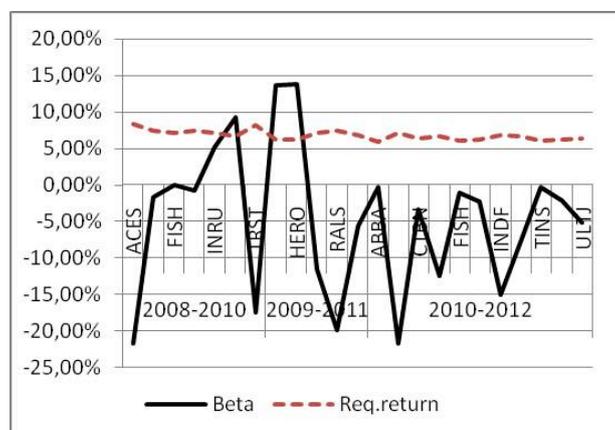
Classic assumptions testing to prove the availability of the multifactor regression model as a tools of hypothesis testing. Progress of classic assumptions testing are multicollinearity, autocorrelation using Durbin Watson table, heterocedasticity using scatterplot graphic to investigate data spread, and normality using P-P plot graphic to investigate data spread around diagonal line. The result is CAPM dan Fama-French Three Factor model available as the tools of hypothesis testing.

F-test (one testing coefficient regression) is aim to testing the effect of whole dependent variables to independent variable. F-test in CAPM regression model are,

Accept  $H_0$  dan reject  $H_1$  if,  $F_0 > F\text{-table}$  and  $\alpha < 0,05$  (*Asymp. Sig. 5% 2-tailed*) which means significant or reject  $H_0$  and accept  $H_1$  if  $F_0 < F\text{-table}$  dan  $\alpha > 0,05$  (*Asymp. Sig. 5% 2-tailed*) means not significant.

$H_0$ : Market risk premium affects securities return.

$H_1$ : Market risk premium not affects securities return.



Source: Yahoo Finance, Analyzed by Researcher  
**Figure 2.2** Beta Coefficient and Required Return of Matched Firms Securities

**Table 3.1** F-test for CAPM Regression Model

Model	F	F <sub>0</sub> vs F-table	Sig.	Sig. 5%	Notes
IPO 2008	2,250	2,250 > 1,69	0,143	0,143 > 0,05	Not significant
IPO 2009	0,888	0,888 < 1,69	0,353	0,353 > 0,05	Not significant
IPO 2010	22,056	22,056 > 1,69	0,000*	0,000 < 0,05	Significant
Matched 2008	0,320	0,320 < 1,69	0,575	0,575 > 0,05	Not significant
Matched 2009	1,369	1,369 < 1,69	0,250	0,250 > 0,05	Not significant
Matched 2010	0,002	0,002 < 1,69	0,966	0,966 > 0,05	Not significant

Notes: \*significance at level  $\alpha = 0,05$  or  $< 0,05$

Source: Yahoo Finance, Bank Indonesia, Analyzed by Researcher

The CAPM regression model on IPO securities 2010 shows market risk premium affects IPO securities return significantly.

F-test for Fama-French Three Factor regression model,

H<sub>0</sub>: Market risk premium, firm size and book-to-market value affects securities return.

H<sub>1</sub>: Market risk premium, firm size and book-to-market value not affects securities return.

Fama-French Three Factor regression model show significant result on IPO 2009 and IPO 2010. Market risk premium, firm size and book-to-market value affects securities return on IPO securities 2009 and 2010 significantly.

**Table 3.2** F-test for Fama French Three Factor Regression Model

Model	F	F <sub>0</sub> vs F-table	Sig.	Sig. 5%	Notes
IPO 2008	1,447	1,447 < 1,69	0,248	0,248 > 0,05	Not significant
IPO 2009	3,651	3,651 > 1,69	0,023*	0,023 < 0,05	Significant
IPO 2010	8,377	8,377 > 1,69	0,000*	0,000 < 0,05	Significant
Matched 2008	1,284	1,284 < 1,69	0,297	0,297 > 0,05	Not significant
Matched 2009	0,457	0,457 < 1,69	0,714	0,714 > 0,05	Not significant
Matched 2010	1,107	1,107 < 1,69	0,361	0,361 > 0,05	Not significant

Notes: \*significance at level  $\alpha = 0,05$  or  $< 0,05$

Source: Yahoo Finance, Bank Indonesia, IDX, Analyzed by Researcher

T-test (partial testing coefficient regression) is aim to test the effect of whole dependent variables to independent variable. F-test in CAPM regression model are,

Accept H<sub>0</sub> dan reject H<sub>1</sub> if,  $T_0 > T$ -table and  $\alpha < 0,05$  (*Asymp. Sig. 5% 2-tailed*) which means significant or reject H<sub>0</sub> and accept H<sub>1</sub> if  $T_0 < T$ -

table and  $\alpha > 0,05$  (*Asymp. Sig. 5% 2-tailed*) which means not significant.

H<sub>0</sub>: Market risk premium affects securities return.

H<sub>1</sub>: Market risk premium not affects securities return.

**Table 3.3** T-test for CAPM IPO Securities Regression Model

Variable	IPO 2008			IPO 2009			IPO 2010		
	Coef.	t-test	Sig.	Coef.	t-test	Sig.	Coef.	t-test	Sig.
Intercept	-0,365	-2,418	0,021	0,003	0,032	0,975	-0,331	-3,222	0,003
Rm-Rf	2,164	1,5	0,143	1,333	0,942	0,353	7,052	4,696*	0,000*

Notes: \*significance at level  $\alpha = 0,05$  or  $< 0,05$

Source: Yahoo Finance, Bank Indonesia, Analyzed by Researcher

T-test result shows IPO 2010, the return of securities affects market risk premium significantly.

**Table 3.4** T-test for CAPM Matched Firms Securities Regression Model

Variable	Matched 2008			Matched 2009			Matched 2010		
	Coef.	t-test	Sig.	Coef.	t-test	Sig.	Coef.	t-test	Sig.
Intercept	-0,262	-2,05	0,048	-	-4,718	0	-0,403	-1,944	0,06
Rm-Rf	0,696	0,565	0,575	0,997	-1,17	0,25	0,133	0,044	0,966

Notes: \*significance at level  $\alpha = 0,05$  or  $< 0,05$

Source: Yahoo Finance, Bank Indonesia, Analyzed by Researcher

No significantly result.

T-test for Fama-French Three Factor regression model,

H<sub>0a</sub>: Market risk premium affects securities return.

H<sub>0b</sub>: Firm size affects securities return.

H<sub>0c</sub>: Book-to-market value affects securities return.

H<sub>1a</sub>: Market risk premium not affects securities return.

H<sub>1b</sub>: Firm size not affects securities return.

H<sub>1c</sub>: Book-to-market value not affects securities return.

**Table 3.5** T-test for Fama French Three Factor IPO Securities Regression Model

Variable	IPO 2008			IPO 2009			IPO 2010		
	Coef.	t-test	Sig.	Coef.	t-test	Sig.	Coef.	t-test	Sig.
Intercept	-	-2,325	0,027	-0,103	-1,043	0,305	-0,305	-2,967	0,006
Rm-Rf	1,4	0,912	0,369	0,725	0,538	0,594	7,562	4,919*	0,000*
SMB	0,169	0,753	0,457	0,491	3,136*	0,004*	-0,409	-1,902	0,066
HML	0,232	1,119	0,272	-0,353	-2,149*	0,039*	-0,135	-0,593	0,558

Notes: \*significance at level  $\alpha = 0,05$  or  $< 0,05$

Source: Yahoo Finance, Bank Indonesia, IDX, Analyzed by Researcher

Firm size and B/M value affects significantly on IPO 2009. Market risk premium affects significantly on IPO 2010.

**Table 3.6** T-test for Fama French Three Factor

Matched Firms Securities Regression Model

Variable	Matched 2008			Matched 2009			Matched 2010		
	Coef.	t-test	Sig.	Coef.	t-test	Sig.	Coef.	t-test	Sig.
Intercept	-0,237	-1,838	0,075	-0,292	-4,335	0	-0,335	-1,576	0,125
Rm-Rf	0,876	0,72	0,477	-0,979	-1,086	0,286	-0,37	-0,12	0,906
SMB	0,027	0,167	0,868	-0,059	-0,272	0,787	-0,161	-0,917	0,366
HML	0,215	1,419	0,166	-0,037	-0,232	0,818	-0,196	1,138	0,264

Notes: \*significance at level  $\alpha = 0,05$  or  $< 0,05$

Source: Yahoo Finance, Bank Indonesia, IDX, Analyzed by Researcher

T-test shows no significantly result.

The result of regression analysis both F-test and T-test with CAPM regression model is the market risk premium affects return of IPO securities 2010 significantly. Its indicates the impact of economic circumstances on initial public offerings. CAPM captured the market risk only.

Fama-French Three Factor Model prove other findings which can not captured by CAPM, such as firm specific variables. F-test with Fama-French Three Factor regression model shows that return of IPO securities on 2009 and 2010 is significantly affects by market risk premium, firm size and book-to-market value (B/M value). T-test of Fama-French Three Factor regression model prove that firm size and B/M value affects return of portfolio IPO securities on 2009 significantly, and market risk premium affects return of portfolio IPO securities on 2010 significantly. Firm size describes small firms could provide higher return. IPO securities have higher book-to-market value (B/M), those are overvalued. Several studies found that higher B/M value tend to earn excess return over long-run investments period (Bodie, Kane, Marcus, 2011:363). The economic circumstances also influences the return of IPO securities.

Matched firms portfolio securities shows no significantly result, either with CAPM regression nor Fama-French Three Factor regression model. Therefore, global economic crisis in 2008 impact on data accuracy.

**CONCLUSIONS**

There are two samples, portfolio of IPO securities and portfolio of matched firms securities, both prove the different empirical result:

1. Market risk premium and firm specific variables (firm size and B/M value) not affects return of matched firms portfolio securities significantly. BEI listed firms are obtain less impact of economic circumstances and they were in stability position than IPO firms.
2. Market risk premium and firm specific variables (firm size and B/M value) affects return of IPO securities on 2009 and 2010. In this context of research, investing IPO securities in three year period provide higher risk and return than that matched firms securities. IPO securities are sensitive to increase or decrease of economic circumstances, while small firms could provide higher securities return. The market expectation to achieve higher return of initial public offerings will increase the market risk. Market optimistic gives good signal for investors.
3. Rational investors will capture an extra risk factors from higher book-to-market value and of course earn higher return of securities. They should analyze the historical data carefully, pay attention to macroeconomic stability, long-run investments pattern of IPO securities volatility and financial performance to obtain future investment. Besides investing

in other BEI listed securities to achieve well-diversified portfolios of risky assets.

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## **MODELLING FINANCIAL AND CASH FLOW RATIOS TO REDUCE RISK OF FINANCIAL DISTRESS**

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### ***ABSTRACT***

*Extant research studies have employed financial ratios to predict firms' financial distress. Interpretation of financial ratios extends beyond its calculation since it demands users' knowledge on interpreting the results. Some studies have applied cash flow ratios and cash flow patterns in predicting financial distress. Researchers claimed that the fact that these studies adopt cash flow from operations as a basis for predicting firm's financial distress, findings prove that the prediction model based on cash flow statement information provide better results and is referred to as effective measures as compared to model that solely relies on financial ratios. Based on total sample of 42 firms consisting of 21 financially distressed firms and 21 non-financially distressed firms in Malaysia, the current study integrates both the financial and cash flow ratios to determine the significant predictors of financial distress. The data was obtained from the financial statements of the firms over five years prior to the financial distress year. The logistic regression analysis was used to analyse the data. The results imply that liquidity and efficiency ratios are the significant predictors of financial distress. This study is significant not only from the theoretical perspective but to the practitioners and regulators in determining the sources of firms' financial anguish.*

**Keywords:** *financial ratios, cash flow ratios, financial distress, distressed firms and non-distressed firms*

## **MONITORING, CONTROLLING & PERFORMANCE: FROM THE NPO'S PERSPECTIVE**

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### ***ABSTRACT***

*Non-profit organization (NPOs) is a group established for the purposes of serving the needs of society and to fill the gap leave by the government. The aim is not only to fulfill social needs of the needy, but to help in developing skills, create employment for individuals, and also as a consultant in specific industries. However, NPOs are said to have less efficient corporate governance. Thus, this study main objective is to examine the relationship between corporate governance and performance of NPOs. The sample consists of NPOs established in Malaysia and registered with either Registrar of Society or Company Commission of Malaysia. A total of 96 questionnaires out of 150 distributed questionnaires were returned. Based on the result of multiple regression analysis, it was found that corporate governance does give some impact towards overall performance and financial performance, but not in the activities performance. The result from the study can help regulators and the authority bodies to effectively monitor these organizations in order to improve the non-profit sector transparency and accountability and can be used to attract others in seeing the importance of the third sector in providing services that cannot be supplied by the government or even profit organizations towards the community at large.*

**Keywords:** *non-profit organization, corporate governance, overall performance, activity performance, financial performance, Malaysia*

## CHARACTERISTIC RELATIONSHIP OF RESOURCE UNIQUENESS AND COMPETITIVE ADVANTAGE WITH COMPETITIVE STRATEGY IN STATE-OWNED CONSTRUCTION ENTERPRISES

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### ABSTRACT

*The purpose of writing this paper is to find out the characteristic of resource uniqueness and competitive advantage that affect the relationship with competitive strategy of State-Owned Construction Enterprises. State-owned construction enterprises are required to contribute to the growth of the economy and should also be able to compete. In order to be able to compete, resource uniqueness is necessary. Resources uniqueness can be created through the combination of three forms of assets that are physical assets (tangible assets), nonphysical assets (intangible assets), and the ability to manage the organization (organizational capability). The implementation of competitive strategy and competitive advantage should be based on the uniqueness of its resources. This research method is conducted by using the conceptual framework of the model (conceptual framework models) by comparing the literature study and previous studies and using a model diagram that has been tested. It is found that the resource uniqueness classified as mediocre, and also found that competitive advantage is in the **inbetween zone** or has the low competitive advantage. So the action of competitive strategy that should be conducted is the cooperation strategy (**comparative strategy**) among the people in the construction industry.*

**Keywords:** *Resource Uniqueness, Competitive Strategy, Competitive Advantage*

### INTRODUCTION

The State Own Enterprises (SOE) are the enterprises which the majority or all of its capital are owned by the state through direct investment originated from the separated asset. The foundation of SOE are built upon corresponding with the SOE Constitution article 2, the Objectives are: (1) Contribute to the Indonesian Economic Growth in general & State Revenue in particular. (2) Profit Maximize. (3) Establish the goods and services for the Public Interest with the creation of good quality product in order to satisfy the people welfare. (4) Pioneer for the business opportunity that the

private sectors are not able to implement. (4) Participate actively to assist and provide the guidance for the small medium size businesses, union, society. Based on the objectives foundation of SOE, therefore it's necessary to optimize the resources in order to gain Indonesia economic growth by using strategy competitiveness and satisfy the stakeholders.

This paper provide the literature study and Conceptual Framework Models which observe the resource uniqueness in order to obtain the optimal competitive advantage strategy in State-Owned Construction Enterprises, which simultaneously will produce a good performance.

**THEORITICAL FRAMEWORK**

**1. Resource Uniqueness**

The company conceptual toward the resource uniqueness is classified by 3 categories; they are physical resources, human resources, and organizational resources (Hit, Ireland & Hoskisson, 2009:21). Affuah (2004:111) expresses that the resource uniqueness, it's the form of tangible asset and the intangible asset. The tangible asset encompasses the earth, physical facilities, and the equipment. The intangible asset are included the Human resources, Company reputation, information and technology expertise.

It can be seen from table 1, according to Wheelen and Hunger (2012:138) the resource uniqueness is created by 3 forms of assets which are physical assets (tangible assets) ; earth, equipment, and location, Human

resources; the number of employee and expertise, also the organization asset which encompasses culture and reputation. Hill and Jones (2004:137) observed two categories of the company resources, they are physical assets (tangible assets) and non physical assets (intangible assets). Meanwhile, Collins and Montgomery (2005:30) proposed 3 (three) categories of organization resources, which are: physical assets (tangible assets), non physical assets (intangible assets) and organization capabilities. Furthermore, Pearce and Robinson (2011:154), expressed 3 (three) basic resource that are required by the company, they are: physical assets (tangible assets), non physical assets (intangible assets) and organization capabilities. Physical and tangible assets are easily to be identified and they can be found on the company's balance sheet, among the production facilities, raw materials, and financial resources.

**Table 1.** The Concept of Resource Uniqueness

No	Founder	Concept
1	Pearce and Robinson (2011:154)	There are 3 (three) basic resources that are needed by the organization, they are: physical assets (tangible assets), non physical assets (intangible assets) and organization capabilities.
2	Wheelen and Hunger (2012)	Resources contains of assets, competency, process, skill or controllable knowledge
3	Hill and Jones (2004)	Proposed 2(two) categories of organization resources, they are: physical assets (tangible assets) and non physical assets (intangible assets).
4	Collis and Montgomery (2005)	Proposed 3(three) categories of organization resources, they are: physical assets (tangible assets), non physical assets (intangible assets) and organization capabilities.

Source: Processed from Strategic Management Book, Pearce and Robinson (2011), Wheelen and Hunger (2012), Hill and Jones (2004), Collins and Montgomery (2005)

Based on the literature of the concept of resource uniqueness above, then in Table 2 is shown the comparison of resource uniqueness

dimensional from different sources together with the author proposals of resource uniqueness variable for the Construction Services as follows:

**Table 2.** Resource Uniqueness Variable Dimension

No	Wheelen and Hunger (2012)	Hill and Jones (2004)	Collis and Montgomery (2005)	Author Proposal (Draft Construct)
1	Physical Asset	Tangible Asset	Tangible Asset	Tangible Asset
2	Human Resource Asset	Intangible	Intangible Asset	Intangible Asset
3	Organization Asset	Organization Capability	Organization Capability	Organization Capability

Source: Processed from Wheelen and Hunger Strategic Management Book (2012), Collins and Montgomery Strategic Management Book (2005)

**2. Competitive Advantage**

Thomson, Strickland, & Gamble (2010) explain that to achieve competitive advantage in the best-cost, the company shall have capabilities as follows: (1) integration of low-cost product provider of the same product features with competitors; (2) provide quality product at a lower price than competitors; (3) develop products that show the best performance at a lower price than competitors; (4) provide lower price on the same services with competitors. Best-cost provider strategy is very suitable for market where the consumers concern with product differentiation and sensitive to price and value. It means the best-close provider is closer to the middle position market, with medium quality product at below average price, or high quality product at high price average.

Barney (2010:10) states that a company has a competitive advantage when such company is

able to create economic value more than its competitors. In this case, the economic value is the deviation between the benefits received by the customer with the cost that will be paid to get/buy a product or a service.

Meanwhile, according to Porter (2004:3) competitive advantage is basically evolve from a value created by a company to its buyers that exceeds the cost of creating a product/service. Value is something that a buyer is willing to pay, and superior value derived from lower bid price than the competitors for equivalent benefits or provide more unique benefits rather than simply offset the higher price.

Thus it can be concluded that the terms of a resource is said to have the competitive advantage if: 1. Must have a value, 2. Something that is rare in the present and future, 3. Can not be exactly replicated, 4 Does not have a replacement.

**Table 3.** Resource Uniqueness Variable Dimension

Thomson, Strickland and Gamble (2010)	Barney (2010)	Porter (2004)	Author Proposal (2016)
1. At the same product quality with a lower price	1. Able to provide better economic value than competitors	1. The company is able to create superior value than competitors	1. Must have a value
2. Development of best performance product at a lower price		2. The company is able to offer lower prices than competitors with quality products / services that are useful and valuable	2. Something that is rare in the present and future
3. Provide better service at a lower price			3. Can not be exactly replicated
			4. Does not have a replacement.

Source : Thomson, Strickland and Gamble (2010), Barney (2010), Porter (2004) and processed by author

### **3. Competitive Strategy**

Definition of strategy in general is a way to achieve long-term goals. The methods can be geographic expansion, diversification, acquisition, product development, market penetration, employee rationalization, divestiture, liquidation, even merger (David. P 15. 2014). Competitive strategy is an attempt to find a position in the industry (Porter, 1987), a process for good defense and resistance (Walker, 2001). Competitive strategy in the long term enable the company to find a position in the market, to protect the position, as well as to fight against competitors. Therefore, the company's growth in the market can certainly grow for the long term. In its development, there are so many types of strategies are emerging as an attempt to protect the company from competitors pressure.

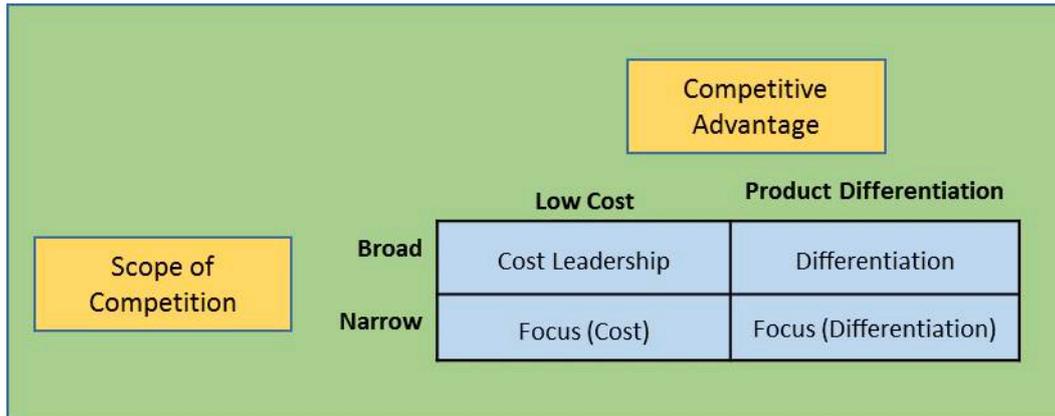
First, the Porter generic strategy which summarizes cost leadership, differentiation, focus (Porter, 1987). Cost leadership focuses on all strategic activities which impact on cost reduction. While the differentiation strategy seeks to create a good corporate image by offering the unique products / services. Second, Adaptive Strategy by Miles & Snow which is based on the organization's success stories in using strategies to adapt with the uncertain environment. In this approach, there are four types of strategies, that are : prospector, defender, analyzer, and reactor. 1). Prospector strategy is a strategy of prioritizing the organization's success in innovation, always create new products and market opportunities. 2). Defender strategy is a strategy that is usually concerned with the stability of its target market. By using this strategy, the organization

generally has only few product lines with narrow market segments. 3). Analyzer strategy is a strategy that analyzes new business ideas before entering the business itself. 4). Reactor strategy, where a company reacts to changes in the environment and makes a change only if there is any pressure from the environment that force the organization to change.

Third is the strategy introduced by Fred David which split into four main types of strategies, that are: integration strategy, intensive strategy, diversification strategy, and defensive strategies (David, 1995).

The selection of competitive strategy is based on the competitive advantage that can be developed by the organization. How does the organization will compete in the industry is the choice of competitive strategy.

In the approach proposed by Porter (1987), there are two substantial factors in creating the suitable competitive strategy. The first is based on the competitive advantage of the organizations. According to Porter, competitive advantage will only be obtained through one of two sources: the excellence to create a low-cost (cost leadership), or the ability of the organization to make differences (differentiation) compared to its competitors. The second factor is the scope of product-market (competitive scope) where the organizations can compete with each other in the broad and narrow market. Combining these two factors forms the foundation of Porter's generic competitive strategy, that are: cost leadership, differentiation, focus (fee-based or differentiation), as shown in Figure 1.



**Figure 1.** Porter Generic Competitive Strategy

Source: Porter (1980)

As shown in Table 4 below, Wheelen and Hunger (2012: 183) Competitive Strategy state that Competitive Strategy is focusing on the position development of business unit competition in goods and services. Then according to Pearce and Robinson (2011: 215) explains that the Competitive Strategy is an effort for the creation of sustainable competitive advantage through the uniqueness of the product and cost leadership. Ireland, Hoskisson and Hitt

(2009: 90) reveal that the Competitive Strategy is the integration and coordination in designing the commitment and action to win the competition in a specific market. Furthermore, Hubbard and Beamish (2011: 20) state that the Competitive Strategy is about how the organizations positioning the business to be more competitive compared to other similar industries.

**Table 4.** Conceptual Comparison of Competitive Strategy

No.	Author Name	Concept
1	Ireland and Hitt (2011)	Competitive strategy is the integration and coordination in designing the commitment and action to win the competition in the specific market
2	Wheelen and Hunger (2012)	Competitive strategy focused on developing position of bussiness unit competency in goods and services.
3	Hubbard and Beamish (2011)	Competitive strategy is about how the organization positioning its business to be more competitive compared to other similar industries.
4	Pearce and Robinson (2009)	Competitive strategy is an effort for the creation of a sustainable competitive advantage through the uniqueness of the product and cost leadership.

Source: Ireland and Hitt (2011), Wheelen and Hunger (2012), Hubbard and Beamish (2011) and processed by author

From the comparison of Competitive Strategy concept above, the Competitive Strategy of State-Owned Construction Enterprises is a set of systematic plan in order to position the product in the market which is relatively more superior when compared to competitors' products.

Time Speed Based Strategy is one of the strategies that affect business performance (Pearce and Robinson (2011)). The aim of time speed based strategy is pursuing a number of strategic initiatives in order to differentiate the results of the company compared to the company's competitors in the faster time service,

so that it can produce some products in a short time. In general, competition with time-based strategy can provide more variety at a lower cost

and in a broader segment of its competitors (Stalk and Hout, 1990).

**Table 5.** Competitive Strategy Dimension

Porter (1987)	Ireland and Hitt (2011)	Pearce and Robbinson (2011)	Hubbard and Beamish (2011)	Author Proposal (Draft Consult)
Overall Cost Leadership	Overall Cost Leadership	Low Cost Strategies	Cost Leadership	Cost Leadership
Differentiation Focus Cost	Differentiation	Differentiation Strategies	Differentiation	Differentiation Strategy
Leadership Focus Differentiation		Speed Based Strategy		Time Speed Based Strategy

Source: Porter (1987), Ireland and Hitt (2011), Pearce and Robbinson (2011), Hubbard and Beamish (2011), and processed by author

**4. Relationship of Resource Uniqueness with Competitive Strategy**

Table 6 shows that Hsieh, Yi Hua, Chen and Hai Ming (2011) move from literature review, mapping the key ideas and relationships, to establish a reward system that is suitable for the human resources strategy and Competitive Strategy. Starting with Porter generic strategies: differentiation, overall cost leadership, and focus. Based on individual characteristics, Competitive Strategy is designed according to

the human resources strategy, that is innovation-oriented strategy, contribution, and commitment. Finally, it is concluded and developed into a proper reward alternatives, that are: human capital reward, output reward, and position reward. These studies have in common with this paper in terms of the relationship between the variables of resources with Competitive Strategy, but differ in terms of method and object of research.

Table 6. Relationship between Resource Uniqueness and Competitive Strategy

No.	Author, Title, Year of Research	Research Purpose	Method, Object, Reseach Variable	Similarity and Difference with Paper
1.	Hsieh, Yi Hua; Chen, Hai Ming  Strategic Fit Among Business Competitive Strategy, Human Resource Strategy, And Reward System (2011)	<i>Examine the strategic compatibility of business competitive strategy, Human resource strategy, reward system</i>	Method : Literature Study  Variable : - <i>Human Resource Strategy</i> - <i>Reward system</i> - <i>Strategi</i>	Similarity: The linkage of company resource with strategy  Difference: Object and research method
2.	Chew, Keim C.  An exploratory case study. Knowledge management: Managing organizational knowledge assets by aligning business strategy, knowledge strategy, and knowledge management strategy (2008)	Examine empirically an alignment model of knowledge management that are coherent, can be explained, and consistent with previous study and theory to help practitioner managers in the implementation of knowledge management assessment and to explore the significant factors that cause misalignment of the	Method : Case study in financial service companies  Object ; Financial service companies  Variable : - Business Strategy - Knowledge Strategy - Knowledge Management Strategy	Similarity: The linkage of company resource with strategy  Difference : Object and research method
3.	Tsai, Wen-Hui;Tsai, Ming-Hong;Li, Sheng- Tun;Lin, Chinho  Harmonizing Firms' Knowledge And Strategies With Organizational	Explain the relationship that involves strategy and knowledge, providing a formal framework of Strategy-Knowledge-Capability-link	Method : Case study  Variable : - <i>Firm knowledge</i> - <i>Organizational Capability</i> - <i>Firm strategy</i>	Smilarity: The linkage of company resource with strategy  Difference: <i>Strategy-Capability-Knowledge/</i>

4	Dr. Alfred B. Ngowi and Dr. Pantaleo D.Rwelamila (1999), What Is a Competitive Advantage in the Construction Industry	Explain the relationship among resource ability, competitive advantage, and competitive strategy	Descriptive examination and questionnaire to the construction company in South Africa	Similarity: There is a relationship between resource capacity with competitive advantages
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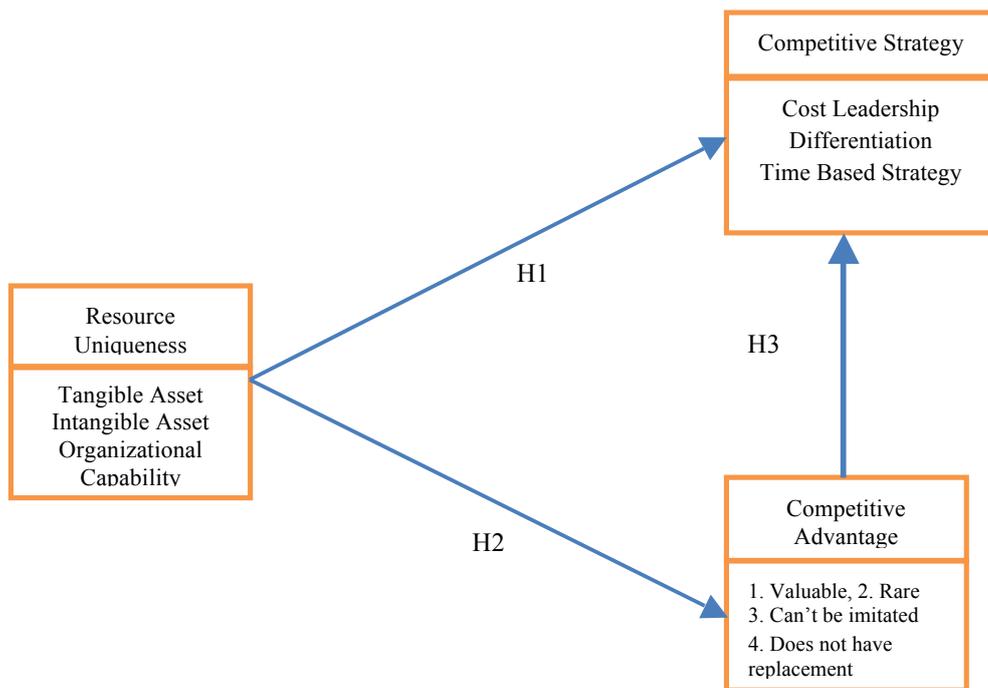
Source: Processed from Various Reference

Based on the literature in Table 6, that are the previous and relevant studies conducted by Hsieh, Yi Hua; Chen, Hai Ming (2011), Chew, Keim C. (2008), Tsai, Wen-Hui; Tsai, Ming-Hong; Li, Sheng- Tun; Lin, Chinho (2012) and Dr. Alfred B. Ngowi and Dr. Pantaleo D.Rwelamila (1999), there is a relationship between the resource uniqueness and

competitive advantages towards competitive strategy.

A. Conceptual Framework Models

The conceptual framework model depicted in Figure 2 below, focusing that the resource uniqueness has an effect on the form of competitive strategy and at once to form competitive advantage.



**Figure 2.** Conceptual Framework Model of the relationship between the resource uniqueness towards competitive strategy and a sustainable competitive advantage

Source: processed by author

**HYPOTHESIS**

From Figure 1 Conceptual Framework can be obtained the following hypotheses:

Hypothesis 1: Resource Uniqueness has an effect on Competitive Strategy

Hypothesis 2: Resource Uniqueness has an effect on Competitive Advantage

Hypothesis 3: Competitive Advantage has an effect on Competitive Strategy.

**RESEARCH METHODS**

1. This study is a combination of literature review and descriptive research study, that is how to resolve the problem by tracing the sources that have been made previously and direct interview to respondent with a questionnaire.
2. Determination of competitive strategy in this study is using the deductive approach with the help of Competitive Frame Work - 3 CA's Model diagram which is quoted from Sucherly 2003.
3. Determination of competitive advantage with the help of Mapping Values of Competitive Advantage Matrix which is quoted from Hitt and Irreland (2011) text book.
4. The respondents in this study are the employee of state-owned construction

enterprises who are selected based on their experience and position in the holding company. The number of respondents is 30 people, all of them are general manager and project manager of PT Wijaya Karya Tbk, PT. Housing Development Tbk, PT Hutama Karya (Persero), PT. Adhi Karya Tbk, PT. Wika Beton Tbk, PT Adhi Realty. Tbk, and PT Waskita Karya Tbk.

**RESULT AND DISCUSSION**

**1. Resource Uniqueness**

Based on a the quotes from the above literature, it can be obtained the dimensions and indicators of appropriate Resource Uniqueness variable for State-Owned Construction Enterprises in Table 7 as follows:

**Table 7.** Dimension and Indicator of Resource Uniqueness

Dimension	Indicator	Remark
1. <i>Tangible Asset</i>	Technology and Innovation	- Realize the benefits of technology - Keep up with technology - Investment in R & D
	Marketing Capability	- Market scope, market location - Win percentage of the taken tender - The ability to predict market changes - Relationship with client and consultant
	Financial Capability	- Financial Status - Creditor trust level - Payment schedule to subcontractor or supplier - Discipline of loan/leasing payment
	Project Management Competency	- Project Manager is talented in trustable - Quality control - Coordination with subcontractor - Contract and Risk Management - SHE management implementation - Knowledge of local construction regulation
2. Intangible Asset	Company Image	-Organization credibility -Company qualification -Project performance notes
3. Organizational Capability	Technical and business capabilities in managing the supply chain is the ability to manage and optimize their sub-contractors and suppliers.	- Manage purchasing/procurement of goods - Manage supplier - Manage relationship with subcontractor

	- Identify the supply chain problem and handle such problem quickly - Risk management
The ability to capture and manage knowledge (Knowledge management) and adjust with the market needs	-Provide study assignment for the selected employee -Attend the national and international seminar
The ability to use new and more sophisticated equipment production for the better process production	-Have experts to manage new and advanced equipment

Source: Processed from Various Reference

## 2. Competitive Strategy of State-Owned Construction Enterprises

Competitive Strategy of State-Owned Construction Enterprises in general is performing competitive strategy with the dimensions of Cost Leadership, Differentiation Strategy, Time-Based Strategy.

These three dimensions are implemented according to the conditions and situation of the project being executed. Project funded by World Bank or foreign loans or state/district budget, then the strategies conducted by State-Owned Construction Enterprises are always using cost leadership strategy and time speed-based strategy.

While on the specialized high-tech projects such as High Speed Train, MRT, LRT, State-Owned Construction Enterprises are using differentiation strategy. This is because such

projects require serious attention as the design and site location are not available yet but should be started and completed as soon as possible.

## 3. Competitive Advantage

Determination of the position of competitive advantage is determined with the aid of a matrix diagram mapping.

Values competitive advantage gained from research and interviews by the author to the respondents, it is known that the capacity of the SOEs JK assets are as follows: (scale 1-5)

- 1 = very unimportant
- 2 = not important
- 3 = sometimes important
- 4 = important
- 5 = very important

**Table 8.** TIROCA Analysis of State-Owned Construction Enterprises (Tangible, Intangible Resources & Organizational Capability)

Dimension	Indicator	V (valued)	R (Rare)	I (Inimitate)	N (Non Substitute?)	Compe- titivenes
1. <i>Tangible</i> Asset	Technology and Innovation	4	4	3	3	Mediocre
	Marketing Capability	3	3	3	2	Low
	Financial Capability	3	3	4	2	Low
	Project Management Competency	4	4	4	3	Mediocre

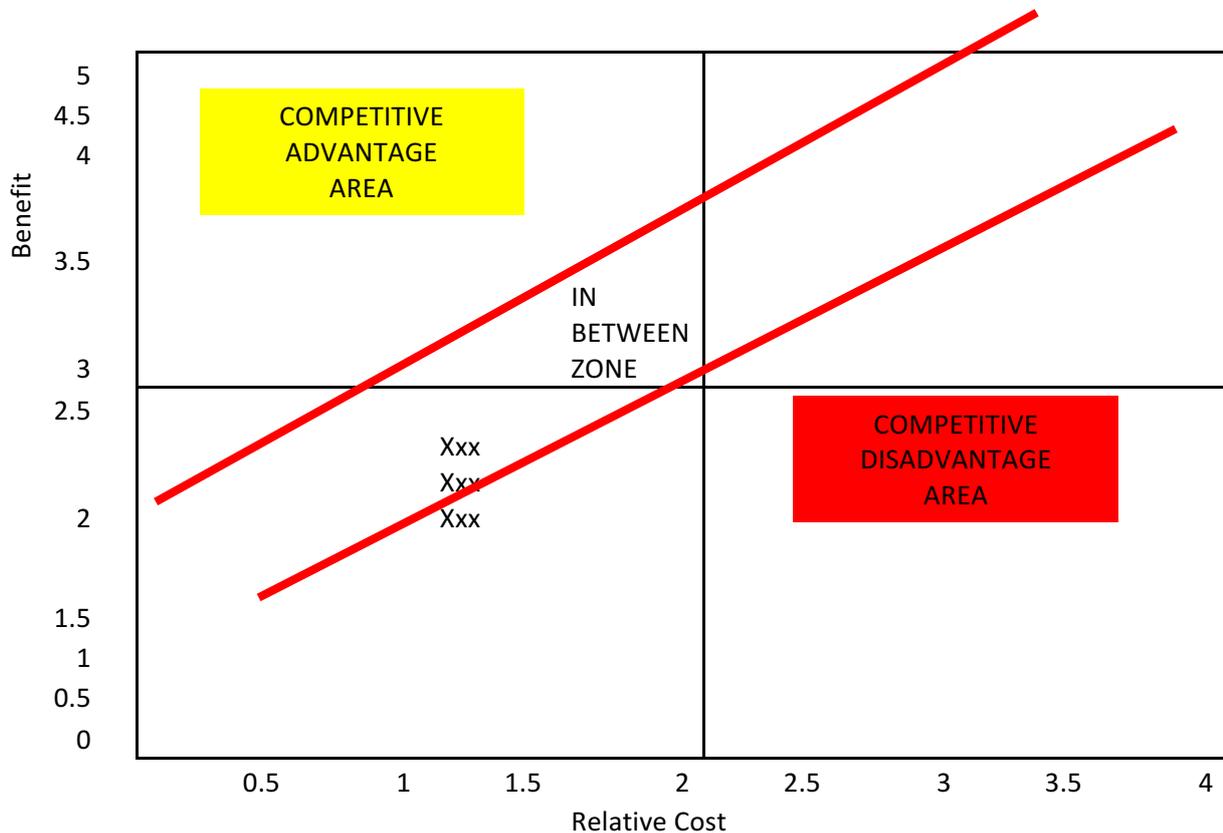
2. <i>Intangible Asset</i>	Company image	4	3	3	3	Low
3. Organizational Capability	Technical and business capabilities in managing the supply chain is the ability to manage and optimize their sub-contractors and suppliers	4	3	3	3	Low
	The ability to capture and manage knowledge (Knowledge management) and adjust with the market needs	4	4	4	4	High
	The ability to use new and more sophisticated equipment production for the better process production	4	3	3	2	Mediocre

Source : Processed from the results of questionnaire and interview with general manager and project manager of State-Owned Construction Enterprises

In Table 8 Tiroca above, the mapping result of the competitive advantage shows that mediocre value is more than the high value, so that the average level of State-Owned Construction Enterprises competitive advantage is at mediocre level.

Determination of State-Owned Construction Enterprises competitive advantage position is based on Mapping Value of Competitive Advantage Matrix (figure 3), found that the benefit scale is between 2 – 2.5 vs relative cost between 2-2.5 1.5-2.0, so that

State-Owned Construction Enterprises are in inbetween zone position or in other words they have no competitive advantage value that should be proud, or the competitive advantage value with mediocre category.



**Figure 3.** Mapping of Superior, Parity, and Inferior Position of State-Owned Construction Enterprises (quoted from Hitt and Irreland (2011) text book)

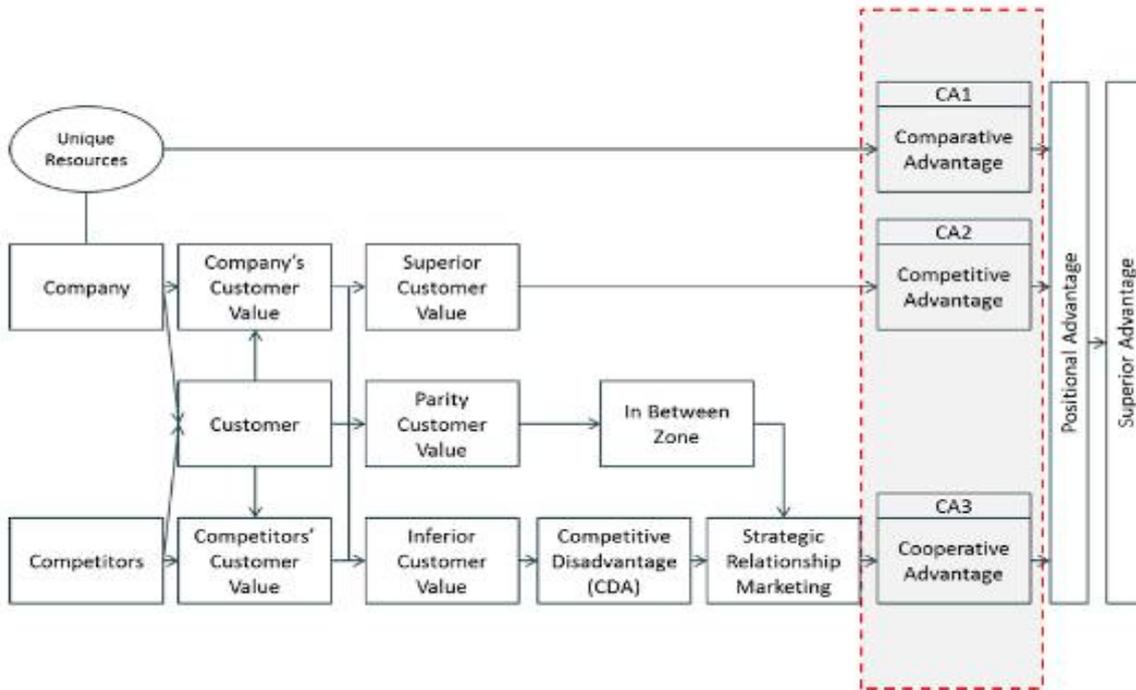
Note: XXX is competitive advantage position of State-Owned Construction Enterprises (obtained from questionnaire and interview with general manager and project manager of State-Owned Construction Enterprises)

**4. Deductive approach with the support of Competitive Frame Work - 3 CA's Model diagram.**

An organization can create positional advantage and superior performance through resource-based comparative advantage (CA-1) approach. In a situation where the organization

and its competitors have a relatively equal resources, the creation of positional advantage and organizational performance can be done with competitive advantage (CA-2) approach that puts customer value on market perspective or market-based (Sucherly, 2003).

### Competitive Framework - 3 CA's Model



**Figure 4.** Deductive Approach, Competitive Strategy Framework,  
Source : Surchely, 2003

In the deductive approach Competitive Framework - 3 CA's Model (Figure 4), the competitive position of State-Owned Construction Enterprise is in the inbetween zone, so that the position between Competitive advantage and Cooperative advantage, that is besides digging internal strength to increase competitive advantage, should also conduct cooperative strategy with competitors or other companies to win the competition.

#### CONCLUSION

1. State-Owned Construction Enterprises have resource uniqueness as follows:
  - Tangible asset → Mediocre categories and not more prominent than the competitors.

- Intangible asset → Low category, no patent or other rights which can be seeded.
- Organizational Capability → Strong category, has been able to empower resource management by innovating on the implementation of projects.

Comprehensively, the resource uniqueness is mediocre category.

2. Competitive Advantage position of State-Owned Construction Enterprises is in the inbetween zone or in other words have no value of competitive advantage to be proud, medium category
3. Due to the State-Owned Construction Enterprises have resource uniqueness that is mediocre, and the competitive advantage is also mediocre, then the competitive strategy used is comparative or competitive strategy cooperation strategy with fellow players in construction services.

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## **CONFLICT MANAGEMENT MODEL OF FINANCIAL ACCOUNTING SYSTEM: APPLICATED IN SEMARANG REGIONAL GOVERNMENT**

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### ***ABSTRACT***

*The purpose of this study was to determine the effect of organizational behavioral factors, cognitive and affective conflict against regional financial accounting system usefulness and behavioral factors influence the organization of cognitive and affective conflict and behavioral factors influence the organization of the usefulness regional financial accounting system intervening by the presence of cognitive and affective conflict. The influence of behavior factors were superiors' support, clarity of purpose and training.*

*The study was conducted at the sub-district and department employees in Semarang. The population is some sub-district and department employees who work on the financial section. Analysis of the data in this research was using Partial Least Square (PLS) method.*

*The results of this study indicate a positive influence of organizational factors on the usability of Regional Financial Accounting System and cognitive conflict and there is a positive effect of cognitive conflict with usability Regional Financial Accounting System. Organizational factors negatively affect affective conflict and affective conflict negatively affects the usefulness of Regional Financial Accounting System.*

**Keywords:** *organizational behaviour factor, conflict cognitive, affective conflict, financial accounting system*

## INTRODUCTION

Regional autonomy is part of democratization in creating a *Powershare* system at every level of government and demands the independence of the management system in the region. The distribution of authority / power is adjusted to the national and local authorities, including the financial authority. To make economic, social, and political decision, the accounting information is needed, one form of which is financial statements to achieve good government.

If we see the financial report of local governments in Indonesia, the government's financial report in Indonesia is something interesting to study further. This is because financial report in Indonesia is used as a means to commit deceitfulness or "*fraud*". From various writings that researcher found from the internet, it seems that in SKPD and local government financial statements there are still many data that do not fit presented. In addition, there are many deviations found by BPK in the financial statements audit of local governments, especially in Semarang government. According to Ilya Avianti, the deviations usually occur in the preparation of budget, the use of budgets and the financial reports which are manipulated. The deviations happen due to the lack of regulations and legislation as well as the limited ability of the government's human resources.

Based on the above cases, to achieve Good Governance, the government continues to intensify the steps in managing local financial. This system is in line with the laws that have been issued by the government that shows the State financial management reformation. The laws are the Law No. 17 of 2003 on State Financial, Law No.1 of 2004 on State Treasury, Law No. 15 of 2004 on Investigation of Management and Responsibility of State Financial. Law No. 32 of 2004 on Regional Government, Law No. 33 of 2004 on Financial Balance between Central and Regional Government,

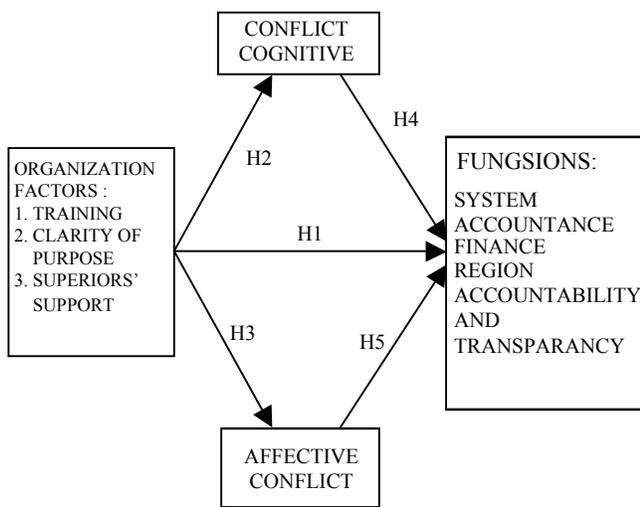
Government Regulation No. 24 of 2005 on the Management of Central and Regional Financial. Government Regulation No. 24 of 2005 on the Government Accounting Standards, Government Regulation No. 58 of 2005 on Regional Financial Management, Minister of Domestic Affairs Regulation Number 13 of 2006 on the guidelines of Regional Financial Management. The issuance of Minister of Domestic Affairs Regulation No. 59 of 2007 revised The Regulation of Minister of Domestic Affairs No. 13 of 2006 on the guidelines of Regional Financial Management. The various laws and regulations above are expected to be a solid foundation for the management of state financial to make *good governance* and *clean government*.

According to Chenhall (2004) in Jamila (2010) attitudes factors related to the success of ABCM application is central management support, linked to competitive strategy, adequacy of resources, accountant proprietary, relationship with evaluation of performance and compensation, training procurement, the clarity of goal and the number of purposes for ABCM. The important dimensions of organization factor are superiors' support, clarity of purpose and training.

linked, well crafted and well developed. It serves as the source of research question and especially the base of the hypotheses that respond to the research objective. We advise to use current and primary sources from trusted international references (top tier-journals). The third part of the manuscript, "Data and method" is designed to describe the nature of the data, its size number through space and time. The method should be well elaborated enhancing the model, the analysis approach and steps. Equations should be numbered as we illustrate (see the example below). The "discussion and analysis" part; highlights the rationale behind the result answering the question "why the result is so?" It shows the theories and the evidence from the results. The part does not just explain the figures but mostly deals with this deep analysis to cope with the gap that is trying to solve. The last part

“conclusion” summarizes clearly the main parts and answers the research questions. It concludes as well briefly the findings and the implications. Limitations and suggestions might be briefly stated, while necessary.

Furthermore, type styles are illustrated that considers the reference, the equation numbering, the table, and the figures.



**Research variable**

The research variables are the objects of research or what becomes the focus point of a researcher (Arikunto, 2006). Analysis of data in this study used the variables consisting of *dependent variable*, *independent variable* and *intervening variable*.

a. Independent Variable (X)

Independent variables in this study are Organizational Factors that includes training, superiors’ support, and clarity of purpose.

b. Dependent Variable (Y)

Dependent variable in this study is Regional Financial Accounting System.

c. Intervening variable

- 1. Affective
- 2. Kognitif

**Population**

Population is the totality of all possible values, whether the results of counting or qualitative measurement of the specific characteristics of all members of

complete and clear group we want to learn its nature. In this case the study population was all districts in Semarang.

Samples are half or representative of the population studied (Arikunto, 2008). Samples are taken since in many cases it is not possible for us to investigate all members of the population; therefore we establish a representative called samples (Ferdinand, 2006). But in this study the samples studied are of overall employees of district and financial department employees in Semarang.

**Inquiry or Questionnaire Method**

Questionnaire is a number of written questions that are used to obtain information from respondents in terms of reports on their personal or things to know (Arikunto, 2006). In this study the questionnaire used is closed questionnaire that is questionnaires in which the answers have already been provided so that the respondents just need to choose.

**Analysis Method**

The dependent variables in this research are the organizational factors that include: (1) Training; (2) Superiors’ support; (3) Clarity of purpose. Meanwhile the independent variable in this study is Regional Financial Accounting System and the intervening variables in this study are the affective and cognitive.

The research was conducted in the District and the Department throughout the city of Semarang where the research objects of this study are employees of the District and the Department in charge of financial sector. The method of data collection / dissemination of the questionnaire used *convenience sampling*. While, the data analysis used in this study was *Partial Least Square (PLS)*. PLS can be used on any kind of data scale (nominal, ordinal, interval, ratio) and a more fleksibel assuming requirement. PLS was also used to measure

the relationship of each indicator with their constructs.

**RESULT AND DISCUSSION**  
**Validity Result**

Validity result can be seen in the table below:

**Table 1.2**  
**Validity Test Results**

Variable	Cross loading	Criteria
DA1	<b>0.541839</b>	<i>Loading faktor score must be greater or over than 0.50 as valid score</i>
DA2	<b>0.608690</b>	
DA3	<b>0.535131</b>	
DA4	<b>0.507222</b>	
DA5	<b>0.636605</b>	
KA1	<b>0.598270</b>	
KA2	<b>0.997524</b>	
KA3	<b>0.509177</b>	
KK1	<b>0.589318</b>	
KK2	<b>0.594425</b>	
KK3	<b>0.788021</b>	
KK4	<b>0.532381</b>	
KK5	<b>0.644288</b>	
KK6	<b>0.560344</b>	
KK7	<b>0.614965</b>	
KK8	<b>0.553614</b>	
KK9	<b>0.672296</b>	
KSAD1	<b>0.747358</b>	
KSAD2	<b>0.633053</b>	
KSAD3	<b>0.740212</b>	
KSAD4	<b>0.655744</b>	
KSAD5	<b>0.607425</b>	
KSAD6	<b>0.759121</b>	
KSAD7	<b>0.712619</b>	
KSAD8	<b>0.748900</b>	
KSAD9	<b>0.634873</b>	
KT1	<b>0.636714</b>	
KT2	<b>0.526670</b>	
KT3	<b>0.510391</b>	
KT4	<b>0.692071</b>	
KT5	<b>0.670957</b>	
KT6	<b>0.671265</b>	
KT7	<b>0.585579</b>	
KT8	<b>0.552323</b>	
KT9	<b>0.529668</b>	

P1	<b>0.531336</b>	
P2	<b>0.538376</b>	
P3	<b>0.567549</b>	
P4	<b>0.552408</b>	
P5	<b>0.674480</b>	

Source: Primary data analysis (2016)

According to table 1.2 above, it can be seen that *factor loading* or *cross loading* 0.7 indicates valid score. Some variables 0.5 until 0.6 indicate valid score.

**Reliability Test**

The reliability test can be seen on Composite Reliability score:

**Table 1.3**  
**Reliability Test**

	Composite Reliability
FO	0.698007
KA	0.645268
KK	0.629066
KSAD	0.882424

Source: Primary data analysis (2016)

According to table 1.3 above, it can be seen that Composite Reliability score greater than 0.6 indicates that it's reliable.

**Hypothesis Test Result**

The hypothesis test result used PLS data can be seen as follows:

**Tabel 1.4**  
**Path Coefficients (Mean, STDEV, T-Values)**

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	Standard Error (STERR)
FO->KA	-0.355888	-0.317836	0.273219	0.273219
FO->KK	0.575391	0.613601	0.085583	0.085583
FO->KSAD	0.370960	0.377384	0.154292	0.154292
KA->KSAD	-0.184310	-0.155442	0.136179	0.136179
KK->KSAD	0.316308	0.320568	0.195684	0.195684

Source: Primary data analysis (2016)

**Table 1.5**  
**Statistic T Value**

	T Statistic ( O/STERR )
FO -> KA	1.702577
FO -> KK	6.723176
FO -> KSAD	2.404270
KA -> KSAD	1.753443
KK -> KSAD	1.676421

Source: Primary data analysis (2016)

H1 Testing is: "The Organizational Factors such as Superiors' Support, Clarity of Purpose and Training give positive effects on the usefulness of Regional Financial Accounting System". The parameter coefficient is 0.370960 which means there is positive effect of the organizational factors on the usability of Regional Financial Accounting System. The higher the organizational factors, the higher the usability of Regional Financial Accounting System with statistic t value of 2.404270 > t table (significance 5% = 1.67) so that hypothesis is accepted. This means organizational factors give positive effects on the usability of Regional Financial Accounting System.

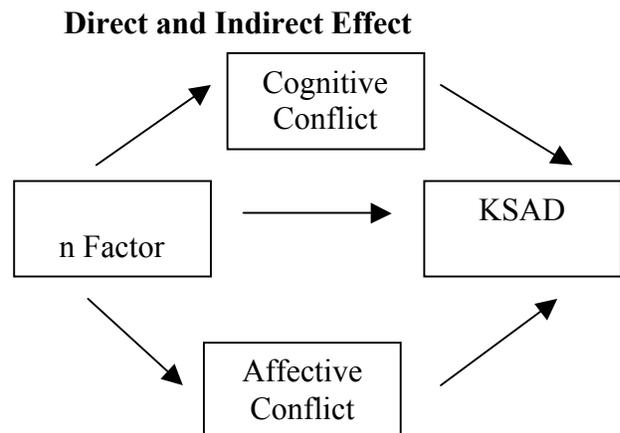
H2 Testing is: "The Organizational Factors such as Superiors' Support, Clarity of Purpose and Training give positive effects on cognitive conflict". The parameter coefficient is 0.575391 which means there is positive effect of Organizational Factors on cognitive conflict. With its statistic t value of 6.723176 > t table (significance 5% = 1.67) so that hypothesis is accepted. It means Organizational Factors such as Superiors' Support, Clarity of Purpose and Training positively affects cognitive conflict.

H3 Testing is: "The Organizational Factors such as Superiors' Support, Clarity of Purpose and Training give negative effects on affective conflict". The parameter coefficient is -0.355888 which means there is negative effects of Organizational Factors on affective conflict with statistic t value of 1.702577 > t table (significance 5% = 1.67) so that hypothesis is accepted. It means Organizational Factors such as Superiors' Support, Clarity of Purpose and Training give negative effect on affective conflict.

H4 Testing is: "Cognitive Conflict gives positive effect with SAKD usability". The parameter coefficient of 0.316308 means there is positive effect of cognitive conflict on SAKD usability. With statistic t value of 1.676421 > t table (significance 5% = 1.67) so that hypothesis is accepted. It means cognitive conflict gives positive effect on SAKD usability.

H5 Testing is: "Affective conflict gives negative effect on SAKD usability". The parameter coefficient of -0.184310 means there is negative effect of affective conflict on SAKD usability with statistic t value of 1.753443 > t table (significance 5% = 1.67) so that hypothesis is accepted. It means affective conflict gives negative effects on SAKD usability.

**Direct and Indirect Effect**  
**Figure 2**



## Conclusion

From the results of discussion and analysis in the previous section, it can be concluded as follows:

1. There is positive effect of organizational factor on the usability of Regional Financial Accounting System.
2. There is positive effect of organizational factors on cognitive conflict such as Superiors' Support, Clarity of Purpose and Training.
3. There is negative effect of organizational factors on affective conflict of Organizational Factors such as Superiors' Support, Clarity of Purpose and Training.
4. There is positive effect of cognitive conflict on the usability of Regional Financial Accounting System.
5. There is negative effect of affective conflict on the usability of Regional Financial Accounting System.

## Suggestion

As for suggestions that could be addressed in this study are as follows:

1. At least the organization should consider organizational factors such as Superiors' Support, Clarity of Purpose and Training because they are proven to give effect on the cognitive and the affective conflicts.
2. Must be able to ensure that the questionnaires sent are completely filled by the researchers' desired objects, further research should strengthen it by having interview or direct observation.
3. This study was only conducted at one time (*cross-sectional*), so there is possibility that individual behavior is changing over time.

## Upcoming Research Agenda

For similar study in the future, it is suggested to extend the area of the sample or to add other variables that affect the usability of Regional Financial Accounting System.

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## THE INFLUENCE OF TAX MANAGEMENT AND EARNINGS MANAGEMENT TOWARD CORPORATE FINANCIAL PERFORMANCE WITH CORPORATE GOVERNANCE AS A MODERATING VARIABLE

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### **ABSTRACT**

*This study aimed to examine: (1) the effect of tax management and earning management to corporate financial performance; (2) the effect of tax management to corporate financial performance with corporate governance as a moderating variable; (3) the effect of earnings management to corporate financial performance with corporate governance as a moderating variable. The Analysis used panel data regressions model with company size and leverage as control variable. The data used in the analysis consist of 228 companies listed on Indonesia Stock Exchange for the period 2010 to 2015 from property sector, real estate to construction building. The results showed that the tax management had a significant effect on the corporate financial performance. Otherwise, the earnings management had a negative and significant effect on corporate financial performance. Corporate governance moderated the relationship between the tax management and earnings management on the corporate financial performance. The result also show that the control variable such as size and leverage had a positive and significant effect on corporate financial performance.*

**Keywords:** *tax management, earnings management, corporate governance, corporate financial performance.*

### **INTRODUCTION**

One of the motivations manager in managing earnings is because of the motivation of taxation. It is implemented to minimize income tax expense so as to maximize the after tax profit. Up to this moment in Indonesia there are no laws and regulations that determine on Earning Management. Therefore, there are still many companies that do Earnings Management. Earnings Management practices that do managers can mislead users of financial statements, especially the stakeholders, because of the financial statements did not describe the actual condition of the company.

Several companies in making decisions by using a company's financial statements. It is

implemented by the company because of the financial statements may reflect the condition of the company. However, the financial statements by some managers at companies with a variety of specific reasons to do manipulation of financial reporting. The actions of managers in manipulating the figures presented in the financial statements is an act of earnings management.

According to Scholes et al.(2005), tax management is a process to set up a company making a minimum tax liability in accordance with tax regulations. Tax management is an attempt to organize the process of taxpayers so that tax debt either income tax or other taxes are in a minimal amount, as long as it does not abuse

the provisions of law (Pohan, 2015). Tax management is part of the tax planning undertaken by the company. Tax practice management according to the rules of taxation are not prohibited as long as the methods used legally and does not abuse the rules and the tax laws that apply in Indonesia at this time. according Pohan (2015), to determining a legal or illegal Tax Management, signs that can be used is the criminal provisions of Article 38, 39, 41, 41A, 41B, and the 43 of Law No. KUP 6 of 1983 as amended by Law No. KUP 28 of 2007 (Pohan, 2015).

Earnings management practices that occur in general because of a conflict of interest between the management (agent) and the owner (principal). Management has a vested interest that was not in line with shareholders, while management hired by the shareholders should work in accordance with the interests of shareholders. The shareholders want to maximize the return from their investment in the company. However, there were some managers who were not consistent with the interests of shareholders who practice enriching themselves, so that the profit expected by shareholders was not optimal.

In order to prevent such a thing happening in a company, the company implemented Good Corporate Governance. In order to prevent such a thing happening in a company, the company implemented Good Corporate Governance. According to Mahmood and the Riaz (2008) defines corporate governance as seen on the theoretical aspects of transparency, accountability and probity. While as a practical, Corporate Governance is a tool to make effective decisions and the achieve organizational objectives with organizations such as the parameters of the understanding of organizational structure, processes, examination, the balance mechanism and monitoring management activities. By the existence of corporate governance, managers are expected not commit fraud again, so that the financial statements presented can be used for making the right decision.

Practices of Earnings Management and the Tax Management undertaken by managers influencing corporate financial performance.

While the practice of good corporate governance to minimize Earnings Management and Tax Management are being made to increase the value of the company. Thus, corporate governance practices can affect the relationship of Earnings Management and the tax management to corporate financial performance. Based on the description of the tax practices of management and the earnings management that can affect corporate financial performance.

The role of corporate governance in the relationship between these variables is as control in the tax practice of management and the earnings management conducted by the management, so that the question in this research are: (1) Does Tax Management and Earnings Management have significant effect on corporate financial performance; (2) Does the corporate governance have effect the relationship between tax management and the corporate financial performance; (3) Does the corporate governance have effect the relationship between earnings management and the corporate financial performance.

The purpose of this study was to determine empirically: (1) The effect of tax management and earnings management toward corporate financial performance (2) The influence of corporate governance on the relationship between tax management and the corporate financial performance: (3) The influence of corporate governance on the relationship between earnings management and corporate financial performance.:

This study was expected to contribute ideas to: (1) the company, can be taken into consideration in addressing agency problems mainly Earnings Management practices; (2) investors and creditors, can be taken into consideration in making investment decisions and the lending; (3) the development of knowledge about the positive accounting theory, especially agency theory and the corporate governance theory, so as to provide the option of modeling in the practice of corporate governance in theory be able to influencing the relationship between tax management and the earnings management to corporate financial performance.

## **Literature Review and Hypothesis Development**

### **Tax Management and Corporate Financial Performance**

Scholes et al., (2005), defines the tax management is a process to set up a company making a minimum tax liability in accordance with tax regulations. Benefits of the Tax Management in the company is a company's activities in the action structured so that income tax expense as low as possible by utilizing the existing regulations to obtain an increase in profit after tax will have an impact on increasing the company's value (Minnick, K., & Noga, T., 2010; Desai and Dharmapala, 2006a; Regol, 2003). Thus it is expected by the tax management can improve Corporate Financial Performance. Some studies such as that conducted by Desai and Dharmapala (2006a), conducting empirical studies on the relationship between the activities of tax evasion and the value of the company using a sample of companies in the United States with the results of a study that found that the positive influence the activity of tax planning on firm value, This shows that the better companies in the activities of tax management will further increase the company's value. Sebaliknya, according to research Wahab and Holland (2012) and Ftouhi, Ayed, Zemzem (2014) found a negative relationship between tax management and corporate financial performance.

**Hypothesis 1 (H1):** Tax management is a significant effect with corporate financial performance

### **Corporate Governance, Tax Management and Corporate Financial Performance**

The compensation method is used by the shareholder companies to encourage managers to work better so as to improve profitability company with the maximum that can be achieved in order to improve the Corporate Financial Performance (Hanlon and Slemrod, 2009). Corporate Governance of the company can monitor the activity of the company in order to measure the company's management in line with the company's goal is to increase the value of the company. By the their corporate governance

activities expected to be strengthen or weaken the positive and negative tax relationship management with corporate financial performance. Desai and Dharmapala (2009). Corporate Governance Mechanisms strong company in the tax relationship management can be considered as a means to improve corporate performance financial (Lee et al., 2015).

**Hypothesis 2 (H2):** Corporate Governance as a moderating variable has the relationship between tax management and corporate financial performance

### **Earnings Management and Corporate Financial Performance**

By the reason of increasing the value of the company, management of opportunistic action by Earning Management. (Cohen et al., 2011). According Suffian, Sanusi and Mastuki (2015), there is a negative correlation between the activity Earning Management and corporate value. This shows that the higher the manager's involvement in the activities of Earning Management, the smaller the value of the company. While other studies, according to Ridwan and Gunardi study (2013) found that management Earnings positive effect on firm value. Managers are required to give a signal about the state of the company to shareholders. The signal given is one reflection of the company's performance through disclosure of accounting information such as the performance of the financial statements (Corporate Financial Performance). According Aliani (2012), the performance of the financial statements is important for external users of the company, because for external parties, the company is therefore no certainty state that guarantees to make an investment in the company.

**Hypothesis 3 (H3):** Earning Management is negatively effect with corporate financial performance

## Corporate Governance, Earnings Management and Corporate Financial Performance

Studies of exploring the relationship between corporate governance and corporate financial performance, both in developed and developing countries have been made. (Hasan and Ahmed, 2012). The concept of corporate governance is carried out by an entity with the aim to make corporate management more transparent for all concerned users of financial statements. According to Xie, et al., (2002), that the coefficient of earnings positive effect on the company's value in the regression model that considers variables corporate governance practices. Therefore, with the practice of corporate governance in the company will limit Earning Management due to the mechanism of control in the company. Corporate Governance Practices can be proxied by the Indonesian Governance Corporate Scorecard is an instrument research and development ranking of Indonesian Institute for Corporate Directorship (IICD) in order to measure the implementation of corporate governance at the company.

**Hypothesis4 (H4):** Corporate Governance as a moderating variable has the relationship between earnings management and corporate financial performance

## Methods

### Sample Selection

The research was conducted on 228 companies in property sector, real estate to construction building listed on the Indonesia Stock Exchange. Application of purposive sampling in this study are based on the following criteria: (1) The service company property sector and real estate listing on the Indonesia Stock Exchange; (2) Company which publishes an annual report (annual report), which ended on December 31 during the period observations 2010-2015; (3) The company reported audited financial Lapoan during the study period; (4) The financial statements are complete sample provided during the observation period and published in rupiah unit.

Technique of data collecting is a method in place to get the needed information. By looking at the financial statements, notes to financial statements, and annual reports. For obtaining data required in this study, the authors used data collection techniques documentation of the data published by the official website of Indonesia Stock Exchange ([www.idx.co.id](http://www.idx.co.id)).

### Variabel dan Measurement

Corporate financial performance as a dependent variable, can be measured by White et al. (2008) model, using Tobin's Q with the formula:

$$Q = \frac{EMV + D}{EBV + D}$$

Where, Q: Corporate financial performance; EMV: Market Value of Equity (Equity Market Value), is obtained by multiplying the closing share price (closing price) end of the year with the number of shares outstanding at the end of the year; EBV: The book value of equity (Equity Book Value); D: The book value of the total debt. Tax Management in this research using Effective Tax Rate (ETR) value in the range of 0-1. So the company that has a value of Effective Tax Rate (ETR) outside of that range are not considered in the analysis. It has to avoid any distortion in the ETR and problems in the models used. ETR which takes into account current and deferred taxes do not reflect the short-term management of tax paid with cash (Minnick and Noga, 2010). To solve these problems, Wild et al. (2010) measure the effective tax using tax payments of cash as a proxy for the management of tax. Because of the reasons, this study used proxy ETR of cash as tax management. Cash ETR is a ratio of of cash tax payments (cash taxes paid) on the company's profit before income tax (pretax income). Cash tax payments contained in the Statement of Cash Flows in the post 'payment of income tax' in 'cash flow from operating activities. While the company's profit before tax contained in the Income Statement in the post 'income before income tax. The calculation can be described as follows:

$$CETR_{it} = \frac{Cash\ Tax\ Paid_{it}}{Pretax\ Income_{it}}$$

Earning Management which is used in the research proxied by discretionary accruals using

the modified Jones model Dechow et.al (1995). All variables are scaled by using asset lag to overcome the problem of heteroscedasticity and the difference in size of the company as practiced by Jones (1991). By using the total accrual and enter the residual term, actual regression estimation becomes:

$$\frac{TAC_{it}}{TA_{it-1}} = \alpha_0 \frac{1}{TA_{it-1}} + \alpha_1 \frac{\Delta REV_{it} - \Delta REC_{it}}{TA_{it-1}} + \alpha_2 \frac{PPE_{it}}{TA_{it-1}} + \varepsilon_{it}$$

Where, TAC<sub>it</sub>: Total accrual firm i in period t; TA<sub>it-1</sub>: Total assets at perode t-1; ΔREV<sub>it</sub>: Changes earnings period t and t-1; ΔREC<sub>it</sub>: Changes in net receivables period t and t-1; PPE<sub>it</sub>: Property, plant and equipment in period t; α<sub>1</sub>, α<sub>2</sub>, α<sub>3</sub>: Coefficient; ε: Error

Moderating variable in this research was measured by Corporate Governance Corporate Governance which in this research proxy with the quality audit and independent commissioners. An independent commissioner be obtained by calculating the percentage of independent directors compared to the total existing commissioners. Quality audits using dummy variable, where the value of 1 if audited by a Big 4 accounting firm and 0 otherwise.

The control variables which is used in this research is size of the company and Leverage. According to Yang, et al. (2005), the larger the size of an enterpriset then the larger chance of the manager to perform Earning Management in which the company has a more complex operational activities. Size of the company can be measured from the natural logarithm of the market value of the company's equity at the end of the year the number of shares outstanding at year end multiplied by the year-end stock market prices. Leverage the company is measured by using total liabilities divided by total assets.

**Research Models**

**Model for H<sub>1</sub> and H<sub>2</sub>**

Hypothesis testing was done by using multiple linear regression analysis using the program STATA version 12 used for data processing. The relationship between Tax Management and Corporate Financial Performance in this research

is shown in equation regression model in the below.

$$Q = \alpha_0 + \beta_1 TM + \beta_2 AQ + \beta_3 KI + \beta_4 TMAQ + \beta_5 TMKI + \beta_6 Size + \beta_7 Lev + \varepsilon$$

.....Regression Model I Note: Q: Values Company, proxied the Tobin's Q; α<sub>0</sub>: Constants; β<sub>1</sub>, β<sub>2</sub>, β<sub>3</sub>, ...: Coefficient; TM: Tax Management; AQ: The quality of the audit; KI: Independent Commissioner; Size: Size of the the Company; Lev: Leverage

The activity of of tax evasion by the company does not increase the value of the company. An assessment of the the tax avoidance is a function of corporate governance and, more broadly, the viewpoint that tax evasion and an attempt by the management to transfer the value of the shareholders. Desai and Dharmapala (2006), the result show that the increase in compensation for the manager tends to reduce the rate of tax sheltering. Tax sheltering an effort to reduce the level of taxable income in order to reach the efficiency of tax payments. Desai and Dharmapala (2009), the result also show that had no significant direct relationship between the activities of tax evasion and the value of the company.

**Model for H<sub>3</sub> and H<sub>4</sub>**

Hypothesis testing was done by using multiple linear regression analysis using the program STATA version 12 used for data processing. The between Earnings Management and Corporate Financial Performance in this research is shown in equation regression model in the below.

$$Q = \alpha_0 + \beta_1 EM + \beta_2 AQ + \beta_3 KI + \beta_4 EMAQ + \beta_5 EMKI + \beta_6 Size + \beta_7 Lev + \varepsilon$$

..... Regression Model II

Note: Q: Corporate Financial Performance, was proxied by the Tobin's Q; α<sub>0</sub>: constants; β<sub>1</sub>, β<sub>2</sub>, β<sub>3</sub>, ...; Coefficient; EM: Earnings Management; AQ: The quality of the audit; KI: Independent Commissioner; Size: Size of the the Company; Lev: Leverage

According to Teoh, et al., (1998) found a negative correlation between the activities of Real Earning Management (REM) and the value

of the company clearly shows that the higher managers' involvement in the activities of REM, the smaller the value Fernandes, et al., (2007) found that earnings management positive effect on corporate financial performance. Corporate Governance associated with the agency problem. The fundamental question is

how to ensure corporate governance investors that they will get a return on investment (Shleifer and Vishny, 1997). Earnings management and poorly corporate governance mechanisms are positively related.

## Results and Relationship Discussion

### Descriptive Statistics and Correlation Matrix

Tabel 1. Descriptive Statistics

	Obs	Mean	Std. Dev.	Max	Min
Q	228	1.275	0.652	4.248	0.190
TM	228	0.349	3.035	37.636	-25.177
EM	228	1.320	0.124	0.685	-0.409
AQ	228	0.601	0.491	1	0
IC	228	0.407	0.104	0.75	0.20
TMAQ	228	0.245	3.028	37.636	-25.177
TMIC	228	0.134	1.613	18.818	-15.106
EMAQ	228	0.010	0.099	0.685	-2896
EMIC	228	0.0005	0.049	0.342	-0.123
Size	228	28.263	1.777	31.132	23.542
Lev	228	1.039	1.005	5.666	0.0273

Source: OUTPUT STATA, Secondary Data, 2016

**Note:** Q:corporate financial performance; TM:tax management; EM: earning management; AQ: audit quality; IC: independent commissioner.TMAQ: the interaction of tax management on Audit quality: TMIC: the interaction of tax management on independent commissioner; EMAQ: the interaction of earnings management on Audit quality: TMKI: the interaction of earnings management on independent commissioner

Mean of value of Corporate Financial Performance of 1.275 with a standard deviation of 0.652, while the minimum and maximum values are the 0.190 and 4.248. While the Tax Management has a mean of 0.349 with a standard deviation of 3.035; as well as the minimum and maximum values of -25.177 and 37.636. Furthermore, the mean of Earning Management are the 1.320 with a standard deviation of 0.124, while the minimum value and a maximum value of -0.409 and 0.685. For variable Corporate

Governance, Audit Quality have an average value of 0.601 and have a standard deviation of 0.491, while the minimum and maximum values of 0 and 1. Variable independent committee have an average value of 0.407 with a standard deviation of 0.104, while the maximum and minimum values of 0.75 and 0.20.

The relationship between the Tax Management the Audit Quality has an average value of 0.245 the a standard deviation of 3.028, while the maximum value and the minimum are the 37,636

and -25.177. Relationship between Tax Management with an independent commissioner has an average value of 0.134 with a standard deviation of 1.613, while the maximum and minimum value amounts to 18.818 and -15.106.

Interaction of Earnings Management the Audit Quality has an average of 0.010 with a standard deviation of 0.099, while the minimum and the maximum value are the -0.290 and 0.685. Meanwhile, the average value of relationship between the Earning Management with an Independent Commissioner of 0.0005 with a standard deviation of 0.049, while the maximum value and the minimum value are the 0.342 and -0.123. The average value of the variable size of 28.163 with a standard deviation of 1.777, while the value of maximum and minimum amounts to

31.132 and 23.542. The average value of the leverage of 1.039 with a standard deviation of 1.005, while the value of maximum and minimum values are the 5.666 and 0.0273.

The correlation of matrix on Table 2 below shows that the relation between Earning Tax Management and Corporate Financial Performance Management to have a significant impact and negative correlation. This relationship is stated that with the behavior of Tax Management and Earning Management conducted by the management company will affect the rate of decline in Corporate Financial Performance.

**Tabel 2. Correlation Matrix**

VARIABLES	Q	TM	EM	AQ	KI	Size	Leverage
Q	1						
TM	-0.240	1					
p-value	0.00						
EM	-0.149	0.019	1				
p-value	0.01	0.393					
AQ	0.238	-0.053	0.441	1			
p-value	0.416	0.083	0.175				
IC	1.316	0.496	-0.024	.279**	1		
p-value	0.27	0.000	0.362	0			
SIZE	.417**	0.537	.149*	.271**	.178**	1	
p-value	0.00	0.000	0.001	0	0.005		
LEV	.333**	0.199	0.004	-0.021	-0.087	.226**	1
p-value	0.00	0.005	0.476	0.381	0.104	0	

\*\*\* significant at the 1 percent; \*\* significant at the 5 percent; \* significant at the 10 percent

## The Results of Hypothesis 1 and Hypothesis 2

**Table 3. The Effect of *Earnings Management* and *Corporate Financial Performance* with or without *Corporate Governance* as a moderating variabel**

$$Q_1 = \alpha_0 + \beta_1 TM + \beta_2 AQ + \beta_3 KI + \beta_4 TMAQ + \beta_5 TMKI + \beta_6 Size + \beta_7 Lev + \varepsilon$$

		Model 1		
Variables	Prediction	Corporate Financial Performance		
		Coefficients	p-value	Std error
Cons		-14.5537	0.000	0.7943887
TM	+/-	0.240373	0.000**	0.0358694
Size	+	0.5369816	0.000	0.0277152
Lev	+	0.1992471	0.005	0.0678682
AQ	+/-	0.238260	0.000	0.0617818
IC	+/-	1.316156	0.000	0.3219282
TMAQ	+/-	-0.053239	0.000***	0.0057279
TMIC	+/-	0.495941	0.000***	0.0709639
Adjusted R2		0.3903		
F-Statistic		161.76		
Prob (F-Statistic)		0.0000		
Woolridge Test		0.5004	**	
Number of Observation		228		

\*\*\*Significant at a level of 1 percent; \*\*Significant at a level of 5 percent; \*Significant at a level of 10 percent

**Note:** Q: corporate financial performance; TM: tax management; Size: Firm Size; Lev: Leverage Size; AQ: audit quality; IC: independent commissioner. TMAQ: the interaction of tax management on Audit quality; TMIC: the interaction of tax management on independent commissioner.

In determination coefficient regression model 1 adjusted R<sup>2</sup> values obtained amounted to 39.03%, which means that variations in the value of the company can be explained by the Tax Management, company size and leverage, while the remaining 60.97% is explained by other variables not be included in the model.

Based on the t test results in Table 3 above shows that the probability t for Tax Management for 0000 is less than 5% and has a coefficient of -0.240373, which means that the Tax Management has a significant negative effect on the Corporate Financial Performance. This means that the first hypothesis which states that the Tax Management positive effect on firm value is not supported. The results of the research are not consistent with research Desai and Dharmapala (2009) find there was no significant direct relationship between the activities of tax evasion and the value of the company.

Based on the result of t test in Table 3 show that the interaction the Tax Management Audit Quality has a probability value for 0000 is less than 1%. It means that moderate the relationship Quality Audit Tax Management the Corporate Financial Performance is negatively and significant. Audit quality can be weaken the relationship between Tax Management and the value of the company, so management will increasingly manage taxes, even to search for the best auditors, so the presence of external auditors that good will increasingly control the management. Therefore, the management will be careful to perform Tax Management.

While the interaction Tax Management with an independent commissioner has a 0.000 of probability is less than 1%. The independent commissioner could be moderated the relationship between the tax management the value of the company in a positive and

significant, so that independent directors strengthen relationships with the company's Tax Management. This was due to management is more cautious in conducting Tax Tax Management Management by doing so well that the company's value increases because of the control of an independent commissioner.

According to Ko, et al., 2013, the tax avoidance is a part of the management decision-

making. According to Ko, et al., 2013, the tax avoidance is a part of the management decision-making. The management decisions be able affect the level of tax avoidance will be a company. External companies can not observe how managers reduce their tax liability, because public companies are not required to release their tax return to the public.

### The Results of Hypothesis 3 and Hypothesis 4

**Table 4. The Effect of Earnings Management and Corporate Financial Performance with or without Corporate Governance as a moderating variabel**

$$Q_2 = \alpha_0 + \beta_1 EM + \beta_2 AQ + \beta_3 KI + \beta_4 EMAQ + \beta_5 EMKI + \beta_6 Size + \beta_7 Lev + \varepsilon$$

Variables	Prediction	Model 2		
		<i>Corporate Financial Performance</i>		
		Coefficients	p-value	Std error
Cons		-15.78564	0.000	0.93488
EM	-	-1.494625**	0.001	0.25207
Size	+	0.5803821	0.000	0.03265
Lev	+	0.184389	0.002	0.05560
AQ	+/-	0.2378255	0.002	0.07300
IC	+/-	1.367832	0.002	0.41056
EMAQ	+/-	0.4413081**	0.000	0.09483
EMIC	+/-	2.239742**	0.006	0.77142
Adjusted R2		0.4106		
F-Statistic		79.34		
Prob (F-Statistic)		0.0000		
<i>Woolridge Test</i>		0.2218	**	
Number of Observation		228		

\*\*\*Significant at a level of 1 percent; \*\*Significant at a level of 5 percent; \*Significant at a level of 10 percent

**Note:** Q: corporate financial performance; EM: earnings management; Size: Firm Size; Lev: Leverage Size; AQ: audit quality; IC: independent commissioner. EMAQ: the interaction of earnings management on Audit quality; EMIC: the interaction of earnings management on independent commissioner.

On the determination coefficient regression models 2 adjusted  $R^2$  values obtained at 0.4106. It means that 41.06% Corporate Financial Performance can be explained by Earning Management, Audit Quality, an independent commissioner, interaction Earning Management Audit Quality, the interaction Earning Management the independent commissioners, company size and leverage, while 58.94% is explained by factors other than the independent variables.

Based on the result of t test in Table 4 show that the of probability t Earning Management of 0.000 which means that the Earning Management has a significant negative influence on the value of the company, because the of probability is less than 5%. This means that the third hypothesis which states that the negative effect on the Earning Management Corporate Financial Performance supported. The results of this study are consistent with the results of research Xie et al., (2002) which states that the practice Earning Management can lower the value of the company, for their opportunistic behavior of management to manage earnings at random which will result in reported earnings is incorrect, so it will cause the company's value to decline in the days to will come.

Based on the result of t test in Table 4 show that the interaction the Audit Quality Management Earning has a probability value of 0.0% is less than 5%. Furthermore, the interaction Earning Management with an independent commissioner has a 0.6% of probability of less than 5%. This means that the independent directors Audit Quality and Earnings Management moderate the relationship the Corporate Financial Performance has a positively and significantly. A proxy corporate governance measure audit quality measured in this study also used firm size. Auditor her everyone in the company will not affect the relationship between Earning Management the Corporate Financial Performance, meaning that the company would using auditor with the quality of the big four or not remains to strengthen or weaken the role of the practice of corporate governance in its

relationship between earnings management and corporate financial performance ,

### **Conclusion**

This research aims to determine the effect on the relationship Corporate Governance Earning Management, Tax Management and Corporate Financial Performance. This research aims to determine the effect on the relationship Corporate Governance Earning Management, Tax Management and Corporate Financial Performance. In this research, there are four hypothesis, however only one accepted hypothesis while the three other hypothesis is rejected.

Tax Management does not have a significant influence on corporate financial performance. This means that the, the presence or absence Tax Management, the management company still perform Earning Management, in the absence of the influence of the external auditor and independent commissioners. Proxy of corporate governance which is used in the research, be able moderate the relationship between the Tax Management the corporate financial performance. However, of the all three proxy have different influences. The independent commissioner Tax Management strengthen relationships the corporate financial performance for the control of an independent commissioner.

Furthermore, the quality audit Tax Management weaken the relationship the corporate financial performance. The external auditor nice will increasingly control diuditnya enterprise management, so that management will be careful to perform Tax Management, so that corporate financial performance to be down because they can not perform Tax Management incorrectly. With the existence of The Corporate Governance, Tax Management has an influence on corporate financial performance and can be considered as a means to raise or lower the corporate financial performance.

Tax Management does not have a significant influence on Corporate Financial Performance. However, Earning Management has a negative and significant impact on the Corporate Financial Performance. Whether there was a Tax Management, the management company still

perform Earning Management, in the absence of interference from external auditors and independent commissioner. The independent commissioner be able moderate the relationship Earning Management and Tax Management the Corporate Financial Performance. This means that a independent commissioner to strengthen connections Earning Management and Tax Management the Corporate Financial Performance.

Earning Management has a significant negative influence on the Corporate Financial Performance. This research indicated that the action Earning Management in the company's property sector and real estate be able bring down corporate financial performance, for their opportunistic behavior of management to manage earnings at random which will result in reported earnings is incorrect, so it will cause the Corporate Financial Performance decreases in the days to come.

From both proxy of corporate governance, only the independent directors who be able moderate the relationship earnings management the corporate financial performance. Meanwhile, audit quality can not moderate the relationship between Earning Management the corporate financial performance because it does not have a significant effect. Independent Commissioner to strengthen connections with the company's Earning Management. Their control of the independent commissioner makes the management does nice Earning Management that will be increase Corporate Financial Performance.

The limitations in this research include: the company's data is incomplete, due to limitations of the data source used by researchers in the search data the company's financial statements. Thus the data used is the period from 2010 to 2014. This study only using a service company property and real estate sector in the sample so that the results of the research can't be generalized to other industrial sectors.

For further research should add the study period, so that might be felt the impact of Corporate Governance. Further research will need to identify other moderating variables to see

how it affects the relationship Earning Management. Tax Management and Corporate Financial Performance. Using a model are more appropriate in calculate the discretionary accrual in accordance with the conditions in Indonesia.

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## VALUE OF RELATIONSHIP ON VEGETABLES BUSINESS WITH SOFT SYSTEM METHODOLOGY APPROACH: BUILD FIRST, RISE NOW!

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### **ABSTRACT**

*Farmer group play an important part in an inclusive agribusiness supply chain. It plays marketing activities to collect agricultural commodities from members and then distributing it to the buyer. The study objectives are to identify and mapping the strengths of farmer group with inclusive agribusiness to convey value creation occurs from the relationship among each farmer group member. The study conducted at Lembang District as one of the highest vegetables production center in West Java Province, with case study took at Lembang Agri farmer group as the prospectus for vegetables cluster in the area. The study apply qualitative research design and utilize descriptive statistics and soft system methodology approach. Survey and focus group discussion applied with representative members of Lembang Agri farmer group. Soft system methodology try to elaborate real issues as real world and subsequently creating conceptual model as system thinking towards a prime horticultural business provider to supply their product to the modern market. The study indicated that not all of farmer group member sold vegetables production to farmer group. Meanwhile, farmer group management presume their members to retail all of vegetables production using modern market channel (e.g. hotel, restaurant, catering). These market network give higher profit contribution, although, these retail buyers apply delay payment procedure from one to two weeks in each buying term. Researchers suggested that agribusiness marketing could improve its sustainability by constructing relationship marketing for long-run profit, through value on commitment, value on trust, and value on business profitability.*

**Keywords:** *value creation, relationship marketing, holistic approaches, horticultural business, inclusive agribusiness*

### **INTRODUCTION**

The supply chain of agricultural commodities has many actors involved. Relations between actors play an important role in their marketing activities. The involvement of actors can be seen from their interests. Right relationship between actors in the agricultural

supply chain may produce a sustainable supply. The availability of supplies serve a better profit among actors.

A key requirements of relationship marketing is that a firm should know the long-term needs and desires of customers so as to be able to offer better and added value on top of the core services (Percy et al, 2010). Agricultural

supply chain actors need the buyer-seller relationship as their value among actor's perspective.

Ndubisi (2007) analyzed, the multiple regression assessed the impact on customer loyalty of four key constructs of relationship marketing (trust, commitment, communication and conflict handling). Ndubisi (2016) give example then, by forging strong and long-lasting relationships with suppliers and distributors, manufacturers can ensure a stable and sufficient flow of quality products in a timely manner at competitive prices.

Relationship marketing in the supply chain management (SCM) of agricultural commodities have particular values that can make a strong connection between supply chain actors. The value may generate an achievement of actor's objectives.

The value-creation process consists of the three key elements, determining what value the company can provide to its customers, determining the value the organisation receives from its customer, and, by successfully managing this value exchange, maximising the lifetime value of desirable customer segments (Christopher et al, 2002). The value creation would escalate the product benefits which worth its premium price that will, in turn; increase the growth of agribusiness industry (Utami et al, 2016).

Firms that effectively integrate their SCM and marketing activities are much more likely to achieve better corporate performance in term of sales, profitability, market share, and even customer satisfaction. The goal of SCM and marketing integration is to create unique competitive advantages by linking together customer value with a more effective flow of products. The flow must always be refined and must create customer value proposition in a constantly changing market (Madhani, 2012).

Horticultural commodities is one of high value sector in agriculture in West Java. Vegetables business provide a high profit for the growers with the number of market choices: traditional and modern market such as

supermarket, hotel, restaurant, and catering services.

Networks involve vertical and horizontal relationship. Vertical relationships reflects the classic supply chain, that is suppliers, manufacturers, distributors and consumer. Horizontal relationships might include competitors as well as spesific services providers, for example, technology-sharing agreements or outsourced information systems management would be typical of this type of relationship. Networks are important vehicles for achieving competitive advantage. We are now entering the era of 'network competition' where the prizes will go to those organisations that can best structure, co-ordinate, and manage relationships with their partners in a network committed to creating customer and consumer value through collaboration (Christopher et al, 2002).

Lembang district is one of vegetables production area in Bandung Barat regency. The vegetable farmers with small land in Lembang became a part of agribusiness inclusive, they are small-scale producers of agriculture supply chain. Farmer sell their products to the wholesaler who distribute it to traditional market in a large number of quantity from many producers. Wholesaler accept in all grade of product, they rarely applied different prices for a high-quality product from farmers. Lembang Agri as Farmer Group Union in Lembang district try to start business towards the modern market chain. Modern market offer the best price for high-quality product from supplier. The study objectives are to identify and mapping the strengths of farmer group union with inclusive agribusiness to convey value creation occurs from the relationship among each farmer group member.

## **LITERATURE REVIEW**

### *Relationship marketing*

Christopher et al (2002) state the challenge to the organisation is to align marketing, quality and customer service strategies more closely. Under the relationship marketing paradigm there

are three areas are merged and given a sharper focus (Figure 1).



Figure 1 The relationship marketing orientation: bringing together customer service, quality and marketing (Christopher et al, 2002).

All actors focus to meet the needs in their relationship by building a network to achieve long-term business goals and role as a partner. Christopher et al (2002) summarised relationship marketing differs from transactional marketing in a number of important ways as shown in Figure 2:

Transactional marketing	Relationship marketing
<ul style="list-style-type: none"> <li>• Focus on volume</li> <li>• Emphasises product features</li> <li>• Short timescale</li> <li>• Little emphasis on customer</li> </ul>	<ul style="list-style-type: none"> <li>▪ Focus on profitable retention</li> <li>▪ Emphasises customer value</li> <li>▪ Longer-term</li> </ul>

service <ul style="list-style-type: none"> <li>• Moderate customer contact</li> <li>• Primary concern with product quality</li> </ul>	timescales <ul style="list-style-type: none"> <li>▪ High customer service emphasis</li> <li>▪ High customer contact</li> <li>▪ Concern with relationship quality</li> </ul>
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Figure 2 Transactional marketing and relationship marketing (Christopher et al, 2002)

Relational marketing aims to build long-term relationships by giving satisfaction to the relevant parties, whether customers, suppliers, intermediaries with long-term business orientation (Kotler, 2000). Business marketing is marketing products or services to other companies, government bodies, institution, and other organisation. Business marketing also includes the marketing of products and services that facilitate their operations. High-quality working relationship with select accounts often provide strategic connection to other opportunities in the business environment (Dwyer and Tanner, 2002).

Business models create value for all the parties involved. Adopting the business model perspectives helps managers and entrepreneurs purposefully structure their activity systems in cooperation and interdependence with other actor and economic agents in their ecosystems. This purposeful design and structuring of business models can be an important source of innovation, particularly during periods of change and resource scarcity, high uncertainty and volatility in both capital and real markets that adversely affect revenues and profit (Amit and Zott, 2010).

### *Value of relationship*

The development of businesses today are powered by globalization, the business not contain profit-oriented only but should be able to do creation and value addition (value creation and value adding) for the businesses involved, likewise agribusiness.

Supply chain management (SCM) provides a further opportunity to achieve collaborative advantages through managing upstream and downstream relationships with suppliers and customers. SCM, by definition, is based on collaborative working across the network as a whole (Christopher et al, 2002).

Madhani (2012) claimed that SCM and marketing must work together in order to achieve organisation goals as firms are increasingly recognizing its integration as the key driver for improving financial and operating performance.

Christopher et al (2002) suggested three prerequisites for successful partnerships in value-creating networks, the relationship must be strategically important for both parties, relationship be based on agreed strategic goals, and relationship enable the value-added exchange of information.

## **METHODOLOGY**

The research utilized qualitative design. Data were collected through questionnaires and focus group discussion. Primary data obtained from indepth interview and discussion results. The study begins with a broad survey in order to generalize results to a population and then in a second phase, focuses on detailed qualitative, open-ended interviews to collect detailed views from participants. Descriptive statistics use for summarization and description of data.

The research conducted in Lembang district, West Bandung regency, West Java Province. Lembang district is one of the highest vegetables production center in West Java Province, with case study at Lembang Agri farmer group union

as the prospectus producer for vegetables cluster in the area.

This problem solving or decision-making using system thinking. One way of thinking system analysis tool is soft system methodology. Jackson (1991) state the formative idea of the system methodologies is that it is possible to construct an ideal-type grid of problem contexts that can be used to classify systems methodologies according to their assumptions about problem situations.

Soft system methodology (SSM) developed by Peter Checkland in 1960 in England. SSM comparing between the real world and the way of thinking systems (systems thinking) into a conceptual model is then performed to confirm the real world (validated). SSM serves as a learning system that exposes the complexity of the actual conditions. Initial exploration began mapping the interactions that lead to the complexity and analyze the intervention itself and the social and political character experienced.

From this exploration activity is expected awakened models that are relevant to its purpose (Checkland in Pidd, 2004). SSM opens new perspectives in the idea of the system is then used in making decisions and solving problems (Jackson, 1991). The first step is to understand the different concepts from an interesting perspective through a rich picture. Intellectual construction that will be used in the analysis of SSM is built up through the root definition (RD). Root definition that will describe the interrelated objectives into a conceptual model that consists of structured activities that must be done to achieve the goal. Thus, defining what the system root definition and conceptual models to explain what should be done so that a well-defined system (Wilson, 2001).

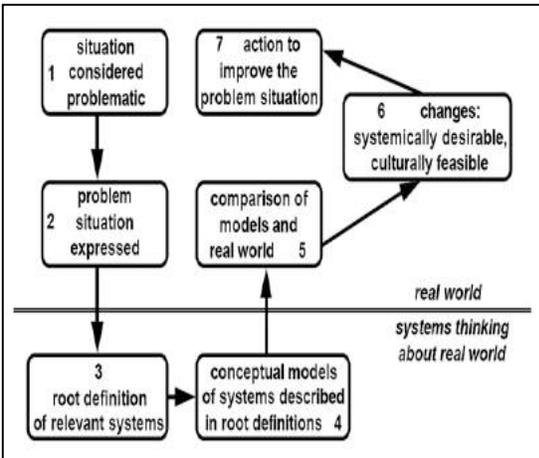


Figure 3 Stages of Soft Systems Methodology (Checkland & Scholes, 1999)

**RESULT AND ANALYSIS**

From the 75 members of Lembang Agri as respondents, 56 are from Tauhid farmer group, 9 are from Berkah Tani farmer group, 6 are from Mulyatani farmer group, and the rest are Kawani Asih and Saluyu farmer group. The research emphasized on the large number of farmer member but few are selling their product to Lembang Agri.

Table 1 The number of farmer members by commodity produced

Commodities	Berkah Tani	Kawani Asih	Mulyatani	Saluyu	Tauhid	Grand total
Broccoli	2	1			5	8
Baby Kenya					8	8
Snap bean				1	5	6
Chili					2	2
Potato					1	1
Lettuce	2				1	3
Petai					1	1
Mustard			1		2	3
Big Lettuce					4	4
Tomato	5	2	5		27	39
Grand total	9	3	6	1	56	75

From 75 responden, only 13 member that sell their product to Farmer Group Union

(Gapoktan), majority of 52 responden sell their product to wholesaler (conventional trader). The data indicated a lack of Lembang Agri role than wholesaler. It takes a value in the relationship between members and Lembang Agri in order to create cooperation benefits for both vegetables producer.

In Table 2 below, seen wholesaler dominate the market target from farmer. Wholesaler selling with cash payment and received all grade of product. These are the challenges of the research. Then the respond of questionnaire have to described how Lembang Agri play role in farmer group and carry out the individual farmer as a member.

Table 2 Main Market of Farmer Group

Farmer Group	Wholesaler	Exporter	Farmer Group Union	Traditional Market	Supermarket	Supplier	Grand Total
Berkah Tani	6		1	1	1		9
Kawani Asih	2		1				3
Mulyatani	6						6
Saluyu	1						1
Tauhid	37	1	11	6		1	56
Grand Total	52	1	13	7	1	1	75

*Soft System Methodology*

*Problem situation*

Ideal conditions described by Lembang Agri as Farmer Group Union had applied the value of relationship marketing to achieve the welfare of the members.

*Rich picture: the unstructured situation*

Rich picture aims to show the real situation and unstructured problems through meaningful images or symbols. Making the rich picture can be done several times until close to the actual situation experienced by the actors there in. (Figure 4)

Member of Lembang Agri Farmer Group Union divided in two type of marketing channel, the wholesaler as their conventional trader and Gapoktan as their modern network. Farmer who has fluctuative production, grows low quality vegetable and need cash for payment, would sell their product to wholesaler. Wholesaler brought the farmer’s product to traditional market in low price. In the other side, farmer who sell their product to Gapoktan gain more benefit although

with delay payment system. Gapoktan Lembang Agri distribute to restaurant and catering services. This supply chain create a problem on stock availability. Modern market needs continuity supplies in a large number, Lembang Agri hard to in fill up the demand. Lembang Agri should to reach all member with better payment system and this collaboration may gain the sustainable supply chain.

*Root Definition*

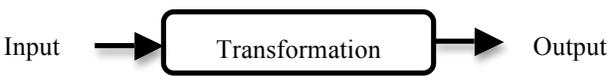


Figure 4 Transformation Process (Wilson, 2001)

The root definition do not exist in reality, the equivalent in real-world terminology might be business objectives, mission statement, specification, and so on. In Figure 7, construction of the root definition requires a particular structure. At its core, a root definition describes a transformation process. The first rule is that for a transformation process to be properly formulated its input and output must be of the same kind (Wilson, 2001).

The process of transformation in this study is "build the value" as the input and "the rise of Gapoktan business" as the output. To help ensure that a draft Root Definition is acceptable Checkland and Smyth (1976) developed the CATWOE below (Table 2).

Therefore, the root definition becomes "The value of relationship will rise the business by

building the value of relationship marketing". Related to this situation, the root definition representing value relationship as a motivation to achieve the goal of Gapoktan Lembang Agri. The embodiment of the great values of the relationship between members and Gapoktan performance might improve in the vegetable supply chain to buyer, is the root definition of this case.

*The conceptual model*

Data of this soft methodology are always regarded based on assumption and opinion. Thus, the conceptual activity models of SSM represent an idealization of the factors captured in a root definition, which itself only make sense in the light of the world view or Weltanschauung (Wilson, 2001).

Soft system methodology, root definition, CATWOE and conceptual models were specifically developed for Human Activity Systems (HAS). These are systems that achieve their purpose through human activity as opposed to software intensive systems or hardware (product) intensive systems (Burge, 2015).

Human Activity System in this research showed the activity of Lembang Agri to actualize the transformation specifically to applied the value of relationship marketing i.e. trust, commitment, and profit among members. These value emerged from primary data of 75 respondents.

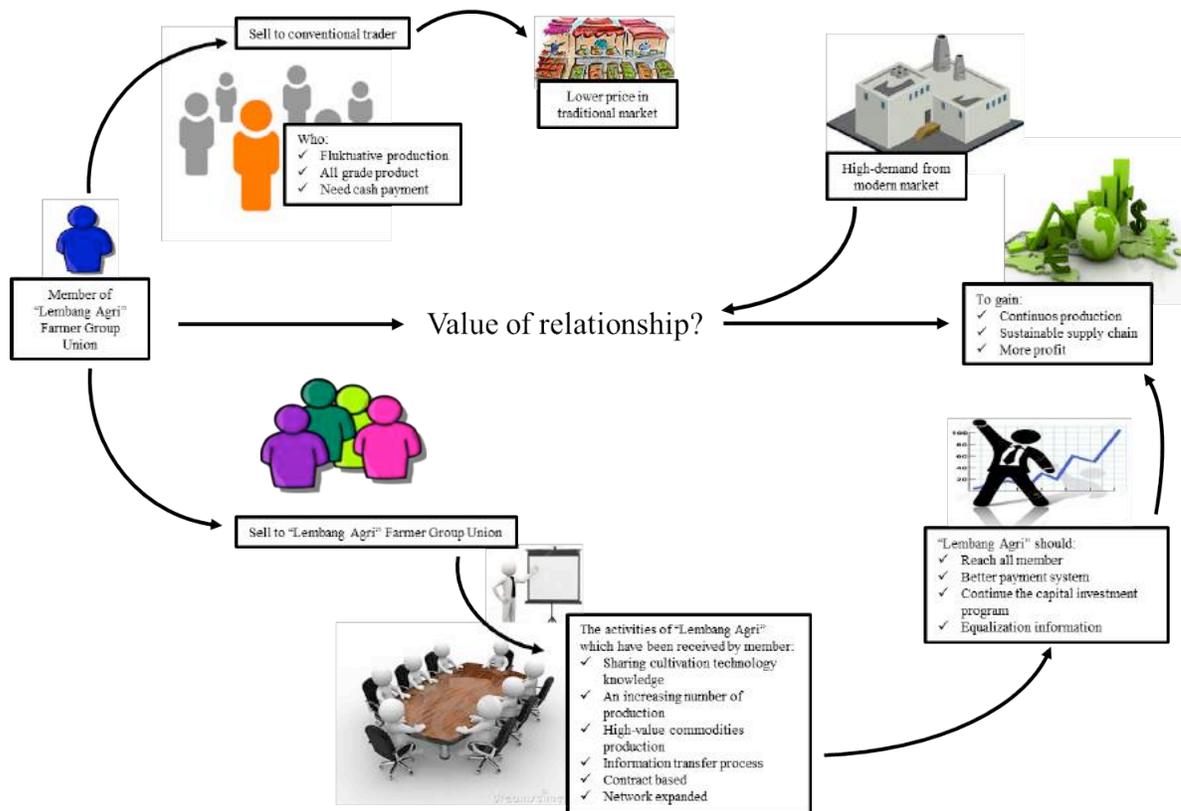


Figure 4. Rich Picture of Vegetables Business of Lembang Agri Farmer Group Union

If a model is intended, as a representation of the real world, then it must be possible to compare it in some way or other with that real world. The credibility comes from the way it was

built, from the way that the people who built it seem to act and one the basis of the insights that it produces (Pidd, 2004).

Table 2. CATWOE Analysis

CATWOE	Description	Case Analysis
Customer	The recipient of the output of the transformation process	Buyer of Gapoktan Lembang Agri product
Actors	Individuals who would do the activities in the resultant conceptual model	Farmer member of Gapoktan Lembang Agri
Transformation	Described either as an input-output conversion	Build the value of relationship marketing
<i>Weltanschauung</i>	Practically interpreted as the statement of belief within the root definition	The value of relationship will rise the business
Owner	A wider-system decision taker with authority over the system defined, with a concern for the performance of the system	Farmer Group Union (Gapoktan Lembang Agri)
Environmental constraints	Features external to the system defined, which are taken to be significant	Gapoktan member who decline to follow the procedur

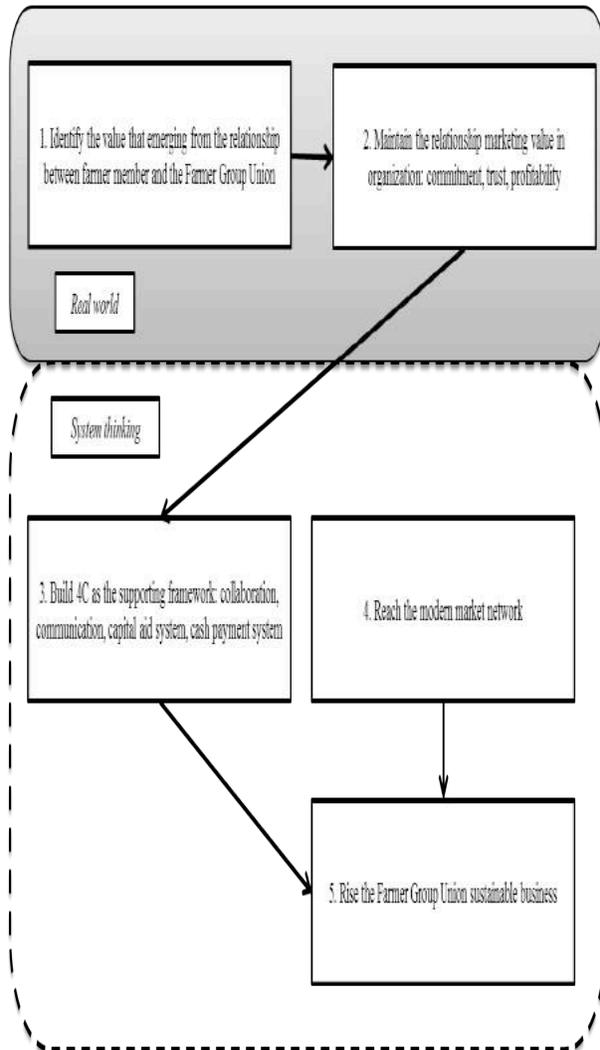


Figure 5 The Conceptual Model of Gapoktan Lembang Agri Relationship Value in Vegetables Business

*Comparison conceptual model with the real world*

The comparison between conceptual model with the real world can be seen in table below.

*Formulation of Changes*

The formulation of these changes can be done with an overview of the strategy. This approach according to Wilson (2001) is considered more efficient and take advantage of the current process to identify changes that will be adopted.

*Capturing action*

Decision made after implementation of corrective actions and improvements. The study indicated that not all of farmer group member sold vegetables production to farmer group. Meanwhile, farmer group management presume their members to retail all of vegetables production using modern market channel (e.g. hotel, restaurant, catering). These market network give higher profit contribution, although, these retail buyers apply delay payment procedure from one to two weeks in each buying term.

value on commitment, value on trust, and value on business profitability which supported by collaboration, communication, capital aid system, and cash payment system. This supporting framework came from Gapoktan member's expectation. If this conceptual model has fit to the real world, Gapoktan Lembang Agri should build the value first and rise the business now.

Table 3 Comparison Model with Real World

No.	Conceptual Model	Exist or Not Exist	Real World
1	Identify the value that emerging from the relationship between farmer member and Farmer Group Union	Exist	Farmer and Gapoktan have the value in their relationship marketing, i.e. trust, commitment, and profit.
2	Maintain the relationship marketing value in organization	Exist	Gapoktan uphold the value in relationship marketing, since Gapoktan has limit to buy member's product, Gapoktan let member to sell to another trader.
3	Build 4C as the supporting framework: collaboration, communication, capital aid system, and cash payment system	Not exist	Gapoktan need to find the best way to communication, the fit system in capital aid and cash payment, and the right time to collaboration. These will reach more members. More members means more supplies to modern market
4	Reach the modern market network	Not exist	Modern market need continous supplies and give better price.
5	Rise the Farmer Group Union sustainability business	Not exist	Gapoktan will able to create the investment system to reach the fair trade among farmers and modern market

**DISCUSSION AND CONCLUSION**

Researchers suggested that agribusiness marketing could improve its sustainability by constructing relationship marketing for long-run profit, through value on commitment, value on trust, and value on business profitability which supported by collaboration, communication, capital aid system, and cash payment system. This supporting framework came from Gapoktan member's expectation. If this conceptual model has fit to the real world, Gapoktan Lembang Agri should build the value first and rise the business now.

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**CONCEPTUALIZING BUSINESS-TO-BUSINESS VALUE OF  
RELATIONSHIPS IN BUYER'S PERSPECTIVE: A FUTURE OUTLOOK ON  
HIGH VALUE VEGETABLE BUSINESS**

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**Abstract**

*Creating marketing unique competence through building relational marketing is one of major theme in buyer – seller relationship research. The study examines conceptual framework from value of relationship occurs between farmer group and modern market buyer and judgment on value of relationship from buyers perspective. The study employed qualitative research design through case study from one vegetable cluster in Bandung Regency. In this regard, preliminary stage from Key Mediating Variables Model and buyer evaluation on business-to-business relationship value was applied. Buyer perspective and attitude examined toward trust, commitment, communication, product benefit, cost, and service. The findings suggest that commitment perform the most important part in building value of B2B relationship, although, local buyer and exporter place different perspective on trust and commitment they expect to be present by farmer group as product supplier. Communication by delivering a proper information between each party, time service delivery, and satisfying the appropriate product quality based on target market standard become additional component that support relationship value and buyer attitude on long-run relation on inclusive agribusiness relationship behavior.*

**Keywords:** *relationship value, value creation, customer judgment, inclusive agribusiness, KMV Model*

## INTRODUCTION

Value concept become robust topic among researchers and academicians. It proposition valuable feedback to assess product or business performance in the industry. Relating to business-to-business (B2B), creating value through relationship marketing could improve customer loyalty (Futrell, 2000). Relationship marketing has the aim to manage relationships with customer and generate continues competitiveness through the evaluation on brands, products, and companies with relative assessment with other brands, products, and competitors (Rangkuti, 2002). Nonetheless, value concept become the most effective competitive strategy to provide company with superior value offered to the customer and considerably substantial component in relationship marketing (Ravald and Gronroos, 1996). Value proposed as essential element to manage connection with customer.

B2B relationships is unlike B2C (business-to-customer) or C2C (customer-to-customer) business concept. It is commonly involve higher-order business model and many of researchers have observed with amount of diverse components and dimensions (e.g., Crosby, Evans and Cowles, 1990; Morgan and Hunt, 1994). Collaboration within networks of relationship was known as understanding marketing phenomena (Gummesson, 1999). More relational the marketing of a business is develop, it could deliver a sense of security for the customers, confidence, produce lower risk, and reduce customer cost (Grönroos, 2004). Creating value in B2B agribusiness sectors has started to arise consideration of emergent profitable relationship (Musaa et al., 2013). It is embodied the practice of B2B successful.

Meanwhile, transactional marketing system is still dominate and widely used by agribusiness marketing in many developing countries these days. As consequence, traditional agribusiness

marketing system rely on conventional marketing and become a constraint to build long-term relationship within the marketing actors in the channel. Traditional marketing system with longer distribution chain gives more challenge for producers in the up-stream agribusiness system to gain better business opportunities and sustainability in long run. The system mostly depends on economic motives. This marketing system will hinder any opportunity of agribusiness producers especially the farmers to thrive in the marketplace. Moreover, this will disadvantage agribusiness producers bargaining position to be put as price taker and lower its competitiveness.

Recent studies on buyer-seller relationship in agricultural business has begun to take into consideration, between agricultural input supplier and farmers (e.g., Batt and Rexha, 2000), food importers and exporters of food (e.g., Gyau and Spiller, 2009), and agro-industrial companies and farmers (e.g., Boniface et al, 2012). The results of these studies showed an efficient supply chain and superior market evaluation to be recommend from creating strong associations between the parties of buyer and seller. Likewise with relationship marketing perspective that based on relation among two parties and construct further value from the exchange of the product and/or service (Grönroos, 2000). Nonetheless, understanding value creation based on buyer-seller relationship in agribusiness sector and evaluate its benefit is mostly challenging, especially in developing country that entail inclusive agribusiness that typically involve smallholder. Thus, it gives impact on marketing in more specific sector of horticultural industry, which showed no particular changes at up-stream system or farm level although down-stream system such as modern retailer enforce rigorous quality standard and became constraint to penetrate this potential market opportunity

for supplier company and tougher for smallholder (Arshad and Rahim, 2008).

Modern marketing concept based on relational marketing, showed the reference of business buyer as intermediaries between producer and end consumer perform significant roles and function in buyer-seller relationship (Musaa et al, 2013). Relational marketing among marketers contribute for long-term business profitability, valuable for both parties in the relationship, create collaborative and interdependent business link with other key stakeholder, increasing relationship performance covering customer satisfaction, loyalty, and retention (Christopher, Payne and Ballantyne 2002), and reveal other non-material competitive competences (Hunt 2000; Saminee and Walter 2003). The emerging of intermediaries' differentiation and type strength the needs of innovation, creativity, and business adaptation to ensure their existence in the industry (Musaa et al, 2013).

Middleman or intermediaries as business buyer in agribusiness sector sometimes perceived as speculator for taking advantage from smallholder (Ellis, 1996). However, the higher knowledge of smallholders that gathered their business capability through formal organization of co-operative company or farmer group assume to be the source of competitive advantage. Farmer group have the opportunity to sell their farm product to modern market with formal business contractual and give them higher possibility to escalate business profit and sustainability. This could override smallholder weakness by being cheating by traditional traders and middlemen for their ignorance of business knowledge on market prices, poverty, seasonal shortages of cash, and lack of post-harvest facilities (Thapa, Koirala and Gill, 1995; Banskota and Sharma, 1999; Shrestha and Shrestha, 2000 and Khushk, 2001). Intermediaries that perform buyer-seller relationship, and categorize as supplier or buyer in

distribution channel would appraise their performance through business power and interactive commitment as mediating component (Musaa et al, 2013; Brown et al, 1995).

There was least study on investigation of business-to-business (B2B) relationship marketing on agribusiness sector especially on specific high value vegetables commodity on business buyer point of view. Smallholder consolidate in farmer group as business seller should acknowledge business buyer behavior. Buyer's perspective provide insight on their attitude and perception on seller strength and performance in the business relationship. It will give advantage for up-stream agribusiness actor to react and predict on down-stream agribusiness actor long run business decision. This study objectives are to demonstrate model of correlation on business buyer decision and product value on buyer's attitude of B2B relationship marketing toward buyer's perspective of B2B relationship marketing, and followed by estimating preliminary stage of causality model on buyer's perspective of B2B relationship marketing.

## **LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT**

### **1. B2B Customer Value on Marketing Relationship**

Customer delivered value is trade-off between total customer benefit and total customer cost (Kotler, 2000). Other define customer value as unit conformity of monetary cost on series of technical economic, service, and social benefits for its price exchange for a product and consider marketing offer and price from provide suppliers (Anderson et al, 1994). Customer perceived value of product could apply for company foundation to evaluate and determine product price in four different way by defining value for its low price; value as product desire by consumer; value as worth for quality;

value as worth for buying-selling exchange (Zeithaml and Bitner, 2000).

Varies and complexity of customer value concept still remained ambiguity in the literature, and resulted various distinct approaches on assessing the significant dimensions (Ulaga and Eggert, 2005). Value could be defined from its value on relationship on business-to-business relationships perspective. Value of relationship emerge as the performance of relationships quality, derived from each party interaction and become experience and habitual from the parties in the relationship composed over time (Ballantyne and Varey, 2006). Business relationships of buyer and seller may develop a series of responsibilities and purposes expose value that beneficial for the actors involved (Anderson et al, 1994).

Business relational value refer to value concept is by far as multidimensional conception that define scopes beyond only on trade-off ratio of cost and quality (Ulaga and Eggert, 2006). There were four different classes of benefit from relationship, consists of economic, technical, service, ad social benefit (Anderson et al, 1994). Value derived from product attribute such as branding and packaging on fresh produce could increase product value (Utami et al, 2016). Product attributes are significant for appraising product quality (e.g. Ludwig and Spiller, 2007). As value defined as ratio between benefit and cost, then cost was defined as customer willingness to pay to spend for a particular product.

It is an important issue in order to reveal the benefits of relationship bounding all parties and create support for sustaining further value-creating activities (Ballantyne and Varey, 2006). This business value will give opportunities for each party to relate their activities, bond together their resources, and develop bounding among people, enabling to evolve bundle of knowledge, create new competences, and improve new activities (Harris and Wheeler, 2005).

H1a: Product attribute effects buyer's attitude on B2B relationship value

H1b: Product quality effects buyer's perspective on B2B relationship value

H1c: Service effects buyer's perspective on B2B relationship value

H1d: Price effects buyer's perspective on B2B relationship value

## **2. Buyer's Attitude towards Business-to Business Relationship Value**

Interaction among two or more parties are commonly called as relationships (Ballantyne and Varey, 2006). The purpose of marketing relational is to develop long-term relationship by delivering satisfaction for stakeholders, respectively for consumer, supplier, and major middlemen or distributor for long-term business orientation (Kotler, 2000). Long-run business perspective has urged as much as business success importance. While other scholar mentioned relationship marketing as a kind of business management philosophy and strategy that concentrated on managing of how to attract, preserve, and improve relationship with customer (Pi et al, 2014).

Relationships are common and beneficial, especially to manage link with seller not just as a one-way-business and move towards more directional communication system in term of relationship marketing, B2B marketing, service marketing, or strategy literature (Ballantyne and Varey, 2006). Relationship marketing utilize as marketing strategy emphasize on continues relation with customer and supplier (Griffin and Ebert, 2007). B2B relationship activities propose to influence and expose other significances over time and place. By emphasizing on long-term by addressing customer and supplier not only on single transaction, but also building robust relation in term of economic and social bounding and generating customer satisfaction and loyalty on higher level and longer period.

Value proposition competitiveness consists of one or more different attributes for specific consumer segment and for willing-to-pay (Nalla and Kouwenhoven, 2016). It is a creation of interdependency with other business agents both from up-stream of down-stream system. Some specific research on particular concern of fresh produce sector undertaking relationship marketing reveal information on influential factors on the relationship, there were power-dependency, exclusivity, trust, conflict, satisfaction, and social bounding (Hingley and Lindgreen, 2002). Consumer will search for unique value and willing-to-pay, subsequently construct loyalty in the future with sustainability in the value proposition (Nalla and Kouwenhoven, 2016).

H2: Buyer's attitude on B2B relationship value effects buyer's perspective on B2B relationship strength

## **2. Buyer's Customer Value towards B2B Relationship Strength**

Three main subjects within research of relationship value known as value analysis, value creation, and value delivery (Lindgreen and Wynstra, 2005). Other research had suggested six phases on emerging value interaction among supplier and buyer (Silva et al, 2010). Moreover, in depth understanding of intangible value derived from relationship marketing perspective stimulation will determine distinct contribution point of view of efficiency apply by intermediaries (Musaa et al, 2013). Value has examined to be the driver for customer satisfaction and loyalty (e.g. Cretu and Brodie 2007; Spiteri and Dion 2004; Sugiati et al. 2013).

Value creation appraisal derived from customer perceived value on value proposition between price and perceived quality (Zeithmal, 1988). Meanwhile, other value scale uses to assess value delivery arise from customer value, buyer satisfaction, end-user loyalty, and market performance related to perceived relationship (Spitery and Dion, 2004).

These studies showed the components comprise value creation approaches from both customer perceived value by assessing bundle of product benefits and cost sacrifices along with value delivery by evaluating the value performance.

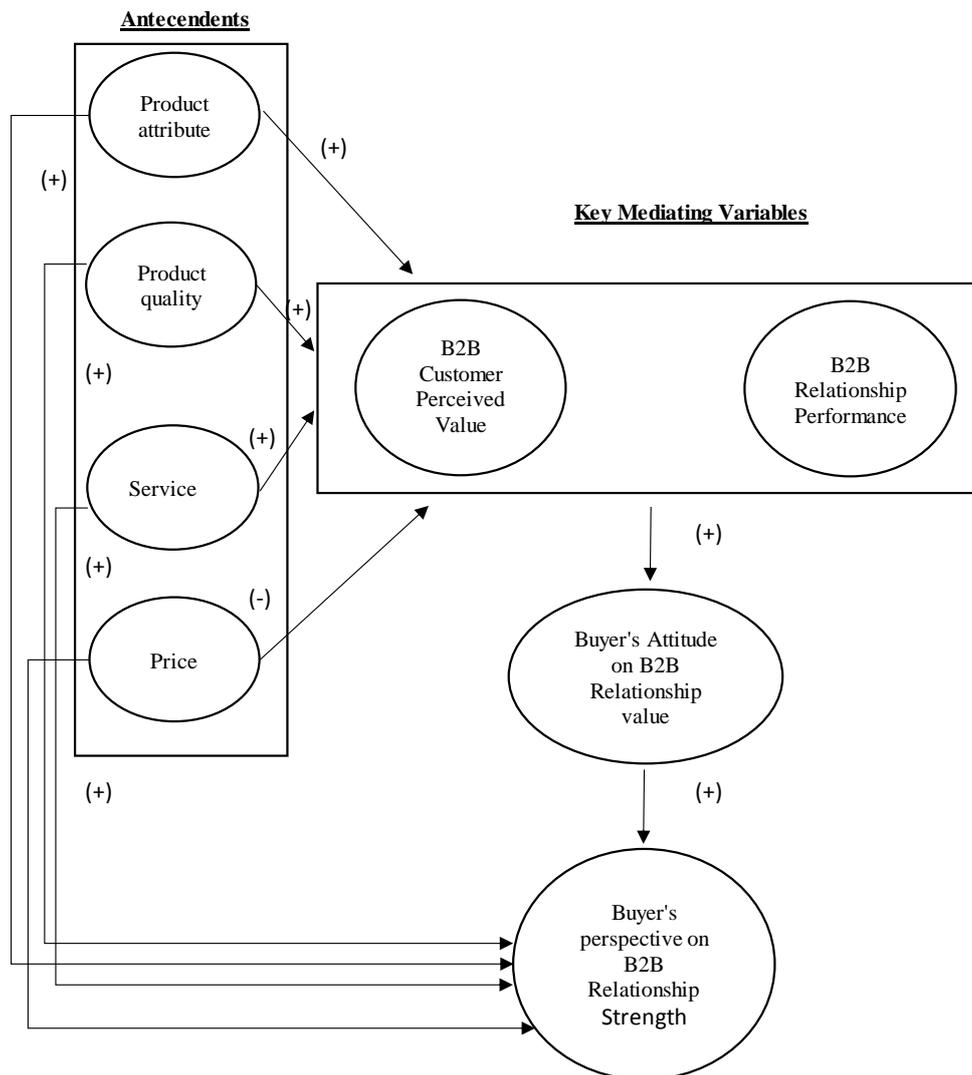
Relationship strength consists of trust, commitment and shared norms, has been presented to differ considerably among companies and subject on the level of each firm sub-constructs (Hausman, 2001). While other considered relationship marketing theory propose three main influencing components, comprise trust (e.g. Dwyer, Schurr and Oh, 1987; Fontenot and Wilson, 1997), commitment to build and maintain relationship (e.g. Geyskens et al, 1998), and communication on its quality to develop and complete the relationship (e.g. Fontenot and Wilson, 1997; Selnes, 1998).

H3a: Product attribute effects buyer's perspective on B2B relationship strength

H3b: Product quality effects buyer's perspective on B2B relationship strength

H3c: Service effects buyer's perspective on B2B relationship strength

H3d: Price effects buyer's perspective on B2B relationship strength



**Figure 1.** Empirical Model of Business-to-Business Value of Relationship on Buyer's Perspective

## **RESEARCH METHOD**

The study apply a qualitative multiple case study method to produce a holistic description on the phenomena of study (Gummesson, 2005). Since the study to propose preliminary phase on model development, the utilization of descriptive research design is necessary to acquire comprehension insight of buyer's perspective on business-to-business relationship and its correlation on value of relationship based on agribusiness inclusive nature. It was applied among vegetables business buyer, both for local market supplier and export market supplied by one of vegetable agribusiness cluster as vegetables production center at West Bandung Regency in West Java Province of Indonesia. The study conducted in two phases. The first phase assisted with two part semi-structured questionnaires (buyer's perspective and buyer's attitude on business-to business relationship) that employ as study instrument. The second phase followed by focus group discussion with the business buyers.

The method use face-to-face interview and group discussion as primary data source with judgment sampling method with five key persons of buyer companies who had knowledge, information, and experience on business-to-business relationship with seller which is farmer group. They are buyer companies' representatives that responsible with marketing and procurement areas. This method is acceptable, as information connected to marketing management areas that based on case study possibly lead to significant theoretical advances as well as suitable for case-based exploration (Ballantyne and Bonoma, 1985). The study covered two independent variables on buyer attitude on B2B customer value and B2B relationship performance, and buyer's perspective on relationship strength for future business decision as dependent variable. In addition, to enhance the research quality

result a non-parametric statistics analysis applied, due to least number of respondents in the study. The analysis of Somers' and Gamma correlation test use for structuring model correlation among variable dimensions. The Gamma statistics commonly utilize to investigate an association for given doubly ordered contingency table, while Somers' represents correction for tied pairs on independent variable (Göktas and Işci, 2011). The next step is followed by developing preliminary stage of key moderating variable model.

## **ANALYSIS AND DISCUSSION**

### **1. Product Attribute Benefit on Value Proposition from Buyer's Point of View**

Product quantity and product quality compliance from farmer group as seller with buyer demand consider as the most important attributes for buyer company. Product quality is related to grading compliance fulfil by seller. These two main attributes are significance for modern business buyer in order to satisfy customer demand standard. Seller competences on product knowledge and comprehension on market needs and buyer requirements become the next important factors from buyer's perspective, as these components may possibly associated to seller commitment and capability for understanding product criteria standard from buyer. This is one of the obstacle of smallholder on agribusiness inclusive that appointed as seller to modern market. Product offer by seller to business buyer from this case study, showed farmer group as seller has competent to accomplish the vegetables grade quality standard as buyer requested, even though the service level fulfilled is fluctuate during business relationship implemented. Buyers also perceived the lack of farmer's knowledge on agribusiness system both from up-stream and down-stream sub system. It will impact the understanding of business dealing with modern market.

## **2. Product Quality Benefit on Value Proposition from Buyer's Point of View**

Fresh produce with high quality that produce by the farmer group in this study are vegetables with high demand product in the market. Thus product quality competitiveness is the priority acquire from business buyer. Product quality consider as determinant factor to select supplier from various propose suppliers applying. Product quality effected by distribution quality and influence on value of relationship quality. Other than product quality in general, the best fresh produce quality supplied will depends on how and when distribution completed. Distribution determinants factors perceived as the important factors are product time delivery, product time delivery accuracy, and product delivery efficiency. Changes or postponement on product delivery is acquire to be communicate with buyer in order to adjust final market supply. Farmer or farmer group with competencies to satisfy buyer's requirements and express professionalism through commitment on quality will obtain buyer's trust.

## **3. Service Benefit on Value Proposition from Buyer's Point of View**

Buyers expect farmer group as seller and product supplier to improve services. The benefit of receiving better services on the business will effecting vegetables delivery and relationship sustainability. Seller will prevent the shortage of product availability. Farmer group as seller sometimes demonstrate inconsistency in service delivery. This related to how seller is be able to attain product continuity and validate business commitment. It became buyer's expectation that seller capable to meet product continuity. In the future business decision, service acknowledged to be the

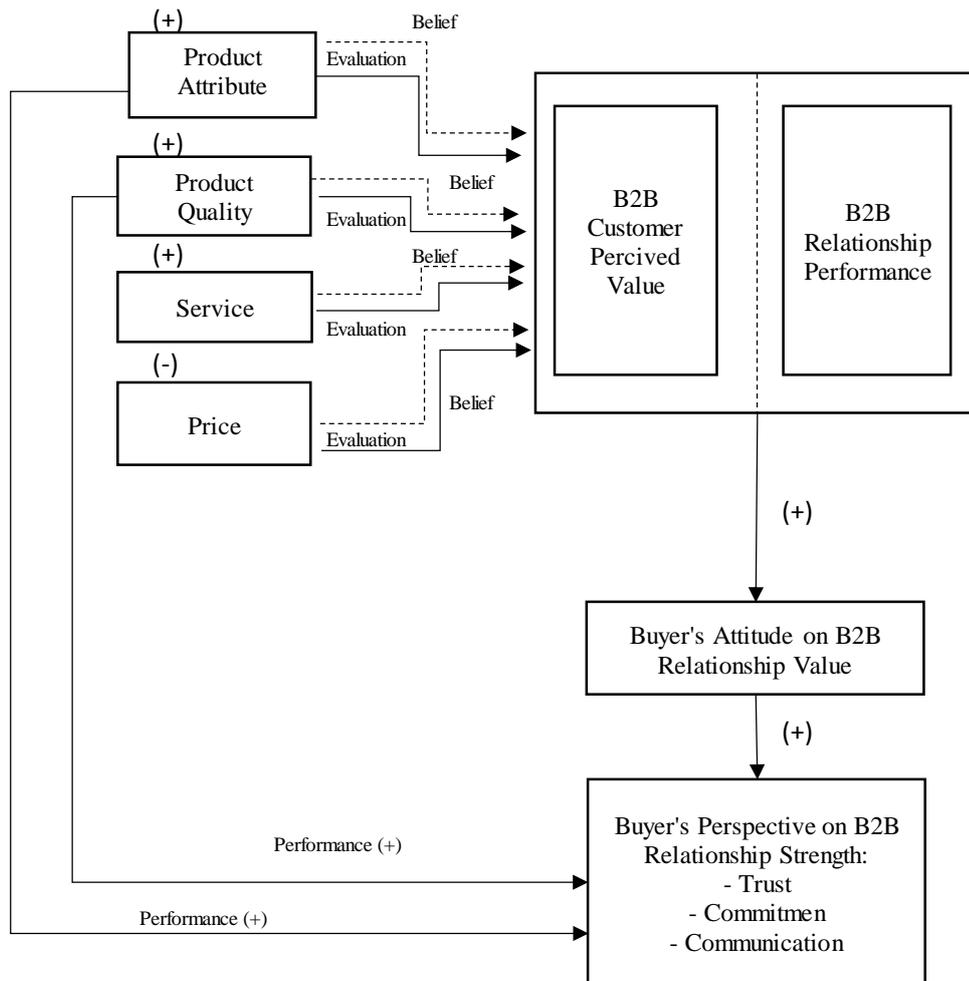
considerable factor on initiate business relation.

## **4. Price Cost on Value Proposition from Buyer's Point of View**

Price is the other substantial factor for buyer to establish business decision. While price is observe as sacrifices on acquiring benefit, but this is not the most important determinant aspect on valuing product in buyer's perspective. Buyer will work on longer relation with seller, as there is a fair price offer by seller with product quantity and quality satisfy as conditions. Internal buyer coordination will be complete to specify commodity prices. Price is an agreement between buyer and seller, taken by buyer's offering. This demonstrate farmer as price taker instead of price maker. Marketing cost is a joint cost based on product delivery destination. Buyer will notify price changes that made informally with no modifications on the contractual letter. Non-material cost serve least considered on business relationship decision, since buyers implacableness on payment method claim by seller that expect cash-and-carry method. Delayed payment apply by buyer correspondence with retail buyer payment method as the next business buyer on distribution chain that utilize delay payment. A two-way communication assume to be the essential factor to resolve price and payment circumstances.

## **Variables Correlation Analysis**

In the original model (see Figure 1), the correlation of Somers' and Gamma measures show some tests badness of fit. Some variables reveal the relation on other variable, but showed failure in significant test. Therefore, the model modification process was necessary conducted to improve the model fit in the next stage after the preliminary testing was constructed.



**Figure 2.** Revised Model

The analysis show the strength of the relationships among the constructs was represented by directional measurement of Somer test and symmetric measurements of Gama test as show in table 1 and table 2. The result of directional measures of Somer test (see Table 1) showed only six of out of eight variables correlation analysis produce significant result. There were buyer's attitude on B2B relationship value had strong correlation on buyer's perspective on B2B relationship strength ( $d = 0.8$ ), product attribute had perfect correlation on buyer's attitude on B2B relationship value ( $d = 1.0$ ), product quality had perfect correlation on buyer's

attitude on B2B relationship value ( $d = 1.0$ ), service had strong correlation on buyer's attitude on B2B relationship value ( $d = 0.8$ ), price also had strong price on buyer's attitude on B2B relationship value ( $d = 0.8$ ), product attribute had strong correlation on buyer's perspective on B2B relationship strength ( $d = 0.8$ ), product quality had strong correlation on buyer's perspective on B2B relationship strength ( $d = 0.8$ ), service had strong correlation on buyer's perspective on B2B relationship strength ( $d = 0.6$ ), and price had strong correlation on buyer's perspective on B2B relationship strength ( $d = 0.6$ ).

Table 1. Overall directional measures of Somers'd Correlation Analysis

	Variables	Value	Asymp Std. Error <sup>a</sup>	Approx. T <sup>b</sup>	Approx. Sig.
Ordinal by ordinal Somers'd	1. Symmetric_1	.800	.219	3.651	.000
	Buyer's attitude on B2B relationship value	.800	.219	3.651	.000
	Dependent				
	Buyer's perspective on B2B relationship strength	.800	.219	3.651	.000
	Dependent				
	2. Symmetric_2a	1.000			
	Product attribute	1.000			
	Dependent				
	Buyer's attitude on B2B relationship value	1.000			
	Dependent				
	3. Symmetric_2b	1.000			
	Product quality	1.000			
	Dependent				
	Buyer's attitude on B2B relationship value	1.000			
	Dependent				
	4. Symmetric_2c	.800	.219	3.651	.000
	Service	.800	.219	3.651	.000
	Dependent				
	Buyer's attitude on B2B relationship value	.800	.219	3.651	.000
	Dependent				
	5. Symmetric_2d	.800	.219	3.651	.000
	Price	.800	.219	3.651	.000
	Dependent				
	Buyer's attitude on B2B relationship value	.800	.219	3.651	.000
	Dependent				
	6. Symmetric_3a	.800	.219	3.651	.000
	Product attribute	.800	.219	3.651	.000
Dependent					
Buyer's perspective on B2B relationship strength	.800	.219	3.651	.000	
Dependent					
7. Symmetric_3b	.800	.219	3.651	.000	
Product quality	.800	.219	3.651	.000	
Dependent					
Buyer's perspective on B2B relationship strength	.800	.219	3.651	.000	
Dependent					
8. Symmetric_3c	.600	.335	1.793	.073	
Service	.600	.335	1.793	.073	
Dependent					
Buyer's perspective on B2B relationship strength	.600	.335	1.793	.073	
Dependent					
9. Symmetric_3d	.600	.335	1.793	.073	
Price	.600	.335	1.793	.073	
Dependent					
Buyer's perspective on B2B relationship strength	.600	.335	1.793	.073	
Dependent					

a. Not assuming the full hypothesis

b. Using the asymptotic standard error assuming the null hypothesis

Other correlation analysis resulted from Gamma correlation test through symmetric measures (see Table 2). Along with Somers' correlation test result, this correlation analysis showed the same determination correlation among variables in the construct model as presented by Somers' correlation test. There were buyer's attitude on B2B relationship value had strong correlation on buyer's perspective on B2B relationship strength

( $G = 0.8$ ), product attribute had perfect correlation on buyer's attitude on B2B relationship value ( $G = 1.0$ ), product quality had perfect correlation on buyer's attitude on B2B relationship value ( $G = 1.0$ ), service had strong correlation on buyer's attitude on B2B relationship value ( $G = 0.8$ ), price also had strong price on buyer's attitude on B2B relationship value ( $G = 0.8$ ), product attribute had strong correlation on buyer's perspective on B2B

relationship strength ( $G = 0.8$ ), product quality had strong correlation on buyer's perspective on B2B relationship strength ( $G = 0.8$ ), service had strong correlation on buyer's perspective on B2B

relationship strength ( $G = 0.6$ ), and price had strong correlation on buyer's perspective on B2B relationship strength ( $G = 0.6$ ).

Table 2. Overall symmetric measures of Gamma Correlation Analysis

	Variables	Value	Asymp Std. Error <sup>a</sup>	Approx. T <sup>b</sup>	Approx. Sig.
Ordinal Gamma by ordinal	1. Buyer's attitude on B2B relationship value on Buyer's perspective on B2B relationship strength N of Valid Cases	.800 5	.219	3.651	.000
	2. Product attribute on Buyer's attitude on B2B relationship value N of Valid Cases	1.000 5	.000		
	3. Product quality on Buyer's attitude on B2B relationship value N of Valid Cases	1.000 5	.000		
	4. Service on Buyer's attitude on B2B relationship value N of Valid Cases	.800 5	.219	3.651	.000
	5. Price on Buyer's attitude on B2B relationship value N of Valid Cases	.800 5	.219	3.651	.000
	6. Product attribute on Buyer's perspective on B2B relationship strength N of Valid Cases	.800 5	.219	3.651	.000
	7. Product quality on Buyer's perspective on B2B relationship strength N of Valid Cases	.800 5	.219	3.651	.000
	8. Service Dependent on Buyer's perspective on B2B relationship strength N of Valid Cases	.600 5	.335	1.793	.073
	9. Price Dependent on Buyer's perspective on B2B relationship strength N of Valid Cases	.600 5	.335	1.793	.073

a. Not assuming the full hypothesis

b. Using the asymptotic standard error assuming the null hypothesis

**Hypotheses Testing**

As the results, table 3 reveal that the hypothesis of H1a, H1b, H1c, H1d, H2, H3a, H3b, and H3d was supported the model, which means that (1) overall benefit and cost of B2B customer value consists of product attribute, product quality, service, and price positively influence B2B relationship value, (2) buyer's attitude on B2B relationship value positively affect buyer's perspective on

B2B relationship strength consists of trust, commitment, and communication, (3) product attributes and product quality positively affect buyer's perspective on B2B relationship strength. However, the hypothesis of H3c and H3d was not supported the model fit, which means service and price does not positively affect buyer's perspective on B2B relationship strength.

Table 3. Hypothesis testing

Hypothesis	Result
H1a: Product attribute effects buyer's attitude on B2B relationship value	Supported
H1b: Product quality effects buyer's perspective on B2B relationship value	Supported
H1c: Service effects buyer's perspective on B2B relationship value	Supported
H1d: Price effects buyer's perspective on B2B relationship value	Supported
H2 : Buyer's attitude on B2B relationship value effects buyer's perspective on B2B relationship strength	Supported
H3a: Product attribute effects buyer's perspective on B2B relationship strength	Supported
H3b: Product quality effects buyer's perspective on B2B relationship strength	Supported
H3c: Service effects buyer's perspective on B2B relationship strength	Not supported
H3d: Price effects buyer's perspective on B2B relationship strength	Not supported

## CONCLUSION

The study found that B2B relationship value on buyer's point of view affected by B2B customer value consists of benefit of product attribute, product quality, and service compare the price as cost of product ownership. The business relationship value will influence buyer's business decision in term of buyer's satisfaction, loyalty, duration of relationship, and business professionalism. Higher value proposition offer by farmer group to their business buyer will tightening the value of business relation in long-run marketing opportunity. Meanwhile, B2B relationship strength consists of trust, commitment, and communication affected by product attribute and product quality. This approved the willingness of buyer companies on seller to achieve the product quantity requirement, meet quality standard, and serve product continuity, In addition, the whole B2B relationship value perceived by buyer affected buyer trust, commitment, and communication successively the business dealing with seller.

The conclusions suggest value of B2B relationship in inclusive agribusiness nature derived from business customer perceived value and relationship performance influence buyer's point of view toward strength of business relationship between parties. Relationship

strength described from business partner attitude on relationship value, while complexity of value evaluation has possibility to enhance by delivering higher value proposition. Commitment implement as the most essential contribution to develop value of B2B relationship from buyer's perspective. Discussion with buyers expose distinct perspective on trust and commitment presented by farmer group as product seller. Delivering trust and commitment is connected through proper communication on delivering a proper information that support marketing relationship value and long-run relation on inclusive agribusiness relationship behavior.

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## **ENHANCING SME CUSTOMERS LOYALTY AND MEMBERSHIP PROGRAM IN FLOUR INDUSTRY IN INDONESIA**

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### ***ABSTRACT***

*Wheat flour industry in Indonesia has grown steadily about five percent annually in the last five years. The potential domestic consumption market is growing positively despite of slow-down of global economic situation. The positive outlook on the market triggers more intense market competition.*

*Small and Medium Enterprises (SMEs) is the main market for wheat flour industry in Indonesia, with 65% consumption of total national consumption. Moreover, SMEs in Indonesia have its own unique characteristics, especially in the way how they manage and run the business. Therefore, building sustainable relationship with them is considered to be critical, in order to sustain the business.*

*Company XYZ tried to build mutually beneficial relationships and strengthen bonds with SMEs in Indonesia using a membership program. However, there are number of challenges in implementing this program effectively. The challenges occur in multiple stages of customer journey, including awareness, execution, and repeat purchase loop stages.*

*Qualitative research with different type of SMEs customers is conducted to explore and better understand SMEs' behavior and preferences, these insights are used to tailor the unique business solution to further enhance the membership program. The potential business solution includes increasing membership program awareness by riding on existing above the line (ATL) and Below the line (BTL) program.*

*Development of mobile-based technology platform is also suggested as enhancement for the program. With user-friendly and more transparent system, participation rates are also expected to grow, thus will lead to stronger engagement with SMEs customers.*

**Keywords:** *small and medium enterprises (SMEs), customer engagement, customer behavior, membership program, mobile application*

## **LOCATION DETERMINANTS OF FOREIGN DIRECT INVESTMENT IN INDONESIA**

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### **ABSTRACT**

*Foreign Direct Investment (FDI) is an important element for economic development. The aggregate FDI inflows over the last few decades have grown remarkably and it flows from the home to the host country. In Indonesian context, majority of FDI flows from the home country to the host provinces in Java Island and the rest flows to the other provinces. It is anticipated that higher FDI inflows into the host provinces in Java Island is associated with better location determinants owned by those provinces. Following the theoretical framework proposed by Dunning, there are three factors need to exit to undertake FDI, namely Ownership, Location determinants and Internalization. This framework is known as O-L-I framework. Ownership and internalization factors are considered as supply-side factor, and location determinants are considered as demand-side factor. Acknowledging the roles of FDI in generating economic growth in a province, each province in Indonesia has been motivated to take any measure to attract more inward FDI. The facts show that the amount of FDI inflows into the provinces outside Java Island is lower than that in the provinces within Java Island. This study aims to scrutinize location determinant factors that may attract inward FDI into the host province in Indonesia. Finally, this study will provide proper recommendations to be taken into account by the host province to accelerate inward FDI in the future.*

**Keywords:** *Location determinants, Foreign Direct Investment*

### **INTRODUCTION**

Foreign direct investment (FDI) is one of the important elements for economic development either for developed or developing countries. FDI inflows have steadily increased due to better investment atmosphere occurs around the world (Quere, Coupet & Mayer, 2007). World Investment Report released by the United Nations Conference on Trade and Development (UNCTAD, 2016) reported that the aggregate FDI flows over the last few decades have

grown remarkably. The report also said that among FDI outflows around the world, majority of them flow to developed countries and the rest flow to developing countries. It is anticipated that higher FDI inflows into developed countries are associated with better location determinants owned by these countries. The differences of inward FDI into the host countries depend on the location advantages owned by these countries.

As an FDI destination, the host country can gain various benefits such as technology transfer and capital accumulation from the home country that lead to generate economic growth in the host country. Acknowledging the roles of FDI in generating economic growth and technology transfer, have motivated the host country to take any measure to attract more FDI inward. Following the Dunning's framework, the magnitude of FDI inflows into the host country highly depend on the location advantages owned by these countries (Dunning, 1993). Most foreign firms are looking for the location determinants offered by the host country.

The characteristics of the host country which are known as location determinants play very important role in attracting inward FDI. In this regards, he argues that large market, low labor cost, huge natural resources, close proximity to western markets, better infrastructure and stable political condition owned by the host country are types of location determinants which may attract foreigner to invest in the host country. In this regards, the study of Deichmann & Sayek (2007) has already proved that foreign

investors prefer to invest in the host country which has favorable initial conditions including better initial economic growth supported by stable exchange rate, good policy and stable security system.

However, there is no clear cut answer what factors most affect each foreign investor to invest in the host country. Normally, good structure of local market, market size and market growth play significant roles to attract all types of FDI to undertaken investments in the host country. In short, all types of FDI would be interesting in a large market, lower labor costs, huge natural resources, and proximity to the exported market (see Lipsey & Sjöholm, 2003; Bevan & Estrin, 2004). Furthermore, the barriers as well as facilities provided by the host countries to have access to local markets, tariffs rate, labor costs, and transport costs may also affect the decision of foreign investors in making the choice for FDI location (see Kinoshita & Campos, 2002; Sass, 2003).

As a developing and host country, Indonesia is also interested in attracting FDI inflows to speed up its economic growth. Therefore, Indonesian government had enacted

the Law Number 1 of 1967 as the first and fundamental legal measure to allow FDI to be invested in Indonesia. After that other several policies also have been made by the government to attract more FDI inflows into Indonesia. Then, in 2003 the government of Indonesia also released new investment policy through the Presidential Decree Number 3 of 2003 to provide certain incentives for foreign investors to invest their capital in Indonesia. The last measure was taken by the government through the Law Number 25 of 2007 on Investment to attract more FDI inward from overseas.

#### **CONCEPTUAL FRAMEWORK OF FOREIGN DIRECT INVESTMENT**

There is no comprehensive understanding about FDI framework has been agreed by the scholars. However, the study of Dunning in 1993 most likely provides clear understanding about FDI conceptual framework. This framework proposes that FDI can be explained by three factors, namely ownership (O), location determinant (L) and internalization (I) factor. This framework is known as “O-L-I” FDI framework.

The first factor is the ownership factor owned by foreign firms to operate in overseas (O). This factor is dealing with a production process to which other firms do not have access to such process. It may include patent rights, copy rights, trademarks of a specific product and blue print which are specifically owned by specific firms. In addition, specific intangible assets or capacities owned by the firms such as specific information, technology, marketing power, entrepreneurial skills, and managerial skills are also considered as the ownership factors (Dunning, 1993).

The ownership factors give the firms valuable cost advantages that outweigh the disadvantages of doing business in the host countries. Firms will not invest in other countries if the cost of production is too high. The main motivation that encourages them to invest in other countries is to obtain higher profits. In other words, home companies will proceed their investment abroad if the expected return is higher than the costs of production. Hence, the source firms need to itemize the expected net profits from that investment before the decision is made (Dunning, 1993). In other words, before doing

business, the firms need to take into account what advantages can be gained from a large scale of production in the host countries. Foreign firms will invest abroad when the expected return exceeds the costs.

The second factor is location determinants offered by the host country to foreign firms to invest in the host country rather than in the home country (L). These factors are dealing with the benefits offered by the host country to foreign firms doing business in that country. Location determinant factors include resource endowments, environmental resources, economic factor, social factor, market size, market structure, economic growth, labor costs, legal enforcement, political stability, government institutions, government policies, government legislation, and tax system existing in the host country. These factors are the attracting determinants that motivate foreign firms to invest their capital in the host country.

In other words, the government in the host country needs to offer specific advantages to foreign firms to attract them to run their business in the host country. The location determinant factors which are most likely

interesting for foreign firms are the availability of infrastructures, sufficient of workers including skilled workers, availability of natural resources, political stability, market size, real GDP, GDP growth, etc. Availability of these factors may stimulate and attract foreign firms to invest in the host country. In this regards, Dunning obviously indicates that location determinants are important for location choice of FDI.

The third factor is internalization factors (I). These factors focus on the rationalization of foreign firms to expand their businesses abroad. In this regards, the most basic question that needs to be raised is that why source firms choose to internalize their business in other host countries rather than in their own countries. Actually, source firms can expand their businesses through exporting or licensing arrangements with local firms to produce the products which are originally owned by source firms. By doing so, the local firms just follow the formulas of the source firms and all trademarks and copyrights are fully owned by the source firms.

Normally market failure and failure in transaction have forced foreign firms to exploit

their products externally in the host country and this process is known as internalization process. Moreover, to some extents firms' assets are considered as public goods within a firm. It means that using such assets in one plant does not diminish use of those assets in other plants. That is why foreign firms with such assets are more likely to have multiple plants including in overseas.

Moreover, a standard hypothesis for this internalization process is that it is difficult for source firms to fully control distance operation in the host country through a licensee agreement with an external party. In this case, a licensee will not offer full value in negotiations over a contract if the intangible asset is not fully revealed. The licensor will not want to reveal the asset until a contract is finalized. In this condition, the optimal decision that can be made by source firms is to internalize their operation in the host country. By doing so, source firms can closely monitor the inputs and keep quality control of their products.

From these three factors proposed by Dunning, the first (ownership) and the third

factor (internalization) are considered as the source-side factors or supply side factors. While, the location determinants are considered as the host-side factor or demand factor. Given the same set of FDI sources, the differences in location determinants of each country may have different magnitude on FDI inflows into the host country (see Charlton, 2002; Bengoa & Robles, 2003; Bloningen, 2005). For instance, FDI inflows into developed countries such as the United States of America, the United Kingdom and the European countries are much higher compared to that into developing countries like Indonesia, India, Malaysia, Sudan and Yaman.

The FDI framework proposed by Dunning above clearly shows that FDI will occur if demand side (location determinants) in the host country match with supply side (ownership and internalization factors) from the home country. In this regards, Bloningen and Piger (2014) argue that in demand side, the location determinants play significant roles in attracting inward FDI. From supply side, the motivation of foreign firms to invest in the host country heavily depends on the aims and

types of FDI itself. Different type of FDI has different motivations of investment.

### **HYPOTHESIS OF THE STUDY**

General hypothesis suggests that facing the same set of sources of FDI stocks in the world, the differences in location factors will have different result on FDI inflows into the host countries. In relation to this study, it can be hypothesized that the number of FDI inflows into the host provinces in Indonesia depends on the location determinants owned by the host provinces. In examining location determinants, this study uses nine independent variables which are correlated with dependent variable (FDI inflows into the host provinces in Indonesia). It is hypothesized that all independent variables except labor cost, have positive correlation with dependent variable.

### **METHODOLOGY OF THE STUDY**

#### **Data collection**

This study focuses on the FDI inflows in the period 2010-2015 because this period is the new wave of FDI inflows into Indonesia. In this case, the data used for this study are all FDI inflows into 33 provinces in Indonesia.

All data required for this study were obtained from various sources; they are Bureau Statistics of Indonesia, Investment Board of Indonesia, journal articles and news paper, etc. This study heavily relies on the secondary data because it is assumed that the data are reliable, valid and up to date because they were collected through the right methods.

#### **1. Dependent and independent variables**

This study uses one dependent variable and nine independent variables. All FDI inflows into 33 provinces in the period 2010 – 2015 are treated as the dependent variable. They are denoted as  $FDI^*_{j,t}$  which means the aggregate FDI inflows from all source countries into the host province  $j$  in year  $t$ . The value of FDI is at constant 2009 US dollar price. Independent variables which are used in this study are provincial GDP denoted as GDP, GDP growth denoted as GDPG, per capita GDP denoted as PGDP, per capita GDP growth denoted as PGDPG, labor cost denoted as LC, transport intensity index denoted as TI, illiteracy rate denoted as ILIT, mining products denoted as MINING, and political stability denoted as POL.

All data about independent variables used in this study, except dummy variable (political stability) are lagged one year because the effect of independent variables at time  $t-1$  appears only within period  $t$  and is fully completed within that period. Lagged one year is the appropriate time to observe this correlation. Lagged one year is applied because FDI inflows in year  $t$  is influenced by the condition of independent variables in year  $t-1$ . In addition, lagged one year formula is

also applied to avoid endogeneity problem in the regression analysis between dependent and independent variables which may influence each other. By doing so, endogeneity problem might not occur. Then, all data (dependent and independent variables) were entered into STATA econometrics computer program as a tool to run regression analysis. The result of data summary run by this program is shown in table 1 below.

**Table 1: Data summary about dependent and independent variables**

. sum

Variable	Obs	Mean	Std. Dev.	Min	Max
year	145	2003	1.419116	2001	2005
province	0				
fdi	145	388.5383	878.2647	.08	5611.6
gdp	145	4.51e+07	6.52e+07	1473275	2.78e+08
gdpg	145	4.629103	1.80132	-3.75	10.24
pgdp	145	6042023	4868168	1662909	3.18e+07
pgdpg	145	3.817586	7.463351	-9.49	63.66
lc	145	703947.6	174634.3	250700	1164200
ti	145	35.88869	25.79029	.02	94.53
ilit	145	4.547107	.3148357	3.673	4.9575
mining	145	5592518	1.07e+07	11254.89	4.98e+07
pol	145	.8965517	.3055991	0	1
time	145	3	1.419116	1	5
prov	145	15	8.395601	1	29
ln_fdi	145	3.843262	2.458186	-2.525729	8.632591
ln_gdp	145	16.89354	1.175347	14.203	19.4437
ln_gdpg	142	1.501764	.3923062	-.6539265	2.326302
ln_pgdp	145	15.4493	.5152189	14.32408	17.27467
ln_pgdpg	131	1.044157	1.021726	-4.60517	4.153556
ln_lc	145	13.43017	.2738947	12.43201	13.96754
ln_ti	145	3.060278	1.583903	-3.912023	4.548917
ln_ilit	145	1.511957	.0725854	1.301009	1.600902
ln_mining	145	13.83069	2.034859	9.328558	17.72293

Table 1 shows that original number of observation (unit analysis) for each variable is 145. However, after log natural (ln) for each variable is done, the number of observation for per capita GDP growth are dropped to 131 because some data which have negative value are omitted by STATA when the regression analysis are done

## EMPIRICAL ANALYSIS

### 1. Variable specification and the model

Following the model used by Chen (2003), the correlation between dependent and

independent variables is examined over time and across provinces. The Kmenta model, an approach (pool) designed especially pooled time-series and cross-section data is applied in this study. With the pooled data, the observations are much larger than would be if just time-series or cross-sectional data are employed. Consequently, the estimation of the regression parameters can be greatly increased.

Furthermore, due to the data used in this study are pooled data, the Generalized Least Square (GLS) technique is appropriate

to be used to run regression analysis. This technique may eliminate or at least reduce heteroskedasticity problem. Moreover, this technique will produce a more efficient regression estimation rather than Ordinary Least Square (OLS). Following the model used by Chen (2000, 2003), the equation model which is used to test the correlation between dependent and independent variables in this study is:

$$\ln FDI^*_{j,t} = \beta_0 + \beta_1 \ln GDP_{j,t-1} + \beta_2 \ln GDPG_{j,t-1} + \beta_3 \ln PGDP_{j,t-1} + \beta_4 \ln PGDPG_{j,t-1} + \beta_5 \ln LC_{j,t-1} + \beta_6 TI_{j,t-1} + \beta_7 ILIT_{j,t-1} + \beta_8 MINING_{j,t-1} + \beta_9 POL_{j,t} + e_{j,t}$$

Where:

$FDI^*_{j,t}$  is the aggregate FDI inflows from all source countries into the province j in year t (million US dollar at constant price 2009).

$GDP_{j,t-1}$  is GDP of province j in year t lagged 1 year (million *rupiah* at constant price 2009).

$GDPG_{j,t-1}$  is GDP growth of province j in year t lagged 1 year (million *rupiah* at constant price 2009).

$PGDP_{j,t-1}$  is per capita GDP of province j in year t lagged 1 year (million *rupiah* at constant price 2009).

$PGDPG_{j,t-1}$  is per capita GDP growth of province j in year t lagged 1 year (million *rupiah* at constant price 2009).

$LC_{j,t-1}$  is labor cost of province j in year t lagged 1 year (million *rupiah* at constant price 2009).

$TI_{j,t-1}$  is transport intensity index of province j in year t lagged 1 year (road distance per 100 km<sup>2</sup>)

t lagged 1 year (percentage of illiteracy rate for population over 15 years old).

$MINING_{j,t-1}$  is mining product of province j in year t lagged 1 year (million *rupiah* at constant price 2009).

$POL_{j,t}$  is political stability of province j in year t (dummy variable: zero for instability and one for stability of political condition).

$e_{j,t}$  is stochastic disturbance and  $\beta_s$  are the estimated coefficient of all variables. The estimated coefficients of all variables except the dummy variables will be elastic.

**Table 2: List of variables of provincial FDI inflows equation**

Variable name	Specification of variables	Source	Expect-ed impact on FDI inflows
Dependent	The aggregate FDI inflows from all source	Bureau	

Variable FDI*j,t	countries into the host province j in year t (millions of US dollars at 2009 constant prices).	Statistics and Investment Board of Indonesia.	
Independent Variables:			
GDPj,t	Gross Domestic Product (GDP) of the host province j in year t (millions of US dollars at 2009 constant prices).	Bureau Statistics of Indonesia.	positive
GDPGj,t	Annual growth rate of GDP of host province j in year t (%).	same as above	positive
PGDPj,t	Per capita Gross Domestic Product (PGDP) in the host province j in year t (Indonesian <i>rupiahs</i> at 2009 prices).	same as above	positive
PGDPGj,t	Annual growth rate of per capita GDP of the host province j in year t (%).	same as above	positive
LCj,t	Annual minimum wages of labor in the host province j in year t (Indonesian <i>rupiah</i> at 2009 constant prices).	same as above	negative
TIj,t	Transport intensity index of province j in year t (kilometers of road per 100 km <sup>2</sup> area size)	same as above	negative
ILITj,t	Illiteracy rate of population 15 years or older in the host province j in year t (%).	same as above	positive
MININGj,t	Mining product in the province j in year t (Indonesian <i>rupiahs</i> ).	same as above	positive
POLj,t	Political stability in the host province j in year t (dummy variable). One for the province which has political stability and zero for the province which has political instability.	various sources (journal, books, newspaper, news, etc.)	

**2. Results and explanations**

Since there are nine independent variables, before running the regression analysis, I conducted a correlation test among

the variables. The test result is shown in the table 3 below.

**Table 3: Correlation test among the variables**

	ln_fdi	ln_gdp	ln_gdpg	ln_pgdp	ln_pgdpq	ln_lc	ln_ti
ln_fdi	1.0000						
ln_gdp	0.7064	1.0000					
ln_gdpg	0.1485	0.0227	1.0000				
ln_pgdp	0.5390	0.5702	0.0846	1.0000			
ln_pgdpq	-0.0557	0.0085	0.4017	-0.0341	1.0000		
ln_lc	0.1537	0.0206	0.2759	0.2600	0.1265	1.0000	
ln_ti	0.1059	0.1448	0.0139	-0.2424	0.1852	-0.0354	1.0000
ln_ilit	0.0088	-0.0163	0.1266	0.2575	-0.0051	0.2913	-0.0843
ln_mining	0.4046	0.5307	0.0593	0.4007	0.0688	0.0854	-0.0494
pol	0.1297	0.1269	0.4141	-0.1015	0.0862	-0.0602	0.0515

	ln_ilit	ln_min-g	pol
ln_ilit	1.0000		
ln_mining	-0.0626	1.0000	
pol	0.1191	-0.1424	1.0000

The test shows that overall correlation coefficients among independent variables are not very high. The highest correlation between dependent and independent variable is 0.7064 (between FDI and GDP). The highest correlation among the independent variables is 0.5702 (between GDP and PGDP) and the lowest correlation is 0.0085 (between GDP and PGDPG). Hence, there is no multicollinearity problem might occur in the regression analysis. Subsequently, in conducting regression

analysis, this study uses random effect because the result of *hausman* test shows that random effect is safe to be used.

Since the main purpose of this study is to scrutinize the determinant factors attracting inward FDI, there are two regression models need to be run so that the significant variables could be obtained. The results of regression analysis are shown in table 4 below.

**Table 4: Regression results of provincial FDI inflow equation, 2010-2015 (lagged one year).**

Variables	Model-1	Model-2
GDP	1.100218 (4.74)***	1.249241 (6.83)***
GDGP	0.8711831 (1.75)*	1.092727 (2.52)**
PGDP	1.07576 (2.14)**	0.8122296 (1.97)**
PGDPG	-0.3392456 (-2.04)**	-0.2979215 (-1.84)**
LC	0.8193957 (1.28)	
TI	0.1558121 (1.26)	

ILIT	-2.908162 (-1.05)	
MINING	0.328764 (0.30)	
POL	0.5378719 (0.67)	
Constant	-31.63131 (-2.49)**	-40.38602 (-5.90)***
Number of observation	130	130
Prob > Chi <sup>2</sup>	0.0000	0.0000
R-squared	0.5729	0.5531

Note: t-statistics in parentheses.

P-value: \*\*\*statistically significant at 1%, \*\*significant at 5%, \*significant at 10%.

Table 4 shows that gross domestic product (GDP), GDP growth (GDPG), and per capita GDP (PGDP) have consistently shown positive and significant correlations with FDI inflows as the dependent variable (see regression model 1 and 2). The regression results of labor cost (LC), transport intensity (TI), mining products (MINING), political stability (POL) have shown positive correlation with FDI inflows. Besides, the regression results of per capita GDP growth and illiteracy rate have shown negative correlation with FDI inflows. Detail explanations of each regression model are as follows:

#### Regression model-1

In the regression model-1 (full model) all independent variables were included into regression analysis. The regression result of model-1 shows that overall this regression

model is significant at 1% (Prob > Chi<sup>2</sup>: 0.0000). R-squared in this regression model is 0.5729 which indicates that around 57.29% of FDI inflows into the host provinces could be explained by all independent variables entered into model-1. Furthermore, among all independent variables; GDP, GDP growth and per capita GDP are significant and have positive correlation to attract inward FDI.

Precisely, GDP is significant at 1% (t-statistics: 4.74), GDP growth is significant at 10% (t-statistics: 1.75) and per capita GDP is significant at 5% (t-statistics: 2.14). These results indicate that all these three variables support the hypothesis. Then, per capita GDP growth is also significant at 5%, but it has negative sign which is opposite to the hypothesis. The other variables entered into this regression model-1, namely transport

intensity, illiteracy rate, mining products and political stability, are not significant to attract inward FDI. Even though these variables do not show significant correlation with inward FDI, they are still in line with the hypothesis except for labor cost which shows the opposite sign with their hypotheses. Detail explanations of each variable will be elaborated in the next section.

#### **Regression model-2**

After regression model-1 was done, it has been found that there are only four variables are significant, the rest are not significant. Therefore, it is considered that the second regression needs to be done. The main purpose of regression model-2 is to examine whether the four variables which are significant in regression model-1 are still significant or not if they are run without other variables. Therefore, the variables entered into the regression analysis model-2 are only four variables, namely GDP, GDP growth, per capita GDP, and per capita GDP growth. The other variables which are not significant in regression model-1 are dropped in the regression model-2. The regression result shows that GDP, GDP growth, per capita

GDP, and per capita GDP growth are consistently significant to influence FDI inflows as dependent variable.

Overall the regression result model-2 is also significant at 1% (Prob > Chi<sup>2</sup>: 0.0000) with its R-squared value is 0.5531. This R-squared value indicates that all independent variables entered into this model-2 can explain around 53.31% independent variable. Compared to the regression model-1, R-squared in the regression model-2 is much lower because it analyzes only four variables. More interestingly, GDP and per capita GDP are consistently significant at 5% with t-statistics are respectively 2.52 and 1.97. Fortunately, the significance level of GDP growth in the regression model-2 increased to 5% with its t-statistics is 2.52. Unfortunately, per capita GDP growth in this regression model still shows negative correlation with inward FDI with the level of significance is at 5% (t-statistics: -1.84).

#### **BASIC FINDINGS AND DISCUSSIONS**

In line with the hypothesis and regression results of this study, below are some basic findings that need to be discussed.

Overall, the regression results show that majority of location determinants used as independent variables in this study except per capita GDP and labor cost have supported the hypotheses laid down in the section below. Detail discussions of each finding are as follows:

### **1. Gross Domestic Product**

The regression results show that GDP has positive and significant correlation with FDI inflows. In the regression model-1, GDP shows significant correlation at 1% with t-statistics value is 14.74. Then, in the regression model-2, GDP is also significant at 1% with t-statistic value is 8.83. Hence, GDP is considered as the most important determinant taken into account by foreign investors before a location choice for FDI is made.

Moreover, the findings of this study also support the previous research about location determinants and provincial distribution of FDI in China conducted by Chen (2003) which found that GDP has positive and significant correlation with inward FDI. In addition, research finding by Chakrabati (2002) which proved that GDP has significant correlation with inward FDI is also

related with this study. It means that these findings strongly support Chen's and Chakrabati's study. Moreover, these findings also support the study conducted by Busse & Hefeker (2007) which concludes that most foreign investors consider GDP as the most important consideration in making their FDI decisions.

Positive and significant contribution of GDP toward inward FDI is quite reasonable because most FDI are interested in higher local GDP. This logical thinking is also quite relevant with the fact in Indonesia which shows that starting from 2001 the total amount of FDI flows into Indonesia has increased gradually in line with the gradual increase of Indonesian GDP after economic crisis hit Indonesia in 1997-1998 (see Kian, 2006). More specifically, FDI inflows into the host provinces which have higher GDP are higher compared to that in the provinces which have lower GDP.

### **2. GDP Growth**

The regression results show that GDP growth has positive and significant correlation with FDI inflows. In the regression model-1, GDP growth shows significant correlation at

10% with t-statistics value is 1.75. Then, in the regression model-2, GDP growth is significant at 5% with t-statistic value is 2.52. In short, in any regression models, GDP growth consistently contributes significant results which mean that the higher the GDP growth, the higher the FDI inflows into the host province. These findings also indicate that GDP growth in the host province is a significant location determinant which may attract FDI inflows into that province.

Furthermore, coefficient value of GDP growth is getting better in the regression model-2 after all insignificant variables are dropped. Coefficient value in the regression model-1 is 0.8711831 which means that 1% change in GDP growth may have positive change around 0.8711831% on FDI inflows. Positive impact on FDI inflows in the regression model-2 becomes higher that is 1.092727% in every 1% change of GDP growth. These coefficient values indicate that the role of provincial GDP growth to attract FDI inflows into that province is relatively high.

These findings are also in line with the fact in Indonesia which shows that Riau

Province has the highest GDP growth in Indonesia. Higher GDP growth of Riau Province had attracted higher FDI inflows into that province. In addition, Riau is one of higher FDI recipient in the west part of Indonesia. In short, GDP growth does have positive effects on inward FDI.

### **3. Per capita GDP**

The regression analysis results show that per capita GDP has positive and significant correlation with FDI inflows. The higher the per capita GDP, the higher the magnitude of FDI inflow will be. More interestingly is that in the regression analysis model 1 and 2, per capita GDP consistently shows significant result at 5% with t-statistics value is 2.14 in the regression model-1 and 1.97 in the regression model-2. In this regards, the regression results have supported the hypothesis of per capita GDP which argues that per capita GDP has positive and significant correlation with FDI inflows.

In addition, both regression results also show higher coefficient values of per capita GDP that is 1.07576 in the regression model-1 and 0.8122296 in the regression model-2. Coefficient value in the regression

model-1 indicates that every 1% change of GDP growth may increase 1.07576% FDI inflows. Similarly, coefficient value in the regression model-2 also indicates that the increasing of 1% in per capita GDP may attract 0.8122296% FDI inflows. Interestingly, coefficient value in the regression model-2 is lower compared to that in the regression model-1. Normally, coefficient value of per capita GDP in the regression model-2 should be higher than that in the regression model-1 because all insignificant variables were not entered into the regression model-2.

These regression results are quite relevant with the real FDI condition which occurs in Indonesia. It has been mentioned earlier that during this period of study, DKI Jakarta consistently held the position as the highest FDI recipient. By contrast, Nusa Tenggara Timur Province consistently held the position as the lowest FDI recipient among all provinces in Indonesia. If we relate with the regression results shown above, these phenomena are quite true because DKI Jakarta province owned the highest per capita GDP. On the other hand, in the same period of time,

Nusa Tenggara Timur province owned lower per capita GDP.

However, it cannot be generalized that higher per capita GDP automatically has linear contribution toward inward FDI. In this case, the fact shows that Kalimantan Timur Province had lower per capita GDP than DKI Jakarta, but this province was not the second highest FDI recipient in Indonesia. The second highest FDI recipient during this period was Jawa Barat Province. So, what can be concluded in this phenomena is that per capita GDP has positive contribution to attract inward FDI. In this matter, higher per capita GDP of Kalimantan Timur province have attracted significant amount of inward FDI.

#### **4. Per capita GDP growth**

The regression results show that statistically per capita GDP growth has negative and significant correlation with FDI inflows. Moreover, per capita GDP growth has consistently showed significant result at 5% in both regression models. Significant level of per capita GDP growth can be understood from its t-statistics, namely -2.04 in the regression model-1 and -1.84 in the regression model-2. At the same time, these results are opposite

with the hypothesis which proposes that per capita GDP growth has positive and significant correlation with FDI inflows.

In line with t-statistic values, the coefficient values of per capita GDP growth are relatively high which are -0.3392456 in the regression model-1 and -0.2979215 in the regression model-2. Coefficient value in the regression model-1 obviously tells us that every 1% increase in per capita GDP growth may decrease 0.3392456% FDI inflows. Similarly, coefficient value in the regression model-2 also indicates that 1% positive change in per capita GDP growth may affect 0.2979215% negative change in inward FDI. These finding are absolutely opposite with numerous literatures and previous studies which have been elaborated in the previous sections of this paper. Most studies found that per capita GDP growth has positive and significant contribution toward inward FDI (see; Kinoshita, 2002; Morris, 2005; Sharma, Wang & Wong, 2014).

It is anticipated that the main reason behind these findings is that the data about per capita GDP growth used in this study do not match with the data about FDI inflows. It has

been known that in 1997-1998 Indonesia faced very severe economic crisis which affected per capita GDP growth dropped to the lowest level. The economics survey shows that per capita GDP growth in Indonesia started to rise to normal level in the year 2005, while the data used in this study are the data from year 2010 to 2015.

### **5. Labor cost**

The hypothesis says that labor cost has negative and significant correlation with inward FDI. However, the regression results show that labor cost is not significant to attract FDI inflows. It is anticipated that labor cost has opposite results with the hypothesis because of the data used this study are nominal wage rate, not efficiency wage rate. Following Nwaogu and Ryan (2013) “the best measure of labor cost should be efficiency wage rate”. Efficiency wage rate is measured by calculating the amount of wages paid to labor divided by marginal product of labor. Therefore, the main reason to use wage rate is that lower nominal wage rate may be accompanied by lower productivity. If it is so, efficiency wage rate becomes high. As a result,

foreign investors will be responsive to this situation.

According to Busse and Hefeker (2007), foreign investors are quite responsive to the level of efficiency wage in the host country because labor cost is an input for their product. In this regards, Biswas (2002) conclude that higher labor cost have negative impacts on FDI inflows because majority foreign investors are seeking for the countries which have lower labor cost. Furthermore, they emphasized that the standard measurement of labor cost used by foreign investors is efficiency wage rate, not nominal wages rate. Therefore, before FDI decision is made by foreign investors, the level of efficiency wage rate is taken into higher consideration. Similar finding is also found by Jenkins & Thomas (2002).

The regression results of this study which show that labor cost has positive correlation with inward FDI is contrast with various literatures and previous studies elaborated above. Actually if we analyze deeply the phenomena behind this regression analysis, the findings of this study are still in line with those literatures. If we observe from

nominal wages, the fact shows that labor cost in Indonesia in the period of 2010-2015 was quite high compared to that in the previous periods. However, it should be noted that higher nominal wages in that period was caused by higher economic cost.

#### **6. Illiteracy rate**

The regression result shows that illiteracy rate is not significant to attract inward FDI which means that this result does not support the hypothesis. Even though statistically transport intensity index is not significant, higher illiteracy rate may have certain roles in discouraging foreign investors to invest in the host provinces. These argument are in line with some literatures which argue that higher illiteracy rate in the host country may deter inward FDI (see Bloningen & Piger, 2014).

These findings are also in line with the real condition happened in various provinces in Indonesia. The real condition shows that illiteracy rate in the period 2010-2015 in the Province of Nusa Tenggara Timur, Sulawesi Tenggara, and Jambi were relatively higher than other provinces. In relation to FDI inflows, the fact also shows that the amount of

FDI inflows into these provinces was also relatively low. On the other hand, DKI Jakarta, Jawa Barat, Banten, Jawa Tengah and Jawa Timur province relatively had lower illiteracy rate. The amount of FDI inflows into these provinces were higher compared to that in the Province of Nusa Tenggara Timur, Sulawesi Tenggara, and Jambi. It means that illiteracy rate has certain contribution toward FDI inflows.

In relation to this finding, the previous study of Yussof & Ismail (2002) found that the level of literacy rate in the host country plays very significant roles in determining FDI decision. Moreover, literacy rate in the host country is an important determinant for foreign investors because it has very close correlation with the quality of human resources. It means that higher human resources may attract more inward FDI. In line with this finding, the study of Chen (2003) in China also found that university students enrolment rate has positive and significant contribution to inward FDI.

To some extents sometimes foreign investors do not consider illiteracy rate in the host provinces in Indonesia as a discouraging factor for their investment. The main reason is

that majority of investment in Indonesia are still dominated by labor intensive projects which do not require higher skilled labors to run the projects. In addition, the number of university graduated workers required to be employed in FDI projects is also quite limited. In this case, higher skilled labors required to run FDI projects can be brought directly from their own countries.

#### **7. Transport intensity index**

The regression result shows that statistically transport intensity index is not significant to attract FDI inflows. However, there are enormous literatures which argue that transport intensity index has positive and significant correlation with FDI inflows. Precisely, the study conducted by Asiedu (2002) proved that better infrastructures such as road, telecommunication and electricity in a host country may lead to better investment climate in that country.

Even though statistically this variable is not significant to determine FDI inflows into Indonesia, the fact shows that transport intensity has certain contribution to attract FDI inflows. The real condition of FDI in Indonesia shows that almost all foreign investors

investing in Indonesia do not build infrastructures especially road to support their investment. Road is considered as pre-condition requirement provided by local government to attract inward FDI (Horn, 2007). Therefore, this study consistently advises that transport intensity is important determinant to attract inward FDI.

The statistical data during this study period show that Aceh, Jambi, Bengkulu, Maluku, Nusa Tenggara Timur and Sulawesi Tenggara are the provinces which have very low transport intensity index among all provinces in Indonesia. On the other hand, DKI Jakarta, Jawa Barat, Banten, Jawa Tengah, Jawa Timur and Sumatera Utara are the provinces which have higher transport intensity index. The fact obviously indicate that the provinces which have higher transport intensity index receive more FDI inflows compared to the provinces which have lower transport intensity index. Therefore, it is wise to conclude that transport intensity has certain contribution to attract inward FDI.

### **8. Mining product**

The regression results show that mining product is not significant to attract FDI

inflows. However, the fact shows that mining product have certain contributions to attract inward FDI from the source countries. Moreover, this finding also shows that FDI inflows into Aceh, Riau and Kalimantan Timur are relatively influenced by the values of mining product produced in these provinces. In line with this, the study of Sahoo (2006) indirectly shows that mining product holds an important determinant to stimulate inward FDI into the host countries especially resource seeking FDI.

This study also argues that resource seeking FDI normally focuses their investment on the natural resources available in the host country. Therefore, the availability of mining products such as gold, silver, sulfur, iron and tin in the host provinces may have positive impacts on inward FDI.

The logical behind this finding is that mining production in Indonesia is not as higher as mining products in other countries like Australia which has huge stock of uranium, or Malaysia which has a lot of tin reserve. Mining products in Indonesia except oil are only sufficient to fulfill domestic needs, not enough to be exported. Moreover, the highest mining

products in Indonesia is just available in few provinces namely Papua, Kalimantan Timur, Riau and Aceh Province

### **9. Political stability**

The regression result of political stability shows that political stability is not a significant variable to attract FDI inflows. At the same time, this finding does not support the hypothesis that states that political stability has positive impacts on inward FDI. In addition, this finding is also contrast with numerous studies which found that political stability is an important determinant to attract inward FDI (Bevan & Estrin, 2004). Besides, Rajenthiran (2002) also found that political stability plays very important roles in attracting FDI inflows.

Moreover, this finding also contrasts with the real condition occurred in Aceh, Maluku and Papua province which show that these three provinces consistently received very low FDI inflows. In relation to political stability, the finding shows that political condition in these three provinces was quite severe due to political instability occurred in these provinces.

If we relate between FDI inflows and political condition in these three provinces, it

seems that political stability may have certain contribution toward inward FDI. The main reason is that foreign investors would be reluctant to invest in the provinces which have severe political condition because it is high risk for them. However, the regression result above shows no significant correlation between political stability and FDI inflows. The reason behind this regression is that the data entered into regression analysis are not free from bias. The source of bias could be from the data obtained by researcher because this study just relies on the secondary data provided by other institutions. The other source of bias could be from misconduct by researcher when the process of quantifying political stability into dummy variable took place.

It is very hard to compute a province into dummy variable (one for stable political condition and zero for unstable political condition) because there is no standard measurement that has been established by previous studies. Therefore, these two sources of bias could affect the result of regression analysis above.

### **CONCLUSION**

This study has found that the distribution of FDI inflows into the host provinces has demonstrated that given ownership advantages and the internalization advantages of the sources firms, the location determinants of the host provinces in Indonesia are very important to attract FDI inflows into that province. Moreover, the differences in the amount of inward FDI into each province is caused by the differences in the location determinants owned by that province.

In analyzing the correlation between FDI inflows and location determinants, the regression results have provided strong support for the acceptance of the hypotheses proposed in this study. The main findings are that higher GDP, higher GDP growth, and higher per capita GDP have relatively attracted higher inward FDI. These findings are also in line with reality in the field showing that the provinces which have higher GDP, higher GDP growth and higher per capita GDP have attracted more FDI inflows from the sources countries, and vice versa. In other words, GDP, GDP growth and per capita GDP are the most significant location determinants which attract FDI inflows into the host province.

Hence, it is suggested that in order to attract more inward FDI, the host province needs to design new policies or reform current policies which can lead to increase their provincial GDP, GDP growth, and per capita GDP. Special efforts and attentions also need to be focused on per capita GDP growth. By doing so, more FDI inflows into the host province could be obtained in the future.

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**ANALYZING THE EFFECT OF OPENNESS AND POLITICAL VARIABLES  
ON FOREIGN DIRECT INVESTMENT INFLOWS IN 30 PROVINCES IN  
INDONESIA 2000-2013**

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***ABSTRACT***

*Recognizing an importance of investment flows as one of the component of development, ASEAN countries member created an ASEAN Economic Community (AEC) 2015 blueprint, as a guideline to create a free and open investment regime in ASEAN. The enactment of AEC makes the issue of foreign direct investment (FDI) in Indonesia becomes more attractive. Indonesia needs strategic plans to compete with other ASEAN members. One of the regulation improvement of FDI is Act 1 of 1967 which is revised by the Act No.25 of 2007. The act managed to increase the amount of FDI inflows to Indonesia. Hence, an increasing number of FDI is followed by uneven absorption of FDI in various regions of Indonesia which concentrated in Java. In addition, the research data also indicates a decrease in FDI inflows during the presidential election, which coincide with the start of the regional autonomy policy in 2004. Both indicate that in addition to the influence of the economy, there are level of openness and other variables, such as presidential election which contribute to the amount of FDI absorption inflows in the region. This study aims to determine whether the disclosure of openness and presidential election have an influence on FDI inflows in 30 provinces of Indonesia. To determine the influence of these variables this research uses pannel data regression with fixed effect model. The results of this study indicate that openness has positive effect, but not significant on FDI inflows. GDRP per capita as a proxy of market size has significantly positive effect on FDI inflows. Besides that, the presidential general election has significantly negative effect on FDI inflows, while the democratic regime has a negative effect, but not significant on FDI inflows.*

***Keywords:*** foreign direct investement, openness, political variables, Indonesia

## INTRODUCTION

The Blueprint of ASEAN Economic Community (AEC) 2015 which has been planned in the past few decades have proven raising awareness foreign direct investment (FDI) in ASEAN countries as well as all over the world. Globalization became one of the important factors that affect high awareness of the importance of FDI in a country.

Hsia and Shen (2003) mentioned that FDI has a positive effect on economic growth in a country. This means that the higher FDI flows into the country, the higher the growth rate of the country. This statement is also strengthened by the Harrod-Domar growth model which stated that in order to spur economic growth an economy requires new investment as it creates additional net capital to reserves or capital stock. Todaro (2012) also mentioned that to measure the success of development in developing countries can be done by increasing economic growth.

The increase in growth is one of the goals to be achieved by AEC later, so since drawn up a blueprint AEC 2015, ASEAN countries are become more concerned to attract investors to their country, especially developing countries which are still experiencing problems with low and unstable economic growth.

FDI is not only have an impact on economic growth, it appears that FDI also has many other positive impacts. According to Ho and Rashid in Jadhav (2012), in addition to foreign investment can raise investment as well as increase the stock of capital, foreign investment also can increase employment by creating jobs and technology transfer. Walsh and Yu (2010) said that FDI can help accessing to international markets and allow the transfer of technology and specific expertise. Jaumotte (2004) also mentions in his research that besides FDI can create jobs, FDI can provide incentives to domestic manufacturers to improve efficiency, and enabling technology transfer to countries which receive FDI. So that local communities will get the chance to develop through technological advances and adjust their

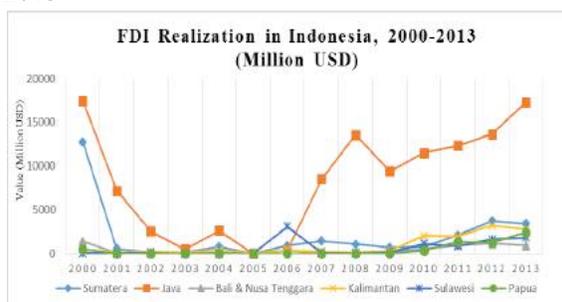
product in accordance with international standards in order to compete with products from other countries.

The benefits of FDI is also felt by Indonesia, which since the beginning (the New Order era) has been paying attention to the FDI. The presence of AEC 2015 blueprint, make Indonesia become increasingly concerned about the FDI. According to the ASEAN Investment Report 2015, Indonesia is the second largest country after Singapore with FDI inflows of 16% of total FDI in ASEAN. The increase in FDI inflows into Indonesia can not be separated from the revision of the Law on foreign investment of Act 1 of 1967 into Act No. 25 Year 2007 on Investment that makes it easier for foreign investors to invest in Indonesia, as well as AEC 2015.

In contrast to other ASEAN countries, Indonesia is an archipelagic country with uniqueness in every region as well as abundant resources. If the potential of each region can be optimized, it is expected that more foreign investor to invest in Indonesia. Along with the implementation of the AEC 2015, Indonesia is expected to be competing competitively with other ASEAN countries. Thus, Indonesia can maintain its position or even surpass Singapore in terms of FDI.

However, as an archipelagic country, Indonesia faces problem in the distribution of the FDI. FDI Inflows from abroad is not equally received by each region. This trend can be seen in the Figure 1.

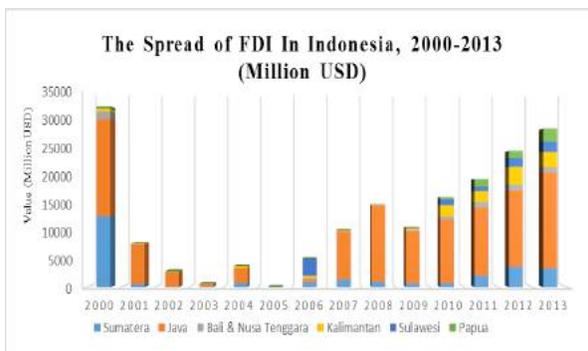
**Figure 1.** FDI Realization in Indonesia, 2000-2013



Source: Indonesia Investment Coordinating Board (2015)

As shown in the Figure 1, it appears that the FDI inflows in Indonesia is still likely to converge in Java. More than half of the total inflows of FDI to flow in Java by 58 percent, then the rest flow into other regions, such as Sumatera by 14 percent, Kalimantan by 12 percent, and the remaining 6 percent flows to another regions.

**Figure 2.** The Spread of FDI in Indonesia, 2000-2013



Source: Indonesia Investment Coordinating Board (2015)

Unequal distribution of FDI received by each region and its tendency to converge are not the only problem Indonesia need to solve, it also seen in Figure 2 that the FDI realization is unstable. There was sharp decline of the FDI inflows from 2000 to 2003, but interestingly enough in 2004 when Indonesia holds a presidential election, the trend of FDI was rising in every region and declined in 2005. This phenomenon can be explained by the research conducted by Jensen (2003) which states that the change of regime to democracy give very positive influence on FDI inflows into the country. Something similar happened in Indonesia, prior to 2004 the President and Vice President shall be elected by House of Representatives (DPR) and in 2004 for the first time the president and vice president directly elected by the people.

This political event was happening again five years later, FDI was increasing from 2006 to 2008, and then dropped in 2009 when Indonesia holds President and Vice President Elections.

Thus, this political event would be observed if it has an impact on FDI flows into Indonesia. Jensen (2008) also agreed to previous research and stated that the unstable political conditions and poor democratic institutions will negatively affect the flow of foreign investment coming into the country.

Apart from the political, economic openness is one interesting issue. According to the Global Competitiveness Report 2013-2014, competitiveness index of Indonesian domestic market is ranked third with a score of 6.2 out of a total score of 7 and Indonesian foreign market is ranked fourth with a score of 6.4 out of a total score of 7. Looking at this report, it can be said that Indonesian market has huge potential for both domestic investors and foreign investors to invest in Indonesia. Economic openness will greatly affect the behaviour of investors, Liavorgas and Skandalis (2012) revealed that the more open the economy of a country, the higher the FDI inflows, as it welcome to multinational companies to enter.

It would be interesting if the case for economic openness began to be observed on a regional basis as it possible that some minority region is still not very open in its economy. Maybe not only from the political, but economic openness of a region is also one of the causes of the unequal distribution of FDI in Indonesia.

## PREVIOUS STUDIES

Various studies have been conducted to examine the factors that affect FDI inflows into a country, some of which are economic openness and political variables. One is the research conducted by Banga (2006), which examines the relationship of economic fundamentals (consisting of market size, market potential, labor costs, availability of experts, the cost of capital, the availability of infrastructure, the real exchange rate, exchange rate stability, inflation, financial health and economic stability, including political stability) and policies implemented by the government against the FDI inflow into a country. Banga examined 15 developing

countries in South Asia, East Asia, and Southeast Asian. In his research, Banga discovered that the market size, the availability of experts, and the availability of infrastructure has a positive impact on the FDI inflow, while the labor and financial health proxied by the number of debts owed to have a negative influence on FDI. That is, the greater the market sizes of a country, the greater the FDI inflows. The other result indicates that the higher labor costs, the country's FDI inflows would also be less. This study also shows that the economic stability, inflation rates, exchange rates, as well as the stability of the exchange rate does not affect FDI.

The effect of economic openness to FDI inflows has also been studied previously by Liavorgas and Skandalis (2012), Koojaroenprasit (2015), and Hakro and Ghumron (2011) who found that economic openness is one of the dominant factor affect FDI inflows in the country. Then, Baek and Qian (2011) found that the political risk and political violence has great influence on the investment decisions of foreign investors in both industrial countries and developing countries. In addition, Jensen (2003) also found it interesting that change in regime appears to have an influence on FDI inflows. Democratic governments have a very high positive impact on FDI, especially in developing countries.

## DATA AND METHODOLOGY

The data used in this study is an annual panel data of 30 provinces in Indonesia with a period of 14 years from 2000 to 2013. Although currently there are 34 provinces in Indonesia, but this sample only covers 30 provinces because the other four provinces just experienced decentralization on year study examined, namely West Papua (2001), Riau Islands (2002), West Sulawesi (2004), and North Kalimantan (2012). Therefore, the data do not cover the entire period of the study.

Sources of data obtained from various publications from several institutions, namely: Province In Numbers (Central Bureau of

Statistics), Indonesia Investment Coordinating Board, Indonesian Statistics (Central Bureau of Statistics), and the General Election Commission, which includes foreign direct investment (FDI), the openness of the economy, the GDRP per capita, dummy democratic regimes, and dummy Presidential elections.

To capture the effect of economic openness and political variables in each region within the period, this research was used the fixed effect model. The model used in this study refers to an earlier study conducted in 2006 by Banga. Banga (2006) conducted a study in ASEAN and Asia-Pacific Economic Cooperation (APEC), which include Bangladesh, China, Hong Kong, Taiwan, India, Indonesia, South Korea, Malaysia, Nepal, Pakistan, Philippines, Singapore, Sri Lanka, Thailand, and Vietnam to examine whether investment is an important factor in ASEAN and APEC. The model proposed by Banga (2006) is as follows:

$$FDI_{it} = f[(Economic\ Fundamental)_{it-1}, (Tariff\ Policies)_{it}, (FDI\ Incentives)_{it}, (Removal\ of\ Restrictions\ on\ FDI)_{it}, (Bilateral\ Investment\ Agreements)_{dgc}, ((Bilateral\ Investment\ Agreements)_{dct}, (Regional\ Investment)_{it}] \dots \dots \dots (1)$$

Where i is the country, t is the time period 1980-81, 1981-82, ..., 1999-2000, dgc is a developed country and dg is a developing country. Furthermore, in a study Banga describe the economic fundamentals into some of the factors that are believed to prompt the foreign capital inflows in those countries. Some of the factors are the size of the market, market potential, labor costs, availability of experts, the cost of capital, the availability of infrastructure, exchange rate, exchange rate stability, inflation, financial health and economic stability, which includes politic stability. Most of these factors are believed to have been examined and have an influence on the increase in FDI. These factors are then modified and adapted to local conditions in Indonesia. Thus obtained model in this study as follows:

$$lfdi_{it} = \beta_0 + \beta_1 openness_{it} + \beta_2 marketsize_{it} + \beta_3 regime_{it} + \beta_4 election_{it} + \epsilon_t \dots \dots \dots (2)$$

where lfdi is the log of FDI per region per year in Indonesia in thousand USD, openness is the ratio of the amount of exports and imports to the GDRP, marketsize is the GDRP per capita per year in thousand rupiah, regime is the dummy variable for democratic regimes (0 = regime before democracy; 1 = a democratic regime), and election is Presidential election (0 = no election; 1 = election).

**RESULTS AND DISCUSSION**

**Table 1:** Regression Results

Variables	Model 1	Model 2
	lfdi	lfdi
openness	0,156 (0,62)	0,285 (0,55)
marketsize	6,738*** (1,03)	6,260*** (0,88)
regime	-0,297 (0,41)	-0,407 (0,32)
election	-0,850** (0,36)	-0,676** (0,31)
dextrapolation	- -	-0,125 (0,30)
Constanta	-48,120*** (8,80)	43,864*** (7,53)
F-stat	23,93	20,55
Prob>F	0,0000	0,0000
R-squared	0,2419	0,2183
N	334	403

The symbols \*\*\*, \*\* and \* represent the degree of significance at level  $\alpha=0.01$ ,  $\alpha=0.05$  and  $\alpha=0.1$ . Source: Result from the estimation

There are two models in this study. The difference of these two models is the first model using original data and not extrapolated and interpolated, while the second model, there is missing data, filled using the method of extrapolation and interpolation. In general the relationship between FDI, openness, the GDRP per capita, a democratic regimes, and

implementation presidential election can be analysed using two equations as follows:

Model 1 :

$$lfdi_{it} = -48,120 + 0,256 openness + 6,738 marketsize - 0,297 regime - 0,850 election + \epsilon t \dots \dots \dots (3)$$

Model 2 :

$$lfdi_{it} = -43,864 + 0,285 openness + 6,260 marketsize - 0,407 regime - 0,676 election + \epsilon t \dots \dots \dots (4)$$

In table 1 shows that economic openness affect positively but not significant to FDI both in model 1 and model 2, which indicates that the more open the economy of a region, the FDI inflows would be even higher. Liarvorgas (2012) stated that economic openness is one of the factors that affect the flow of foreign investment. This means the higher the degree of economic openness, the greater the opportunity for investors to expand their markets.

While having a positive effect, but the results show that economic openness did not significantly affect the FDI. Similar results were also demonstrated in a study conducted by Chakrabarti (2001), Globerman and Shapiro (2002), and Busse and Hefeker (2007). Asiedu (2002) stated that the impact of economic openness to FDI depends on the type of foreign investment. Horizontal FDI may be attracted by countries with higher trade barriers, which also protects the output of foreign investors in the local market against imports from competitors. Otherwise, a multinational company engaged in the export-oriented investment, or FDI Vertical, will invest in a more open economy for their trade barriers will increase the transaction costs that must be borne. Moreover, the existence of

trade restrictions may also be associated with other forms of imperfection policy applied, especially in developing countries (Chakrabarti, 2001). Whether or not resulting in significant, economic openness is influenced by the type of FDI (Busse and Hefeker, 2007).

In the case of Indonesia, the FDI inflows mostly categorize as Vertical FDI where foreign companies only need input from Indonesia for processing materials in its home country, and re-sold in Indonesia. High transaction costs and barriers to investment in Indonesia, particularly in the non-oil sector is what enables economic openness becomes insignificant. Although the government has revised foreign investment law, which is one way the government do to improve the investment climate in Indonesia. But apparently there is no improvement in terms of significant investment easiness for investor to invest in Indonesia.

Ease of Doing Business Survey (EOBD) 2013 conducted by the World Bank-International Finance Corporation (World Bank-IFC) still put Indonesia on the ranking of 128. The rating put Indonesia under ASEAN6 countries, such as Singapore (1st), Malaysia (12th), Thailand (18th). Although Indonesia in 2016 level up to position 109, but this rating is still relatively poor (EOBD, 2016). This is because not only Indonesia, but other ASEAN countries also experienced a rapid increase, such as Thailand (ranked 49), Vietnam (ranked 90th), Philippines (ranked 103). While Singapore remained in first position and Malaysia on 18th.

Insignificant economic openness can be seen from the value of exports and imports through sea ports are being concentrated in a few large ports. This problem makes the distribution of export and import volumes become unequal in each region. In Table 2 in the appendix shows that the highest export was in Port of Tanjung Priok, Port of Dumai, Port of Tanjung Perak, Port of Bontang, and Port of Belawan. Meanwhile, there are several ports that export value is even less than half of the export value of the four ports. Something similar happened on imports (see Table 3), the Port of Tanjung Priok

is still ranked first in the sector, followed by the Port of Tanjung Perak, Port of Cilacap, Port of Balikpapan, and Port of Merak. Their geographical conditions of each region is different which makes not all areas have a sea port, for example, areas far from the sea or close to the sea but the water conditions do not enable it to build the port. So that the spread of export-import value through sea ports is not accepted by any port in the area.

**Table 2:** Export Value According to Province Main Port (Million USD)

Province	Main Port	2012	2013
Aceh	Blang Lancang (Arun)	1.197	930
North Sumatera	Belawan	8.871	7.982
West Sumatera	Padang/Teluk Bayur	2.362	2.208
Riau	Dumai	15.516	14.195
South Sumatera	Palembang - Plaju	642	4.036
South Sumatera	Musi River	3.629	2.931
Lampung	Panjang	3.698	2.096
DKI Jakarta	Tanjung Priok	42.697	41.708
West Java	Balongan	421	425
Banten	Merak	634	825
Central Java	Tanjung Emas	4.423	4.697
Central Java	Cilacap	213	622
East Java	Tuban	328	111
East Java	Tanjung Perak	13.228	12.649
NTB	Bima	596	399
West Kalimantan	Pontianak	964	893
South Kalimantan	Banjarmasin	4.654	4.318
South Kalimantan	Kotabaru	4.821	4.162
East Kalimantan	Balikpapan	3.688	3.066

East Kalimantan	Samarinda	6.025	5.366
East Kalimantan	Bontang	13.577	11.566
North Sulawesi	Bitung	941,	665
South Sulawesi	Ujung Pandang	547	605
South Sulawesi	Malili	949	924
South East Sulawesi	Kolaka	108	101
South East Sulawesi	Pomalaa	486	307
Maluku	Ambon	166	134
North Maluku	Ternate	368	569
Papua	Amamapare	1.996	2.609

Source: Central Bureau of Statistics (2016)

**Table 3:** Import Value According to Province Main Port (Million USD)

Province	Main Port	2012	2013
North Sumatera	Belawan	4.775,60	4.826,3
Riau	Dumai	1.084,90	1.064,5
South Sumatera	Boom Baru	506,40	551,30
Lampung	Kota Agung	1.716,20	1.552,9
DKI Jakarta	Tanjung Priok	81.102,90	77.412,0
Banten	Merak	6.463,00	6.631,8
Banten	Cigading	3.961,70	4.059,0
Central Java	Tanjung Emas	5.103,10	5.704,7
Central Java	Cilacap	8.869,30	10.031,1
East Java	Tanjung Perak	16.430,70	17.463,6
Bali	Benoa/Loloan	41,90	36,90
NTB	Bima	263,70	171,90
NTT	Waingapu	41,40	19,00

West Kalimantan	Pontianak	470,20	404,50
South Kalimantan	Kota Baru	2.752,70	2.478,1
East Kalimantan	Balikpapan	6.122,00	7.228,0
East Kalimantan	Samarinda	543,70	439,70
East Kalimantan	Tanjung Sangata	1.135,50	1.008,2
North Sulawesi	Bitung	122,60	106,50
Central Sulawesi	Pantoloan	2,70	15,50
South Sulawesi	Ujungpandang	872,30	876,70
South Sulawesi	Malili, Sulawesi	308,50	313,10
Maluku	Ambon	423,80	354,70
Papua	Amamapare	1.020,40	503,90

Source : Central Bureau of Statistics (2016)

In the other hand, per capita income shows different significance impact to FDI. Per capita income has positive and significant impact on FDI at the confidence level of 1 percent. The GDRP per capita as a proxy of market size. Which means, the larger the size of the market in the region, the greater the FDI inflows into the area. This is in accordance with the initial hypothesis. Banga (2006) mentioned that the market size has a positive and significant impact on the FDI. Koojaroenprasit (2015) confirms that the market size (GDRP per capita) would be significant at the level of 1 percent of the FDI inflows. Thus, the market size is proxied by the GDRP per capita is an important factor to attract foreign investment (Chakrabarti, 2001). Asiedu (2002) adds that the investors will be more developed when investing in a larger market (market size) which has a high income per capita. This indicates that the market size in the region in Indonesia is very potential to attract foreign investors.

Political variables that proxied by democratic regime and the holding of elections have different direction and significance.

Democratic regime give negative effect, but the effect is not significant. This result contrasts with research conducted by Jensen (2008). This may be caused by following a democracy, there are many ways the society can do to express their aspiration. Sometimes in ways that do actually lead to conflict, so it makes the investor more concern to make an investment.

Things are different shown by the election variables. Election gives negative and significant effect to FDI on the confidence level of 5 percent. This is according to Jensen (2008), indicates that the political events negatively affect FDI inflows. In addition, MIGA (2010) stated that investors tend to avoid markets that have a fairly high political risk due to political instability would tend to reduce profitability of foreign investment. The uncertainty of the prospective head of government also raises the pessimism of investors which resulted in their investment patterns in Indonesia. This was confirmed by Busse and Hefeker (2007) in his research found that investors are very sensitive to changes in political stability and a change of government. Not only that, Jensen (2008) adds that the democratic institution is also one of the factors triggering the low FDI inflows into a country. As already known that the political conditions in Indonesia closer to the election will become unstable due to the enthusiasm of party members in each region and it often cause commotion or even more conflict. Some of these events are what drives the behavior of foreign investors to invest in Indonesia.

## **CONCLUSION**

The level of economic openness has a positive effect, but does not significantly affect FDI inflows. This is not in accordance with the initial hypothesis of the study, but similar results are shown in the research conducted by Busse and Hefeker (2007) and Gliberman and Shapiro (2002). Seim (2009) explains that the geographical position, geographical conditions, and possible income levels correlated with the degree of economic openness. There is also a

tendency that a country which has larger market size would possibly has lower economic openness, because the higher income levels. In addition, the high export and import through sea ports is one contributing factor. This is because not all areas have a sea port and trading mostly takes place only at big seaports, like the Port of Tanjung Priok, Port of Tanjung Perak, and Port of Bontang.

In this study also proved that the income per capita which is a proxy of the market size has a significant effect on FDI inflows in the region. Lastly, the political variables that proxied by democratic regime and the event of general elections have two different effects. Democratic regime gives negative effect, but not significant to FDI inflows. While the Presidential election give significant and negative effect on FDI inflows.

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**A STUDY ON THE DIFFERENCES OF INTENTIONS TO PURCHASE  
GREEN-ELECTRIC PRODUCT IN TERMS OF STUDENTS' GENDER-BASED  
ENVIRONMENTAL AWARENESS**

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***ABSTRACT***

*Recently, issues of global warming had been increasing to be concerned on. In this case, consumers brought themselves into line of such situation by considering their purchasing behavior and environmental issues when shopping. This paper aimed to examine the differences of students' environmental awareness and intention to purchase based on their gender. It also aimed to examine the role of environmental awareness on their purchase intentions in linear manner. The students of Surabaya State University participated as the subject of this study. Data were collected by providing questionnaire to 110 respondents in order to test these present research hypotheses. As independent samples, t-test was used to test whether or not, with gender as the base, the distinctive intentions to purchase green-electric product did happen. In addition, a simple linear regression analysis was used to linearly examine the role of environmental awareness on the purchase intentions of green electricity product. The results indicated that no differences happened, by gender, on the students' environmental awareness and purchase intentions. Furthermore, the environmental awareness had positive effect on purchase intentions. This work had some implications for marketers in the terms of identifying, designing, and managing marketing mix by considering the discrepancies of purchase intentions on the green electricity product by gender. Hence, marketer could be better in designing their marketing strategies and better understanding on purchasing behavior.*

**Keywords:** *Environmental Awareness, Intentions to Purchase, Green-Electric Product*

## SHOPPING ORIENTATION AND ONLINE FASHION PURCHASE IN JAKARTA

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### **ABSTRACT**

*Online fashion businesses which selling through website, social media and online forums are a fast growing business in the past few years. This research examine online fashion business that run in an online website (single seller) as well as analyze the role of gender in relationships of shopping orientation and online fashion purchase in Jakarta.*

*Regression analysis and independent t-test are used for testing the hypothesis and analyzing the differences between independent groups of male and female, respectively. The results indicate that need for personnel advice has negatively relates to online fashion purchase, shopping for fun positively relates to less fun and quick shopping positively relates to online fashion purchase. Furthermore, there are slightly differences between male and female shoppers toward online fashion purchase.*

*In conclusion, to increase the number of online fashion purchase, online features which offer customer some advice and fun shopping experience must be added to attract customer online purchases.*

**Keywords:** online fashion purchase, fashion, need for personnel advice, quick shopping, difficulty in selecting items, shopping for fun, less fun.

### **INTRODUCTION**

In 2014 when the total number of population in Indonesia was around 253 million people there were approximately 83.7 million active internet users in Indonesia (Internet World Stats, 2014). It is estimated the active users have a steady increase of approximately ten million users each year. Therefore, it is predicted to reach 123 million internet users by the end of 2018 (Statista, 2015).

Along with the increase of active internet users, Indonesian e-commerce market is growing too. The majority of the internet users reside in Jakarta and around 23% of them have had online shopping experience (APJII, 2013). The online shopping are generally done through three different channels, First, the online shops or websites that offer particular or various fashion brands. Second, it is the from that enable buyers and sellers to interact each

other, such as KasKus. Lastly, the social networks channels such as Facebook and Instragram. The products that are most likely being bought through online channels are clothing. While most women are likely to buy clothing, men are more various in buying online products. Aside from clothing, they are likely to buy mobile phones, travel / show tickets, and also computer / laptops. However, there are several reasons for some people who are still reluctant to shop online. Besides those people are not able to touch and see the goods directly before purchasing, they are also concern about the fraud (APJII, 2013).

Eventhough, several research in regards of online shopping behaviour has been conducted before, but there are still few studies examining the relationship between online fashion shopping orientation and online purchase especially in Jakarta, Indonesia. Therefore, replication study is adapted from a journal title "Shopping orientation and online clothing purchases: the role of gender and purchase situation " by Hansen and Jensen (2009) to explain the context of fashion online purchase in Jakarta. The research questions of this study is as follows:

RQ1: Does the need for personnel advice negatively relate to online fashion purchase?

RQ2: Does the need for personnel advice positively relate to difficulty in selecting items?

RQ3: Does shopping for fun positively relate to less fun?

RQ4: Does shopping for fun negatively relate to online fashion purchase?

RQ5: Does quick shopping positively relate to online fashion purchase?

RQ6: Does difficulty in selecting items negatively relate to online fashion purchase?

RQ7: Does less fun negatively relate to online fashion purchase?

RQ8: Is there any differences between male and female toward online fashion purchase?

## **1. Development of Hypotheses and Research Model**

### **1.1 E-Business, E-Commerce and E-Marketing**

E-business, e-commerce, and e-marketing are known to be part of the internet applications. E-business is defined as the continuous development of company's activities that expanded through digital channels such as computer and the internet. E-Commerce is defined as 'the subset of e-business focused on transaction that includes buying /selling online, digital value creation, virtual marketplaces and storefronts and new distribution channel intermediaries' Whereas, e-marketing is about using the available information technology for the marketing activities, such as create, communicate deliver, and exchange value for customers, clients and partners (Strauss & Frost, 2012). E-business strategies will most likely help firms in decreasing costs, increasing revenue and also increasing benefits. The increase in benefits, are benefits such as the ability of the customer to access the shops 24/7, therefore it will eliminate time barrier in doing shopping. Some of the businesses will also allow customers and sellers to learn, engage and communicate through social networking sites, therefore it will help customers who need personnel advice in buying their products (Strauss & Frost, 2012).

### **2. Shoppers and Shopping Orientation**

Stone (as cited in Vijayasarathy & Jones, 2000) suggest four different types of shoppers. First, economic shopper is the one that perceived shopping as an economical activity; therefore they should find the best price and quality option available. Second, the personalizing shopper, those who like to build a good relationship with the store personnel and like to shop at the nearest stores that are close to their house. Third, the ethical shopper, which perceives a moral obligation to shop in the local stores. The last type of shopper is the apathetic shopper, those who do not enjoy their

time while shopping and try to minimize the need of shopping. Through the research done by Vijayasathy & Jones (2000), it was found that there are seven different shopping orientations. First, in-home shoppers are those who like to conduct shopping activity from home. Second, mall shoppers are those who like to go to the mall to shop for their needs. Third, personalized shoppers are those who like to go to a shop in which they know the sales personnel. Fourth, economic shopper; those who care about the quality and the price of the items he/she needs to purchases so much so that they will look around different shops before finally deciding to purchases. Fifth, the ethical shopper, which shows a moral obligation through buying from the local stores. Sixth, convenience shopper are those who prioritize their convenience while doing shopping. Last is the enthusiastic shoppers who are the people who simply enjoy shopping. Hansen and Jensen (2009) categorize three shopping orientation which are 'need for advice from personnel', 'shopping for fun', and 'quick shopping'.

### **2.1. Need for advice from personnel**

Each of the sales service person presentation becomes an essential factor to understand the consumer's purchasing behavior (Merwe et al., 2008). According to Tatzel; Shim and Kotsiopoulos; Moye and Kincade (as cited in Hansen & Jansen, 2009) suggest that each clothing shoppers has different needs regarding the advice from store personnel when they are buying clothes. Female shoppers and male shoppers are also different in terms of their need regarding advice from other people. Female shoppers are likely to have more confident compared to male shoppers when it comes to buying clothes. Female shoppers perceive that they have a good ability to select the right clothing for themselves.

H1: Need for personnel advice negatively relates to online fashion purchase.

Need for personnel advice is unlikely became the main need of woman shopper, yet for other shopper sometimes they do not feel as confident as women in selecting items therefore they need some guidance or help to decide on the items they would like to purchase (Hansen & Jensen, 2009).

H2: Need for personnel advice positively relates to difficulty in selecting items

### **2.2 Shopping for Fun**

Shopping for fun is one of the examples of hedonic shopping motivation (Hansen & Jensen, 2009). Hedonic shopping motivation is believes to be a shopping style in which consumers try to look for happiness, fantasy, awakening, sensuality and enjoyment through shopping. Through a hedonic shopping motivation, the benefits are experience and emotional for the consumers. Most hedonic shoppers love to shop because of the shopping process (To et al., 2007). According to Bloch et al. (as cited in Hansen & Jensen, 2009) clothing products are one of the products that are related to a fun experience to be searched among the consumers.

H3: Shopping for fun positively relates to less fun.

According to Hansen and Jensen (2009) customers who has a hedonic shopping behavior will find that online fashion purchase are less enjoyable therefore they will be less likely to conduct an online fashion purchase.

H4: Shopping for fun negatively relates to online fashion purchase.

### **2.3 Quick Shopping**

Quick shopping is related to time time saving oriented customers, in which the customers would likely to accomplish the shopping activity as fast as possible (Hansen & Jensen, 2009). Therefore, customers will find the closest store to their house in order to create easeness and save time rather than to travel. Yet, due to the new phenomenon in

which customers are likely to save time to shop, people start to do an online shopping compared to going to the store in order to minimize the time needed (Kim & Kim, as cited in Hansen & Jensen, 2009).

Customers will find the closest store to their house in order to create easeness and save time rather than to travel. Kim and Kim (as cited in Hansen & Jensen, 2009) due to the new phenomenon in which customers are likely to save time to shop. Compare to physical stores, online shopping has more benefit such as convenient and time saving (Javadi et al., 2012).

Some customers want to minimize the time consume for shopping outside therefore, online fashion purchase might be their option to minimize the time taken doing shopping on a brick-mortar shop (Hansen & Jensen, 2009).

H5: Quick shopping positively relates to online fashion purchase

### **3. Perceived Online Barriers**

#### **3.1 Difficulty in selecting items**

Some customers feels that to shop a certain products especially, fashion product they need to feel and touch the product. Therefore online shopping might be hard for those customers to pick on their products (Javadi et al., 2012).

H6: Difficulty in selecting items negatively relates to online fashion purchase.

#### **3.2 Less Fun**

For hedonic consumers, they will search a fun experience in their purchase of fashion products. They will look for a real experience and not merely seeing products on the screen. This hedonic type of customers enjoy every steps of trying the fashion products that they would like to buy (To et.al, 2007). Some customers who have hedonic behavior might find out that shopping online have less fun compare to brick and mortar shop where customers can try on the clothes or accessories they like (Hansen & Jensen, 2009).

H7: Less fun negatively relates to online fashion purchase

#### **3.3. Gender differences in Online Purchase**

Gender has become one of the main differentiation aspects toward online purchase. According to Ulbrich et al. (as cited in Rahim and Rosly, 2014), in the virtual community, gender differences between male and female plays an important role toward communication and e-commerce decision. The analysis suggest that men use the internet to increase and protect social status (Awad and Ragowsky, as cited in Rahim and Rosly, 2014). On the contrary, woman are concerned regarding privacy when they are using the internet and also risk of online purchasing. (Garbarino and Strahlievits, as cited in Rahim and Rosly, 2014).

H8: There are differences between male and female toward online purchase

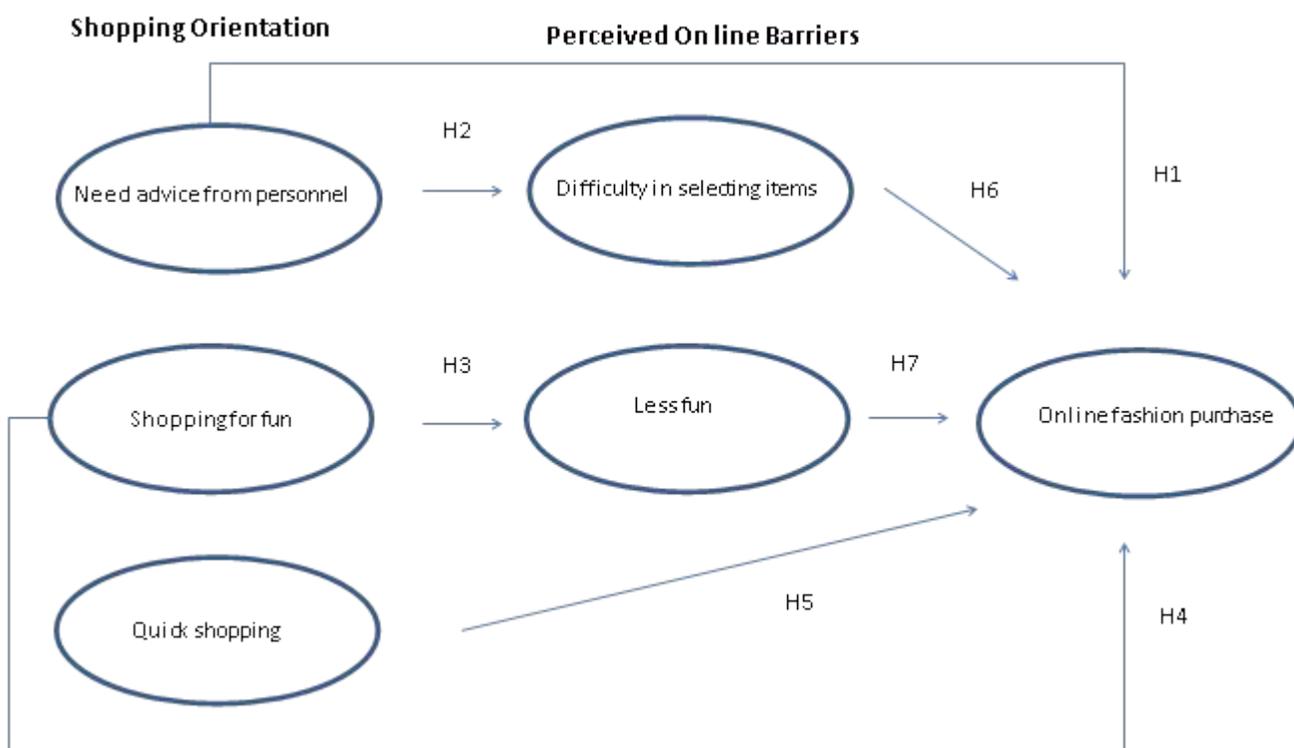


Figure 1. Adapted and modified conceptual model from Hansen & Jensen (2009)

## METHODS

Before testing the hypotheses, an exploratory research are conducted to explore the trends of online shopping in Jakarta. Three questions have been distributed through Freeonline surveys.com. The first question ask "Have you ever shop online?" is participated by sixty-six respondents, sixty-two respondent answer " yes". The second polling ask "What kind of product do you shop online?" is answered by fifty-eight respondents in which forty-two respondents answer 'fashion', nine respondents answer 'music/video/games', six people answer 'electronics (laptops, mobile phones)', and only one person answers 'books'. The last polling ask 'How many times have you purchased online?', from fifty-four respondents twenty-six of them have shopped online more than six times, ten respondents have shopped online for around four to six times, and eighteen respondents answer that they have shopped online around one to three times. Based on the polling results, it shows

that people are getting familiar with online shopping, most of them have shopped for one time, and fashion is the most product that the respondent shopped.

Quantitative research with survey data collection method is used to test the hypothesis. Convenience sampling is conducted with the target respondents are people who reside in Jakarta, age between 16-45 years old, have internet access, have experienced buying fashion products through online websites (single seller) for example Zalora, Berry Benka, Hij Up, Local Brand, Tees, Bro Do, Below Cepek, Maskoolin or other single seller websites. From 200 distributed questionnaire, only 150 respondents' result are valid.

In this study, to measure a reliability of a variable the results are being tested by Cronbach's Alpha and the Cronbach's Alpha are being compared to its acceptable level. The acceptable level of Cronbach's alpha is >0.6, thus the variable that has lower value than 0.6 are not acceptable (Creswell, 2012). To

measure the validity of the variables in this research, there are three things to be measured, which are KMO, communalities, and cumulative variance, which obtain by running a confirmatory factor analysis.

Multiple linear regression is used to test the hypotheses relating to relationship research questions. Meanwhile, independent sample T-test is applied to investigate differences between two independent groups in which the gender, male and female, toward online fashion purchase.

## **RESULT AND ANALYSIS**

The reliability and validity is conducted by distributing 30 questionnaires to 30 respondents. The variables that are being tested include: need for personnel advice, shopping for fun, quick shopping, less fun, difficulty in selecting items, and online fashion purchase. Each variable is represented by several questions that modified from Hansen and Jensen (2009). The reliability test shows each variable are being compared to its Cronbach's alpha coefficient number. The acceptable level of Cronbach's alpha is  $>0.6$  (Creswell, 2012). All variables being tested have Cronbach's alpha  $>0.6$ .

Validity testing uses to determine whether the questions that represent each variable measured what is it supposed to measure. The results of validity analysis consist of four tables; KMO Value, cumulative variance, communalities, and component matrix. Each results of the validity testing shows that the questionnaires are valid.

### **Descriptive Statistics**

From the total 150 valid respondents, there are 68 male respondent (45.33%) and 82 female respondents (54.67%). The majority of the respondents which is 73 or 48.67% use their smartphone to conduct an online transaction; 49 respondents or 32.67% use their laptop and other respondents use PC and

Tablet PC when they are making an online transaction. In regards the frequency conducting online shopping, 43 respondents or 38.76% shop online more than six times a year; 23 respondents or 15.33% around 4-6 shop online; 84 respondents or 56% shop online for 1 -3 times a year. Around 71 respondents or 47.33% prefers to shop online at Zalora's website; the others shop online at BerryBenka; BelowCepek, Local Brand and others.

### **Regression analysis**

Multiple regression analysis is conducted to test the hypotheses: H1, H4, H5, H6 and H7. The R-square is 0.136 means that 13.6 % of the variance in online fashion purchase could be explained by the five variables and 86.4% are explained by other variables. According to Frost (2013) involving human psychology on how each respondent gives opinion regarding their preferences and their habits will result a low R-Square. Need for personnel advice has the highest impacts toward online fashion purchase with the highest beta value which is 0.273, the second is quick shopping with beta value is 0.212. Aside from the two highest beta values, the three variables are proven to positively relate to online fashion purchase. The p-value for need for advice from shopping personnel, is 0.002 which p-value  $< 0.05$ . It proves that need for advice from personnel is negatively relates toward online fashion purchase. The p-value for quick shopping is 0.028, which is p-value  $< 0.05$ , and so quick shopping is positively relates toward online fashion purchase. Thus, the hypothesis state is supported by the data. However, p-value for shopping for fun, less fun and difficulty in selecting items are 0.468; 0.937 and 0.211 respectively, therefore the hypothesis are rejected.

Simple regression is applied to test the hypothesis H2 and H3. The R-square result from testing the H2 which is 0.1% of the total variance of difficulty in selecting items can be

explained by need for advice from personnel. A low R- square in the research might due to the limited number of independent variable.

The H3 test also results low R- square which is 3.4% of the total variance of less fun can be explained by the linear relationship of

shopping for fun, while the rest could not be predicted or explained by this variable. The p value for shopping for fun is 0.025, which is  $p < 0.05$ . It proves that shopping for fun is positively relates toward less fun.

**Table 1:** Hypothesis result

H	Test	Male and Female
H1	Need for personnel advice negatively relates to online fashion purchase	Supported
H2	Need for personnel advice positively relates to difficulty in selling items	Not supported
H3	Shopping for fun positively relates to less fun	Supported
H4	Shopping for fun negatively relates to online fashion purchase	Not supported
H5	Quick shopping positively relates to online fashion purchase	Supported
H6	Difficulty in selecting items negatively relates to online fashion purchase	Not supported
H7	Less fun negatively relates to online fashion purchase	Not supported

**Independent T-Test**

H8 is tested using independent T-test/ there are 82 female respondents with the mean of 3.1524 and 68 male respondents with the mean of 3.3456. According to the test result the significant value is 0.180, therefore it can be concluded that the variability between male and female are about the same. The 2-tailed value is 0.05, therefore it can be concluded that there is slightly differences between online fashion purchases between female and male.

**CONCLUSION**

Based on the result, the need for personnel advice negatively relates to online purchase is supported which means the higher the need for personnel advice will create a lower tendency of people of doing online fashion shopping. On the other hand, the need of personnel advice positively relates to difficulty in selecting items is not supported which means the higher the need of personnel advice does not necessarily the higher the difficulty of selecting items. There might be other reasons of people when asking personnel advice rather

than find difficulties on selecting items. Shopping for fun positively relates to less fun. Therefore, the more people do shopping for fun, the more they feel less fun to do online fashion shopping. Shopping for fun is negatively relates to online fashion purchase is not supported which means it is not necessary that the higher the need of shopping for fun will decrease the online fashion purchase. Quick shopping positively relates to online fashion purchase. Therefore, the higher the need for quick shopping the higher the online fashion purchases. Difficulty in selecting items negatively relates to online fashion purchase is not supported. Therefore, the higher the difficulty of selecting items does not necessarily decrease the online fashion purchase. Less fun negatively relates to online fashion purchase is not supported. Therefore, the higher the customer who feels less fun in doing online fashion shopping does not necessarily decrease the decision to online fashion purchase.

**MANAGERIAL IMPLICATIONS**

Advice from personnel might be an important factor for some consumers' decision on doing online fashion purchase. Unlike female shoppers, male shoppers are more likely needed some advice from others before they decide on which products they are going to buy. Therefore, in order to further do some improvements, online fashion websites might consider to add more features to the website such as online personal assistant which customers can chat with sales personnel in order to ask for advices. Online fashion websites should be able to compete with offline stores in terms of fun experience that the offline stores offer to customers. A feature to be added in a website is virtual changing room here customers might be able to experience and try the products that they would like to purchase. Time saving has become one of the reasons for customer do online purchase. Not only a fast response from the website and the easy process on checking out items that they would like to buy. Fast delivery services offer by the company will be an additional point for the customers in choosing the selected websites, as most people expected that they can receive the products that they order as soon after they do the payment on the websites. Yet, online websites must make sure that each feature are working properly and can be access easily. The customers should easily do the buying and payment process. Customers might perceive that online fashion shopping harder compare to the offline stores. As fashion is type of products where customers need to feel and touch the products. Therefore, a detailed information on the products should be provided in order to give the customer better knowledge about the products.

#### **LIMITATION OF RESEARCH**

The respondent only within the Jakarta area and the scope of study is only fashion industry. The future research might be conduct in the other cities that have high number of

internet users. In addition, the current research applies five variables to be analyzed toward online fashion purchase. Based on the research's findings, the variables used are insufficient to investigate the relationship of shopping orientation toward online purchase. Therefore for the future research, the researcher suggest that some variables relates to shopping orientation such as convenience shoppers, price shoppers, and also some barriers in the online purchase such as security.

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**INFORMATION PRECISION AND NEW PRODUCT DEVELOPMENT  
PERFORMANCE: TEST OF GENDER DIFFERENCE'S EFFECT IN  
EXPERIMENTAL SETTING**

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***ABSTRACT***

*This paper examines how gender affects the relation between cost information precision and product design's performance. Previous studies on new product development (NPD) recognize the importance of cost information to support NPD in a cost effective way. Meanwhile, decision making studies show how decision may differ due to gender difference which makes it important to test gender's effect on new product development outcomes. A laboratory experiment is conducted to investigate the joint effect of cost information precision and gender difference on product design's cost-effectiveness. Result of 2x2 between subject experiment suggests a strong relation between cost information precision (specific or relative) and gender difference. Specifically, this study finds that more precise (operationalized by "specific" amount of cost) information will lead to more cost-effective product compared to less precise (operationalized by "relative" comparison of cost) information only for female designer – and not for male designer. This result is consistent with the underlying theory namely selectivity hypothesis which states that females tend to integrate more and shows an intense level of cognitive processing whereas males tend to focus on information that are relatively easy and quick to process. Implications of this study include contribution for management's policy in presenting management accounting information and in considering gender for new product development team assignment.*

**Keywords:** *Cost Information Precision, New Product Development, Gender, Selectivity Hypothesis*

## VALUE RELEVANCE OF FIRMS' REPORTABLE SEGMENTS PROFIT OR LOSS RECONCILIATION

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### ABSTRACT

*The International Financial Reporting Standards (IFRS) No.8 adopted in PSAK No. 5 requires a company to provide a reconciliation of the total of the reportable segments' profit or loss to the firm's profit or loss. The objective of this standard is to improve the value relevance of information in the financial statement. This study aims to investigate the value relevance of the segment reconciliation and the determinants of segment income dissimilarity, i.e. audit quality, agency cost, and proprietary cost.*

*The result shows that the reconciliation of total of segments' profit or loss to the firms' profit or loss positively affects market value of equity; this means segments' reconciliation disclosure has value relevance for the investment decisions. Audit quality negatively affects the segment income dissimilarity, while agency cost and proprietary cost have no effect. This is consistent with hypothesis which states that firms audited by the Big Four tend to avoid disclosure of dissimilarity between firms profit or loss and segment profit or loss. Large public accounting firms probably will avoid disclosure of segment profit dissimilarity by advising their clients to use consistent measurements of profit at segment level and at firm level in order to increase consistency and comparability of financial reports across time so that investors do not misprice the persistence of segment profit information.*

**Keywords:** *Segment Reconciliation, Value Relevance, Agency Cost, Proprietary Cost, Audit Quality*

### INTRODUCTION

As businesses diversify and become increasingly complex, investors seek information that are more relevant in investment decision making. Investors and analysts need to understand how various components in a diversified firm behave economically. It is a difficult task for both investors and analysts to predict the entirety of amount, time and risk in future cash flows of firms completely without segmentation. This makes segmental information crucial for investment analysis and for other users of financial statements in economic decision

making (Alfaraih & Alanezi, 2011; Berger & Hann, 2007).

Recognizing important role of segmental information in helping investors in economic decision making, International Accounting Standards Board (IASB) published International Accounting Standard (IAS) 14 and International Financial Reporting Standards (IFRS) 8 on segment reporting. The purpose of the standards are to establish principles of financial information reporting based on business lines and geographical area to assist better comprehension for users of financial statements about firms' financial performance. This enables better assessment on

overall return and risk of firms. (IASB, 2008). IFRS 8 has been adopted in PSAK No. 5 (2012, revised 2009), came into effect on 1 January 2011.

Segment information might be difficult for external parties to observe and monitor due to noncompliance of firms in segment reporting according to current standards. Previous studies point out some problems in segment reporting, in particular managerial discretion in disclosure of segment information (Street & Bryant, 2000). Firms observe disclosure of segment information but do not apply it in entirety, which results in substantial noncompliance (Prather-Kinsey & Meek, 2004). Firms' failures that cost hundreds of millions of dollars, as occurred in Australia, United States, and other countries, attracted worldwide attention in early of 21st century, and highlighted the important role of disclosure and compliance to regulations (Birt et al., 2007).

Larger discretion given by an accounting standard will cause more worries that regulators have created a loophole for accounting manipulation. Some studies (Dechow et al., 2010; Matsumoto, 2002) conclude that giving management discretion on accounting standards will impair quality and predictability of profit. Enron was an example in which management used its discretion to manipulate segment profit. On the other hand other studies concluded that giving managerial discretion according to accounting standards would increase predictability of profit (Elliott & Philbrick, 1990; Ewert & Wagenhofer, 2005). Thus discretion in segment profit reporting has become increasingly important in segment reconciliation to provide needed information for investors to differentiate segment profit reported according to accounting standards from profit reported with "managerial approach".

Previous researchers (Venkataraman, 2001; Chen & Zhang, 2002; Graham, et al., 2005; Fitriany & Aulia, 2009; Hope, et al, 2009) generally found that segment reporting gave additional benefit of predicting profit and value

of firms but they did not focus on segment reconciliation. Studies related to segment reconciliation segment (Hollie & Yu, 2010; Alfonso et al., 2012) found that segment profit reconciliation positively correlated to market value of firms. Market does not only value segment reconciliation information, but in certain cases, market can also misprice persistence of profit reconciliation. Thus this study aims to retest value relevance of segment profit reconciliation reported by firms in Indonesia by using the same method as Alfonso et al.'s study (2012).

The second aim of this study is to test factors that determine the difference between total operating segment profit and firms' profit and loss. Previous studies (Stulz, 1990; Lamont, 1997; Berger & Hann, 2007) found that agency cost plays an important role in choosing segment disclosure by a manager to hide unprofitable segment or perform subsidy from profitable segment to unprofitable one. Other studies (Baiman & Verrecchia, 1996; Hayes & Lundholm, 1996; Bestari, 2012; Alfonso et al. 2012) found that proprietary cost influences the decision to disclose segment information. Other factors determining the disclosure of segment reporting are audit quality, segment quantity, firm size, and firm financial performance (Fitriany & Aulia, 2009; Wang et al., 2011; Alfaraih & Alanezi, 2011; Bestari 2012; Alfonso et al., 2012; Ibrahim & Jaafar, 2013). Our study focuses on agency cost, proprietary cost, and audit quality as important determinants that reduce dissimilarity in segment profit.

## **LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT**

In January 2005, IASB decided the best method to achieve convergence related to segment reporting, that is to adopt the same standard approach as accounting standards used in the United States (SFAS No 131: Disclosures about Segments of an Enterprise and Related Information, June 1997). Subsequently IASB issued IFRS 8 on operating

segment in November 2006 to replace IAS No. 14 (IASB, 2013). Standards on operating segment are developed mainly to enable external users to view firms from management point of view. As a consequence this standard requires firms to report the same information externally as well as internally to evaluate performance and decision to allocate resources to operating segments; this requirement is known as “management approach”. This approach, in addition to enable external users to view firms from management point of view, is also expected to reduce information asymmetry between internal and external users with better alignment of internal and external financial reporting.

Accounting standards on operating segment (SFAS 131, IFRS 14, PSAK 5) state that segment information reported by firms must be consistent to management or organizational approach of firms. In determining a segment profit and loss, “the standards require that the amount in each segment item reported shall be the measure reported to chief operating decision makers for the purpose of making decision about allocating resources to the segment and assessing its performance.” Firms might report different measurement of profit and loss on their segments from profit measurement on consolidated statements. As a result profit measurement reported at segment level may be consistent or inconsistent to measurement at firm level, namely profit before interest and tax or net profit. Consequently, overall firm profit is different from the sum of segment profits which are parts of a firm, this requires managers to provide segment reconciliation.

All substantial elements that are reconciled must be identified and explained separately. For example, the amount of each necessary material adjustment for segment profit and loss reconciliation reported toward entity profit and loss arising from different accounting policies must be identified and explained separately. Firms are required to perform reconciliation on all the followings: (1) Total of reportable segment profits or losses reported towards

consolidated income of entity before income taxes and discontinued operation (If an entity allocates item such as tax to reported segment, then the entity reconciles the total amount segment profit and loss towards profit and loss of entity after these items.), (2) Total of reportable revenues of segment towards consolidated revenues of entity before taxes, (3) Total asset of segment reported towards asset of entity, (4) Total liability of segment reported towards liability of entity if liability of entity is reported in accordance to PSAK 5 paragraph 23 (on information on profit and loss, asset and liability), (5) Total of reportable segment amount for every other significant items of information disclosed to the corresponding entity amount. Significant reconciliation items should be disclosed separately.

Standards on operating segment are expected to reduce information asymmetry between internal and external users but can also cause increasing information asymmetry and decreasing consistency and comparability of financial statements among companies (Botosan & Stanford, 2005). Besides, flexibility allowed in standards for operating segment may lead to performance measure at segment level in aggregate is not the same as performance measure at firm level.

When reported profit and loss of segment is different from that of consolidated profit and loss at firm level, a valuation is needed not only at accounting data at firm level which aims to report firm operation as a whole but also data at segment level which aims to provide information in differences among segments. Studies on value relevance of segment reconciliation information, Chen & Zhang (2003) found that value relevance of segmental information, in general, was quite inconsequential. However value relevance increased when operating segments had different profitability and increasing growth opportunity. Study by Alfonso, et al (2012) found that reconciliation of segment profit positively correlated to market value of firm but the market value decreased when segment

reconciliation interacted with unexpected earnings. This result was consistent with Hollie & Yu (2010), which found that market did not only value segment reconciliation information, but also in some cases, mispriced persistence of profit reconciliation, particularly when reported segment earnings were different from earnings of firm as a whole.

H1a: Segment profit reconciliation affects positively to value of firm.

H1b: Interaction between segment profit reconciliation and unexpected earnings affects negatively to value of firm.

Agency cost hypothesis predicts that managers have incentives to make self-serving decision which may not be the best for shareholders (Jensen, 1986). Investors and boards of commissaries use accounting information to monitor managers and to reduce agency cost (Healy & Palepu, 2001). This urges managers to involve in “strategic” reporting to limit the use of accounting information monitoring (Kalyta & Magnan, 2008). Berger & Hann’s study (2007) found that when agency cost motive dominated, managers tended to hide low profitability abnormally in disclosing segment information with the aim of avoiding strict external monitoring. This is supported by Hope & Thomas (2008) that found that firms stopped disclosing geographic earnings when adopting SFAS 131, then experienced “empire building” in greater expansion form from foreign sales coupled with decrease of profit margin from foreign sales.

Managers who take advantage of larger agency cost in “empire building” are more reluctant to disclose different growth among segments. Managers can continue to operate and invest in segments with extremely low growth to maintain firm’s size and complexity, which points to higher compensation. Managers can also avoid attention to segments with low growth by manipulating segment definition in low-growth segment. Research by Wang et al. (2011) concluded measurement of agency cost was negatively associated to

disclosure of different growth among segments, because managers tended to hide information related to self-gain from stakeholders. This was supported by Alfonso et al. (2012) which showed negative impacted of agency cost to different segment profits reported and firm entity as whole (dissimilarity of segment profit).

H2a: Agency cost negatively affects segment profit dissimilarity.

Proprietary cost hypothesis related to adherence to segment disclosure, states that firms with higher proprietary cost tend to be associated to nonobservance of segment disclosure. Result of Berger & Hann study (2005) showed that firms with higher abnormal profit coupled with intense decrease of abnormally high profit tended to aggregate their segment reports. This was consistent to finding by Ettredge et al. (2006) which stated that firms operating in highly competitive industries are more likely to aggregate segment reporting and to disclose less variability.

As competition in certain industries increase, managers are more likely to limit segment reporting to limit additional information of reports released to market participants (Alfonso et al., 2012). Thus to avoid segment disclosure, firms must use their discretion to make aggregate segment profits the same as firm profit. Wang et al. (2011) explained that firms operating in a very competitive industry earned relatively lower abnormal profit compared to their peers were less likely to protect information. On the other hand firms operating in concentrated industry tended to protect information from their competitors.

H2b: Proprietary cost negatively affects segment profit dissimilarity

DeAngelo (1981) defined audit quality as the probability an auditor found material misreporting (auditor competency) in client’s financial reports and reported those misreporting (auditor independency). Auditors in big public accounting firms are believed to

have higher audit quality because big public accounting firms have higher reputation, more resources to attract staffs with higher competence and acquire more sophisticated technology in detecting fraud or material misreporting.

Large public accounting firms have solid reputation thus will suffer greater loss if they fail to report infringement or err in their audit reports (De Angelo, 1981). Small PAF (Public Accounting Firms) are more sensitive to clients' demands due to economic consequence of losing clients (in Alfaraih & Alanezi, 2011). Because of this sensitivity phenomenon, big public accounting firms are less likely to depend on one or several clients. The lack of attachment to clients (independency) enables larger PAF to demand greater disclosure of their clients' annual reports (Wallace & Naser, 1995).

Wallace et al. (1994) research showed that firms audited by internationally affiliated PAF, particularly the Big Four, were more likely to provide more detailed information than those audited by local PAF. The reason was internationally affiliated PAF tended to be larger and more experienced than local PAF. The finding was supported by Prather-Kinsey & Meek (2004) study which stated that firms audited by the Big Four would disclose more segment information. Based on their competence and independence large PAF are more likely to focus on the cause of difference in reported segment profit and firm profit as a whole so that they can suggest or demand clients to use profit measurement at segment level that is consistent with measurement of firm level and disclose it in firm financial statements.

H2c: Audit quality negatively affects segment profit dissimilarity.

## 1. Research Methods

Object of this study focuses on segment reporting and value of firm. The firms observed are firms in manufacturing industry listed in Indonesian Stock Exchange from 2009 to 2013.

Purposive sampling method yields 59 firms in manufacturing industry. This research uses secondary data, i.e. data in financial reports published by companies including operating profit, segment income statements, other accounts related to operating segment reconciliation and their disclosures.

## 2. Operationalization of Variables

Two research models are used to test proposed hypothesis, namely Model 1 is a panel regression model that aims to test the effect of segment reporting to value relevance of firms. The value relevance can be measured through statistical relationship between information in financial statements and market value of firm. Accounting information are said to have value relevance if the information has significant relationship with market value of equity (Barth et al., 2001). Consistent to measurement used by Aliabadi et al., (2013), market value of equity (MVE) uses the following formula:

$$MVE = \frac{\text{common stock O/S} \times \text{ends of fiscal year price}}{\text{Total Assets}} \quad (1)$$

Model 1 has 2 independent variables, namely:

### 1) Segment Reconciliation

Segment reconciliation is the difference between segment profits and firm operating profit. Consistent to study by Alfonso et al (2012), SR is defined as follows:

$$SR = \frac{|\text{Firm's Operating Income} - \text{Sum of Segment Profits}|}{\text{Total Assets}} \quad (2)$$

### 2) Unexpected Earnings

Profit is an important determinant in firm valuation, and unexpected earnings (UE) occurs when a firm reports profit per share different from profit estimated by market or analysts' consensus (Hsu, 2002; Hope et al, 2009; Alfonso et al, 2012).

$$UE = \frac{\text{Operating Income}_t - \text{Operating Income}_{t-1}}{\text{Total Assets}} \quad (3)$$

In Model 1 the effect of interaction between unexpected earnings and segment reconciliation to market value equity (MVE) is tested.

Model 2 is a logistic regression model, aims to test factors affecting dissimilarity between reported segment profit and firm operating profit. Segment income dissimilarity (SID) is the difference between overall firm operating profit after depreciation and total segment profit. The variable measurement uses dummy variable, where 1 indicates the presence of dissimilarity between firm operating profit and total segment profit (SID ≠ 0) and 0 indicates absence of dissimilarity between firm's operating profit and total segment profit (SID = 0). There are 3 independent variables in Model 2, namely:

1) *Agency Cost*

Pertinent to agency cost, Jensen & Meckling (1976) states that if principals and parties try to maximize their own utilities, then there is a reasonable reason to believe that managers do not always act on the interest of owners or shareholders. The cost incurred by both parties or one party to control conflict of interest is agency cost. To measure agency cost, two proxies are used, namely:

(i) *Free cash flow*

Jensen (1986) defines free cash flow (FCF) as cash flow from excess fund needed to finance all projects with positive net present values (NPV). Free cash flows have important information that are useful for shareholders and firm management. Referring to Wang et al.'s (2011) research, free cash flow is formulated as follows:

$$FCF = \text{operating net cash flow} - \text{cash dividend} - \text{capital expenditures} \quad (4)$$

(ii) *Discretionary Accrual*

Discretionary accrual is defined as cash flow adjustment chosen by managers in order to affect reported net profit (Healy & Palepu, 2001). High abnormal accrual is a strong

indicator of poor monitoring and shows adverse agency cost problem. Abnormal accrual is detected by using Modified Jones Model (Dechow et al 1995) which is formulated as the following:

$$TA_{it} = \beta_0 + \beta_1 \left( \frac{1}{AT_{it-1}} \right) + \beta_2 (\Delta REV_{it} - \Delta AR_{it}) + \beta_3 PPE_{it} + \varepsilon_{it} \quad (5)$$

2) *Proprietary Cost*

Proprietary cost is defined as a decrease in future cash flows that are part of disclosure. Voluntary information disclosure potentially changes future firm profit, in which information that can lower consumer demand of firm products; it can be said that proprietary cost is competitive disadvantage (Dye, 2001). Measurement of proprietary cost in this research uses Herfindahl Index (HHI) which is an alternative to predict industry concentration (Harris,1998; Wang et al.,2011). Higher Herfindahl Index shows higher industry concentration and lower industry competition (Berger and Hann, 2005). HHI is calculated by using the formula:

$$HHI_j = \sum_{i=1}^n \left( \frac{\text{sales}_{ij}}{\text{sales}_j} \right)^2 \quad (6)$$

3) *Audit Quality*

De Angelo (1981) defines audit quality as a possibility of auditor will find and report violations in client's accounting system. Big public accounting firms have higher incentive to publish high quality audit report to preserve their reputation. Dummy variable is used to indicate PAF, where 1 indicates firms audited by the Big Four and 0 indicates firms audited by non-Big Four.

**3. Hypothesis Testing**

Model 1 in this study tests the hypothesis of the impact of segment profit reconciliation to firm equity value. If significant impact of profit reconciliation to firm equity is present, then information on segment profit reconciliation has value relevance in investment decision making. The model used to test the hypothesis,

consistent to model used by Alfonso et al. (2012) is as follows:

$$\widehat{MVE} = \beta_0 + \beta_1|SR|_{it} + \beta_2UE_{it} + \beta_3|SR| * UE_{it} + \varepsilon \quad (7)$$

where MVE = Market Value of Equity is number of outstanding shares x stock price at the end of fiscal year, |SR| = Segment Reconciliation is the absolute value of difference between firm operating profit after depreciation and segment operating profit. UE = Unexpected Earnings is the difference between current firm operating profit after depreciation and last year's current firm operating profit. |SR|\*UE is the interaction between segment reconciliation and unexpected earnings. All variables are scaled by total assets.

Model 2 is a logistic regression analysis used to test the impact of agency cost, proprietary cost and audit quality to dissimilarity between segment profit and firm profit, with the following formula:

$$\ln\left(\frac{p_i}{1-p_i}\right) = \beta_0 + \beta_1AC + \beta_2PC + \beta_3BIG4 + \varepsilon \quad (8)$$

where p = probability of segment income dissimilarity (SID), uses dummy variable with 1 if the is a difference between firm operating profit and total segment profit (SID ≠ 0), and 0 if there is no difference between firm operating profit and total segment profit (SID = 0), AC is agency cost measured by using free cash flow and discretionary accrual, PC is proprietary cost measured by using Herfindahl Index, BIG4 is audit quality, 1 for firms audited by Big Four and 0 for firms audited by non-Big Four.

## ANALYSIS AND DISCUSSION

Test results of model 1, namely results of hypothesis test on the impact of segment profit reconciliation towards firm value are in the Table 1.

Table 1 shows that the model is significant (prob = 0.0000) which means that the model can be used to explain dependent variable. The result indicates that segment reconciliation (SR), unexpected earnings (UE) and interaction

variable between variable SR and UE (SRUE) jointly explains market equity value (MVE) with explanation power (adjusted R2) of 79.83%. The results of t-test show that segment reporting variable (SR) significantly have positive effect value relevance. This result is consistent to the proposed hypothesis and is in line to study by Alfonso et al (2012) which shows the positive correlation between segment reporting (SR) and market value equity (MVE). The result of this study explains that information of segment profit reconciliation is important in stock market because the information is relevant in investment decision.

**Table 1. Result of Linear Regression Analysis**

$$\widehat{MVE} = \beta_0 + \beta_1|SR|_{it} + \beta_2UE_{it} + \beta_3|SR| * UE_{it} + \varepsilon \quad (9)$$

Variable	Coefficient	Prob.
SR	12.04325	0.0000
UE	0.020693	0.3205
SR*UE	-25.38210	0.0005
C	2.316599	0.0000
Prob(F-statistic)	0.000000	
R-squared	0.840126	
Adjusted R-squared	0.798270	

Dependent variable: MVE

Meanwhile the test results of Unexpected Earnings (UE) show insufficient evidence that the variable has significant impact on market equity value (MVE). This is not in line with study by Alfonso et al. (2012) which shows that market equity value decreases in the presence of unexpected earnings accompanied by segment reporting. The result supports findings by Hollie & Yu (2010) which stated that market did not only value but also could mispriced persistence of segment reporting, especially when firm profit was different from the reported segment profit.

Test on model 2 is a hypothesis test of factors affecting segment profit dissimilarity by using logistic regression analysis. The result of model significance (Hosmer & Lemeshow Test) shows a Chi-square value of 6.127 and

significance of 0.633 and coefficient determination R<sup>2</sup> of 9.4% (see appendix). The result shows that agency cost (free cash flows and discretionary accruals), proprietary cost (herfindahl index) and audit quality (BIG4) jointly explain the tendency of dissimilarity between sum of segment profit and firm profit (segment income dissimilarity) with explaining power of 9.4%. The result of regression coefficients (t-test) are as follows:

**Table 2. Result of Coefficient Test (t-Test)**

Variable	$\beta$	Sig
Free cash flow	0.000	0.508
Discretionary accrual	-1.863	0.452
Herfindahl index	12.176	0.760
BIG4	-0.863	0.012
Constant	-1.105	0.000

The result of t-test shows that there is insufficient evidence that agency cost (free cash flow dan discretionary accruals) affect dissimilarity of reported segment profit. The result is not consistent with proposed hypothesis which states that there is a significant negative impact between agency cost and segment reporting (Alfonso et al, 2012 and Wang et al, 2011). On the other hand the result is in line with study by Bestari (2012) in which free cash flow dan discretionary accruals are not the significant explanatory variables. Logical reason to the no impact of free cash flows are probably caused by managers' interest do not have active role in aggregate segment reporting decision. The absence of dominance of internal management motivation is probably caused by other motives that affect decision in segment information reporting disclosure such as external motive. This external motive is an incentive outside firm's environment such as presence of competitors and capital market incentive. Besides the monitoring and care of stockholders in management's action in allocating free cash flows to inter-segment investment are not material so that it does not affect dissimilarity in segment profit.

Explanation for the insignificance of effect of discretionary accrual is the possibility of managers' intent to manipulate profit in order to show better performance and efficient management of segments are not yet followed by large incentive for management personal interest. Reward mechanism applied by shareholders to managers' performance in increasing firm profit in the form of cash bonus, stocks or promotion has not given strong incentive to managers such that it affects decision to disclose profit growth in firm's segments. Furthermore there probably is a more dominant factor in deciding levels of disclosure among segments such as political cost and capital market incentive. Monitoring of shareholders and external parties is deemed insignificant to management's action. Demand of information by shareholders to management is fairly weak so that the absence/ presence of management who manipulates profits does not significantly affect segment profit dissimilarity (Bestari, 2012).

The result of t-test shows that proprietary cost (Herfindahl Index) is not proven to have significant impact on segment profit dissimilarity. The result does not support proposed hypothesis but it is consistent with result of study by Berger & Hann (2005), Wang et al (2011) and Bestari (2012). This indicates that competitors and firms' competitive standing do not affect managers' decision in segment reporting. Besides there is a possibility that method used to calculate Herfindahl Index is only used to measure competition at industry level without considering segment existence.

The result of t-test on segment audit quality (BIG4) shows that audit quality significantly negatively affects segment profit dissimilarity. This is consistent with hypothesis proposed by Alfonso et al. (2012) which states that firms audited by the Big Four tend to avoid disclosure of dissimilarity between firms profit and segment profit. Large public accounting firms probably will avoid disclosure of segment profit dissimilarity advising or demand their clients to use consistent measurements of profit at segment level and at firm level in order to

increase consistency and comparability of financial reports across time so that investors do not misprice the persistence of segment profit information.

## CONCLUSION AND SUGGESTIONS

The result of test on Model 1 shows that segment profit reconciliation significantly and positively correlates to equity market value while its interaction with unexpected earnings negatively correlates to equity market value. The results supports findings by Alfonso et al (2012) dan Hollie & Yu (2010), and conclude that information on segment profit reconciliation have relevant value in investment decision but equity market value will decrease in the presence of unexpected earnings accompanied by segment profit reporting especially when firm profit is different from reported segments' profit.

The result of test on Model 2 shows that agency cost (free cash flow dan discretionary accruals) dan proprietary cost (Herfindahl Index) are not shows to have significant impact on segment profit dissimilarity but audit quality (BIG4) shows significant negative impact on profit segment dissimilarity. The result is consistent with proposed hypothesis and findings by Alfonso et al (2012) which states that firms audited by big accounting firms tend not to report dissimilarity between firm profit and segments' profit.

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## APPENDIX

**Table L.1 Process of Sample Selection**

No	Items	Number of Companies
1	Manufacturing firms listed at ISE during 2009-2013	142
2	Manufacturing firms that implement mergers and acquisition during 2009-2013	10
3	Incomplete financial reports and no information on segment reporting	35
4	Segment in corporate form	4
5	Segments are not classified as operating segments	16
6	Financial reports not in Rupiah currency	18
<b>Total</b>		<b>59</b>

**Table L.2 Result of Multiple Linear Regression**

$$\widehat{MVE} = \beta_0 + \beta_1|SR|_{it} + \beta_2UE_{it} + \beta_3|SR| * UE_{it} + \varepsilon$$

Dependent Variable: MVE

Method: Panel Least Squares

Sample: 2009 2013

Periods included: 5

Cross-sections included: 59

Total panel (balanced) observations: 295

Variable	Coefficient	Std. Error	t-Statistic	Prob.
SR	12.04325	1.792786	6.717619	0.0000
UE	0.020693	0.020785	0.995564	0.3205
SRUE	-25.38210	7.185708	-3.532303	0.0005
C	2.316599	0.082369	28.12462	0.0000

### Effects Specification

#### Cross-section fixed (dummy variables)

R-squared	0.840126	Mean dependent var	2.409761
Adjusted R-squared	0.798270	S.D. dependent var	3.087359
S.E. of regression	1.386667	Akaike info criterion	3.676085
Sum squared resid	448.0227	Schwarz criterion	4.450974
Log likelihood	-480.2225	Hannan-Quinn criter.	3.986370
F-statistic	20.07206	Durbin-Watson stat	1.221488
Prob(F-statistic)	0.000000		

**Table L.3 Result of Logistic Regression Analysis:  
Hosmer and Lemeshow Test**

Step	Chi-square	df	Sig.
1	6.127	8	.633

**Model Summary**

-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
260.483 <sup>a</sup>	.057	.094

		B	S.E.	Wald	df	Sig.
Step 1 <sup>a</sup>	<b>Free Cash Flow</b>	.000	.000	.438	1	.508
	<b>DA</b>	-1.863	2.478	.565	1	.452
	<b>HHI</b>	12.176	39.821	.093	1	.760
	<b>BIG4(1)</b>	-.863	.342	6.368	1	.012
	<b>Constant</b>	-1.105	.274	16.312	1	.000

**THE EFFECT OF FINANCIAL DISTRESS AND SALES GROWTH  
TO THE INTEGRITY OF FINANCIAL STATEMENTS  
WITH CORPORATE GOVERNANCE  
AS MODERATING VARIABLE**

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***ABSTRACT***

*This study aimed to analyze the effect of financial distress and sales growth towards the integrity of financial statements and whether the corporate governance weaken the influence of financial distress and strengthen the influence of sales growth towards the integrity of financial statements. The method used in this research are multiple regression analysis and logistic regression using SPSS 18. The samples used in this research are 372 which is the data of 93 manufacturing companies listed in Indonesia Stock Exchange from 2012 - 2015. The results show that financial distress, corporate governance, and leverage had significant effect on the integrity of financial statements but sales growth and return on assets did not had significant effect on the integrity of financial statements. The result also show that corporate governance weaken the influence of financial distress towards the integrity of financial statements but cannot strengthens the influence of sales growth towards the integrity of financial statements.*

**Keywords:** *Financial distress, Sales growth, Corporate governance, and Integrity of financial statements.*

**INTRODUCTION**

Indonesia is currently adopting International Financial Reporting Standards (IFRS) as applicable financial accounting standards for financial reporting purposes. An agreement to use IFRS as the financial reporting standards aim to unify understanding of the financial statements so the company's financial statements between countries that have used IFRS as the financial reporting standards can be compared. The use of IFRS as well as to facilitate the preparation of the consolidated financial statements for companies with foreign branches or subsidiaries abroad. In addition, by using the IFRS, the financial statements will be expected

to have integrity. This is because IFRS requires highly detailed disclosure when compared with Generally Accepted Accounting Principles (GAAP).

The flexibility of a standard would result in confusion in its application (Gaganis and Pasiouras, 2007). One of the fundamental differences between IFRS and GAAP is on the nature of the standard used. In GAAP, using a rules-based, which means all existing standards will be explained in detail implementation. While on IFRS, using a principles-based, which is given only general guidelines only (no detail for every existing conditions) (Choi and Meek, 2011). Therefore, the use of IFRS, the more use

of professional judgment, may cause differences in the application of the standard.

In general, Choi and Meek (2011) revealed that, the financial statements of a company designed to assist investors in assessing the performance of the company's management, to predict cash flows in the future, and the possibility to make a profit. With the heavy use of professional judgment in the application of standards for the preparation of financial statements, it is feared may compromise the integrity of the financial statements because there are differences in the standard interpretation. Disruption of financial integrity can lead to the stakeholders make the wrong decision so that the reliability of the financial statements will be questioned. In addition, it is feared there are also those who deliberately take advantage of it to commit fraud or manipulation of financial statements because someone opinion can be vary.

Good corporate governance is one way to reduce the existence of fraud or manipulation of financial statements. Attention of the need for good corporate governance start from a variety of financial manipulation case from a reputable company that is exposed to the public, known as Enron and Worldcom. Implementation of corporate governance at the company will have an impact on increasing awareness of the management company's responsibility to its stakeholders. One way is by providing real information to the stakeholders of companies, particularly the information contained in the financial statements (Hamdan, Al-Hayale, and Aboagela, 2012). Companies that have implemented good corporate governance will make the stakeholders pleased to be associated or to do transaction with the company. The better company's relationship with its stakeholders will increase the trust in one another so that stakeholders, especially users of financial statements. Therefore, with the presence of good corporate governance is expected that the integrity of the financial statements of the company will increase.

The financial statements of the company is another way to communicate information to stakeholders. The financial statements of the company can describe the condition of the company and the company's financial condition as a whole so that the financial statements are often used as the basis for decision making by investors. Companies that are experiencing

financial difficulties will usually attempt to manipulate its financial statements as good as possible so that the company still looks healthy, as happened in the case of Enron and Worldcom. Financial difficulties of an enterprise can be predicted long before before the company experienced a business failure (Bringham and Ehrhart, 2008). This indicates that companies that are experiencing financial difficulties will be trying to manipulate its financial statements so that the integrity of the financial statements of the company will decrease.

Company's good conditions generally can be seen from the company's sales growth. The company's growth is a good signal for investors that in general, information about the increase in sales will be responded positively by investors because they expect growth in the future (Dechow and Sloan, 1997) so that the company will be happy to report increase in sales. Previous research conducted by Ahmed, Billings, Morton, and Stanford-Harris (2002) and Ahmed and Duellman (2007) also found that the growth of sales has an influence on the integrity of financial statements. Therefore, increased of the sales growth indicates the better integrity of the financial statements.

The purpose of this study was to analyze (1) whether the financial difficulties have a significant negative effect on the integrity of financial statements; (2) whether the sales growth has a significant positive effect on the integrity of financial statements; (3) whether the corporate governance weaken the influence of financial difficulties on the integrity of financial statements; and (4) whether the corporate governance strengthen the influence of sales growth in the integrity of financial statements. The difference of this study with previous research, based on the results of the literature study, is (1) the addition of financial distress variable as an independent variable; (2) using the book-to-market approach as a measurement for the integrity of financial statements; and (3) using corporate governance variable as a moderating variable.

The contribution of this study is divided into practical contributions and contribute to the development of science. Practical contribution of the results of this study to the regulatory authorities are in terms of increasing understanding about the integrity of the financial statements. Practical contribution of the results

of this research for the public accountants is that the results of this study can be considered by public accountants in the preparation of the integrity of the financial statements. Practical contribution of the results of this research for the company and other parties is that the results of this study can be the input and evaluation of the company and other parties related to financial reporting integrity criteria. Contributing to the development of science is to contribute ideas, additional information and additional empirical evidence in the field of financial accounting related to the integrity of financial statements for subsequent researchers. This study is divided into five parts. The first part is an introduction. In the second part will discuss the related theory and previous research and hypotheses development. In the third part will discuss ways of collecting samples and data. In the fourth section will discuss the results of research and sensitivity analyzes. The conclusions, recommendations, and limitations of the study will be discussed at the fifth part.

## **LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT**

### **1. Financial Distress and the Integrity of Financial Statements**

The financial statements of the company is another ways to communicate information to stakeholders. The financial statements of the company can describe the condition of the company and the company's financial condition as a whole so that the financial statements are often used as the basis for decision making by investors. The company's financial condition also can be seen from the opinion given by the auditor. Companies that are experiencing financial difficulties will generally be obtained going concern audit opinion which will have an impact on market reaction (Chen and Church, 1996). Companies that are experiencing financial distress will usually attempt to manipulate its financial statements as good as possible so that the company still looks healthy, as happened in the case of Enron and Worldcom. Financial difficulties of an enterprise can be predicted long before before the company experienced a business failure (Bringham and Ehrhart, 2008). This indicates that companies that are experiencing financial difficulties will be trying to manipulate its financial statements so that the

integrity of the financial statements of the company will decrease.

**H<sub>1</sub>: Financial distress have a significant negative effect on the integrity of financial statements.**

### **2. Sales Growth and the Integrity of Financial Statements**

Generally, companies good conditions can be seen from the company's sales growth. Their sales growth indicates that companies have the opportunity to develops in the future. The company's growth is a good signal for investors that in general information about the increase in sales will be responded positively by investors because they expect growth in the future (Dechow and Sloan, 1997) so that the company will be happy to report increase in sales. Previous research conducted by Ahmed, Billings, Morton, and Stanford-Harris (2002) and Ahmed and Duellman (2007) also found that the growth of sales has an influence on the integrity of financial statements. Therefore, increased of the sales growth indicates the better integrity of the financial statements.

**H<sub>2</sub>: Sales growth has a significant positive effect on the integrity of financial statements.**

### **3. Corporate Governance**

Companies that have implemented good corporate governance, the company's business processes will improve as well as reduce the likelihood of fraud within the company, especially fraud in financial reporting so as to improve the integrity of its financial statements. The financial statements must be able to convey all the information about the company, both financial and non-financial, completely, absolutely, nothing was hidden, timely, and in accordance with generally accepted accounting principles to all stakeholders of the company. Bushman, Chen, Engel and Smith (2004) also noted that the company's limited transparency system requires good corporate governance in order to overcome the information gap between companies and investors.

The implementation of corporate governance at the company will have an impact on increasing awareness of the management company's responsibility to its stakeholders. One way is by providing real information to the stakeholders of companies particularly the information contained in the financial statements

(Hamdan, Al-Hayale, and Aboagela, 2012). Therefore, companies that have been implementing good corporate governance will certainly would reveal financial distress and sales growth experienced by the company. Thus, the implementation of corporate governance in the financial statements of the company can improve the integrity of the financial statements.

Research related to the influence of corporate governance on the integrity of the financial statements have been made by Ahmed and Duellman (2007), Hardiningsih (2010), Hamdan, Al-Hayale, and Aboagela (2012), and also Nicolin and Sabeni (2014). Results of research conducted by Ahmed and Duellman (2007), Hardiningsih (2010), and Nicolin and Sabeni (2014) shows that corporate governance has a significant effect on the integrity of financial statements. Results of research conducted by Hamdan, Al-Hayale, and Aboagela (2012) showed that good corporate governance does not have a significant impact on the integrity of financial statements.

**H<sub>3a</sub>: Corporate governance weaken the influence of the financial distress towards the integrity of financial statements.**

**H<sub>3b</sub>: Corporate governance strengthens the influence of sales growth towards the integrity of financial statements.**

## RESEARCH METHODS

### Research Design

Design of this research is causality because this study aims to determine the factors that can affect the integrity of the financial statements. Factors that may affect the integrity of the financial statements in this research is financial distress, sales growth, and corporate governance. The unit of analysis in this research is the organization because the collected data related to companies listed in the Indonesia Stock Exchange. Time horizon in this research is cross-sectional and longitudinal with research period from 2012 until 2015.

### Data and Sample

The data used in this research are secondary data. Secondary data used in this research are the financial statements of companies listed on the Indonesia Stock Exchange from 2012 until 2015. Sample selection in this research was done by purposive sampling. Criteria used in the sampling of this research were (1) manufacturing

companies listed in Indonesia Stock Exchange, (2) the financial statements are presented in rupiah, and (3) have the complete financial statements and have been audited from 2012 until 2015. Based on the sampling criteria, 26 companies did not present financial statements in rupiah and 25 companies did not provide the complete data needed, hence obtained final sample 372 samples (93 companies for 4 years) to be used for this research.

## Variabels and Measurement

### Dependent Variable

#### Integrity of financial statement

Integrity of financial statements variable is a variable that is used to indicate the accuracy of the information contained in the financial statements. The integrity of financial statements can be indirectly measured by seeing how far the conservatism of the financial statements. Variable the integrity of financial statement in this research will be measured using accounting conservatism as used by Hamdan, Al-Hayale, and Aboagela (2012), the book-to-market approach. Book-to-market approach can be calculated with the following formula:

$$\text{Book-to-Market Approach} = \frac{(\text{Total Shareholders' Equity} - \text{Preferred Stocks})}{\frac{\text{Weighted-Average Number of Share Outstanding}}{\text{Closing Price at the End of Year}}}$$

Book-to-market approach is used to measure the integrity of financial statement variable because it can show the difference between the assessment by the company and the market. Thus, the market acts as assessor whether the information conveyed by the companies is accurate or not. The smaller the result of book-to-market approach, or has a value below 1 indicates the higher accounting conservatism in the financial statements.

### Independent Variables

The first independent variable is financial distress. Financial distress variable showed the company that are experiencing financial difficulties. The variables of financial distress will be measured using bankruptcy prediction developed by Altman (1968). Bankruptcy prediction by Altman (1968) can be calculated using the formula:

$$Z = 0,012 X_1 + 0,014 X_2 + 0,033 X_3 + 0,006 X_4 + 0,999 X_5$$

Where, Z is overall index; X<sub>1</sub> is Working capital divided by total assets; X<sub>2</sub> is retained earning divided by total assets; X<sub>3</sub> is earning before interest and taxes divided by total assets; X<sub>4</sub> is

market value of equity divided by book value of total debt; and  $X_5$  is sales divided by total assets.

The second independent variable is sales growth. Sales growth variable shows the company's sales increased from year to year. The sales growth variable will be measured using the sales growth (Ahmed and Duellman, 2007), which is the ratio of annual sales growth.

The third independent variabel is corporate governance. Corporate governance variable shows how well a company runs its business activities so as to prevent and reduce fraud significantly in running the company. Measurement of corporate governance variables in the research refers to Chahine (2007), which is the largest share ownership of the companies.

**Control Variables**

Control variables that use in this research is leverage and return on assets because based on the research done by Ahmed, Billings, Morton, and Stanford-Harris (2002) these variables had effect on integrity of financial statements. Leverage variables are variables that are used to measure a company's ability to meet all liabilities of the company. The leverage variable will be measured by dividing the total long-term liabilities to total assets of the company, as used by Ahmed, Billings, Morton, and Stanford-Harris (2002). Variable return on assets is a variable that is used to show the the company's ability to generate profits by using the assets owned by the company. The variable return on assets will be measured by dividing the net income to total assets of the company, as used by Ahmed, Billings, Morton, and Stanford-Harris (2002).

**Research Model**

In this study, the data analysis technique used is multiple regression analysis with the help of statistical data processing program, namely Statistical Product and Services Solutions 18 (SPSS 18). The research model is as follows:

$$IFS_{it} = \alpha + \beta_1 FD_{it} + \beta_2 SG_{it} + \beta_3 CG_{it} + \beta_4 LEV_{it} + \beta_5 ROA_{it} + \epsilon_{it} \dots \dots \dots (1)$$

$$IFS_{it} = \alpha + \beta_1 FD_{it} + \beta_2 SG_{it} + \beta_3 CG_{it} + \beta_4 (FD * CG) + \beta_5 (SG * CG) + \beta_6 LEV_{it} + \beta_7 ROA_{it} + \epsilon_{it} \dots \dots \dots (2)$$

where:

- IFS = Integrity of financial statement, measured by *book-to-market approach*.
- For sensitivity test, 1 = IFS; 0 = Non IFS
- FD = Financial distress, measured by *Altman's Z-Score Model*
- SG = Sales growth, measured by the ratio of annual sales growth
- CG = *Corporate governance*, measured by the largest share ownership of the companies
- LEV = *Leverage*, measured by dividing the total long-term liabilities to total assets of the company
- ROA = *Return on Assets*, measured by dividing the net income to total assets of the company

**RESULTS OF RESEARCH AND DISCUSSION**

**1. Descriptive Statistics and Correlations Matrix**

**Tabel 1. Descriptive statistics**

Variables	Minimum	Maximum	Mean	Std. Deviation
IFS	-7.5926	95.0940	1.7525	5.8893
IFS_DUMMY	0.0000	1.0000	0.5600	0.4960
FD	-2.3286	59.6188	4.7238	5.7604
SG	-0.8993	5.9473	0.1055	0.3812
CG	0.1017	0.9818	0.5110	0.2310
FD*CG	-0.7917	44.8807	2.6229	3.8424
SG*CG	-0.4503	2.0221	0.0528	0.1624

LEV	0.0050	2.1286	0.1503	0.2157
ROA	-0.2792	0.6572	0.0665	0.1040

**Note:** IFS: integrity of financial statement; IFS\_DUMMY: integrity of financial statement dummy; FD: financial distress; SG: sales growth; CG: corporate governance; LEV: leverage; ROA: return on assets; FD\*CG: interaction between financial distress and corporate governance; SG\*CG: interaction between sales growth and corporate governance.

The results of descriptive statistics can be seen in table 1. Based on the results of descriptive statistical analysis, it can be seen that the average of the integrity of financial statements of companies in this study is still not good because it is very far from 1. This indicates that there is still a difference between what being served in the financial statements with the truth. On average the company's financial condition in this study are also quite good, although there are some companies experiencing financial distress. In addition, the average company also experienced sales growth, although there are some companies that declined. Company's corporate governance in this study also been running well enough. On average companies in this study using long-term liabilities to acquire the assets and some of the companies are

indicated having difficulties to pay off its liabilities. Average companies in this study also earn substantial profits even though there are some companies that suffered losses.

The correlations matrix in table 2, showed that the financial distress and leverage have significant negative correlation with the integrity of financial statements as had been predicted. Sales growth has a positive relationship with the integrity of financial statements. Corporate governance and return on assets have a negative relationship with the integrity of financial statements. The interaction between financial distress and corporate governance have a significant negative relationship with the integrity of financial statements. The interaction between sales growth and corporate governance has a negative correlation with the integrity of financial statements.

**Tabel 2. Pearson correlations matrix**

VARIABLES	IFS	FD	SG	CG	LEV	ROA	FD*CG	SG*CG
IFS	1							
FD	<b>-0.092</b>	1						
(p-value)	<b>(0.076)</b>							
	*							
SG	0.006	-0.032	1					
(p-value)	(0.914)	(0.535)						
CG	-0.070	<b>0.158</b>	-0.013	1				
(p-value)	(0.179)	<b>(0.002)</b>	(0.800)					
		***						
LEV	<b>-0.137</b>	<b>-0.239</b>	0.050	-0.044	1			
(p-value)	<b>(0.008)</b>	<b>(0.000)</b>	(0.333)	(0.392)				
	***	***						
ROA	-0.022	<b>0.578</b>	0.049	<b>0.273</b>	<b>-0.304</b>	1		
(p-value)	(0.676)	<b>(0.000)</b>	(0.348)	<b>(0.000)</b>	<b>(0.000)*</b>			
		***		***	**			
FD*CG	<b>-0.093</b>	<b>0.816</b>	-0.018	<b>0.492</b>	<b>-0.224</b>	<b>0.624</b>	1	
(p-value)	<b>(0.072)</b>	<b>(0.000)</b>	(0.731)	<b>(0.000)</b>	<b>(0.000)*</b>	<b>(0.000)</b>		
	*	***		***	**	***		
SG*CG	-0.001	0.001	<b>0.918</b>	<b>0.151</b>	0.023	<b>0.136</b>	0.07	1
(p-value)	(0.990)	(0.977)	<b>(0.000)*</b>	<b>(0.004)</b>	(0.657)	<b>(0.008)</b>	1	
			**	***		***	(0.169)	

\*\*\* Significant at the level of 1 percent; \*\* Significant at the level of 5 percent; \* Significant at the level of 10 percent.

**Note:** IFS: integrity of financial statement; IFS\_DUMMY: integrity of financial statement dummy; FD: financial distress; SG: sales growth; CG: corporate governance; LEV: leverage; ROA: return on assets; FD\*CG: interaction between financial distress and corporate governance; SG\*CG: interaction between sales growth and corporate governance.

**2. Hypothesis Testing Results**

The classical assumption test for the research model without moderation and moderation research shows that both models are not having multicollinearity, heteroscedasticity, and

autocorrelation problems but does not meet the assumptions of normality. However, because the sample used in this study is quite large, the t test and F test still can be done (Gujarati and Porter, 2009).

**Table 3. Regression results of the research model without moderating**

IFS <sub>it</sub> = α + β <sub>1</sub> FD <sub>it</sub> + β <sub>2</sub> SG <sub>it</sub> + β <sub>3</sub> CG <sub>it</sub> + β <sub>4</sub> LEV <sub>it</sub> + β <sub>5</sub> ROA <sub>it</sub> + ε <sub>it</sub>					
Variables	Prediction	Coefficients	P-Value	Collinearity Statistic	
				Tolerance	VIF
Constant	+/-	3.791	<b>0.000***</b>	--	--
FD	-	-0.138	<b>0.034**</b>	0.658	1.519
SG	+	0.118	0.882	0.987	1.013
CG	+	-1.579	0.246	0.923	1.083
LEV	-	-4.511	<b>0.002***</b>	0.896	1.116
ROA	+	1.271	0.735	0.598	1.673
Total Observation			372		
Durbin-Watson Stat			2.031		
Kolmogorov-Smirnov Test			0.000		
Adjusted R <sup>2</sup>			0.026		
Prob (F-Statistic)			<b>0.012**</b>		
*** Significant at the level of 1 percent; ** Significant at the level of 5 percent; * Significant at the level of 10 percent.					
<b>Note:</b> IFS <sub>it</sub> : integrity of financial statement firm <i>i</i> in year <i>t</i> ; FD <sub>it</sub> : financial distress firm <i>i</i> in year <i>t</i> ; SG <sub>it</sub> : sales growth firm <i>i</i> in year <i>t</i> ; CG <sub>it</sub> : corporate governance firm <i>i</i> in year <i>t</i> ; LEV <sub>it</sub> : leverage firm <i>i</i> in year <i>t</i> ; ROA <sub>it</sub> : return on assets firm <i>i</i> in year <i>t</i> .					

Table 3 shows the results of hypothesis testing in research for the first model, that is without the moderating effects. Overall, all independent variables in this study had an effects on the integrity of financial statements. For the research model without the moderating effects,

only financial distress and leverage that had a significant negative effect on the integrity of financial statements, while sales growth, corporate governance, and return on assets had no significant effect on the integrity of financial statements.

**Table 4. Regression results of the research model with moderating**

IFS <sub>it</sub> = α + β <sub>1</sub> FD <sub>it</sub> + β <sub>2</sub> SG <sub>it</sub> + β <sub>3</sub> CG <sub>it</sub> + β <sub>4</sub> (FD*CG) + β <sub>5</sub> (SG*CG) + β <sub>6</sub> LEV <sub>it</sub> + β <sub>7</sub> ROA <sub>it</sub> + ε <sub>it</sub>					
Variables	Prediction	Coefficients	P-Value	Collinearity Statistic	
				Tolerance	VIF
Constant	+/-	3.736	<b>0.000***</b>	--	--
FD	-	-0.123	0.244	0.248	4.025
SG	+	-0.165	0.940	0.132	7.562
CG	+	-1.476	0.416	0.522	1.916
FD*CG	-	-0.031	0.865	0.187	5.354
SG*CG	+	0.727	0.889	0.128	7.814
LEV	-	-4.512	<b>0.002***</b>	0.896	1.116
ROA	+	1.344	0.731	0.553	1.807
Total Observation			372		

Durbin-Watson Stat	2.031
Kolmogorov-Smirnov Test	0.000
Adjusted R <sup>2</sup>	0.021
Prob (F-Statistic)	<b>0.042**</b>
*** Significant at the level of 1 percent; ** Significant at the level of 5 percent; * Significant at the level of 10 percent.	
<b>Note:</b> IFS <sub>it</sub> : integrity of financial statement firm <i>i</i> in year <i>t</i> ; FD <sub>it</sub> : financial distress firm <i>i</i> in year <i>t</i> ; SG <sub>it</sub> : sales growth firm <i>i</i> in year <i>t</i> ; CG <sub>it</sub> : corporate governance firm <i>i</i> in year <i>t</i> ; LEV <sub>it</sub> : leverage firm <i>i</i> in year <i>t</i> ; ROA <sub>it</sub> : return on assets firm <i>i</i> in year <i>t</i> ; FD*CG: interaction between financial distress and corporate governance; SG*CG: interaction between sales growth and corporate governance.	

Table 4 show the results of hypothesis testing in research for second models, that is with the moderating effects. Overall, all independent variables in this study have an effects on the integrity of financial statements. In a research model with the moderating effects, only leverage who has a significant negative effect on the integrity of financial statements. While the financial distress, sales growth, corporate governance, return on assets did not had a significant effect on the integrity of the financial statements and corporate governance can not weaken the influence of financial distress and strengthen the influence of sales growth towards the integrity of financial statements.

### 3. Sensitivity Test

Sensitivity test in this research was conducted to test the robustness of the model used in this research. Because when using the multiple regression, normality assumption is not met, then sensitivity analysis in this research will be done by logistic regression. Sensitivity test in this study will be done by changing the measurement of the integrity of financial statements from the ratio data to the nominal data, so that the data analysis technique used is the logistic regression analysis. Sensitivity test results in this study can be seen in Table 5 for the research model without moderating and Table 6 for a research model with moderating. The classical assumption test for the sensitivity test for the research model without moderating and with moderating shows the that both models do not had multicollinearity and autocorrelation problems.

**Tabel 5. Logistic regression results of the research model without moderating**

IFS_DUMMY <sub>it</sub> = α + β <sub>1</sub> FD <sub>it</sub> + β <sub>2</sub> SG <sub>it</sub> + β <sub>3</sub> CG <sub>it</sub> + β <sub>4</sub> LEV <sub>it</sub> + β <sub>5</sub> ROA <sub>it</sub> + ε <sub>it</sub>					
Variables	Prediction	Coefficients	P-Value	Collinearity Statistic	
				Tolerance	VIF
Constant	+/-	-2.244	<b>0.000***</b>	--	--
FD	-	0.323	<b>0.000***</b>	0.658	1.519
SG	+	-0.003	0.992	0.987	1.013
CG	+	1.470	<b>0.007***</b>	0.923	1.083
LEV	-	3.591	<b>0.000***</b>	0.896	1.116
ROA	+	0.132	0.942	0.598	1.673
Total Observation				372	
Durbin-Watson Stat				2.031	
Nagelkerke R Square				0.283	
Prob (F-Statistic)				<b>0.000***</b>	
*** Significant at the level of 1 percent; ** Significant at the level of 5 percent; * Significant at the level of 10 percent.					
<b>Note:</b> IFS_DUMMY <sub>it</sub> : integrity of financial statement dummy firm <i>i</i> in year <i>t</i> ; FD <sub>it</sub> : financial distress firm <i>i</i> in year <i>t</i> ; SG <sub>it</sub> : sales growth firm <i>i</i> in year <i>t</i> ; CG <sub>it</sub> : corporate governance firm <i>i</i> in year <i>t</i> ; LEV <sub>it</sub> : leverage firm <i>i</i> in year <i>t</i> ; ROA <sub>it</sub> : return on assets firm <i>i</i> in year <i>t</i> .					

Table 5 shows that overall, all independent variables in this study had an effects on the integrity of financial statements. For the research model without the moderating effects, only financial distress, corporate governance, and the leverage that has a significant positive effect on the integrity of financial statements, while sales growth and return on assets has no effect on the integrity of financial statements.

Table 6 shows that overall, all independent variables in this study had an effects on the integrity of financial statements. For the research

model with the moderating effects, corporate governance has a significant negative effects, leverage has a significant positive effects on the integrity of financial statements, and corporate governance weaken the effects of financial distress towards the integrity of financial statements. Meanwhile the financial distress, sales growth, and return on assets have no significant effect on the integrity of financial statements and corporate governance can not strengthen the effect of sales growth towards the integrity of financial statements.

**Table 6. Logistic regression results of the research model with moderating**

$IFS\_DUMMY_{it} = \alpha + \beta_1 FD_{it} + \beta_2 SG_{it} + \beta_3 CG_{it} + \beta_4 (FD*CG) + \beta_5 (SG*CG) + \beta_6 LEV_{it} + \beta_7 ROA_{it} + \varepsilon_{it}$					
Variables	Prediction	Coefficients	P-Value	Collinearity Statistic	
				Tolerance	VIF
Constant	+/-	-1.070	<b>0.018**</b>	--	--
FD	-	0.036	0.639	0.248	4.025
SG	+	-0.154	0.856	0.132	7.562
CG	+	-1.953	<b>0.063*</b>	0.522	1.916
FD*CG	-	0.891	<b>0.000***</b>	0.187	5.354
SG*CG	+	0.299	0.882	0.128	7.814
LEV	-	4.113	<b>0.000***</b>	0.896	1.116
ROA	+	-1.716	0.371	0.553	1.807
Total Observation			372		
Durbin-Watson Stat			2.031		
Nagelkerke R Square			0.326		
Prob (F-Statistic)			<b>0.000***</b>		
*** Significant at the level of 1 percent; ** Significant at the level of 5 percent; * Significant at the level of 10 percent. <b>Note:</b> IFS_DUMMY <sub>it</sub> : integrity of financial statement dummy firm <i>i</i> in year <i>t</i> ; FD <sub>it</sub> : financial distress firm <i>i</i> in year <i>t</i> ; SG <sub>it</sub> : sales growth firm <i>i</i> in year <i>t</i> ; CG <sub>it</sub> : corporate governance firm <i>i</i> in year <i>t</i> ; LEV <sub>it</sub> : leverage firm <i>i</i> in year <i>t</i> ; ROA <sub>it</sub> : return on assets firm <i>i</i> in year <i>t</i> ; FD*CG: interaction between financial distress and corporate governance; SG*CG: interaction between sales growth and corporate governance.					

**4. Discussion of Research Results**

The results using multiple regression supports the first hypothesis of this study. This proves that the company that is experiencing financial distress will be trying to manipulate its financial statements so that the integrity of the financial statements of the company will decrease. In addition, leverage also has a significant negative effect on the integrity of financial statements. The significant negative effect of leverage also support the result of the first hypothesis, which suggests that companies tends try to hide liabilities. Sales growth has no significant effect on the integrity of financial statements, the results of this study is different

from Ahmed, Billings, Morton, and Stanford-Harris (2002) and Ahmed and Duellman (2007) who found that the growth of sales has an influence on the integrity of financial statements.

Moreover, return on assets also have no effect on the integrity of financial statements. Sales growth and return on assets have no effect on the integrity of financial statements, it is probably because the increase of the company's sales and earnings due to the rise in selling prices and improvement of economic conditions. Corporate governance also has no effect on the integrity of financial statements, as well as research conducted by Hamdan, Al-Hayale, and Aboagela (2012) but not according to research

conducted by Ahmed and Duellman (2007) which shows that corporate governance has a significant effect on the integrity of financial statements. In addition, corporate governance can not weaken the effects of financial distress and strengthening the effects of sales growth on the integrity of financial statements. It can be caused due to corporate governance is less or even not implemented because its only comply with existing regulations only.

The sensitivity test results showed that the financial distress and leverage have significant positive effect on the integrity of financial statements. The different coefficients directions with the results of primary research model shows that there is a possibility that the financial distress and liabilities faced by the company is already disclosed in the financial statements thereby enhancing the integrity of the financial statements. Overall, financial distress and leverage have a effect on the integrity of financial statements. Different coefficients directions indicate that there are companies that disclose financial distress that it faces as well as leverage and there are companies who are trying to cover it up. Corporate governance also has a significant positive effect in the equation without the moderating effects and significant negative effect in the equation with the moderating effects, indicating that corporate governance can increase or decrease the integrity of financial statements of the company depends on the success of the implementation. In addition, corporate governance also weaken the effect of financial distress on the integrity of financial statements, but is unable to strengthen the effect of sales growth on the integrity of financial statements. This can be due to that the largest owner of the company which is the proxy for corporate governance is very concerned about the company's financial condition which as stated by Bushman, Chen, Engel and Smith (2004) that the good corporate governance system is able to address information gaps between companies and investors. The test results with two kinds of regression are differences, but overall strengthen the results of this study.

## **CONCLUSIONS**

This study aimed to analyze the negative effects of financial distress and the positive effects of sales growth towards the integrity of

financial statements and whether corporate governance weaken the influence of financial distress and strengthen the influence of sales growth to the integrity of financial statements. This study using 372 samples that obtained after the sample selection process.

Based on the results of research and the previous discussion, it can be concluded that the financial distress had a significant effects on the integrity of financial statements and corporate governance weaken the effects of financial distress towards the integrity of financial statements. In addition, the control variable, leverage also have a significant effects on the integrity of financial statements. Overall variable, financial distress, sales growth, corporate governance, leverage, return on assets, corporate governance\*financial distress, and corporate governance\*sales growth has effects on the integrity of financial statements.

This study is not free from the limitations that arise during the study. One of them is the multiple regression equation used in this study did not meet the assumptions of normality. However, because the sample used in this study is quite large, the t test and F test still can be done (Gujarati and Porter, 2009) and also in the sensitivity test, the research model also tested again by logistic regression. The small number of previous research with the theme of the integrity of financial statements is also one of the obstacles in this study. Based on the research results, recommendation that can be given to the stakeholders of the company is to pay attention to the company's financial condition, governance conducted by the company and leverage of the company in assessing the integrity of financial statements of a company. In addition, the regulator is expected to create standards that regulate the governance that should be done by the company, more widely and detail so that the integrity of the financial statements can be maintained. For further research, recommendation that can be given is to use another measurement tool for measuring the corporate governance, such as the ASEAN Corporate Governance Scorecard. In addition, further research may also use all companies listed in Indonesia Stock Exchange or add the observation period.

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## **EARNINGS QUALITY: BEFORE AND AFTER IFRS ADOPTION**

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### ***ABSTRACT***

*As a part of G-20, Indonesia has obligation to adopt IFRS as accounting standard. The IFRS adoption obligation is expected will elevate the quality of financial reporting due to the changing accounting standards and disclosures in information for many companies, and due to the implementation of the principle-based accounting standards. This research aims to evaluate whether there is any increasing in financial reporting quality after the IFRS adoption.*

*Listed companies at Indonesian Stock Exchange (IDX) that belong to LQ-45 index are used as the subject in this research. In this research, we are using the LQ 45 as the sample companies with the consideration that these companies could work as a representation for the implementation of the IFRS adoption in Indonesia. The population in this research are the companies becoming the member of LQ 45 for the period 2009-2014. At the end, this research is using 58 sample companies. This research is using paired sample test to analyze the data. Instead of using one proxy as the representation of the earnings quality, we use three proxies of the earnings quality, in order to get more objective findings: earnings response coefficient, discretionary accruals, and deferred tax expenses.*

*After conducting several tests, we concluded that IFRS adoption increased the quality of financial reporting. The result showed that the financial reporting quality after the IFRS adoption was higher than the financial reporting quality before the IFRS adoption. As a conclusion, the financial reporting quality of the Indonesian companies was increasing after the adoption of the IFRS. Further, the IFRS adoption increased the financial reporting quality.*

**Keywords:** *Earnings Quality, Earnings Response Coefficient, Discretionary Accrual, Deferred Tax Expense, IFRS Adoption.*

### **INTRODUCTION**

Each country has different accounting which is adjusted with the needs of the country. To increase the financial statement comparability and quality in the global market, we need to set

an international accepted accounting standard (Yurisandy & Puspitasari, 2015). The international accounting standard provides the benefits, such as reducing the distinctive reporting regulation between countries, reducing

the cost of multinational company financial reporting, and reducing the cost of financial statement analysis. Beside the benefits, there are some obstacles in implementing the international accounting standards. One of the obstacles is the conflict between interested parties: politician and private party (Choi and Richard, 1988).

Danke and Gunther (2006) find empirical findings that International Financial Reporting Standard (IFRS) adoption can elevate the earnings quality. Barth et.al (2007) do study about the earnings quality for before and after IFRS adoption using 327 companies as sample from 21 different countries. The investigation demonstrate that earnings management level is decreasing after the IFRS. The research also discover that value relevance of accounting information is elevating; and the loss is being recognized earlier after the IFRS adoption. Morais and Curto (2008) also find the same result that the income smoothing practices in Portuguese has decreased after the country adopting the IFRS. Some other studies prove that the IFRS has increased the earnings reporting quality.

However, some other investigations find the opposite evidences. Jeanjean and Stolowly (2008) find that earnings management activity in Australia, France, and UK for the period 2005-2006 does not decrease after the IFRS adoption. In other word, the earnings management is still excessive. Further, the findings show that the implementation of high accounting standards do not directly raise the quality of accounting information (Ball et. al, 2003). The study concludes that the incentive and motivation of the financial information preparer (management) along with auditor will also influence the quality of financial information. In other word, there are other factors affecting the financial information quality other than the accounting standard.

The inconsistent findings is presumed caused by the not existence of the direct measurement over the financial statement quality (Barth e.al, 2008; Schipper & Vincent, 2003; Cohen et.al, 2004; and Nicholas & Wahlen, 2004). Yurisandy and Puspitasari (2015) investigate the quality of financial reporting

before and after IFRS adoption in Indonesia using the qualitative approach (content analysis). The study find that the financial reporting quality in Indonesia is increasing from the relevance, understandability, and comparability point of views. Expanding Yurisandy and Puspitasari (2015) examination, this study attempts to elaborate the previous researches in examining the earnings quality before and after the IFRS adoption by using earnings response coefficient, discretionary accrual, and deferred tax expense – quantitative approach, and using the same company sample.

## **THEORITICAL FRAMEWORK AND HYOPTHESES DEVELOPMENT**

Ewert & Wagenhofer (2005) explain that the higher earnings quality could be achieved by implementing the accounting standards that restrict the accounting choices and regulate the the accounting treatment distinctively. The International Accounting Standard Board (IASB) has been developing IFRS which comprise of accounting methods and approaches to improve financial information accountability, transparency, and comparability. However, there are debates whether the IFRS do enhance the accounting information quality (Barth et.al, 2008; Daske et.al, 2008; Karampinis and Hevas, 2011; Alali and Foote, 2012).

IFRS has been developed using the principle-based over the rule-based standard. Hence, the use of the fair value measurement has been massively escalated. There are arguments that the use of the fair value measurement can increase the accounting information quality since it can reflect the company real economic condition. Yet, Barth et. al (2008) presume that the use of fair value can limit the management in presenting the real condition financial information. It is caused by the use of the fair value can limit the managerial discretion in selecting appropriate method that reflecting real company economic condition. Therefor, there is contradictory in the fair value measurement benefit.

Up to now, there is no absolute measurement method in evaluating the earnings quality. There are three quantitative proxies over the earnings quality: earnings response coefficient, discretionary accruals, and deferred tax expenses.

### **Earnings Response Coefficient (ERC) as Earnings Quality Proxy**

Cho and Jung (1991) explain that ERC is the effect of each dollar of unexpected earnings to the stock returns. ERC is usually measured by the coefficient slope of the abnormal return and unexpected earnings regression. The ERC measurement evaluates the earnings quality based on the market reaction to the published earnings information.

When the company reports the earnings information based on the accounting principle based standard (IFRS), we presume that the earnings information will have more relevant quality in presenting the real economic condition. Therefore, we expect the investor will consider the information presented by the company will convey more relevant information. Further, the investor will appreciate the information more and produce higher ERC, which means the company produces high earnings quality. On the contrary, if the investor assumes that the earnings contain less information, the investor will not appreciate the information and produce lower ERC, which means the company produces low earnings quality. If this occurs, it implies the investor will believe that the management is using the principle based accounting as an instrument to manage the earnings.

Beisland (2013) analyzes whether the IFRS adoptions influence the book value equity and earnings using the changing or ERC. Beisland uses the Norwegian companies as the sample for the 'pre-adoption' and 'post-adoption' of IFRS. Before the IFRS adoption, the companies use the local accounting standard (Norwegian General Accepted Accounting Principle/NGAAP). NGAAP uses the historical cost and matching principle (Johnsen & Eilifsen, 2003). The main difference between the NGAAP

and IFRS is the use of the fair value measurement (Gjerde et al., 2008). The result of the Beisland (2013) study finds that the IFRS adoption increases the earnings persistence or the earnings quality.

Clarkson (2011) has the same findings. Using the 3,488 companies from Australia, England, France, Portuguese, Ireland, and Belgium, Clarkson proves that the earnings quality and the value relevance (ERC) has increased after the companies adopted the IFRS.

However, a different outcome is found by Lin (2012). Lin investigates whether there are any accounting information quality differences before and after the IFRS adoption in Germany. Lin's result is that the value relevance (ERC) has decreased after the IFRS adoption.

Based on the description above, we propose the following hypothesis:

*H<sub>1</sub>: The ERC as the earnings quality will differ after Indonesian Accounting Standard (Standar Akuntansi Keuangan/SAK) adopts the IFRS.*

### **Discretionary Accruals as Earnings Quality Proxy**

Accounting standards instruct the companies to use the accrual basis in preparing their financial statements. By implementing the accrual basis, the companies will record and recognize the transaction when it occurs, without considering whether the cash flow has been involved or not. The accrual could be divided into two classifications: non-discretionary accrual and discretionary accrual. Non-discretionary accrual is the accrual that cannot be influenced by the management policy. In other words, the management does not have any flexibility in controlling the amount (Scott, 2000). Meanwhile, the discretionary accrual represents the accrual that can be controlled by the management because of its discretion and flexibility. The accrual recording could be subjective, depending on management decision. Therefore, the earnings accrual component is vulnerable to earnings management because the management can control the decision (Sloan,

1996). One the accrual subjectivity is the amortization and depreciation expenses. The bigger the discretionary accruals indicate the earnings management.

The IFRS has the extensive discretionary accruals because it uses the principle based standard. Principle based is the accounting principle which use the accountable and responsible judgment and estimation. The principle based drives the company to report financial information that more reflect the economic substance over the form of the transaction in order to improve the transparency (Maines et.al, 2003). However, the flexibility in the accrual could be used by the management to manipulate the reported earnings.

Ismail (2010) investigates whether the earnings quality – discretionary accruals has increased after the IFRS adoption in Malaysia. The result is the discretionary accruals after the IFRS adoption is decreasing. It means the earnings quality has been increasing since the IFRS adoption. Using the same approach, Chen (2013) find the same results in the European Union countries. However, if the analysis is being done to each European Union country, only in France, Germany, and Dutch experience the elevated earnings quality (less discretionary accrual exists). Sellami and Fakhfakh (2014) also discover the same facts in France.

Based on the description above, we propose hypothesis:

*H<sub>2</sub>: The discretionary accruals as the earnings quality will differ after Indonesian Accounting Standard (Standar Akuntansi Keuangan/SAK) adopt the IFRS.*

### **Deferred Tax Expenses as Earnings Quality Proxy**

Deferred tax represents the amount of income taxes payable in future years (deferred tax liabilities) or amount of income tax recoverable in the future periods in respect of temporary differences (IAI, 2009). The deferred tax expenses can explain whether the company is doing earnings management or not (Yulianti, 2004). Book-tax differences can detect the

earnings management since it can separate the discretionary and non-discretionary management activity. Further, there is assumption that the company prefers to manage the earnings by increasing the earnings without any tax-increasing consequences (Philips et.al, 2003).

The ‘red flag’ potential could also being detected by the financial statement user from difference of the accounting income and the fiscal income. The fiscal income is being determined based on the taxation act which has asset, liabilities, revenues, and expenses measurement restrictions. Meanwhile, the accounting income is being computed based on the accounting standard which provides the company with the flexibilities.

The investigation is being done by Martinez (2015). Martinez examines the benefit of the IFRS implementation in Brazil using the deferred tax approach. Martinez finds that the difference between the accounting income and fiscal income decreases after the IFRS adoption. The same conclusion is found by Benyarsrisawat (2011). Benyarsrisawat studies the earnings smoothing, represented by deferred tax, has decreased after the IFRS adoption in Thailand.

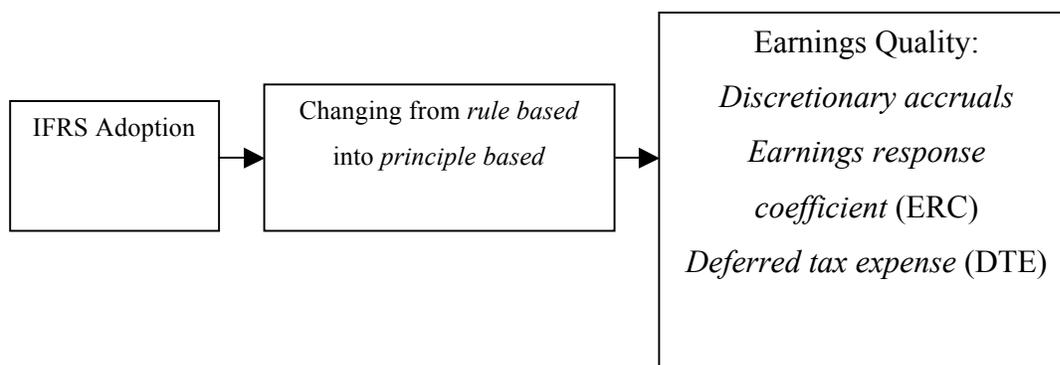
*H<sub>3</sub>: The deferred tax as the earnings quality will differ after Indonesian Accounting Standard (Standar Akuntansi Keuangan/SAK) adopt the IFRS.*

## **RESEARCH DESIGN**

### **Empirical Design**

The purpose of this research is to find empirical findings about the earnings quality using quantitative approaches: earnings response coefficient, discretionary accruals, and deferred tax expenses.

Below is the research model we use in this study:



### Earnings Response Coefficient

ERC is being determined by doing several steps of calculation. The ERC is represented by the slope of  $\alpha_1$  in Cumulative Abnormal Return (CAR) and Unexpected Earnings regression.

$$CAR_{it} = \alpha_0 + \alpha_1 UE_{it} + \varepsilon_{it} \quad (1)$$

Where,

$CAR_{it}$  = cumulative abnormal return of company  $i$  for window period (11 days; 5 days before financial statement publication date, publication date, and 5 days after financial statement publication date).

$UE_{it}$  = unexpected earnings of company  $i$  for period  $t$

$$= \frac{E_{it} - E_{it-1}}{E_{it-1}} \quad (2)$$

$E_{it}$ : earnings of company  $i$  for period  $t$

$E_{it-1}$ : earnings of company  $i$  for period  $t-1$

$E_{it-1}$ : earnings of company  $i$  for period  $t-1$

$\varepsilon_{it}$  = error component of company  $i$  for period  $t$

### Discretionary Accruals

We use the modified Jones model to determine the discretionary accruals as follows:

- a. Calculating the total accrual using the *cash flow approach*  
 $TACC_{it} = NI_{it} - CFO_{it}$

3)

Where,

$TACC_{it}$  = Total Accrual of company  $i$  for period  $t$

$NI_{it}$  = Net Income of company  $i$  for period  $t$

$CFO_{it}$  = Operating Cash Flow of company  $i$  for period  $t$

- b. Determining the coefficient of the accrual regression model

Discretionary accrual is the difference between the total accrual (TACC) with the non discretionary accrual (NDACC). In order to find the *nondiscretionary accrual*, first we to perform regression model below:

$$TACC_{it}/TA_{it-1} = \beta_1(1/TA_{it-1}) + \beta_2(\Delta REV_{it} - \Delta REV_{it-1}) + \beta_3(PPE_{it}/TA_{it-1}) + e_{it} \quad (4)$$

Where:

$TACC_{it}$  = Total Accrual of company  $i$  for period  $t$

$TA_{it-1}$  = Total assets of company  $i$  for period  $t-1$

$\Delta REV_{it}$  = The revenue changing of company  $i$  from period  $t-1$  to period  $t$

$PPE_{it}$  = *Property, plant, equipment* of company  $i$  for period  $t$

$\Delta REC_{it}$  = The net receivable changing of company i from period t-1 to period t  
 $e$  = Error

- c. Determining *nondiscretionary accrual*  
 The regression model from equation (2) produce the coefficient  $\beta_1$ ,  $\beta_2$ , dan  $\beta_3$ . Those coefficient then is used to predict the *nondiscretionary accrual* through below equation:  
 $NDACC_{it}/TA_{it-1} = \beta_1(1/TA_{it-1}) + \beta_2(\Delta REV_{it} - \Delta REV_{it-1}) + \beta_3(PPE_{it}/TA_{it-1}) + e_{it}$

(5)

Where:

$NDACC_{it}$  = Nondiscretionary accrual of company i for period t

- d. Determining *discretionary accrual*  
 After we get the non discretionary accrual we then calculate the *discretionary accrual* by reducing the total accrual form the step a calculation with the non-discretionary accrual from step c.

$DACC_{it} = (TACC_{it}/TA_{it-1}) - NDACC_{it}$

(6)

Where:

$DACC_{it}$  = *Discretionary accrual* of company i for period t

### Deferred Tax Expenses

We calculate the deferred tax expenses using below equation:

$EM_{it} = \alpha + \beta_1 DTE_{it} + \beta_2 TA_{it} + \beta_3 In_{it} + e$

7)

Where:

$EM_{it}$  = Equity market value of company i for period t

$DTE_{it}$  = Deferred tax expenses of company i for period t

$TA_{it}$  = Ln Total Assets of company i for period t

$In_{it}$  = Tax Planning

$$\text{Tax Plan} = \frac{\sum_t^{-1} (25\% \times \text{PTI} - \text{CTE}) / n}{\text{TA}} \quad (8)$$

Where:

PTI = *Pre Tax Income* of company i for period t

CTE = *Current Tax Expense* of company i for period t

n = years

TA = Total Assets of company i for period t

### Hypothesis Testing

The purpose of this research is to empirically evaluating the financial reporting quality before and after the IFRS adoption. To achieve that, we perform mean comparison test using paired sample test if the data is distributed normally, and using the Wilcoxon non parametrik analysis if the data is not distributed normally. We use this model in order to find the level of significance of the financial reporting quality changes before and after IFRS adoption. We use SPSS program version 16.00 and microsoft excel to run the data.

### Sample

Listed companies at Indonesian Stock Exchange (IDX) that also belong on LQ-45 index are used as the subject in this research. The LQ-45 consists of the companies that are listed in Indonesian Stock Exchange with the highest market capitalization. In this research, we are using the LQ 45 as the sample companies with the consideration that these companies could work as a representation for the implementation of the IFRS adoption in Indonesia. The companies that become the LQ-45 member are evaluated every six months by the IDX. The population in this research are the companies becoming the member of LQ 45 for the period 2009-2014. At the end, this research is using 58 sample companies. This reseach is using paired sample test to analyze the data. The financial reporting quality before the IFRS adoption is represented by the period 2009-2010, while the

financial reporting quality after the IFRS is represented by the period 2012-2014. The research is not using 2011 period with the consideration that the period is the starting point of implementation the IFRS adoption in Indonesia. We analyze the quality of the financial reporting using the annual reporting prepared by the companies (see Table 1).

## **RESULTS**

### **Descriptive Analysis**

From Table 2, 3, and 4, we could see that the level of ERC, Discretionary Accruals, and Deferred Tax Expenses represented by the sample company were lower compared to the ERC, Discretionary Accruals, and Deferred Tax Expenses after the IFRS adoption. It implied that the earnings quality proxied by the ERC after the IFRS adoption had increased.

### **Hypotheses Testing**

Based on the hypothesis testing we found that the earnings quality increasing were significant. Table 5 displayed the results of the earnings quality (proxied by the ERC) comparison testing based on the Wilcoxon Test. The difference were significant at the level 1%.

Further, Table 6 also proved that the results of the earnings quality (proxied by the Discretionary Accruals) after the IFRS adoption has elevated. We used comparison testing based on the Wilcoxon Test. The difference were also significant at the level 1%.

Last but not least, Table 7 demonstrated the same thing that the earnings quality (proxied by the Deferred Tax Expenses) has likewise escalated. We used mean comparison testing. The result were significant at the level 1%.

## **DISCUSSION**

From the result above we could see that the mean of earnings response coefficient after the IFRS adoption was higher compared to before the IFRS adoption. The increasing of the ERC meant that the investor did response to the

financial statement published by the companies and the response was going stonger after the IFRS adoption. This result implied that the investor presumed that the financial information became more relevant and informative in their decision making after the IFRS adoption. The outcome was in accordance with the Beisland (2013) study in Norwegia. The market gave more convincing reaction after the IFRS adoption. We suggested the result described that the earnings quality after IFRS adoption was better.

The result showed that the the mean of discrestionary accrual elevated after the IFRS adoption. The mean of discretionary accrual reached 0. This finding implied that the flexibilities being used by the company after the IFRS adoption – certain estimations and assumptions, had decreased. In other word, the company was using the principle-based to reflect more economic reality instead of using it to do earnings management. The evidence we found was in line with the one being found by Ismail (2010) in Malaysia. Both investigations proved that the earnings quality had improved after the IFRS adoption.

Meanwhile, based on the result we could ensure that mean of the deferred tax after the IFRS adoption was diminishing compared to the deferred tax before the IFRS adoption. The smaller the deferred tax expenses suggested that the differences between the accounting income and fiscal income was reduced. Further, the finding proved the earnings quality was getting better. This outcome was in accordance with the Benyarsisawat (2011) which also proved that the earnings quality represented by DTE in Thailand was increasing.

## **CONCLUSION AND IMPLICATION**

This study investigated the elaboration the previous researches in examining the earnings quality before and after the IFRS adoption by using earnings response coefficient, accrual discrestionary, and deferred tax expense – quantitative approach, and using the same company sample being examined by Yurisandi

and Puspitasari (2015). We proved that the earnings quality being measured with the quantitative approaches increasing after the IFRS adoption. The earnings quality measured by the ERC, discretionary accrual, and deferred tax expenses had improved after the IFRS adoption. The findings supported the previous research. While Yurisandi and Puspitasari (2015) proved that the financial reporting quality – relevance, faithful representation, understandability, comparability, and timeliness had improved after the IFRS adoption.

Both studies implied that the IFRS adoption did elevate the quality of accounting information. Not only just the numbers, but also in the disclosure of the accounting information. Further, the principle based accounting standard could be presumed enhancing the quality of the financial statement and reporting, since the company did have opportunity to present the real economic condition in the financial statement in Indonesia.

**Table 1 - Sample**

No	Kode Saham	Nama Emiten
1	AALI	Astra Agro Lestari Tbk.
2	ADHI	Adhi Karya (Persero) Tbk.
3	ADRO	Adaro Energi Tbk.
4	AKRA	AKR Corporindo Tbk.
5	ANTM	Aneka Tambang (Persero) Tbk.
6	ASII	Astra International Tbk.
7	BBCA	Bank Centra Asia Tbk.
8	BBNI	Bank Negara Indonesia Tbk.
9	BBRI	Bank Rakyat Indonesia Tbk.
10	BBTN	Bank Tabungan Negara Tbk.
11	BDMN	Bank Danamon Tbk.
12	BHIT	PT MNC Investama Tbk.
13	BISI	Bisi International Tbk.
14	BKSL	Sentul City Tbk.
15	BLTA	Berlian Laju Tanker Tbk.
16	BMRI	Bank Mandiri Tbk.
17	BMTR	Global Mediacom Tbk.
18	BNBR	Bakrie & Brothers Tbk.
19	BNGA	Bank Niaga Tbk.
20	BNII	Bank Internasional Indonesia Tbk.
21	BRPT	Barito Pacific Tbk.
22	BTEL	Bakrie Telecom Tbk.
23	BUMI	Bumi Resources Tbk.
24	BYAN	Bayan Resources Tbk.
25	CPIN	Charoen Pokphand Indonesia Tbk.
26	CTRA	Ciputra Development Tbk.
27	DEWA	Darma Henwa Tbk.
28	ENRG	Energi Mega Persada
29	EXCL	XL Axiata Tbk.
30	GGRM	Gudang Garam Tbk.
31	IMAS	Indomobil Sukses International Tbk.
32	INCO	Vale Indonesia Tbk.
33	INDY	Indika Energy Tbk.
34	INKP	Indah Kiat Pulp & Paper Tbk.
35	INTP	Indocement Tunggul Prakasa Tbk.
36	ISAT	Indosat Tbk
37	ITMG	Indo Tambangraya Megah Tbk.
38	JSMR	Jasa Marga Tbk.
39	KIJA	Kawasan Industri Jababeka Tbk.
40	KLBF	Kalbe Farma Tbk.
41	LPKR	Lippo Karawaci Tbk.
42	LPPF	Matahari Department Store Tbk.

43	LSIP	PP London Sumatera Tbk.
44	MAIN	Malindo Feedmill Tbk.
45	MAPI	Mitra Adiperkasa Tbk
46	MEDC	Medco Energi International
47	MLPL	Multipolar Tbk.
48	MNCN	Media Nusantara Citra Tbk.
49	PGAS	Perusahaan Gas Negara (Persero) Tbk.
50	PTBA	Tambang Batubara Bukit Asam (Persero) Tbk.
51	PWON	Pakuwon Jati Tbk.
52	SCMA	Surya Citra Media Tbk.
53	SMRA	Summarecon Agung Tbk.
54	TINS	Timah (Persero) Tbk.
55	TRAM	Trada Maritime Tbk.
56	UNSP	Bakrie Sumatera Plantations Tbk.
57	UNVR	Unilever Indonesia Tbk.
58	WIKA	Wijaya Karya Tbk.

Source: Indonesia Stock Exchange (IDX)

**Table 2 – Descriptive Analysis (ERC) Before and After The IFRS Adoption**

	ERC Before IFRS Adoption	ERC After IFRS Adoption
<b>Mean</b>	0.0941	0.52621
<b>Maximum</b>	68.41530	8.86459
<b>Minimum</b>	-33.16238	-0.99586
<b>Std. Dev.</b>	10.20056	1.82228

Sources: Research Data

**Table 3 - Descriptive Analysis Discretionary Accrual  
Before and After The IFRS Adoption**

	Discretionary Accrual Before The IFRS Adoption	Discretionary Accrual After The IFRS Adoption
<b>Mean</b>	-5.15841	-0.01696
<b>Maximum</b>	-0.07567	0.35800
<b>Minimum</b>	-44.17979	-0.30970
<b>Std. Dev.</b>	6.08500	0.10225

Sources: Research Data

**Table 4 - Descriptive Analysis Deferred Tax Expense  
Before and After The IFRS Adoption**

	<b>DTE Before IFRS Adoption</b>	<b>DTE After IFRS Adoption</b>
<b>Mean</b>	0.19195	0.05412
<b>Maximum</b>	0.32467	0.17257
<b>Minimum</b>	0.08328	-0.07478
<b>Std. Dev.</b>	0.058108	0.05433

Sources: Research Data

**Table 5 – Earnings Quality ERC**

	<b>Mean</b>	<b>Z</b>	<b>Z-table</b>	<b>Decision</b>	<b>Sig</b>	<b>Conclusion</b>
Before IFRS	0.09	-3.635	±1.96	H <sub>01</sub> Rejected	0.000	Significant
After IFRS	0.53					

Sources: Research Data

**Table 6 – Earnings Quality Discretionary Accruals**

	<b>Mean</b>	<b>Z</b>	<b>Z-table</b>	<b>Decision</b>	<b>Sig</b>	<b>Conclusion</b>
Before IFRS	-5.16	-6.624	±1.96	H <sub>02</sub> rejected	0.000	Significant
After IFRS	-0.02					

Sources: Research Data

**Table 7 – Earnings Quality DTE**

	<b>Mean</b>	<b>Z</b>	<b>Z-table</b>	<b>Decision</b>	<b>Sig</b>	<b>Conclusion</b>
Before IFRS	0.19195	12.675	±2.002	H <sub>03</sub> rejected	0.000	Significant
After IFRS	0.05412					

Sources: Research Data

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**IMPLEMENTATION OF ACCRUAL ACCOUNTING IN MOVING  
TOWARDS BETTER GOVERNANCE BASED ON THE PERCEPTIONS OF  
MALAYSIAN PUBLIC SECTOR ACCOUNTANTS**

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***ABSTRACT***

*The move from cash to accrual accounting in public sector was initially made by the Malaysian government in year 2011. When the government made the announcement, it gave a huge shock to the preparers of the governmental financial reporting. The announcement made by the government in 2011 acted as stimuli to change. Therefore, it urged the preparers of the public sector financial report, whom in this case are the public sector accountant, to be ready for the change. One of the factors that dampened the effectiveness of accrual accounting system in public sector accounting is the attitude of the user of the accounting system. The objective of the study is to examine the mediating effect of attitude on perception of public sector accountants towards the implementation of accounting system in public sector. Questionnaires were distributed and analysed using Likert scale. It was found that attitude and perception do contribute towards the success of the implementation of accrual accounting.*

**Keywords:** *Accrual Accounting, Attitude, Perception, Public Sector Accountant, Malaysia*

## CONSEQUENCES OF REAL EARNINGS MANAGEMENT AND ACCRUAL EARNINGS MANAGEMENT TOWARD THE AGGRESSIVE TAX BEHAVIOR

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### ABSTRACT

*This research aimed to examine the effect of real earnings management and accrual earnings management toward aggressive tax behavior, and investigate the role of quality audit on the relationship of real earnings management and accrual earnings management to aggressive tax behavior. The study was conducted on companies listed in Indonesia Stock Exchange during the period 2010 to 2013, with a total of 209 companies, 836 firms-year observations. The analysis was performed with panel data. The results show companies that perform real earnings management tend to have a less aggressive tax behavior than companies that perform accrual earnings management. Contrary to the companies audited by the Big Four show companies that perform real earnings management are likely to behave aggressively taxes than companies that perform accrual earnings management. The results of this study support the research conducted by Cohen et al. (2008) and Zamri et al. (2013) which shows that companies are audited by the Big Four showed that a higher audit quality tend to make less use of accrual earnings management and switch to using real earnings management, because with better quality audits lead managers have limited to accrual earnings management. This study contributes by providing evidence that saw the effect of both real and accrual earnings management toward aggressive tax behavior, and switching behavior of both the earnings management with better quality audits.*

**Keywords:** *Real Earning Management, Accrual Earning Management, Tax Aggressive and Audit Quality*

### 1. INTRODUCTION

The tax raises significant expense, therefore, it is not a secret anymore if there are attempts taxpayers to regulate the amount of taxes paid. As a profit-oriented company, of course, domestic and multinational companies seek to minimize income tax expenses by exploiting weaknesses in the system of the existing tax provisions. Based on this relationship it is suspected that the owner of the company would be likely to encourage management to take action aggressive tax (Chen

et al., 2010). Slemrod (2004) and Slemrod and Yitzhaki (2002) argues that aggressive taxation includes a transaction whose main purpose is to reduce the tax liability without involving a real response by the company and is part of the activities of tax avoidance are more common.

The income tax expense is calculated based on the level of corporate income generated. Corporate income is also used as an indicator to measure management performance. Therefore, it can be crucial when profits are influenced by

components that can still be touched by discretion or policy management to achieve desired income through earnings management. Earnings management is activities that manipulate and manage income so that accounting profit can reach the desired target company. One way to do earnings management is manipulating the accrual earnings management without a direct consequence of the cash flow. Besides conducting manipulation of accruals, managers also have an incentive to manipulate significant events during the year to meet certain profit targets (Roychowdhury, 2006).

From the survey research conducted by Graham et.al (2005) reported that 80% of study participants taking economic measures such as reducing the burden of expenditure discretionary on R & D, advertising and maintenance to meet profit targets particular, it shows that managers prefer to manage earnings through estate activity over economic decisions rather than accrual accounting. In addition, according to Roychowdhury (2006) showed that although Real Earning Management can reduce the value of the company, but managers are more willing to manage earnings through estate activity as it may be less able to attract the attention of the auditor or the supervision of the regulator.

Based on the literature review conducted by the researcher, earnings management is done for tax purposes more refers to the accrual earnings management. This is also strengthened by the statement Hanlon and Heitzman (2010) which states that overall there is some evidence that the income tax expenses accruals are used to manage earnings, such as the change of time for calculation, disclosure or other factors (eg lists of deferred tax assets that are part of the rules in the equity), so the extent to which companies can manage their income through the tax expense account could change significantly. Based on the observations of researcher have not found other studies that examine the effect of real earnings management for tax purposes. According to the results of research conducted Barton and Simko (2002) also showed that the presence of the limitations of the company to improve accrual, and a company with a high degree of limitation

on the accrual tend to be less earning management through accrual. Companies are limited to accrual earnings management would have an incentive to switch accrual earnings management through real activities, also known as real earnings management. Limitations of the company to be able to do through the accrual earnings management, in some studies, referred to as accounting flexibility. In this case researcher interested in conducting examine the influence of real earnings management and accrual earnings management on the behavior of aggressive tax.

Earnings management may contain opportunist actions undertaken by managers. Therefore monitoring can be done by shareholders, debt holders, and regulators. Monitoring can be done through audit quality for monitoring the company so it can reduce agency costs with debt holders and shareholders (Jensen and Meckling, 1976; Watts and Zimmerman, 1983). Audit quality in some studies can be used as a proxy to detect errors in the financial statements. Base on research conducted by Hirst (1994) who found that the auditor would be sensitive on earnings management and tend to concentrate on managerial incentives for the excess profits of recording so that in this case the high-quality audits will reduce aggressive tax behavior. This result is also supported by research conducted Becker et.al (1998) and Chung et.al (2005) showed that high-quality audits will limit discretionary accruals made by management. While the results of the study conducted by Cohen e.al (2008) and Zamri et.al (2013) show that companies are audited by the Big Four who has a good name and provide high-quality audits, will be less inclined to use accrual earnings management and more use of real earnings management. Therefore, this research interested in investigating the role of audit quality on earnings management whether it is real or accrual against aggressive tax behavior.

This research has two main objectives: first to investigate the effect of earnings management both real or accrual against aggressive tax behavior. Second to determine the role of audit quality on earnings management relations both

real and accrual against aggressive tax behavior. The research investigated in terms of real earnings management and accrual earnings management. Real earnings management used three measurements developed by Roychowdhury (2006); Cohen & Zarowin (2010); Zang (2012) and Ge & Kim (2014). While for accrual earnings management using measurement Khotari et.al (2005). This study contributes to provide evidence of the role of real earnings management in aggressive tax behavior and the role of audit as a quality control of the mistakes in presenting the financial statements thus resulting in limited earnings management conducted accrual and switch by performing real earnings management. The results of this research can add to the literature on the influence of both real earnings management and accrual against aggressive tax behavior.

## **2. CONCEPTUAL FRAMEWORK AND HYPOTHESES DEVELOPMENT**

### **2.1. Aggressive Tax Behavior**

Income tax expense is a fairly large component which is spent by the company. So companies tend to do some ways to be able to save these expenses, therefore it will encourage companies on the behavior of aggressive tax. (Chen et al., 2010). The behavior of aggressive tax argued by Slemrod (2004) and Slemrod and Yitzhaki (2002) includes a transaction whose main purpose is to reduce the tax liability without involving a real response by the company and is part of the activities of tax avoidance. So that aggressive tax behavior can be categorized as part of tax avoidance. The proxy used for aggressive tax behavior is also the same as the proxy for tax avoidance. In Hanlon and Heitzman (2010) there is some measure used as a proxy of tax avoidance, but this study only uses three measurements of tax avoidance as follows:

- a. Effective tax rate (ETR), which is calculated by dividing the estimated tax liability with a pre-tax income or cash flow, these measurements captures the average rate of tax paid on the income or cash flows. There are several measurements ETR, such as GAAP ETR, Cash ETR, and Current ETR.

- b. The book-tax difference (BTD), it is the difference between the accounting pre-tax income and taxable income. Based on previous studies have shown that book-tax difference may provide information regarding tax avoidance behavior. But tax avoidance information in book-tax difference is difficult to document because it is difficult to obtain valid tax results.
- c. Abnormal book-tax difference (ABTD). This measurement was developed by Desai and Dharmapala (2006) which measures abnormal book-tax difference by regressing total book-tax difference to the total accrual, total accrual earnings are intended to control earnings management. Residuals of the regression are used as a construct of tax avoidance.

Other than on three measurements are still many proxies that can be used to measure the behavior of aggressive tax. The previous study also showed mixed results. Accordingly need to be developed the proxy that can be used as a measure for tax avoidance that can give consistent results.

### **2.2. Real Earning Management and Accrual Earning Management**

The company's profit is also used as an indicator in the measurement of performance management and income tax expense is calculated based on the profit of the company. Therefore, it can be crucial when profits are influenced by components that can still be touched by discretion or policy management to achieve the desired income is through earnings management. Earnings management is manipulating and managing activities so that the profit according to the accounting can achieve the desired target company. One way to do earnings management is to manipulate accrual without a direct consequence of the cash flow.

Roychowdhury (2006) shown that in addition to manipulating accrual, managers also have an incentive to manipulate the real activity during the year to meet certain profit targets. Roychowdhury (2006) find consistent evidence that the manager will manipulate significant

events for them to avoid the loss annual reporting. Roychowdhury (2006) finding the evidence that the temporary discount price will boost sales, excess production is reported to lower cost of sales, and the reduction of policy discretionary to improve margins reported. Roychowdhury (2006) shown that real earnings management can reduce the value of the company, managers are more willing to manage earnings through real activity may be due to less attractive the auditor's attention or supervision of the regulator. Graham et al. (2005) of a survey conducted his research also showed that managers prefer to manage income through real activity on the economic decisions rather than accrual accounting.

Based on previous studies showed that earnings management is performed for tax purposes more refers to the accrual earnings management. This is also strengthened by the statement Hanlon and Heitzman (2010) which states that overall there is some evidence that the income tax expense carried accruals to manage earnings, such as the change of time for calculation, disclosure or other factors (eg lists of deferred tax assets that are part of the rules in the capital). The company could manage revenue through income tax expense account may change significantly. Until now the researcher has not found other studies that look at the effect of real earnings management for tax purposes. Meanwhile, according to the results of research conducted Barton and Simko (2002) also showed that the presence of the limitations of the company to improve accrual, and a company with a high degree of limitation on the accrual tend to be fewer earnings management through accrual. Companies are limited to accrual earnings management would have an incentive to switch earnings management through real activities, also known as real earnings management. Limitations of the company to be able to do through the accrual earnings management, in some studies, referred to as accounting flexibility. Barton and Simko (2002) showed the substitution between accrual earnings management to real earnings management. Limitations of the company to perform accrual earnings management will

encourage companies to tend to have more aggressive tax behavior than companies that do the real earnings management. The hypothesis 1 and 2 are as follows:

Hypothesis 1: Companies that perform real earnings management will tend to behave less aggressive tax

Hypothesis 2: Companies that perform accrual earnings management will tend to behave more aggressive tax

### **2.3. The Effect of Audit Quality on Earnings Management**

The supervision from shareholders, debt holders and regulators is required for the actions undertaken by manager opportunist through earnings management. Such oversight could be done through an audit as a form of supervision that is worth to the company and to reduce agency cost with debt holders and stockholders (Jensen and Meckling, 1976; Watts and Zimmerman, 1983). Quality audits in some studies can be used as a proxy to detect errors in the financial statements. Based on research conducted by Hirst (1994) who found that the auditor would be sensitive on earnings management and tend to concentrate on managerial incentives excess profit recording. High-quality audits will reduce taxes aggressive behavior. Thus hypothesis 3 is expressed as follows:

Hypothesis 3: Companies that have a better audit quality tends to reduce aggressive tax behavior

Research conducted by Becker et al. (1998) and Chung et al. (2005) showed that high-quality audits will limit discretionary accruals made by management. While the results of the study conducted by Cohen et al. (2008) and Zamri et al. (2013) show that companies are audited by the Big Four who has a good name and provide high-quality audits, will be less inclined to use accrual earnings management and more use of real earnings management. Causing companies that have better quality audit will switch from accrual earnings management to real earnings management in order to improve the behavior of aggressive tax. Therefore, the study suggests the hypothesis 4 and 5 as follows:

Hypothesis 4: Companies with high-quality audits will increase real earnings management influence on the behavior of aggressive tax.

Hypothesis 5: Companies with low audit quality will degrade accrual earnings management influence on the behavior of aggressive tax.

## 2.4. Research framework

Based on the conceptual framework and the development of hypotheses, the framework of the proposed research are as follows:

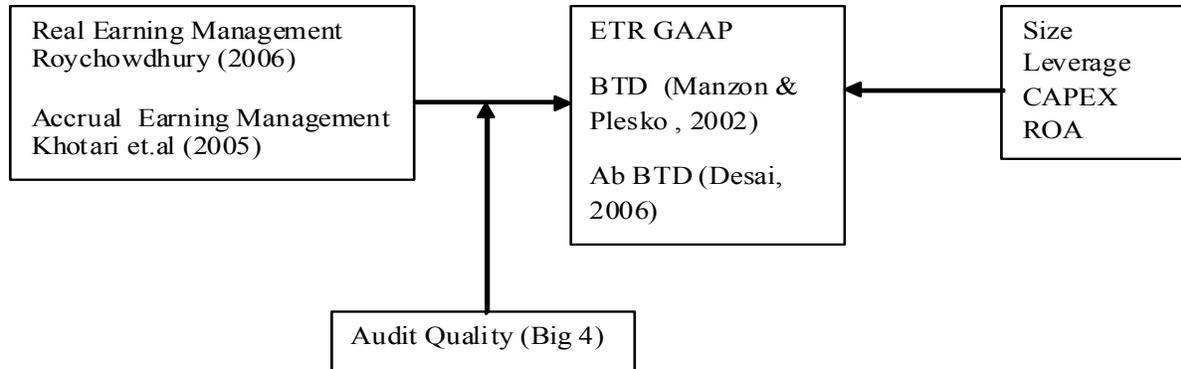


Figure 1. Research Framework

## 3. RESEARCH METHODOLOGY

### 3.1. Types and Data Sources

Types of data used are annual financial statements and annual reports of 2010 to 2013 issued by the Indonesia Stock Exchange on site [www.idx.co.id](http://www.idx.co.id) and datastream

### 3.2. Population and Sample

The population is defined as all the elements of concern in the research. The population in this research are all industries that are listed on the Indonesian Stock Exchange during the period 2010-2013. This research uses all of the industry is to look at the effect of accrual earnings management and real earnings management on the behavior of aggressive tax on every kind of different industries, therefore, to control the data used hence in this research using a dummy industry. While the reason for this study used financial data since 2010 because it is based on the Income Tax Act No. 36 of 2008 that the income tax rate is set at 25% starting from the year 2010. In order to control in this research, we used a dummy year. The sample in this study was selected based on certain criteria, the criteria used are:

1. Eliminating observations with negative sales or where the total asset value is zero or missing
2. Exclude financial institutions and the utility industry because this industry have differences in accounting rules, the operating characteristics, and debt financing
3. The fiscal year ended December 31, in this case for uniformity in the accounting period.
4. Companies that have a current income tax expense, in this case as a proxy to measure the book-tax difference, and to affirm that the company did not experience a loss in fiscal terms.
5. Companies that have relevant data in accordance with the measurement variables.

### 3.3. Operational Definition and Measurement of Variables

#### 3.3.1. Dependent variables

Aggressive tax behavior which is a dependent variable used in this research using multiple proxies tax avoidance as listed in Hanlon and Heitzman (2010) as follows:

- a.  $GAAP\ ETR = \text{Income tax} / \text{pre-tax income}$
- b. BTD is by using the measurement conducted by Manzon and Plesko (2002), the book-tax

gap for firm  $i$  in year  $t$  scaled by lagged total assets

BTD = commercial income - taxable income  
Taxable income = Current tax expense / tax rate applicable

In Indonesia based on the income tax Act 36 in 2008 upon clause 17, paragraph 1b and 2a, the corporate tax rate applicable since 2010 is 25%. But it needs to be adapted to clause 31e on the facility's gross income tax deduction, and Government Regulation No. 77 in 2013 about the reduced tax rate 5% lower the corporate tax rate in the country if it meets the criteria imposed.

- c. Abnormal BTD, developed by Desai and Dharmapala (2006) using total accruals for separating the components from the book-tax difference caused by earnings management for tax purposes. Components are then inferred to be the size of tax avoidance activity, the measurement process is as follows:

$$BT_{it} = \beta_1 TA_{it} + \mu_i + \varepsilon_{it}$$

BT = Book-tax gap for firm  $i$  in year  $t$  scaled by lagged total assets

BT = commercial income – taxable income  
Taxable income = Current tax expense / tax rate applicable

TA = Total accruals firm  $i$  in year  $t$  scaled by lagged total assets

Residuals of the regression is a component of the book-tax gap caused by earnings management for tax purposes called tax management. This value is interpreted as a measure from tax sheltering or tax avoidance and is expressed in the form:

$$TA_{it} = \mu_i + \varepsilon_{it}$$

### 3.3.2 Independent variables

This study used two independent variables as follows:

- a. Accrual Earnings Management  
Accrual earnings management using measurements developed by Kothari et al. 2005 which is a modified from Jones model (Dechow et al., 1995), as follows:

$$ACC_{it} = b_{0it} + b_{1it} (1/Asset_{it-1}) + b_{2it} (\Delta Rev_{it} - \Delta AR_{it}) + b_{3it} GPPE_{it} + b_{4it} ROA_{it} + \varepsilon_{it}$$

ACC<sub>it</sub>: Total accruals scaled by lagged total assets for the firm  $i$  in year  $t$

Asset<sub>it-1</sub>: Total assets for firm  $i$  in year  $t$

ΔRev<sub>it</sub>: Changes in income scaled by lagged total for the firm  $i$  in year  $t$

ΔAR<sub>it</sub>: Change in accounts receivable scaled by lagged total assets for the firm  $i$  in year  $t$

GPPE<sub>it</sub>: Gross property plant and equipment scaled by lagged total for the firm  $i$  in year  $t$

ROA<sub>it</sub>: Earnings before taxes were scaled by total assets last year for the firm  $i$  in year  $t$

The equation regressed cross sectional by adding dummy-industry and dummy-year as control variables. Residual from the above equation ( $\varepsilon_{it}$ ) is used as a proxy for accrual earnings management that showed discretionary accruals management

- b. Real Earning Management

The proxy used to measure Real Earnings Management (REM) using a measurement developed by Roychowdhury (2006), which estimates the normal level of business activity that real is reflected in cash flow from operations, production costs, and discretionary spending. Residual from each model is used as a proxy for REM. Consistent with previous studies (Cohen & Zarowin 2010; Zang, 2012; Ge & Kim, 2014), this study used a model to construct REM measurement that consists of three models:

- 1) To estimate the normal levels of operating cash flow

$$CFO_t/Assets_{t-1} = \alpha_0 1/Assets_{t-1} + \alpha_1 Sales_t/Assets_{t-1} + \alpha_2 \Delta Sales_t / Assets_{t-1} + \varepsilon_t$$

CFO is cash flow from operating activities; Assets are total assets; Sales are net sales; and ΔSales is the rate of change in the sales end of the year compared with the number of sales earlier in the year.

- 2) To estimate the cost of normal production

$$\text{Prod}_t / \text{Assets}_{t-1} = \alpha_0 \text{ 1/Assets}_{t-1} + \alpha_1 \text{ Sales}_t / \text{Assets}_{t-1} + \alpha_2 \Delta \text{Sales}_t / \text{Assets}_{t-1} + \alpha_3 \Delta \text{Sales}_{t-1} / \text{Assets}_{t-1} + \varepsilon_t$$

Prod is the amount cost of goods sold and inventory changes.

3) To estimate the normal level of discretionary costs.

$$\text{DisExp}_t / \text{Assets}_{t-1} = \alpha_0 \text{ 1/Assets}_{t-1} + \alpha_1 \text{ Sales}_{t-1} / \text{Assets}_{t-1} + \varepsilon_t$$

DisExp is a discretionary expense is measured from the sum of the advertising expenses, R&D expences, sales expenses and general and administrative expenses.

Residuals of the regression result describing the activities of real earnings management. From the results of the residuals of the investigator multiplying the residuals of the model for measuring Ab\_CFO and ab\_DisExp to -1, so that a higher value indicates a higher probability of making real decisions to increase revenue (Cohen & Zarowin 2010; Zang, 2012; Ge & Kim, 2014 ). Whereas for the residual of the model ab\_Prod not multiplied by -1 because of higher production costs is an indication of the excess to reduce the cost of goods sold. To capture the effects of earnings management through all three of these activities in a comprehensive measure, we build the whole proxy REM by summing the standardization Ab\_CFO, Ab\_Prod, and Ab\_Dexp.

### 3.3.3 Moderating Variables

The proxy of audit quality in this study used the Big 4 as dummy variables, ie one for companies audited by the Big 4 and 0 otherwise. Four largest public accounting firms ie KPMG, Ernst & Young, Deloitte, and PWC, where they that having a good name, so it has a higher quality audit.

### 3.3.4 Control Variables

This study uses several control variables. Based on the literature review, there are several variables that can influence the aggressive tax behavior.

- Size, as measured using the natural logarithm of the total assets of the firm i in year t. From the results of previous studies (Mill et al., 1998; Rego, 2003; Dryeng et al., 2008; and Chen et al., 2010) showed that the size of the company has a diverse effect on the behavior of aggressive tax.
- Leverage, measured using the total debt divided by total equity. Taxes affect the capital structure through a tax deduction on interest expense paid. It is one of the reasons used by companies to raise capital by issuing debt (Graham, 2003). It can be concluded that the leverage can increase aggressive tax behavior
- Capital Expenditure, that measured by using the total capital expenditure scaled by total assets. Capital incentives in the industry led to lower ETR for their incentive to undertake new investment, this means that capital expenditure may improve the behavior of aggressive tax (Armstrong et al., 2011; Dryeng et al., 2008; Mills et al., 1998)
- ROA, measured on the profit before tax divided by total assets. Dryeng et al. (2008) found that small companies with a high growth rate will have higher ETR. Also according to Rego (2003) and Chen et al. (2010) showed that the probability that a company can influence tax avoidance.

### 3.4. Research Model and Hypothesis Formulation

In this research, there is three research model to test the hypothesis, ie. a major research model and two additional research models that test the influence of each real earnings management and accrual earnings management on the behavior of aggressive tax. Here attached research model tested:

#### The Main Research Model

$$\text{Aggressive Tax} = \beta_0 + \beta_1 \text{ REM}_{it} + \beta_2 \text{ AEM}_{it} + \beta_3 \text{ AUD}_{it} + \beta_4 \text{ REM}_{it} * \text{AUD}_{it} + \beta_5 \text{ AEM}_{it} * \text{AUD}_{it} + \beta_6 \text{ SIZE}_{it} + \beta_7 \text{ LEV}_{it} + \beta_8 \text{ CAPEX}_{it} + \beta_9 \text{ ROA}_{it} + \text{Ind Dummies} + \text{Year Dummies} + \varepsilon_{it}$$

**Additional Tests for REM**  
 Aggressive Tax =  $\beta_0 + \beta_1 \text{ABCFO}_{it} + \beta_2 \text{ABPROD}_{it} + \beta_3 \text{ABDISEXP}_{it} + \beta_4 \text{AUD}_{it} + \beta_5 \text{ABCFO}_{it} * \text{AUD}_{it} + \beta_6 \text{ABPROD}_{it} * \text{AUD}_{it} + \beta_7 \text{ABDISEXP}_{it} * \text{AUD}_{it} + \beta_8 \text{SIZE}_{it} + \beta_9 \text{LEV}_{it} + \beta_{10} \text{CAPEX}_{it} + \beta_{11} \text{ROA}_{it} + \text{Ind Dummies} + \text{Year Dummies} + \epsilon_{it}$

**Additional Tests for AEM**  
 Aggressive Tax =  $\beta_0 + \beta_1 \text{AEM}_{it} + \beta_2 \text{AUD}_{it} + \beta_3 \text{AEM}_{it} * \text{AUD}_{it} * \text{DummyAEM}_{it} + \beta_4 \text{SIZE}_{it} + \beta_5 \text{LEV}_{it} + \beta_6 \text{CAPEX}_{it} + \beta_7 \text{ROA}_{it} + \text{Ind Dummies} + \text{Year Dummies} + \epsilon_{it}$

**Figure 2.** Research model

- Aggressive Tax = ETR GAAP, and Abnormal BTD
- REM = Real earnings management by measurement (Roychowdhury (2006))
- AbCFO = Real earnings management based on operating cash flow, measurement (Roychowdhury (2006))
- AbPROD = Real earnings management based on the cost of production, measurement (Roychowdhury (2006))
- AbDisExp = Real earnings management based on the cost diskresionary, measurement (Roychowdhury (2006))
- AEM = Accrual earnings management by measurement

- DummyAUD = Dummy for accrual earnings management of measurement by Khotari et al. (2005), which is 1 for positive discretionary accrual (increase of earnings management) and 0 otherwise.
- AUD = Quality auditor, dummy variable 1 for big 4 auditor, and 0 otherwise
- Size = Natural logarithm of total assets
- Lev = Total debt divided by total equity
- CAPEX = Capital expenditures divided by total assets

**3.5. Analysis Techniques**

The analysis technique used in this research is descriptive quantitative and regression analysis on panel data to examine the effect of real earnings management and accrual earnings management toward the tax aggressive behavior. Analyses were performed used eview and SPSS.

**4. RESULT AND DISCUSSIONS**

**4.1. General Description of Research Samples**

The samples in this research are all public companies listed on the Indonesia Stock Exchange period 2010 until 2013. The financial data in the form of Annual Financial Statements and Annual Reports obtained from site [www.idx.co.id](http://www.idx.co.id). It also uses the company's financial statements are available from the datastream.

**Table 1:** Sample Selection Research

	number of observations
Public company registered in the period 2010 – 2013	503
Sectors of the financial industry	(84)
Sectors of the utilities industry	(51)
Companies that do not have financial statements from 2010-2013	(81)
Companies that do not have current tax expense	(72)
Outliers data	(6)
Final sample companies	209
Samples final firm-year (4-years)	836

Source: Data processed April 2015

Table 1 shows that there are 503 companies with nine industrial sectors from 2010-2013 listed in Indonesia stock Exchange. This research did not use the financial and insurance industry sector (sector 8) consists from 84 companies, and utility sector (sector 7) consists of 51 companies. This research uses panel data, the companies that do not have a complete financial statement for the period from 2010 to 2013 were excluded from the sample, which comprises 81 companies. There were 72 companies that do not have a current income tax expense as a proxy that is used to

measure the book-tax differences (Manzon and Plesko, 2002) were excluded from the sample. There are 6 companies as outliers were excluded from the sample. The final data used in this study was 209 companies or 836 firms-year.

#### 4.2. Descriptive Statistics and Correlations

Descriptive statistical measurements in this research are intended to facilitate observation by calculating mean, median, minimum value, the maximum value and standard deviation. Descriptive statistics of the variables used are presented in Table 2.

**Table 2:** Descriptive Statistics

	N	Mean	Median	Maximum	Minimum	Std. Dev.
ETRGAAP	836	0.24613	0.24943	6.59948	-7.24601	0.50902
BTD	836	-0.00987	-0.00815	0.76577	-0.85962	0.07459
ABBTB	836	0.00404	0.00516	0.51966	-0.64962	0.06714
REM	836	0.04109	0.22966	9.48789	-10.90186	2.07871
ABCFO	836	-0.01515	0.02815	3.73617	-4.55320	0.73690
ABPROD	836	0.02641	0.09339	5.01225	-7.66818	0.90825
ABDISEXP	836	0.02983	0.11927	3.47615	-5.82314	0.87571
AEM	836	-0.00185	-0.01068	1.02057	-0.81052	0.12622
DUMMYAEM	836	0.43660	0.00000	1.00000	0.00000	0.49626
AUD	836	0.44258	0.00000	1.00000	0.00000	0.49699
SIZE	836	9.28824	9.30186	11.32532	6.12579	0.70023
LEV	836	0.62111	0.36669	28.34166	-8.83327	1.41832
CAPEX	836	0.05930	0.03965	0.37885	0.00000	0.06017
ROA	836	0.12673	0.09538	1.22233	-0.81215	0.14819

Source: Data processed April 2015

The dependent variable, on the proxy aggressive tax behavior indicates ETRGAAP, BTD and AbBTD has a mean value smaller than

the median value, which means that the behavior of aggressive tax for the three proxies that performed relatively larger. It can also be seen in

the proxy BTD where the mean (median) amounted -0.00987 (-0.00815) which shows that on average in the study sample have taxable income greater than commercial income. Similarly for the independent variables on real earnings management and accrual earnings management also showed a mean value smaller

than the median value, which means that companies tend to manage earnings for both real and accrual. While for the dummy variables on audit quality which showed a mean value greater than the median, which means less than half of the study sample are audited by the Big Four.

**Table 3: Correlation**

	ET R GAA P	BTD	ABBT D	REM	AB CFO	AB PRO D	ABD IS EXP	AE M	DU MM Y AEM	AUD	SIZE	LEV	CAPE X	RO A
ETR GAAP	1	- .044	-.046	.027	.017	.046	.002	.041	.007	.054	-.021	- .073 *	.012	.006
BTD	-.044	1	.927 **	-.049	-.060	-	-.027	.283 **	.068	-	-	-.098 *	-.033	.358 **
ABBT D	-.046	.927 **	1	-	-	-	-.050	.002	-	-.044	-.072 *	-	.059	.359 **
REM	.027	-.049	-.170 **	1	.709 *	.929 **	.814 *	.471 **	.354 *	-	.007	.172 *	-	-.539 **
ABCFO	.017	-.060	-.279 **	.709 **	1	.566 **	.254 *	.776 **	.606 *	-	-.007	.189 *	-	-.561 **
ABPROD	.046	-.038	-.115 **	.929 **	.566 *	1	.692 *	.344 **	.237 *	-	.022	.144 *	-	-.510 **
ABDIS EXP	.002	-.027	-.050	.814 **	.254 *	.692 **	1	.109 **	.084 *	-	.001	.101 *	-	-.280 **
AEM	.041	.283 **	.002	.471 **	.776 *	.344 **	.109 *	1	.674 *	-.036	.014	.115 *	-	-.039
DUMMYA EM	.007	.068	-.108 **	.354 **	.606 *	.237 **	.084 *	.674 **	1	-.041	.041	.104 *	-.066	-.098 **
AUD	.054	-.096 **	-.044	-.172 **	-.154 *	-.159 **	-.113 *	-.036	-.041	1	.411 **	.028	.153 **	.282 **
SIZE	-.021	-.110 **	-.072 *	.007	-.007	.022	.001	.014	.041	.411 *	1	.095 *	.179 **	.082 *
LEV	-.073 *	-.098 **	-.096 **	.172 **	.189 *	.144 **	.101 *	.115 **	.104 *	.028	.095 **	1	.077 *	-.158 **
CAPEX	.012	-.033	.059	-.222 **	-.211 *	-.190 **	-.151 *	-.117 **	-.066	.153 *	.179 **	.077 *	1	.158 **
ROA	.006	.358 **	.359 **	-.539 **	-.561 *	-.510 **	-.280 *	-.039	-.098 *	.282 *	.082 *	-.158 *	.158 **	1

\*\* . Correlation is significant at the 0:01 level (2-tailed).

\* . Correlation is significant at the 0:05 level (2-tailed).

Correlation analysis between the variables attached in Table 3. ETRGAAP proxy for the behavior of aggressive tax showed 5% significant negative correlation with leverage. These results are consistent with previous studies that the company would be likely to conduct aggressive tax behavior by increasing the amount of debt in the capital structure. BTD proxy for the behavior of aggressive tax showed 1% significant positive correlation with Accrual Earnings Management (AEM), according to the second hypothesis in this study that companies that conduct AEM are likely to behave in aggressive tax. Quality audit 1% significantly negatively correlated with BTD which shows that the higher audit quality would further reduce aggressive tax behavior. Proxy for the aggressive tax behavior , ie AbBTD shows REM (Real Earning Management) significantly negative 1% in accordance with the hypothesis 1, that

companies that perform real earnings management activities would less aggressive tax behavior. The component of REM have 1% negative significant effect to AbBTD is AbCFO and AbPROD. Control variable such as size, leverage and ROA shows a significant correlation with BTD and AbBTD proxy in accordance with the direction of the previous research.

### **4.3. Empirical Test of Hypothesis**

An empirical test of the hypothesis can be seen in table 4 From the three proxy of aggressive tax behavior indicates that the value F-statistics for ETRGAAP is significant at 10%, and the value F-statistics for BTD and AbBTD shows significant at 1%. These results indicate that the proxy ETRGAAP weaker in the research model than the other two models of research (ie BTD and AbBTD).

Table 4: Research Model

dependent Variables	prediction	Model 1 ETRGAAP		Prediction	Model 2 BTD		Model 3 ABTBD	
		Coefficient	Probability		Coefficient	probability	Coefficient	Probability
Intercept	?	0.70604	0.00760		0.04172	0.11415	0.02848	0.20400
REM	H1 (+)	0.00853	0.30575	H1 (-)	-0.00287	0.07595 *	-0.00371	0.03130 **
AEM	H2 (-)	-0.01565	0.46875	H2 (+)	0.22746	0.00000 ***	0.05667	0.00840 ***
AUD	H3 (+)	0.08427	0.02515 **	H3 (-)	-0.01790	0.00025 ***	-0.01693	0.00045 ***
REM * AUD	H4 (-)	-0.00456	0.41210	H4 (+)	0.01287	0.00000 ***	0.01261	0.00000 ***
AEM * AUD	H5 (+)	0.60512	0.04120 **	H5 (-)	-0.20919	0.00000 ***	-0.19902	0.00000 ***
SIZE	+/-	-0.04849	0.05200 *	+/-	-0.00945	0.00409 ***	-0.00576	0.05165 *
LEV	-	-0.03356	0.00465 ***	+	-0.00182	0.11850	-0.00163	0.14295
CAPEX	-	0.27311	0.19065	+	0.01355	0.35785	0.03936	0.14360
ROA	+/-	-0.04199	0.39805	+/-	0.26095	0.00000 ***	0.21299	0.00000 ***
Dummy Ind		Include			include		Include	
Dummy Year		Include			include		Include	
N		836			836		836	
adj R2		0.01234			0.34608		0.20224	
F-Statistics		1.57978			25.55096		12.76019	
p value (F- Stat)		0.05871 *			0.0000** *		0.0000** *	

In eviews *p-value* of t-statistic for the hypothesis one direction divided by two. Number in parentheses are *p-value* of t-statistic and F-statistics, where significant \*\*\* 1%, \*\* significant 5%, and \* significant 10%

Model 1 shows that AUD has a significant positive effect at 5% with ETRGAAP, which means that hypothesis 3 can be accepted. Audits Quality will reduce aggressive tax behavior in a company. Moderation of audit quality with accrual earnings management also showed the positive significant effect at 5% with ETRGAAP, accepted the hypothesis 5, which means that companies audited by the Big Four will likely have limited to make accrual earnings management causing ETR will be larger. For the control variables, SIZE and LEV showed significant gains against ETRGAAP with directions in accordance with previous studies.

Models 2 and 3 show all main variables on the hypothesis 1 to hypothesis 5 significant at 1% and 10%, conform prediction research directions, which means all hypothesis at model

BTD and AbTBD is acceptable. These results provide evidence of the accounting flexibility for Real Earnings Management (REM) and Accrual Earnings Management (AEM) on aggressive tax behavior, where a company that does REM will be less aggressive tax behavior than companies that do AEM. Because there is no limitation of the company to conduct AEM, so that companies that do AEM will likely behave in aggressive tax. Conversely when the quality of audits increased with an audit conducted by the Big Four causes of the limited company doing accrual earnings management, so the company will switch to REM. These results contributed to the earnings management behavior that can substitute on real earnings management and accrual earnings management toward the aggressive tax behavior.

#### 4.4. Additional Empirical Test

For strengthening the research results conducted additional testing with separate test each independent variable on REM and AEM to aggressive tax behavior. REM variables using its components namely AbCFO, AbPROD and AbDisexp. While AEM variables using dummy

variables, 1 for companies doing positive discretionary accruals and 0 for companies doing negative discretionary accrual. The result can be seen in table 4.5 and 4.6. F-statistic for all models is identical to the main results, where the F-statistic for the proxy ETRGAAP much lower than the F-statistics for proxy BTD and AbBTD.

**Table 5:** Additional Tests for REM

dependent Variables	prediction	Model 1 ETRGAAP		Prediction	Model 2 BTD		Model 3 ABBTD	
		Coefficient	probability		Coefficient	probability	Coefficient	Probability
Intercept	?	0.68189	0.01000	?	0.01948	0.29060	0.01056	0.37830
ABCFO	H1 (+)	-0.01967	0.31575	H1 (-)	0.01458	0.00165 ***	-0.02129	0.00000 ***
ABPROD	H1 (+)	0.04976	0.09975 *	H1 (-)	0.00543	0.12285	0.00425	0.17315
ABDISEXP	H1 (+)	-0.02173	0.30295	H1 (-)	0.00637	0.10520	0.00519	0.14475
AUD	H3 (+)	0.08028	0.03160 **	H3 (-)	-0.02063	0.00005 ***	-0.02007	0.00005 ***
ABCFO *	H4 (-)	0.03045	0.32190	H4 (+)	0.01384	0.04100 **	0.01074	0.08075 *
AUD	H4 (-)	0.06734	0.18720	H4 (+)	0.03846	0.00000 ***	0.03950	0.00000 ***
ABPROD *	H4 (-)	-0.03935	0.26200	H4 (+)	-0.02833	0.00010 ***	-0.02738	0.00005 ***
ABDISEXP *	H4 (-)	-0.04696	0.05915 *	+/-	-0.00891	0.00710 ***	-0.00388	0.13390
AUD	-	-0.03237	0.00615 ***	+	-0.00146	0.17460	-0.00123	0.20605
SIZE	+/-	0.22510	0.23660	+	0.02747	0.23415	0.02872	0.21580
LEV	-	0.08828	0.30250	+/-	0.39218	0.00000 ***	0.23935	0.00000 ***
CAPEX	+/-	Include			include		Include	
ROA		Include			include		Include	
Dummy In d		836			836		836	
dummy Year		0.01116			0.32894		0.23004	
N		1.47096			21.46463		13.47355	
adj R2		0.083552			0.00000 ***		0.00000 ***	
F-Statistics		*						
p value (F-Stat)								

In views *p-value* of t-statistic for the hypothesis one direction divided by two. Number in parentheses are *p-value* of t-statistic and F-statistics, where significant \*\*\* 1%, \*\* significant 5%, and \* significant 10%

Table 5 which examine the effect of REM components towards aggressive tax behavior was just testing for hypothesis 1, 3 and 4. The results show AbProd significant positive at 10% towards ETRGAAP, hypothesis 1 is accepted. Audit quality is significantly positive at 5% towards ETRGAAP. This suggests that REM component that influence in model ETRGAAP is

AbProd. For models 2 and 3, accepted hypothesis is the hypothesis 3 and 4. Hypothesis 4 for REM components have a significant effect is AbCFO and ABProd. This suggests that REM component will aggressive tax behavior when audit quality increase is related to cash flow and production costs.

Table 6 examines the effect of companies that do positive discretionary accruals towards aggressive tax behavior only test the hypothesis 2, 3 and 5. The results showed accept the hypothesis 5. Companies that perform positive

discretionary accruals, when the audit quality increases, would reduce taxes aggressive behavior. These results are consistent with three proxies aggressive tax behavior.

**Table 6:** Additional Tests for AEM

dependent Variables	prediction	ETRGAAP		prediction	BTD		ABBTD	
		Coefficient	probability		Coefficient	probability	Coefficient	Probability
Intercept	?	0.69093	0.00840	?	0.04171	0.11705	0.02935	0.19965
AEM	H2 (-)	-	0.45150	H2 (+)	0.22862	0.00000 ***	0.04984	0.00580 ***
AUD	H3 (+)	0.02970	0.25975	H3 (-)	-0.00839	0.06720 *	-0.00816	0.07145 *
AEM * AUD *	H5 (+)	1.29759	0.00090 ***	H5 (-)	-0.21069	0.00000 ***	-0.18715	0.00010 ***
DUMMYAEM								
SIZE	+/-	-	0.06675 *	+/-	-0.00957	0.00380 ***	-0.00609	0.0435 **
LEV	-	-	0.00235 ***	+	-0.00079	0.30725	-0.00071	0.32270
CAPEX	-	0.23320	0.22280	+	0.00800	0.41465	0.03763	0.15380
ROA	+/-	-	0.17760	+/-	0.23289	0.00000 ***	0.19205	0.00000 ***
dummy Industry		Include			Include		Include	
dummy Year		Include			Include		Include	
N		836			836		836	
adj R2		0.02167			0.32827		0.18162	
F-Statistics		2.15580			26.50396		12.58185	
p value (F-Stat)		0.00531 ***			0.00000 ***		0.00000 ***	

In views *p-value* of t-statistic for the hypothesis one direction divided by two. Number in parentheses are *p-value* of t-statistic and F-statistics, where significant \*\*\* 1%, \*\* significant 5%, and \* significant 10%

## 5. CONCLUSION

This research aimed to examine the effect of real earnings management and accrual earnings management towards aggressive tax behavior, and investigate the role of quality audit on the relationship of real earnings management and accrual earnings management to aggressive tax behavior. The study was conducted on companies listed in Indonesia Stock Exchange during the period 2010 to 2013, with a total of

209 company, 836 firms-year observations. The analysis was performed with panel data. The results showed consistent with all hypothesis, companies that perform REM will be less aggressive tax behavior than companies that perform AEM. Because there is no limitation of the company to conduct AEM, so that companies that perform AEM will likely behave aggressive tax. Conversely when the quality of audits increased with an audit conducted by the Big Four causes of the limited company doing

accrual earnings management, so the company will switch to REM. These results contributed to the earnings management behavior that can substitute on real earnings management and accrual earnings management toward the aggressive tax behavior.

Additional tests on variables of REM components and dummy AEM shows that the REM components consistently affect the behavior of aggressive tax when the quality audit increases are AbCFO and AbProd. Dummy variable AEM shows that the companies are performing positive discretionary accruals when audit quality increased will be limited to accrual earnings management, so that tend to be less aggressive tax behavior. This research has limitations, especially for the proxy of aggressive tax behavior on ETRGAAP which showed low F-statistic. It can be developed for future research by using proxy aggressive tax behavior more appropriate to reflect the ETR.

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## **TAX AMNESTY: “TERROR” OR SAVIOR?**

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### ***ABSTRACT***

*Tax amnesty is one of the steps which are taken by the Indonesian government to increase revenue from tax sector. Basically, the application of this policy aims to improve taxpayer compliance and to save the country by securing cash receipts taxpayer assets that had been taken out of the country to avoid taxes. However, many people who think that the tax amnesty is unfair and protecting tax offenders. Thus, the purpose of the study is to reveal the factors that relate individual taxpayers to follow tax amnesty program through the Theory of Planned Behavior viewpoint. This study is a qualitative research with interpretive paradigms and phenomenology approach. Informants in this study are individual taxpayers who follows the tax amnesty and registered in LTO of Samarinda. Data is obtained from open interviews with informant related their views and the reason why they followed the tax amnesty. The results of this study indicate that factors relate individual taxpayers to follow tax amnesty based on the Theory of Planned Behavior consists tax justice, tax morale, social environment, trust, low tax audit, and high tax fines. Interestingly, the additional finding of the study is mostly informants felt forced to follow the tax amnesty. The study concluded that if the tax amnesty is not accompanied by the tax reform, it will cause injustice to the taxpayers and will decrease the trust of taxpayers on government performance. This study will contributes to the DGT of Indonesia in order to formulate better tax policy in the future.*

**Keywords:** *tax amnesty, taxpayer compliance, theory of planned behavior, phenomenology*

### **INTRODUCTION**

Tax is the main source of revenue in the structure of the State Budget (APBN). In order

to ensure that national development continues over time, the government and the Directorate General of Taxation (DGT) should pursue the

target of tax revenue that is always rising every year. The government is targeting revenues in the state budget in 2016 amounted to Rp. 1822.5 billion, revenues from taxes amounting to Rp. 1546.7 trillion and non-tax receipts amounting to Rp. 273.8 trillion. However, acceptance until May 2016, only reached Rp. 364.1 trillion, or just new to approximately 26.8 percent of the government's target.

Indonesia's tax ratio in 2015 reached 10.8%, still lower than other ASEAN countries, even compared to the tax rate in 2014 amounted to 11.9% (<http://www.kemenkeu.go.id/>). Factors that lead to low tax ratio is due to the difference in interest between the tax authorities and the taxpayer. Tax authorities have an interest to raise taxes as much as possible, while the taxpayer has an interest to pay taxes to a minimum. The taxpayer will be making every effort to be able to avoid the tax burden is too great. Low transparency of reporting circulation of business, property and income of the taxpayer, and not maximal level of efficiency of tax administration also contribute to the low tax ratio in Indonesia (Zainie, 2001: 31-34).

To be able to dig the state revenue from the tax sector real efforts are needed, as well as the implementation in the form of government policy. Such efforts may include intensification and extension of tax (Ragimun, 2012). Intensification of tax can be done by increasing the number of registered taxpayers and increase tax revenues, while tax extension can be done by expanding the tax object that has not been explored to date. One of the policies that can be

considered to increase enrollment and tax compliance is a tax amnesty.

Tax amnesty is not new in the taxation policy in Indonesia. The Indonesian government implements the first tax amnesty in 1984. However, this policy does not run as expected due to the lack of response from the taxpayer and the lack of reform of the tax administration system as a whole. Besides, the role of the tax sector in the state budget system is still functioning as a complement because at that time the reception state dominated by the export of oil and gas, so there is no serious effort of the government at that time.

This year tax amnesty policy targeting the redemption of taxpayer assets both inside and outside the country who have not been reported in the tax return. With the enactment of tax amnesty is expected that taxpayers will be aware to be able to pull their assets invested abroad to Indonesia so that it can help the economy in Indonesia that are declining. Although the law enforcement tax amnesty period applies only six months in 2016, the government expects revenue scooped from the policy reaches Rp. 165trillion (<https://m.tempo.co>).

According to the DGT ransom taxes collected until the first wave of implementation of tax amnesty to more than 80 trillion rupiah. Tax amnesty participants for the first wave was dominated by individual taxpayers. This achievement can be said to be a remarkable achievement, even when compared to the tax amnesty in another country.

However, if the taxpayer enthusiasm in following the tax amnesty could increase taxpayer compliance? It is still uncertain as most in the implementation of tax policy implementation even cause new problems (Devos, 2012). These problems arise when implementing tax policy does not match the expectations of the taxpayer (Bayer et al., 2014). Therefore, the government should be able to know the expectations of the taxpayer if it wants tax amnesty policy can be implemented well and improve taxpayer compliance in the future.

Tax compliance plays an important role to achieve the tax revenue target. According to the Theory of Planned Behavior (TPB), the behavior displayed by individuals arise because of their intention to behave is determined by three determining factors, namely behavioral beliefs, normative beliefs, and control beliefs (Ajzen, 1991). TPB Model can be used to give a full explanation of the factors that can influence the behavior of taxpayers to meet their tax obligations.

This study aims to determine the factors that influence the behavior of individual taxpayers (WPOP) to follow the tax amnesty program in the context of tax compliance. In order to get the full picture and depth, this study will use the phenomenological method to conduct intensive interviews with taxpayers who have been following the tax amnesty program. From the results of these interviews will be drawn a thread that will unravel the factors that influence the behavior of individual taxpayers in the context of the theory of planned behavior (TPB).

Several previous studies have examined the factors that influence taxpayer compliance and what factors influence the decision of taxpayers to follow tax amnesty. The study including research Andreoni (1991), Torgler et al., (2003), Ritsema et al., (2003), Rechberger et al., (2010), Marchese (2014), Bayer et al., (2014), Nar (2015), and Mouloud (2015). The difference this study with previous research is the study using an individual taxpayer who follows the tax amnesty as a respondent and conducted when the tax amnesty is still ongoing. Individual taxpayers used as respondents to be able to know more deeply what factors influence taxpayer in making tax decisions. Therefore, the motivation of this study is to uncover what factors relate taxpayers to follow tax amnesty in the context of increasing taxpayer compliance.

## **LITERATURE REVIEW**

### **Tax Amnesty**

Tax Amnesty (tax forgiveness) is the government's efforts to generate tax revenue that has not or poorly paid, in addition to improving adherence to pay taxes because of increasingly effective supervision as more accurate information about the list of taxpayer wealth (Hutagaol, 2007).

Type Tax Amnesty (remission of taxes), consisting of, first, filling amnesty, is forgiveness given by abolishing penalties for taxpayers who are registered but never fill SPT (non-filers), forgiveness granted if they want to begin to fill the SPT, second, record-keeping amnesty, is provides for sanctions for failure to

maintain the tax documents in the past, forgiveness granted if the taxpayer to the next can maintain their tax documents, third, revision amnesty, is an opportunity to improve returns in the past without the sanction or sanctions given reduction. Forgiveness allows the taxpayer to fix her tax return earlier (which causes the accrued tax) and pay taxes that are not (missing) or unpaid (outstanding). Taxpayers will not automatically immune to inspection and investigation actions, forth, investigation amnesty, is forgiveness will not investigate promising source of income reported in certain years and there are a number of "money forgiveness" (amnesty fee) to be paid. Forgiveness of this type are also promising for the investigation would not action against the source of income or the amount of actual income. Forgiveness is often known as forgiveness closely with laundering (laundering amnesty), fifth, prosecution amnesty, is forgiveness which provides for criminal offenses for taxpayers who violate the law, sanctions eliminated by paying compensation (Farida & Prawira, 2015)

### **Deterrence Theory**

Deterrence theory is a theory that explains the behavior of a person based on that person paradigm of the benefits, costs, and risks of each selected action. This theory was developed by Allingham- Sandmo (1972) and Yitzhaki (1974). There are differences between the models of deterrence theory Yitzhaki (1974) with the

traditional model developed by Allingham-Sandmo (1972). The differences found in the application of severe sanctions more to find the behavior of tax evasion (tax evasion) by reducing the tax burden should instead disclosure of income that is not true. Model theory of prevention of Yitzhaki (1974) is more accurate in describing what happened to the taxpayer. Purposes of taxpayers depending on their level of income of each taxpayer and the income that is hidden from tax authorities.

Theory Allingham- Sandmo (1972) and Yitzhaki (1974) assumes that such a high level of non-compliance when viewed from an economic standpoint. Behavior taxpayer based on a desire to maximize expected utility. This theory believes that no individuals or taxpayers are willing to pay taxes voluntarily (voluntary compliance). Fundamentally believed that tax evasion depends inversely on the possible sanctions and the magnitude of the sanctions imposed. Equity in earnings of smuggled decreased with increasing fines and penalties. The point of this theory simply laid on the shoulders of tax compliance of taxpayers, while the behavior of the tax authorities (tax authorities) ignored altogether, whereas in practice the behavior of taxpayer compliance is directly proportional to how tax authorities treat them (Yitzhaki, 1974).

The theoretical analysis of this model indicates that by increasing the possibility of audits and penalties heavy taxes can increase tax compliance. This theory also predicts a positive relationship between rates of sanctions by the

level of taxpayer compliance. Besides this theoretical model can predict the magnitude of the tax rate by assuming that the taxpayer show signs of a significant reduction of tax avoidance behavior and the assumption that the increase in tax rates will also increase the exists of taxpayer compliance.

### **Theory of Planned Behavior (TPB)**

Theory of Planned Behavior is one model of social psychology is most often used to predict behavior. The analytical tool used in this study was developed by Ajzen (1991). TPB model is used to examine the behavior more specific, ie it can be used to analyze the behavior associated obedient or not the taxpayer to the tax provisions. Based on the model of TPB in Ajzen (1991), can be explained that the compliance behavior of individual to the tax provisions is influenced by intention (intention) to behave adherent or non-adherent. Intention to behave is influenced by three factors, the first is behavioral belief, that belief will be the result of a behavior (outcome belief) and the evaluation of the results of such behavior. Confidence and evaluate the results of this will form the variable attitude toward the behavior. Next are normative belief, the belief of the individual against the normative expectations of others that reference, such as family, friends, and tax consultants, and motivation to achieve these expectations. This normative expectations form the variables on a subjective norm of behavior. The third is a control belief, that an individual's belief about the existence of the things that support or inhibit

behavior and perception of how strong these things relate their behavior. Control variables belief formed perceived behavioral control.

Several previous studies conducted research after the event or after the tax amnesty was conducted to determine the effect of tax amnesty to tax compliance and economic growth. As research conducted by Orrenius & Zavodny (2012), Agbonika (2015) who studied the effect of related tax amnesty on tax compliance and economic growth. Their results found that when the tax amnesty is not followed by tax policy reforms and increased probability of detection will decrease the tax compliance and taxpayer confidence in the government may even increase the occurrence of tax evasion because the taxpayer was not satisfied. Other studies have revealed several factors that can relate taxpayers to follow tax amnesty include justice (Rechberger et al., 2010), socialization, periods and cultures (Torgler et al., 2003), the pressure and increasing the probability of detection (Leonard & Zeckhauser, 1987), moral (Ritsema et al., 2003), the government's commitment, trust and political taxpayer (Marchese, 2014), tax risk and moral hazard (Andreoni, 1991), and voluntary tax compliance (Nar, 2015).

### **DATA AND RESEARCH METHOD**

Related to the purpose of this research to uncover what factors influence the behavior of an individual taxpayer associated with their participation in the tax amnesty program will be analyzed using the TPB. In contrast to some previous studies, this study tried to find out in more detail the behavior of taxpayers by using

qualitative method with phenomenological approach and paradigm interpretive. Phenomenological study assumes that every individual experiences a phenomenon with his consciousness, while the interpretive paradigm is used to understand resource on experience and their perception of direct interviews (Indrianto & Supomo, 2013: 12; Moleong, 2011: 6).

The informant involved in this study is an individual taxpayer who follows the tax amnesty program. Informants for the research sample consisted of some professions such as merchants, online merchants, civil servants, managers, and entrepreneurs. The data used in this study is the result of an open interview with the informants. Furthermore interview data will be processed and analyzed using the TPB to address issues that have been formulated previously.

## **DISCUSSIONS AND ANALYSIS**

### **Tax Amnesty “Terror” Us ?!**

Nothing is certain in addition to taxes and death in this world. Every citizen is required to pay the tax, even since I was in the womb. In effect, the tax is a burden to all taxpayers, both individuals and entities. So normally there is no one taxpayers to voluntarily to pay taxes. But because the tax is a levy that is mandatory, then in fact the state does not require the "willingness of the taxpayer", all it takes is obedience. Damayanti (2012) revealed that the self-assessment system that was developed in Indonesia implies higher dependency of tax revenue to the taxpayer compliance. This system

full gives credence to taxpayers to actively enforce reviews their tax obligations.

Self-assessment system this can be exploited by the taxpayer as a loophole for tax evasion. It is certainly not in line with the spirit that created in the self assessment system Because the system's emphasis on self-awareness of the taxpayers to create voluntary compliance. Because through the self-assessment system, since register for a TIN up to report and pay taxes into the voluntary compliance, which are based on intent, awareness and honesty of taxpayers to implement them.

Evaluating the economic behaviors in terms of psychology was considered as irrational at the beginning and this situation was rejected by many Also economics (Nar, 2015). However, "the concept of psychology" has a special importance within social studies. Torgler et al., (2002) disagrees that individuals are identified within the concept of "homo economicus" and points out the emotional dimension of the topic. According to Kirchler (2007), this situation is related to psychological perception because psychological factors are the foremost elements directing economic attitudes and behaviors.

As it is known that the tax amnesty is needed to get immediate income. Actual tax amnesty can improve taxpayer compliance in the future if coupled with a good commitment from the government. Several studies have shown that increasing the threat of tax can increase the participation of taxpayers to follow government policy. But most of the way only improve adherence while even actually increase tax

evasion.

In relation to tax compliance, attitude is the perspective of compliance in the tax system (Damayanti, 2012). Edlund (1999) stated that the attitude or perspective on taxes Refers to how social groups would appreciate or even be the opposition to the existing tax system. This study focused on the informants who follow the tax amnesty. Taxpayers who used informants consists of several professions. Some informants felt compelled to follow this tax amnesty. It is apparent from the statement given by one of the informants, Mr. F (traders):

*"I afraid of the sanction if I'm not follow tax amnesty, so I chose to report my assets as soon as possible in order to get the smallest ransom"*

From the above statement, it appears that the tax penalties makes one think more in making decisions. Alm et al., (1990) stated that given the percentage of tax returns that are audited and the penalties that are imposed on audited tax returns, tax payers would have to exhibit risk aversion far in excess of anything ever observed for compliance predicted by expected utility. Prior research supports that the threat of penalties is indirectly related to the noncompliance decision (Schwartz & Orleans 1967). Avoidance of penalties could be a reason for coming forward during an amnesty (Ritsema et al., 2003).

The behavior shown as constituted by the pressure of sanctions can lead to a negative or positive depending on the perceptions and expectations of the individual behaviors that they show. This is illustrated in the following resource statement, Mr. A (traders):

*"... Well, the point is I want to be obedient taxpayers in the future, but I also hope that the regulation were better in the future so that fairer"*

From the above statement, it can be concluded that the Taxpayers may view the fairness of a tax, as a attitude toward behavior, based on how much they spend differently than on how much they earn. In previous research it called equity exchange, as defined by Jackson & Milliron (1986), Refers to the difference between the amount of tax that the taxpayer pays and to the benefits they receives from tax. If a taxpayers feels that they pays too high of an amount relatives to the benefits they receives, taxpayers will find that the tax unfair (Syakura, 2015). Thus, in accordance with the TPB and deterrence theory, the second statement above could be attributed as a factor attitude toward behavior, where each individual has the confidence and expectations of every behavior exhibited.

Any behavior that indicated a taxpayer may be influenced also by the conditions and the influence of the environment surrounding the taxpayer. In TPB, it is also known as Subjective norms regarding the behavior. The findings in this study indicate that the influence of family, business associates, and people around the taxpayer can influence the behavior shown. This is reflected in the statement of Mr. F (trader) and Mr. M (online trader) the following:

*"I was asked directly by my main suppliers to follow the tax amnesty, they suggest it for me to avoid the tax sanctions"*

*"Almost all my friends (other online traders) are participating tax amnesty, they fear about the tax penalties that apply to taxpayers who are not obedient, so I also follow ..."*

From the above statement can be concluded that the social environment around the taxpayer can influence decisions. Grasmick & Bursik (1990) investigated the influence of family and friends on compliance behavior. Also morality was not a determinant for the unintentionally non-compliant group. Intentional evaders owing a higher percentage of income tax report that family and friend or co workers influenced reviews their participation in the amnesty program (Ritsema et al., 2003).

If the individual perceives that important referents think that the individual should not engage in the behavior, a negative subjective norm will result (Syakura, 2015). Further, an individual who is less motivated to comply with important referents expectations will hold a relatively neutral subjective norm.

Confidence will be something that supports and inhibit behavior portrayed on factors perceive behavior control in the TPB. Some studies suggest that increases the likelihood of a tax audit and sanctions can force taxpayers to follow tax amnesty program (Andreoni, 1991; Leonard & Zeckhauser, 1987). This is reflected in the statement of Mr. N (PNS):

*"... Well yeah, it's still a lot of my assets that I have not been reported in the tax return, So I joined the tax amnesty because I am afraid of the tax audit ..."*

From the above statement can be concluded that the increasing threat of tax audits and tax penalties may influence the decision taxpayer. This as like deterrence theory explain. In practice, tax amnesties have been coupled with enhanced enforcement efforts, a feature that seems essential to preserve the legitimacy of the tax code (Leonard & Zeckhauser, 1987). An amnesty might be the only way to bring many evaders back into compliance as long as it is accompanied by tax reform

Amnesties can also be used systematically as a discriminatory mechanism to improve the efficiency or even the equity of the tax system, but only if government commitment to enforcing tax law is credible. If such credibility is lacking, amnesties may actually undermine future tax revenue by breaching the implicit, psychological contract between taxpayers and the state, thus reducing taxpayers' internal motivation for compliance (Marchese, 2014).

From the analysis above, it can be said that the taxpayer was in the "terror" or depressed by the tax amnesty. The advent of information disclosure in 2017 and the amount of the sanctions provided for taxpayers who have caught assets have not been reported in the tax return has raised concerns inside the taxpayer. Besides the influence of people around the taxpayer also increased the motivation for the taxpayer to be able to avoid the risks and costs more taxes in the future.

Social pressure and increase the likelihood of detection was able to increase revenues and tax compliance. However, compliance behavior

arising from pressure will not last long, but on the contrary would increase tax evasion (Ritsema et al., 2003). In particular, people will only be related by the amnesty if they face risky consumption, and will only exercise the option reviews their amnesty if they suffer a bad shock to sufficiently reviews their consumption (Andreoni, 1991). Thus, the government must be consistent with the increasing likelihood of detection and policy reform taxation, so that ultimately the taxpayer does not regret following the tax amnesty program.

### **Tax Amnesty is Our Savior !**

Basically, the application of tax amnesty is expected to increase the amount of the taxpayer, subject and object while increasing tax revenues from the funds in the "parked" outside of the country (Ragimun, 2012). Tax amnesty can increase revenues while increasing taxpayer compliance if coupled with good tax policy reforms. This is evident from the success of some countries that have implemented tax amnesty like South Africa, South Korea and India (Ragimun, 2012).

For most taxpayers, tax amnesty could be the right moment to be able to "return to the right path". Leonard & Zeckhauser (1987) suggest that a well-publicized amnesty combined with stricter enforcement futures considerably increases the level of future voluntary compliance with tax laws. Thus, tax amnesty is the Savior for some taxpayers who had had problems with the tax obligations. This is illustrated by the statement of Mr. Y (online

traders) and Mr. D (Businessman) of the following:

*"For me, this tax amnesty certainly helped me to be obedient taxpayers, because previously I had never carry out my duty as a taxpayer ..."*

*"... Well, we as the local businessman welcomes and also participate for the success of this program, but the government must be completely consistent to improve tax audits and catch taxpayers who do not obey., Otherwise it would be unfair for us ..."*

Consistency of government is expected for taxpayers who participate in the program's tax amnesty. As mentioned in the statement above that taxpayers feel that the tax amnesty and assured that the government would be consistent with the policies formulated. This is in line with the findings of Leonard & Zeckhauser (1987) which states that an amnesty might be the only way to bring many evaders back into compliance. Recent government approval of a sweeping tax reform, designed in part to restore legitimacy to the tax code, provides an opportune time to Consider a federal tax amnesty coupled with more vigorous enforcement to capitalize on and help mark a new regime.

In TPB, beliefs and expectations that arise within the individual can influence the decision of the individual to behave. It is included in the factor attitude toward behavior. If it is associated with the statement above, it can be said that the taxpayer considers tax amnesty as a policy that helps them to become obedient taxpayers and avoid the risk of sanctions is greater.

Interests and expectations of those around taxpayer relate a taxpayer's decision. This is

illustrated by the statement of Mr. C (manager) of the following:

*"I decided to join this tax amnesty for consideration of my investors and business associates who are both joining the program, and we felt helped by these tax amnesty at all ..."*

Social influence plays an important role for the individual in the act. Especially for an entity or enterprise in which many parties who have an interest in it. The manager or head of the company should be able to take the right decisions in order to sustain the company and meet the expectations of shareholders.

As defined by Marchese (2014), in many cases, it turns out that those who cooperated are ready to sacrifice a share of their gains in exchange for implementing the punishment. If amnesties are perceived as a breach of the psychological contract of taxation, they will encourage further tax evasion. However, it is also true that honest taxpayers might consider participants in an amnesty as willing to change their behavior. Frustration that some evaders may go unpunished in amnesties can also be dealt with if the hidden evaders are threatened with harsher penalties (Marchese, 2014).

Therefore, the government and tax authorities should be consistent in order to reinforce the confidence of taxpayers and voluntary compliance. If this is not done, then the taxpayer will feel that their adverse tax amnesty program that would give rise to tax evasion behavior. Implementation of the tax amnesty this year is the right decision at all because it coincides with welcoming the era of

the information in the next year. It also relates the taxpayer's tax amnesty program is, as expressed by Mr. H (Businessman) of the following:

*"... well as to my knowledge that next year we are entering the era of information, therefore I joined the tax amnesty to be obedient taxpayers and avoid risks in the future ..."*

From the above statement can be seen that taxpayers find it helpful to follow this tax amnesty in order to avoid the possibility detected and sanctioned. The emergence of an individual's behavior is also influenced by other things that support or hinder the individual in the act. This factor, called Ajzen (1991) as the perceived behavior control. So, we can said that some taxpayers decide to follow the tax amnesty in order to avoid the risk of sanctions or penalties in the future.

There can be no forgiveness many times, that's the key word. Because, forgiveness repeatedly can reduce the authority of the government (Farida & Prawira, 2015). Thus, the timing and implementation of tax amnesty period is also very important because if one to confirm it could be a boomerang for the government and tax authorities. In addition, the tax amnesty should be such that the taxpayers who will come forward will be guaranteed confidentiality so that in the future they may not be marked as a potential evader (Agbonika, 2015).

## CONCLUSION

There are several findings about factors that influence taxpayers to follow tax amnesty according to TPB, the attitude toward behavior that consists of the trust factor, justice and hope the taxpayer. Furthermore, subjective norm is composed of factors influence the social environment around the taxpayer both internally and externally. Lastly is perceive behavior control consisting of factors increase the probability of detection, consistency, and avoid the risk of tax penalties. Governments and tax authorities should pay attention to these factors in order to increase the trust of taxpayers and voluntary compliance.

Tax amnesty should not be repeated, because if it was more than once it will cause a negative perception of the taxpayer on government performance. This becomes quite reasonable because it could lead to a tax amnesty political interests. As expressed by Marchese (2014), the long-term benefits of tough tax enforcement, politicians who stay in power for a limited period are likes to be tempted by amnesties that grant immediately available proceeds, while they might not be so worried about the damage that will materialize only in the long run, after they step down.

Motivations to join tax amnesty may not same across groups and that all taxpayers will not respond to the same motivating factors. Thus, as Ritsema et al., (2003) said that the government and tax administrators should use multiple enforcement measures to appeal to a

broader spectrum of taxpayers. While citizens are obliged to pay taxes, the state must treat them respectfully yet punish those who fail to comply. If the tax authority does not punish them, the citizens who did comply may feel betrayed and be came a new evaders.

Overall, in order to determine the effectiveness of tax amnesty in achieving revenue goals and improve voluntary compliance in the future it is necessary to invent some advanced research in terms of formulating strategy in the success of this tax amnesty program and determine the effect after the enactment of tax amnesty. Also, the authority must state and tax benefits as well giving reward and sanction to those who participated and cause high anxiety when not participating.

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## **TAX INCENTIVES ON ASSET REVALUATION : CASE STUDY IN INDONESIA**

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### **ABSTRACT**

*Indonesian Government issued economic policy which is related to tax incentives on fixed asset revaluation, in order to stimulate the economic growth, at the end of 2015. Asset revaluation believed will improve company's financial performance. The purpose of this study is to evaluate whether there are any increasing in company's leverage performance after revaluation of fixed assets, the disclosure compliance and the effectiveness of this policy. We use companies listed in Indonesia Stock Exchanges as the sample of this study. This research use descriptive research method. The impact of asset revaluation on financial statement describe by the changes on accounts balance on financial statement. The disclosure level measured base on disclosure requirement. The effectiveness of this policy measured by percentage of the listed companies participated. We found evidence that revaluation did not improve company financial leverage performance. Study show that companies has already complied with most fixed asset disclosure requirement, with several item still need to be improved. The effectiveness of this policy, up to December 2015, was still relatively low.*

**Keywords:** *Tax Incentives, Asset Revaluation, Leverage, Disclosure Compliance*

### **INTRODUCTION**

In second quarter of 2015, Indonesia's economic growth had been slower that it reached only 4.67 percent, the lowest during the last six years. Dealing with this unfavorable condition, made Indonesian Government launched fifth round of stimulus measures to spur economic growth, included the new tax incentives on revaluation of fixed assets

Many companies's fixed assets have been reported far below current market prices (undervalued), as they were obtained many years ago. Company, previously tended to refrain from increasing the value of their fixed assets, as they had to pay a ten percent of tax on company's fixed asset's growth. By this new tax incentives, the government gave 70 % discount on the tax rate, where companies will only have to pay three % tax on the increased amount of fixed assets, if

they submit their proposals for fixed asset revaluation before the end of 2015

This new tax incentives on revaluation of fixed asset is very interesting and tempting. It could resulted in an income tax for the state, which was still needed by the government, as the income tax realisation was much less than the targeted one. The tax revenue is very needed by government in providing and supporting society's welfare, as planned before. It will also give benefit for the company, as they will report their fixed assets based on current market price or fair value, which will increase company's equity. This will affect companies's financial performance, as the increased equity will improve company's leverage, it will easier for company to obtain source of fund. All of these benefit, will be reflected in company's financial statement.

The financial statement of entity with public accountability, of the listed and state owned company in Indonesia should be prepared based on Statement of Financial Accounting Standard (*Pernyataan Standar Akuntansi Keuangan* or *PSAK*) and related regulation. These regulation also determine the requirement for preparation of company's financial statement, including the disclosure aspect. Therefore it is important, to evaluate the company's financial statement disclosure compliance.

## **LITERATURE REVIEW**

In second quarter of 2015, Indonesia's economic growth had been slower that it reached only 4.67 percent, the lowest during the last six years. Dealing with this unfavorable condition, made Indonesian Government launched fifth round of stimulus measures to spur economic growth, included the new tax incentives on revaluation of fixed assets

Tax is one of country's economic instrument, as a source of income that could be used to provide a better welfare for society such as infrastructure development, health and education service. Tax moreover could be used to cover budget deficit and to distribute income among society, which is the world economic problem nowadays (Sulastyawati, D., 2014: 125).

Tax as state source of income is very important, as it shows state financing ability with lower risk compared to loan. Tax policy should be handled with prudence, as it will also influence the buying power of society, as the tax payer. In order to create a conducive business climate, the government needs to implement a very well planned tax strategy, by giving a tax incentive under certain conditions or for certain areas, which need to be improved.

Different points of view regarding tax incentives, still remain. Tax incentives may be viewed as inequitable because they single out a particular sector for preferential treatment. Further they undermine the sense of fairness, because a heavier tax burden must be placed on other sectors to raise a given tax revenue (Dale Chua, in Sutrisno A., et al, 2011: 2)

Much has been written about the desirability of using tax incentives to attract new investment. The United Nations, the International Monetary Fund (IMF), the OECD, and the World Bank have produced useful reports that provide guidance to policymakers on whether to adopt tax incentives and how to best design them. The empirical evidence on the cost-effectiveness of using tax incentives to increase investment is inconclusive. While economists have made significant advances in determining the correlation between increased tax incentives and increased investment, it is challenging to determine whether tax incentives caused the additional investments. This is partly because it is difficult to determine the amount of marginal investment associated with the tax benefit that is to say, the investments that would not otherwise have occurred "but for" the tax benefits. While foreign investors often claim that tax incentives were necessary for the investment decision, it is not easy to determine the validity of the claim. Governments often adopt tax incentives in a package with other reforms designed to improve the climate for investment, making it difficult to determine the portion of new investment that is attributable to tax benefits and the portion that relates to other pro-investor reforms. With these qualifications, it is sometimes easy to conclude that a particular tax incentive scheme has resulted in little new investment, with a substantial cost to the government. In other cases, however, tax incentives have clearly played an important role in attracting new investment that contributed to substantial increases in growth and development (Zolt, E., Schill, M., 2015: 4).

At one level, tax incentives are easy to identify. They are those special provisions that allow for exclusions, credits, preferential tax rates, or deferral of tax liability. Tax incentives can take many forms: tax holidays for a limited duration, current deductibility for certain types of expenditures, or reduced import tariffs or customs duties. At another level, it can be difficult to distinguish between provisions considered part of the general tax structure and those that provide special treatment. This distinction will become more important when countries become limited in

their ability to adopt targeted tax incentives. For example, a country can provide a ten % corporate tax rate for income from manufacturing. This low tax rate can be considered an attractive feature of the general tax structure as it applies to all tax payers (domestic and foreign) or it can be seen as a special tax incentive (restricted to manufacturing) in the context of the entire tax system (Zolt, E., Schill, M., 2015:5)

Alexander, K., (2009: 3) stated several types of tax incentives:

1. Tax holidays: Temporary exemption of a new firm or investment from certain specified taxes, typically at least corporate income tax. Sometimes administrative requirements are also waived, notably the need to file tax returns. Partial tax holidays offer reduced obligations rather than full exemption.

2. Special zones: Geographically limited areas in which qualified firms can locate and thus benefit from exemption of varying scope of taxes and/or administrative requirements. Zones are often aimed at exporters and located close to a port. In some countries, however, qualifying companies can be declared “zones” irrespective of their location.

3. Investment tax credit: Deduction of a certain fraction of an investment from the tax liability. Rules differ regarding excess credits (credits in excess of tax liability) and include the possibility that they may be lost, carried forward or refunded.

4. Investment allowance: Deduction of a certain fraction of an investment from taxable profits (in addition to depreciation). The value of an allowance is the product of the allowance and the tax rate. Unlike a tax credit, its value will thus vary across firms unless there is a single tax rate. Moreover, the value is affected by changes to the tax rate, with a tax cut reducing it.

5. Accelerated depreciation: Depreciation at a faster schedule than available for the rest of the economy. This can be implemented in many different ways, including a higher first year depreciation allowances, or increased depreciation rates. Tax payments in nominal terms are unaffected, but their net present value is reduced and the liquidity of firms is improved.

6. Reduced tax rates: Reduction in a tax rate, typically the corporate income tax rate.

7. Exemptions from various taxes: Exemption from certain taxes, often those collected at the border such as tariffs, excises and VAT on imported inputs.

8. Financing incentives: Reductions in tax rates applying to providers of funds, e.g., reduced withholding taxes on dividends.

In October 2015 Indonesian Government issued economic policy by reducing a tax rate, as a tax incentives on fixed asset revaluation. This was stipulated in Minister of Finance Regulation number 191/PMK.10/2015. Fixed assets is intangibles asset possessed to be used in production of goods or service to be rented to other party or for administrative purposes and is expected to be used for more than one period (Ikatan Akuntan Indonesia, 2015).

The valuation of fixed assets could be based on its historical cost or fair value. In commercial practices, the implementation of valuing fixed asset based on its fair value, should be done according to the tax regulation authorised by Republik Indonesia Minister of Finance. The revaluation of fixed asset is the adjustment of company's fixed assets value which had been used for generating income, as the value is no longer reflected the fair or market value. The purpose of asset revaluation is enabling company to calculate its income and expense more fairly, so it will reflect company's real value.

As time pass, the economic condition will be influenced by many factors, such as inflation. This condition will cause company's fixed asset value on the financial statement will not show the market value, at the reporting date, so the financial statement is not represented faithfully. The revaluation of fixed asset will ensure that the asset value on financial statement will reflect the real fair value and also will increase company's overall value (Kusmahargyo, H., 2015).

The preparation of company's financial statement, including its disclosure, must be made based on PSAK and related regulation. Disclosure became an important issue under IFRS and also other accounting standard based on IFRS, including PSAK. The more disclosure

made to investor, the more effective capital market. By providing mandatory disclosure, enabling company to list its share in the capital market, to increase its reputation and to minimize its cost of capital which will increase company's value (Meek, et al in Ari, A., 2016).

Previous study on the impact of Asset Revaluation on Financial Performance, shown that asset revaluation has significant and negative impact on debt to asset ratio (Ari, A., 2016).

Study on tax incentives shown that tax incentives can play a useful role in encouraging, specifically both domestic and foreign investment. How useful they can be, and at what cost, depends on how well the tax incentive program are designed, implemented and monitored (Zolt, E., Schill, M., 2015). Study on disclosure, revealed that the average mandatory disclosure level by manufacturing company in the first year of full adoption IFRS in Indonesia, is only 63% from all mandatory disclosures required by Bapepam-LK (Ari, A., 2016).

This research aims to evaluate whether there are any increasing in company's leverage performance after revaluation of fixed assets, the fixed assets disclosure compliance and the effectiveness of the tax incentives policy on fixed asset revaluation.

## DATA AND METHOD

This research employed descriptive method, which study on object, a set of condition to make a systematic and accurate description on facts, characteristic also relation between phenomenon being studied.

Researcher collected data by downloading annual report from companies/stock exchange website. The first purpose of this research is to empirically evaluate the leverage performance before and after revaluation of fixed assets. To achieve that, we perform mean comparison test using t paired sample test. We use this model in order to find the level of significance of the company's leverage changes before and after revaluation of fixed assets. Leverage was measured by Debt to Equity Ratio (DER) :

$$\text{DER} = \text{Total Debt} : \text{Total Equity (1)}$$

Hypotheses being tested in this research is:

$$H_a : \mu_{\text{after}} \neq \mu_{\text{before}}$$

Before conducting the hypotheses test, we performed normality test, using Kolmogorov Smirnov. The data has a normal distribution if the value of *asymptotic significance* is higher than 5%.

For the second purpose, to evaluate the fixed assets disclosure compliance, we used disclosure item requirement based on PSAK 16, as listed in the table one.

**Table 1: Fixed Assets Disclosure Checklist**

No	Disclosure Item
1	Measurement base for determining the carrying amount (gross)
2	Depreciation method employed
3	Useful life or depreciation rate
4	Gross carrying amount and accumulated depreciation, at the beginning and ending of period
5	Reconciliation of fixed asset carrying amount addition, at at the beginning and ending of period
6	Reconciliation of the carrying amount of asset held to be sold, at the beginning and ending of period
7	Reconciliation of the acquisition amount from business combination, at the beginning and ending of period
8	Reconciliation of any increase or decrease on carrying amount, due to revaluation at the beginning and ending of period
9	Reconciliation of impairment loss on income statement
10	Reconciliation of any reversal of impairment loss on income statement
11	Reconciliation of the accumulated depreciation, at the beginning and ending of period
12	Reconciliation of gain or loss on exchange rate due to financial statement translation, at the beginning and ending of period
13	The description and amount of restricted fixed asset and property as debt collateral
14	The amount of expenditure capitalised as asset under construction
15	The amount of contractual commitment to acquire fixed assets
16	The compensation amount from third party for any impaired, lost or disposed fixed asset

Source : Pernyataan Standar Akuntansi Keuangan Nomor 16

Researcher conducted analysis, by made disclosure checklist enlisted 16 items of fixed assets that have to be disclosed, as stated in table 1. The checklist indicate whether the indicators fixed asset item disclosed or not disclosed. Researcher will give 1 if the items is disclosed, give 0 if items is not disclosed and give blank if the disclosure item is not applicable for certain company. Researcher will calculate disclosure score by adding all of disclosure checklist items.

For the the effectiveness of the tax incentives policy on fixed asset revaluation, as the third pupose, we analyze by comparing the number of listed companies participated in asset revaluation with the total number of

listed companies in Indonesian Stock Exchange.

Research population is all companies listed in Indonesian Stock Exchange in 2015, totalled 534 companies, then reduced by 88 companies which did not publish financial statement in 2015, 47 companies which made fixed asset revaluation based on accounting, and 367 companies did not participate in fixed asset revaluation for tax puposes until the end of 2015. At the end, this research is using 31 sample companies

#### DISCUSSION AND ANALYSIS

Table 2 display the 31 sample companies along with the debt to equity ratio, before and after fixed asset revaluation for tax purposive.

**Table 2: Debt to Equity Ratio**

No	Companies	DER	
		Before	After
1	PT Adhi Karya Tbk.	5.4	2.2
2	PT Asuransi Harta Aman Pratama Tbk.	2.0	1.5
3	PT Aneka Tambang Tbk.	0.8	0.7
4	PT Bank Negara Indonesia Tbk.	5.6	5.3
5	PT Bank Rakyat Indonesia Tbk.	7.2	6.8
6	PT Bank Yudha Bhakti Tbk.	0.8	1.0
7	PT Bank Maspion Indonesia Tbk.	0.9	0.8
8	PT Bank Bumi Arta Tbk.	7.6	4.3
9	PT Berlina Tbk.	2.7	1.2
10	PT Bank Sinarmas Tbk.	5.7	6.6
11	PT Bank Victoria Internasional Tbk.	0.9	0.9
12	PT Surya Esa Perkasa Tbk. (US\$)	0.4	0.5
13	PT Gema Grahasarana Tbk.	1.6	1.4
14	PT Greenwood Sejahtera Tbk.	0.1	0.1
15	PT Indal Aluminium Industry Tbk.	6.3	4.5
16	PT Indorama Synthetics Tbk. (US\$)	1.5	1.7
17	PT Jembo Cable Company Tbk.	5.4	2.7
18	PT JAPFA Comfeed Indonesia Tbk.	2.0	1.8
19	PT Jaya Pari Steel Tbk.	0.1	0.1
20	PT Kedaung Indah Can Tbk.	0.5	0.4
21	PT Bank Mega Tbk.	8.6	4.9
22	PT Mitra Keluarga Karyasehat Tbk.	0.2	0.1
23	PT Bank Panin Syariah Tbk.	0.8	0.7
24	PT PP Properti Tbk.	1.6	1.1
25	PT PP Tbk.	5.2	2.7
26	PT Sarana Mediatama Metropolitan Tbk.	1.4	0.6
27	PT Tower Bersama Infrastructure Tbk.	9.3	13.3
28	PT Bank Mestika Dharma Tbk.	3.1	3.2
29	PT Betonjaya Manunggal Tbk.	0.2	0.2
30	PT Budi Starch & Sweetener Tbk.	1.7	2.0
31	PT Sekar Laut Tbk.	1.5	1.5

Sources : Research Data

We conducted normality test using Kolmogorov Smirnov, which shown the sig value is less than 0.05, so the data did not fulfill normality assumption, therefor reseracher used

non parametric statistic to test the hypotheses. We used the wilcoxon signed rank test, as the data is paired sample.

**Table 3: Leverage Performance Descriptive Statistics**

		Statistic	Std. Error	Bootstrap <sup>a</sup>			
				Bias	Std. Error	95% Confidence Interval	
						Lower	Upper
BEFORE	N	31		0	0	31	31
	Minimum	0.10					
	Maximum	9.30					
	Mean	2.9387		-0.0185	0.4858	1.9970	3.8900
	Std. Deviation	2.79675		-0.7416	0.28922	2.13593	3.26654
AFTER	N	31		0	0	31	31
	Minimum	0.10					
	Maximum	13.30					
	Mean	2.4129		-0.0258	0.4713	1.5645	3.4221
	Std. Deviation	2.77017		-0.1660	0.66839	1.45185	3.87905
Valid N (listwise)	N	31		0	0	31	31

Sources : Research Data

From the table we can see that the overall leverage performance after the fixed asset revaluation has decreased compare to leverage performance before the fixed asset revaluation.

We performed Wilcoxon Signed Rank Test, which result is provided in the table 4, below.

**Table 4: Wilcoxon Signed Ranks test**

		N	Mean Rank	Sum of Ranks
After - Before	Negative Ranks	19 <sup>a</sup>	14.08	267.50
	Positive Ranks	7 <sup>b</sup>	11.93	83.50
	Ties	5 <sup>c</sup>		
	Total	31		

a. after < before

b. after > before

c. after = before

Test Statistics<sup>a</sup>

	After - Before
Z	-2.343 <sup>b</sup>
Asymp. Sig. (2-tailed)	0.019

a. Wilcoxon Signed Ranks Test

b. Based on positive ranks.

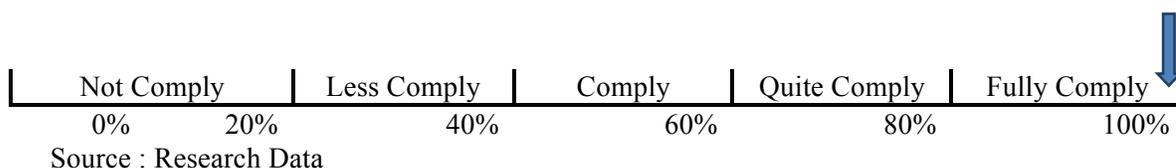
Sources : Research Data

From table 4, we found that the z value is -2.343 with p value (Asymp. Sig 2 tailed) is 0.019 which is more than 0.05, so the conclusion was reject  $H_a$ . It means there is no significant difference on leverage performance between before and after fixed asset revaluation for tax purposes. The researchers presumed this empirical result is caused by unfavorable economic condition in 2015 (after fixed asset revaluation) compare with 2014 (before fixed asset revaluation), which could cause much decreased in company's equity, despite of fixed asset revaluation undertaken.

For evaluating the fixed assets disclosure compliance, we performed disclosure checklist analysis on each of 16 disclosure item, required by PSAK 16, as follow :

1. Measurement base for determining the carrying amount (gross)
  - Disclosure score = 31
  - Maximum score = 31
  - Disclosure compliance score =  $31/31 \times 100\% = 100\%$
  - Interval range = (maximum score - minimum score)  $5 = (100\% - 0\%) : 5 = 20\%$

Continuum Line of Disclosure compliance level for measurement base is described in figure 1.



**Figure 1 Continuum Line – Compliance Level Measurement Base**

Disclosure compliance level for this item is excellent (100%), which means that all of companies used as a sample in this study, has already implemented it.

2. Depreciation method employed

- Disclosure score = 30
- Maximum score = 31
- Disclosure compliance score (%) =  $30/31 \times 100\% = 97\%$

Disclosure compliance level for depreciation method employed is 97 % or almost excellent.

3. Useful life or depreciation rate

- Disclosure score = 30
- Maximum score = 31
- Disclosure compliance score (%) =  $30/31 \times 100\% = 97\%$

Disclosure compliance level for this disclosure item is 97 % or almost excellent.

4. Gross carrying amount and accumulated depreciation, at the beginning and ending of period.

- Disclosure score = 31
- Maximum score = 31
- Disclosure compliance score (%) =  $31/31 \times 100\% = 100\%$

Disclosure compliance level for this disclosure item is 100 % which is excellent

5. Reconciliation of fixed asset carrying amount addition, at at the beginning and ending of period)

- Disclosure score = 30
- Maximum score = 31
- Disclosure compliance score (%) =  $31/31 \times 100\% = 97\%$

Disclosure compliance level for this disclosure item is 97 % which is almost excellent.

6. Reconciliation of the carrying amount of asset held to be sold, at the beginning and ending of period

- Disclosure score = 13

- Maximum score = 17
- Disclosure compliance score (%)=  $13/17 \times 100\% = 76\%$

The disclosure compliance level for this item is not too good, as is is only 76 % (in quite comply level)

7. Reconciliation of the acquisition amount from business combination, at the beginning and ending of period

- Disclosure score = 18
- Maximum score = 22
- Disclosure compliance score (%)=  $18/22 \times 100\% = 82\%$

Disclosure compliance level for this disclosure item is 82 %.

8. Reconciliation of any increase or decrease on carrying amount, due to revaluation at the beginning and ending of period

- Disclosure score = 21
- Maximum score = 31
- Disclosure compliance score (%) =  $21/31 \times 100\% = 68\%$

Continuum Line of Disclosure compliance level for reconciliation of any increase or decrease on carrying amount, due to revaluation d in figure 2.



Source : Research Data

**Figure 2 Continuum Line – Compliance Level Change Carrying Amount Due to Revaluation**

- Disclosure compliance level for this disclosure item is 68 %, which is quite low.
9. Reconciliation of impairment loss on income statement
- Disclosure score = 15
  - Maximum score = 21
  - Disclosure compliance score (%) =  $15/21 \times 100\% = 71\%$
- Disclosure compliance level for this disclosure item is 71 %.
10. Reconciliation of any reversal of impairment loss on income statement
- Disclosure score = 6
  - Maximum score = 6
  - Disclosure compliance score (%) =  $6/6 \times 100\% = 100\%$
- Disclosure compliance level for this disclosure item is 100 %, which is fully comply.
11. Reconciliation of the accumulated depreciation, at the beginning and ending of period
- Disclosure score = 30
  - Maximum score = 31
  - Disclosure compliance score (%) =  $30/31 \times 100\% = 97\%$
- Disclosure compliance level for this disclosure item is 97 %
12. Reconciliation of gain or loss on exchange rate due to financial statement translation, at the beginning and ending of period
- Disclosure score = 23
  - Maximum score = 28
  - Disclosure compliance score (%) =  $23/28 \times 100\% = 82\%$
- Disclosure compliance level for this disclosure item is 82 %
13. The description and amount of restricted fixed asset and property as debt collateral
- Disclosure score = 14
  - Maximum score = 26
  - Disclosure compliance score (%) =  $14/26 \times 100\% = 54\%$
- Disclosure compliance level for this disclosure item is only 54 %, which is quite low.
14. The amount of expenditure capitalised as asset under construction
- Disclosure score = 20
  - Maximum score = 23
  - Disclosure compliance score (%) =  $20/23 \times 100\% = 87\%$
- Disclosure compliance level for this disclosure item is 87 %
15. The amount of contractual commitment to acquire fixed asset
- Disclosure score = 10
  - Maximum score = 18
  - Disclosure compliance score (%) =  $10/18 \times 100\% = 56\%$
- Disclosure compliance level for this disclosure item is only 56 %
16. The compensation amount from third party for any impaired, lost or disposed fixed asset
- Disclosure score = 2
  - Maximum score = 3
  - Disclosure compliance score (%) =  $2/3 \times 100\% = 67\%$
- Disclosure compliance level for this disclosure item is only 67 %.
- Researcher measure the effectiveness of this tax incentives policy, by comparing the number of listed companies participated in asset revaluation, up to the end of December 2015, with the total number of listed companies in Indonesian Stock Exchange, as described below :
- Number of listed companies = 534
  - Companies did not publish 2015 Financial Statement = (88)
  - Companies with fixed asset revaluation for accounting = (47)
  - Sub total = 399

- Companies participated up to the end December 2015 = 31 = (31/399) % = 7.77%

Researcher presumed this could be caused by there is still quite long period for company, to take this tax incentives policy. This policy is still valid until December 2016, eventhough with higher tax rate. Company may need time to prepare all the requirement needed to participate in this tax policy.

## CONCLUSION

This research shown us that there is no significant difference on leverage performance between before and after fixed asset revaluation for tax purposes. The average performance after fixed asset revaluation for tax purposes is less than before fixed asset revaluation. This finding is on the contrary with the theory. Researchers presumed this caused by economic downturn exist in 2015, which impact the company's performance. In order to measure the pure impact of fixed asset revaluation on leverage performance, the next researcher can compare leverage on certain date by restatement the financial statement, as if the revaluation never existed.

Overall, the compliance disclosure level has already in a very good or excelent condition, This study revealed certain fixed assetd disclosure item, which still need to be improved, as mentioned below:

- disclosure item related with reconciliation of the carrying amount of asset held to be sold,
- disclosure item related with reconciliation of any increase or decrease on carrying amount due to revaluation,
- disclosure item related with reconciliation of impairment loss
- disclosure item related with description and amount of restricted fixed asset and property as debt collateral
- disclosure item related with the amount of contactual commitment to acquire fixed asset

- disclosure item related with compensation amount from third party for any impaired, lost or disposed fixed asset

This study shown the effectiveness of this tax policy up to the end of December 2015 is quite low, as only 7,7 % listed companies participating. To obtain more accurate result, it will be better if the next researcher using period 2015 and 2016 as a research period

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**THE INFLUENCE OF COMPETENCIES AND  
LEVEL OF TAXPAYER'S INTERNAL CONTROLS ON AUDITORS' TAX  
FRAUD JUDGMENT**

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***ABSTRACT***

*In performing the tax audit and investigation, tax auditors' fraud judgment is critical as it reflects the actual implementation of tax law. Failure to provide accurate fraud judgment may cause to serious implications (e.g. undetected tax fraud and undercharged of tax payment). As the tax fraud techniques presently have become complex, tax auditors are expected to be competent in performing their duties. However, in the process of making judgment, tax auditors are dealing with varying level of taxpayer's internal controls which are expected to affect their judgment. Therefore, this study aims to examine the influence of the tax auditors' competencies (qualification and years of experience) and; the level of taxpayer's internal controls on their tax fraud judgment. A sample of 135 of Inland Revenue Board of Malaysia tax auditors was employed, using a 2 x 2 "between-subjects" experimental design. The result of this study indicate that tax auditors' competencies and level of taxpayer's internal controls have significant influence on their tax fraud judgment. This study contributes to the audit judgment literature by providing some empirical evidence and insights on how tax auditors' competencies and internal controls linked to their fraud judgment.*

**Keywords:** *Fraud Judgment, Tax Auditor, Competencies, Internal Controls*

## THE ROLE OF CREATIVITY IN LINKING EMPOWERMENT TO PERFORMANCE

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### ABSTRACT

*The fast-moving business environment needs creativity to strengthen competitive advantage. Creativity, defined as a production of new useful ideas for related working person or group (Zhou & Shalley, 2003), is posited as a valuable characteristics of a cross-border employees. Salesperson is an employee who is standing in the mid of intersection between company and customers. S/he is requested to spill-over in the cross-border relation between company and its customers. Becoming creative is a productive behavior to minimize inevitable conflicts happening in selling activities. While the role of creativity is considered, studies intended to explore its predictor and consequences have also attracted considerable attentions (Parnell, Lester, & Menefee, 2000; Runco & Sakamoto, 1999). However, study to explore the impact of leadership on creativity deferring to performance is limited. This study aims to analyze the effect of empowering leadership to employee creativity and its impact to job performance via three other variables those are psychological empowerment, adaptability, and creativity process engagement.*

*This research uses data collected from questionnaires done by 143 health assurance salespeople. Those respondents work on insurance companies at DKI Jakarta and DI Yogyakarta selected using purposive sampling technique. Data were analyzed by using Structural equation modeling (SEM) based on partial least square (SEM-PLS).*

*Findings shows the role of creativity in linking the relation between empowering leadership and performance. The empowering leadership has a positive effect to psychological empowerment which positively effecting adaptability and creativity process engagement. Furthermore, these two variables have positive effects on creativity. Finally creativity contributes positively toward job performance. The findings imply to salesperson management focusing on excellence performance.*

**Keywords:** *empowering leadership, psychological empowerment, adaptability, creativity process engagement, creativity, job performance.*

### INTRODUCTION

Working environment is unpredictable today. In a short time, a company can be experiencing a very difficult situation in

which the best solutions are badly needed. New ideas must be delivered to deal with such dynamic situations. Such conditions urge the company managers to understand

that they have to drive their employees to be creative (Shalley & Gilson, 2004). What is meant by creative is that this refers to new ideas significantly useful for both individuals and groups of cooperating individuals (Zhou & Shalley, 2003).

The efforts to improve the employee creativity are based on a fact that creativity gives contribution to innovation, effectiveness, and survival of an organization. Creativity is a resource for companies to compete and obtain competitive superiority. Employee creativity enables any companies to innovate and produce a better performance. When employees show their creativity, they will produce new and very useful ideas about products, practices, services, and their organization procedures (Shalley, Zhou, & Oldham, 2004).

Creativity enables employees to apply their creative ideas into their works and transfer to other employees within organization for use. This is why the use and development of creative ideas make organizations possible to adapt and respond any opportunities to grow and compete (Nonaka & Takeuchi, 1995).

Knowing the effects of creativity toward the company performance, many researchers try to get the picture of the forming factors by for examples relating with strategy (Hitt, Hoskisson, Johnson, & Moesel, 1996; Parnell, Lester, & Menefee, 2000), structure (Damanpour, 1991), working atmosphere (Isaksen, Lauer, Ekvall, & Britz, 2001), diffusion practices (Abrahamson, 1991), group interaction (Mumford, Feldman, Hein, & Nago, 2001), and individual performance competence (Runco & Sakamoto, 1999). Despite those factors, there is a less noticed potential factor called leadership, especially empowering leadership. This factor is considered potential since it can be used as evidence that influencing employees in leadership will potentially increase the number of ideas produced by the employees in that these

ideas will in turn be developed to be beneficial products.

Both managers and high ranks must support any efforts to push the employee creativity. Only the employees know which work needs creativity. Managers also have strong effects in certain situations possibly triggering creativity (Shalley & Gilson, 2004). Oldham and Cummings (1996) found that supporting moderate supervision from the high ranks has positive correlation with the employee creativity these theories are in line with the statements of Dvir, Avolio, and Shamir (2002) that leadership style positively affects the employee creativity. Nevertheless, only a few researches discuss the effect of leadership toward employee creativity, and mostly focus on the issue of leaders' support (e.g. Amabile, Schatzel, Moneta, & Kramer, 2004) and leader-member exchange (Tierney, Farmer, & Graen 1999; Scott & Bruce, 1994). Not many researches talk about empowering leadership, though leadership characteristics are considered influential to creativity (Mumford, Scott, Gaddis, & Strange, 2002).

Traditionally, leadership is not regarded having significant effects to creativity. Many believe in the old concept saying that creativity refers to ideas and innovation that are inherent within individuals' hard efforts (Jung, 2001). Many researchers separate leadership and creativity based on the argument that instead of leadership, there are professionalism, skills, and autonomy that create someone creative (Kerr & Jermier, 1978). Those are some reasons why only a few have concern on this subject.

Spreitzer (1995) states that with empowering leadership, the employee creativity will rise and will positively affect the employee performance. The positive effect of empowering leadership toward creativity is based on the practice of empowering leadership covering up power sharing by mainly focusing on increasing the employees' motivation and investment on their job (Thomas & Velthouse, 1990).

Empowering leadership has an authority delegation to help increase the job contexts that encourage and empower employees to explore their creativities to finally come to one creative solution (Amabile, Conti, Coon, Lazenbey, & Herron, 1996). As mentioned previously, creativity affects the employees' optimum performance.

This research aims to analyze the effect of empowering leadership to employee creativity and its impact to the working performance by using sales persons as the respondents. A sales force is conducting a personal selling to all different consumers. Such a working atmosphere with various kinds of consumers is one of the examples of an unpredictable working condition. Each different consumer requires the sales force to make different approaches too. At this point is creativity expected to emerge so that any sales forces may find the way to approach individual consumer, do their duties, and meet their selling targets.

Empowering leadership affects creativity gradually through interrelated phases. These phases involve some variables i.e. psychological empowerment, adaptability, and creative process engagement. The previous researches indicated that those variables were present in the relation between empowering leadership and creativity (e.g. Zhang & Bartol 2011; Ahearne, Matheieu, & Rapp, 2005). This study aims to analyze the effect of empowering leadership to employee creativity and its impact to job performance via three other variables; those are psychological empowerment, adaptability, and creativity process engagement.

## **THEORETICAL BACKGROUND AND HYPOTHESES DEVELOPMENT**

### **Empowering Leadership Behavior and Psychological Empowerment**

Empowerment gives employees opportunity and skill to plan, implement, and control the implementation of the working plan under the responsibility of individual employee or group or employees (Nangoi,

2001). According to Arnold, Arad, Rhoades, and Drasgow (2000), there are five factors influencing empowering leadership i.e. leading by example, participative decision-making, coaching, informing, and showing concern/interacting with the team. Empowering leadership is closely related to psychological empowerment to employees. Behling and McFillen (1996) define psychological empowerment as the employees' belief upon their strength, their competence to organize their working places to deal with and overcome any obstacles when controlling a certain event. Psychological empowerment applies to four cognitions i.e. meaning (the meaning of a working goal), competence (a belief on self-competence and expertise in running projects) self-fulfillment (a feeling related to the choice in running a working process), and effect (a certain level enabling individual to affect the strategic, administrative, and operational results) (Thomas & Velthouse, 1990; Gist, 1987; Ashfort, 1989).

Empowering leadership helps employees understand the importance of employees' contribution to the effectiveness of a company as a whole so that this may strengthen the meaning. A manager shall strengthen the employees' self-confidence by trusting their competence and will that they are working well; a leader shall also give a chance to the employees to participate in decision-making (Ahearne *et al.*, 2005; Arnold *et al.*, 2000). Self-fulfillment of the employees shall be supported by empowering leadership through giving autonomy and encouragement to the employees to deal with their problems in their own ways (Pearce *et al.*, 2003). Effect shall be reinforced by empowering leadership because this style of leadership encourages the participation of the employees in decision-making (Manz & Sims, 1987).

Hypothesis 1: Empowering leadership behavior has positive effects to psychological empowerment.

### **Psychological Empowerment and Adaptability**

Psychological empowerment emerges when there are bigger authorities and responsibilities for the employees and policies to ensure that they can run their responsibilities (Nangoi, 2001). Such a process drives self-confidence and competence of the employees and creates sense of adaptability among them.

When an employee feels that the course of the company is in line with his own standard value, the job has already given a meaning to him and he will totally work with all of his passion. For instance, when a problem arises due to variously different needs of the clients, sales forces will adapt to these differences. Sales forces with psychological empowerment will feel convinced upon their competences, have self-determination to select their own working methods, and believe that they give positive impacts to the entire performance of the company. A sales force with psychological empowerment will feel challenged to keep improving performance with an expectation that effectively adaptive selling will bring positive impacts to the company. Though needing more efforts and competence, he keeps practicing adaptive selling because he is confident with his competence.

Hypothesis 2: Psychological empowerment has positive effects to adaptability.

### **Psychological Empowerment and Creative Process Engagement**

Not only does an employee having psychological empowerment understand that his work gives significant meaning and contribution to the entire performance of all the employees (Ahearne *et al.*, 2005), but he also tends to be more convinced of his competence and the capability of the company to effectively deal with any obstacles in the job (Behling & McFillen, 1996). The experiences in psychological empowerment will later optimize the engagement of creative process.

An employee feeling that his work is important, needed, and meaningful will totally engage the working process. He will work more to understand and deal with any emerging problems. He tries his best to explore various views, search various sources of information, and synthesize those variously different sources of information to come to a solution (Shaley & Gilson, 2004).

When an employee believes that he has a competence to do his job well, has a sense of engagement in carrying out his job, and produces an expected result, he will be more persistent, longer, and focused in ideas or problems (Spreitzer, 1995). An employee with such an attitude is willingly to take a risk, find out new solution, and be flexible to any ideas (Amabile *et al.*, 1996).

Hypothesis 3: Psychological empowering has positive effects to creative process engagement.

### **Adaptability and Creativity**

When applying adaptive selling, sales forces adapt themselves to their working obstacles. One of the obstacles is different clients. The adaptation emerges in the form of creating ideas for various approaches and presentations in selling. This is called creativity, a creation of new and useful ideas by one or more individuals (Amabile *et al.*, 1996) to adapt to task obstacles (Stenberg, 1999). The more dedicated a seller is in implementing adaptive selling, the more creative he will be.

Hypothesis 4: Adaptability has positive effects to creativity.

### **Creative Process Engagement and Creativity**

Creative process engagement is a process showing the level of engagement and contribution of an employee in the process of creativity. The more an employee engages in a creative process, the more creative he is in conducting his job. This is based on the consideration that to have creativity, one must engage in creative activities such as identifying problems,

observing environment, collecting data, doing subconscious mental activities, and formulating, evaluating, and implementing solutions (Shalley, 1991). These creative processes determine the flexibility in finding solutions, the level of focus toward certain aspects in job tasks, and the level of consistence in following the path during the search of a solution (Amabile *et al.*, 1996).

Hypothesis 5: Creative process engagement has positive effects to creativity.

### **Creativity and Job Performance**

In the process of selling, creativity runs in line with adaptability. Creativity has contribution to innovation, effectiveness, and survival of an organization. Having employee creativity, an organization is able to innovate and produce better performances because the employees are able to create new and useful ideas concerning the products, practices, services, and procedures of the organization (Shalley *et al.*, 2004). Creative sales forces are more capable in finding solutions and more flexible in dealing with various consumers covering up the ways to both approach the consumers and deliver selling presentation. With such a consideration, it is expected that the more a seller is creative, the better his selling performance will be.

Hypothesis 6: Creativity has positive effects to Job performance.

Figure 1 shows the research model used in this research.

[Insert Figure 1]

## **METHODS**

### **Research Setting and Respondents**

The primary data used in this research were obtained from direct sources without filter and interpretation from the second party. Primary data collection was done by the use of self-administered survey, a survey run by the researcher by directly disseminating questionnaires to related respondents to fill out (Cooper & Schindler, 2011).

The respondents of this research are those working in health insurance companies. The respondents are limited to those who have already worked for at least one year with minimum age of 18 years old, and been assigned to offer and sell insurance products directly to consumers. They are elected with some considerations that their jobs interact both with the superiors, in that this enables the analysis on empowering leadership and psychological empowerment variables, and with the consumers in that this allows to see the creativity, adaptability, and creative process engagement variables. Hence, the researcher believes that health insurance sales forces are representative samples for this research.

The data collecting took three months to accomplish. There are 179 data collected. A number of 36 data cannot be further processed because the questionnaires are incomplete and the respondents are not qualified. Therefore, there remain 143 data (79.88% response rate) able to be processed for this research.

### **Measures**

Likert scale is used to measure the comment for each statement in the questionnaire to analyze the intensity of agreement of the respondents toward the statement in a scale (Sekaran & Bougie, 2010). The scale uses a span of 1 until 5 with following meaning: 1 = strongly disagree; 2 = disagree; 3 = neutral; 4 = agree; and 5 = strongly agree.

*Leadership Empowerment Behavior.* To measure empowering leadership, the writer used 39 statement items developed by Arnold *et al.* (2000) by measuring five dimensions of empowering leadership. Below are the five dimensions along with the statement samples used:

- a. leading by example (e.g.: my leader is a hard worker, a boss works hard as do the other employees);

- b. developing participation in decision-making (e.g.: my leader supports me to give inputs and share my opinions);
- c. giving co-companion (e.g.: my leader gives suggestion to improve performance);
- d. giving information (e.g.: I get information from my leader about the goal of the company policies); and
- e. showing care (e.g. my leader is concerned with my welfare).

*Psychological Empowerment.* Psychological empowerment is measured with 12 statement items developed by Spreitzer (1995). Some examples of each cognitive aspect are as follows: (1) this job is very important for me, (2) I am confident with my competence to do the job, (3) I have right to determine the way I do my job, and (4) the result of my work is very influential to this field of job.

*Creative Process Engagement.* The creative process engagement is measured with 11 items developed by Zhang and Bartol (2010) based on conceptual works of Amabile (1983) and Reiter-Palmon and Illies (2004). Those eleven items are divided into three dimensions, which are the cognitive process of creative process engagement. Below are the three dimensions along with the sample statements proposed to the respondents:

- a. identifying problems (e.g.: I spare my time to understand the problems in the job);
- b. searching and interpreting information (e.g.: I meet many people and discuss with them to get various kinds of information);
- c. generalizing ideas (e.g., I take information from various sources into consideration to develop new ideas).

*Adaptability.* The writer measures adaptive selling by using 15 items of adaptive selling scale such as (1) I like to try various methods of selling, (2) I am flexible in applying selling methods, and (3) I am very sensitive to the consumer's will. The adaptive selling scale developed in the research of Spiro and Weitz (1990) measured the degree of the

sales force's selling adaptation in responding the selling situation.

*Creativity.* Creativity is measured with 13 statement items developed by Zhou and George (2001), on:

- a. ways, ideas, processes, and new techniques proposed by employees
- b. employees' attitudes and reactions toward new things

*Salesperson Performance.* The writer measures this variable using 10 statement items developed by Martin and Bush (2006) such as (1) in general I have a good conduct to my work, (2) I am effective in solving problems, and (3) I make high efforts in increasing sale.

### **Analytical Procedures**

This research applies structural equation modeling (SEM) based on variants or partial least square (SEM-PLS) for the analyses. SEM is a kind of multivariate analysis, which is a statistic method to analyze some research variables simultaneously in social sciences. SEM has two superior abilities, which are ability to test a complex research model simultaneously and ability to analyze unobserved variables. This can also calculate measurement errors. There are two sub-model steps in running PLS-SEM analysis: measurement model and structural model.

Measurement model will show how observed variables representing latent variables are measured so that they can be used to test validity and reliability constructs (Ghozali & Latan, 2012). Structural model or inner model is used to predict causality relation among latent variables and becomes the next phase after the reliability and validity tests. The research data are processed by using software named SmartPLS 3.0 in that a bootstrapping process is done to evaluate the inner model.

There are three bootstrapping results needing a serious attention: path coefficient ( $\beta$ ) because the value is bigger than the inter

latent variables relation, p-value because of showing the significance of inter latent variables relation, R-squares because of showing the level of contribution of certain exogenous variables towards endogenous variables, and f-square effect (effect size) because it is an absolute value of individual contribution of every predicting latent variable toward R-square value of criterion variable.

## RESULTS

Construct validity is divided into convergent validity and discriminating validity. Convergent validity is obtained through outer loading value and AVE, while divergent validity is obtained through cross loading and the comparison of AVE root with the correlation value of inter latent variables. By using the previously mentioned terms, all the constructs, including the constructs with loading factor between 0.6-0.7 but with the communality and AVE values meeting the terms, are declared to pass the convergent validity test. The measurement equipment also passed the discriminating validity test because the cross loading value is higher than 0.7 and the AVE root is bigger than the latent variables correlation (Chin, 1995 in Jogiyanto, 2009).

The writer used composite reliability and cronbach's alpha to test the construct reliability. According to Hair *et.al.* in Jogiyanto and Abdillah (2009) rule of thumb, the value of composite reliability and cronbach's alpha is more than 0.7 even though the value between 0.6 – 0.7 is in consideration.

Table 1 presents the test result for the cronbach's alpha and composite reliability values. The table shows that the cronbach's alpha and composite reliability values for all variables are more than 0.7. Thus, all the variables pass the reliability test.

[Insert Table 1]

Hypothesis test is run by seeing the values of path coefficient and p-value. Table 2 and Figure 2 present the summary of the

values of path coefficient, p-value,  $R^2$ , and  $f^2$  for every hypothesis.

[Insert Figure 2]

[Insert Table 2]

## DISCUSSION

The research is conducted to test the relationship between empowering leadership and creativity along with its effects to the employees' performances. The relationship among those three variables is explained with the support of other three variables, which are psychological empowerment, adaptability, and creative process engagement. The relationship among those six variables is embodied into six hypotheses. These six hypotheses are reliable based on the test results.

The first hypothesis, which says that empowering leadership creates psychological empowerment, is supported with the research result by Ahearne *et al.* (2005). The research shows that employees feel psychologically empowered when feeling that their superiors conduct empowering leadership.

Empowerment enables employees to plan, implement, and control the work plan under the responsibility of either individual employee or group of employees (Nangoi, 2001). This practice is in line with the definition of psychological empowerment i.e. a belief in both self-competence and organization capability to deal with any obstacles and control any events (Behling & McFillen, 1996). As the opinion of Ahearne *et al.* (2005), empowering leadership behaviors give positive effects to competence, which is self-belief or self-confidence on individual competence and skill in running work activities (Spreitzer, 1995).

Psychological empowerment is positively related to adaptive selling or adaptability, which is an adjustment on selling method by sales forces in dealing with any situation. Spreitzer (1995) states that psychological empowerment is a motivational concept having four cognitions:

meaning, competence, self-fulfillment, and effect. Those four dimensions reflect an active orientation on work role in that an individual wants and feels capable to carry out role in his job. As mentioned by Spiro and Weitz (1990), sales forces must have motivation and competence to implement adaptability. In other words, a sales force experiencing psychological empowerment will be able to improve his adaptability. The more the sales forces implement adaptability, the more the creativity of the sales forces creates approaching methods. This is in line with the definition of creativity, the creation of new and useful ideas by one or more individuals (Amabile *et al.*, 1996) to adapt to the task obstacles (Stenberg, 1999).

Psychological empowerment will also make employees more engaged in creative process covering up identifying problems, searching information, interpreting information, formulating ideas, and formulating solution alternatives (Reiter-Palmon & Illies, 2004). Psychological empowerment makes employees feel their work is meaningful and personally important. According to Gilson and Shalley (2004), an employee feeling his work is meaningful and personally important tends to be more serious in comprehending any emerging problems and finding the solutions (Gilson & Shalley, 2004). Creative process engagement then positively affects creativity. The more the employees engage in creative processes, the better the ideas will come up (Zhang & Bartol, 2010). As stated by Shalley (1991), one must engage in a creative process to have creativity. That creative process determines the employee's flexibility in finding solutions for any task problems (Amabile, 1996).

Creativity has positive effects to performance. Employees must be able to produce the best ideas and solutions to adapt themselves to their dynamic work environment Shalley and Gilson (2004). Employee creativity gives contribution to innovation, effectiveness, and survival of an

organization. Having employee creativity, an organization can innovate and produce better performance because of being able to result in new and very useful ideas about products, practices, services, and the organization procedures (Shalley *et al.*, 2004).

#### **IMPLICATIONS, LIMITATIONS, AND FUTURE RESEARCH**

There are only few researches discussed the relationship between empowering leadership with creativity. Leadership style positively affects the employee creativity, but only a few researches discussed the effect of leadership toward employee creativity Dvir *et al.* (2002). Most researches focus on the issue of leaders' support (e.g. Amabile *et.al.* 2004) and leader-member exchange (Tierney, Farmer, & Graen 1999; Scott & Bruce, 1994). This research entitled "*Kreativitas Karyawan: Pengaruh Kepemimpinan Pembedayaan dan Dampaknya pada Kinerja*" (Employee Creativity: The Effects of Empowering Leadership and The Impacts to Performance) will augment the literature on empowering leadership and creativity and be one of the references for researchers and academicians. This research will also augment the literature on psychological empowerment, adaptive selling, creative process engagement, and performance.

The insurance environment is dynamic and unpredictable. The sales force directly encounters many consumers with various backgrounds of life and various situations. This badly needs sales force to keep finding the best ways and solutions for such various and changing environments. Such conditions urge the managers to always realize that they have to encourage their employees to be creative (Shalley & Gilson, 2004) and find the ways to boost their creativities.

This research states that empowering leadership will gradually boost creativity. The organization can use empowering leadership to boost the employee creativity.

It is suggested that an organization apply empowering leadership to not only increase creativity but also improve performance. Some examples of empowering leadership behaviors are showing the importance of the employee jobs, giving wider autonomy in decision-making, trusting the employees' competence, removing job obstacles, and encouraging employees to participate in job decision-making. (Ahearne *et al.*, 2005).

Due to the limited time and fund, this research has thus limitations. Here are some limitations along with the suggestions for further research:

1. The samples of this research are insurance sales forces of two insurance companies in Jakarta and Yogyakarta. Other sales forces of other cities may have different characteristics possibly resulting in different research outputs. Generalization is limited due to this condition. It will be better if the next researchers take more respondents not only from Jakarta and Yogyakarta but also from other regions and other different insurance companies.
2. The data were obtained only from the questionnaires filled out by the respondents. There were no other data from, for examples, the managers or the companies to confirm the data obtained from the sales force respondents. This limitation may lead into common method variance bias.  
It is recommended that additional data be taken to refine the next research. The additional data shall be from the managers and the companies evaluating the creativity and performances of the employees to justify the ones obtained from the sales forces.
3. The companies were involved only in term of permit processing for data collecting. They did not intensively engage to confirm the sales forces on the importance of their being respondents. Hence, there is possibility that some respondents were not committed in data completion.

The company commitment to get more involved in the research is believed to produce more qualified data collecting process. With a total support from the company, it is expected that the research will have more and better data in shorter time.

4. The questioned items are considered too many. There were 99 items to respond. Moreover, the construct is a translation version of English in that it may lead some kind of misperception from the respondents toward the actual meaning of the questionnaires. Such a condition may spoil the concentration of the respondents during the process of filling out the questionnaires.

The writer of this research suggests that the next researchers obtain data through integrated interview methods. This aims to confirm that respondents completely understand the real meaning of every construct they are dealing with. Interviews can also build a better interaction between the respondents and the researchers so that the concentration of the respondents in data completion can be consistently maintained.

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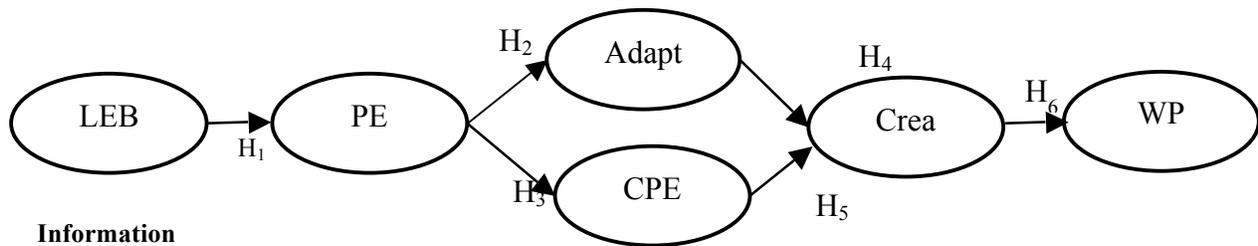
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**Figure 1**  
**Hypothesized Model**



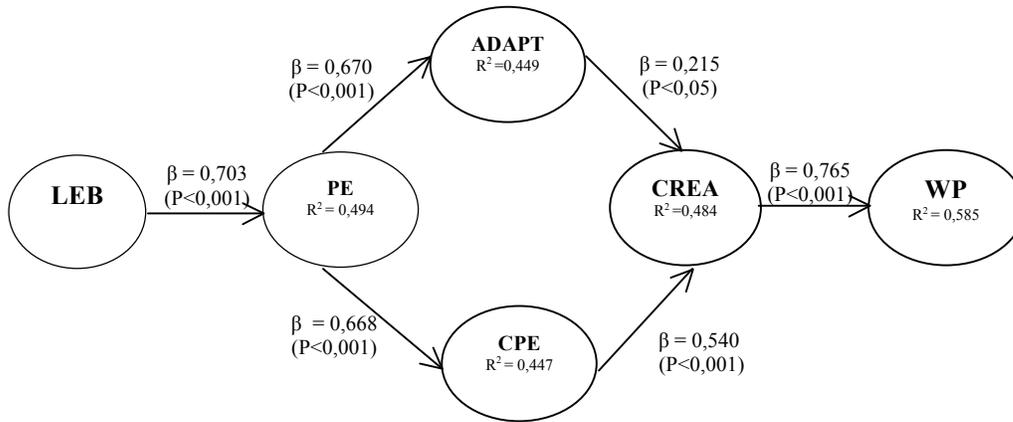
**Information**

- LEB : Leadership empowerment behavior
- PE : Psychological empowerment
- Adapt : Adaptability
- CPE : Creative process engagement
- Crea : Creativity
- WP : Work performance

**Table 1**  
**Reliability Test Result**

Variable	Cronbach's Alpha	Composite Reliability
Leadership empowerment behavior	0,978	0,979
Psychological empowerment	0,941	0,949
Adaptability	0,959	0,963
Creative process engagement	0,941	0,949
Creativity	0,948	0,955
Work performance	0,922	0,935

**Figure 2**  
**Path Coefficient Result**



**Information**

LEB : Leadership empowerment behavior  
 PE : Psychological empowerment  
 Adapt : Adaptability  
 CPE : Creative process engagement  
 Crea : Creativity  
 WP : Work performance

**Table 2**  
**Hypothesis Test Result**

Path	B	P-value	R <sup>2</sup>	f <sup>2</sup>
LEB -> PE	0,703	P<0,001	0,494	0,978
PE -> ADAPT	0,670	P<0,001	0,449	0,815
PE -> CPE	0,668	P<0,001	0,447	0,807
ADAPT -> CREA	0,215	P<0,05	0,484	0,054
CPE -> KREA	0,540	P<0,001	0,484	0,342
CREA -> WP	0,765	P<0,001	0,585	1,409

**Information**

LEB : Leadership empowerment behavior  
 PE : Psychological empowerment  
 Adapt : Adaptability  
 CPE : Creative process engagement  
 Crea : Creativity  
 WP : Work performance

## **WHY DO ACCOUNTING STUDENTS AT HIGHER LEARNING INSTITUTIONS CONDUCT AN ACADEMIC DISHONESTY?**

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### ***ABSTRACT***

*Academic dishonesty is a serious educational problem. One of the big impact of academic dishonesty is difficulties to produce high quality accounting students. Nonis and Smith (2001) found that the tendency to cheat at workplace appertain with the frequency of cheating in college. This study aims to empirically examine the influence of individual factors and situational factors to the intention of accounting students to conduct an academic dishonesty. There are 342 accounting students as respondents involved for this study. They are consisting of first to third year students of undergraduate program in accounting at one state university in Yogyakarta. This study used survey as data collection technique by using a set of a questionnaire. Respondents response were measured using a Likert scale. There are six hypotheses in this study which were tested using multiple linear regression. This study found that the individual factors which consist of attitudes, subjective norms, and perceived behavioral control are have positive and significant effects to the intention of the accounting students to commit an academic dishonesty. However, among three situational factors only pressure and definitional ambiguity that have a positive and significant effect to the intention of accounting students.*

**Keywords:** *academic doshonesty, attitute of accounting student, subjective norms*

## ORGANIZATIONAL BLOCKAGES IN HIGHER EDUCATION PERFORMANCE: TQHRM AND KNOWLEDGE STRATEGY APPROACH

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### **ABSTRACT**

*Output in higher education is human resource management and their capabilities, so the priority will be quality. The quality assurance assessment is conducted by an accrediting agency, called Badan Akreditasi Nasional Perguruan Tinggi (BAN-PT). Otherwise, it is also conducted on international standard such as QS. World, 4ICU, and Webometrics. Therefore, there is different perspective about the success indicators of the organization. When referring to activities related to human and knowledge that need to streamline management through Total Quality Human Resource Management (TQHRM) approaches in order to support the application of knowledge strategy to achieve the optimum organizational performance. But, first of all, to achieve this goal, it is necessary to identify the inhibiting factors, so that all can run optimally. These problems sometimes achieve less attention by some parties. Based on this phenomenon, this study aims to identify the organizational blockages of the organizational performance improvement, application TQHRM, and knowledge strategies in higher education. The study was conducted in Universitas Pendidikan Indonesia with study program and the entire unit of the department as the unit of analysis.*

**Keywords:** *Organizational blockages, organizational performance, TQHRM, knowledge strategy, higher education*

### **INTRODUCTION**

In the globalization era, the development of digital information and technology is followed by the increasing number of knowledge-based society. Ease of access to education through technology makes the people to be more selective in choosing a desired university. The opportunity to choose a university based on its reputation will produce globally competitive graduates. However, it is not yet in force in Indonesia.

The challenges and demands given by the community to the university lead to the emergence of various indicators of the performance assessment of a university along with a wide range of references used. These references include QS. World, 4ICU, Webometrics, and THES with their own different assessments and indicators. However, generally speaking, the assessment mainly refers to the output of teaching, research, and community service activities along with the development of

information technology. This is presumably due to the performance of Universitas Pendidikan Indonesia (UPI) is still not optimal.

Based on the assessments issued by independent assessments agencies, the title of the best university of Indonesia has always been obtained by ITB, UGM and UI. In 2015, DIKTI conducted an assessment of the best university based on the quality of the management, human resources, research and scientific publications, and student activities. The results showed that ITB was the first best university, UGM ranked second, and UPI was not included in the top 10. Among these rankings, Universitas Indonesia was the only university included in the top 10 in QS.World and ranked 4 in THES.

UPI is included in the top 10 best university by 4ICU and Webometrics but in the version of DIKTI, it has not been able to enter the top 10. UPI is the 4th largest state university in West Java, ranked 12th best in Indonesia and placed as rank 2342 in the world.<sup>1</sup> However, based on the accreditation or assessment issued by the national standards in Indonesia from Badan Akreditasi Nasional Perguruan Tinggi (BAN-PT), it is still in the "B" category so that it can be predicted that UPI has not fully met the DIKTI assessment criteria.

According to the data of higher education Tridarma (education, research, and community service), UPI is still lacking in terms of scientific publications. It is seen from the number of unpublished researches in either national or internationally accredited journals. In 2014, there were 587 articles published from a total number of 1,236 lecturers (an average of 0.4 articles per education staffs). This number is still below the target of UPI strategic plan which is targeted to reach an average of 1.6 or as many as 1,977 articles produced.<sup>2</sup> Then, the ratio of lecturers and students was 1:29 and it has not been able to meet the standards set by DIKTI, 1: 30.

Reviewing the organization performance of the university in Indonesia is very interesting because the university is not only a non-profit organization, but also an organization that has

autonomy in its management and ability to compete. According to Dr. Sahid Susanto, MS, we need to determine the key performance index (KPI) that can be correlated with the lecturers' performance and should be reflected through Tridarma education (teaching, research, service to the community) along with important elements that are needed to take the university to the global community through its reputation and governance management.<sup>3</sup>

Therefore, the university needs the support from not only the top management but also the entire academic community, education staffs and staff, in improving the performance of the three responsibilities: education, research, and community service that is integrated with science. Therefore, the university is an organization where all activities are related to the knowledge, also known as a knowledge organization. It can be said that knowledge is the main input other than the human resources, so that the development of knowledge will be more easily accomplished. Based on some theoretical studies and the results of previous researches, knowledge management and its activities can improve the effectiveness of the organization of S1 study program in UPI by improving the effectiveness of knowledgeable workers. But, knowledge management must be integrated into the strategic policy of the university as a knowledge-based organization, known as the knowledge strategy.<sup>4</sup> To create an optimal knowledge strategy, it is necessary to control the quality of all main components and support the quality. The concept of quality has long been adopted by universities through total quality management (TQM) which is an approach that focuses on quality, based on the participation of all actors within the organization.

According to the research conducted by Reddy (2012), the concept of total quality management refers to the process of quality to achieve customer satisfaction that became a tool in preparing policies and resources to support the process of knowledge management. In addition, based on the research conducted by Zwain

1 ([www.kampusundip.com](http://www.kampusundip.com))

2 Laporan Tahunan UPI Tahun 2014, p:231-232

3 [www.manajemenpendidikantinggi.net](http://www.manajemenpendidikantinggi.net)

4 Suharsaputra, Uhar. 2015. *Manajemen Pendidikan Perguruan Tinggi "Strategi Menghadapi Perubahan"*. Refika Aditama. Bandung.

(2012), TQM has a positive and significant impact on the knowledge management as well as the organizational performance of a university.

According to Jain and Gupta (2012), the TQM process in the continuous improvement should be coupled with employees who want to work optimally so that it requires an approach to human resource management or referred to as Total Quality Human Resource Management (TQHRM) which output is empowering employees resulted in employee engagement outcomes.

But, the key factor of its application is how each university can know the internal situation and identify inhibiting or driving factors of organizational performance improvement, knowledge strategy and TQHRM in order to make it more effective and efficient.

Organizational blockages are variables considered to be the inhibiting factor for the organization. This includes the level of individual, group and organizational structure. However, we can not generalize the inhibiting factor for the entire organization. All depends on the application of any of the variables studied.

From the research conducted by Gavrea, Ilies, and Stegorean (2011) on the performance of the organization, it is shown that there are 13 determinant variables.

Then, according to Lowery (2011), aspects that affect TQHRM are commitment, coordination and communication. Meanwhile, knowledge strategy depends on the culture of the organization itself and is accompanied by technology support.

Based on this background, this study aims to identify blockages in higher education Organizational performance: TQHRM and Knowledge Strategy Approach.

**LITELATURE REVIEW**

**1. Organizational Performance Blockages**

Based on the results of the research on the determinants of organizational performance conducted by Gavrea, Ilies, and Stegorean in 2011 against 92 companies in Romania using Pearson Product Moment, the organizational

performance blockages can be divided into two categories: external environment and internal environment. The external environment consists of suppliers, competitors and partners while the company's internal conditions such as: strategic leadership, human resources (HR), organizational structure, quality, assessment of performance, innovation and development, information technology and Good Corporate Governance (GCG). The dominant variable affecting the performance of the organization are the assessment of performance, human resources, external environment, strategy, corporate governance, innovation and development, leadership, quality (through ISO), and information technology while the organizational structure has a low impact on the development of performance as shown in Table 1.

**Table 1.** Pearson Correlations

Variabel	Performance (Total)
Performance Assessment	0.485
Human Resources	0.454
External Environment	0.445
Strategy	0.429
Good Corporate Governance	0.398
Innovation and Development	0.379
Leadership	0.328
Quality	0.286
Information and Technology	0.260
Organizational Structure	0.147

Source: Gavrea, Ilies, dan Stegorean (2011)

Table 1 shows that the highest correlation is performance assessment variable. This is consistent with the existing phenomenon of the issue of performance assessment indicators, which, until now, is still a problem as it does not focus on one assessment whether it is financial or non-financial. Likewise, the university is currently using indicator-based administration that has not been correlated with the performance of teachers and education personnel. Meanwhile, based on the research conducted by Lopez (2003) against 72 companies manufacturing in Spain, there was a significant correlation between internal resources (the company's reputation, human capital and organizational culture) and organizational performance. In addition,

Henderson and Cockburn (1994) and Carmeli and Tishler (2004) put through a study of 99 departments of local governments in Israel and found a positive and significant influence of internal resources (capability of managerial and organizational culture) toward the performance of the organization, and culture was the most powerful organizational variables affecting organizational performance.

Similarly, a research conducted by Armia (2002) on higher education departments, which focus on improving the performance of organizations in terms of non-financial, found the influence of the cultural dimensions of Hofstede (power distance, uncertainty avoidance, individualism / collectivism, and masculinity / femininity) toward the characteristics of the individual or organizational culture which eventually determine the organizational system, monitoring system, evaluation system, and reward systems that match the characteristics of the individuals within.

Based on a series of literature study and previous studies, the inhibiting and driving factors of organizational performance improvement for this study are: Performance Assessment that includes context, content and assessment processes of the organization, human resources consist of human resources quality and commitment of human resources, strategy of the university, Good Corporate Governance, Innovation and development, Leadership, Quality (ISO role), information technology, organizational culture and managerial capability.

## **2. Total Quality Human Resource Management (TQHRM) Blockages**

Based on the results of research on quality, using the Malcom Baldrige Scheme, human resource management greatly affects the successful implementation of total quality management (TQM). According to Schonberger, TQM can be implemented in a department if there is an evolution of human resource management practices that lead to 3C (commitment, cooperation, and communication). This evolution is called total quality human resource management (TQHRM).

TQHRM is one of the approach of human resource management that involves the concept of quality management because within the framework of the system (input-process-output), either TQM or TQHRM transforms the resource but has different output. TQM produce products and services that achieve customer satisfaction while TQHRM output is in the form of qualified human resources through employee empowerment. TQHRM also illustrates the evolution of the practice of human resource management from support functions into a leadership function. Thus, the role of human resource management in TQHRM will be different from the usual approach, which is conventionally used to identify, prepare, direct, and appreciate the organizational actors who adhere to the organization scenario. Meanwhile, the concept of TQM functions more on strategic policy development procedures to ensure that employees can perform, improvise and be creative when needed, and set themselves in efforts for continuous improvement of the quality of products and customer service.

However, in the implementation process, we will need to identify the inhibiting and or driving factors in order to run effectively. We need to identify what factors impede the empowerment of the employees. According to Unblocking Based Organizational Questionnaire (UOQ) developed by Dave Francis and Mike Woodcock (1994) against various companies both in small and large scale in the world, organizational barriers in the employees empowerment include 14 common obstacles, namely:

Unclear aims, unclear values, Inappropriate Management Philosophy, Lack of Succession Planning and Management Development, Confused Organizational Structure, Inadequate Control, Inadequate Recruitment and Selection, Unfair Rewards, Poor Training, Personnel Stagnation, Inadequate Communication, Poor Teamwork, Low Motivation, and Low Creativity.

UOQ was also applied in the company in Indonesia in a study conducted by Kadiyono and Sumantri to 265 employees PT.X and the results found three main inhibiting factor for the organization, namely:

1. Low work motivation of the employees
2. Ineffective Team Work
3. The relationship between superiors and subordinates are not in harmony

These three factors were derived from the three highest ranking given by the subjects of the research based on the Theory of Organization Blockages by Mike Woodcock & Dave Francis (1994). This is in accordance with Schonberger in Lowery (2000) that TQM can be implemented if there is evolution of human resources management practices that lead to 3C (commitment, cooperation, and communication).

From these explanations, it can be concluded that the application of enabling and constraining TQHRM involves (1) motivation, (2) commitment, (3) cooperation, (4) communication.

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### **3. Knowledge Strategy Blockages**

Basically, Knowledge Strategy is a knowledge that has been integrated into the strategic vision and mission of the organization, which is supported by information technology. Therefore, the activity consists of:

#### **1. Knowledge Retrieval**

Knowledge retrieval refers to the collection of information and knowledge for planning, decision making and problem solving. This involves the process of capturing the existing knowledge through formal representations and acquires the necessary knowledge and information.

#### **2. Knowledge Utilization**

It refers to the extent to which a person applies or uses knowledge to make a strategic decision, the act of taking information and modify behavior in order to achieve the purpose of the Organization, or has the potential to change the practice patterns of the organization separately.

#### **3. Knowledge Sharing**

It refers to the extent to which a person wants to share his knowledge and experience. It involves the distribution of knowledge from one party to the other and the transmission of

knowledge of the organization for all those who need such knowledge.

Judging from its activities, in achieving successful implementation of knowledge strategy, there must be support from various aspects including:

- 1) Culture: It shows whether the behaviors within an organization enable effective knowledge management. Awareness and Commitment is confirmed from responses that show whether staffs understand the concept of knowledge management and whether senior management is committed to its use. Incentives given are checked from whether the organization properly gives rewards to those who support its efforts towards knowledge management.
- 2) Organization: The degree to which the organizational structure supports knowledge management. And, it's external focus demonstrates whether an organization is attempting to look beyond its own boundaries in order to maximize its business opportunities
- 3) Strategy: It refers to whether the organization has committed to a programmer of Knowledge management improvement and how it is managed to ensure Business benefit.
- 4) Effective & Systematic Processes: IT: It indicates whether the IT in place is sufficient and used effectively enough to support knowledge management.
- 5) Measures: Indicates Using and Applying Knowledge: Whether the business actually uses and exploits the knowledge inherent in the company in an effective manner.

The condition can be a stimulus and obstacles in the application of Knowledge Strategy, which is the readiness of organizations adopting in their activities. Based on this, so in this study, factors inhibiting the implementation of Knowledge Strategy, namely:

- 1) Knowledge culture
- 2) Knowledge organization
- 3) Strategy, systems, and Infrastructure IT

## METHODOLOGY

This research was conducted in Universitas Pendidikan Indonesia (UPI). The primary data were collected through a questionnaire survey distributed to 73 organization in UPI such as study programs and other departments including 55 study programs and 18 supporting department taken as sample using Slovin and Slovilla formula with error 5% and 1 person from each organization as respondent. The respondents are chairman of the program of study and chairman of organization. The data is categorized into four criterions: low, less, enough and high.

## FUNDING AND DISCUSSION

### Organizational Performance Blockages

The field surveys of the 73 samples showed that, of the 13 factors thought to be the inhibiting factor in organizational performance improvement in UPI, human resources (HR), particularly the commitment of human resources, is ranked as the first inhibiting factor as expressed by 82% of respondents. And, content organization assessments ranked last or ranked 13th as stated by 27% of respondents so that it is considered less likely to be a barrier for organizational performance improvement in UPI. The following is an inhibiting factor assessment in UPI organizational performance environment, as shown in Table 2.

**Table 2.** Organizational Performance Blockages of UPI

No.	Organizational Blockages	%
1.	HR Commitment	82
2.	Quality Culture (ISO)	73
3.	Organizational Culture	71
4.	HR Quality	70
5.	University Strategy	68
6.	Innovation and Development Capacity	65
7.	Managerial Ability	58
8.	ICT Application	57
9.	Leadership	53
10.	Organizational Performance Process	52
11.	GCG Application	45
12.	Organizational Performance Context	31

Source: Processing Data (2016)

Table 2 shows that the commitment of human resources, as expressed by 82 % of the respondents, becomes the main factor inhibiting the performance of UPI. In this case, the commitment of the university human resources is low. Based on field observations, public universities employees are mostly civil servants and the absence of a performance-based assessment system forms a working culture that does not demand performance. Then, it may also caused by the characteristics of the lecturer who is not tied to the organization and just do the workload set by the government in terms of education, research and community service, and other work. In addition, the assessment of individual performance does not affect the compensation obtained so that each education staffs or educators are not interested to work optimally and work only to get the promotion. And, it's all still the responsibility of the individual while the organizations, both study programs and the university, doesn't not have the authority to conduct the evaluation.

In addition, factors that do not become an obstacle to the performance of UPI is an assessment of the organization as stated by 27% of the respondents. This may be because universities have to follow the rules used by the national accreditation board which is only applicable in Indonesia. As a result, each university cannot refuse the policy.

### TQHRM BLOCKAGES

Based on theoretical concept on this research, motivation, organizational communication, organizational commitment and coordination as important because can be predicted as TQHRM blockages.

In addition, respondents gave a rating variables considered would be an obstacle to the implementation TQHRM in UPI, Showed at Table 3.

**Tabel 3.** TQHRM Blockages

No.	Variable	%	Category
1	Organizational Commitment	61.04	Enough
2	Motivation	19.48	High
3	Organizational Communication	12.99	Enough
4	Coordination	6.49	Very Good

Source: Data Processing, 2016

Table 3 showed that the perception of the respondents of TQHRM blockages at UPI 61.04% respondent agree if organizational commitment as first blockages and also very important. Motivation for ranking 2, and then organizational communication in third position. In the last position is coordination.

Table 16 showed that UPI has High motivation its means all organization has good contribution to increase their performance. But only 19.48% respondent, motivation as TQHRM Blockages. Because not only from individual motif but also needed organizational stimulus. So far UPI has remuneration system to appreciate their employee performance. Otherwise, employee criteria in UPI as civil servant so for their career path decided by itself. And also, to motivate their employee especially for lecturer, the university have incentive program who has publication international indexing by scopus. Then, has program to evaluate lecturer quality by satisfaction survey by their colleges. All that program can be stimulus motivation to improve their performance. So, the data interpreted that motivation in UPI is high category.

In descriptive statistic showed that level of coordination in UPI has very good condition and only 6.49% said being TQHRM blockages. The reason of this situation because university who has small unit organization such as program study and department and responsibility itself to their performance, even though must connected with university goals.

Other variable who has predicted as TQHRM blockages is organizational communication.

Based on descriptive statistic showed in fairly good condition and only 12.99% said as TQHRM blockages. The same with level of coordination, organizational communication of university consist of program study and department or small unit organization, to faculty and then to university. So it can be miss communication.

But based on data, 61.04% of respondent said organizational commitment as the most important think as TQHRM Blockages in UPI. TQHRM as quality approach, so needed full contribution and continuous in all units and all employee. But the interesting phenomenon is organizational commitment of all organization in UPI has fairly enough. The situation can be predicted based on characteristic of the employee, such as lecturer and colleges. For colleges such as employee in administrative area can be controlled in remuneration system. But for lecturer who their activities including 3 point such as teach, research and community services is hard to control by university. Because for lecturer performance appraisal and their reward doesn't exist, so almost lecturer has side job in other organization. It's affected in their performance, who has minimal contribution as long as minimum standard.

### KNOWLEDGE STRATEGY BLOCKAGES

Based on theoretical concept on this research, knowledge culture, knowledge organization, and strategy, systems and infrastructure IT can be predicted as knowledge strategy blockages.

Based on descriptive statistic and compare with respondent answer to variable rank who predicted as knowledge strategy blockages implementation, as showed as Table 4.

**Table 4.** Knowledge Strategy Blockages

No.	Knowledge Strategy Blockages	%	Category
1	Knowledge Culture	39	Fairy enough
2	Strategy, System and IT infrastructure	34	Very Good
3	Organizational Knowledge	27	Fairy Good

Source: Data Processing, 2016

In table 4, knowledge culture has the first rank who predicted as knowledge strategy blockages or 39% respondent. But compare in reality from statistic descriptive has fairly enough. Its because core business of university is knowledge, so their activity from create, sharing, use knowledge from tacit to explicit but didn't guaranteed become their culture or called knowledge culture. Based on observation, to build knowledge culture need effective and continuous knowledge sharing, but different in real situation. All people in the organization hard to share their knowledge with other. Almost keep their knowledge for her/himself.

And for second rank as knowledge strategy blockages is strategy, system and IT infrastructure. For descriptive statistic 34% respondent answer has very good condition. UPI has good rank in webometrics so quality in infrastructure in internet access has good condition and also all their activities by online.

The last rank as knowledge strategy blockages is organizational knowledge, and it compare with descriptive statistic showed has fairly good category. Its reflected university is organizational based knowledge.

## CONCLUSION

Based on research, have 3 conclusion they are:

1. From 14 who predicted as organizational performance blockages in UPI from human resources such organizational commitment become first rank, and content of organizational performance become last position. Its implied that small unit or program study and all department must have connected with university goal. Today to evaluated university performance in Indonesia used BAN-PT standard, so content of organizational performance cannot be blockages.
2. From 4 variable who predicted as TQHRM blockages in UPI commitment become the most important. And the situation in UPI commitment of all

employee in enough category. Its showed more treatment to increase all employee commitment.

3. From 3 variable who predicted as knowledge strategy blockages in UPI needed build strong knowledge culture with system, strategy and infrastructure IT in very good condition especially has good access of internet with integrated in all system. And also organizational knowledge.

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Laporan Tahunan UPI Tahun 2014

## **THE IMPACT OF ANTENATAL CARE PROGRAM TO BIRTH WEIGHT ON PREGNANT MOTHER IN INDONESIA: INSTRUMENTAL VARIABLE REGRESSION APPROACH**

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### ***ABSTRACT***

*Development is not only about increasing the economic growth, but also increasing the quality of education and health. Maternal and child health is one of the national development goals which already listed as one of the Millennium Development Goals (MDGs) and now has become the Sustainable Development Goals (SDGs). This paper evaluates the impact of antenatal care check-up program - ANC on pregnant mother to birth weight, which it's one of the indicators of the healthy baby born. In this study, characteristics of the recipient of ANC are pregnant mothers who are measured by her weight and her blood pressure, checked of urine, taken a blood sample, received the tetanus injection and the iron tablets. This study using data from The 2012 Indonesia Demographic and Health Survey (Survei Demografi dan Kesehatan Indonesia, SDKI 2012). This study also uses instrumental variable regression to deal with endogeneity of antenatal care program. The results confirm that antenatal care program (ANC) can increase the birth weight about 366.45 grams. However, the probability of pregnant mother got antenatal care program (ANC) in rural areas 1.22% less than urban areas.*

**Keywords:** *human development, antenatal care check-up program (ANC), birth weight, instrumental variable regression*

## VALIDATING INFORMATION SYSTEM SUCCESS FACTORS MODEL: A STUDY OF STATE-OWNED INSURANCE APPLICATIONS

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### **ABSTRACT**

*The growth of e-government in Indonesia leads to increasing demand towards better public services; hence the measurement on the e-government success should be performed. This study aims to assess modified Delone & McLean IS Success Factors model that determined by five variables: system quality, information quality, service quality, user satisfaction and individual perceived net benefit.*

*This study used quantitative approach and was conducted in a state-owned insurance company. The numbers of total samples are 298 employees who are the users of these applications, from regional division and branches office all over Indonesia. The results provide an extended understanding of the variables that measure IS success and implications of this study are discussed.*

**Keywords:** *system quality, information quality, service quality, user satisfaction, individual perceived net benefit, e-government*

### **INTRODUCTION**

This template uses MS Word 2010 and saved The growth of Information and Communication Technology (ICT) enables the development of e-government, in order to improve access and service delivery of government into citizens, business partners and employee either locally, state or municipal level (Gupta, Dasgupta, Gupta, 2008).

In Indonesia, development of e-government begin from the year 2003 based on instruction of the president of Republic Indonesia number 3 of 2003 about national policy and strategy development of e-government, stating that the government is trying to apply electronic based government system to increase the effectiveness and efficiency of public services. Then, continue in year 2006 based on President Decree number

20/2006 regarding the establishment of the Council of National Information and Communication Technology (Detiknas) to formulate the general policy and strategic direction of nation development, by utilization of ICT. After that, in 2014 based on President Decree number 1/2014 the responsibility of Detiknas was increased into utilization of ICT on infrastructure, application and content. In the presidential era of Indonesian current president Joko Widodo, government continues to develop e-government system. It will increase the transparency between government and citizens, as people are able to access any government document, including the national budget.

This state-owned insurance company as one of government institution in Indonesia that specialized in public health sector, also demanded to improve their public services by aligning ICT

advantages into their business. Core and supporting applications have been developed in order to support operational activities. It is expected to deliver the value of business and enhance the performance of employee in doing their work. However, there is no specific evaluation established to measure the effectiveness of these applications.

In order to evaluate the success of information systems (IS) investment, Delone and McLean (2003) developed a model named as IS success model which consist of interdependent variables such as system quality, information quality, service quality, use, user satisfaction and net benefit, is one of the suitable models which have been used by many researchers in several contexts. In the context of government, this model has been used by Wang & Liao (2008) on Taiwan government-to customer (G2C) system, and also by Ali & Khan (2010) on Swedish Taxation, as well as Lee (2010) on web based state or local e-government systems. In Indonesia, this model has been used to measure the success of e-government system by Dewi (2010) in Sragen government, and Wahyuni (2011) in West Java, Central of Java and East Java local government that used regional management information system (SIMDA) application as well as Budiyanto, Santoso, & Saputro (2015) in Pekalongan government.

## **LITERATURE REVIEW**

Due to high pressure on competition in the market, Petter et al. (2008) argues that starting from 2008 organization are keen to evaluate the investment in technology to know about what kind of return that the company will retrieve from those investment. In contrast with traditional IS evaluation, e-government success evaluation is considered as a complex process (Wang and Liao, 2007). Moreover, Alshawi and Alalwany (2009) argues that e-government success evaluation is harder to conduct because it have multiple views of the stakeholders, in which not only fulfill the demand from the public, but also other parties who use the same e-government service.

At early stage, traditional evaluation such financial calculation are keen to be used by companies to measure the investment return (Rubin, 2004; in Petter et al., 2008). This also considered the most familiar approach to measure the success of e-government by calculating such return on investment, cost/benefit, present worth and payback period, but limited only into tangible assets (Alshawi and Alalwany, 2009). After that, since IS investment contain intangible assets, balance score card also used by companies to measure the performance of it as an alternative options (Kaplan and Norton, 1992).

As a response to the evaluation on there IS success model, Delone and McLean revised their model by adding service quality inside three quality dimensions along with information quality and service quality (Delone and McLean, 2003). Also, the alteration added in merging individual impact and organizational impact into net benefits. This change was due the impact of successful IS not only to individual but can be broad as organizational or industries, therefore net benefits will represent both perspective advantages (Myers., et al 1997; Seddon, 1999).

System quality refers to performance of the system in which they can provide information to the users and decision makers (Delone and Mclean, 2003). Then Seddon (1997) stated that system quality is issued the existence of a bug of the system, user interface consistency, ease of use, documentation quality and occasionally the program code maintainability. Furthermore, Petter et al. (2008) argued measurement on system quality can be done by using several parameters such as ease of use, flexibility of the system, reliability of the system and system ease of learn, followed by feature inside the system, sophistication and system response time. Other measurement parameters of system quality also has been used in the previous study such as accessibility (Bailey and Pearson, 1983), adaptability, availability, and usability (Delone and Mclean, 2003), attractive, easy to navigate, and system interactivity (McKinney. et al, 2002).

Information quality means the desired attribute of information that the systems will provide, such as the content that support the user

to perform their task while using the system or application (Petter et al., 2008). After that, information quality also have strong relationship between user satisfaction (Livari, 2005; Wu & Wang, 2006; in Petter et al., 2008). This relation was proven by Edlund & Lovquist (2012) state that information that provided by the system should be easily understand by the users and it must be accurate, in other hand the user might get frustrated if that condition not meet.

While measuring the information quality, in the previous study there are several components can be included such as accuracy (Seddon and Kiew, 1994; in Petter et al., 2008), completeness (Delone and McLean, 2003; Petter, 2008), ease of understanding (Bailey and Pearson, 1983; Seddon, 1997; McKinney and Zahedi, 2002; Delone and McLean 2003; Petter et al., 2008), relevancy (Bailey and Pearson, 1983; McKinney and Zahedi, 2002; Delone and Mclean 2003), and timeliness (Seddon, 1997; Petter, 2008; Song, 2010).

Service quality is a new component inside the Delone and Mclean IS success model. This variable has been studied by Parasuraman in (1988) by the establishment of SERVQUAL which includes 5 dimensions of service quality assessment by the customer: tangibles, responsiveness, assurance, empathy and reliability. Furthermore, Parasuraman (1988) describes “tangibles” as an equipment and facility provided by the personnel, “responsiveness” as fulfillment of the service that has been promised before, “assurance” as knowledge of the employee to give confident the customer, “empathy” as individual attention given to the customer and understanding the customer needs, and “responsiveness” as providing prompt service to the customer. In IS context Delone and Mclean (2003) define service quality as a support service provided by the IT support personnel of related system to the user (Delone and Mclean, 2003).

The measurement of information system effectiveness is widely derived from user satisfaction (Delone and Mclean, 2003). This theory also strengthens by Seddon (1997) argued that Information system success common

measurement is based on the satisfaction from the user towards the system. After that, Petter et al. (2008) defined user satisfaction as the level satisfaction of users towards web sites, reports and support services. In addition, Lee (2010) mentioned that user satisfaction covers both positive and negative perspective from the users after they had experiencing and using the system.

The measurement parameters that commonly used by the researchers are End-User Computing Satisfaction (EUCS) including content, format, accuracy, ease of use and timeliness (Doll and Torkzadeh, 1988). The other parameters are overall satisfaction of the system (Luarn and Lin, 2003), the system meet the expectations of the users (Luarn and Lin, 2003), information satisfaction (Manchanda and Mukherjee, 2014), and system effectiveness (Song, 2010; Manchanda and Mukherjee, 2014) also been used in the previous study.

Net benefit refers to the impact retrieved either by individual or organization by using the system (Petter et al., 2008). Sedera et al. (2004) divide two types of perspective of net benefit that are individual level and organizational level. For individual level, parameter such as learning, awareness, decision effectiveness, and individual productivity are used. While for organizational level, the parameters are organizational costs, staff requirements, e-government, improved outcomes and overall productivity, (Sedera et al., 2004). In this study, net benefit was measured only from individual perspective that defined as individual perceived net benefit. The impact of the system regarded as direct impact that the user earn by using the system.

## **HYPOTHESES DEVELOPMENT**

The main purpose of this research study is to apply the updated Delone and Mclean IS success model (2003) as a measurement model in context of core and supporting application success inside the company. To test the applicability of the modified Delone and Mclean IS success model and the relations between its variables, the following hypotheses are defined:

Livari (2005) argues there is a strong relationship between system quality and user

satisfaction in individual context. Then, other previous studies also found that system quality positively affect user satisfaction (Wu and Wang, 2006; Wang & Liao (2008), Song (2010), Ali & Khan (2010), Edlund & Lovquist (2012)), hence:

*H<sub>1</sub>: System quality will gives positive influence towards user satisfaction of the application.*

Information quality also have strong relationship between user satisfaction (Livari, 2005; Wu and Wang, 2006; in Petter et al., 2008). This relation was proven by Edlund & Lovquist (2012) state that information that provided by the system should be easily understand by the users and it must be accurate, in other hand the user might get frustrated if that condition not meet, hence:

*H<sub>2</sub>: Information quality will gives positive influence towards user satisfactions of the application.*

In service quality, the measurement used in this research is based on SERVQUAL model from Parasuraman et al (1988). The strong relationship was found between service quality and user satisfaction on previous study by Song (2010), Ali & Khan (2010), Edlund & Lovquist (2012), hence:

*H<sub>3</sub>: Service quality will gives positive influence towards user satisfactions of the application.*

The significant relationship between user satisfaction and net benefit also found in the previous study Wang & Liao (2008), Ali & Khan (2010), Edlund & Lovquist (2012). Then, user satisfaction also affecting the user productivity and work effectiveness (Halawi et al, 2007; in Petter et al., 2008), therefore:

*H<sub>4</sub>: User satisfaction will gives positive influence towards individual perceived net benefit.*

Intention of use is a measure of the likelihood a user would employ the application. However, for employees to use the application is mandatory in order to perform the work. Therefore, it was dropped from the proposed model.

## RESEARCH METHODOLOGY

The scope of this research limited into the users of following applications: membership, finance, *arsip digital* and is deductive type of research; Hyde (2000) argues that deductive approach is the examination whether the theory that has been established first can be applied into particular instances. Then, the causal relationship between independent and dependent variables is examined. There are five variables in this research which are system quality, information quality and service quality as independent variables and user satisfaction and individual perceived net benefit as dependent variables.

To obtain the data for this research, online questionnaire was used. The demographic questions consist of Gender, Age, Job Position, Department/ Division, Working Experience, Application Used, Application Usage Frequency, and Application Usage Intensity. While main questionnaires consist of System Quality questions (5 items), Information Quality questions (4 items), Service Quality questions (3 items), User Satisfaction questions (3 items), and Individual Perceived Net Benefit questions (4 items). The questionnaire distribution was also supported by the company internal parties who distribute the online questionnaire link into targeted respondents (application users).

Further, the retrieved data from the questionnaire was analyzed and calculated using SPSS statistical software including reliability test that measures the Cronbach's Alpha, validity test that measures KMO value, and descriptive statistics which includes means, minimum, maximum and standard deviation. For hypothesis testing, the data was examined using partial least square (PLS) in SMARTPLS version 3.0 as PLS enables to do analysis for more than one dependent variables. Lohnmoller (1988) also describes that in this technique there are two types of measurement which are variables in the model (measurement model) and significance relationships among variables (structural model).

**FINDINGS**

From total 336 respondent there are 298 (88.6%) valid respondent retrieved from regional division and branch offices in all over Indonesia. The result shows that, the majority of the application used is membership with the users number of 120, followed by others application that had 86 users, arsip digital with 43 users, finance application 39 users and new edabu which is the lest application that used by the users with number of 10 users.

In terms of gender, overall female users slightly defeat the male user, which has 167 (56 %) respondents out of 298, compared with the male user that had total 131 (44 %) respondents. While according to age that has been divided into four ranges, which are 20-30 years old, 31-40 years old, 41-50 years old, then followed by 50 years old and above. In specify, the highest volume of the user is from 20-30 years old, that has 67% (199 number of respondent), followed by the other age ranks that decrease gradually, which are 86 person (29%) from 31-40 years old; 3% of respondent from 41-50 years old (9 people); above 50 years old that is only 1 %, that consist of 4 people.

In working experiences category, the highest rate is from 1-3 years of working experiences as stated of 177 correspondences (59%), then followed by five years and above that has the value of 26 % (76 person), and the last is 3-5 years within 15% as representative of 45 numbers of correspondence. Most of the user use the application as daily basis is 89% or can be defined as 264 of respondents. Then, it reflects that it is the highest peak of the number,

compared to 8% from several times per week, 2% from several times per month, and 1% from several times per year.

Majority of the users 62%, 186 people) use the application for more than 4 hours that can be reflected towards the result. Some (20%, 58 people) use the applications for less than one hour. Lastly, one to four hours of intensity (18%) stated as the third positions. Job position's profile of the users is staff (93%), manager second level (6%), and only 1 percent was coming from higher level managers.

Regarding the reliability and validity, all variables are considered as reliable since the Cronbach's Alpha value is higher than minimum accepted level of 0.6, and valid as all KMO values are higher than the minimum accepted.

The next step performed was inferential statistic which testing the hypothesis, this test was done in SMARTPLS version 3.0 that consists of two steps: measurement model test and structural model test. Measurement model test involves factor loading, path coefficient and their significant level, also with coefficient of determination ( $R^2$ ) (Gefen et al, 2010). The results of measurement model test is presented in the Figure 2.

The result shows that the factor loadings of almost each variable produce a positive result with value more than the minimum accepted level of 0.7. Only indicator SYSQ1 produce value of 0.698, lower than 0.7 but since 0.6 also accepted for the exploratory research, therefore indicator SYSQ1 still able to use for further analysis. Table 5 shows the result of coefficient of determination ( $R^2$ ).

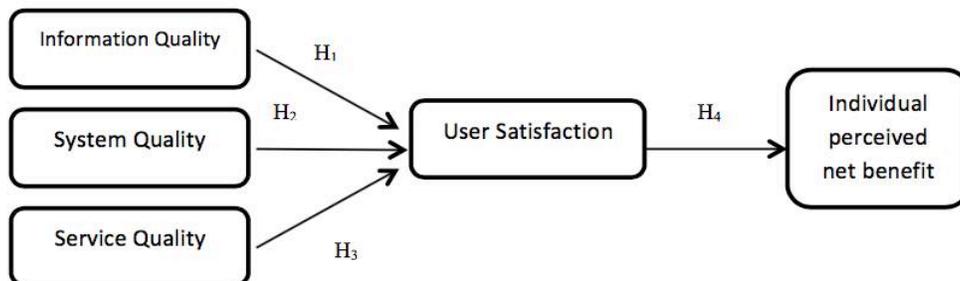


Figure 1. Modified Delone & Mclean IS Success Model (2003)

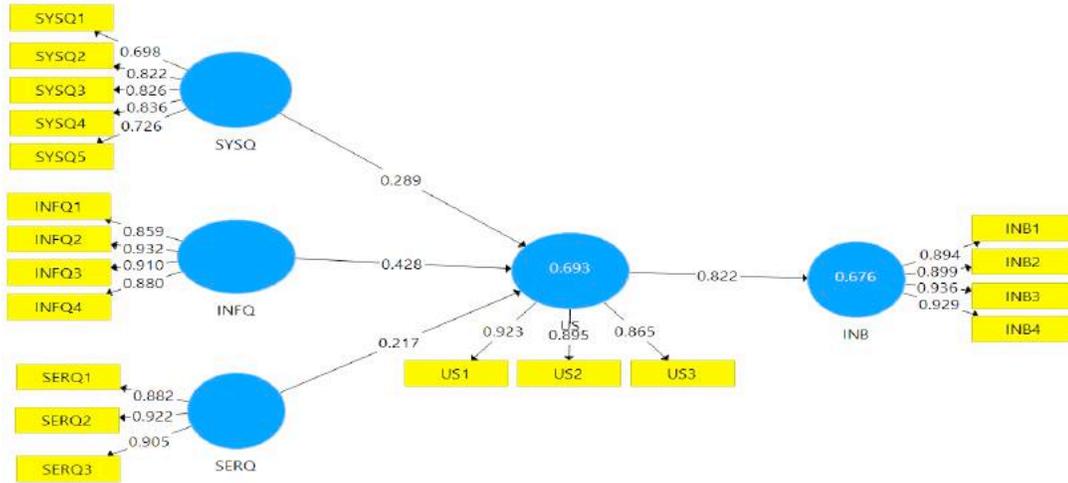


Figure 2. Measurement Model Test

The result shows that the factor loadings of almost each variable produce a positive result with value more than the minimum accepted level of 0.7. Only indicator SYSQ1 produce value of 0.698, lower than 0.7 but since 0.6 also accepted for the exploratory research, therefore indicator SYSQ1 still able to use for further analysis. Table 5 shows the result of coefficient of determination (R2).

The coefficient of determination (R2) test resulting R square adjusted value of 0.675 for user satisfaction and 0.690 for individual perceived net benefit dependent variable. This means 67.5 % of user satisfaction is explained by independent variable system quality, information quality and service quality. While the 32.5 %

(100% - 67.5%), explained by other variable outside this research model. Then, 69% of individual perceived net benefit is explained by independent variable user satisfaction, means the rest (21%) is defined by other variable outside this research model. In addition, this model considered as strong with R square adjusted value for more than 0.67 (Chin, 1998).

In structural model or hypothesis testing, involves the calculation of path coefficient by using SMARTPLS version 3.0 in bootstrap sampling method from 1000 generated samples (Figure 3). In addition, P-Value and T-value were also calculated for determining the significance level (Table 1).

Table 1: R Square and R Square Adjusted Test

Variables	R square	R square adjusted
User Satisfaction (US)	0.676	0.675
Individual Perceived Benefit (INB)	0.693	0.69

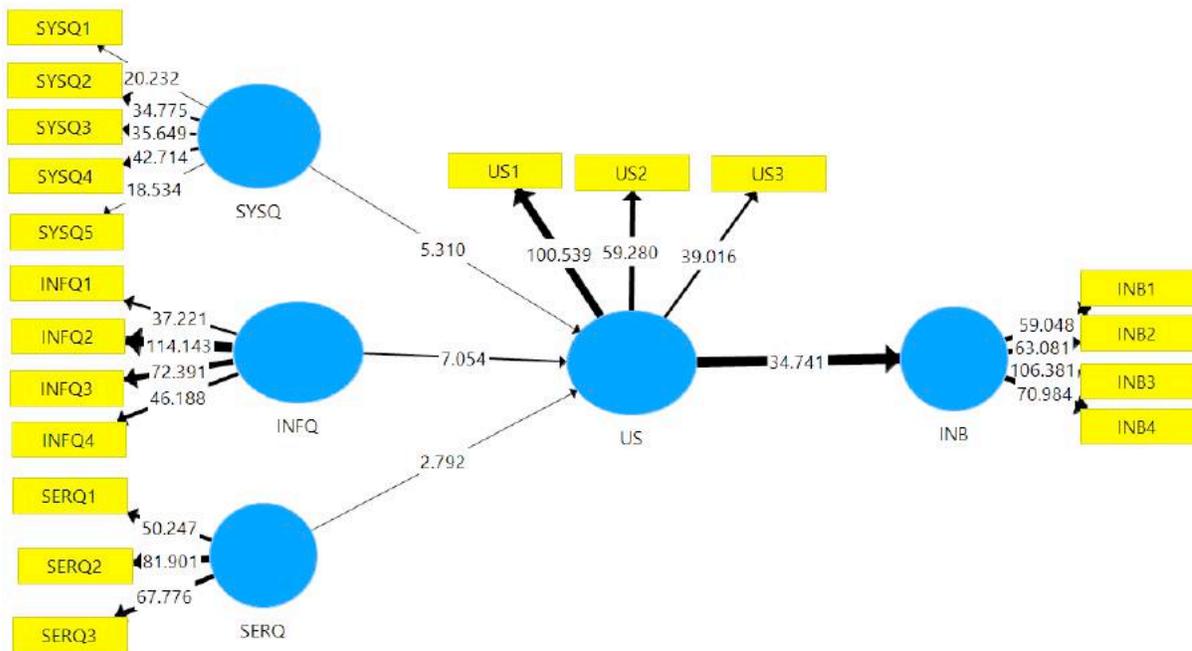


Figure 3. Structural Model Test

Table 2: . Path Coefficient and Significant Test

	Path Coefficient	Std Deviation	T-Statistical value	P-value
SYSQ -> US	0.289	0.054	5.310	0.000
INF -> US	0.428	0.061	7.054	0.000
SERQ -> US	0.217	0.078	2.792	0.005
US -> INB	0.822	0.024	34.741	0.000

Based on the table above, the result shows all the variables show the positive result in both aspects. For P-value, all variables had P-value under 0.05 which means it is significance. Next, the result of T-statistical value of all variables indicates higher than the minimum accepted level of 1.96, dominated by user satisfaction with 34.741 and the least score produce by service quality with value of 2.792.

The empirical results provide considerable support for the model. All hypothesized relationships were found to be significant. Variable individual perceived net benefit is considered as the main aspect compared with other variable. This variable value is derived from the quality dimensions and user satisfaction variable. Application developer should develop application with good system quality, information quality and service quality then it gives the satisfaction from the users and the individual perceived net benefit will be earned by the users from using the application. Moreover, user satisfaction indicates strongest direct effect towards individual perceived net benefit. This result was proven by the previous study conducted by Ali & Khan (2012) on evaluating Swedish E-taxation system that highest direct effect in perceived net benefit was produced by user satisfaction variable.

Regarding the quality dimensions, information quality show the most robust direct effect on user satisfaction and indirect effect on individual perceived net benefit. This outcome is supported from the previous study by Wang & Liao (2008) on G2C e-government which indicates the same result. In addition, information quality and user satisfaction had strong relationship as mentioned in previous literature (Wu & Wang, 2006; Petter et al., 2008; Wisudiawan, 2015). Hence, application developer of the company should consider information quality as the most important aspect of the application. With complete, accurate, relevant and timeliness information provided inside application, the user will perform their work effectively and produce the right result.

Service quality shows least significance relationship. Previous study also concluded that service quality has marginally supported relationship between user satisfaction (Wang & Liao, 2008; Song, 2010; Ali & Khan, 2012). Hence the application user are not really concern about the service quality given or due to poor performance of IT personnel support in the

company which bring the result into least significance. This might because there is limited resources of IT personnel support teams compared with the great number of applications users.

Some interview with personnel/users were conducted to gain more insights of the result. It was confirmed that information quality are the most significant variables that affecting the user satisfaction. Core and supporting applications are integrated and it increased the integrity of information which part of information quality. Furthermore, user satisfaction are the most significant variables affecting individual net benefit which also aligned with the current fact in the company according to the interview result, this application satisfaction level is considered as good.

Additional statistical analysis also conducted in determining which indicator in demographic section is considered as a moderate variable, therefore Welch-Satterwait test are performed in SMARTPLS version 3.0. The result of this analysis indicates only gender is the moderate variable, specifically on information quality and service quality. First, in terms information quality, Hoyer & MacInnis (2010) suggested gender has different perspectives in retrieving information. Next, regarding service quality, this research use indicators of Parasuraman et al. (1988) about SERVQUAL which consist of responsiveness, empathy, and assurance. In line with the result that shown service quality is affected by the gender differences towards user satisfaction, the previous study by Mokhlis (2012) has proven that male respondents produce bigger influence compared with the female respondents in terms of empathy, tangibles, and reliability. It shows the result of moderate variables in this research was also supported the previous study.

## **CONCLUSION AND RECOMMENDATION**

The empirical results provide considerable support for the model. All hypothesized relationships were found to be significant. The empirical results showed that the system quality, information quality, and service quality had a significantly positive influence on user satisfaction. It can be interpreted as a response to the three types of user expectations about a system: they want their applications to be of high

system quality, have high information quality, and provide accepted standard of service quality.

All the relationship between variables in this research is significant based on the path coefficient value of each variable. In this study, the significance relationship is divided into two: direct

and indirect effect since there are two independent variables. Below here is the result of the significance rank of variables based on path coefficient value as described in Table 3.

**Table 3:** . Path Coefficient and Significant Test

	Total Effect		
	US	INB	Rank
US		0.822	1 <sup>st</sup>
INFQ	0.428	0.35	2 <sup>nd</sup>
SYSQ	0.289	0.18	3 <sup>st</sup>
SERQ	0.217	0.239	4 <sup>th</sup>

For future development and improvement, the company should pay more attention on information quality because this variable is the most crucial compared the others. In providing good information quality of the application, the company is suggested to focus on indicators such as *completeness, accurateness, relevancy and timeliness of the information.*

In addition, it is suggested to the company to provide sufficient server and databases since to handle back-end process, added with better integration among applications. Furthermore, the integration between external parties also needed to be improved. From the interview, application response time and application availability are two top issues on most of the applications. Therefore, having a good application infrastructure will improve information and system quality.

Third, although service quality is considered as the least significance variable, it is still important to consider on indicators such as *service desk availability, empathy from service desk staff and service desk staff sufficient knowledge.* With the insufficient number of service desk staff compared with the number of application users, the service desk staff need to be increased. The addition of service desk staff will make the complaints from the application user are easier to solve and manage.

Also, regarding with the knowledge that each staff had, it also need to be improved by

providing better training for them. Hence, with sufficient knowledge, the retrieved complaint can be solved directly without escalate them into the application developer. In addition, based on the interesting fact found regarding gender influences on service quality, in the future the role of service desk can be assigned as male staff for problem solving and female staff for retrieving the complaints from the users.

Lastly, to improve user satisfaction the company needs to refer on the quality dimension that has been explained above. If the quality dimension has been fulfilled the user requirement, then user satisfaction will be earned. The author suggested the company to perform this evaluation method frequently in the company because this evaluation method is only by using questionnaire which is easy to do. Hence the feedback from the user regarding the application success can be earned and future improvement can be made.

The validity of a this IS success model cannot be truly established on the basis of a single study. Thus, it is needed to exercise caution when generalizing the findings. Validation of measurement requires the assessment of measurement properties over a variety of samples in similar and different contexts. Furthermore, samples from different government institutions should be gathered to confirm, evaluate, or refine the model.

In addition, many important exogenous variables, such as managerial factors (e.g. attitudes of top management), facilitating conditions (e.g. reward), environmental factors (e.g. trust, organizational culture), and resource availability may have an influence on IS success. The study indicated that user perceived benefits played a significant role in IS success, but it is necessary to understand the relationship between user perceptions of IS benefits in order to generalize our findings.

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## **CORRELATION BETWEEN TOTAL QUALITY HUMAN RESOURCE MANAGEMENT (TQHRM) AND EMPLOYEE PERFORMANCE**

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### ***ABSTRACT***

*Public universities have always had management problems especially in terms of the performance of its employees including both lecturers and academic staffs. The quality of lecturers as well as the optimal performance quality of academic staffs are the main source of the success of a university. Indonesian Education University (UPI) is one of the university that focuses on improving the quality of academic services through building the capacity of its education personnels who serve as the key determinant of good management. This will affect the achievement and target of the performance management and resource quality improvement. One way is through improving the quality of human resources, which is integrated in the activities of human resource management functions and total quality human resource management (TQHRM). Accordingly, this study aims to (1) describe the total quality human resource management (TQHRM) and employee performance, and (2) determine the relationship between total quality human resource management (TQHRM) and employee performance. This study was conducted in Indonesian Education University (UPI) where 76 educators selected as the sample using the formula of proportional stratified random sampling. Data analysis technique used was the Pearson Product Moment Correlation coefficient. The findings reveal that the level of total quality human resource management (TQHRM) and the performance of educational staffs are high and there is a significant correlation between these two variables.*

**Keywords:** *TQHRM; employee performance, human resource management, higher education*

### **INTRODUCTION**

Nowadays, the competition in the world of higher education is very strict similar with

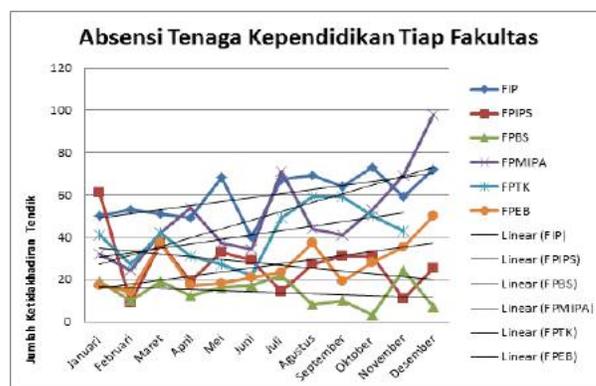
the profit-oriented business world because of the growing number of both public and private universities. In addition, the existing level of competition is not only at the domestic

level but also international level. In response, in 2015, related parties in Indonesia, Ministry of Research, Technology and Higher Education of the Republic of Indonesia, announced the 10 best universities based on four indicators of assessment, including: (1) the quality of human resources, (2) the quality of management and organization, (3) the quality of research and scientific publications and (4) the quality of student activities. The indicators are based on the three responsibilities of Higher Education, namely teaching, research, service to the community coupled with the quality of the management, organization and student activities.

It is interesting that Universitas Pendidikan Indonesia was not included in the first cluster. Based on the 2014 annual report of UPI published in 2015, the main focus of UPI is to increase the capacity of educational personnel and also the capacity of lecturers. This is because educators are the support system of all activities associated with the administration service as one of the key factors of healthy management. This is in accordance with the target of the university to improve its professional academic service quality through human resources capacity building especially educational staffs.

However, based on the preliminary survey conducted to the user of UPI administrative services, it was found that 45% of the respondents said that the performance is still low, 50% of the respondents thought that the bureaucratic system was still complicated, and 62.5% doubted the user complaints handling process. This may be caused by the educational qualification of the education staffs are high school (48.3%).

In addition to the constraints in human resources management, according to Bernardin (2003), a factor that affect employee performance evaluation is the presence of the employee, which is known as timeliness, related to the time required to complete the activity or products. This means that attendance is one of the important assessment for the individual because it will relate to how effective he can produce as shown in Figure 1.



Source: Biro Kepegawaian UPI

Figure. 1 Absenteeism of Colleges

Figure 1 shows the fluctuations in the absence of the educational staffs in each faculty which tends to increase during the period of 2015. The absence is one of the factors of individual performance assessment. The reasons for the absence are various such as leave, without news, hospital, outstation and so on. These may affect the overall performance.

One of the actions carried out by UPI is implementing ISO certification. It is one of the effort of implementing Total Quality Management aiming for continuous improvement by UPI management thoroughly. In relation to human resources, TQM practice is known as Total Quality Human Resource Management or TQHRM. It is an approach regarding the human resources involving a lot of concepts of quality management and aiming to empower the employees. Empirical studies conducted by Juran (1999), entitled Total Quality Human Resource Management-TQHRM, found a significant relationship between total quality management and human resource consisting of four dimensions, alignment, authority, capability and commitment. (VanDevender (2011)

## LITERATURE REVIEW

Every working individual definitely wants to produce something. It is an achievement pursued by someone. Related to the concept of performance, Bernardin (2003) states that the performance is a record of the results produced (generated) on a particular job function or activity during a specific time period. The dimensions of performance are aspects to be used in the assessment of performance that

consists of six basic criterias for measuring performance, namely;

- 1) *Quality* : process or result of an almost perfect / ideal in meeting the intent or purpose.
- 2) *Quantity*: unit number or quantity produced.
- 3) *Timeliness*: the time needed to complete an activity or produce.
- 4) *Cost-effectiveness* : the level of use of organizational resources (people, who, material, technology) to obtain or obtaining the results or waste reduction in the use of organizational resources.
- 5) *Need for supervision* : the individual's ability to complete the job or job functions without the assistance of a managerial or supervisory intervention leader.
- 6) *Interpersonal impact* : the individual's ability to increase feelings of self-esteem, goodwill, and cooperation among fellow workers and subordinates.

Employee performance improvement is how to improve the employee quality through human resource development approach. One is through a quality approach. Evolution of total quality movement starts from the time and motion study by Father of Scientific Management, Frederick Taylor, in the 1920s. Along with the increasing complexity of invoicing, quality also becomes increasingly difficult. The rationale for the necessity of TQM is simple, that the best way to compete and excel in the global competition is to produce the best quality. Therefore, continuous improvement in the capacity of the human, environmental and process are required. The success or failure of the implementation of TQM is largely determined by the ability of the company's HR and / or organization to make it happen.

According to Schonberger, changes in human resource management is necessary for TQM to be implemented and institutionalized. (Tjiptono & Anastasia, 2003) The demand for the creation of the human resources competence, which is suitable with the requirements of TQM, trigger a shift in the practice of HRM. The evolution of traditional HRM practices which is based on the principle of 2C (command and control) is replaced with a new policy that is based on the principle of 3C (commitment, cooperation and

communication) known as the new HRM practices or total quality human resource management (TQHRM).

Empirical studies conducted by Juran (1999) found a relationship between total quality management and human resource that has four (4) dimensions, alignment, authority, capability, and commitment. All of these indicators make human resources more competitive and able to support the innovation activities of the organization. Those are the source of the competitive advantage of the organization. (VanDevender, 2011)

Total Quality Human Resource Management is an approach to HR that involves a lot of concepts of quality management. TQHRM approach focuses on empowering employees through alignment, authority, capability, and commitment.

- 1) *Alignment*. Alignment of organizational goals can be achieved when employees realize:
  - the needs of customers and stakeholders;
  - Know, explain, and be prepared to contribute to strategies, objectives and plans of the organization.
- 2) *Authority*. In terms of authority and the opportunity to contribute to the organization, a step that needs to be done includes:
  - Authority, responsibility, and the ability of individuals are consistently done;
  - Obstacles to the success of the work authority has been abolished;
  - The availability of facilities, infrastructure and adequate support.
- 3) *Capability*. The ability of employees can be developed through:
  - organizations have the initiative to do the training;
  - education development
- 4) *Commitment*. An organization must obtain a commitment from employees through:
  - Recognition;
  - Appreciation

Employee empowerment can be realized when there is alignment between HR objectives and goals of the organization, but they also have the authority and the opportunity to maximize their contribution and are supported by appropriate means. The main focus TQHRM approach is

basically the employee empowerment program that can be implemented through the training and development of employees. ((Asiya, Aamir Saeed, Jefery and Naeem, 2012), (Karahana & Tetik, 2012), (Tripti Singh, Geetika, Dubey, 2011), (Shahraki, Konarizadeh, Paghaleh, Zarei, 2011)). According to Juran (1999) employee empowerment system can be implemented by following the steps summarized in the concept AACC (Alignment, Authority, Commitment and Capability). (VanDevender, 2011) Then according Izvercian Radu Ivascu, Ardelean (2014), the purpose of TQM and Human Resource Management is to improve performance; not only improve the quality of the system, but also to improve employee performance. Implementation of TQM in HRM have a positive impact on the sustainability and competitiveness of the company.

Until now, the implementation of TQHRM in a strategy is still rare. Therefore, the author intends to examine more on improving employee performance, especially the educational staff at UPI, via TQHRM approach. The hypothesis of this research is: there is a relationship between Total Quality Human Resource Management and employees' performance.

**METHODOLOGY**

The study involves two variables consisting of TQHRM of Juran (1999) as the independent variable and the performance of employees of Bernardin (2003) as the dependent variable. In accordance with the purpose of research, the research method used is descriptive and verification. The findings are categorized into three categories, namely low, moderate and high. Then, the data analysis technique used is a simple correlation Pearson Product Moment.

This research was conducted at UPI. Educational personnel as many as 318 employees were selected using a formula slovin sovilla (error 10%). Only 76 employees are taken into the sample. The sampling technique was Proportionate Stratified Random Sampling.

**FINDING & DISCUSSION**

**(1) Total Quality Human Resource Management (TQHRM) Variable**

Based on the results of descriptive statistics, it is found that the implementation of TQHRM UPI fall in the high category. Sub variable that obtains the highest score is the Alignment, which means that the level of alignment between the vision of the university's mission and its smaller work units, namely the department and directorate, have been aligned so that the level of understanding of the education personnel about the desire of the user, especially students and teachers, is good. But, the employees are considered not to have a high commitment to the organization as seen from the total score of the lowest sub-variables. This means that they just work on the normal work load without any initiative or desire to do more business in order to achieve optimal performance. Here is therecapitulation of the total score of the sub-variable TQHRM in Table 2.

**Table 2** Recapitulation variable of TQHRM

Sub Variable	Ideal Score	Score	Presentation
Alignment	760	677	89%
Authority	1520	1126	82.9%
Capability	1140	968	84.6%
Commitment	1140	926	81.2%

Source: Data Processing, 2016

From Table 2, it seems that the steps to be taken by the university is how to increase employee commitment by giving authority and responsibility within their means with the support of adequate facilities and infrastructure or focus on authority.

**(2) Employee Performance Variable**

Based on the results of descriptive statistics, it is found that the employee's performance at UPI education personnel is in the high category. The highest score is quantity. This means that education personnel have been carrying out their work in accordance with the targets set. The overall score of each sub variable employee performance of UPI education personnel are summarized in Table 3.

**Table 3** Recapitulation variable of Employee Performance

Sub Variable	Ideal Score	Score	Presentation
Quality	760	632	73,2%
Quantity	380	347	91,3%
Timeliness	760	619	81,4%
Cost Effectiveness	380	292	76,8%
Need Supervision	1140	906	79,4%
Interpersonal Impact	1900	1644	86,4%

Source: Data Processing, 2016

This means that the level of the quantity of work of employees based on the number of output and the initial target, can be implemented optimally. Sub variable with the lowest score is Quality. This means that the level of quality of work based on the suitability of the work of employees with a target load and the quality of the work can be carried out by the employees well. This is because most educators have not been able to streamline their working time and still require supervision of the supervisor. However, communication between employees in both the external and internal parties have been established quite well.

**(3) Correlation Analysis**

Based on the results of data processing, it is found that the correlation coefficient is 0.644 with a significance of 0.000 on testing of 76 respondents to the significance level of 0.05 (0.000 < 0.05). Thus, H1 is accepted and, in other words, there is a positive relationship between total quality human resource management and employee performance.

In order to know the magnitude of the relationship between the independent variables and the dependent variable simultaneously, the simple correlation analysis is used. Below is a table about the relationship between Total Quality Human Resource Management (X) with employee performance (Y) using a simple correlation analysis in SPSS 23.0 for windows as shown in Table 5

**Table 5** Summary Model

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.644 <sup>*</sup>	.415	.407	4503.692827

a. Predictors: (Constant), X  
 b. Dependent Variable: Y

Based on a simple correlation table, the value of the coefficient between Total Quality Human Resource Management with the employee's performance is 0.644. At coefficient interpretation table, according Sugiyono (2011: 184), the value is in the interval from 0.600 to 0.799, or at the level of a strong relationship.

R Square is found to be 0.415, which means that the performance of employees related to total quality human resource management amounted to 41.5%, while the remaining 58.5% (100% - 41.5%) is influenced by other factors not examined by the authors ,

**CONCLUSION**

Based on research that has been done on employee education personnel from UPI Bandung to determine the relationship between total quality human resource management with employee performance, the conclusion are as follows:

1. Overview of the education personnel of TQHRM UPI Bandung tends to be high. It is based on the score continuum that is in the category of high criterion. Sub Variable Alignment gets the highest score. While sub-variables that received the lowest score is the Commitment. From these explanations it can be concluded that the overall Total Quaity Human Resource Management on employee Personnel UPI Bandung is good enough.
2. Overview of performance tend to be at a high category. Sub Variables which obtained the highest score is the Quantity whereas sub variables obtained the lowest score is Quality. This means that the level of quality of work based on the suitability of the work of employees with a target load and the quality of the work can be carried out by the employees well. From these

explanations it can be concluded that the overall performance of Personnel UPI Bandung is good enough.

3. From the analysis of correlation, it is known that there is a positive relationship between Total Quality Human Resource Management with employee performance of UPI education personnel by 0.644.

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## INQUIRING THE BEST-FIT MODEL OF WORK ENGAGEMENT FOR DIGITAL TALENT IN THE PALM OIL INDUSTRY

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### ABSTRACT

*Indonesian palm-oil industry plays strategic role either in global or in national scope. Since 2006, Indonesia has been succeed to become the biggest producer of CPO in the world which getting the better of Malaysia. For the national scope, palm oil industry has become the national economic pillar, the prime contributor of non oil-gas export, the driver of gross regional domestic income for the districts, the solution for the unemployment, and the catalyst of remote area development. On the other side, palm oil industry is facing various obstacles and difficulties. The three critical issues of strategic human capital management in palm-oil industry are talent shortage, talent war, and digital talent engagement. Working condition and environment in palm-oil industry has a lot of difference from other industry such as manufacturing, services or information industry. There are four distinctive characteristics of palm-oil industry : labor intensive, dominantly outdoor activity, remote area with limited data communication access and challenging social condition.*

*This paper try to propose work engagement model which is best-fit to the digital talent in the palm oil industry. The model is a recursive or mutually contingent. The model explains interdependence of three variables : engagement driver, work engagement, and engagement outcome. The engagement driver influences the work engagement which influences the engagement outcome, and finally the engagement outcome influences back to the engagement driver. The engagement driver consists of four variables which are job-related variable, personal resource variable, social support variable, and organizational treatment variable. The work engagement is defined into cognitive (say), emotional(stay), behavioral (strive), and spiritual dimension (pray). Meanwhile engagement outcome consists of four variables which are the impact on attitudes, the impact on behavior, the impact on the business, and the impact on sustainability.*

**Keywords:** *work engagement, digital talent, palm-oil industry*

## **INTRODUCTION**

Indonesia palm oil industry may be viewed from global, national, industrial perspective (macro foundation) and also from the company perspective which is represented by PT SMART Tbk as the prominent player in Indonesia palm oil industry (micro foundation). From the global perspective, Indonesia palm oil industry plays a strategic role as the largest supplier for global demand of vegetable oil. It is reasonable because if we refers to FAO nutritional recommendation and UNDP predictions about the world population, then the global demand of vegetable oil demand in 2050 will ranged between 24 - 170 million tons per year. If this demand is fulfilled by other vegetable oils, it needed 48 - 340 million hectares for newly additional plantation area. But if the demand is fulfilled by palm oil, then it only requires 8 - 34 million hectares newly additional planted area. (Sipayung, 2016 : 29). So that why the palm oil plantation is better choice for feeding the world demand of vegetable oil and for inhibiting larger global deforestation.

There are several source of vegetable oil. They are sunflower oil, soybean oil, rapeseed oil and palm oil. Global consumption of vegetable oil has already changed. In 1965 the global consumption of palm oil was only amounted to 1.21 million tons or only 22 percent. But in 2014 the global consumption of palm oil has grown rapidly into 62.32 million tons or 41 percent (Sipayung, 2016 :13). And since 2006, Indonesia has surpassed Malaysia in palm oil production. In 2014 Indonesia CPO production was 53 percent, while Malaysia was only 33 percent (Sipayung, 2016 : 3). So that's it is reasonable to state that the Indonesia palm oil industry plays a strategic role as

the biggest provider of global vegetable oil demand.

From national perspective, Indonesia palm oil industry also plays a strategic role too. Saragih (2000) explains that at least there are six critical roles of agribusiness for Indonesia economic development such as: (1) generating gross domestic product. PASPI (2014) research found that CPO production correlated positively and significantly to the regional gross domestic income in the district with palm-oil plantation. In every 1 percent increase of CPO production will influence the increase of regional domestic income 2.46 percent, (2) lowering the unemployment effectively. Brodjonegoro (2015:12) stated that agro industry especially palm oil industry is one of the three economic sectors which the most creating jobs and business opportunities, (3) generating surplus foreign trading incomes. Sipayung (2016) stated that palm oil is the superior commodity that the most generating non-oil export income, where the value of palm oil exports are likely to increase since 2008 to 2015 while the value of net exports of non-oil is going to decrease since 2012, (4) providing food. Palm oil provide various product such as cooking oil, soap, shortening, margarine, vanaspati, frying fats, specialty fats for coating, ice cream, cookies, crackers, cake mix, icing, instan noodles, non-diary creamer, biscuits, dough fats, biodiesel and so on. Kemenperin (2016) stated that Indonesia is currently only able to produce 47 derivative products, while Malaysia has reached 100 derivative products, (5) distributing economic development. Amzul (2011) explains that palm oil plantation is agent of development for the remote areas. Opening newly palm oil plantations in disadvantaged remote areas will trigger the emerging at least ten related economic sectors. Besides

that according to PASPI (2014) research found that palm oil farmer have average annual revenue ranges from Rp 120 million until Rp 140 million. While non palm-oil farmers had only average annual revenues Rp 20 million, and (6) doing the environmental preservation. From the national perspectives, the palm oil industry give a strategic impact on economic development for government, farmers, communities in the remote areas, and consumers.

From the industry perspective, the palm oil industry is : (1) superior commodity. The agro-business sector is composed by four sub-sectors: food, horticulture, plantations and farming sub-sector. Situmorang (2013) stated that in 2010 only the plantation sub-sector had a surplus of US\$ 20 billion, which is derived from palm-oil (US\$ 15.5 billion), rubber (US\$ 7.8 billion) and coffee (US \$ 1.7 billion), (2) palm oil industry is covering a large plantation area. According to Sipayung (2016) in 2014 Indonesian palm oil plantations already cover an area of 10 million hectares with a production of 29 million tons of CPO. The plantation is managed by a private companies (55 percent) and the rest is managed by government and self-help or plasma farmers, (3) palm oil industry is rapid growth industry. Based on GAPKI membership data - the organization of Indonesia oil palm plantations which consists of private companies, state enterprises, and cooperatives, which in early establishment in 1981 consisted of 23 members. Whereas in 2010 GAPKI consisted of 382 members, and in 2016 already has 644 members. It mean that GAPKI have average 18 new members per year. But since 2010, GAPKI have average 44 new members each year, (4) palm oli industry is facing various business challenges from the legal, social, economic, and human resources aspects. According to Pitakasari (2013),

several challenges faced by the palm oil industry are (1) legal uncertainty issue in terms of spatial, (2) double taxation by government, (3) moratorium or termination of license for plantations expansion, and (4) domestic market is not well-developed are the challenges. According to Noviani (2013), the business challenges faced by palm-oil industry are social conflict and theft of fruit by the public is a challenge facing Indonesia's palm oil industry. Meanwhile, according to Sipayung (2016), public misperception or negative stigma to the palm oil industry. At least there are 75 myths believed by public are not proven factually is a crucial business issue faced industrial oil palm plantations in Indonesia. And according to Manuwoto et al. (2010), the supply of agricultural scholar is also declined drastically marked with lack of interest of students to study in the agriculture faculty and the closing of many agriculture faculties in Indonesia The shortage of agriculture graduate is a challenge faced by the Indonesian palm oil industry.

In the context of micro foundation, the palm oil industry is viewed from the perspective of PT SMART Tbk (Sinarmas Group), the prominent player and the market leader in this industry. PT SMART Tbk has been operating since 1962 and manages large palm oil plantation in Sumatra, Kalimantan, Sulawesi, and Papua, even to Liberia, Africa. Based on focus group discussions were conducted with 37 units head managers in Central Kalimantan (April 13<sup>rd</sup> 2016) and 24 unit head managers in South Kalimantan (April 21<sup>st</sup> 2016), it was successfully identified ten distinctive resources that make the difference between the PT SMART Tbk with its competitors. And from 10 distinctive resources only five one which are valuable, rare, costly or timely to be imitated, and can be organized well by

organization. So this five distinctive resources are source of sustainable competitive advantage. They are : (1) end-to-end business control systems, (2) centralized supporting system, (3) biotechnology research, (4) systematically and continuously leadership development program, and (5) capability of agro-industry professionals. From those distinctive resources, for this paper I decide to focused on elaborating the agro-industry professionals. Because agro-industry professional are the forefront of management line. They are called as Asisten Divisi who are responsible for planning, supervising, and ensuring the smooth of operation about 500 hectares of palm oil plantation. They are an agriculture bachelors who are recruited by PT SMART Tbk from reputable universities all over Indonesia. They must follow and accomplish on-boarding program which is named by Basic Managerial Development Program (BMDP) before being placed to all over Indonesia.

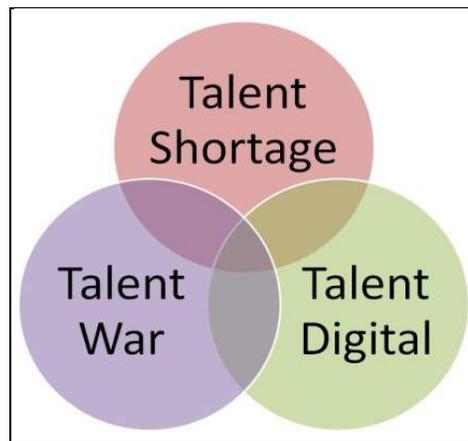


Figure 1 – Critical Issues Related to Agro-Industry Professional

According to Saputra (2011) there are three critical issues related to agro-industry professionals :

1) talent shortage - the palm oil industry is still experiencing a shortage of agricultural undergraduate or bachelor as many as 834 people per year (45 percent). This estimation is based on

several assumption: government plans to develop until 20 million hectares palm-oil plantation with production of 52 million tons CPO in 2020 (Obidzinski, 2013), in 2014 the plantations was only 10 million hectares which 55 percent of the plantations are managed by private companies (Sipayung, 2016); agro-industry professional is responsible for 500 hectares, there are only 20 agriculture faculty in Indonesia (Khudori, 2008) which graduates 1000 bachelors annually.

2) talent war - the rapid increase of GAPKI member is an indicator of the increase number players in Indonesia palm-oil industry. So it is inevitable occurrence of hijacking talent among competing players especially managerial talents and agro-industry professionals. In the organizational structure of palm-oil company, there are four managerial level, namely Asisten Divisi (supervisor level), Asisten Kepala (junior manager level), Unit Head Manager (middle manager level), and the Regional Controller or Plant Controller (general manager level). And every year it is estimated that palm-oil industry need additional asisten divisi 1734 persons, additional asisten kepala 347 persons, additional unit head managers 173 personels, and additional regional or plant controller 43 persons.

3) digital talent - the emergence of gen-y or the millenials in palm oil industry. Tapscot (2009) reveals that there has emerged a newly generation to the world of work that have behaviors, habits, and lifestyles are different from previous generations. They were born between 1978 - 1997 and is called internet generation or gen y or the millennials. Behavior of this generation is strongly influenced by the internet technology. In 1997 amounted to 27 percent of the US population and they have a pattern of behavior such as requiring more freedom, customization, concerned to

detailed (scrutinizer), respect for the integrity, love to play, enjoyed the collaboration, impatient to wait and full of innovation (Tapscot, 2009). In this paper the digital talent is refer to the agro-industry professionals which is categorized as millennials or gen y or internet generation.

On the other hand, the characteristics of working environment in palm oil plantation are : 1) labor intensive - psychical endurance demanding job 2) massive outdoor activities, 3) located in remote areas with limited internet access and 4) challenging physical and social environment, far away from social and entertainment facilities. Because of the low suitability between generic behavior pattern of the digital talent and specific working environment of palm oil plantation, it is not easy to keep agro-industry professionals to be engaged with the work and the company. This is in line with Saputra (2011) which stated that PT SMART Tbk has 22 percent of digital talent and its engagement level is significantly lower than the previous generation.

**RESEARCH PROBLEM**

Based on the strategic role of Indonesia palm oil industry - globally and nationally, the various business challenges in palm oil industry today, and three critical issues related to the professional agro-industry - talent shortage, talent war, and digital talent; then the problems outlined in this paper is: "how to inquire the work engagement model which is best-fit for digital talent in Indonesia palm oil industry ?".

Because this paper is conceptual, the methods used is literature review on various books and papers that discuss work engagement, whether it refer to

term of employee engagement or job engagement or personal engagement. The 'literature review' is where there is extensive reference to related work engagement; it is where connections are made between the source texts that i draw on and where position myself and my research among these sources (Ridley, 2012).

**THEORITICAL BACKGROUND**

The work engagement is a popular concept today both among practitioners and also academics. This is in line with research conducted by Bain & Company since 1993 to about 13.000 corporate executives from 70 countries and has been performed 15 times by answering the question "what are management tools they used and how effective these tools have an impact on business performance?". From those research Rigby & Bilodeau (2015) reports that there are 17 management tools most frequently used by the worldwide executives and five management tools are most used in the world and also in the Asian region. They are (1) customer relationship management, (2) employee engagement surveys, (3) strategic planning, (4) outsourcing and (5) supply change management.

	Global	N. America	EMEA	APAC	L. America
Customer Relationship Management	1	4	3	2	4
Benchmarking	2	3	1	1	3
Employee Engagement Surveys	2	1	3	8	9
Strategic Planning	2	2	9	5	1
Outsourcing	5	6	3	5	9
Business Scorecard	6	7	2	1	3
Mission and Vision Statements	6	3	8	18	3
Supply Chain Management	8	7	10	2	13
Change Management Programs	9	9	6	7	9
Customer Segmentation	10	14	6	12	7
Core Competencies	11	10	-	7	-
Big Data Analytics	11	-	-	1	-
Total Quality Management	11	-	-	8	-
Satisfaction and Loyalty Management	10	-	-	9	-
Digital Transformation	10	-	-	10	-
Business Process Reengineering	15	-	-	-	6
Strategic Alliances	17	-	-	-	8

Table 1 – Most Popular Management Tools

According to Albrecht (2010 : 7), the concept of work engagement can be

approached from various theories: (1) *Social Exchange Theory* (Blau, 1964) explains that getting the resources from the organization raises a feeling of obligation to reciprocate with prosocial attitudes and engagement related behavior to the organization; (2) *Self-Determination Theory* (Deci & Ryan, 1985) describes the engagement experience requires fulfillment on basic needs such as competence, autonomy, and relatedness with the organization; (3) *Conservation of Resources Theory* (Hobfoll, 1989) describes how employees strive to acquire and protect resources and why they will perform more effectively when they have individual access to resources and employment; (4) *Job Demands-Resources* (Bakker & Demerouti, 2007) which explains that job resources (such as autonomy, feedback, support) and personal resources (such as self-efficacy, optimism, resilience) directly affect work engagement, which also affect in-role performance, extra-role performance, creativity and financial outcomes. Besides theories which is described above, work engagement can also be approached from other theories such as : *Social Identity Theory* (Tajfel, 1974); *Job Characteristics Theory* (Hackman & Oldham, 1980), *Role Theory* (Kahn, 1990); and *Broaden-and-Build Theory of Positive Emotion* (Fredrickson, 2001).

By merging Shuck & Wollard (2010) and Welch (2011), we can realize that the work engagement concept has evolved and is now entering the third wave or phase. Kahn is a psychologist who first discussed the work engagement definitively through an article in the *Academy of Management Journal* which entitled "psychological conditions of personal engagement and disengagement at work" (Kahn, 1990). Kahn used term personal engagement to explain work engagement and define it as "seriousness

of the members of the organization to carry out the roles through expressing physically, cognitively and emotionally so as to achieve the expected performance" (Shuck & Wollard, 2010; Sakovska, 2012; Welch, 2011, Andrew & Sofian, 2012).

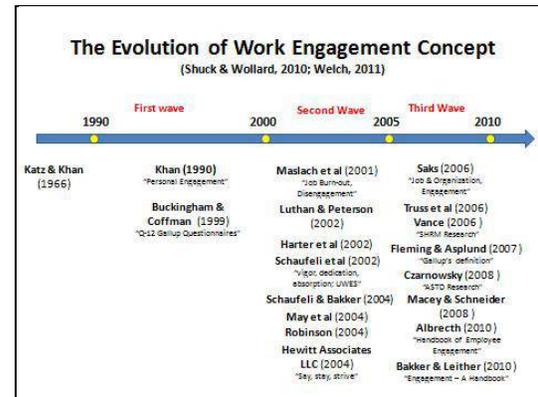


Figure 2 – Evolution of Work Engagement

The first wave of work engagement concept evolution was since 1990 until 2000. There is limited scientific works during this first wave. Until finally in 1999 through the popularity of "First Break All the Rules" (Buckingham & Coffman, 1999) makes the term employee engagement into something sensational in the world of management consulting. Buckingham & Coffman (1999) also introduce "Q-12 Gallup Questionnaire" as a tool for measuring the level of employee engagement. This is the moment when lot of the world's leading management consulting firms - including Gallup, Towers Watson, Corporate Leadership Council, ASTD and SHRM - start to claim that they are experts in work engagement subject. Since that time concept of work engagement evolved and entered the second wave. The second wave was period from 2001 until 2005. At this period work engagement was much more conceptual than proved empirically. In the meantime, many academics began to run research on work engagement. They

were Maslach et al (2001) who explained that the job burn-out affecting the disengagement, Luthan & Peterson (2002), Harter et al (2002), Schaufeli et al (2002) developed the questionnaires UWES to measure work engagement into three dimensions - vigor, dedication and absorption; Schaufeli & Bakker (2004), May et al (2004), Robinson (2004), and Hewitt Associates (2004) defined work engagement into three dimensions - say, stay and strive.

The third wave took place since 2006 up to now. The enthusiasm and the rapid development of work engagement concept inspired the practitioners to conduct empirical research too and endorse the academics to write a comprehensive handbook about work engagement. Research conducted by a leading management consultant in third wave period are Gallup (Fleming & Asplund, 2007), SHRM (Vance, 2006), and ASTD (Czarnowsky, 2008). While the academics published two handbooks which entitled "Work Engagement - A Handbook of Essential Theory and Research" (Bakker & Leiter, 2010) and "Handbook of Employee Engagement - Perspectives, Issues, Research and Practice" (Albrecht, 2010). So that why at the third wave the work engagement concept achieved stronger theoretical basis for further research and development.

### **Related Behavioral Concepts**

There are eight concepts related to and overlapped with work engagement, such as : (1) *Extra-Role Behavior* – Organ (1997) define it as “discretionary behavior that goes beyond in-role behavior, also called organizational citizenship behavior”; (2) *Personal Initiative*. Frese & Fay (2001) define personal initiative as self-starting behavior, proactivity, and persistence”; (3) *Job Involvement*. - Lodahl & Kejner

(1965) define it as “the degree to which a person is identified psychologically with his work, or the importance of work in his total self-image”; (4) *Organizational Commitment* - Mowday, Steers, & Porter, (1979) define it as “the relative strength of an individual’s identification with and involvement in a particular organization”; (5) *Job Satisfaction* – Locke (1976) define it as “a pleasurable or positive emotional state resulting from the appraisal of one’s job”, (6) *Positive Affectivity* - Watson, Clark, & Tellegen (1988) define it as “ a domain-specific psychological *state* that corresponds with positive affectivity, being a context-free dispositional *trait*, (7) *Flow* - Csikszentmihalyi (1990) define it as “focused attention, clear mind, mind and body union, effortless concentration, complete control, loss of self-consciousness, distortion of time, and intrinsic enjoyment; (8) *Workaholism* - Schaufeli et al. (2008) showed that work engagement and workaholism are related to different variables: both types of employees work hard and are loyal to the organization they work for, but in the case of workaholism this comes at the expense of the employee’s mental health and social contacts outside work, whereas engaged workers feel quite well, both mentally as well as socially.

## **RESULT & DISCUSSION**

The work engagement concept developed on this paper refers to the generic conceptual causal ABC Model (Matsuno et al., 2005) where internal and external environmental factors which driving work engagement as antecedent (A) which influence work engagement as an observed behavior (B) and then work engagement influence engagement outcome as consequences (C). Research was started from these three subjects – engagement driver, work engagement and engagement outcome. The author

conducted literature review on empirical papers about those subjects.

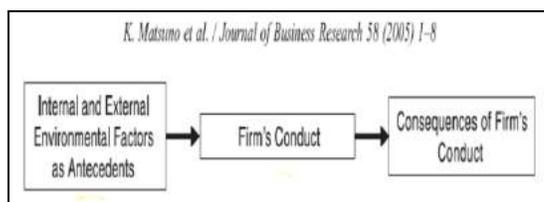


Figure 3 – Generic Conceptual Causal

### Engagement Driver

Based on literature review conducted on a various empirical research about the engagement driver that influence the work engagement, it is obtained 32 variables. All these engagement drivers are grouped into four variables : (1) personal resource variable, (2) work-related variable, (3) social support variable, and (4) organizational treatment variable.

The personal resource variable is personal uniqueness that influence positively or negatively on the growth and development of work engagement in a person. This can be either psychological state, mental attitudes, habits, personal strength, multiple intelligence, competence or individual talent. Personal resource variable found on previous research are : *affective commitment* (Shuck et al., 2011); *career intentions* (Saradha & Patrick, 2011); *individual personality characteristics* (Wildermuth, 2010); *self-awareness, self-esteem, optimism and self-efficacy* (May et al., 2004; Schaufeli & Salanova, 2007; Xanthopoulou et al., 2007; Halbesleben's, 2010); and *voice* (Beugré, 2010; Schneider et al., 2010).

The work related variable is many kinds uniqueness of the work or job that may affect positively or negatively on the growth and development work engagement in oneself. Work related

variable which found on previous empirical research are *characteristics of the job* (Saks, 2006); *activity within the organization* (Rashid et al., 2011); *job autonomy* (Bakker & Demerouti, 2007; Halbesleben's, 2010); *job control* (Maslach et al., 2001; Mauno et al., 2010; De La Rosa & Jex, 2010); *job enrichment* (May et al., 2004); *meaningful and valued work* (Maslach et al., 2001; De La Rosa & Jex, 2010); *participation in outside activities* (May et al., 2004); *person-job fit* (Fleck & Inceoglu, 2010; May et al., 2004; Shuck et al., 2011), and *sustainable and challenging workload* (Kahn, 1992; Maslach et al., 2001)

The social support variable is characteristics or quality of the interaction with the social environment of the employees who may influence positively or negatively on work engagement. Social support variables which found from previous empirical research are *being involved in making decisions* (Rashid et al., 2011), *feedback* (Bakker & Demerouti, 2007; Halbesleben's, 2010), *leadership style and support* (Bakker & Demerouti, 2007; Barling, 2007; Meyer et al., 2010; Segers et al., 2010; Ologbo and Saudah, 2011; Saradha & Patrick, 2011), *social support from supervisor* (May et al., 2004; Saks, 2006; Hakanen et al., 2006; Ologbo & Saudah, 2011), *social support from colleagues* (Maslach et al., 2001; May et al., 2004; Hakanen et al., 2006; Bakker & Demerouti, 2007; De La Rosa & Jex, 2010; Mauno et al., 2010; Halbesleben's, 2010; Ologbo & Saudah, 2011; Andrew & Sofian, 2012), *trust in senior leadership* (Beugré 2010; Federman, 2010; Schneider et al., 2010; Karsan, 2011; Ologbo & Saudah, 2011; Vaijayanthi et al., 2011) and *ability to communicate with individuals at corporate offices* (Federman, 2010; Vaijayanthi et al., 2011; Andrew & Sofian, 2012).

The organizational treatment variable is any initiative or action or treatment or policy given by company organizations to employees that might influence positively or negatively on work engagement consists. The organizational treatment variable which found on previous empirical research are: *company image* (Ologbo & Saudah, 2011), *compensation, reward & recognition* (Maslach et al., 2001; Koyuncu et al., 2006; Saks, 2006; Saradha & Patrick, 2011; Rashid et al. (2011); *employee development opportunities* (Fleck & Inceoglu, 2010; Ologbo and Saudah, 2011; Andrew & Sofian, 2012); *fairness and justice* (Maslach et al., 2001; Saks, 2006; Laschinger, 2010); *get a sufficient recovery during leisure time* (Sonnentag, 2003; Binnewies & Fetzner, 2010), *leadership opportunities* (Saradha & Patrick, 2011), *organizational climate or adherence to co-worker norms* (May et al., 2004; Hakanen et al., 2006; Halbesleben's, 2010; Shuck et al., 2011), *organizational infrastructure* (Federman, 2010; Vaijayanthi et al., 2011), *perceived organizational support* (Rhoades & Eisenberger, 2002; Saks, 2006), *performance management* (Mone & London, 2010), and *proper orientation to the company* (Federman, 2010; Fleck & Inceoglu, 2010; Vaijayanthi et al., 2011)

### The Work Engagement

The academics and practitioners developed definition of work engagement in three dimension: *meaningful, safety, and availability* (Kahn, 1990); *vigor, dedication and absorption* (Schaufeli et al, 2002), *cognitive, emotional and behavioral* (Sakovska, 2012); *say, stay and strive* (AON Hewitt, 2015); *enjoyment, belief and value* (Phelps, 2015; [www.ddiworld.com](http://www.ddiworld.com)); *extra-mile effort, enablement and energy* (Towers-Watson,

2014); *commitment, motivation and performance* ([www.mercerHR.com](http://www.mercerHR.com)).

If these definitions are mapped in the concept of whole-person paradigm (Covey, 2004) where the man was described in four dimensions: physical, emotional, intellectual and spiritual; then these definitions as in the following Tabel 2. In general, academics and practitioners are more likely to define work engagement in three dimensions: physical, intellectual and emotional.

Source of Definition	Whole-Person Paradigm			
	Physical	Intellectual	Emotional	Spiritual
Khan (1990)	availability	meaningful	safety	
Schaufelly et al., (2002)	vigor	absorption	dedication	
Sakovska (2012)	behavior	cognitive	emotional	
AON Hewitt (2015)	strive	say	stay	
Phelps (2015)	enjoyment	believe		value
Tower Watson (2014)	extra-effort	enablement	energy	
Mercer	performance	commitment	motivation	

Table 2 – Whole Person Mapping

### The Engagement Outcome

Based on literature review conducted on a various empirical research on the engagement outcome, it is obtained 43 variables. All this engagement outcomes are grouped into three variables: (1) impact on attitude variable, (2) impact on behavior variable, and (3) impact on business variable .

The impact on the attitude variable is the outcome of work engagement in the form of psychological aspects or internal state that arise in self of employees. This variable which found on previous research are: *eudaimonic or sense of purpose* (Robertson & Cooper, 2010), *job satisfaction* (Saks, 2006; Schaufeli & Salanova, 2007; Andrew & Sofian, 2012; Bakker & Demerouti, 2014), *better working environment & more pleasant colleagues* (Bakker & Demerouti, 2007), *burnout* (Bakker & Demerouti, 2014), *connectedness* (Bakker & Demerouti, 2014), *enthusiastically apply their energy at work* (Schaufeli & Salanova, 2007), *experience of doing work* (Kahn, 1992),

*integrative & creative perspective* (Bakker & Leiter, 2010), *intensively involved in their work* (Bakker & Leiter, 2010), *intention to turnover* (Saks, 2006; Halbesleben's, 2010; Shuck et al., 2011; Andrew & Sofian, 2012), *new knowledge* (Lockwood, 2007; Schaufeli & Salanova, 2007), *positive feeling towards the organization & work* (Cropanzano & Wright, 2001; Fredrickson, 2001; Fredrickson & Joiner, 2002; Schaufeli et al., 2002; Schaufeli & Bakker, 2004; Mauno et al., 2007; Bakker & Demerouti, 2008), *positive health effect* (Crabtree, 2005; Hakanen et al., 2006; Lockwood, 2007; Mauno et al., 2007; Schaufeli & Salanova, 2007; Halbesleben's, 2010), *positive psychological* (Schaufeli & Salanova, 2007; Robertson & Cooper, 2010), *safety* (Harter et al., 2002), *support the company* (Schaufeli & Salanova, 2007), and *the important well-being* (Robertson & Cooper, 2010).

The impact on the behavior variable is outcome of work engagement in form of external aspects or observable behavior that appear in self-employee. This variable found on previous empirical research are *organizational commitment* (Andrew & Sofian, 2012), *absenteeism* (Harter et al., 2002; Schaufeli & Bakker, 2004; Bakker & Demerouti, 2014), *commitment* (Halbesleben's, 2010), *discretionary effort* (Shuck et al., 2011), *do not hold back* (Schaufeli & Salanova, 2007), *dynamically change* (Bakker & Leiter, 2010), *employee retention* (Harter et al., 2002; Schaufeli & Bakker, 2004; Salanova et al., 2005; Hakanen et al., 2006; Hallberg & Schaufeli, 2006; Bakker & Demerouti, 2007; Bakker & Leiter, 2010), *employee turnover* (Harter et al., 2002; Schaufeli & Bakker, 2004; Hallberg & Schaufeli, 2006), *employees in taking initiative* (Sonnentag, 2003), *go beyond the job description or extra mile* (Lockwood, 2007; Schaufeli & Salanova, 2007; Bakker & Leiter, 2010),

*organizational citizenship behavior* (Saks, 2006; Andrew & Sofian, 2012), *organizational commitment* (Schaufeli, et al. (2002); Harter et al., 2002; Salanova, et al., 2003; Saks, 2006; Schaufeli & Salanova, 2007; Bakker & Demerouti, 2014), *pay attention to the details* (Bakker & Leiter, 2010), *pursuing learning goals* (Sonnentag, 2003), *respond to opportunities* (Lockwood, 2007; Schaufeli & Salanova, 2007), *successful organizational change* (Graen, 2008), and *mentoring & volunteering* (Schaufeli & Salanova, 2007).

The impact on business variable is outcome of work engagement which appear in the quantity or quality or speed of work performed by employees. This variable found on previous empirical research are: *productivity* (Bakker & Leiter, 2010), *profitability* (Bakker & Leiter, 2010), *competitive advantage* (Richardson & West, 2010; Albrecht, 2014; Costa et al., 2014), *customer satisfaction* (Harter et al., 2002; Towers Perrin, 2003; Heintzman & Marson, 2006; Vance, 2006; Wagner & Harter, 2006; Bakker & Leiter, 2010), *employee loyalty* (Salanova et al., 2005; Hakanen et al., 2006; Hallberg & Schaufeli, 2006; Bakker & Demerouti, 2007), *employee performance* (Kahn, 1990; Kahn, 1992; Schaufeli & Salanova, 2007; Halbesleben's, 2010), *increased sales* (Bakker & Leiter, 2010), *productivity* (Kahn, 1992; Harter et al., 2002; Schaufeli, et al., 2002; Salanova et al., 2003) and *profitability* (Harter et al., 2002; Schaufeli et al., 2002; Salanova et al., 2003; Czarnowsky, 2008; Ketter, 2008; Markos & Sridevi, 2010).

### **Proposed Model**

Based on engagement driver, work engagement and engagement outcome which found on the previous empirical researchs, then I made a conclusion that

work engagement model that exists today is: (1) defined in physical, intellectual and emotional dimension; (2) work engagement is influenced by engagement driver which is explained by personal-resource variable, job-related variable, social support variable and organizational treatment variable; (3) work engagement influences engagement outcome which is explained by impact on attitude, impact on behavior and impact on business. This existing model is illustrated on Figure 4 .

Referring to working environment characteristics of the palm oil plantation which tends to be labor intensive, massive outdoor activities, located in remote areas with limited internet access and deal with challenging environment, so that why palm-oil plantation need a different model of work engagement from the existing model.

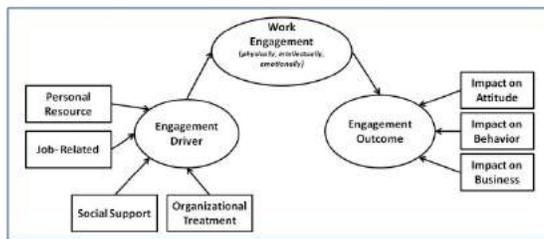


Figure 4 – Current Model

This paper proposes the work engagement model that fit to the palm-oil industry characteristics. The proposed model is: (1) work engagement is defined in physical (strive), intellectual (say), emotional (stay) and spiritual dimension (pray). The proposed model include spiritual dimension, because it is to respond the challenging environmental characteristic of palm oil industry. Where in doing their work, the digital talent is frequently to deal with the risks have an impact on their security and personal safety. So sometimes encourage employees not only use physical strength, intellectual

and emotional alone but also spiritual strength; (2) work engagement is influenced by engagement driver which is explained by personal-resource variable, job-related variable, social support variable and organizational treatment variable. Personal resource variable includes the ecological intelligence. Because it is to respond the challenging environmental and massive outdoor activity. To carry out his/her duties and responsibilities effectively in the oil palm plantations, the digital talent should have a good sensitivity, natural closeness and fondness to interact with nature, both flora and fauna. So ecological intelligence factors is relevant enough to work engagement in the palm oil industry; (3) work engagement influences engagement outcome which is explained by impact on attitude, impact on behavior, impact on business and impact on sustainability. The proposed model includes impact on sustainability because palm oil industry deal with social issues and the negative sentiment on the environment. The demands of stakeholders especially customers from developed countries in which they requested that the palm oil production must follow the rules of sustainability management. So it is necessary also to be explored whether work engagement has an impact on sustainability; (4) the model was recursive or reciprocal where engagement outcome variable influences back to engagement drivers. Because it refer to the social exchange theory (Blau, 1964) which explained that the relationship between the individual and the organization is two-way by giving each other mutual impact (mutually rewarding by both parties). so that the proposed model is not the only form of causal models but also models of alternating or recursive model which engagement drivers affects work engagement. Then work engagement affect the outcome engagement and ultimately affect the engagement

outcome back. This proposed model is illustrated on Figure 5.

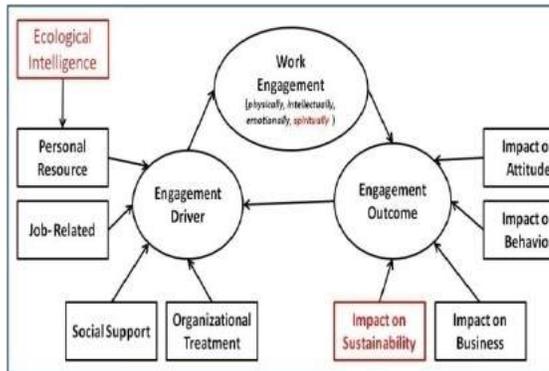


Figure 5 – Proposed Model

## CONCLUSION

Indonesia palm oil industry plays a strategic role in national and global scope. It is facing a various business challenges. One of them is the shortage of agro-industry professionals. There are three issues related to it - talent shortage, talent and digital talent war. It is necessary to look for work engagement model that is best-fit to Indonesia palm oil industry. Based on literature study and refer to generic conceptual model, this paper proposed work engagement model that is recurcive or reciprocal, includes ecological intelligence as engagement driver, is also defined in spiritual dimension, and includes impact on sustainability as engagement outcome.

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**DYNAMIC CHANGE IN “PRODUCTS MAPPING” OF INDONESIAN AGRICULTURAL PRODUCT: REVALED SYMMETRIC COMPARATIVE ADVENTAGE (RSCA) AND TRADE BALANCE INDEX (TBI)**

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***ABSTRACT***

*Indonesia is a large country and most populous among member of ASEAN Economic Community (AEC). As an agricultural country, therefore agricultural commodity is a strategic product for Indonesia economy. The purpose of this study is to perform a "mapping products" for agricultural commodity in Indonesia. This study utilizes data on export and import four-digit in the Standard International Trade Classification (SITC) Revision 2 from UN-COMTRADE for the period 1984-2014. We use Reveled Symmetric Comparative Advantage (RSCA) combine with Trade Balance Index (TBI) in our analysis. The primary result shows that dynamic change in agricultural commodity in Indonesia. Agricultural commodity that de-specialization is rice, meat of sheep and goats (fresh, chilled or frozen). On the other hand, agricultural commodities which experience specialization are fishery products. Policy implication regarding this study is even though rice is categorized de-specialize, but as rice is main food staple for majority of Indonesian, rice production should be kept sustainable.*

***Keywords:*** *products mapping, agriculture product, international trade*

## **EVOLUTIONARY THEORIES IN AGRO-TOURISM SUPPLY CHAIN: BASED ON THE PERSPECTIVE OF RURAL SUSTAINABLE DEVELOPMENT**

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### ***ABSTRACT***

*Supply Chain Management (SCM) in the manufacturing industry has attracted widespread research interest over the past two decades, whereas studies of SCM in the tourism industry are very limited. In this paper, recent advances in theory of traditional manufacturing SCM is applied to study of agro-tourism supply chain based on the perspective of rural sustainable development. A large-scale relevant literature review concerning agro-tourism supply chain is performed, in which current research and deficiency are reviewed. Although there is an emerging literature on Agro-Tourism Supply Chain Management or its equivalents, but progress is uneven, as most research focuses on distribution and marketing activities without fully considering the rural sustainable development perspective. Stakeholders in the agro-tourism industry interact with each other to resolve their divergent business objectives across different operating systems. The potential benefit of considering not only individual enterprises but also the agro-tourism value chain becomes evident. These paper examines the characteristics of agro-tourism products, and identifies and explores core issues and concepts in agro-tourism supply chain management based on rural development perspective. This paper provides a systematic review of current agro-tourism supply chain management studies based on rural development perspective and develops a framework for Agro-tourism Supply Chain Management research that should be of great value not only to those who wish to extend their research into this new perspective, but also to stakeholder decision maker.*

***Keywords:*** *agro-tourism supply chain, rural sustainable development perspective*

### **INTRODUCTION**

The concept of SCM has long been used in the manufacturing industry. This concept is commonly used to measure the efficiency of the flow of goods used in the production process to produce a product and marketing / distribution of these products to consumers. Competition in the global market of the 21st century has elevated the concept of SCM became an interesting research rather than research focuses on the supply chain of a company only. In a macro perspective the corporate network with other stakeholders ranging from the supply of raw materials to the marketing of products helped determine the company's competitiveness in the global market. With the meaning that the SCM

concerning the forward flow of goods and a backward flow of information.

The concept of SCM talks about the company's efforts to position its suppliers as part of the production process. It means companies and suppliers as a chain that can not be separated. The company's success is supported by suppliers and the supplier's success is support from company too. There is a reciprocal relationship between each other. This supply chain process to work in the planning, implementation and control effectively, the efficiency of the procurement process, management, storage, services and information from a start point to the point of consumption.

Based on the urgency of SCM concept in built the industry competitiveness, so this concept can also be applied in others industry. But in trend research, SCM more done on the manufacturing industry while SCM study for the service industry are still very limited. This paper try to be applied this concept in service industry especially in agro-tourism industry. Whereas tourism industry in the era of the creative economy today has contributed significantly to the economic performance. In some countries even the development of the tourism industry is more prominent than the growth of other industries. So it's important to analyze the competitiveness of the tourism industry from the perspective of SCM.

The tourism industry is interested visitors at this time is natural tourism. This kind of tourism is most prevalent in rural areas, so it is also known as agro-tourism. Agro tourism includes any income-generating activity conducted on a working farm for the enjoyment and education of visitors. It includes the interpretation of the natural, cultural, historical, and environmental assets of the land and people working on it "(George et al., 2008). Many operators have appointed people value resources, and can offer opportunities for a diversity of tourism, recreation, and learning experiences. For the visitor, agro-tourism can be active involvement in a variety of activities and experiences, through actual overnight accommodations on a farm, through heritage and cultural programs, hunting and fishing activities, or other guided trips. Agro-tourism merges the world of travel with experiences of farming and agricultural system, and lets the traveling public interact directly with farmer and workers, and experience a variety of agriculturally related activities and experiences.

The development of agro-tourism as a business/industry require linkages between stakeholders in the rural communities and farmers, governments, scientists and the private sector (tourism bureau, hospitality, food producers, airlines, etc.). The complexity of the stakeholders as well as different purposes of each of the relevant parties will of course be a complex network.

Some tourism-SCM research has been done more use tourism marketing perspective. Research conducted Buhalis (2000), Middleton and Clark (2001), Pearce and Schott (2005), Stuart et al. (2005), and Pearce et al. (2007) have used this approach. But studies in agro-tourism SCM from sustainable rural development perspective is very limited. So this research is intended for it.

### **SCM IN AGRO-TOURISM**

Tourism can play a crucial part in the rural economy, with particular significance and contribution to counteracting rural economic decline (Fleischer & Pizam, 1997; Reichel et al., 2000; Sharpley, 2002). Tourism can address the economic challenges facing peripheral rural areas, primarily those associated with the decline of traditional agrarian industries to achieve a wide range of economic benefits including diversifying local industry base, increasing public employment, enhancing incomes, enlarging tax bases, and improving business revenue growth (Black et al., 1999; Williams & Shaw, 1999; Sharpley, 2002). The combination of tourism and agriculture reflects a process of increased intensification and specialization of farming activities (Frater, 1983; Reardon, Berdegue, & Escobar, 2001). In the process, agro-tourism is a "new" industry for rural areas introduced from and with some characteristics of urban economies such as modern industry (Yang 2010).

According to Porter (1980), every industry has an under-lying structure, or set of fundamental economic and technical characteristics, that gives rise to its operational and competitive characteristics. That is, every supply chain varies according to the type of products supplied. Thus, identifying the features of the agro-tourism industry and its products is of great importance in describing a agro-tourism SCM. For instance, agro-tourism products are normally based in a specific territory and provided to tourists from a specific source market, so they often vary according to

destination and source market. Based on the existing definitions of agro-tourism supply chain in the literature and taking into consideration the characteristics of the agro-tourism industry, the following definition of an agro-Tourism SCM is advanced.

Agro-tourism supply chain is defined as a network of tourism organizations engaged in different activities ranging from the supply of different components of agro-tourism products/services such as flights and accommodation to the distribution and marketing of the final tourism product at a specific agro-tourism destination, and involves a wide range of participants in both the private and public sectors (Zhang 2009).

To identify the key challenges for successful SCM Agro-tourism, understanding of the characteristics of agro-tourism products and the agro-tourism industry is of central importance. In the process, agro-tourism is a “new” industry for rural areas introduced from and with some characteristics of urban economies such as modern business management practices. A part of the service sector of the global economy, agro-tourism possesses a number of characteristics that distinguish it from the manufacturing and primary sectors. Six characteristics of agro-tourism are outlined as follows.

1) Agro-tourism is a multi-faceted activity rooted in social and environment resources. It can take advantage of various cultural, social, environmental, economic resources to develop a variety of cultural and environmental tourism products (Cawley & Gillmor, 2008; Garrod, Wornell, & Youell, 2006). Agro-tourism products are developed based on local rural traditions, and the image or a set of images shaped by the history, geography, and culture of a specific territory. Agro-tourism enterprise can develop agricultural, natural, and heritage resources for outdoor recreation, tourism, and educational opportunities. Agro-tourism also prioritize the use of local transportation facilities, created and managed by the community in agro-tourism area, the food offered is also from local/traditional food

and use of local guides. Therefore agro-tourism can provide a direct benefit to the local/rural economics.

- 2) Agro-tourism activities tend to form a close relationship between local communities, conservationists and scientists, as well as travelers through the process of learning and sharing experiences together.
- 3) Agro-tourism is a coordination-intensive industry in which different products/services (transportation, accommodation, and so on) are bundled together to form a final agro-tourism product. Kaukal et al. (2000) note that a typical agro-tourism value chain consists of four components, the agro-tourism supplier, tour operator, travel agent and customer, which are in a single linked chain. Each of these components must have financial responsibility in environmental conservation.
- 4) Tourists need to travel to the destinations where agro-tourism products are produced to consume these products. Agro-tourism products are generally based on natural and rural environment. For visitor, original nature attraction has the highest value for the satisfaction traveled. According Damanik and Weber (2006) agro-tourism journey using local transportation and accommodation are managed directly by local communities that are environmentally friendly. Utilization of similar facilities managed by an outsider would reduce the agro-tourism role for the economy of rural communities.
- 5) Agro-tourism using simple technology available in rural areas, especially technology are energy efficient, environmentally friendly, use local resources and involving the local community.
- 6) Agro-tourism activities scale is limited, both in setting the number of tourists as well as units of managed services, though in a way that gains tended to shrink, but it was done in order to balance the satisfaction rating with the carrying capacity of the environment as well as profit-making that

will be enjoyed by the local community (Chafe and Honey 2004).

For every agro-tourism success story, there is at least one counter-story of a farmer who got out of agro-tourism because it was not profitable or was too challenging (Burr et al, 2010). The development of agro-tourism is not without challenges, as issues related to zoning, permitting, environmental health and food regulations, visitor safety, and liability and insurance often act as constraints to the successful development of tourism resources for an agro-tourism operator. Farmers/ agro-tourism enterprise often become “frustrated and overwhelmed with their county’s policies and procedures, and the expenses related to initiating or expanding an agro-tourism enterprise on their farm” (Rilla et al., 2011). Additional challenges relate to the development of a sound business plan incorporating agro-

tourism activities, effective marketing and management, and taking a community and regional development approach. Although agro-tourism has great potential for farmer/ agro-tourism enterprises to generate additional revenue, capitalize on underused assets, and educate the public, it is not a “magic bullet” and not all agro-tourism ventures have succeeded (Burr 2016)

**CRITICAL ISSUES IN AGRO-TOURISM SCM**

To facilitate a better understanding of both the critical elements and activities associated with agro-tourism SCM research, a framework that provides a coherent view of these fundamentals is provided in Fig. 1. Critical issues in Agro-tourism SCM are analyzed in terms of their contribution to Agro-tourism SCM research.

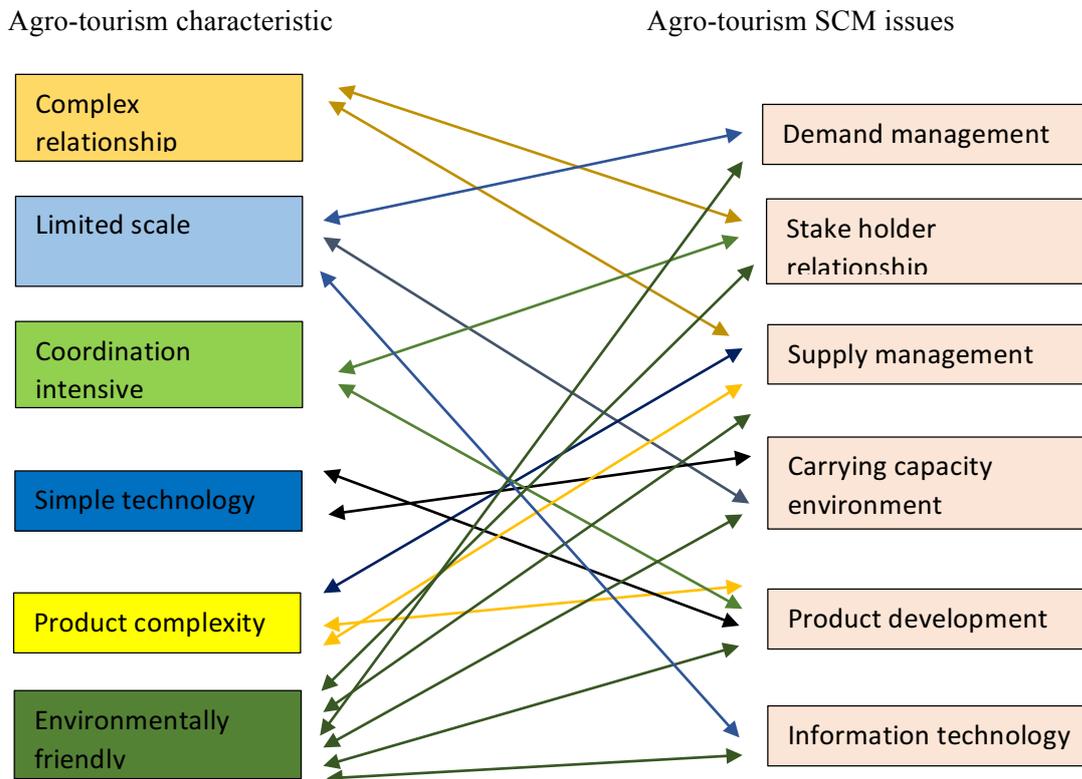


Figure.1 Agro-tourism characteristic and related SCM Agro-tourism issues

**a. Demand Management**

Agro-tourism market characteristics are very important in controlling the agro-

tourism SCM. Investment decisions on infrastructure depending on market demand estimate because it requires long-term financial

commitments. From an operational perspective, activities of the supply chain party such as accommodation providers, tour operators, recreational facilities, and consumption are also influenced by the characteristics of agro-tourism market. Development of agro-tourism in of rural development perspective should consider segmenting travelers who have an interested for agro-tourism destination. Because of the key role of the market demand as the determinant of the business profitability, estimated market demand becomes an important element in planning agro-tourism development in rural area.

According to TIES (2000), an important feature of the agro-tourism market segment is looking for a new experience by learning from and with local communities on a variety of natural resources, social cultural and natural village environment.

Besides of business profitability aspect, agro-tourism activity in contrast to other conventional travel. Agro-tourism is a tourist activity that pays great attention to the preservation of natural resources. Agro-tourism has responsible travel to natural areas that conserve the environment and improve the well-being of local people. Heher (2003) noted that agro-tourism is a form of tourism industry based agricultural environment that explores the use of various resources in the countryside (natural, social, cultural) while maintaining sustainability while creating employment opportunities and income for local communities and helping nature conservation activities itself.

Therefore agro-tourism businesses are usually small scale with aim of balancing visitor satisfaction with environmental carrying capacity.

#### **b. Stake Holder Relationship**

In agro-tourism supply chain implies stake holders relationships in which all party have relationships with other entities, including tourists, the agro-tourism enterprises, supporting agro-tourism services, government, local communities, non-governmental organizations and other firms carrying out complementary activities, to better accomplish their operations and fulfil customer needs. For this reason, the effective management of two-party relationships within an agro-tourism supply chain is a crucial issue in SCM agro-tourism.

Effective supply chain management, therefore, relies greatly on the success of relationship management. As mentioned, a TSC is a complex network involving a wide range of sectors, each has its own goal and market structure. Agro-tourism is also an integral part of the market which a powerful driving force in the development of system. More activity component is also determined by various external factors like economic situation, national/international policy, and so on. Theuvsen (2004) points out that coordination among enterprises/ many parties could benefit the agro-tourism industry as a whole. Tapper (2003) note that Tourism supply chains involve many components like Fig.2

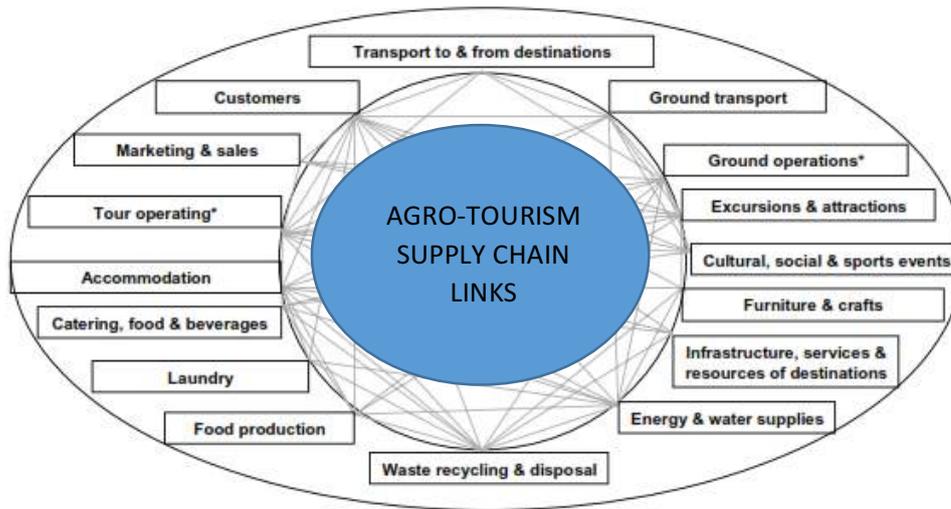


Figure 2. Link Component of Agro-tourism Supply Chain Management

### c. Supply Management

Characteristics of agro-tourism are small-scale (85% of them), which employ less than 20 people, but this agro-tourism business rich of US \$ 250 million turnover (The International Eco-tourism Society 2000). Element of agro-tourism supply can identified from triple A's analysis consist are attraction, accessibility and amenity. Agro-tourism offered the natural attractions and agricultural environment (plantation, forest, national parks and other). For visitor, attractions pristine nature has the highest value in the satisfaction traveled. But trend attractions today shifted to activities for seeking new experiences based in local environmental, enjoy the local culture and foster a closer relationship with the local community. So many visitor prefer to be called a traveler not a tourist (Prebensen, et al 2003). Accessibility covers all transport infrastructure that connects travelers from, to and during in agro-tourism area. According Damanik and Weber (2006) agro-tourism can using local/traditional transportation and managed by local communities directly. Local transportation facilities that are environmentally friendly and energy efficient has become very interested for visitor. 2008). Many agro-tourism enterprises have amenity resources people value, and can offer opportunities for a diversity of tourism, recreation, and learning experiences. For the visitor, agro-tourism can be active involvement

in a variety of activities and experiences, through actual overnight accommodations on a farm, through heritage and cultural programs, hunting and fishing activities, horseback riding or horse packing, or other guided trips.

### d. Carrying Capacity Environment

To develop agro-tourism, needed a strong awareness and concern for environmental and social changes in local culture due agro-tourism activities. Although agro-tourism contributes positively to rural economy, but on the other hand should also be considered non-economic costs would cause, such as environmental damage, public social tensions, shifting patterns of resource ownership and more.

Agro-tourism development that considers environmental carrying capacity is a manifestation of sustainable rural development. Agro-tourism stakeholders should be aware that there is no point gain big profits in the short term but lead to greater losses in the long term. Therefore, the business scale agro-tourism must be balanced with the carrying capacity of the local environment.

### e. Product Development

Agro-tourism products should be based on market demand trends. Travelers should be given a lot of products alternative with variation

qualities. Even though natural landscape or cultural activities as a main attraction, but it's better if the product support also developed. The goal is to allow tourists to stay longer and enjoy the varied attractions. For providers of course this will provide greater economic benefits. Market segmentation also must be considered carefully. It's intended to minimize of risk in agro-tourism product selected.

Based on sustainable rural development context, there are a number of requirements that must be considered in agro-tourism products, are as follows: first: the visitor has the willingness to consume products and travel services selectively, the products are not obtained by excessively exploiting local resources. Second, environmentally based product, third, travel activities geared towards preserving the environment and sensitive to local culture, fourth, society must be involved in the planning, implementation, and monitoring. Fifth, the villagers and farmer have equitable benefit from agro-tourism activities. Sixth, increasing in bargaining position of local communities in local resource management.

#### **f. Information technology**

Information is “the lifeblood of the tourism industry” which holds together activities within the tourism supply chain in terms of both inter firm links and agro-tourism product distribution. It is hardly surprising that since its emergence, information technology (IT) has played a significant role in the agro-tourism industry. Frew (2000) explores the interaction between IT and tourism and provides a research framework to characterize the utilization of IT in the tourism industry. Buhalis and Law (2008) comprehensively review and analyze the published studies of Internet applications in tourism over the past 20 years. In addition to transforming business operations, IT can also enhance the coordination of activities regionally, nationally, and globally, creating new opportunities for agro-tourism businesses and enhancing their competitive advantage.

Based on some literature, there is a growing interest in the importance and

necessity of IT usage in tourism industry. O'Connor, Buhalis, and Frew(2001) examine the effect of changes in IT on tourism distribution channels and highlight the key areas of concern for tourism suppliers. The impacts of the Internet (Wynee, Berthon, Pitt, Ewing, & Napoli, 2001) and computer reservation systems (Alamdari, 2002; Duliba, Kauffman, & Lucas Jr., 2001) on tourism distribution channels have also been discussed.

### **THEORETICAL RESEARCH FRAMEWORK**

SCM is a new management topic in the agro-tourism industry. This framework is developed to guide research efforts and provide insights for managerial practices. The theoretical support for the framework is follow Zhang (2009), which has been developing tourism framework.

#### **Objectives of SCM Agro-tourism**

The ultimate goal of a SCM agro-tourism is balance between tourist satisfaction and sustainability environment. Tourist satisfaction is the degree to which tourists are satisfied with the agro-tourism products and services received. Visitor satisfaction will be followed by tourism sustainability. Tourism will sustainable if each sub-components system based agro-tourism activities on profit-making efforts and optimum satisfaction with environmental sustainability.

New a days, market tourism trend has shifted to tourism products that promote environmental factors, agriculture activities and socio-cultural community as the main attraction, as well as the comparative advantage of the agro-tourism development. Growing environmental awareness and cultural sensibility as a most important point to develop agro-tourism in rural development perspective.

#### **Network structure**

Agro-tourism supply chain implies relationship of stake holders in a network configuration. Agro-tourism actors including tourists, agro-tourism enterprises, supporting services, government, local communities, non-

governmental organizations and other firms carrying out complementary activities. We

propose a general network of agro-tourism actor in Fig. 2.

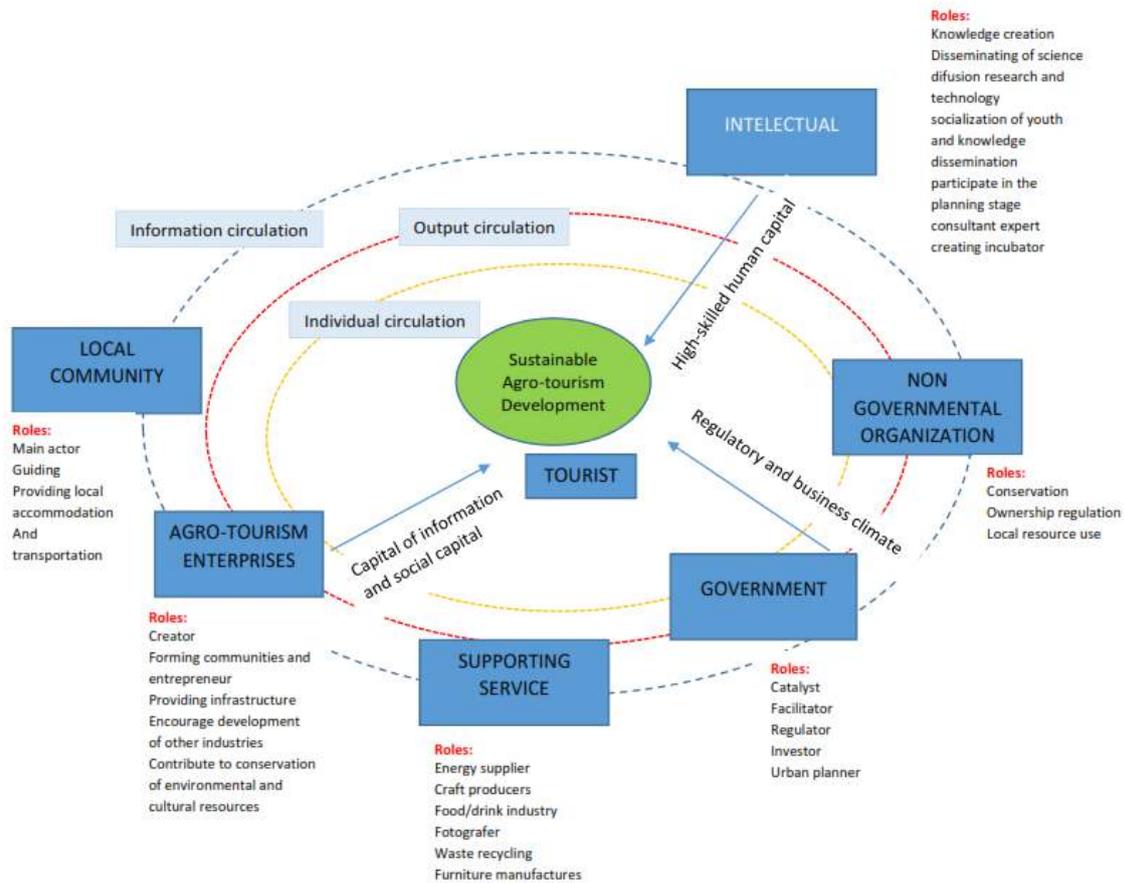


Fig.2 General Network of Agro-tourism Actors

**Decision Variable**

Agro-tourism SCM decisions span a large spectrum of an organization’s activities, and can be strategic, tactical, or operational.

- a) Strategic decisions have long-lasting effects on organizations, and include decisions regarding the agro-tourism taxation policies of the local government, capital investment in the agro-tourism industry, capacity building of agro-tourism facilities, zoning, and the entry or deterrence of potential agro-tourism businesses.
- b) Tactical decisions are made on a medium-term (quarterly or annual) basis by agro-

tourism industry and include purchasing and production decisions, pricing strategies, product differentiation, and advertising.

- c) Operational decisions mainly concern the weekly or daily endeavors of agro-tourism industry in tour scheduling, route planning, and issuing quotations on agro-tourism tour products.

**Performance Measurement**

The most important performance measurement of agro-tourism supply chain system is tourist satisfaction. But that does not mean customer satisfaction is everything, because sustainable agro-tourism should

maintain a balance between economic objectives with environmental sustainability and cultural sensibility. Performance measures

that have been used in supply chain analysis can be categorized as follows Table .1

Table.1 Performance Measurement of Agro-tourism

Financial Performance	Non Financial Performance
Profit	Tourism Satisfaction
Total revenue	Environmental sustainability
Return on investment	Preserving local cultural
Tax and retribution	Growing environmental awareness
Total cost	Environmental friendly accommodation
Distribution cost	Little traffic and good public transport
Conservation cost	Eco label of Agro-tourism product
Other cost	Local community development

### Methodology

The solution methodologies that can be used to address SCM of Agro-tourism problems can be divided into the following areas.

- a) Conceptual studies – research that analyzes TSCs in an attempt to define, describe, and develop methods for Agro-tourism SCM, including frameworks, taxonomies, and literature reviews.
- b) Case-oriented empirical studies – research that involves specific firms and uses the data collected by researchers or from other qualified sources to analyze Agro-tourism SCM issues.
- c) Quantitative studies – research that aims to develop methods for Agro-tourism SCM using quantifiable models (including optimization, simulation, stochastic models, and heuristics).

### CONCLUSION

This paper try to applied theory of traditional manufacturing SCM in to agro-tourism industry based on rural sustainable development perspective. Agro-tourism SCM has emerged as an important area in tourism research, and is attracting increasing attention from both the academic and practitioner communities. The paper has set out a new perspective for agro-tourism SCM research. Under the proposed conceptual framework, relationship and coordination among actors can

be investigated based on different role and different goal. In addition, agro-tourism SCM can be used in the development of agro-tourism competitiveness by considerations of economic, ecological, social and cultural factors.

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## VALUE DIMENSION APPROACH OF FARMER PERFORMANCE: A VEGETABLE SUPPLIER SCORECARD FRAMEWORK

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### **ABSTRACT**

*Customer prefer to buy product from high perform producer. Determining producer performance, customer applied several importance criteria in evaluation and selection process. These criteria based on their expectation of value when they decide to buy the product. Producers are encouraged to understand and had knowledge of customer demand in order to creating customer value. Consequently, it is essential to value dimension scorecard framework that identify producer performances. This study using qualitative design through case study in vegetable supplier company, that the vegetable supply by the farmers, in Bandung Regency. The scorecard applied are cost, quality, delivery, responsiveness and innovation. Particularly, farmer should improve their performances in term of responsiveness through service level enhancement and innovation through capability product development.*

**Keywords:** *value dimension, scorecard, producer performance, vegetables.*

### **INTRODUCTION**

Buyer need a high perform supplier because they, especially retail, depend on product supply in order to fulfill their shelf on the store. According to Mesa and Gomez (2015), supplier adaptation to retailer demand would support retailer performances. Hence, supplier need to improve their performance in giving value to their buyer, because according to Fawcett (2014) customer purchase decision is influenced by value that give by the supplier. In agribusiness value creation is an essential factor as Gow, et al. (2003) stated farmer marketing development through value creation will build successful long term value.

Agriculture product characteristic is a challenging factor for supplier to adapt and create

value to customer in order to achieve high performances in agribusiness. In agriculture sector, mostly of the fresh product sold as a homogenous product. Homogenous product happened when one producer to another can produce substitute product (Tongeren, 2001). Marketing of fresh agriculture homogenous product is more complex than industry product that has a various feature between one and another product. Therefore, product differentiation is needed to win the competition in commodity market. According to National Research Council (2002), commodity transform to industrial differentiate product based on market demand can be done through scientific differentiation and marketing differentiation. While scientific differentiation need a huge effort and small farmer will find difficulties to do the

research, marketing differentiation is easier to be added in the product.

Vegetable supplier assessment applied to all supplier that involve in supply chain because all the actors in the supply chain will impact direct and indirectly to the farmer business. Therefore, it need adjustment to the marketing channel that used by the farmer. Generally, supply chain in vegetable involve many actors with a different types of marketing channel. Farmer prefer to choose the type of marketing channel option that give significance profit to the farmer.

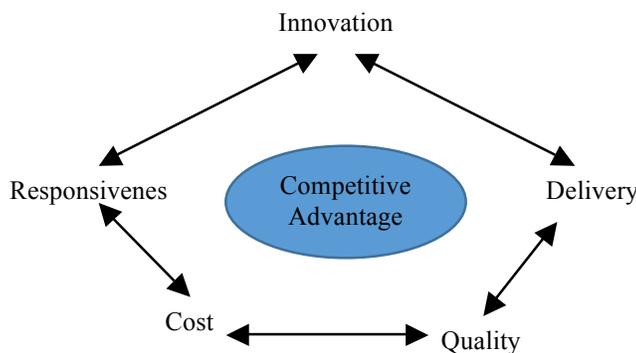
Although there are many challenge from vegetables characteristics and marketing channel type, in order to improve competitive advantage, farmer should increase their performance to create value in their relationship. Consequently, it is important to understand appraisal from buyer perspectives on farmer and actors in marketing channel performance based on supplier scorecard that adjusted to agriculture product.

**LITERATURE REVIEW**

The differentiation is essential for agricultural product, and it requires a strategy to differentiate

the product in order to win the market (Utami dan Sadeli, 2013). The differentiation can be done through put an attribute to show uniqueness and attractive appearance, namely branding and packaging (Utami et al, 2016). Brand and packaging is important to help customer purchase decision. Brand development application is a technique to discharge from commodity market and price competition (Aaker and Joachimsthaler, 2000). While, packaging create identity and differentiation for most of the homogenous perishable consumer goods (Ampuero and Vila, 2006; Underwood, 1999). Nevertheless, packaging used to protect and contain the product (Sara, 1990).

The supplier scorecard of farmer as a fresh product supplier should represent the value creation that adapt with the characteristic of product in agriculture sector. Therefore, farmer effort in added packaging and branding to their product should as a supplement to the supplier performance that create value through value dimension. Value creation is a tools to reach competitive advantage (Fawcett, 2014).



**Figure 1. Value Creation Dimension (Fawcett, 2014)**

There are previous researches about value dimension in customer perspective. According to Fawcett (2014), five criteria that apply for supplier score cards to meet customer needs and competitive advantage are cost, quality, delivery, responsiveness and innovation. Whilst, Ulaga

(2003) stated eight relationship value drivers between manufacturer and supplier are product quality, delivery, time-to-market, direct product cost (price), service support, supplier know-how, personal interaction and process cost.

**Table 1. Previous Study of Supplier Value Dimension Performances Indicator.**

Authors	Value Drivers/Dimension	Relationship
Fawcett (2014)	cost, quality, delivery, responsiveness and innovation	Supplier - Customer
Ulaga (2003)	Product quality, delivery, time-to-market, direct product cost (price), service support, supplier know-how, personal interaction and process cost.	Supplier - Manufacturer

**DATA AND METHOD**

The study object is the performance of farmer and actors in the supply chain as a supplier of vegetables. The design that used in this study is a qualitative method. Data collection techniques through interview to key informant, namely, farmer and manager of vegetable supplier company. Questioner design based on value dimension, namely, quality, cost, delivery, responsiveness, innovation and personal

interaction (Fawcett, 2014; Ulaga, 2003) that adjusted with modern agriculture product that has marketing differentiation by applied packaging and branding.

Currently, tomato is one of the vegetables that has applied packaging and branding. The research conduct in farmer, branded and packaged tomatoes supplier company and modern retail that sold branded and packaged tomatoes that located in Bandung.

**Table 2. Value Dimension Scorecard for Branded and Package Vegetable Supplier**

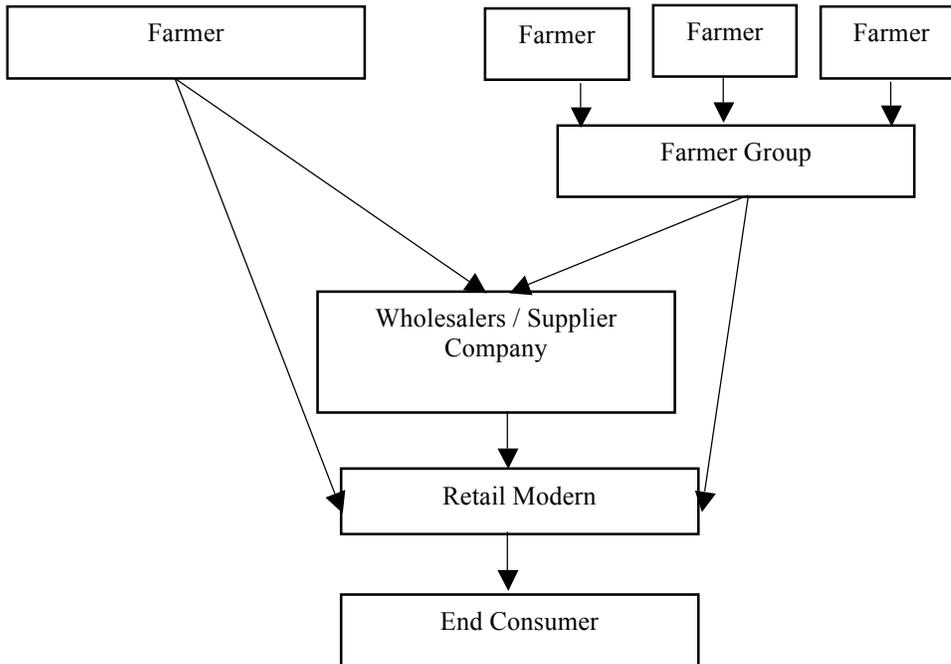
Value Dimension	Key Performance for Branded and Package Vegetables Supplier
Cost*	Product Price
	Delivery Cost
	Brand and Packaging Cost
Quality*	Standardization and Grading (Conformity the number of product per kg, taste, shape and color)
	Durability
	Freshness
	Packaging
Delivery*	Accuracy (compliance with schedule) delivery
	Delivery time
	The ability to minimize losses or shrinkage weight of product that delivered in the shipping process
	The ability make efficient and minimize place during delivering using packaging (sent the maximum quantity without sacrificing quality)
Responsiveness*	Service level
	Product continuity
	Delivery flexibility in term of quantity
	Packaging Flexibility (supplier capability to adjust type and shape of packaging as customer demand)
	Planting schedule flexibility
Innovation*	Product Research and development
	Branding and Packaging Research and development
	Supplier knowledge in term of packaging and branding
Personal Interaction**	Communication **
	Problem solving **
	Mutual goals**

Source: \*) Fawcett, 2014; and \*\*) Ulaga, 2003

**DISCUSSION AND ANALYSIS**

The actors that involve in the distribution of branded and package tomatoes is farmer, farmer group, vegetables supplier company and modern retail. Since there are several actors in the supply

chain, not only the farmer performance should be measured, but the vegetables supplier company also has a role in farmer vegetables marketing. The supply chain of tomatoes branded and package vegetables as follows.



**Figure 2. Brand and Package Tomato Supply Chain**

**Vegetables Supplier Company Evaluation on Farmer Group and Farmer Performances**

Small farmers usually incorporated in farmer group in order to collaborate between them to supply the vegetables to supplier company. Farmer performances are evaluated by vegetable supplier company.

**A. Cost**

Tomato prices offered by the farmers is essential for vegetable supplier company because it will affect the profits that earned by the company. The price set by the agreement between farmer and vegetables supplier company. Ideally this agreement running smoothly, however sometimes some farmer

uncommitted when prices that offered by traditional market is higher than the agreement price. These farmers want to gain the highest profit from tomatoes selling, therefore, they prefer sold their tomatoes to traditional market than send it to vegetables supplier company.

In theory, not only price that used as evaluation parameters, but also delivery cost. It is estimated that the cost of shipping affects the performance of farmers. Because usually small farmers have no proper delivery vehicle, almost all delivery cost incurred by vegetables supplier company, except farmer that placed close to the supplier company who sent tomatoes to the supplier company directly. Therefore,

shipping cost not a factor that considered to select farmer as supplier.

Packaging and brand attributes used to increase the value of the product. Currently, tomatoes are delivered by farmers in bulk form so no expenses for those attribute. Tomato farmer sends vegetable supplier to the company using a plastic container box, that provide by vegetable supplier company, to avoid tomatoes damage during the shipping process

#### B. Quality

Tomato quality in terms of color, shape and taste that suitable with supplier company demand is very important. Meanwhile other attributes such as brand and packaging are considered unimportant because the company will add a brand of the company in primary packaging tomatoes.

The suitability tomato color is essential for vegetable supplier company. Currently farmers have a good understanding of tomatoes color that expected by supplier company that is red partially green. Tomato color reflects tomato maturity level. This contributes to the durability of tomatoes, in particular, when it displayed on the shelf at modern retail store. In addition, it attracts customer to buy tomatoes.

In addition to color, shape tomato is an important in determining the quality of tomatoes in accordance with consumer demand, especially in terms of aesthetics. Conformity of tomato shape is excellent because farmers have used tomato varieties that recommended by a supplier. The assistances have done through field assistance that monitor the tomatoes farming regularly.

Tomato flavor is adjusted with end customer need and want. Consumers who would make tomato juice want sweeter taste of tomato. From supplier company perspectives, farmer have a good performances of tomato fulfillment in term of flavor. In order to get the proper taste of tomato, farmer cultivated the appropriate tomato varieties. However, the taste can be influenced also by environmental conditions during the process of cultivation of tomatoes, such as

climate factor that will affect the intensity of the light.

#### C. Delivery

The accuracy of the delivery schedule tomato is a very important factor. Farmer should deliver tomato exact as in timetable because the modern retail, as a buyer from vegetable supplier company, give no toleration for late delivery. Delays in delivery by the farmer cause the tomato that send by the vegetable wholesales rejected in modern retail, therefore, farmers should be able to send tomatoes punctually. Vehicle for vegetables pick up operate since four am and have been socialized to the farmers, so that farmers can send tomato in accordance with the schedule.

The ability to minimize the loss or shrinkage weight due to damage in the delivery process is very important for supplier company because it will affect the size of the depreciation of tomatoes delivered. Losses of tomato is minimized by using an appropriate plastic container that is in medium size which maintain air circulation that affect the freshness of the tomatoes. Farmers able to meet the demand of supplier company to conduct the initial packing by inserting a tomato crop into the plastic container with approximately 25 cm high. This could minimize the place, where tomatoes will be prepared as much as 2 stacks of tomatoes in the container to maintain tomatoes physical condition. Farmer has a good understanding about tomatoes delivery handling.

#### D. Responsiveness

Service level is considered a very important factor because it affects the ability of farmers to meet supplier company high demand. Currently, supplier company assess service level of farmers is bad, because farmer very rarely able to fully meet the expected service level, even less fulfillment only by 50 percent. It can not be avoided because of land ownership of farmers planting partners mostly narrow field that makes difficulties to comply with substantial demand from the supplier company. This is the reason why the supplier company has many partner

farmers and spread in some areas vegetables centers in Bandung.

Consistency of continuity in deliver tomato is a very important factor for supplier company, because continuity is very influential in how many tomatoes were ready to be supplied from supplier company to the modern retail. Supplier company and modern retail has been done agreement of tomatoes quantity to be supplied, so that continuity is one factors that are evidence of commitment and trust that given by supplier company to farmers. Supplier company has already implementing planting schedules that adjusted to market demand especially modern retail so that compliance with the request. Farmers have been able to make tomatoes deliveries supply in accordance with the planting schedule that agreed with supplier company so that fulfillment of tomato can be met continuously.

Tomato quantity delivery flexibility is very important because the supplier company strives to provide the best service in terms of fulfilling the demand of the buyer. However, when there is an increase or decrease in demand from the supplier company, farmers can not meet the demand suddenly due to the seasonal reasons.

#### E. Innovation

Research and development on tomato vegetable products is very important as it supports the product conformity with the wishes of the end consumer. Currently farmers still considered not able to do research and development on tomato vegetables due to technological problems and lack of expertise on the application of the brand and packaging. In addition, although farmers' have knowledge about the importance of brand and packaging as the product attributes which target the end consumer who shop in modern retail, farmers do not make an effort to implement the brand and packaging for a supplier company only requires bulky tomato.

#### F. Personal Interaction

Supplier company and farmer has a good quality of communication. It shows when both

actors decide planting schedule, agreement about price and product quality. Also, services and complaint handling considered very important by the supplier company. This is because the supplier company often require a lot of information updates about the condition of the tomato farm field. In addition, service that related complaints from supplier company to farmer deliver through field assistance teams. Farmers have been able to provide excellent service and complaint handling. Also, farmers are open to feedback that given and facilitate complaints quickly.

### **Modern Retail Evaluation on Vegetables Supplier Performances**

Modern retail evaluated performances of vegetables supplier performances for vegetable supplier company and farmer. Vegetables supplier company performances indirectly describe farmer performances that supply tomato.

#### A. Cost

Price offered by vegetables supplier is taken into consideration to determine supplier selections. The price depends on type of tomatoes. Branded and packaged tomatoes have higher price than bulky tomatoes. Shipping costs and packaging cost not considered in supplier selection evaluation because the tomato price has already included both cost. Currently, modern retail assesses supplier performance on the price offered is good because price determination based on negotiation and bargaining between two party.

#### B. Quality

Attribute tomatoes in the form of tomatoes packaging design, brand and color are very important attribute for evaluation. Retail perceive packaging design as an attributes that reflect quality and a tool for attract customer. Currently, packaging from tomatoes made from clear plastic, so that customer still can see tomatoes through the plastic. Not only packaging, but also brand as mark of product quality and identity that helps customer to differentiate between one product to another. Moreover, modern retail need red greenish tomatoes because they want

tomatoes that has durability, so that it will increase time length on store shelf display. The longer the tomatoes display, the higher opportunity to sold the product. In addition, there are other attributes that into consideration for determining the quality of retail although not the main one, which is the tomato standard form. Flavor attributes is not factor that considerate ultimately in determining tomatoes quality. In fact, tomato flavor identic with tomato varieties. Retail assess suppliers tomatoes quality offered are very good, especially for brand, color and shape attributes.

C. Delivery

Retail view good perform of delivery performances is important, in term of delivery schedule accuracy, delivery speed, and tomato weight loss and space efficiency during delivery process. The ability of suppliers in delivery process affect tomatoes readiness degree at the grocery store along store operating hours. Supplier must send the tomatoes before the store open in the morning. There are two destination point from delivering tomatoes. Bulky tomatoes that sent by the supplier to the distribution center. While branded and package tomatoes that sent directly to each branch store because this product ready to put on the store self. Currently, retail assess supplier performance marked good.

D. Responsiveness

The ability of suppliers to meet demand both in terms of quantity, continuity, flexibility tomato demand, and the flexibility of determining packaging are factors that is considered very important. Retail assess responsiveness supplier performances rated very good. However, supplier

only reach approximately 90% of retail demand quantity.

E. Innovation

Factors innovation especially product and packaging innovation development also supplier knowledge of branding and the packaging is considered as a factor that important. However, this factor is not a major consideration in determining supplier evaluation. Currently the supplier's performance associated with innovation is already considered good for brand and packaging development.

F. Personal Interaction

Communication considered as an important factor because without it both actors cannot have an agreement in terms of price, quality and quantity. Modern retail usually informs about the specification of branded and packaged tomato that they want. Vegetable supplier will give feed back about the ability to fulfill the vegetable specifications. Vegetable supplier has a good service and complaint handling, also open when modern retail gives a feedback.

There are differences and similar key performances on value dimension in order evaluate supplier performances in the supply chain, in particular within vegetables supplier (wholesaler) evaluation on farmer performances and modern retail evaluation on vegetables supplier performances. Mostly the dimension that has different key performances, namely value dimension of cost, quality, innovation and personal interaction. On the contrary, the dimension of responsiveness and delivery almost have the same key performance within both actors.

**Table 3. Value Dimension Supplier Scorecard in Supply Chain Actors**

Value Dimension	Vegetables Supplier Company (Wholesaler) Evaluation on Farmer Performances	Modern Retail Evaluation on Vegetables Supplier Performances
Cost	<ul style="list-style-type: none"> <li>- Product price is important and set by agreement.</li> <li>- Price only for bulk product.</li> </ul>	<ul style="list-style-type: none"> <li>- Product price is important and set by negotiation and bargaining.</li> <li>- Price include price for product,</li> </ul>

Value Dimension	Vegetables Supplier Company (Wholesaler) Evaluation on Farmer Performances	Modern Retail Evaluation on Vegetables Supplier Performances
		branding and packaging.
Quality	<ul style="list-style-type: none"> <li>- Color, shape and flavor is an very important attribute, Color is red greenish and variety depend on the demand.</li> <li>- Brand and primary packaging considered unimportant.</li> </ul>	<ul style="list-style-type: none"> <li>- Packaging, packaging design, brand, and color is very important.</li> <li>- Prefer packaging with a clear plastic and attractive design.</li> </ul>
Delivery	<ul style="list-style-type: none"> <li>- Delivery schedule accuracy and ability to minimize loss is very important.</li> </ul>	<ul style="list-style-type: none"> <li>- Delivery schedule accuracy, delivery speed, and tomato weight loss and space efficiency during delivery process is important to maintain.</li> </ul>
Responsiveness	<ul style="list-style-type: none"> <li>- Service level in term of quantity and continuity is very important. Currently, only fulfill app. 50% from demand due to narrow field. Company applied planting schedule.</li> </ul>	<ul style="list-style-type: none"> <li>- quantity, continuity, flexibility. Supplier only reach approximately 90% of retail demand</li> </ul>
Innovation	<ul style="list-style-type: none"> <li>- Innovation is important especially in tomato attribute. However farmer faced technological problems and lack of knowledge.</li> </ul>	<ul style="list-style-type: none"> <li>- Product and packaging innovation development is important.</li> <li>- Supplier knowledge of branding and the packaging is considered as a factor that important.</li> </ul>
Personal Interaction	<ul style="list-style-type: none"> <li>- A good quality of communication for planting schedule, price and product quality agreement is important.</li> <li>- Information updates through field assistance.</li> <li>- Providing excellent complaint handling.</li> </ul>	<ul style="list-style-type: none"> <li>- Communication considered as an important for agreement in terms of price, quality and quantity.</li> <li>- Also, giving feed back about the ability to fulfill the vegetable specifications.</li> </ul>

## CONCLUSION

Vegetables supplier company and modern retail as buyers prefer to buy product from high perform supplier. Determining producer performance, customer applied several importance criteria in evaluation and selection process. These criteria based on their expectation of value when they decide to buy the product. Producers are encouraged to understand and had knowledge of customer demand in order to creating customer value. Value dimension

performance can be improving to increase vegetable supplier performance.

There are differences key performances on value dimension in vegetable supplier company and modern retail, particularly in cost, quality, innovation and personal interaction dimension. In term of responsiveness and delivery both actors have almost the same perception.

The dimension that has a high influence to improve package and branded vegetables supplier performance is responsiveness. Buyer

perceive that that the service level enhancement and flexibility in delivering tomato to buyer is high importance, however it has a low performance. Therefore, farmer should improve they capability in produce higher product quantity. In addition, innovation through capability product development and farmer knowledge of brand and packaging should be regenerate to encourage high farmer performance in order to win the competition.

Farmer or farmer group supply unbranded tomato to vegetable supplier company but already applied secondary package, even though the packaging owned by vegetable supplier company. On the other hand, supplier to modern market has applied brand and package for the tomato.

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## MEASUREMENT MODEL FOR BUSINESS PERFORMANCE ON CREATIVE INDUSTRIES IN BANDUNG CITY

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### ABSTRACT

*Business performance in a creative industry is a matter to be taken into consideration as one of the indicators hinting whether the business has reached success. This research aims at investigating how business performance on creative industry is and what are the factors which dominantly measures the industries' business performance.*

*In order to answer the research questions, the method of analysis used is descriptive analysis to be later followed by Structural Equation Modeling. The descriptive analysis is used to attain a general depiction concerning the creative industries' business performance. Furthermore, each variable will go through an empirical hypothesis testing by using SEM (Structural Equation Modeling) on Lisrel Version 8.3 software. The population in this research includes creative industry companies which comprise 15 business type with the total of 5291 companies, with the sampling of 165 companies. The sampling technique applied is proportional stratified random sampling.*

*All indicators in business performance should be able to be deemed valid both in terms of discriminant validity and convergence validity. The result of convergence validity analysis also reveals that the most dominant indicator in measuring business performance variable is the sales volume. This indicates that business performance variable is highly correlated with sales volume. The higher the sales volume is, the greater the business performance will be.*

**Keywords:** *Business Performance, Creative Industries, Bandung City*

### I. INTRODUCTION

The creative industry is an industry that continues to grow and develop in Indonesia is included in Bandung. The development of creative industries in Bandung, which makes this industry very rapidly become a mainstay industry of the government of Bandung today and an industry that are seeded in the future.

Creative industries rely heavily on creativity, abilities and talents of individuals someone in the company. Yet at the same time, the increased complexity of the environment, competition and market volatility, making reliance on individual creativity alone is not enough, take a few ways that business performance in companies in the creative industries is constantly increasing.

Conditions that exist today in the city of Bandung creative industries is that the leaders in the creative industry in general is no longer reluctant to take risks in creating its business both in the creation of products and improved service. It can be seen from the many innovative products that have sprung up in the city of Bandung and very diverse ranging from food, clothing products, handicrafts and various other creative products. The purpose of it all is to increase business performance for companies in the creative business

Measurement of business performance in the creative business is a challenge given the output of its creative industry is different from ordinary products manufactured goods relatively more easily measured. It is therefore a matter that

needs to measure business performance in the creative industries in the city of Bandung.

### Research purposes

This study aimed to study the effect of the rate of return on investment (X1), company's profits (X2), market share (X3), Sales Volume (X4) and Product Quality (X1) to Business Performance (Y).

## II. LITERATURE REVIEW

### 2.1 Creative Industry

The creative industry became one of the areas that are considered in the current era of the creative economy. The creative industries have huge potential for prosperity and job creation. Activities creative industry relies on individual creativity, skill and talent. In contrast to most other industries whose main output is a material product or service that is immediately used, the creative industries output in the form of intellectual property.

Definition of the creative industries most widely used as a reference until now is the definition of the Creative Industries Task Force of DCMS yaitu: "*Creatives Industries as those industries which have their origin in individual creativity, skill & talent, and which have a potential for wealth and job creation through the generation and exploitation of intellectual property and content*" (Pengembangan Ekonomi Kreatif Indonesia 2025, 2008: 4)

Definition of the creative industries in Indonesia refers to the notion of Creative Industries Task Force of DCMS is as follows: "The industry derived from the use of creativity, skill and talent of individuals to create wealth and jobs through the creation and utilization of creativity and inventiveness of the people" (Pengembangan Ekonomi Kreatif Indonesia 2025, 2008: 4)

So from an understanding of the creative industry proclaim that the core of the creative industry is the use of creativity, skill and talent of individuals as output with the process of change through creativity and inventiveness so that the output is in the form of creative products.

### 2.2 Business Performance

#### 2.2.1 Definition of Business Performance

Berbagai pengertian umum dari istilah kinerja bisnis adalah organizational performance (Ford & Schellenberg, 1982), atau strategy-based performance (Kaplan & Norton, 2001; Slater, Olson, & Reddy, 1997). Ford dan Schellenberg (1982, p 50.) Mengidentifikasi tiga perspektif kinerja organisasi: (a) pendekatan tujuan dimana kinerja didefinisikan oleh pencapaian tujuan dan sumber daya (b) pendekatan sistem di mana kinerja didefinisikan oleh kemampuan suatu organisasi untuk mengamankan sumber daya yang langka dan (c) pendekatan proses di mana kinerja didefinisikan pada perilaku peserta organisasi ". (Linda L. Vytlačil, 2010: 33)

Various general sense of the term performance of the business is the organizational performance (Ford & Schellenberg, 1982), or strategy-based performance (Kaplan & Norton, 2001; Slater, Olson, & Reddy, 1997). Ford and Schellenberg (1982, p 50.) Identify the organizational performance of three perspectives: (a) approach where performance objectives defined by the achievement of goals and resources (b) a systems approach in which performance is defined by the ability of an organization to secure scarce resources and (c) where the process approach defined performance on the behavior of the participant organizations. "(Linda L. Vytlačil, 2010: 33)

Venkatraman dan Ramanujam (1986) melihat kinerja bisnis sebagai bagian dari efektivitas organisasi secara keseluruhan, meliputi indikator keuangan dan kinerja operasional, sedangkan dalam penelitian sebelumnya kinerja ekonomi bisnis sering mencakup kinerja keuangan (Venkatraman & Ramanujam, 1986).

Venkatraman and Ramanujam (1986) view of business performance as part of the overall effectiveness of the organization, including financial and operational performance indicators, whereas in previous studies of economic performance businesses often include financial performance (Venkatraman & Ramanujam, 1986).

#### 2.2.2 Business Performance Measurement

Business performance awakened from multidimensional variables which include financial performance is return on assets (ROA) and return on investment (ROI) and operational performance (market share, the success of new products, product quality, marketing effectiveness, customer loyalty, satisfaction).

Venkatraman and Ramanujam (1986) in Sorensen, 2009: 742.

Zebal (2003: 76) conducted a study on the effect of market orientation on business performance with a sample of 120 companies. Business performance seen from the performance of economic and non-economic performance. The economic performance of an organization is seen from several performance functions such as return on investment, profits, market share, sales volume, product quality and other financial performance, whereas the non-economic performance such as employee commitment, customer satisfaction and repeat purchases. (Narver and Slater, 1990, Jaworski and Kohli, 1993, Matsuno and Mentzer, 2000).

Additionally Ailawadi, Dant and Grewal(2003: 3) gives the following opinion:

*Several important marketing constructs, like market orientation, culture, innovation, customer satisfaction, and relationship quality, are difficult to measure and even more difficult to relate to performance. Researchers have to develop and validate perceptual measures of these constructs, and then gather data on them through self-report surveys. Given the cost and effort involved, longitudinal panels are usually impractical. More importantly, objective performance data, especially for comparable units of analysis, are difficult to obtain, and researchers often rely on self-reported perceptual measures of performance.*

From these explanations can be explained by the perception that the measurement is often used by researchers, especially for marketing studies, market orientation, culture, innovation and customer satisfaction. Researchers in this developing perceptual measurement.

As with the Baker and Sinkula (2005: 484) states regarding performance measurement: performance measure usually consists of one or more consisting of the following: (1) the success of new products; (2) profitability; (3) market share; (4) measure of financial performance, for example, the average profitability, sales, sales growth, return on investment (ROI), the success of new products, market share and (5) performance measures eg marketing, customer

satisfaction, employee satisfaction, customer retention, service customer, product quality perception.

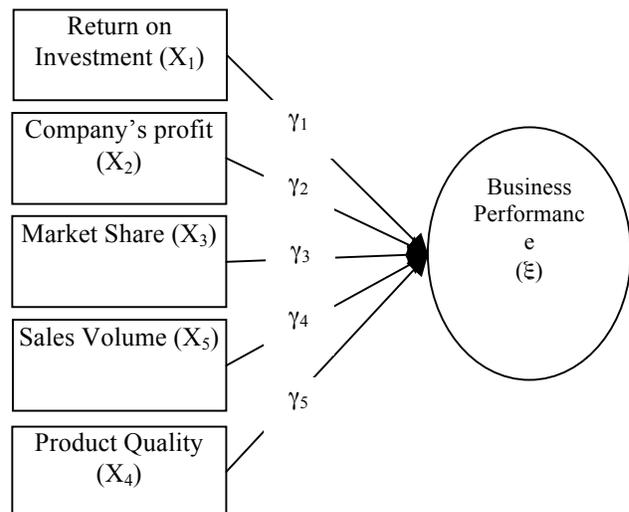
### III DATA AND METHODS

#### 3.1 Research Design

This study aimed to study the effect of the rate of return on investment (X1), Company's profit (X2), market share (X3), Sales Volume (X4) and Product Quality (X5) to Business Performance (Y).

To answer the purposes of this study the authors used the analytical techniques Partial Least Square Path Modeling (PLS-PM). PLS PM is the analytical techniques used to model the effect involving latent variable. (Hair, et al, 2013). Latent variable is a variable whose value can not be determined directly but through the measurement of the indicators. Model PLS-PM consists of two models, namely models of inner and outer models. Inner Model is a model which explains the influence of latent variables, the model outer sedangkan a measurement model that describes the effect on the variable indicator (formative model) or model variables influence the indicators (reflectif).

This research model on the outer level model that describes the formative influence of the indicator of business performance to variable business performance. Model research can be described as follows:



Picture 1 Structure Analysis

Path diagram above can be written in the following models:

$$\xi_1 = \gamma_{11} X_1 + \gamma_{12} X_2 + \gamma_{13} X_3 + \gamma_{14} X_4 + \gamma_{15} X_5 + \varepsilon$$

Keterangan

$\xi_1$  : Business Performance

$\gamma$  : Coefficient of Influence

$\varepsilon$  : Error

### 3.2 Parameter Estimation

In more detailed parameter estimation method (estimation) in PLS is the least squares method (least square methods). The estimation of the parameters in the PLS includes three (3) things:

1. Weight Estimate is used to create the latent variable score
2. Estimate the path (path estimate) that connects between the latent variables and the estimation of loading between the latent variables with the indicator
3. Means and location parameters (value of the constant regression, intercept) to indicators and latent variables

### 3.3 Evaluation Measurement Model

#### Convergent Validity

Convergent Validity Convergent validity measure the correlation between a construct with latent variables that include individual inspection item reliability, internal consistency or construct reliability and average variance extracted. Individual item reliability checks can be seen from the value. Rated loading factor above 0.7 can be said to be ideal, it means that the indicator is valid as an indicator that measures the construct. Nevertheless the value of standardized loading factordiantara 0.7 to 0.5 is acceptable, while the value of loading factor below 0.5 by Hair (2013) will be excluded from the model. While communalities is the square of the value loading factor. Selanjutnya composite measurement of internal consistency reliability to look at reliability. Formula for Composite Reliability (CR)

$$CR = \frac{\sum \lambda_i^2}{\sum \lambda_i^2 + \sum \varepsilon_i^2}$$

Equal to the value of Cronbach's Alpha, the CR value above 0.7 means acceptable, above 0.8 and 0.9 means very satisfying .. Another measure of convergent validity is the value of average

variance extracted (AVE). AVE value indicates the amount of variance or diversity manifest variables that can be contained by the latent construct.

### 3.4 Hypothesis Testing

To determine the significance of the effect on the variable indicators used hypothesis as follows:

$H_0 : \gamma_{ii} = 0$ , There is no influence rate of return on investment (X1), Company's profit (X2), Market Share (X3), Sales Volume (X4) or Product Quality (X1) to Business Performance (Y)

$H_1 : \gamma_{ii} \neq 0$ , There is the influence rate of return on investment (X1), Company's profit (X2), Market Share (X3), Sales Volume (X4) or Product Quality (X1) to Business Performance (Y)

To test this hypothesis using student t test statistic with the formulation

$$t_t = \frac{Y_{it}}{SE(Y_{it})}$$

Reject the null hypothesis if the value of t thitung greater than the value t table at a significance level of 5%

## IV, FINDING & DISCUSSION

### 4.1 Descriptive Analysis

Business performance as part of an overall organizational effectiveness indicators include financial and operational performance. (Venkatraman and Ramanujam (1986). On the business performance variables will be discussed: the rate of return on investment, company's profits, market share, sales volume and product quality.

**Table 1 Table 1 Calculation of Indicator Accumulation Business Performance**

Indicator	Total Score	(%)
-----------	-------------	-----

Return on Investment	X <sub>1</sub>	621	73.9
Company's profit	X <sub>2</sub>	650	78.8
Market Share	X <sub>3</sub>	642	77.8
Sales Volume	X <sub>4</sub>	637	77.2
Product Volume	X <sub>5</sub>	663	80.4
		3213	77.9

From the calculation results of questionnaires that can be seen in the table above 4:11, the business performance of companies in the creative industries in the city of Bandung in the high category. (77.9%). The investment made by the company is certainly expected to have a positive impact, returns that correspond to the making of investments made. Table 1 shows an increase in the return on investment of the company (73.9%). Certainly it can be said that the creative industry is one industry that is promising to be lived. The creative industry is an industry that promotes creativity and innovation as a primary value. Related to this, the creativity and the innovation should be rewarded with good, so companies will be encouraged to continue to produce and manage the creativity and innovation in order to return the investments made.

Tom Lembong a member of the association investment said foreign investors consider tourism sector and creative industries rather than commodities. Because according to him, the sector is more potential given the price of commodities such as coal and oil kept depressed, especially natural resources are now running low<sup>1</sup>. One area that increased investment in the creative industries is the city of Bandung. From this it can be concluded that the potential return on investment in the creative industries will continue to rise.

Profit is one of the main objectives of a company established. Company's profits will have an impact on the sustainability of the business, whether it's the creative industries as well as in other industries in general. Various methods are used to achieve the profit target, either from the target of increasing sales, increasing the number of subscribers, to erosion costs are considered scattering.

From the research results can be seen that the company's profits have increased and greatly increased, expressed from table 1 we can see a total score of 77.9%. It is assumed that the company's creative industries can provide increased profitability for the culprit, making the creative industries as a means of profit making good enough to do. Likewise with the growing market share is desired by any company, because of the increasingly broad market share will get a lot of customers. This occurred in market share in the creative industries, are shown in Table 1, which the company claimed that an increase in market share (77.8%). The market share is the amount of sales-owned competitors in the relevant market. The increase in market share can be due to the increased motivation of human consumption, along with improving the quality of life where in the city of Bandung, the average community is now more meginginkan product that is no longer the market or commodity products but have noticed the design, quality, uniqueness and that other things were indeed obtained of creative industry products.

The sales volume in the creative industries in Bandung also increased (77.2%). This occurs as a result of increased market share as described as above before. Calculation of sales volume in the creative industries would vary for example in the subsectors of advertising seen from how much the ad requests from clients during the year, of goods art & antiques, crafts fashion and culinary rather the number of products sold, performing arts seen from how many spectators present at a time performances, from the sub-sector TV and radio advertising could be seen rising pemasaran, the architect subsector seen from how many designs are created and so on as the unit of measurement.

The increase in sales volume occurred because of many things, in addition to an increase in demand for domestic products, also because of the current demand for products from overseas markets. Many creative product Bandung, which has penetrated the overseas market or purchased by foreign consumers. Some respondents in this study also has a foreign consumers, for example in the advertising industry, PT.Lintas Mediatama has had foreign markets such as Zara of Spain. Cosmic distros already have an agency in Brunei, Australia, Malaysia and Germany, as well as with Ouval and Greenlight, from

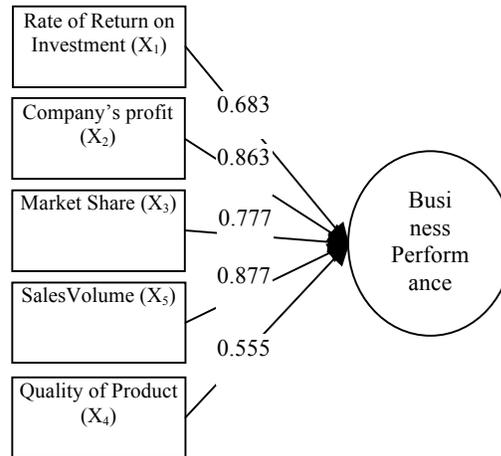
performing arts subsector there Saung Angklung Ujo, from culinary in cookies and of course there are many more players who have penetrated into many countries.

Sales increased due to the continuous creative industry companies generate creativity and innovation that is done, so that customers and consumers do not feel tired and even feel satisfied, so as to make increased sales. In addition, the number of satisfied customers create word of mouth that ultimately impact on sales.

The desire of consumers to get the quality that suits your needs and expectations are the things that need to be considered by the company. In harmony with this, though needed a more expensive price related to quality improvement, but it is a natural thing to remember, the better and the quality of goods, it is necessary to sacrifice a little more needs to be done.

From table 1 illustrated that the company's product quality has increased. From interviews and literature studies conducted by the author on some of the actors in the creative industries stated that if the company already have a vast market and high consumer loyalty then maintaining or improving quality is an absolute must do. For some cases the creative industries that have customers from abroad they usually have a high standard for a creative product and willing to pay more. As performed by Hedi one of the perpetrators of the craft sector that makes accessories for bikers like headbands and necklaces, when entering foreign markets, he reorganized the product from the previous one made by artisan become like made by cool artists All indicators of business performance at companies in the Creative Industries at the high category. The highest indicator is the quality of the product. Improving the quality of this product occurred almost in all sub-sectors in the creative industries. Superior product quality is one key to success of the company to achieve competitive advantage.

Analysis of Effect of Rate of Return on Investment (X<sub>1</sub>), Company's profit (X<sub>2</sub>), Market Share (X<sub>3</sub>), Sales Volume (X<sub>4</sub>) Quality of Products (X<sub>5</sub>) to Business Performance (Y)



Picture 2 Measurement Analysis

**Quality Testing Model**

The coefficient of influence on the path diagram above can also be expressed as a coefficient validity indicator in measuring business performance variables. All items declared valid by the validity of greater than 0.500. In addition to a valid, reliable fifth indicator is also expressed with cronbach's alpha reliability coefficient of 0.810 and D.G. rho of 0.8670. The reliability values more than 0700 so it can be declared reliable.

Table 2. Results of Hypothesis Testing

Manifest variables	Effect	t-value	t-table	Sig
Rate of Return on Investment (X <sub>1</sub> )	0.683	11.569	1.975	Significant
Company's profit (X <sub>2</sub> )	0.863	41.680	1.975	Significant
Market Share (X <sub>3</sub> )	0.777	14.892	1.975	Significant
Sales Volume (X <sub>4</sub> )	0.877	35.762	1.975	Significant
Quality of Product (X <sub>5</sub> )	0.555	7.311	1.975	Significant

Test results showed all the indicators give significant effect to variable business performance with t value is greater than the value of the t table.

The analysis finds sales volume indicator provides the most impact on business performance with great effect as the standard deviation 0877. In second position is the

company's profit indicator by 0863 the effect of standard deviation. The indicator with the lowest effect is an indicator of product quality.

Communalities coefficient of this model of 0587 which stated that 58.7% of that diversity of business performance can be affected by the indicator.

## 5. Conclusion

All indicators of business performance at companies in the Creative Industries at the high category. The highest indicator is the quality of the product. Improving the quality of this product occurred almost in all sub-sectors in the creative industries. The results of hypothesis testing showed all the indicators give effect to variable influence significantly the performance of the business, which means this hypothesis can be accepted. Sales volume indicator provides the most impact on business performance.

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## **THE EFFECT OF KNOWLEDGE SOURCES ON INNOVATION CAPABILITIES AMONG RESTAURANTS AND CAFÉ BUSINESS IN INDONESIA**

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### ***ABSTRACT***

*To conduct innovation, firms absorb and utilise internal and external knowledge. This study examines the effect of internal and external knowledge in terms of breadth and depth of knowledge sources, on a firm's innovation. The breadth of knowledge sources refers to the amount of knowledge sources used within the firm. The depth of knowledge sources is the amount of knowledge sources intensively used by the firm. This study is aimed to answer the following questions: a) what knowledge sources are mainly used?; b) what type of innovation is frequently conducted?; and c) what are the effects of the breadth and the depth of knowledge sources on innovation capabilities among Indonesian restaurants and cafés. The resource-based theory and resource-dependency theory are used to understand the role of internal and external knowledge on innovation within a firm.*

*We distributed a semi-structure questionnaire to 101 owners/managers using a purposive sampling and a snow-balling technique in five big cities (Bandung, Bogor, Malang, Surabaya, and Yogyakarta) in Indonesia. The results show that the Indonesian restaurants and cafés utilised external knowledge sources more often than internal ones. The firms produce more incremental product innovation than radical one. The depth of internal knowledge sources has positive significant impact on a firm's innovation capabilities, which supports the previous studies. Meanwhile, the breadth of internal knowledge sources is found not to have a significant effect on innovation. Additionally, the effect of breadth and depth of external knowledge sources on innovation capabilities are also insignificant.*

**Keywords:** *breadth and depth of knowledge sources, internal knowledge sources, external knowledge sources, innovation, restaurants and cafés*

# **THE IMPACT OF ELECTRONIC WORD-OF-MOUTH ON BRAND IMAGE, ATTITUDE TOWARD PRODUCT, PERCEIVED QUALITY AND VISIT INTENTION: AN EMPIRICAL STUDY OF THE FOOD AND BEVERAGE INDUSTRY IN JAKARTA**

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## ***ABSTRACT***

*This research is a synthesized study of two previous studies conducted by Jalilvand and Samiei (2012) and Jalilvand, Samiei and Ebrahimi (2012). The context of the research has been adapted to the food and beverage industry in Jakarta. The respondents of this study are individuals who have experience in visiting restaurants located in Jakarta. In total, there were 163 usable responses. The findings of the study show that electronic word-of-mouth (eWOM) influences brand image and visit intention to a restaurant. The findings suggest that restaurant managers should pay attention to the kind of eWOM that can be found in a variety of social media and internet platforms.*

**Keywords:** *brand image; food industry; electronic word-of-mouth; perceived quality; restaurant; intention to visit*

## **INTRODUCTION**

This research is a synthesized research of two previous studies. The first study was conducted by Mohammad Reza Jalilvand and Neda Samiei with the title “The effect of electronic word of mouth on brand image and purchase intention: an empirical study in the automobile industry in Iran” (2012). The second study was conducted by Mohammad Reza Jalilvand, Neda Samiei, and Abolghasem Ebrahimi titled: “Electronic word-of-mouth effects on tourists’ attitudes toward Islamic destinations and travel intention: an empirical study in Iran” (2012).

The food and beverage (F&B) industry has become one of the biggest industries in Indonesia. As stated in the Indonesian Ministry of Industry’s website (2015), the F&B industry contributed 20% to the country’s income. The

industry’s growth is about 9.54%, higher than the manufacturing industry which grew by 5.02% in 2015. Due to the F&B industry’s significant growth, the Indonesian government classified it as one of the nation’s prioritized industries (Ministry of Industry, 2015). In addition to that, most Indonesians favor creating a business in the F&B industry over other industries to start their entrepreneurship attempt (Hartono & Halim, 2014).

As the number of business in F&B industry keeps increasing, the competition gets fiercer, eventually leading to a higher number of restaurant reviews that can be found all over the internet (Sweeney, Soutar & Mazzarol, 2008). Customers’ demands and fiercer competition have driven restaurants’ brands to be one of the most important elements (Majid, Alias, Samsudin, & Chik, 2016). To better position their offerings and improve their sales,

many companies have utilized word-of-mouth from opinion leaders as means to promote products or to criticize competitors' offerings (Bao and Chang, 2014). Moreover, the advancement of technology and the growth of online social networks and social media platforms have further helped the spread of eWOM (Bao and Chang, 2014). In this research, the authors investigated about how e-WOM could have had a significant impact on visit intention, brand image, attitude toward the brand and perceived quality for restaurants in Jakarta.

The focus group discussion conducted by the author reveals that for the past few years, Pantai Indah Kapuk (a region in north Jakarta) has been one of the main areas of attraction for food enthusiasts in Jakarta, followed by Senopati (south Jakarta) and Kelapa Gading (north Jakarta). However, Pantai Indah Kapuk is seen as having more potential for new restaurants because the availability of shop-houses waiting to be rented. It can also be seen by the number of hashtags for each location. Pantai Indah Kapuk for example, has been talked about by customers more than 250,000 times on Instagram, while Senopati and Kelapa Gading were discussed over 20,000 and 160,000 times respectively as per January 11, 2016.

With the fast-paced growth of the F&B industry in Jakarta, it becomes more difficult for customers to decide which place to eat. Hence, customers are increasingly reliant on e-WOM to decide which restaurant to visit. People who dared to visit a restaurant before looking for e-WOM may become the pivot for other newcomers, which is why the restaurant owners are willing to invite influential people to visit their restaurants. Electronic word-of-mouth has become more effective today because those belonging to the Generation Y

cohort spend quite a large amount of time looking at their smartphones, which is why available information can be obtained quickly (Litvin, Goldsmith, & Pan, 2008). Generation Y has the most impactful voice in spreading e-WOM (Sweeney, Soutar, & Mazzarol, 2008). The advancement of technology has enabled the consumers to express their opinions using variety of media that goes beyond direct communication (Gheorghe and Liao, 2012).

Interestingly, a focus group discussion (FGD) conducted by the author revealed that customers do not pay attention regarding the source of information. There is paid content that means content made by a writer who was paid by a certain party to write good reviews regarding the restaurant. Consumers also tend to believe in one source without comparing the score from other similar platforms. Average score numbers and written reviews easily become references for their visit; sometimes just a nice picture of food is enough to create their intention to visit a restaurant. This could mean that the business owners can make their own reviews or ask friends and relatives to write reviews for them.

Word-of-mouth on the internet can be in various forms; the FGD also revealed that some people may crave a product after reading reviews from other customers, but to some, amateur photographs may be enough to convince them to visit the restaurants. Hence, generating positive e-WOM should be in the minds of restaurant managers.

In addition to that, there are limited studies regarding the impact of e-WOM toward perceived quality of restaurants. The relation of perceived quality and visit intention also varies in the context of the studies, which indicates that there is a strong need to investigate the relationship between these variables further.

## **LITERATURE REVIEW**

### **1.1 Electronic Word-of-Mouth**

Traditional word-of-mouth is a form of non-commercial communication shared between acquaintances and it has evolved into modern form due to the advancement of technology, known as electronic word-of-mouth (Cheung & Thadani, 2010). Like its predecessor, eWOM can be defined as any comments, positive or negative, made by past, present or future customers regarding a product or a company via the internet (Hennig-Thurau, Gwinner, Walsh & Gremler, 2004).

According to Cheung and Thadani (2010), there are exclusive attributes that differentiate traditional WOM and eWOM; one is that eWOM possesses a revolutionary scale and diffusing speed while traditional WOM is only shared to smaller individual groups and the spread is not as fast as eWOM. eWOM can be found in many platforms on the internet; it can be on customers own websites (such as blogs), discussion forums, review websites, news articles, e-bulletins, and social media websites. Another attribute of eWOM is that it is more persistent and easier to access since eWOM information is mostly in the form of text and available for an unrestricted time period (Hennig-Thurau, Gwinner, Walsh & Gremler, 2004). The third exclusive attribute is measurable (Park & Lee, 2009); with this attribute, people can observe the longevity, persistency, and viral rate of the information. Finally, eWOM does not share equal credibility with traditional WOM, as generally the traditional WOM is received from people who are known by the recipients, such as friends, family, or acquaintance while eWOM can be from anonymous sources.

There are several reasons why customers read e-WOM, First, customers use e-WOM as a means of obtaining information, to achieve social orientation, to have a sense of belonging and to learn ways to consume

products (Bao & Chang, 2014). Through e-WOM, customers can get the illustration of a product and begin to perceive its quality (Lecinsky, 2011).

Jalilvand and Samiei (2012) have stated that eWOM is a significant element for customers in gathering pre-purchase information. It has become a common activity for future customers to search information on the internet and this creates purchase intention. Due to this behavior, a strong term has been created for marketers, which is the 'zero moment of truth' (ZMOT). ZMOT means that customers already have information or can predict the quality of products or services before they actually see and experience them (Lecinsky, 2011). Lecinsky (2011) pointed out that current customers shopping behavior urges them to have their questions answered before they actually go shopping, and the easiest way to achieve the answers is from eWOM.

Through e-WOM, customers can get the illustration of a product and begin to perceive its quality (Lecinsky, 2011). The internet gives customers the ability to learn about a company's products, price, place and promotion, and then define the quality of such a company.

There are several reasons why customers read e-WOM, First, customers use e-WOM as a means to obtain information, to achieve social orientation, to have a sense of belonging and to learn ways to consume products (Bao & Chang, 2014).

### **1.2 Brand Image**

The definition of brand image according to Kotler (2000) is "a name, sign, symbol, or design, or a combination of them, intended to identify the goods or service of one seller or group of sellers to differentiate them from those of competitors". Kotler and Keller (2006) add the difference of brand image of

one brand and another may be “functional, rational, or tangible – related to the product performance of the brand” and can also be “symbolic, emotional, or intangible – related to what the brand represents”. Saeed (2013) elaborates, “the corporate brand is a valuable intangible asset that is difficult to imitate which may help to achieve sustained superior financial performance”.

A study conducted by Saeed et al. (2013) states that brand image is an important part of brand strength and it is evaluated by fame and market share; thus whichever brands are more spoken about are superior to other brands in the industry. Onigbinde and Odunlami (2015) said in their studies that customers appraise identical products depending on how the products are branded and some of the brand image’s functions are to shorten the duration for customers to make their purchase decision, and reduce the risk of being disappointed after making their decision.

Jalilvand and Samiei (2012), found that customers will become seriously aggravated when the purchased products or services given by providers did not match their expectations. Customers tend to trust and rely on a small number of providers that deliver products or services with quality that consistently meet their standards. In addition, Su and Yang (2015) also mentioned that every interaction between sellers and buyers is critical and becomes the input for both party’s next action, inclined toward the buyers. Therefore, it is crucial for everyone in an organization to always provide and deliver consistent, predictable, and high quality performance to the customers.

In the restaurant industry, Wu et al. (2011) found that both store image and service quality have a direct and positive effect on brand image and visit intention. Brand image in the restaurant business is one of the competitive tools to win the market as it can be a determinant aspect for customers to visit, revisit and become loyal (Yohn, 2012). According to Yohn (2012), the brand image of

a restaurant should always be rejuvenated to keep the brand relevant with the market conditions and to do this, managers can simply add new menu items or change the design of the restaurant. In conclusion, brand image in restaurant business is a tool emotionally connected with the customers and the quality of brand image should be maintained and renewed to keep the restaurant relevant in the market.

### **1.3 Perceived Quality**

Zeithaml (2000) defined perceived quality as customers’ subjective appraisal of a product as a whole regarding its value, benefit and excellence. Personal experience, unique needs and situation while using the product can influence customers’ subjective appraisal of the quality.

In service industry, service quality performance is an indicator of customer satisfaction and eventually behavioral intentions (Brady and Cronin, 2001). This suggests that measurement of service quality has been discussed widely by industry practitioners and researchers over the years (Hwang and Ok, 2013).

According to Dodds (2002), perceived quality is the customers’ trust and belief of the benefit(s) they will get from a product or a brand. Thus, we can summarize that perceived quality is the customers’ assumption of a product’s benefit(s) and their hopes that it will match their expectation.

Perceived quality of a product or service can determine the value of such a product or service and directly influence customers’ decision to purchase and their loyalty to the brand. Positive perceived quality will push customers’ decision to purchase goods and increase their loyalty toward related brands, while negative perceived quality will do the opposite (Yoo, 2000). Knowing the majority of customers’ perceived quality toward a brand, marketers can predict what is going to happen to such brand. According to Durianto et al., (2004), brand positioning can

become customers' starting line to perceive a product or service quality, whether the brand is at a premium or an economical level as well as whether the brand is the best in class or is competitive in the market.

In the restaurant context, Jang and Namkung (2008), conceptualized that perceived quality is supported by different sets of stimuli, such as service stimuli, environmental stimuli, and product stimuli. Product stimuli consist of food taste, freshness and presentation; this stimulus as well as the other two play a very crucial role to predict the customers' response and behavior.

Durianto et al. (2004) stated that perceived quality has 7 dimensions which are performance, service, durability, reliability, product characteristic, compliance with specification and result. Each dimension affects customers' perceived quality toward a product; for instance, restaurants with great food but with lackluster service would create varied perceived quality in every customer; some may only care for the food while some care for both product and service.

Products perceived quality dimensions are as follows (Umar, 2005):

- *Performance*, related to the functional aspects of a product and the main characteristics to be considered by customers to purchase such a product;
- *Features*, a performance aspect that can enhance the basic function. This is generally related with available product options and customization;
- *Reliability*, related to the products performance probability when operating its function;
- *Conformance*, it confirms the accuracy of product characteristic with its standard specifications;
- *Durability*, reflects the endurance and/or age of a product;

- *Serviceability*, a characteristic that is related to the speed, competitiveness, simplicity and accuracy in providing service to repair products;
- *Aesthetics*, a characteristic with subjective nature regarding the aesthetic values related with personal opinion and reflected from individual preference;
- *Fit and finish*, this refers to the subjective nature related with customers' feeling about the product's position as a quality product.

According to Zeithaml (2000), there are several dimensions of perceived quality, including tangibility, reliability, responsiveness, assurance, and empathy. *Tangibility* covers the physical appearance such as the building design, parking availability, cleanliness, facilities and employees' appearance. *Reliability*, is the ability to provide services as promised; *Responsiveness* is the employees' response to help customers and give fast and perceptive service. *Assurance*, covers the capability of employees with accurate product knowledge, friendliness, attentiveness and courteousness in providing service, security, skills and information. More importantly, it is the ability to embed customers' trust in a firm. *Empathy*, which is the individual attention given by a firm to the customers.

Gatti (2012) has noted that perceived quality will spark customers' curiosity to act. Curiosity makes customers want to materialize their expectation into reality. Thus, visit intention is possibly related to perceived quality.

#### 1.4 Attitude Toward the Brand

Attitude is an important construct in human psychology to predict and influence behaviors (Jalilvand et al., 2012). Attitude can be defined as an individual response or

reaction in either favorable or unfavorable gestures to a particular matter (Shahrokh, 2012). According to Shimp (1981), attitude has two components; the first is the affective components that generate emotion that caused are by the matter and cognitive components that shows how good and useful the matter is. Lefton & Brannon (2008) defined attitude as a pattern of feeling, trust and behavioral tendency toward a person, idea, or object over a long period of time. Thus, it can be summarized that attitude is the expression or pattern of feeling, trust and behavioral tendency to respond to a matter consistently, either favorably or unfavorably. Hanna and Wozniak (2001) found that attitude is the result from experience of a product or from information give from other individuals.

Abzari and Ghassemi (2014) stated that customers' attitude formation often depicts the relationship of trust, attitude and behavior. Belief, trust and customers' evaluation of a product forms customers' attitude. Attitude holds a significant role in forming behavior (Aminu and Hartini, 2008)

### **3. RESEARCH METHODOLOGY**

The study utilizes a survey as its main data collection method. The questionnaires were distributed online and offline. The offline method was conducted by distributing the printed questionnaires to potential respondents in Jakarta, especially in several universities in the city. The online method was distributed through social media, chatting platforms, and e-mail.

The objective of the study and the author's declaration to keep the gathered information anonymous and solely used for academic purposes was provided in the cover page. The questionnaire was divided into 3 sections. The first section gathered the respondents' demographic information: gender, age, occupation and monthly expenses.

In the context of customer attitude toward an object, objects can be defined in a category of product, brand, service, advertisements, etc. (Ristiyanti et al., 2005). Ristiyanti et al. (2005) also add that attitude is directional and has its own intensity; it is directional because attitude causes people to have positive and negative views toward an object. How substantial the pleasure or displeasure is will depend on the attitude intensity.

In the F&B industry, attitudes toward food and beverages are determined by a variety of personal factors, such as the individual's economic conditions, socio-demographic and cultural environment (Sparke & Horská, 2007). Mohan (2013) noted, customers' attitudes toward food are elastic; although every customer has their own taste such as avoiding spicy or sour tastes, but they are open to new kinds of food if it matches their criteria.

Thus, it can be hypothesized that: The more positive the attitude towards the restaurant brand, the higher the intention to revisit the restaurant. The second section determined whether the respondents are eligible to participate in the survey with a filter question. The third section of the questionnaire contained questions related to the main variables of the study. The hypotheses were determined by analyzing the relationship of variables in the third section.

The measurement in this study was adopted from various previous studies. Measurement of electronic word-of-mouth was adapted from the work of Lin et al. (2013); the measurement of attitude toward the restaurant brand was adapted from Jalilvand et al. (2012), while the measurement of perceived quality was adapted from Jang and Namkung (2006) and Chen et al., (2014). Lastly, the measurement of visit intention was adapted from Jalilvand et al. (2012).

Prior to the distribution of the actual questionnaires, the measurements were pre-

tested to ensure their validity and reliability.

Table 3.1 Measurement Reliability

Variable	Cronbach's Alpha	Acceptable Value	Number of Items	Remarks
eWOM	0.881	>0.6	6	Reliable
Brand Image	0.855	>0.6	5	Reliable
Attitude toward the Brand	0.812	>0.6	3	Reliable
Perceived Quality	0.941	>0.6	10	Reliable
Visit Intention	0.912	>0.6	3	Reliable

The reliability test was conducted to measure the internal consistency and stability of the questionnaire. In other words, to see whether the questionnaire would produce consistent results when it was tested repeatedly (Malhotra, 2012). The reliability is measured by the value of each variable's Cronbach's Alpha; if the result is above 0.6, then the measurement is considered to be reliable.

As shown in Table 3.1, every variable in the study was reliable since it passed the minimum requirement of 0.6 for the Cronbach's Alpha. Thus, it can be concluded that the measurements were reliable.

The value from KMO determines the adequacy of the degree of the analysis. To be

adequate, the value needed to be equal greater than 0.5 and if the result was below 0.5, the author needed to increase the sample size. (Kaiser,1970). According to Malhotra (2010), cumulative variance is expressed as a percentage which refers to the sum of variance of a construct's variables and it is proper if for each construct when the variance's percentage is greater than 60%. The component matrix indicator tests the validity of the measurement. According to Malhotra (2010), this indicator shows the relationship between every variable and the component; it is considered good when the value of every variable is greater than 0.7.

The table below show the communalities value for each variable.

Variable	Communalities (>0.5)	Value	KMO Value	Remark
e-WOM	EWOM1: 0.637 EWOM2: 0.622 EWOM3: 0.624 EWOM4: 0.650 EWOM5: 0.636 EWOM6: 0.685		0.806	Acceptable
Brand Image	IMAGE1: 0.607 IMAGE2: 0.791 IMAGE3: 0.640 IMAGE4: 0.581 IMAGE5: 0.549		0.787	Acceptable
Attitude toward the Brand	ATTITUDE1: ATTITUDE2: ATTITUDE3:	0.759 0.749 0.681	0.709	Acceptable
Perceived Quality	QUALITY1: QUALITY2: QUALITY3: QUALITY4: QUALITY5: QUALITY6: QUALITY7: QUALITY8: QUALITY9: QUALITY10:	0.574 0.745 0.749 0.604 0.575 0.609 0.596 0.679 0.692 0.733	0.8	Acceptable
Visit Intention	INTENTION1: INTENTION2: INTENTION3:	0.912 0.753 0.891	0.702	Acceptable

#### 4. FINDINGS AND DISCUSSION

All 211 respondents had experience of using food review platforms, indicating that none of the responses received were excluded from the analysis. However, among the respondents, there were 48 people who were not part of Generation Y, thus there were only 163 valid responses for this study. There were 96 male respondents (58.9%) and 67 female respondents (41.1%), with ages ranging from 17 to 35 years old. The majority of the respondents (38.7%) spent Rp 1,000,001 to Rp

2,000,000 (approximately USD 80-150) in a month to dine out. In addition to that, 61 respondents (37.4%) spent around Rp 2,000,001 to Rp 3,000,000 (approximately USD 150-250) a month. The rest of the respondents (9.8%) spent less than Rp 1,000,000 a month to eat out and 19 (11.7%) spent Rp 3,000,001 to Rp 4,000,000. Lastly, only 4 respondents ((2.5%) spent more than Rp 4,000,000 to dine out.

The main findings of the study can be further be observed from the table below:

Table 4.1 Findings of the study

Hypothesis	<i>p value</i>	R <sup>2</sup>	Remarks
H1 eWOM has significant impact on Visit Intention	0.00	.264	Accepted
H2 eWOM has significant impact on Brand Image	0.00	.213	Accepted
H3 eWOM has significant impact on Perceived Quality	0.047	.024	Accepted
H4 eWOM has significant impact on Attitude toward the Brand	0.000	.133	Accepted
H5 Brand Image has significant impact on Visit Intention	0.032	.264	Accepted
H6 Perceived Quality has significant impact on Visit Intention	0.557	.264	<b>Rejected</b>
H7 Attitude toward the Brand has Significant impact on Visit Intention	0.005	.264	Accepted

**1. RQ1: Does e-WOM have significant impact on the visit intention to restaurants**

The study reveals that e-WOM has a significant impact on visit intention to restaurants. It is proven by the existence of a direct linear relationship between e-WOM and visit intention. Thus, it can be concluded that the more and better reviews of a restaurant, the higher the likelihood of potential customers wanting to visit that restaurant. The finding is aligned with the study conducted by Jalilvand and Samiei (2012) that e-WOM has an impact on customers' intention.

Food review platforms such as Zomato.com and Qraved.com have rating systems so the customers can draw a conclusion from the average rating of a restaurant before reading what the reviewers have written. Pictures in Instagram can also be edited to look very appetizing so customers may not have the need to read further details.

Another explanation of this finding is that the individuals' behaviors tend to follow trends, especially what they have learned from

the internet, including trends in the F&B industry. A higher number of strong reviews for a restaurant could create hype among food enthusiasts. The word spreads through the Internet and by word of mouth, creating a new trend and curiosity and urging potential customers to plan a visit to the restaurant. Hence, it is important for a restaurant to stimulate its customers to write reviews about it.

**2. RQ2: Does e-WOM have significant a impact on restaurant's brand image that will influence them to visit the restaurant?**

According to the findings in the study, e-WOM has a significant impact on brand image of a restaurant and brand image influences the customers to visit the restaurant. The author's finding confirms the previous study by Jalilvand and Samiei (2012) that e-WOM has a significant impact on brand image and brand image toward intention. Some studies pointed out how eWOM may have a stronger influence compared to traditional advertisements (Hung & Li, 2007). As noted by Zhang, Ye, Law and Li (2010), online

customer reviews' influence is particularly pertinent in the domain of hospitality and tourism.

Zero Moment of Truth theory suggests that customers learn about a product or a brand before they have even gone and experienced such a product or brand (Lecinsky, 2011). That is the function of e-WOM. Potential customers learn about the restaurant from the food review platform and/or social media. Then they relate with the brand image impression from the reviews.

The more positive reviews of a brand on the internet could create the customers' mindset that the brand is trustworthy and reliable. Customers must trust that the brand will not disappoint them. Reliable brand image induces the intention of customers to experience its products or service. A study by Lien (2014) stated that customers must be attracted to the brand image first, before they have the intention to purchase. Such a brand also should not hurt the customers' social status since brand image represents a social status symbol of its customers.

### **3. RQ3: Does e-WOM have a significant impact on perceived quality toward certain restaurants that will influence customers to visit the restaurant?**

The most interesting finding in this study is that perceived quality does not have significant impact toward visit intention. It may be due to the customers' experience of similar kinds of restaurant (similar food offered, style, location, price) so they do not have the urge to visit another one. Food reviews often include the pictures of the food. Some platforms occasionally show the complete menu and price. Customers who write reviews give detailed information of the restaurant they went to, complete with the parking conditions, restaurant ambience, and the service. Such information gives potential customers the idea to perceive the quality of a restaurant, especially since the intangibility of

the service may cause difficulties in assessing the service quality (Kushwaha & Agrawal, 2015).

According to Khajittanakorncharoen and Chirapanda (2010), when the customers already have a set of quality standards for a certain product, the quality of other similar products would not affect their intention to try, unless it has distinguished differentiation from what they have experienced. In other words, customers compare quality among products. If they perceive that they can get the same quality from the product they have trusted, they will have little intention to try the new one.

Moreover, it has been suggested that the interaction between customer and service provider can have a significant influence on how customers evaluate a restaurant's service quality (Jang & Namkung, 2009).

### **RQ4: Does e-WOM have a significant impact on attitude toward the brand on certain restaurants that will influence customers to visit the restaurant?**

The results of this study have shown that e-WOM has a significant impact on attitude toward the brand for certain restaurants and such an attitude will influence them to visit the restaurant. These findings confirm the study in a different context and time conducted by Jalilvand, Samiei and Ebrahimi (2013).

Customers' attitude toward such brands and products was not developed until they learned about the products (Ladhari & Michaud, 2015). Hence, customers will learn about the existence of new kinds of restaurant brands, food and beverages and eventually will develop attitudes towards such products. Satisfied customers would write positive reviews; these positive reviews create positive attitudes toward the brand. The customers' positive attitude toward certain products is caused by the fast information spread through e-WOM. When the attitude is positive it can

affect customers intention to visit the restaurant.

## **5. CONCLUSION AND RECOMMENDATIONS**

This study has shown that e-WOM affects the brand image, attitude toward the brand, perceived quality and the customers' intention to visit restaurants, indicating the importance of generating positive e-WOM. To start generating e-WOM, restaurant managers have to register their restaurants on social media and food review platforms. Social media such as Twitter, Instagram, and Facebook have a "hashtag" system where a restaurant can create the trend and follow the trend. The hashtag system is similar to keyword system whereas the user can categorize what topic their product or service is.

In order to increase customer awareness towards their restaurants, managers might need to create a buzz through enlisting the assistance of endorsers. This is where food bloggers are needed as endorsers. However, managers need to carefully choose which bloggers to endorse, since the bloggers are segmented as well.

Reviews from natural customers are earned either when they are satisfied or disappointed. To stimulate customer satisfaction and willingness to review, managers may want to lure the customers with rewards. For example, a steak restaurant in Indonesia called HolyCow rewards customers with a free slice of tiramisu and another restaurant called Suntieng rewards a cup of ice cream to those who proved that they have posted a picture or written a review regarding the restaurant on an internet platform.

Managers should also carefully choose which platforms that they use to invest their marketing budget. According to the findings in this study, most people use *Zomato.com* and

Instagram to find food references and read reviews; thus to learn how those platforms work is crucial to make an efficient and effective strategy.

Brand image is proven to be a significant factor to create visit intention. Thus, there are several notes addressed toward F&B entrepreneurs and managers in managing a restaurant's brand image. Prior to starting a business, the brand name, logo, and theme should be carefully designed. These restaurant owners and managers need to know their target customers first before formulating the brand image, as strong brand image is expected to attract customers that feel the connection with the brand.

Brand image symbolizes the restaurant's integrity and reputation. The workers in the restaurants must be trained to never disappoint the customer and if the customers ever get disappointed, it is better to fix the problem right away. For example, Pizza Hut Delivery (PHD) holds its promise that if the food was delivered later than 30 minutes, then the customers would get a voucher for free pizza for their next purchase. Brand image should never get sullied; if the brand does not have promises such as PHD, the manager must be quick to handle customers' complaints. Handling customers complaints can be done by apologizing and giving discount or free products for compensation. Disappointed customers can hurt the brand image, make the brand less trustworthy if the word gets out and spreads as negative word-of-mouth. It is harder to rebuild the brand image than to protect it.

Based on the findings, positive attitude toward the brand increases the probability of customers' visit intention. Positive attitude is formed either by direct positive experience or positive information gained from other people (Hannah & Wozniak, 2001). Then, it is important to have positive e-WOM.

Managers can pay the food bloggers to post pictures and write a good review about their restaurant. However, another aspect that

customers see is the restaurant rating. In addition, customers can quickly create their attitude just by looking the rating.

The author suggests that managers should have someone dedicated to handle the social media and digital marketing of the brand. That person needs to find the reasons of why the rating is dropping or increasing and report to managers once he or she found the reasons. If the brand condition is acute, rebranding might be needed by creating promotions such as discounts or introducing new products.

This study has shown that perceived quality does not have a significant impact on visit intention. However, it does not mean that restaurants should not pay attention to its products and service quality. Tsiotsou (2005) suggests that quality is the base of brand image. If a brand sells products or service with low quality, it means that brand is relating itself toward segments that accept low quality product or service. Since quality is related to brand image, and brand image has significant impact toward visit intention, then the restaurant managers must firmly decide their segments and the level of quality that is desired by those chosen segments.

The findings of this study may face several limitations due to factors such as respondents' profile limitation. The younger generation (for example Generation Z) and older generation (generation X) were not included in this study. Generation Z are technology native, they are avid users of gadgets and they tend to follow trends. Portions of generation X are also open to technology and they tend to have greater purchasing and decision-making power over the younger generations.

Generation Y is considered as the current most curious generation. They are at the age with most freedom; some still single, some are married without kids yet, some with kids that do not share their opinions to

influence yet (Bradford, 2015). Generation Z, the younger generation still has to obey their parents and their financial power is still limited compared to previous generations while Generation X are not heavy social media users and therefore are less active in community forums compared to the generation Y (Allaway, 2015). In addition to that, the choices of restaurants provided in the questionnaire consisted of restaurants which were popular during the period of September 2015; however, there is a possibility that the trends of the restaurants in Jakarta can change from time to time which may influence the findings.

The study does not incorporate possible reasons why respondents were interested in reading e-WOM at the first place. Different types of platforms that the respondents utilized to read the reviews may also have an impact on the strength of the influence of e-WOM.

There are several recommendations for further research. First, a study on generation X within a similar context is encouraged. Generation X are decision makers in a young family that includes Gen Y and/or Generation X, as generally they are the ones who have purchasing power. Moreover, there is a tendency that Generation X also has higher exposure to social media. Interestingly, from 48 gen X respondents that were excluded in this study, all of them had experience of using social media and food review platforms to find food references.

The study could also be conducted in other big cities in Indonesia and could be specified to a certain type of restaurant. For example, a study strictly on high-end restaurants to investigate further about perceived quality of similar type of restaurants.

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## DURIAN SUPPLY CHAIN CHARACTERISTICS IN INDONESIA

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### **ABSTRACT**

*Durian is one of the national horticultural commodities which have high profitability. Indonesia has suitability of agro-ecological to develop durians, moreover durian cultivation spread in all the Indonesia regions. Not only that, Indonesia could produce durian year-round and the largest market for durian comes from local consumers. Unfortunately, the durian distribution system has lack of technology to keep the quality and lack of commercialization for the local durians. This article discusses of the durian supply chain characteristic. This research question to be answered; what the ideal supply chain characteristic to develop local durian?. This research uses a case study that aim to understanding the characteristic of durian supply chain pattern, and it should be an alternative to manage the market needs. This Research are located in 10 district in Indonesia, there are; Kulon Progo, Purworejo, Bogor, Lampung, Banyuwangi, Pasuruan, East OKU, Katingan, North Luwu, and Tapanuli Center. This article indicated that durian supply chain has complexity and difference characteristic of supply chain in each region, high variability of the durian varieties, durability of products are limited, differences of cultivation system, lack of application technology, and involved many actors. Durian supply chain pattern could be an alternative to develop the integrated durian supply chain and could show the uniqueness of each durian varieties.*

**Keyword:** *Supply Chain management, Durian, Characteristic*

### **INTRODUCTION**

Durian (*Durio zibethinus*, Murr) is a tropical fruits from Indonesia (Kalimantan and Sumatera Forest) and Malaysia, and spread to Thailand, Burma, India, and Pakistan. Indonesia has lot of durian varieties who spread in all the Indonesian

regions and has the potential to produce durian year-around. Each region has difference characteristic and type of durian varieties, such as durian Petruk and Sukun produced from Central Java, durian Sitokong and Sijapang produced from DKI Jakarta, while Bogor renowned produced of durian Simas, durian Sunan produced from

Jejara, durian Sidodol and Sihijau produced from South Kalimantan, etc. (Pusdatin, 2014).

Data of statistic show that the production of durians period 2009 to 2014 has been fluctuated. Production of durians amounted to 797,798 tons in 2009 and reached to 859,127 tons in 2014. The largest production of durian comes from East Java with 15.39% production of durians and average production growth of durians with 2.95% per year (Central Bureau of Statistic, 2015). The largest market for local durians comes from local consumers and the average of the national durian consumption held by 1.18 kg/capita/year period 2002-2013 (Pusdatin, 2014).

Indonesia is the second producer of durian in Asia with a contribution of 35% against the Asian production of durians (PAEDA, 2013). Meanwhile, amount of import durians are still high than amount of export durians. Indonesia lied in 4 (four) position as importer of durians in Asia with 7,495 ton import of durian in 2014 (Ministry of agricultural, 2015). While, the volume of durian export from Indonesia is still low and only 0.01% durian can be export. Indonesia does not have competitive advantage to develop export; this is happened because Indonesia lacks to develop a durian supply chain management.

This condition happened because agricultural in Indonesia does not linkage and integrated between production system and market demand. Most of farmers in Indonesia have small-scale farming business and spread in several region. Hence, the agricultural production cannot stable both of quality and quantity of products, and most of farmers sell their products without applied harvest and post-harvest handling, and farmers did not

applied “Good Agricultural Practice” (GAP) as effort to get value added and competitive advantage (Perdana, 2012).

To develop competitive advantage, need a collaboration action between stakeholders and need a supply chain development model which is efficient, effective, and involve small-scale farmers (Perdana, *et al*, 2011). Involvement of small-scale farmers is the main factors to develop agribusiness supply chain and agro-industry in developing country (Chowdury *et al*, 2005; Vorley and Proctor, 2008; Da Silva *et al*, 2009). The development of supply chain will be increased small-scale farmers capacity to fulfill the market demand (both traditional and modern market).

To develop potentials of local durian, need an integrated supply chain system. Supply chain system should be an alternative to gain profitability and competitiveness. This article discusses the prospect of the supply chain characteristics to development durians commodity which also developing the potential of the region to concentration of supply chain networks.

## **METHODS**

This research is case study to grasp a deep understanding regarding the development of supply chain characteristics in Indonesia with focus on durian commodity. The case was chosen due to the durian has unique characteristic and local seeded fruits in Indonesia and has high economic value.

In order to understanding of complexity and dynamic in these supply chain characteristics, this study also developed the concept of supply chain management and the nature of the durian

agribusiness in Indonesia. Field observation, in-depth interview, literature study, and document analysis both primary and secondary data are used to understanding the characteristic of durian Supply Chain. Key informants were being interviewed consist of all actors who involved in durian supply chain such as farmers, middleman/intermediaries, and traders.

Data gained from the fieldwork were analyzed and understanding as the baseline information to analyze characteristics of durian supply chain in Indonesia. The analysis built from the real situation with using integrated qualitative analyzing to develop key information which integrated, coordinated, and interconnected.

## **RESULT AND DISCUSSION**

### **Background Data**

#### *Desk Study*

Information regarding the general statistical data about durian in Indonesia was collected during the desk study. The result are briefly presented as follows; The national production base of durian is comes from East Java with 27% contribution to national production, second, about 20% durian production comes from North Sumatera, West Java contributed around 19% to national durian production, Central Java contributed about 14%, Banten contributed around 11%, and West Sumatera has contributed the durian production around 9% (Pusdatin, 2015). The production of durian in Indonesia period 2000 – 2014 has been fluctuated. The highest production reached to 888.130 ton in 2012 and in 2014, durian production decreased with 855.553 ton (Central Bureau of Statistic, 2015).

Durian is one of the main horticulture products in Indonesia who has competitive and comparative advantage. Indonesia has 67,778.64 Ha area planted of durian which spread the entire regions. The average of productivity is about 123.94 Kg/tree and the average of weight durian around 2 – 5 Kg per fruit depend on varieties and farmland condition (Central Bureau of Statistic, 2015). The durian consumption in Indonesia period 2002-2013 has increased around 1.18 Kg/capita/year. The consumption of durian in 2013 reach 1.41 Kg/capita/year and 1.98 Kg/capita/year in 2014 (Susenas, 2014). The increasing of durian consumption in Indonesia is the impact of the increasing of middle class income; hence the standard of living and purchasing power has contributed to the increasing of nation durian consumption.

#### *Breeding Management*

Very little research in durian breeding has been done in Indonesia. This is understandable, the wide diversity of durian germplasm existing. Recently, Government has been considered to develop durian seed certified, this is an effort to develop durian production centers in Indonesia (Pusdatin, 2014). Every district or province in Indonesia has already developed main durian varieties which has specification and differences varieties and enhance the durian seed certified as supporting the development of productions centers. Government has been spread 4,415,589 tree durian seed certified in Indonesia in 2013 and the largest in North Sumatera (1,561,837 tree), West Java with 1,325,918 tree, and around 510,411 tree durian seed certified spread in Bali (Pusdatin, 2014).

#### *Crop Management*

The characteristics of durian production in Indonesia are small-scale farmers, generally durian cultivation are using durians non-certified seed, minimum of cultivation technology, lack of applied “Good Agricultural Practice” (GAP), high risks in cultivation activities, no irrigation, lack of capital, and cultivation are not intensive and there is no renewable tree.

#### *Crop Protection*

Generally, in durian cultivation there are no intensive pests and diseases handling as a preventive action to avoid pests and diseases attack. The main pests are squirrel, stem borer, fruit borer, *Hypoperigae leprosticta* (larval fruit), *Marumba dyras* (moth), and bats. Meanwhile, the main diseases are rotten root diseases and rotten fruit diseases.

#### *Harvest and Post-Harvest*

The durian harvesting is not applied Standard Operational Procedure (SOP). Ideally, 15 days before durian reaches 100% maternity durian should be binding. This method is used to avoid damage to fruit. However, farmers are never cut off the durian branch and tree so that binding fruits technique is hard to do. The durian post-harvest handling are cleaning from other things (such as soil, leaf, etc.), sorting, grading, packing, pre-cooling and cooling system, waxing, and spraying fungicide (only for export). Those have not been done, because the most durian is sold locally and farmers do not know about post-harvest handling.

#### **Durian Supply Chain in Indonesia**

This study based on 10 districts, there are: Kulon Progo, Purworejo, Bogor, Lampung, Banyuwangi, Pasuruan, East OKU, Katingan, North Luwu, and Tapanuli

Center. Those districts have competitive and comparative advantage to develop durian cultivation. Each districts have difference varieties, Kulon Progo concern to produce durian Menoreh Kuning, Purworejo with Petruk varieties, Bogor as the main producer of Si Mas and Matahari varieties, Lampung as Sitokong and Dahlan durian producer, Banyuwangi as the main producer of Durian Merah, Pasuruan as Petruk durian producer, East OKU (Ogan Komaring Ulu) produce Bakul durian, North Luwu produce Sawirenggalih, Lalong, and Tamatalea varieties, Tapanuli Center produced local varieties and monthong varieties, and Katingan produce Kasongan varieties. Each variety has difference taste, texture of pulp, color of pulp (most of varieties has yellow pulp (except durian merah has red and white pulp), and difference of flavor.

#### *Product Flow*

Figure 1 show that durians are distributed from farmers to consumers directly or to traditional market through intermediaries in each village or middleman from other district or province. Most of durian production sold to the traditional market and less than 10% durians sold to the modern market (supermarket, restaurant, food processing industry, or export). Local durian has rind vulnerable rupture, farmers did not know about the phase of growth, the period of production, period of decline in production, and the process of harvesting and post-harvesting, and most of farmers have durian plants as a legacy. Farmers do not applied Standard Operational Procedure (SOP), lack knowledge of farming practice; the entire of cultivation has a unity to develop a great quality and continuity production of durians.

Durian merah, durian menorah kuning, durian matahari, and durian Si Mas are the new varieties development as the government and private sector support.

These new varieties introduced to farmers as an effort to decrease durian import and increase export market.

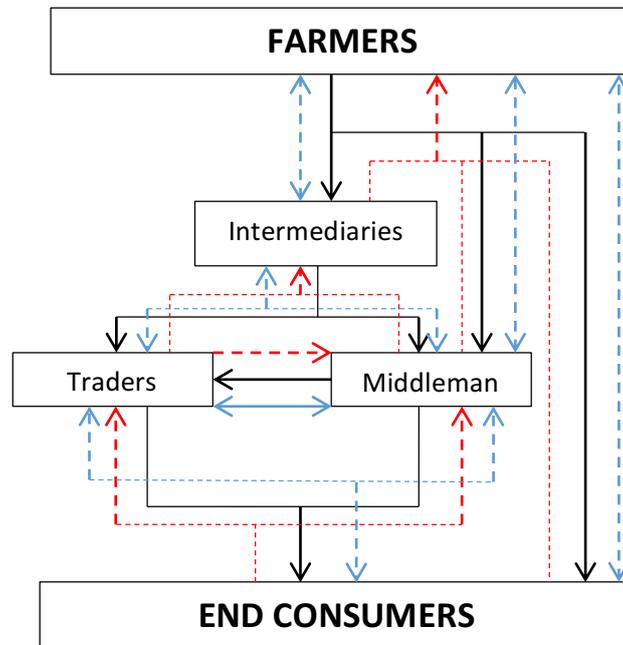


Figure 1. Durian Supply Chain in Indonesia

#### Money Flow

Farmers are deal with delayed payment from intermediaries, delayed payment between 1 to 7 days after products delivered to the markets, because intermediaries does not have enough financing and intermediaries faced with delayed payment from middleman. Meanwhile, for direct selling to the consumers farmers can get cash payment, and middleman applied two (2) payment systems; there are cash payments (middleman buy the products before mature, than middleman can get cheap price) and delayed payment (after farmers harvest the fruits and do post-harvest), delayed payment around 1 to 4 week after products delivered to the market. But most

of farmers prefer cash payment rather than delayed payment, because with cash payment farmers do not have to pay for harvesting and post-harvesting. Farmers get price around IDR 5,000 – IDR 80,000/fruit only for local varieties, while for durian merah, menorah kuning, and matahari the price is around IDR 200,000 – IDR 300,000/fruit.

Most of farmers do not have credits or loan to enhance their cultivation activities. This is because farmers do not have enough collateral, do not have financing access because banks or other financing institution supposed that durian commodities has high risk and does not have enough price guarantee from markets.

### *Information Flow*

Durian production does not linkage with market needs, hence, farmer's lack of market information, this is impact to the lack of competitiveness and value added, and also farmers cannot get highest price because the information was limited. Intermediaries and farmers are price takers. Farmers only get price information from intermediaries and middleman without knowing the market needs. While, farmers can get consumers information direct from consumer who buy the products.

### **The Ideal Supply Chain Characteristics to Develop Local Durian**

The development of supply chain management in agricultural sector need to develop agribusiness cluster, agricultural logistics services, and development of inclusive supply chain management (Perdana, 2013). This model aimed to increase competitive advantage and also to reduce several risk in durian supply chain. The development of agribusiness supply chain should be an alternative to develop production capacity, farmers capability, linkage with the market needs, and gain the value added. Agricultural supply chain could be an alternative to develop agricultural system based on market.

### *Development of Agribusiness Cluster*

To maintain the consistency of production, farmers should be joined with farmers group or other association to planned production capacity oriented to the market needs. Cluster are geographic concentrations of interconnected companies, specialized suppliers, service providers, firms in related industries, and association institutions (e.g. universities, standards agencies, trader associations) in a

particular field that compete but also cooperate (Porter, 2000). Agribusiness cluster is farmer's linkage, local entrepreneurs, banks, and business development services in the region (Toma, 2009). According to De Witt, Giunipero, and Melton (2006), agribusiness cluster can be viewed as the geographical concentration in supply chain networks.

Development of agribusiness cluster will be increased value added and farmer's income. The success factors in development of agribusiness cluster is market oriented, technology innovation, geographical concentration, the new "wiratani" (the new agricultural entrepreneur), and the involvement of multi-stakeholders (Perdana, *et al*, 2014). The increasing of market orders will be responded by crop planning/crop scheduling based on market needs. To develop durian supply chain should be consider the market needs and the information flow is the success prerequisite of the durian supply chain development.

Durian supply chain in Indonesia is dominated by small-scale farmers; therefore development of agribusiness cluster should be an alternative to manage the quantity and quality of products, increase the competitive advantage, and farmer's income. Basically, development of agribusiness cluster is built from domestic competition strengthened by geographical advantages. Agribusiness cluster has forward and backward linkages between private sector, products and services, agribusiness cluster will be increased value added for agribusiness products, development of the whole supply chain in the upstream and commercialization and downstream diversification. The forward and backward linkages will be impact to the business opportunity, capital investment,

and labor. That is as a dynamic process which has multiplier effect to develop a new agribusiness, supplier, competitors, and cross-cluster linkages.

#### *Development of Agricultural Logistics Services*

Supply chain is logistics network which is linkage with all of actors such as producers, supplier, manufacturer, distribution, retailer, and consumers. Logistics management is widely considered capable in improving the efficiency and affectivities in production (goods or services) starting from product procurement, marketing, distribution, until the products in the consumers. According to Cooper *et, al* (1997), logistics management is the part of supply chain management that plans, implements and control the efficiency, effectiveness, and storage of goods, services and related information in order to deal with consumers need with satisfy the other stakeholders need (such as government and retailers).

In liberalization and globalization era, logistics management is considered capable to improve competitive advantage, capable to maintain quality and quantity of products (goods or services) for the consumers with the competitive price. Logistics services in agribusiness cluster should be more flexible in responding the consumers' needs and other stakeholders in supply chain network.

Logistics services are represented of the business processes that occur in the structured market (domestic or export market). Logistics services take roles as the Hub to maintain the continuity and quality products, assured the development of partnership between farmers group or producers and market (distributors) to do the production contract. Logistics services

is an agribusiness supply chain that provided the efficiency, effectiveness, and responsive system to fulfill the consumers need with minimum cost production.

Logistics services will be manage and maintain the *inventory of products* that will effect to the quality and quantity of products, cost production, and certainty of time. *Transportation* is needed to facilitate the fulfillment of supplier in supply chain system, *facilities* is to provide production facilities, processing facilities, and distribution Centre to maintain supply chain performance, and *information* is to maintain the data and analysis of stock, transportation, facilities, and consumers need in supply chain network.

#### *Development of Inclusive Supply Chain Management*

Supply chain management involved many actors and consist of various activities. According to Roekel *et, al.*, (2002) that the purpose of supply chain management in agricultural sector are to reduce loses of products, increase sales, dissemination of technology, technique, model, and knowledge between supply chain actors. The information flow will be manage the product flow, market, and technology, supply chain transportation, traceability of the products supply, a good preventive to maintain the quality and products safety, and investment and risk priority is shared among supply chain partners.

Woods (2004) stating that the aimed of the development of supply chain management in developing country is to develop the capacity and capability of local producer to be able produced the products according to domestic and export market needs. Another effort is to support local

farmers in developing country to take the advantage of the increasing of word food consumption needs. Based on that statement, development of inclusive supply chain management should be involved small-scale farmers which have supported by durian agribusiness system. The inclusive supply chain management should be an alternative to develop competitive advantage for small-scale farmers, develop value added for local products, increased of productivity for farmers, increase of farmer's income, maintain the sustainable of production, and increased trade volume.

## CONCLUSION

- 1) Human resource development to support the development of durian supply chain system.
- 2) Development of the inclusive of agribusiness Supply Chain that emphasizes the aspects of efficiency and justice.
- 3) Development of agribusiness cluster as a whole region that could create a dynamics relationship and improve of technological knowledge, convergent, and build a foundation of productivity, profitability, competitiveness, both domestic and international markets.
- 4) Development of small holders-based on commercial garden (revitalization garden) is the main of the development of national durian.
- 5) Development of Agribusiness logistic service as supporting partners to development of durian agribusiness cluster.
- 6) Development of agroindustry to take advantage of off grade and the expansion of employment.
- 7) Development of basic and supporting infrastructure as an effort to accelerate

the development of durian agribusiness cluster.

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## **SUPPLY CHAIN ANALYSIS AND PERFORMANCE ASSESSMENT OF SME FISHERIES CLUSTERS**

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### ***ABSTRACT***

*Study of SME in Indonesia related with business networks and performance in these business organizations. In many cases, regional administration in Indonesia develops SME business network in the form of clusters. This study analyzes SME fisheries clusters with supply chain analysis. We also develop performance assessment of SME fisheries cluster by using multivariate model. This study involves 62 SMEs in Sragen, Central Java Indonesia. Those SMEs includes in fisheries cluster in the area. Our findings show that SME fisheries cluster has in-efficient supply chain. This business clusters has problems in profit setting and delivery time which harm their performance. We measure business performance by using business selling, profit rate and asset growth. We found that cost structure, man power and physical production has positive effects to business performance.*

**Keywords:** *supply chain management, SME clusters, business performance, business growth.*

**SUPPLY CHAIN RISK MANAGEMENT OF ORGANIC RICE IN INDONESIA  
FOR EXPORT MARKET: CASE STUDY IN SIMPATIK ASSOCIATION,  
TASIKMALAYA, WEST JAVA**

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**ABSTRACT**

*Organic rice can be used as one of the answer in solving the problem of food security, faced by Indonesian people at this time. Organic rice can increase farmers competitiveness in international market trade due to the vast potential, yet the productions of organic rice has not been able to meet the export markets as well as the local markets. There are many risk faced by organic rice supply chain, therefore organic rice cannot meet the market demands. Simpatik Association is one of the farmers group who produce organic rice to be distributed to the export market. The purpose of this study was to identify the risks that occur in the supply chain of organic rice in Simpatik Association and undertake mitigation actions to minimize the occurrence of such risks. This research's data analysis is using; House Of Risk (HOR) stages 1 and 2. The results showed there were three top risks occurred in first stage. First, the agreement contract was not detail; the rights and obligation of association and farmers, second, association did not invest their money in farmer group and third, the extreme climate change. In second stage there are 9 preventive actions that can be used to eliminate or decrease the level of priority risk agents. The preventive actions are consolidation and associating the system of organic rice, develop financing access, applied and develop the appropriate technologies.*

**Keyword:** *Export Market, House of Risk, Organic Rice, Supply Chain Risk Management*

**INTRODUCTION**

Rice is a strategy commodity for some countries, especially for Asian countries. Most of the population makes rice as a staple food, therefore food self-sufficiency in the regions of

Asia are essentially to be reflected by its ability to meet the ability of staple foods, such as rice from own production [1]. Rice is the staple food for Indonesian people, consumption of rice as a main source of carbohydrate reaches 47 percent compare to another carbohydrate [2]. Rice consumption in 2013 reached 97.40 kg per

capita per year. The population of Indonesian is at 237 million with an average growth rate of 1,49% should be balanced with the availability of adequate food. Those demands, force modern agriculture to encourage food production in large numbers. Modern agriculture is identically with the high use of pesticides, herbicides and chemical fertilizers to boost production, but have many bad effects on the environment for the long term. According to FAO (2015) the use of proportional fertilizers in some countries can increase the yield of foods [3]. Chemical fertilizers have the ability to increase the productivity of the soil in a relatively short time, the chemical fertilizer is considered as a powerful weapon to increase production and put an end to food insecurity [4]. So, we need agricultural systems that consider the health and environmental sustainability so as to create sustainable agriculture.

Sustainable agriculture is a farming system that is harmonious and balanced in with the order of the environment [5], "Back to nature" movement based on an awareness of the importance of maintaining health and environmental sustainability has become world trend that have been developed internationally through global regulations which requiring that agricultural products should have attributes: safe to eat, environmental friendly and high in nutrients. Those are the main incentives of the development of organic agriculture [6]. In supporting the development of organic agriculture, Indonesian government has made a program called *Pembinaan dan Sertifikasi Pertanian Organik*. The program aims to expand internationally certified land in Indonesia, increasing the competitiveness of farmers in order to compete in international trade, in addition, the government also wants to achieve food security for the whole of society with increased production of organic rice.

Simpatik Association as a pioneer institution in the production of organic rice in Indonesia are already producing organic rice for the export market since 2009, in cooperation with PT. Bloom Agro as an exporter. Until now association cannot meet the demand for organic rice requested by PT. Bloom Agro. In the years 2010-2015 the demand range of 160,000-180,000 kg annually. However, Simpatik

Association only able to meet a maximum of 172,176 kg per year. This is caused by various factors, including fluctuations in farmers' groups that become a members of association, farmers who do not comply with the rules of organic farming that do not qualify for certification, many farmers are selling their land, weather and climatic conditions are extreme, etc. Agriculture sector is the sector that has greatest risks in economy activity. The main risks faced by supply chain of agriculture is the risk of weather and climate, natural disasters (including weather and climate extremes), the risk of biological and environmental, market risk, the risk of logistics, infrastructure and risk management, and operations [7].

Based on observations, the production of organic rice in association experiencing a wide range of major risks as stated before. Therefore, for increase the production of organic rice in required the identification of risks that occur in the supply chain. This research was aims to identify the risks in supply chain of organic rice and find suitable mitigation for each risk.

## **METHODOLOGY**

This research uses a technique of case studies conducted in Simpatik Association Kampung Cisayong, Desa Mekarwangi, Tasikmalaya district, West Java Indonesia. This study applied primary data which is the specification information for the purpose and research need. The data obtained by getting in directly from the respondents and participatory observation during the field.

Methods of data analysis in this research is the House of Risk (HOR). HOR is a modification of model development Failure Mode and Effect Analysis (FMEA). Pujawan and Geraldin (2009) explained, and adapt the House of Quality (HOQ) to prioritize which risks are first handled and to select the most effective action to reduce the potential risk of the agent risk [8].

HOR method is divided into two parts, the first HOR and second HOR . HOR 1 is the first stage to identify risk events and risk agents. Each of these risks will be rated using a scale of 1-10. Then made the correlation between the two risks. After that, calculate values based on

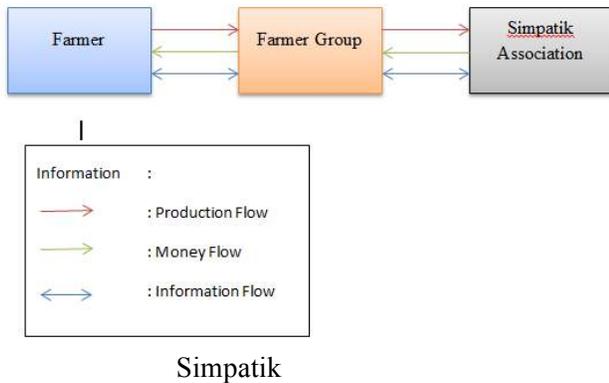
the value ARP correlation between risk event and risk agents. HOR 2 is used to determine the handling problems which must be solved first. Companies should choose the ideal treatment action to reduce the possibility of agent or source of risk. Choose an agent of risk with a high priority level using the principle of Pareto diagram (If 20 percent of the crucial risks can be addressed, the company has been able to avoid the 80 percent loss) [9]. HOR 2 is a phase that is used to determine appropriate mitigation strategies for each risk agents, to determine the strategy required interviews with each stakeholder involved, then calculate the value of ETD to get a mitigation strategy that is effective and efficient to implement.

**RESULT AND DISCUSSION**

*A. Supply Chain in Simpatik Association*

Simpatik Association has implemented an integrated supply chain system that connects the various actors involved in the supply chain flow for a functioning chain of sustainable.

**Figure 1.** Supply Chain of Organic Rice in



Process flow of goods in Simpatik association start from farmers who cultivate rice organically in accordance with the provisions given by association. The rice yields was partly consumed by farmers and other parts sold to the farmer groups. Farmer groups collect paddy from all organic farmers who are members in Simpatik association, then pack into sacks and sent to association. Simpatik association tasked are cultivate paddy into rice, make the process of sorting, packaging and marketing. The process flow of money or payment systems applied in Simpatik association is that exporters paid an

advance of 50 percent, after that paying off the remaining 60 days after the goods are exported. As for the payment to the farmer groups, Simpatik association pay in cash when the group sold the paddy to association. The payment system was same as for the payment of farmers' groups to farmers.

The flow of information regarding price, product type, quantity and quality required, market information, product availability in farmers, constraints faced by farmers in producing etc.

*1. Risk Management on Association*

- *Measurement of Risk Agent Priority on Association*

**Table 1.** List of Risk Agent Priority

Risk Agent	ARP	Rank	% ARP	% ∑ ARP	Category
A3	1245	1	17.12988	17.12988	Priority
A2	864	2	11.88773	29.01761	
A6	810	3	11.14474	40.16236	
A14	738	4	10.1541	50.31646	
A13	648	5	8.915795	59.23225	
A15	450	6	6.191524	65.42378	
A20	432	7	5.943864	71.36764	
A1	405	8	5.572372	76.94001	
A7	360	9	4.95322	81.89323	Non Priority
A4	330	10	4.540451	86.43368	
A10	270	11	3.714915	90.1486	
A21	168	12	2.311502	92.4601	
A5	138	13	1.898734	94.35883	
A8	135	14	1.857457	96.21629	
A9	88	15	1.210787	97.42708	
A18	84	16	1.155751	98.58283	
A11	54	17	0.742983	99.32581	
A17	24	18	0.330215	99.65603	
A12	21	19	0.288938	99.94496	
A16	4	20	0.055036	100	

There are eight risk agent priority on Association stage, namely Contract Problem

(A3), No production target (A2), do not have cooperation with other exporter (A6), low participation of farmer member (A14), lack of organic certified farmer (A13), lack of competent labor (A15), limited land ownership (A20), and Powerless bargaining position of Association (A1). To mitigate those risk agents priority, it needs the appropriate strategy and in accordance with the environment.

Based on the analysis, there are three mitigation strategies on Association stage, namely Intensive Assistance and mentoring systems of organic rice (PA2). Develop market access (PA3) and the review and adjustment of the contract between association, farmer group and farmer. Contract sales from farmers to association reformulated with deliberation together, the points in the contract of sale shall be stated by clear and firm also give mutual benefit between two sides (PA1).

2. Risk Management on Farmer Groups Stage  
 • Agent Risk Priority on Farmer Groups Stage

There are three risk agents priority in farmer group stage, namely lack of capital (A3), Contract Problem (A1), and lack of marketing channel (A4). These risk agents priority on farmer groups needs the most effective and possible mitigation to implement. To reduce these risk agents priority, the stakeholders need to improve finance access, financing on agribusiness required to manage of cash flow analysis to determine the smoothness and continuity in the flow of goods. Institutional consolidation between Farmer groups and association (PA2), the consolidation should make the communication between both sides is well maintain and empower the farmer group to increase the productivity. Another strategy to decrease the risk is develop market access.

Table 2. Risk Agent Priority on Farmer Groups

3. Risk Management On Farmers  
 • Risk Agent Priority on Farmers

Table 3. List of Mitigation Action on Farmers

Risk Agent	ARP	Rank	% ARP	% Σ ARP	Category
A3	1296	1	34.64314	34.64314	Priority
A1	576	2	15.39695	50.0401	
A4	441	3	11.78829	61.82839	
A6	360	4	9.623095	71.45148	
A2	336	5	8.981556	80.43304	Non Priority
A5	285	6	7.618284	88.05132	
A9	180	7	4.811548	92.86287	
A8	162	8	4.330393	97.19326	
A7	105	9	2.806736	100	

Risk Agent	ARP	Rank	% ARP	% Σ ARP	Category
A8	945	1	17.9863	17.9863	Priority
A1	648	2	12.33346	30.31976	
A2	450	3	8.564903	38.88466	
A13	406	4	7.727446	46.61211	
A12	370	5	7.042254	53.65436	
A4	315	6	5.995432	59.64979	
A19	315	7	5.995432	65.64522	
A20	288	8	5.481538	71.12676	
A14	287	9	5.462505	76.58927	
A17	216	10	5.138942	81.72821	Non Priority
A15	216	11	4.111153	85.83936	
A6	270	12	4.111153	89.95051	
A10	156	13	2.969166	92.91968	
A16	108	14	2.055577	94.97526	
A5	90	15	1.712981	96.68824	
A3	72	16	1.370384	98.05862	
A9	54	17	1.027788	99.08641	
A18	30	18	0.570994	99.6574	
A7	10	19	0.190331	99.84774	
A11	8	20	0.152265	100	

There are nine risk agents priorities on farmer risks mitigation, namely; high rainfall intensity (A8), Powerless bargaining position of farmer (A1), lack of motivation (A2), Standard operational Product (SOP) not strict (A13), long term dry season (A12), lack of labor (A4), organic fertilizer problem (A19), still use conventional farming (A20), no reward and penalty for farmer (A14)

To reduce risk agent priority, farmers need to Implement of adaptive agricultural technology, technology can also help farmers to improve the agricultural activities and resolve agricultural risk, intensive mentoring from internal control system (ICS), the role of ICS is to ensure all the activities in cultivation based on the organic standard from certificate organization, last, create a proper Standard operational Product (SOP) based on each location of farmer group.

CONCLUSION

The supply chain risk management in Simpatik Association still faced some problems. In this case the risks comes from all the actors who involved in the supply chain process. Risk stemming from farmers, such as some farmer never make daily schedule of cultivation, lack of motivation from farmer itself to produce rice in high quantity, decreasing the quantity of farmer as a labour, 2) risk stemming from the nature (such as long term dry season, rainfall, pests and diseases attack), 3) risk stemming from market actors (such as price satisfaction, limited of market access, powerless bargaining position to the exporter, limited to financial access).

## SUGGESTION

Agriculture is associated with many types of risk that expose farmers and agribusiness entities to potential losses. For this case many approaches can be employed to manage the agriculture risks such as institutional consolidation between farmer group and association, Need to build more intensive relations between actors in supply chain (farmers, farmer groups and association) to optimize the effectiveness and efficiency of communication so that the supply chain can run well. This approach to build a positive organizational culture by increasing trust among supply chain actors, transparency of information, guidance, and supervision of business activities. Consolidation and mentoring also need to apply in production of organic rice. Consolidation and assistance conduct start from choosing good seeds or varieties that will be planted until the process of marketing.

The last but not least, the association should make careful planning and production data collection more detail in the process of planning, procurement, production quantities, shipping, and returns the results of production for farmers, farmer groups and association.

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## **DO ORGANIZATIONAL CULTURE & STRUCTURE ENHANCE INTERNAL CONTROL EFFECTIVENESS? EVIDENCE FROM MALAYSIAN COOPERATIVES**

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### ***ABSTRACT***

*The establishment of cooperatives in Malaysia over three decades ago has shown several positive impacts on the economic and social development in Malaysia. Being under the definition of the third sector, cooperatives are currently categorized as social enterprises. Social enterprises are hybrid organizations that act as a catalyst to complement the role of private and public sector in enhancing the economic development while at the same time emphasizing on the social development. Similar to private and public sector, internal control in cooperative plays an important role on the successfulness of the organization and is a mirror to effective governance. Nonetheless, little is known about the effectiveness of internal control of cooperative in Malaysia as current practice did not require the organization to follow any prescribed standard of internal control and to report it in their annual report. Hence, this study will shed some light on the factors that influence the effectiveness of internal control in cooperative. This study focuses on the examination of cooperatives' organizational culture, organizational structure and age of cooperative on internal control effectiveness. Data were collected using questionnaires and were distributed to Top 100 Cooperatives for the year 2014. Based on the analysis of 56 responses received, regression analysis revealed that only organizational culture and cooperative age shows a significant relationship with internal control effectiveness in Malaysian cooperatives.*

**Keywords:** *Internal control effectiveness, cooperative, social enterprises, contingency characteristic*

## **REAL EXCHANGE RATE MISALIGNMENT AND CURRENCY CRISIS**

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### ***ABSTRACT***

*This paper aims to calculate the real exchange rate misalignment (RERM) in the Indonesian rupiah and examine whether the misalignment contribute to explain the exchange rate crisis by employing dynamic regime switching model and BEER approach. This paper found the following. First, net foreign assets and relative sectoral productivity differential were found to significantly influence the equilibrium exchange rate, indicating that external as well as internal balance determine the behavior of Indonesia rupiah in the long run. Second, the BEER approach can predict properly the misalignment of Indonesian Rupiah, especially in explaining the overvaluation periods of rupiah before the Asian crisis. The regime switching model also performed well in classifying the stable and crisis episodes of rupiah. Third, from both models, it was found that from seventeen crisis episodes, ten of which were always preceded by a quite high degree of RERM.*

**Keywords:** *currency crisis, exchange rate misalignment, regime switching*

## **UNDERSTANDING THE DYNAMICS IN SUSTAINING CHANGE AND INNOVATION IN PUBLIC SERVICE ORGANISATIONS**

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### ***ABSTRACT***

*This study aims to investigate how territoriality play roles in determining the efforts of public organisations in sustaining change initiatives. While public sector changes have been extensively studied, there is a lack of study investigating how territoriality plays role in change, especially when such changes involving multi-organisational setting. In the case of Indonesia, public sector changes have been proliferated following reform movement in 1998. Since then, the national government encourages various change and innovation initiatives as well as initiates award granting for innovative public organisations. While such initiatives were embraced by public organisations, most organisations had to deal with the fact that the management of changes was not only about initiating change, but also sustaining it. Management of change becomes a challenging issue, especially when the changes involved multi-organisational arrangement. In order to capture the dynamics of the management of change, the lens of territoriality is used. The study is exploratory in nature as it deals with how people involved in changes programs perceive the changes. Hence, qualitative method is proposed. Furthermore, the study plans to collect primary data using semi structure interviews from some organisations involved in change implementation. Data collected will be analysed using a method informed by grounded theory approach. This study contributes to understand the dynamics of sustaining change and innovation by elaborating the concept of territoriality and found that in order to be able to sustain and maintain change and innovation initiatives, organisations need to manage their territoriality or territorial behaviour.*

**Keywords:** *Organisational change, innovation, territoriality, public sector*

## **THE EFFECT OF ASEAN FREE TRADE AREA (AFTA) ON INTRA-ASEAN TRADE**

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### ***ABSTRACT***

*The ASEAN Free Trade Area (AFTA) was formed in 1992, the basic feature of the AFTA is the liberalization of trade in the region through the elimination of intra-regional tariffs and non-tariff barriers, AFTA is expected to make manufacturing sectors in ASEAN more efficient and lead to compete in the global market, This agreement continued into the ASEAN Economic Community (AEC) enforced starting January 2016. The aim of this study to investigate the effect of trade creation on intra-ASEAN trade among five ASEAN member countries. To analyze trade creation used modified of gravity model and this model will be estimated using least squares. The data used is panel data from 2000 to 2013 (before and after global crisis in 2008). The results show that there are trade creation (both before and after the economic crisis), it's mean there is a shift in consumption domestic from high-cost imported goods from outside ASEAN countries to imports low cost from ASEAN member countries. Besides that coefficient value shows trade creation after the crisis is smaller than before the crisis reflects that the economic crisis has reduced the value of ASEAN trade*

**Keywords:** *AFTA, Intra-ASEAN trade, Gravity model, Trade creation, Trade Diversion*

## **VERIFYING OF BETA CONVERGENCE FOR SOUTH EAST COUNTRIES OF ASIA**

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### ***ABSTRACT***

*The convergence means the process of balancing disparities in chosen indicators of homogeneous economic groups.  $\beta$ -convergence and is based on the assumption, where less developed economy grows faster than advanced ones, so GDP per capita has higher speed in less developed economy. In this article is verified Beta convergence based on dependency between the growth of real GDP per capita and the initial level of real GDP per capita (in PPP) and by modifications of this relationship by using of Least Squares Method for 9 countries of South East Asia in sample since 2000 till 2015. For completely explanation of dependency and calculation of consistent, minimal estimator are used dummies and created a structural parameter, which eliminate shocks and possible disparities between chosen countries.*

***Keywords:*** Beta convergence, GDP per capita, Compensation per capita, Least Squares Method

### **INTRODUCTION**

The concept of convergence is actually matter of debates, since many economies are reaching maximum current capacity and growing is more slowly or vice versa with fast speed. The convergence engaged in balancing of disparities between the various indicators in framework of homogeneous economic groups. For testing of convergence is necessary to operate just with homogenous economic groups with similar level of development. There is just rarely to reach the same level of steady state for no homogenous economic groups, because they may be different in starting conditions, policy, demography, education system, health, level of life standard, investments and also in historic development. Important role in observing may play customs and traditions of the population, particularly when being formulated rural economic units.

Definition of the Beta convergence is possible to express when poorer, less developed countries tries to catch up with richer, more developed countries and converge to the same level of steady state, so these processes reduce disparities between two or more variables at a time and because process of convergence is mostly based on long run processes and cooperation between countries, that are trying to create one homogenous economic group. For this reason is necessary to analyze nominal and real convergence. The nominal convergence is joined with unite treaty or constituent for group of economies, that want to become one union. This criteria are general for each member economy and there are taken comply with them in order to accelerate the process of integration of unity. Typical example of nominal convergence is European Union or United States of America. The real convergence has background in mathematical methodology and application for

verifying of convergence between already homogenous or similar economies. The most important convergence factor is the real Gross Domestic Product per capita in purchasing power parity (real GDP per capita).

Because of existing real ideas of integration of South East Asia countries to one unity, we decided to verify Beta convergence between period since 2000 until 2015 within this countries. In our article are used two indicators: the real GDP per capita in PPP and compensation per employee in each sector of economies. There is not condition of the existence the same level of steady state for selected variables. Beta convergence is based just on the assumption, where less developed economy grows faster than advanced ones, so GDP per capita increases faster in less developed economy. Calculation and definition is explained in methodology of article and the main studied factor is parameter of convergence.

#### DEFINITION OF METHODOLOGY

For verification of the Beta convergence is used verification by Least Squares Method. The concept is based on the methodology of R. Barro and X. Sala-i-Martin (Barro, Sala-i-Martin, 2004). We test assumption of convergence between nine chosen countries (Cambodia, Indonesia, Laos, Malaysia, Philippines, Singapore, Timor - Leste, Thailand and Vietnam, excluded Myanmar - per this country is not possible to look for homogenous data) by dependency between logarithm of growth of real GDP per capita (PPP) - dependent variable and logarithm of GDP per capita in the initial time - explanatory variable per each analyzed period. We definite five groups of period between 2000 and 2015 during which we apply testing of convergence: 2000 - 2004, 2004 - 2008, 2008 - 2012, 2012 - 2015, 2000 -2015. The main intention of our dividing is the great development of chosen countries during last fifteen years when they have been transformed and changed policy system and abroad business. The second reason is because of contribution, which could bring the year 2008, this year is known as official start year of world economic and business crises. Another question is about length of chosen period between 2000 until 2015. The interval was chosen based on the availability of necessary database per each

country from one source, because we prefer homogenous source from reason of the same used methodology during the calculation and collection of information of indicators. Data were downloaded from website of word bank, so reader may be definitely sure about consistency and credibility of used data. The dependence between logarithm growth of real GDP per capita in PPP and logarithm of GDP per capita in the initial time is possible to express by formula

$$\left(\frac{1}{T}\right) * \log\left(\frac{y_{iT}}{y_{i0}}\right) = \alpha - \left[\frac{(1-e^{-\beta T})}{T}\right] * \log(y_{i0}) + u_{i0,T} \quad (1)$$

where

T - the range of years between the initial and the last observation value,

*i* - particular country,

$\alpha$  - the rate of technological progress, we assume the same  $\alpha$  per each country,

$\beta$  - parameter of convergence,

$y_{i0}$  - the real GDP per capita in PPP in country *i* in the initial year,

$y_{iT}$  - the real GDP per capita in PPP in country *i* in the last year,

$u_{i0,T}$  - the random shocks in production conditions and preferences,

$\alpha = x_i + (1 - e^{-\beta T})(\log(y_i^*)) + x_i(T)$  - the level constant,

$-\left[\frac{(1-e^{-\beta T})}{T}\right]$  - the speed of convergence.

$\beta$  is the most important parameter for verification of Beta convergence is and this parameter has to be significant. Based on this parameter we can verify existence of convergence. Predicted value of parameter convergence is negative, based on formula  $-\left[\frac{(1-e^{-\beta T})}{T}\right]$  - speed of convergence, which should be positive value. Negative parameter may occur just in some undeveloped countries of Central Africa.

In the verification of Beta convergence is necessary to count with geographical and political disparities between chosen countries. Because countries have still different kind of political direction, we are not make a calculation of completely homogenous countries, just similar. This may has really strong impact for explanation of previous dependence, so based on this argument we have to add to model (1) dummies by which is possible this disparities

balances. Model without dummies is not completely specified, what has important impact for express of random variable, the model without dummies may has treatment of breach of the presumption of randomness. We create four dummies, when countries are joined according their similarity of policy practice and business characteristics as:

- first group: Indonesia, Malaysia, Thailand,
- second group: East Timor,
- third group: Singapore,
- forth group: Cambodia, Laos, Philippines, Vietnam.

The model can incorporate k-1 variants, so a new model is explained as

$$\left(\frac{1}{T}\right) * \log\left(\frac{y_{iT}}{y_{i0}}\right) = \alpha - \left[\frac{(1-e^{-\beta T})}{T}\right] * \log(y_{i0}) + \gamma_i First_{it} + \varepsilon_i Second_{it} + \vartheta_i Third_{it} + u_{i0,T} \quad (2)$$

where

$First_{it}$ ,  $Second_{it}$ ,  $Third_{it}$ , - chosen dummies,  $\gamma_i$ ,  $\varepsilon_i$ ,  $\vartheta_i$  - parameters of used dummies, we used k-1 variations of dummies.

Others variables has the same meaning as variables in the previous model, explained by formula (1). The best results were reached by addition of first, second and third group of dummies.

Even of the new specification of the model, there still exists high probability of completing of used model and doubts the random variable  $u_{i0,T}$  is in each period dependent on the previous random shocks - impaction of shocks from economic activities of each country. Because of high probability of existed correlation between the explanatory variables and random shocks, the parameter of convergence  $\beta$  may be distorted. To avoid parameter's distortion we expand model (2) by addition of a structural variable, which may aggregated the effect of the economic nature of each monitored country. This structural variable is constructed as a weighted summarization of the average growth in compensation per capita in the various sectors of the economy, our calculation consists from nine economic departments (Agriculture, Industry excluded Construction, Construction, Trade and services, Education, IT and services,

Transportation, Government and Health and Finance). The structural parameter is possible to express as

$$S_{it} = \sum_{j=1}^9 \omega_{ij,T-0} * \left[ \log\left(\frac{y_{iT}}{y_{i0}}\right) \right] \quad (3)$$

where

T - the range of years between the initial and the last observation value,

i - particular country,

$y_{iT}$  - the compensation per capita in country i for the last year,

$y_{i0}$  - the compensation per capita in country i for the initial year,

$\omega_{ij,T-0}$  - the weight of economic structure of department j in country i.

The new modification of model is expressed as

$$\left(\frac{1}{T}\right) * \log\left(\frac{y_{iT}}{y_{i0}}\right) = \alpha - \left[\frac{(1-e^{-\beta T})}{T}\right] * \log(y_{i0}) + \gamma_i First_{it} + \varepsilon_i Second_{it} + \vartheta_i Third_{it} + \varphi_i S_{it} + u_{i0,T} \quad (4)$$

where

$S_{it}$  - the structural variable,

$\varphi_i$  - the parameter of the structural variable.

Others variables have the same explanation as the model (2). The structural variable  $S_{it}$  reveals how much country would grows if each of used sectors grew at the national average rate. If country i specializes in the agriculture and that the aggregate agriculture sector does not grow over the period between T and 0, so low value of the structural variable  $S_{it}$  of this country indicates that it should not grow very fast because of the agriculture sector has suffered from random shocks.

In each of used models are verified basic assumptions of model. Just in case of fill assumptions, significant dependency with correlated and homoskedastic residuals, which have normal distribution may explain relationships right and truly with a minimum, consistent and sustaining estimator, which is explained by Least Squares Method. Even that Correlation is one of the basic assumption, in whole sample of article are used panel data, so potential Autocorrelation is not solved, because

this assumption is possible to ensure by easy layout of used data.

Homoskedastic residuals are verified by Breusch Pagan Godfrey test and its P-value and for every model are verified various shapes and dependencies of heteroskedasticity. For ensuring of heteroskedastic residuals we apply the Weighted Least Squares Method. Effective estimator is also possible to provide by White's estimation of parameters, which is resistant against heteroskedasticity. For application is necessary to construct particular weights, what depends on used model. In the case of model with one parameter (1) and model (2) is the weight only one explanatory variable. In the case of several explanatory variables (3) are weights constructed as their linear combination using auxiliary Breusch Pagan Godfrey equation, which is defined as

$$e^2 = \alpha + \lambda X \quad (5)$$

where

$e^2$  - dependent variable - squares of residuals,

$\alpha$  - vector of level constant,

$\lambda$  - vector of convergence parameters,

$X$  - matrix of explanatory variables for each economy.

Application of auxiliary equation is calculated estimation of parameters and estimation of fitted values squares of residuals and this fitted values have to be positive because of square roots of fitted values. This square roots are calculated weights. In case of no positive fitted value, this is replaced by the corresponding actual square of residuals. Followed this, heteroskedastic model is divided by series of calculated weights and estimated by Least Squares Method again. After application of this procedure we may reach homoskedastic residuals model.

Last procedure is verification of normal distribution of residuals, where is provided by JarqueBera test and its P-value. If is normal distribution verified information content of T-statistic of individual model parameters and F-statistic of model are relevant, estimator is minimal. The most common procedure for provision of normal distribution is change of specification or change in functional form of the model. This methodises is not important specified, are very commonly used and good known.

## USED DATA

Data were downloaded from online database sources of The World Bank (<http://data.worldbank.org/>) and chosen period is since 2000 till 2015. For common verification was sample of data divided for four shorter period and whole sample:

- 2000 - 2004,
- 2004 - 2008,
- 2008 - 2012,
- 2012 - 2015,
- 2000 - 2015.

Point of this division is based on year 2008, which is understand as official year of beginning of economic and financial crises around the world, so is predicted strong impact by this year.

## RESULTS

Verification of Beta convergence for chosen nine countries of South East Asia is tested by Least Square Method based on previously formulas (1) (2) and (4) between years 2000 and 2015. Results of Beta convergence parameters and explanatory parameters for each model are shown in Table 1 for each subperiod and whole sample together with T-statistics and its P-value of parameters, Coefficient of Determination, F-statistic and P-value of F-Statistic.

Table 1: Results of Beta Convergence

 $\beta$ -convergence explains 48,14% of the total

Results	2000 - 2004			2004 - 2008			2008 - 2012			2012 - 2015			2000 - 2015		
	Model (1)	Model (2)	Model (3)	Model (1)	Model (2)	Model (3)	Model (1)	Model (2)	Model (3)	Model (1)	Model(2)	Model (3)	Model (1)	Model (2)	Model (3)
B0	0,019	0,078	0,054	0,105	0,105		0,041	0,056	0,044	0,033	0,035		0,043	0,077	
T_stat_B0	0,890	2,755	4,799	3,769	3,371		3,820	1,462	0,663	2,249	1,182		4,099	4,958	
P_T_stat_B0	0,403	0,051	0,002	0,020	0,043		0,007	0,218	0,555	0,059	0,303		0,005	0,008	
B1	0,000	-0,017	-0,008	-0,022	-0,023		-0,006	-0,010	-0,007	-0,004	-0,004		-0,005	-0,015	
T_stat_B1	0,027	-1,934	-2,549	-2,726	-2,476		-2,039	-0,946	-0,416	-1,149	-0,460		-1,826	-3,173	
P_T_stat_B1	0,979	0,125	0,038	0,053	0,090		0,081	0,398	0,705	0,289	0,669		0,111	0,034	
gama		0,006		0,006	0,008			0,002	0,001		-0,005			0,003	
T_stat_gama		0,933		1,143	1,099			0,339	0,043		-1,020			0,849	
P_T_stat_gama		0,404		0,317	0,352			0,752	0,968		0,365			0,444	
epsilon		-0,025		-0,013	-0,012			0,004	0,004		-0,013			-0,013	
T_stat_epsilon		-5,152		-2,571	-2,009			0,577	0,499		-3,114			-4,584	
P_T_stat_epsilon		0,007		0,062	0,138			0,595	0,652		0,036			0,010	
teta		0,017		0,019	0,022			0,010	0,007		-0,006			0,012	
T_stat_teta		1,432		1,659	1,526			0,700	0,365		-0,561			1,753	
P_T_stat_teta		0,225		0,173	0,224			0,522	0,739		0,605			0,155	
fi					0,064				0,027						
T_stat_fi					0,443				0,236						
P_T_stat_fi					0,688				0,829						
F_stat	0,001	6,649	6,499	4,293	2,784		4,156	1,518	0,939	1,319	5,417		3,334	8,480	
P_F_stat	0,979	0,047	0,038	0,094	0,124		0,081	0,348	0,558	0,289	0,065		0,111	0,031	
R2	0,000	0,869	0,481	0,811	0,823		0,373	0,603	0,610	0,159	0,844		0,322	0,895	

The degree of significance at level  $\alpha=0.05$ .

Source: Results from the estimation

The most important parameter for verifying of convergence into the same steady level of the real GDP per capita in PPP is parameter of convergence  $\beta_1$ . This parameter has to be significant, what is in article verified by P-value of parameter in 90% significant level. Based on results of this parameter, is possible to write, there is verified convergence per each model just for period since 2004 till 2008. Following this contention are interpreted reached results only for this sample.

For the model of convergence described dependence of logarithmic growth of real GDP per capita on initial logarithmic GDP per capita (1), parameter of convergence  $\beta$  is equal -0,0077 (is negative, so we expect positive speed of convergence) and parameter is significant. The level constant is significant too. Coefficient of determination  $R^2$  is 0,4814, so the model of

variability of the growth of real GDP per capita in PPP over the chosen sample and model as whole is also significant. Basic assumptions of model are filled, model has homoskedastic and normal distributed residuals, because value of Breusch Godfrey Serial Correlation LM Test is 2,1198 and its P value 0,1454, so there is no heteroskedastic residuals in model. Based on Jargue Bera test with value 0,4193 and its P value is 0,8109 is proven normal distribution, so basic assumptions of model are filled. Because parameters are significant and also whole model is significant, P-value of F-statistic is equals to 0,03814, we may constant, there is verified Beta convergence between period since 2004 till 2008 for nine chosen countries of South East Asia, so chosen economies reach the same steady state and we may calculate speed of convergence based on formula  $-\left[\frac{(1-e^{-\beta T})}{T}\right]$ . Based on negative parameter of convergence, speed is positive with calculated speed of convergence equals 0,75%. The real growth of GDP per capita in the sample since 2004 till 2008 for chosen countries is in average 2,55% even in the fact, that some of them have higher growth - Laos,

Vietnam, Indonesia (more than 5%) , but countries as Singapore or Thailand have less growth (Singapore approximately 2% and Thailand just since 0,5% - 1%), so average growth of real GDP per capita is very close with average growth of GDP per capita of USA. Because calculated value of convergence speed is in comparison with average value understated, we are not sure about proven result of convergence in the one steady state of real GDP per capita for chosen countries and further specification is necessary by model (2) and (4).

Second model (2) is modification of the model (1), where dummies - artificial variables were added, following this, countries of South East Asia are divided for individual groups according to their geographical and economic division how is described in methodology of article. Parameter of  $\beta$  is again negative, equals -0,0223 and is significant also together with the level constant, but not every added dummy is significant. It may conclude, that dummies significantly do not influence the explanation of Beta convergence. Coefficient of determination is equals 0,8111, so the model of Beta convergence explains 81,11% of the total variability of the growth of the real GDP per capita in PPP over the chosen sample and model as whole is also significant, because of F-statistic of model is 4,2933 and its P-value is equals 0,0936. Because coefficient of determination substantially increased and model is better specified, is possible to write, our opinion of deeper specification of model was right. Homoskedastic model was verified again, value of Breusch Godfrey Serial Correlation LM Test is 3,4918 and its P-value is 0,1745, so there is no heteroskedastic residuals in model. Based on Jargue-Bera test with value 0,2244 and its P-value equals 0,8675 is proven normal distribution - basic assumptions of model are filled. Just parameter  $\varepsilon$  is significant from used dummies and also whole model is significant, F-statistic is equals 4,2933 and its P-value to 0,0936, we may constant, there is again verified Beta convergence between period since 2004 till 2008 for nine chosen countries of South East Asia, so chosen economies reach the same steady state level of real GDP per capita. Calculated speed of convergence based on formula  $-\left[\frac{(1-e^{-\beta T})}{T}\right]$  is again positive and value of convergence speed is 2,1162%. This value is really closer to average value of GDP growth for

chosen countries 2,55% and also similar value of 2% speed of convergence of USA, so results is neither understated nor overvalued and we can believe the informative value of model. Follow this conclusion of verifying and to be sure verified convergence, we interpret the last model (4).

The last model (4) is an extension with incorporation of the structural variable  $S_{it}$ , which consist of nine sectors (Agriculture, Industry excluded Construction, Construction, Trade and services, Education, IT and services, Government and Health, Transportation and Finance). Parameter of  $\beta$  is for this model negative too, equals -0,0232 and is significant together with level constant. Again dummies and even the structural parameter are not significant. Interpretation of third model is almost the same how for second model. Coefficient of determination is equals 0,8227 (again increased in comparison with previous used models) and the model of Beta convergence explains 82,27% of the total variability of the growth of real GDP per capita in PPP over the chosen sample since 2004 till 2008. F-statistics of model is 2,7839 and its P-value is equals 0,2144, whole model is not significant. F-statistics is really low number with no signification, what is not common in Econometrics. We doubt of used specification and may not be completely sure about the description ability and model verification, so firstly we verify basic assumptions of model. Homoskedastic residuals and normal distribution are in this model also verified, based on value of Breusch Godfrey Serial Correlation LM Test is 2,2879 and its P-value 0,3186 and value of Jarque-Bera test equals 0,4603 and its P-value 0,7944, so model's assumptions are filled even in the fact, that whole model is not significant. Parameters of others used explanatory variables are not significant, whole model is not also significant so this model has for us information and theoretical character, which is not confirmed. We only may constant, that there exists Beta convergence between period since 2004 till 2008 for nine chosen countries of South East Asia, with no impact by dummies or structural shocks in chosen countries, but we cannot prove it. If was speed of convergence calculated by formula  $-\left[\frac{(1-e^{-\beta T})}{T}\right]$ , result would be almost the same with previous model equals to 2,19% and again close to 2% average speed of convergence reached for monitored nine

countries, what look very trustworthy result of convergence speed.

## DISCUSSION

In article is explained methodology of Beta convergence verification. This convergence approach is based on hypothesis, when poorer countries tent to grow faster per capita than richer.

Based on results from three different models, there was proved concept of Beta convergence in sample since 2004 till 2008 of chosen nine countries of South East Countries of Asia. For us the leading indicator is the parameter of convergence, which is significant in every model, we constant convergence to the same level of real GDP per capita in PPP in followed sample since 2004 till 2008 between countries. Convergence was verified only for sample since 2004 till 2008, other divided samples did not prove Beta convergence between chosen countries, also whole sample since 2000 till 2015 verify the general result - no existential convergence between whole period since 2000 till 2015. We may conclude, that division of shorter period is more exact.

In future, we want to monitor convergence with extended database for each country and use another causes of methodology. The main contribution of article is in verification of Beta convergence for chosen nine countries of South East Asia. Because the real existence of future integration to one unity between this countries, based on mathematical results of our verification governments may easier predict effects of integration and provide useful steps.

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**THE IMPACT OF MARKETING AMBIDEXTERITY ON MARKETING PERFORMANCE IN FMCG INDUSTRY: THE ROLE OF MARKET KNOWLEDGE DEVELOPMENT AND CROSS-FUNCTIONAL MARKETING CAPABILITIES**

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***ABSTRACT***

*Ambidexterity, the company's ability to exploit and explore simultaneously, in the context of the science of marketing to achieve superior firm's performance become the main focus of the study. The studies that focusing on marketing ambidexterity (MA) and its impact on the firm's performance are still not widely found. The study aims to analyze the influence of MA towards firm performance (especially marketing performance) and discovers the influence of MA antecedents. The study used single cross-sectional design in which data are collected by survey method and the selection of the sample using non probability convenience and purposive sampling. The respondents are 30 managers of different firm in fast moving consumer goods (FMCG) industry. The analytical method used is multiple regression with software SPSS 20.*

*The result shows that market knowledge development affect significantly towards cross-functional marketing capabilities and marketing ambidexterity and cross-functional marketing capabilities affect marketing ambidexterity significantly. On the other hand, marketing ambidexterity does not affect marketing performance significantly.*

**Keywords:** *Marketing Ambidexterity, Market Knowledge Development, Cross-Functional Marketing Capabilities, Marketing Performance, FMCG*

## **INTRODUCTION**

Ambidexterity generally refers to the ability of the company to achieve different goals, the exploitation and exploration (March 1991), the efficiency and flexibility (Adler et al. 1999), incremental and radical innovation (de Visser et al. 2010), or the alignment and adaptability (Gibson and Birkinshaw 2004) simultaneously. Josephson et al (2015) stated that the exploitation based on marketing includes activities that increase competence to extract value or economic rents available from the current environment (eg, Vorhies et al. 2011; Voss and Voss 2013 ). In this way, exploitation activities carried out to create a stronger competitive position in the current market (eg, Han et al. 2001). The study noted that marketing-based exploitation activity mostly involving advertising promotional strategies (eg, McAlister et al. 2007). Advertising is a exploitation-based practice that focus on activities to facilitate and create exchanges with market companies today that further to extract value (Mizik and Jacobson 2003). While marketing based exploration focus on search, experimentation, and development opportunities and new knowledge through activities associated with innovation (eg, Vorhies et al. 2011; Voss et al., 2008). These activities involve a lot of R & D capabilities (eg, Gupta et al. 2006). Exploration activities keep the company ahead of its competitors and pressure of the environment through superior innovation (eg, Vorhies et al., 2011).

There are two perspectives ambidexterity namely trade-off (structural ambidexterity) and paradoxical thinking (contextual ambidexterity) (Sok & O'Cass 2015). Where the paradigm of trade-offs states companies have to choose one of two adaptation process the exploration or exploitation facilitated by a different organizational structure because it is impossible the company can achieve the exploitation and exploration simultaneously (such as Ancona et al., 2001). Many contemporary management theories showed the phenomenon of organizational ambidexterity into separate categories and contrasts that encourage companies to focus on one of the exploration or exploitation (Denison, Hooijberg, & Quinn, 1995).

Researchers who support this perspective (eg, Tushman and O'Reilly, 2004) state that the

organizational practice of simultaneous exploitation and exploration is almost impossible to achieve. The organization can not have both power (exploratory and exploitative capabilities) as well as their pressure derived from the process of knowledge-management conflict. Other researchers also argued that the company needs to keep the concept of exploration and exploitation as a trade-off which is the company had to choose between supporting organizations to exploit existing competencies or explore new competence because two activities require fundamentally different structure, strategy and context (Ancona, Goodman, Lawrence, & Tushman, 2001). Tushman and O'Reilly (2004) also stated that only a few companies successfully manage ambidexterity, for the exploration and exploitation that logically and fundamentally different and each requires a different structure and strategies as well as the conflict between the two is difficult to reconcile. Vorhies Orr & Bush (2011) confirmed that companies typically use exploitive capabilities gradually and can use the exploratory capability if exploitative capability failed.

While in the paradoxical thinking or contextual ambidexterity, which is one of the vanguard is March (1991) stated that companies must use two expertise adaptation processes at high levels simultaneously in order to have superior performance and survive in the long term (such as Atuahene-Gima 2005; Kyriakopoulos and Moorman 2004; He & Wong, 2004; Lubatkin Simsek, Ling and Veiga, 2006; O'Reilly & Tushman, 2004, 2008; Gupta, et al., 2006; and Raisch & Birkinshaw 2008). Some researchers have also recognized the importance of balance exploration and exploitation of these seemed apparent contradictions (Adler, Goldoftas, & Levine, 1999; Katila & Ahuja, 2002). Researchers whose opinion refers to the flow of paradoxical thinking also state that excessive investment in one capability can have a negative impact on the firm performance. Where over-exploration activities might improve the company's ability to renew its knowledge base but can cause a stuck in a cycle of failure (a failure traps) and traps search cycle that never ends. The failure is affected by uncertainty that comes from new innovations. Companies that focus exclusively on the "exploration" will never get a "full return" or known as unrewarding change of investment in the innovation process (Atuahene-Gima 2005; Volberda & Lewin,

2003). While the activity of over-exploitation can cause companies have lower performance than its competitors because it ignores new market that are sourced from the trap of competence or pitfalls of success (a success trap or a competency trap). The company is too dependent on existing competencies and can not respond to changes of environment quickly. In essence, the company that applying the perspective of trade-offs that only focuses on one of exploitation or exploration activity alone will have lower performance compared to firm performance that implement paradoxical perspective thinking that balance and synergize both of exploration and exploitation activities simultaneously.

Both of adaptation processes mentioned above need to be developed in the context of marketing as a form of organizational learning, because marketing exploration and exploitation (MA) are valuable, rare, inimitable and non-substitutable (characteristic VRIO's Barney & Hesterly 2011) that can support firm's sustainable competitive advantage. The marketing exploitation can create value by strengthening and upgrading existing skills and practices in marketing while marketing exploration could create value through the development of new marketing skills and practices (Kyriakopoulos & Moorman, 2004). Marketing strategies that focus on exploration helped the company to be competitive in a dynamic environment with an emphasis on new ideas, risk taking, flexibility and radical innovation. Exploration strategy includes activities to enter the market with a product category closest to the product or brand "that is relatively new to the company" (Vila, Bharadwaj & Bahadir, 2015). In a dynamic industry, the adaptation of products and marketing practices of the company is necessary through greater exploration. Companies will be able to transform the dynamic market changes into new growth opportunities if the built system consistently creating new products, designed to respond to market changes. Companies that focus on exploration can create superior long-term performance by tapping into new market opportunities. But exploration strategy could hinder the company's ability to generate short-term gains for the resources dedicated to the long-term needs.

Therefore, to achieve the goal of short-term profit, marketing exploitation strategy should be

done by designing products and marketing activities in existing markets rather than entering new markets (Vila et al 2015). By not having to spend research and development to explore new market offerings, exploitation strategies can respond to the market faster and have a greater ability to take the advantage of short-term opportunities. Exploitation strategy also allows companies to build and maintain a competitive position by improving product availability at this time. The product expansion strategy also contributes to the company's growth, especially when it has excess financial resources (Mishina, Pollock and Porac, 2002). However, exploitation strategies can hamper company's ability to grow over time. Thus, companies should consider the trade-offs when determining the level of investment for exploration and exploitation of marketing strategy.

## **LITERATURE REVIEW**

### **Antecedents and Consequences of Marketing Ambidexterity**

To execute MA strategies requires the cooperation and cross-functional coordination between marketing and other functions in the company. O'Cass, Heirati & Ngo (2014) concluded that the company can be ambidextrous as exploitative and explorative strategy at corporate level interact with exploratory and exploitative capability at operational level through multiple functional areas. Cross-functional marketing capabilities (CFMCap) can help organizations to explore new opportunities, to adjust the changing business environment and simultaneously be able to exploit the opportunities that exist to achieve the benefits of business efficiency (Benner and Tushman, 2003). Therefore, it requires the development of market knowledge that are expected to increase CFMCap. CFMCap is the capability of marketing that combines multiple specialization such as product, price, distribution channels, marketing communications, sales management and marketing research with input from other functions (Morgan, 2012 p. 107) and is not structurally placed on marketing organizational structure formally in the company (Srivastava, et al 1999) but embedded or work in business systems and processes that run in its business units. In the previous literature, there are three components of CFMCap that are considered important namely brand management, CRM

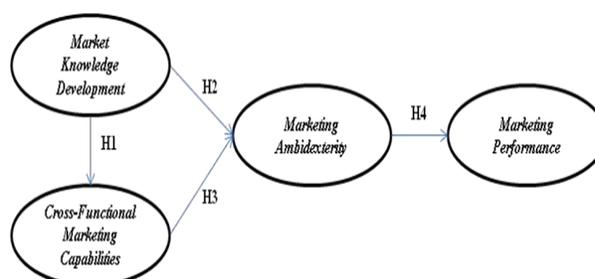
(customer relationship management) and NPD (new product development) (Morgan, 2012).

To enhance the CFMCAp requires the development of the market knowledge. Because to increase the marketing capabilities, the business process that being carried out and built need to be modified by adding new knowledge about the various aspects of the market including customers, competitors, market trends, and government regulations (Lavie 2006). Atuahena-Gima (2005) and Vorhies et al., (2011) also stated that in order to encourage strategies of Contextual MA or a combination of marketing exploitation adaptability (the development of current skills, processes and capabilities of marketing) and marketing exploration adaptability (the development of new skills, processes and capabilities of marketing) require the development of new knowledge about the market. The development of this market knowledge can be obtained in four ways namely *market information acquisition*, the activity of producing knowledge that focus on understanding the market (Hult et al 2007); *market information dissemination*, the process by which information from multiple sources distributed (Hult et al 2007); *market information analysis*, the process by which member companies evaluate the data and information (Morgan et al 2005); and *a shared understanding*, the process by which members develop a common understanding of the data and events (Hult et al 2007). One example of the companies that have applied MA is Apple (iPhone and iPad) that successfully balance these two skills. In which the first, Apple has the ability to "think different" by creating a new category of products different from the existing products in its industry and do not allow other companies to give effect to its products. According to the authors the ability of Apple creating a category of products based on its ability to promote knowledge about the market. Second, the management style that integrates all functions such as hardware, operating system, applications and services supported by the executive committee and the third, Apple has a very strong principle of product development (www.time.com, 2012). The integration of all the functions above shows a CFMCAp that are well managed.

## HYPOTHESES AND RESEARCH MODEL

### Market Knowledge Development and Cross-Functional Marketing Capabilities as Antecedents

Based on the concept of Resource Based View (Barney, 2001) and Dynamic Capabilities View (Helfat et al., 2003), the development of marketing capability that related to organizational learning through MKD is a potential source for sustainable competitive advantage that will contribute to organizational performance (Tamayo-Torres et al, 2014). The following is the conceptual framework of the research:



Source: Adapted from Morgan (2012); Mu (2015); O’Cass et al (2014), Raisch & Birkinshaw (2008); Vorhies et al., (2011)

**Figure 1.1.** Conceptual framework

Krasnikov and Jayachandran (2008) stated that the market knowledge of consumer needs and the company's experience in predicting and responding to customer needs can facilitate the development of marketing capabilities. Furthermore, Tseng (2016) concluded that the company’s capability to manage market knowledge positively influence the company's ability to manage relationships with customers. This capability is part of a CFMCAp. To develop marketing capabilities, the employees have to repeatedly apply their knowledge and skills and develop repeated efforts that have become "routine operation" which useful to optimize market-based resources. Based on the above arguments, the authors propose the following hypothesis:

H1: Market Knowledge Development will positively influence Cross-Functional Marketing Capability

Based on the organizational learning theory (eg, March 1991), there are two basic processes of adaptation within the marketing organization that is exploration and exploitation. In the context of marketing, according Kyriakopoulos and Moorman (2004), marketing exploration capability refers to the development of new

skills, processes and capabilities of marketing through the development of new knowledge about the market (Atuahena-Gima 2005; Kyriakopoulos and Moorman 2004). While marketing exploitation (Kyriakopoulos and Moorman 2004) refers to the capability that focuses on the enhancement and improvement of current skills, processes, and capabilities of marketing and the value resulting from the company's capability associated with the existing market.

To obtain the necessary knowledge of the market, MKD is needed when the company's knowledge of the market are not sufficient. Marketing theory indicates that firms with a level higher market knowledge is believed to provide more information and better for marketing exploration and exploitation (Atuahene-Gima 2005; Kyriakopoulos and Moorman 2004). The process that used for marketing exploration and exploitation activities requires the supply or input of information in order to function properly and successfully. Companies with a higher level market knowledge will be able to gather and process the relevant information about the customer's needs, the steps of competitors and market trends better (Atuahene-Gima 2005).

Furthermore, based on the studies of Kyriakopoulos and Moorman (2004) and Raisch and Birkinshaw (2008), it is clearly visible that the market orientation and resource endowment can facilitate to ambidexterity. Where Kyriakopoulos and Moorman concluded that companies that have strong marketing orientation positively impact on marketing exploration and exploitation simultaneously which can improve the financial performance of new products. Based on those logic argumentations, the authors argue that the increase or accumulation of market knowledge may also encourage and increase MA. Therefore, based on the results of several studies before, the authors propose the following hypothesis:

H2. Market Knowledge Development will positively influence Marketing Ambidexterity

Studies Vorhies et al. (2011) support the theory that there is a strong relationship between marketing exploration and exploitation and CFMCap. On the other hand Morgan (2012) states that brand management and CRM capabilities (or customer-focused marketing capabilities) together with NPD capabilities, which became known as CFMCap will influence

the decision of a marketing strategy including market selection strategy. MA is a decision of a marketing strategy at business level which aims to serve their target market. So it can be said that CFMCap including brand management, CRM and NPD capabilities can be a key driver factor of ambidexterity. This statement is supported by the J. Mu's study (2015) which states that the marketing capabilities that are realized in the form of market sensing (the company's ability to anticipate future market evolution and growing opportunities based on information collected through its business ecosystem); engaging customer (the company's ability to create an intimate relationship with the customer); and partner linking (the company's ability to cooperate in the creation of value) can be a driving force of MA.

J. Mu's study which refers to the paradoxical thinking paradigm pioneered by March (1991) also state that companies must use two expertise adaptation process, marketing exploration and exploitation simultaneously in order to have superior performance and survive in the long term (such as Atuahene- Gima 2005; Kyriakopoulos & Moorman 2004; He & Wong, 2004; Lubatkin et al, 2006; O'Reilly & Tushman, 2004, 2008; Gupta, et al., 2006; and Raisch & Birkinshaw 2008). J. Mu (2015) concluded that marketing capability can become antecedent of "ambidexterity" in which the company has the ability to market sensing and engaging customer/partner linking that can help firms to innovate gradually (incremental innovation) as well as a radical innovation. Both types of these innovations can be done through the implementation and development perspectives outside-in marketing capabilities. This perspective is a marketing capability that emphasizes the importance of the customer and external information to create customer value and competitive advantage of the company. Through this perspective, companies can detect consumer's desire that is not visible (latent) (Day, 2011; Day & Moorman, 2010). Hence, based on the above arguments, the authors propose the following hypothesis:

H3: Cross-Functional Marketing Capabilities will positively influence Marketing Ambidexterity.

### **Marketing Performance as an Outcome**

Some researchers claim that the ability of companies to manage marketing capability to

maintain business efficiency as well adaptive to changing environments (ambidextrous) is the key to be a successful enterprise (Gibson & Birkinshaw, 2004; Raisch & Birkinshaw, 2008). Ambidexterity is very conducive for sustainable company's performance, where the marketing exploitation undertaken to improve the company's performance in the short term. While the marketing exploration is directed to improve the company's performance in the long term. Josephson, et al. (2015) state that strategic MA (include exploitation and exploration that focus on the creation and extraction of value through marketing functions (eg Voss and Voss, 2013) can increase returns through exploitation. Furthermore, Sanal, et al. (2013) also found that ambidexterity has better performance impact that are both the performance of innovation and financial performance rather than each of exploitation or exploration. Kyriakopoulos and Moorman (2004) also stated that the market orientation which facilitates the strategy of marketing exploration and exploitation at high levels can produce better financial performance of new products. Next Clercq, et al. (2014), affirm that the contextual ambidexterity can be a positive influence on firm performance under tight competition. Some previous researchers as Atuahene-Gima (2005) and Gupta et al. (2006) also found companies that are "ambidextrous" (has both adaptation process "exploration" and "exploitation") have significant advantages compare to companies that are "less ambidextrous".

Furthermore O'Cass, et al. (2014) found that the implementation strategy of exploratory and exploitative simultaneously encourage the success of new products through the creation of a unique positional advantage to customers in the form of differentiation and cost efficiency. Next, Z. Wei et al. (2014) state that interaction between exploration and exploitation activities have a positive impact on firm performance. Likewise, Tinoco (2014) concluded that synergizing of exploration and exploitation activities will have positive impact on innovation strategies that maximize customer value and drive corporate performance. The other researchers have also proved that organizations that are "ambidextrous" performed better than companies that use approaches one side only (He and Wong, 2004; Lubatkin, et al, 2006; Simsek, 2009; Chandrasekaran et al. 2012) in business competition (Raisch & Birkinshaw 2008) and

high dynamic business environment (Jansen, Van den Bosch & Volberda 2005). Several other researchers like Hsu, et al., (2013) and Martin, et al (2014) showed that in companies that have an existence ambidexterity with two balance basic activities adaptation process-exploration and exploitation have produced higher performance than companies that do not use this strategy. Lastly, Yu et al (2015) concluded that the service-sales ambidexterity can contribute positively to the branch performance. Thus, based on the above findings, the authors propose the following hypothesis:

H4: Marketing Ambidexterity will positively influence Marketing Performance

## **METHODOLOGY**

This study uses a single cross-sectional design. The number of respondents of this study is 30 managers from different companies, engaged in the fast moving consumer goods (FMCG) sector in Indonesia, which include food and beverages, cigarettes, cosmetics, pharmacy, and household's supply and equipment. The sample firms are those that has been established for minimum five years and have sales more than Rp 200 Milion and the managers are those that have been minimum three years working in FMCG industry.

The data collection is done either by the on-line media including email, social media networks such as facebook, What's Up and other social media as well as through off-line or face-to-face (door-to-door). The variables used in this study were adapted from previous studies, whereas Market Knowledge Development is adopted from the studies of Hult, et al. (2007) and Vorhies et al. (2011). Marketing ambidexterity was adapted from the studies of Atuahene-Gima (2005); Kyriakopoulos & Moorman (2004) and Vorhies et al. (2011). Cross-Functional Marketing Capabilities (CFMCap) were adapted from the studies of Vorhies and Morgan (2005), Vorhies et al. (2011), Morgan (2012) and Subramaniam and Venkrataman (2001). Finally, Marketing Performance was adapted from the studies of Ambler et al. (2004) Combs et al (2005), Frosen et al (2013), Morgan (2012) and Kouropalatis et al (2012) and expert judgment. The analysis of data using multiple regression with IBM SPSS 20 software.

**RESULTS**

**Validity and Reliability**

Pretests were conducted to 30 respondents. From the results of validity and reliability of all the indicators of the five constructs (market knowledge development: market information acquisitions, MI development, MI analysis, shared understanding; CFMCAp: CRM, BM, NPD; MA: marketing exploration and exploitation; MPer: BE, MP, FP, CF, CE, CA, SP) are almost all valid and reliable where all indicators have Cronbach's Alpha value equal to or greater than 0.6 and has a KMO value of above 0.5 (Maholtra, 2010) so that it can proceed the subsequent analysis process. The constructs are There is only one dimension of performance marketing is not valid and reliable (the dimension of innovation) which Cronbach's Alpha value below 0.6 and has a KMO value below 0.5. Here are the results of validity and reliability test:

Construct	Indicator	Cronbach's Alpha	Conclusion	KMO	Bartlett's Test	Factor Loading	Conclusion
ment	CRM3						0,792 Valid
	CRM4rev						0,844 Valid
	CRM5rev						0,868 Valid
New Product Development	NPD1	0,771	Reliable	0,714	0,00		0,832 Valid
	NPD2						0,677 Valid
	NPD3						0,886 Valid
	NPD4						0,646 Valid
	NPD5rev						0,567 Valid
Marketing Exploitation	Mt1.fl	0,899	Reliable	0,722	0,00		0,789 Valid
	Mt2.fl						0,904 Valid
	Mt5.fl						0,785 Valid
	Mt6.fl						0,779 Valid
	Mt7.fl						0,903 Valid
	Mt8.fl						0,872 Valid
	Mt9.fl						0,900 Valid
	Mt10.fl						0,890 Valid
	Mt3rev.f2						0,826 Valid
	Mt4rev.f2						0,857 Valid

Source: Processed by Researchers

**Tabel 1.1:** Validity and reliability test

Latent Variable	Indicator	Cronbach's Alpha	Conclusion	KMO	Bartlett's Test	Factor Loading	Conclusion
	MIAc1					0,587	Valid
Market Information Acquisition	MIAc2	0,545	Reliable	0,535	0,00	0,866	Valid
	MIAc3					0,830	Valid
	MIAc4rev					0,900	Valid
Market Information Development	MID1	0,618	Reliable	0,59	0,00	0,731	Valid
	MID2					0,776	Valid
	MID3rev					0,864	Valid
	MID4rev					0,611	Valid
Market Information Analysis	MIAAn1	0,628	Reliable	0,580	0,00	0,867	Valid
	MIAAn2					0,870	Valid
	MIAAn3rev					0,582	Valid
Shared Understanding	SU1	0,721	Reliable	0,614	0,00	0,843	Valid
	SU2					0,902	Valid
	SU3rev					0,723	Valid
Brand Management	BM1	0,569	Reliable	0,641	0,00	0,928	Valid
	BM2					0,792	Valid
	BM5					0,857	Valid
	BM3					0,615	Valid
	BM4rev					0,911	Valid
Customer Relationship Management	CRM1rev	0,774	Reliable	0,626	0,00	0,844	Valid
	CRM2					0,633	Valid

**Tabel 1.1:** Validity and reliability test (cont.)

Latent Variable	Indicator	Cronbach's Alpha	Conclusion	KMO	Bartlett's Test	Factor Loading	Conclusion
Marketing Exploration	Mr1rev.f2	0,843	Reliable	0,713	0,00	0,470	Valid
	Mr3.f2					0,662	Valid
	Mr2.f1					0,542	Valid
	Mr4.f1					0,555	Valid
	Mr5.f1					0,609	Valid
	Mr6.f1					0,683	Valid
	Mr7.f1					0,872	Valid
	Mr8.f1					0,884	Valid
	Mr9.f1					0,795	Valid
	Mr10.f1					0,598	Valid
Brand Equity	BE1	0,844	Reliable	0,50	0,00	0,931	Valid
	BE2					0,931	Valid
Market Position	MP1	0,641	Reliable	0,50	0,09	0,858	Valid
	MP2					0,858	Valid
Financial Position	FP1	0,696	Reliable	0,588	0,00	0,912	Valid
	FP2					0,609	Valid
	FP3					0,835	Valid
Innovation	INN1	0,206	Unreliable	0,499	0,13	0,840	Invalid
	INN2					0,791	Invalid
	INN3					-0,341	Invalid
Customer Feedback	CF1	0,611	Reliable	0,663	0,03	0,692	Valid
	CF2rev					0,600	Valid
	CF3					0,771	Valid
	CF4					0,707	Valid
Customer Equity	CE1	0,687	Reliable	0,640	0,00	0,831	Valid
	CE2					0,862	Valid
	CE3					0,716	Valid
Channel Activity	CA1rev	0,836	Reliable	0,553	0,00	0,808	Valid
	CA2rev					0,925	Valid
	CA3					0,875	Valid
Sales Process	SP2	0,887	Reliable	0,500	0,00	0,949	Valid
	SP3					0,949	Valid

Source: Processed by Researchers

**Respondent's Profile**

Of the thirty-five questionnaires that received, only thirty were valid for further analysis. The rests did not meet the criteria for a sample (both respondent's and/or company's criteria).

The following are the profile of respondents:

**Tabel 1.2:** Respondent's profile

Demography	items	%
Respondent Age	<30years old	17%
	30 - 35 years	17%
	36 - 40 years	40%
	41 - 45 years	17%
Gender	Male	67%
	Female	33%
Job Position	Director	17%
	General Manager	30%
	Manager	40%
Firm Age	5-10 years	20%
	21-30 years	23%
	>75 years	33%
Sales Mean	≤ Rp 50 billion	17%
	Rp 101 - 300 billion	10%
	Rp 1,1 - 10 trillion	17%
Total Firm Asset	Rp 11 - 100 billion	33%
	> Rp 10 trillion	23%
Business Sector	Rp 101 - 300 billion	13%
	Food & Beverage	50%
	Cigarette	13%
Full time worker	Farmacy	17%
	≤ 99 employees	17%
	100 - 300 employees	30%
Meeting times	1001 - 5000 employees	33%
	1 times in a month	20%
	2 - 3 times in a month	37%
	> 3 times in a month	27%

Source: Processed by researchers

The following is the summary of the four hypotheses test:

**Tabel 1.3:** Summary of hypotheses test

Hypotheses	Path	t (sig.)	Results
H1	MKD → CFMCap	3,810 (0,001)	Data support the hypothesis
H2	MKD → MA	5,527 (0,000)	Data support the hypothesis
H3	CFMCap → MA	3,722 (0,001)	Data support the hypothesis
H4	MA → MPer	1,029 (0,313)	Data does not support the hypothesis

Source: Processed by Researchers

**Path 1: MKD → CFMCap**

The finding of the study supported by the previous studies, such as Tseng (2016) that said the capability of company to manage market knowledge positively influence the company's ability to manage relationships with customers. Other study stated that to develop marketing capabilities, the employees have to repeatedly

apply their knowledge and skills in marketing problems (Vorhies et al. 1999)

Path 2: MKD → MA

The research finding about the influence of market knowledge development towards marketing ambidexterity supported by Mom et al (2007). They stated that the success of ambidexterity is closely associated with the flow of knowledge. Vorhies et al, (2011) also stated that to support marketing ambidexterity, the company needs to improve and develop its market knowledge.

Path 3: CFMCap → MA

The finding of the study (i.e. CFMCap affect marketing ambidexterity significantly) is supported by the study of Vorhies *et al.* (2011). They stated that brand management and CRM capabilities (together with NPD capabilities) (i.e. Cross-functional marketing capabilities) will influence the decision of marketing strategy/market selection strategy. Then marketing capabilities can be the antecedent of "ambidexterity" in which the ability of market sensing and customer engaging/partner linking can help firms to innovate incrementally as well as radically.

Path 4: MA → MPer

The study shows that marketing ambidexterity doesn't affect marketing performance significantly. However, from the regression analysis about the effect of marketing ambidexterity towards eight dimensions of marketing performance, there are two dimensions are significantly influenced by marketing ambidexterity namely the sales process and channel activity. The results of the study are supported by Z. Wei et al. (2014) which states that a positive interaction between exploration and exploitation activities have a positive impact on company performance. The study was also supported by the finding O'Cass et al (2014) which states that the integrated exploratory and exploitative marketing strategy can drive market performance.

**CONCLUSIONS AND RECOMMENDATION**

From the above findings where market knowledge development affect positively and significantly towards cross-functional marketing

and marketing capabilities ambidexterity, the author gives some suggestions. First, to improve cross-functional marketing and marketing ambidexterity, the authors suggest to marketing team to hold meetings with customers at least twice a year to determine what products are needed by customers in the future. Secondly, the marketing team should meet customers at least twice a year to assess the quality of our products. Third, the marketing team should encourage the front liners to collect information related to the needs of customers on an ongoing basis and monitor the competitors in depth to see potential opportunities or opportunities lost.

Furthermore, the management team must improve market information dissemination through meetings between departments routinely carried out for example at least one time in four months to discuss various trends and market developments. Second, when there is something important developments with the consumer or the main market, then it must be immediately informed to the organization in a short time. Third, streamline the process of sharing information between the marketing department and other departments and enable informal networks to ensure that decision makers have the information necessary marketing.

Next, the management team also must improve market information analysis includes analysis of various new marketing ideas at regular intervals to measure the potential benefits; evaluate various alternative marketing strategies have always carefully; and properly manage market information on a regular basis.

To improve marketing capabilities ambidexterity, the management team needs to improve shared understanding includes a detailed explanation marketing steps that must be done to all the marketing team; regularly develop a shared understanding about marketing information; and to develop a common understanding of the implications routinely conducted marketing activities. In addition to improve the marketing ambidexterity, the management team also need to improve cross-functional marketing capabilities address the improvement of brand management, customer relationship management and new product development. To increase brand management, the management should periodically use a deep understanding of the customer to identify the brand positioning of value to customers, consistently building associations desired brand

into the minds of consumers, maintain a positive brand image relative to competitors and increase brand awareness from time to time as well as systematically to leverage brand equity based on the perception of the customer to determine the points of sales channels.

Next, to improve the CRM, the company must establish a "dialogue" with targeted customers; regularly invites targeted customers to try a variety of products; seeks to meet long-term needs of the customers that purchase occurred repeatedly; systematically maintain the loyalty of key customers; and regularly improve the quality of relationships with key customers.

Finally, to enhance new product development capabilities, team management should frequently launch new products; always being the first to introduce new products; simultaneously introduce several versions of products at the same time in a number of markets different; respond to the specific demands of each market is different; and develop the ability to penetrate new markets.

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**RELATIONSHIP BETWEEN QUALITY OF LIFE AND CONSUMER TRUST TOWARDS MARKET RELATED INSTITUTIONS IN THE BELOW AND ABOVE POVERTY LINE COMMUNITY IN INDONESIA**

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***ABSTRACT***

*This research is focused on relationships between (1) Consumer Trust in Market Related Institutions (2) Distrust For Individuals and (3) Quality of Life which are polarized between people above the poverty line and below the poverty line in Indonesia. Consumer trust in market related institutions consist of (a) trust in government regulation b) trust in consumer group (c) trust in manufacturers and businesses d) trust in news media and entertainment media. Comparisons between two models are analyzed using multisample confirmatory factor analysis.*

*Data are collected using questionnaire that was adapted from Ekici and Peterson (2009). Questionnaire was given to people in Jakarta, Bogor, Depok, Tangerang, and Bekasi region. The study found that people under the poverty line shows a low quality of life and tend to have a low level of trust towards market related institutions while people above the poverty line tend to show high level of trust towards market related institutions and tend to show a higher quality of life.*

***Keywords:*** *consumers' trust, institutional trust, quality of life, above the poverty line community, below the poverty line community*

**INTRODUCTION**

Based on report by World Bank in 2000, a reliable and transparent institutions are needed by developing countries to translate economic growth into improved quality of life of poor people (Wolfensohn, 2000). Researchers continuously observe market or physical market as a set of institutions that have an important contribution in determining the welfare of society (Mittelstaedt and Kilbourne, 2006; Wilkie and Moore, 1999). Therefore, Indonesia, as one of developing country (UN, 2014) need to pay more attention to it.

According to data reported by BPS (2015), indonesia have 28.59 million people considered poor or equal to 11.22% of the total population. This number is increased compared to 2013 and 2014 data.

**Tabel 1:** Number of Poor People in Indonesia 2010-2015

Year	Amount of Poor (in million)	Presentage
2010	31,02	13,33%
2011	29,89	12,36%
2012	28,59	11,66%
2013	28,55	11,47%
2014	27,73	10,96%
2015 (Maret)	28,59	11,22%

Source: BPS

Through a series of study, institutional researchers assume that trust is a mechanism that connects sellers and buyers in the exchange market (Fligstein and Dauter, 2007). More importants the scope of influence of trust has overstepped the boundaries of market itself. Various studies have found that the degree of trust between one people to another and to institutions in society give a positive contribution to them (Michalos, 1990). Vice Chairman of Kadin Indonesia in Banking and Finance, Rosan Perkasa Roeslani said that it is important for Indonesian government to implement policies to improve trust and confidence for the improvement of Indonesian Economic condition (Ismail, 2015). Referring to this, it is necessary to retrace the formation of beliefs to gain knowledge about how trust can differently affect

the quality of life the poor and non-poor people in developing countries especially in Indonesia.

This study try to sharpen the understanding of perception of consumer confidence towards market related institution such as (1) government or regulator (2) consumer group (3) manufacturing and business and 4) news media and entertainment media. The key dfeatures of this research design is allowing us to compare people above the poverty line (non-poor) and people below the poverty line (poor) in the context of a developing country like Indonesia. Comparison of polarized relationship between consumer trust in market related institution (CTMRI), quality of life (QOL), and distrust for individuals (DFI) between two groups separated by poverty line will help policy makers to redesign the relationships among institutions in market to improve the quality of life of people.

In preparation for directing this research, first we will measure the CTMRI and then analyze possible differences in the level of quality of life between consumer with limited financial capabilities and consumer without limited financial capabilities. Then three research questions in this study are what is consumer trust towards market related institution (CTMRI), quality of life (QOL), and distrust between individuals (DFI)? What is the interaction between CTMRI, QOL, and DFI? and What is the differences between CTMRI, QOL, and DFI viewed from the perspective of poor and non-poor people?

As performed by Ekici and Peterson (2009) this research focused on consumers' confidence towards four institutions namely (1) government or regulators (2) consumer group (3) manufacturers and bussinesses (4) news media and entertainment media. The trust is associated with the quality of life and distrust towards other individuals. Those interactions then compared between those who live below the poverty line and those who live above poverty line. The unit analysis of this study are men and women from two economics category which are below the poverty line and above poverty line. Criteria of poverty referes to the BPS definition of the poverty line and its attributes. In the geographic

coverage of this study are the area of Jakarta, Bogor, Depok, Tangerang, and Bekasi.

## **LITERATURE REVIEW**

### **Trust in Government Institution**

Trust is an important strategy to face the uncertain and uncontrolled future. This way, trust can be understood as simplification of strategies that enables people to adapt in complex and uncertain environment (Earle & Cvetcovich, 1995).

Various definition of trust have been proposed and formulated. But, the key elements of all definition is trust is become more important when people have to deal with uncertain and risky environment. The relationship between human also won't established without the presence of trust between two parties. Trust is needed to solve bounded rationality problems and incentive conflict which refers to possibility that one party will cancel contracts because of another more profitable opportunity (Gulati, Lawrence & Puranam, 2005).

Institutional trust can be defined as public trust toward specific institution where actions and interactions happens (Sztompka, 1999). The objects of trust itself are media, military, police or other governmental agents and other kinds of institution such as schools, universities, bank, worshipping or prayer place, and business entity (Rose and Mishler, 1997; World Value Survey, 2008). People's trust towards institution positively affects people's trust that derived from assumption that community cohesion and social capital are affected by perception from institution's environment and good institution performance (Sechi et al., 2012). McLaren (2012) also said that people's trust towards institution can be seen as people's readiness to take risk to let their representatives to make a decision for them.

Trust towards governmental institution as a concept is different than dyadic trust. In the concept of institutional trust, people believe that institutions will play their role. In other words, trust towards institution represent how well people perceived the work of the institution (Stokes, 1962; Miller, 1974; Hetherington, 1998).

As an example, lack of trust towards media make people rely the most on other source of information such as family and friend. Lipset and Schneider (1987) also said that trust towards media will be followed by the presence of trust towards other institutions. Trust towards institutions (such as government and bank), trust towards corporation, and trust towards other people are important things to strenghtening corporation and social capital in the community (Baron et al., 2000).

### **Relationship between Trust Towards Institution and Quality of Life**

Previous research found that there is a positive relationship between economic performance and people's trust towards public institution. Knack and Keefer 1997) said that trust towards institution associated with social capital that become the engine of economic growth and development. Social capital can be defined as social relationship that facilitate teh achievement of objective (Coleman, 1990 in Gabbay & Leenders, 1999). People's believe in higher institution tend to improve the performance of the institution where the performance of the institution is related to economic growth (Effendic et al., 2011). But most of the studies related to this topic is more focused on the public's perception of govermennt institutions (political trust) and paying less attention to other important institutions in society such as market related institution.

Trust acts like a lubricant and make group activities runs more efficiently (Fukuyama, 1995). Sociologists assume that trust is essential for the existence of social institutions (Lewis & Weigert, 1985). Researchs that study the concept of quality of life consider trust as an important requirement of quality of life, safety and market and economic based exchange (Michalos, 1990). Quality of life is defined as an individual perception towards their position in the context of culture and value system in where they lived that related to goals, expectation and their standard of life (Salehi et al., 2015)

Tokuda et al (2008) in Salehi et al (2015) said that positive psychological factor such as

sociability, trust and optimism play an important role in determining quality of life. Previous researches also found that trust have a significant contribution to happiness, quality of life, and life satisfaction. Because of that reason, Michalos (1990) suggested a positive association between trust and subjective welfare. Inglehart & Rabier (1996) using people in the community as the unit analysis in their studies and they found that there is a positive relationship between level of trust and subjective welfare of the community.

Current studies usually combine two areas which are trust towards institution and quality of life. There are several literatures discussing about trust in the context of social science. Dyadic or horizontal trust defined as trust towards other individual. This kind of trust is closely associated with social trust (Freitag, 2003), who believes that foreigners can be trusted (Uslaner, 2002). However there only a few research that discuss about holistic (Hudson, 2006), vertical (Newton, 1999) and institutional trust (Rose & Mishler, 1997)

There are a lot of research related to quality of life and consumer's perception towards business entities and marketing practices (Sirgy, 2001; Sirgy et al. 2006). But there haven't been a study that simultaneously analyze the relationship between government organization and quality of life of the Indonesian people. In the context of developing country like Indonesia, the important and relevant question is how strong is the relationship between trust toward market related institution and quality of life of people in Indonesia.

The quality of life depends on the quality of some important aspects in life such as relationship with other, health, employment, income, spirituality, and happiness (Diener & Biswas-Diener, 2008). Market that work well tend to alleviate people's psychological burden (reducing the uncertainty or fear about the economic outlook) and liberating people's capability to do something because it is reducing corruption rate reducing economic injustice. Therefore, a positive relationship between CTMRI and quality of life can be revealed. The problem that is interesting to study is how the

relationship strength can be different between people below poverty line or above poverty line.

There are two conflicting explanations regarding institutional trust (Hudson, 2006). Cultural theory identifies the institutional trust as an exogenous thing that is based on interpersonal and social trust that is learned since early (eg Inglehart, 1997). In contrast to previous theory, institutional theorists believe that institutional trust is endogenous and is affected by the performance of the institution itself (Hetherington, 198; Hudson, 2006; North, 1990). Cultural theorists said that people's assessment of institution is learned in a cultural context and passed from one generation to another without affected by the performance of the institution. In addition, trust towards institution may be considered as a function of culture in the form of culture of trust (Inglehart, 1997).

Consistent with that view, interpersonal and social trust are associated with institutional trust. Hudson (2006) also said that this two views regarding institutional trust can be considered complementary. For that reason, this study incorporates both perspectives in a model. Institutional theory view is considered in the formation of CTMRI and cultural theory view is considered in the formation of DFI.

## **HYPOTHESES AND RESEARCH MODEL**

After analyzing the results of in-depth interviews and FGDs with consumers in the Midwestern and Western in the USA, Ekici (2004) describes how consumers view the role of institution-related on the market in the food safety system. The study indicates that institutional confidence in the food safety system may be associated with CTMRI for food. However, the research will be measured CTMRI, a key measure of market functions. CTMRI likely to be measured through factor analysis approach to order-two (Bollen 1989). With this way, trust in institutions, such as business or agent of government regulators, will be combined with metaconstruction representing CTMRI. To making a way for measure CTMRI is a valuable contribution to the research on trust institutions because most of the research trust institutional

done, only focusing on the micro level that one or several elements from several institutions, for example, the Federal Trade Commission or the Federal Communications Commission (Abbott & Dalton, 1999; Lazarus, 1991; McGarity 1986; Renn and Levine, 1991). As far as researchers observation, various institutional research has not been using a macro view that comprehensively reviewed a number of institutions or aggregate functions institutions simultaneously as part of an ecosystem of markets in society such as the media, business, or government regulation (Hudson, 2006; Norris 1999; Rose and Mishler 1997).

From the perspective of institutional theory and QOL within the framework of marketing, CTMRI can be understood by assessing the level of effectiveness of public and private institutions that were involved in marketing quality of life. This can be measured by the consumer confidence that this institution will provide results such as (1) a safe product, (2) appropriate regulations, (3) news accurate and positive exposure of news, and (4) the activity of non-governmental organizations for consumers importances that are free of corruption. Consumers will trust in the public and private institutions as long as they believe that this institution will do a good job and have high integrity.

Departing from the previous explanation, cultural theorist who studied the relationship between trust with subjective quality of life in many countries stated that the formation of the trust agency focuses on interpersonal and social trust. Inglehart (1999) found that interpersonal trust associated with subjective well-being. Inglehart and Rabier (1986) reported that people are more likely to be happy if they trust each other.

Therefore, this study tries to explain the nature of CTMRI and ability to holistically represent confidence in the marketing system based on consumer confidence in the four institutions which interlinked in the market: (1) business, (2) governance, (3) the media, (4) and consumer groups. In this way, the community feedback on the performance of four institutions

can be a measuring tool of trust in the eyes of institutional theorists. While in the perspective of cultural theory, this research involves the DFI in which there is a tendency for people not to believe the opposite to each other represents the major influence of institutional trust. In the end this study sought to compare how CTMRI and DFI correlated with QOL (subjective well-being) in two groups: those who are under the poverty line and those living above the poverty line.

### **Subjectives Welfare for Consumers with Financial Limitations**

Research on the quality of life of consumers with financial limitations mainly measure certain vulnerable groups, such as recipients, people who are homeless, and poor children and their families who live in developing countries. For example, the recipients of the study suggested that the quality of life of recipients is low because they are not able to get goods and services to meet their basic needs (Hill 1998; Hill and Macon 1996; Hill and Stephens 1997). Moreover, mothers who receive welfare benefits program may request another form of donations for conditions of their lives.

Biswas-Diener (2008) and Easterlin (2001) describes the relationship between income and quality of life (eg, happiness) is complex. Material well-being appears to be important to subjective well-being of people living in conditions of uncertainty (although a strong desire for the welfare may reduce the subjective well-being that although the rich because of excessive materialism). At the national level (aggregate), Diener and Colleagues (1999) found a strong positive relationship between the welfare state and the average subjective quality of life of people in the country. Because the rich countries tend to be more democratic and egalitarian than poor countries, welfare effects in this study found that there are some indirect impact on other benefits than welfare itself.

Various studies on consumer behavior with financial limitations (consumers who are below the poverty line) suggests that income (revenue) are positively related to subjective of the quality of life. About 30 years ago, studies in various

countries that focus on poverty (Gallup 1977) found that poverty limited people surveyed claimed not pleased with their lives. In line with these findings, the theory of Maslow's needs explain the relationship between income and quality of life. Based on Maslow's theory, the need for a higher satisfaction level resulting from a higher quality of life. As Sirgy (2001) explain that people who live with a higher income will have a higher basic needs, and produce a high quality of life for subjective. Conversely, people who have low incomes will be difficult to meet their basic needs and will ultimately result in a lower quality of subjective life.

#### **Differences in the Relationship Trust and Quality of Life among Community Being under and above the Poverty Line**

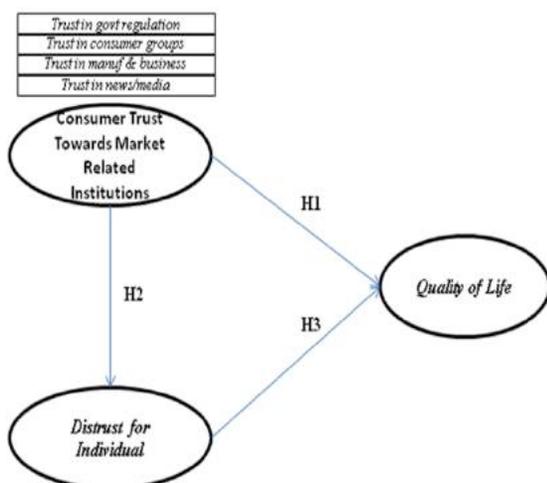
Several previous studies that found the relationship between trust and the quality of life too much in assessing the role of socioeconomic background (high and low earnings ratio) in understanding this relationship. The views of institutional trust theory suggest that trust in the performance of certain institutions affect people vote against the institution. In other words direct and indirect experiences with institutions affect the quality perception of the people towards the institution. This perception then contributes to the levels of trust (or distrust) of a person in an institution (Ekici, 2004; Hudson 2006). Direct experience with institutions showed differences among people with different socioeconomic backgrounds. Low-income consumers may buy low-quality products and may perform different interactions with the retailer when compared to high-income people. Of course, the definition of institutions geographically, such as the development of a number of local retailers, by itself may be different in poor areas to rich areas in terms of customer service, store cleanliness, treatment of consumers, product variation, and design shops. In addition, people from different income groups may have the news and entertainment media outlets are different and therefore may have a different opinion because it could influence whether or not the news and entertainment media can be trusted.

Previous studies did not provide a clear picture of whether the poor (or rich people) have little (or a lot) of confidence in the relevant institutions. Researchers are linking education and income with social trust, argued that education and income make people become more open (Freitag 2003). As deduced Hudson (2006) that the more educated and prosperous, one should show a high degree of institutional trust. Access to more social capital allows one to interact more in associations and groups, and this makes them have a level of trust among one another. Then this trust has a relationship with the reduced transaction costs, improve the quality of public institutions, and ultimately contribute to economic performance (Mota and Pereira, 2008). This argument is consistent with the observation Putnam (2000) which states that in all societies the poor tend not to believe more than the rich because the poor feel they are treated unfairly.

However, trust of the poor people for relevant institutions and to each other is not a simplistic phenomenon. Because of their refusal, many poor people have to deal with the dire situation on the material and psychological pressure that lasted for years and does not accept the exclusion of the public (Hill and Stephens 1997). Therefore, Many of them often feel sorry for each other in addition to material deprivation they experience. Briefly, to measure people's trust in the institutions and one another in developing countries is vital work of this study. Therefore, measures the relationship clearly the relationship CTMRI, QOL, and DFI will provide a better understanding of how consumers in developing countries simultaneously thinking about them, other people, and community institutions. As a result, the main formal research question in this study is how similar the pattern of relationship between CTMRI, QOL, and DFI for people living below the poverty line compared with those living above the poverty line.

#### **Research Model**

Based on the literature review above, the research model can be described as follows:



Source: Adapted from Ekici and Peterson (2009)

**Figure 1.** Research Model

Therefore the hypotheses are following:

- H1: Customers' Trust in Market-Related Institutions has positive effect on Quality of Life
- H2: Customers' Trust in Market-Related Institutions has positive effect on Distrust in Individuals
- H3: Distrust in Individuals has negative effect on Quality of Life

**METHODOLOGY**

In general, the main question in this research is about how could the interaction between CTMRI, DFI, and QOL became subjectively different for people who live below poverty line and for people who live above poverty line. In that matter, the research design must specifically chosen so we could compare the interaction network between CTMRI, DFI, QOL factor in people who are lack of financial capabilities and people who are not. This is a conclusive and descriptive analytical research . Conclusive research design has a purpose to test the hypothesis to explain relationship between variable specifically (Malhotra, 2010). Meanwhile descriptive research is a conclusive research which explain a phenomenon that occurs

in society by analyzing the relationship and/or influences that occur between variables (Malhotra, 2010).

This research aims to analyze relationship CTMRI, DFI, and QOL factors in society within a specific period. Therefore, this research included in cross-sectional research which the data collection was conducted once in a certain period of time (Malhotra, 2010).

**Population and Sample**

This research use respondent samples who live in Jakarta as metropolitan city, and Depok, Bekasi and Tangerang as buffer area. Based on social-economic condition, research respondent was divided into two, people below poverty line and above poverty line. This sampling from two different group has purpose to find out the difference CTMRI, DFI, and QOL interaction factor from people below poverty line and people above poverty line point of view.

To obtain the right respondent with social-economic condition, there's a few stage. First, identified demographic data in Jakarta and Jakarta greater area as reference to choose a survei point. Second, categorize the head of family information which include in people below poverty line or people above poverty line. Based on this data, social-economic condition in a certain area can be categorized so the respondent is precisely intended target. Third, decide sample from the selected population.

This research use self-administered questionnaire as a tool to collect data. the questionnaire made based on Ekici and Patterson journal (2009), then distributed to respondents from two social-economic group, poor people and non-poor people. In poor people group questionnaire is distributed directly, while in non-people group the questionnaire is distributed using Google Spreadsheet as online media.

**RESULTS**

**Validity and Reliability**

Pretest conducted to 33 respondents. Pretest was held to verify each indicator in question, whether the indicator was properly represent the variable of the research so that error can be

minimized previously. Reliability analysis is based on the parameter in Cronbach's Alpha measurement, the variable can be considered as reliable if the value of Cronbach's Alpha  $\geq 0,6$ . For validity analysis, the parameters consist of the value of Kaiser-Mayer-Olkin (KMO), Bartlett Test of Sphericity, and Component Matrix. The variable can be considered as valid if the value of KMO greater than 0.5 and the value of Bartlett's Test of Sphericity below 0.05, and the value of component matrix above 0.5 respectively for each indicator.

Here is the pretest result for respondents living above and below the poverty line, each explained in Table 2 below:

From the results obtained for group of respondents living above the poverty line, it is known that all of the variables, which consist of quality of life, trust in manufactures and business, trust in government regulation, trust in consumer groups, and trust in news/entertainment media have values of Cronbach's Alpha greater than 0,6. Those show that each question on the research variables has a good level of reliability and can be used in this study. Only distrust in individuals variable has values below 0,6, specifically is 0,59.

It is also shown in the table that variables of quality of life, trust in manufactures and business, trust in government regulation, trust in consumer groups and trust in news/entertainment media are meet the minimum requirements of validity, their KMO value is above 0,5. In addition, the value of factor loading in each variable is above 0,5 and has a value of Bartlett's test below 0.05. Those show that each question in the questionnaire has good validity and appropriate to be proceeded in the next stage. Only distrust in individuals variable has KMO value below 0,50, which specifically is 0,48 with DFI3 item has loading factor value below 0,50, specifically is 0,47. But researchers assume that the invalid and not reliable variable is caused by the few numbers of respondents involved in the pretest, which are only thirty three persons. The result still can be different if the numbers of respondents are increased. Therefore, researchers don't decide to remove this variable in the main test.

A 160 respondent was collected in this study consists of 92 for non poor and 68 for poor households. For non-poor, a 88 respondents are classified as 21-30 years old category (95,7%), while 1,1% respondents are classified as 51-64 years old category. At the same time, the majority of poor respondents are classified as 51 -64 years old category (31%).

**Table 2:** The Results of Reliability and Validity Check in Pretest

Latent Variable	Indicator	Cronbach's Alpha	Conclusion	KMO	Bartlett's Test	Factor Loading	Conclusion
Quality of Life	QOL1	0,82	Reliable	0,73	0,00	0,87	Valid
	QOL2					0,93	Valid
	QOL3					0,76	Valid
	QOL4					0,83	Valid
	QOL5					0,55	Valid
Trust in Manufacturers and Business	TIB1	0,74	Reliable	0,60	0,00	0,80	Valid
	TIB2					0,86	Valid
	TIB3					0,74	Valid
	TIB4					0,57	Valid
Trust in Government Regulation	TIG1	0,93	Reliable	0,80	0,00	0,82	Valid
	TIG2					0,94	Valid
	TIG3					0,95	Valid
	TIG4					0,93	Valid
Trust in Consumer Groups	TIC1	0,80	Reliable	0,68	0,00	0,90	Valid
	TIC2					0,90	Valid
	TIC3					0,78	Valid
Trust in News/Entertainment Media	TIM1	0,77	Reliable	0,50	0,00	0,90	Valid
	TIM2					0,90	Valid
Distrust for Individuals	DFI1	0,59	Not Reliable	0,48	0,00	0,80	Valid
	DFI2					0,89	Valid
	DFI3					0,47	Invalid

Source: Processed by Researchers

**Measurement of Reflective Model**

Measurement of Reflective model emphasizes the measurement between the indicators and variables (latent variable). In this measurement, there are three kinds of measurements which consist of Internal

Consistency, Convergent Validity, dan Discriminant Validity. Internal Consistency is measured by Cronbach’s Alpha and Composite Reliability.

**Table 3:** Internal Consistency

Variable	Cronbach's Alpha		Composite Reliability	
	Non Poor	Poor	Non Poor	Poor
Consumers' Perception of Trust in Market-Related Institutions	0,934	0,746	0,943	0,676
Quality of Life	0,910	0,885	0,933	0,916
Trust in Manufacturer and Business	0,939	0,784	0,956	0,864
Trust in Government Regulation	0,926	0,897	0,948	0,928
Trust in Consumer Groups	0,904	0,756	0,940	0,86
Trust in News Media & Entertainment Media	0,832	0,797	0,922	0,908
Distrust in Individuals	0,798	0,266	0,879	0,607

Source: Processed by researchers using SmartPLS3

From the table 3 above, it is shown that both of variables for non poor respondents and for poor respondents have cronbach’s alpha value and composite reliability more than 0,6. Only distrust in individual variable for poor respondents which has Cronbach’s Alpha value equal to 0,266.

Convergent validity is measured by using outer loading and average variance extracted (AVE) for each variable. Indicator can be identified as valid if it has outer loading value more than 0.7. All variable can be identified as valid when having AVE value more than 0.5.

**Table 4:** Convergent Validity

Variable	Indicator	Outer Loading		AVE	
		Non Poor	Poor	Non Poor	Poor
Quality of Life	QOL1	0,910	0,867	0,738	0,688
	QOL2	0,908	0,906		
	QOL3	0,883	0,827		
	QOL4	0,843	0,832		
	QOL5	0,740	0,701		
Trust in Manufacturer and Business	TIB1	0,931	0,583	0,845	0,619
	TIB2	0,912	0,818		
	TIB3	0,940	0,873		
	TIB4	0,894	0,838		
Trust in Government Regulation	TIG1	0,799	0,838	0,821	0,764
	TIG2	0,947	0,880		
	TIG3	0,937	0,915		
	TIG4	0,933	0,861		
Trust in Consumer Groups	TIC1	0,932	0,802	0,840	0,672
	TIC2	0,956	0,814		
	TIC3	0,859	0,843		
Trust in News Media & Entertainment Media	TIM1	0,926	0,916	0,856	0,831
	TIM2	0,925	0,908		
Distrust in Individuals	DFI1	0,843	0,629	0,707	0,357
	DFI2	0,838	0,355		
	DFI3	0,842	0,741		
Consumers' Perception of Trust in Market-Related Institutions	TIB1	0,786	0,600	0,563	0,394
	TIB2	0,779	0,735		
	TIB3	0,849	0,674		
	TIB4	0,832	0,673		
	TIG1	0,627	0,513		
	TIG2	0,835	0,439		
	TIG3	0,783	0,602		
	TIG4	0,827	0,447		
	TIC1	0,716	0,618		
	TIC2	0,738	0,665		
	TIC3	0,724	0,607		
	TIM1	0,602	0,757		
	TIM2	0,598	0,725		

Source: Processed by researchers using SmartPLS 3

From the table above, we can see that all of indicators and variables for non poor respondents have outer loading value more than 0,7, so that all the indicators can be identified as valid, excepting for three variables which are the indicators of Consumers' Perception of Trust in Market-Related Institutions. They consist of TIG1, TIM1, and TIM2. The AVE score for all variables for non poor respondents are also more than 0,5, so that all the variables for non-poor respondents can be identified as valid.

For poor respondents, there are some indicators that don't qualify for outer loading value more than 0,7, those indicators consist of TIB1, DFI1, DFI2 and indicators which are the element of Consumers' Perception of Trust in Market-Related Institutions variable, specifically TIB1, TIB3, TIB4, TIG1, TIG2, TIG3, TIG4, TIC1, TIC2, and TIC3. AVE value for poor respondents variable are overall qualify the minimum standard of AVE (>0,5), excepting for Distrust in Individuals and Consumers'

Perception of Trust in Market-Related Institutions variable with AVE value respectively is 0,357 and 0,394.

Discriminant validity is measured by using cross loading, which compares loading of an indicator in one variable, where the value of loading indicator is existed in another variable.

**Table 5:** Cross Loading for Non Poor Respondents

Variable	Indicator	QOL	TIB	TIG	TIC	TIM	DFI	CTMRI
Quality of Life	QOL1	0,910	0,504	0,324	0,479	0,202	0,332	0,491
	QOL2	0,908	0,572	0,412	0,521	0,335	0,338	0,584
	QOL3	0,883	0,479	0,397	0,366	0,276	0,238	0,488
	QOL4	0,843	0,411	0,296	0,390	0,214	0,259	0,420
	QOL5	0,740	0,412	0,352	0,261	0,304	0,206	0,419
Trust in Manufacturer and Business	TIB1	0,469	0,931	0,525	0,546	0,388	0,247	0,786
	TIB2	0,575	0,912	0,496	0,578	0,399	0,276	0,779
	TIB3	0,493	0,940	0,631	0,543	0,512	0,270	0,849
	TIB4	0,522	0,894	0,606	0,606	0,471	0,361	0,832
Trust in Government Regulation	TIG1	0,380	0,425	0,799	0,334	0,405	0,170	0,627
	TIG2	0,365	0,609	0,947	0,551	0,519	0,260	0,835
	TIG3	0,379	0,546	0,937	0,502	0,464	0,186	0,783
	TIG4	0,395	0,632	0,933	0,560	0,428	0,251	0,827
Trust in Consumer Groups	TIC1	0,443	0,576	0,475	0,932	0,285	0,337	0,716
	TIC2	0,440	0,582	0,484	0,956	0,344	0,335	0,738
	TIC3	0,433	0,540	0,540	0,859	0,406	0,294	0,724
Trust in News Media & Entertainment Media	TIM1	0,303	0,475	0,429	0,363	0,926	0,168	0,602
	TIM2	0,273	0,419	0,501	0,335	0,925	0,310	0,598
Distrust in Individuals	DFI1	0,366	0,261	0,074	0,233	0,190	0,843	0,230
	DFI2	0,211	0,150	0,116	0,222	0,208	0,838	0,199
	DFI3	0,229	0,338	0,372	0,396	0,247	0,842	0,426

Source: Processed by researchers using SmartPLS 3

From the cross loading table of non poor respondents above, it is shown that each indicator in each variable has qualified the discriminant validity, because the overall outer loading in each indicator has exceeded 0.7 the loading value of the indicator in the other variables.

**Table 6:** Cross Loading for Poor Respondents

Variable	Indicator	QOL	TIB	TIG	TIC	TIM	DFI	CTMRI
Quality of Life	QOL1	0,867	0,278	-0,329	0,297	0,021	0,313	0,326
	QOL2	0,906	0,265	-0,285	0,264	0,162	0,280	0,332
	QOL3	0,827	0,253	-0,321	0,151	0,118	0,262	0,293
	QOL4	0,832	0,330	-0,319	0,259	0,145	0,351	0,365
	QOL5	0,701	0,316	-0,266	0,308	0,353	0,042	0,409
Trust in Manufacturer and Business	TIB1	0,336	0,583	-0,258	0,560	0,373	0,330	0,600
	TIB2	0,290	0,818	-0,371	0,364	0,625	0,328	0,735
	TIB3	0,321	0,873	-0,140	0,391	0,590	0,156	0,674
	TIB4	0,157	0,838	-0,082	0,473	0,623	0,106	0,673
Trust in Government Regulation	TIG1	-0,232	-0,265	0,838	-0,149	-0,256	-0,599	-0,513
	TIG2	-0,381	-0,121	0,880	-0,174	-0,097	-0,652	-0,439
	TIG3	-0,373	-0,327	0,915	-0,287	-0,232	-0,586	-0,602
	TIG4	-0,300	-0,211	0,861	-0,072	-0,146	-0,460	-0,447
Trust in Consumer Groups	TIC1	0,261	0,468	-0,188	0,802	0,435	0,301	0,618
	TIC2	0,207	0,562	-0,115	0,814	0,569	0,152	0,665
	TIC3	0,302	0,347	-0,203	0,843	0,509	0,227	0,607
Trust in News Media & Entertainment Media	TIM1	0,127	0,621	-0,168	0,678	0,916	0,206	0,757
	TIM2	0,224	0,680	-0,228	0,442	0,908	0,057	0,725
Distrust in Individuals	DFI1	0,153	0,140	-0,533	0,117	0,132	0,629	0,316
	DFI2	0,012	-0,012	-0,246	-0,027	0,060	0,355	0,090
	DFI3	0,277	0,273	-0,391	0,270	0,075	0,741	0,351

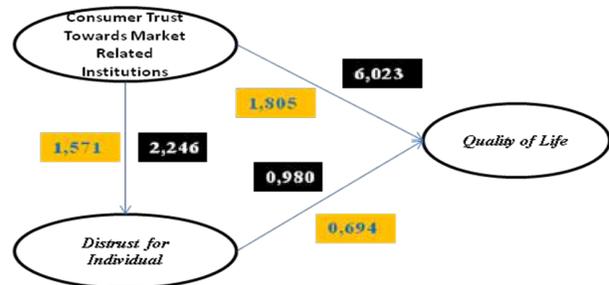
Source: Processed by researchers using SmartPLS 3

From cross loading table for poor respondents above, it is shown that each indicator in each variable has qualified discriminant validity because the overall outer loading in each indicator has exceeded the loading value of the indicator in the other variables. There is only 1 variable which doesn't qualify discriminant validity, specifically Trust in Government Regulation variable (TIG1, TIG2, TIG3, dan TIG4).

**Measurement of Structural Model**

Measurement of Structural Model examines capability of the model and the relationship among variables. Measurement of structural model consists of collinearity measurement, significance test and relevancy test of structural model relationship, R2 level measurement, f2 calculation, and Q2 magnitude prediction.

Here is the path diagram model as the result of this research:



Annotation:

- Non Poor Respondents
- Poor Respondents

Source: Processed by researchers using SmartPLS 3

**Figure 2:** The Path Diagram

Here is the t-value table from the result of this research

**Table 7:** The t-value and Conclusions

Hypotheses	T Value		Conclusion	
	Non Poor	Poor	Non Poor	Poor
H1: Customers' Trust in Market-Related Institutions → Quality of Life	6,023	1,805	Significant	Significant
H2: Customers' Trust in Market-Related Institutions → Distrust in Individuals	2,246	1,571	Significant	Insignificant
H3: Distrust in Individuals → Quality of Life	0,980	0,694	Insignificant	Insignificant

Source: Processed by researchers using SmartPLS 3

**CONCLUSIONS**

**AND**

**RECOMMENDATION**

For respondents above poverty line; the higher consumer trust towards market related institutions the higher quality of life; the higher consumer trust towards market related institutions the lower distrust for individual; on the other hand distrust for individual doesn't affect quality of life. Meanwhile the respondents below poverty line; the higher consumer trust towards market related institutions the higher quality of life; consumer trust towards market related institutions doesn't affect on distrust for individual; and distrust for individual doesn't affect quality of life.

**Recommendations**

To improve the quality of life of consumers both living above or below the poverty line, policy makers should create public policy that improve consumer confidence towards government policies, consumer groups, business community and media by maintaining and increasing their credibility.

To increase public trust towards public policy, the government should make public policies that pro poor, protect the consumer rights, make regulations appropriate for the companies so not detrimental to consumer, ensure public safety related products and services by doing proper research. To increase public trust towards business, the government should urge the business to provide product safety, good product packaging, obey the rule of consumers protect, and provide efficient service. To increase consumers' s trust towards consumer groups, the government should ask the consumer groups to

give believable information and educate consumers about their rights and obligation

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# THE EFFECTS OF INFORMATION PROCESSING CONFIDENCE AND CONSUMER SUSCEPTIBILITY TO PEER INFLUENCE OF ONLINE REVIEW TOWARD CONSUMER PERCEPTION AND ITS IMPLICATION TO USAGE BEHAVIOR; A STUDY OF INDONESIAN DIGITAL NATIVE

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## **ABSTRACT**

*People have a tendency to be influenced by others' opinions in their decision making. Online consumer reviews play an important role in influencing consumers' purchasing decisions by providing potential consumers about products and services. Opinions posted by peers have been recognized as more trustworthy than company-sponsored advertising, they are also considered a more valuable and sought-after source of information. Online reviews can benefit both the consumers and the companies that choose to use them. Uncertainty Reduction Theory was employed as the conceptual framework to reexamine consumers' use of online reviews. The purpose of this paper is to examine consumer perceptions of online consumer reviews and effects on consumer attitudes and usage behaviors in relation to individual characteristics particularly among the digital native. This research uses descriptive research design, which use purposive sampling techniques. Data were collected by spreading the questionnaire with total samples of 155 respondents who are members of Zomato (popular online application which provide food and beverage online reviews) which also digital natives. Structural Equation Modelling (SEM) were conducted to analyze the data using AMOS software. Researchers found that consumers perceived both benefits and costs from online consumer reviews and that both benefits and costs influenced consumer attitudes toward, and usage behaviors of, online consumer reviews. Individual characteristics – confidence in the information process and consumer susceptibility to interpersonal influence – were shown to determine how online consumer reviews were perceived, specifically the perceived benefit. The results provide insight to retailers and marketers as to how they can use consumer reviews for their products or services to improve business performance.*

**Keywords:** *online consumer review, usage behavior, information processing confidence, consumer susceptibility to peer influence, uncertainty reduction theory.*

## **INTRODUCTION**

The existence of internet-based communication technology has changed the way consumers gather information, interact and go for shopping, in this case is online shopping (King et al. 2014). One of the problems with

online transactions is the degree of uncertainty and risk that is higher than offline transactions on the shop brick-and-mortar (Dellarocas, 2003). One of the mitigation taken by the consumer is trying to dig deeper information related to products, services or retailer through an online consumer reviews. Online consumer reviews are

the opinions of people who have bought the products and services which are then posted on a website (online) or any other digital platform. Online consumer review platforms typically include features "comment" even equipped with a rating of a product and services (Hennig-Thurau and Walsh, 2003).

Opinions or reviews posted by fellow consumers are believed to be more reliable than advertising (Dellarocas, 2003; Sher and Lee, 2009); considered even more valuable and also is information that is much sought after by others (Goldsmith and Horowitz, 2006). Consumer online reviews are not only beneficial for our fellow consumers but also for the company. The results of the online reviews that are positive can improve consumer intention to buy a product (Yao et al., 2009). Although definite effect of a review of the purchasing behavior has not been explained with certainty, but the research shows that the products have been reviewed sold better than products that do not obtain sufficient review (Creamer, 2007). However, online consumer reviews also potentially have a negative impact on consumer decision if the information displayed instead be negative and inconsistent (Park and Lee, 2008; Yao et al., 2009).

The high demand and consumer interest in creating or reading online reviews make increasingly marketers need to understand how consumers perceive the benefits and cost of an online review and how it affects to usage behavior. Meanwhile, in terms of managing online consumer review platforms, either as a brand holder of products or services, or third party service providers as a platform review, of course, such conditions can be viewed as a business opportunity and marketing potential. Seeing these conditions, a deeper understanding of antecedents of attitudes and usage behavior of online consumer review platforms becomes important.

Until now, lack of empirical research that directly examines the benefits and costs of the consumers on the use of online consumer reviews and its antecedents and implications for marketers. One previous study, in the middle is still little research on online consumer review, has shown that the perceived benefits and perceived costs driven by information process confidence and consumer susceptibility to

interpersonal influence that shapes attitudes and usage behavior of online consumer review (Lee & Ma 2012). Even the important contribution to the body of knowledge of online consumer reviews, these research still have some limitations, one of them is this research not yet accommodate the different aspects of demographic sample. Digs deeper relevant response patterns and the use of the online platform of consumer reviews on specific demographic groups, such as digital native (Prensky 2001) were very concerned about online review as one mode of search information, it will provide additional contributions in order to understand better about patterns of consumer attitudes and behavior related online consumer reviews.

According to data from Internet World Stats, in 2015 the world's Internet users are 3,366,261,156 users that were dominated by Asia by 48.2%, equivalent to 1,622,084,293 users. One of the countries in Asia, Indonesia, is in the 4th position as the country with the most Internet users after China, India, and Japan, as 78 million users (Internet World Stats, 2015). Recent data indicate that numbers then increased substantially into 88.1 million users in January 2016 (We are social, 2016). Indonesia with a population of more than 255 billion people, approximately 60% of which are digital native (APJII, 2012). Digital native is the younger generation who are born and live in the internet age, aged 15-37 years. They tend range to be trend leaders. Meanwhile almost 40% more digital immigrant is the older generation (aged 38-68 years) who know the internet when she was an adult, they often feel the need to always learn to adapt with the new technologies (APJII, 2012).

Nielsen Global Trust in Advertising Report states that 89% of Indonesian people believe Word-Of-Mouth or often abbreviated as WOM, broader terminology that includes online customer review (Marketing, 2015). Nowadays, more and more consumers who depend on WOM to evaluate the product, in other words WOM has a persuasive role to influence consumer purchase decisions (Lin and Lu, 2010). Poleretsky (1999) says that consumers are not happy about the negative experience will tell five friends, whereas the presence of the Internet led to this figure doubled to 5,000. The fact that

Indonesia is one country with the highest number of Internet users in Asia with more than 50% of its demographic structure consists of a digital native is certainly an interesting alternative context to be reviewed in order to further research related to online consumer reviews.

This study is testing the model on previous research on online consumer review (Lee & Ma 2012) in a different context, in this case the digital native in Indonesia with a slight simplification of the measurement instrument. This research is expected to provide two contributions to the body of knowledge of online consumer reviews. First, the research is expected to provide additional empirical evidence in a different context from its original research as contributing to the generalization model of antecedents and implications of perceived benefits and perceived costs of online consumer reviews. Previous research models offer the idea that consumers do not just feel the positive impact (perceived benefits) but also negative effects (perceived cost) of reading online reviews, and this experience influence the behavior of their use of online review (Lee & Ma 2012). Most studies on online consumer reviews that others just focus on the positive aspects perceive any benefit (Park et al, 2006; Park and Lee, 2008; Yao et al., 2009).

Second, this research attempts to answer the limitations of previous studies (Lee & Ma, 2012), which does not yet accommodate the demographic differences in testing the model in particular by providing empirical evidence of a specific age interval that the current state belong to a group of digital natives. The reason is that individuals have different abilities to absorb and process information (Alba and Hutchinson, 1987). It certainly has the potential to show patterns of response, attitudes and different online consumer's behavior review compared with the group of users on another generation. Furthermore, digital native born and raised in the digital age so it is more familiar and capable of managing digital information than the previous generation (Prensky 2001).

## **THEORETICAL FRAMEWORK AND HYPOTHESES**

### ***Uncertainty Reduction Theory***

Uncertainty Reduction Theory (Berger and Calabrese, 1975) was employed as a conceptual framework to test the use of online consumer reviews. Uncertainty Reduction Theory in principle is about interpersonal communication, stating that the uncertainty can naturally occur when two people first meet. Uncertainty is common in everyday life (Hogg, 2007), usually comes from someone's inability to predict other's behavior and potential responses to the interactions (Berger and Calabrese, 1975).

In the context of online shopping, the uncertainty can be happen related to products, processes, and emotional aspects experienced by consumers (Hu et al., 2008). For example, the level of uncertainty increases when there is a difference between the real product with a product that is expected or imagined by consumers. Uncertainty can also increase when someone shop for products from the seller which previously he or she had no experience of shopping with or even no knowledge at all about the seller.

To assist consumers in obtaining information online, consumer reviews can be used in order to reduce uncertainty by confirming their purchasing decisions by reading comments from other consumers about the information of a product (Brumfield, 2008; Hu et al., 2008; Rameriz et al., 2002). Hu et al. (2008) revealed that the information about the product quality, the security and safety of shopping on the specific online retailers can easily be obtained from the website. When consumers feel the need for more information, online reviews can be used to reduce the uncertainty associated with the products, new processes (such as a purchase online or from a website that is unknown), or the company. However, at the same time consumer reviews also can increase uncertainty if consumers experiencing cognitive incongruence because of conflicting information in other consumers' opinions (Yao et al., 2009). Similarly, the surplus of information presented in the consumer reviews may lead to information overload (Park and Lee, 2008). This often happens when consumers are not confident about their purchase decisions and are in ambiguous

situations (Schneider, 1987). Therefore, the perception of online consumer reviews can vary by situation or individuals; previous research of such is discussed in the following section.

***The effects of information processing confidence on perception of online consumer reviews***

Research that was conducted by Park et al. (2006) and Park and Lee (2008) has identified concern about amount of information or content presented by consumer reviewers (Yao et al., 2009). When faced with heavy information and large number of reviews, some consumers will be overwhelmed, and may not be able to process the information and feel less confident in their decisions (Parks et al., 2006; Park and Lee, 2008). In addition, conflicting opinions make consumers difficult to determine which product information that is accurate (Yao et al., 2009). In this context, information processing confidence is an appropriate measure because it illustrates how confident someone to process the information posted on the virtual platform (Chatterjee, 2010; Dellarocas 2003; Bolton et al, 2004; Weinberg and Davis, 2005). Consumers

***The effects of consumer susceptibility to interpersonal influence on perceptions of consumer reviews***

Some research state that people have a tendency to be influenced by the opinions of others in their decisions making (Mourali et al., 2005). Bearden et al. (1989) defined the concept of consumer susceptibility to interpersonal influence, referring to an individual's tendency to seek information from others to learn about products, brands, and services. Consumers who are highly likely to be influenced by others will be more subject to others' opinions. Research has shown that individuals commonly seek out information from others who are significant to them when making purchasing decisions (Mourali et al., 2005).

Consumer susceptibility to interpersonal influence has been successfully applied in the context of online shopping, especially in evaluating word-of-mouth such as recommendations and suggestions about the product through online communication (Park and Lee, 2009). Considering the information presented in the online consumer reviews are

with high confidence are less likely to be hesitant with processing information and will be more confident in processing the information from online consumer reviews, in that they may be Able to maximize benefits while spending less time and effort than individuals with low confidence. Furthermore, the effect of information processing confidence may be more salient in a situation of overloading as well as conflicting information presented by virtual portals review.

In summary, users with high information processing confidence may be able to perceive more benefits and less costs associated with using online consumer reviews than those with low information processing confidence. Therefore, the following hypotheses were proposed:

- H1: Information processing confidence will positively affect perceived benefits of online consumer reviews.
- H2: Information processing confidence will negatively affect perceived costs of online consumer reviews

perceived as being more valuable (Goldsmith and Horowitz, 2006), and more trustworthy (Dellarocas, 2003; Sher and Lee, 2009) than information given by companies, individuals with high consumer susceptibility to interpersonal influence would Likely have a greater tendency to be influenced by the information presented in the online consumer reviews, both positive and negative, Compared to the consumers with low consumer susceptibility to interpersonal influence.

Park and Lee (2009) found a significant positive effect on perceived usefulness in that consumers with a greater consumer susceptibility to interpersonal influence perceived online reviews as being more useful than the consumers with less consumer susceptibility to interpersonal influence. Thus, this research investigating consumer susceptibility to interpersonal influence and its effect on benefits and costs of online consumer reviews. Therefore, the following hypotheses are proposed:

- H3: Consumer susceptibility to interpersonal influence will positively affect perceived benefits of online consumer reviews.

H4: Consumer susceptibility to interpersonal influence will positively affect perceived costs of online consumer reviews.

#### ***Consumer perception of online consumer reviews***

Consumer review offers a lot of information about products or services that can be used for the purchase decision (Clemons et al., 2006). In previous research, consumers feel that it is helpful reading online consumer reviews because it can reduce information search time (Hennig-Thurau and Walsh, 2003; Goldsmith and Horowitz, 2006). The existence of the reviews can make consumers feel comfortable in choosing unfamiliar retailer that offers other benefits, such as lower price (Chatterjee, 2010). Read what other users have posted can also make consumers aware of the popular products by other consumers (Hennig-Thurau and Walsh, 2003; Goldsmith and Horowitz, 2006; Park and Lee, 2008; Sher and Lee, 2009). A great number of positive reviews will encourage the purchases (Park and Lee, 2008). Readers can also rely on consumer reviews to ensure their purchase by confirming that their peers also have a similar opinion about the product (Hennig-Thurau and Walsh, 2003; Creamer, 2007).

Most previous studies indicate positive values of online consumer review, while several other studies showed negative aspects (Parks et al., 2006; Park and Lee, 2008; Yao et al., 2009). Park and Lee (2008) states that the more reviews indicate the popularity of the product, but least review will were translated by consumers as an indication of that the product is not good. A large number of reviews can lead to information overload, it would hindering decision-making. Inability to process large amounts of information that is presented through the review may lead individuals especially those who have great difficulty in searching for information, to get discouraged and feel less confident in their decisions (Park et al., 2006).

Other studies have shown that sometimes consumers are skeptical of the validity of online consumer review because lack of trust towards reviewer (Sher and Lee, 2009). In addition, when a website only gives a positive review, users may doubt the authenticity and credibility (Doh and Hwang, 2009). Conflicting reviews about

products, services, or companies can also inhibit the consumer role in processing information and making it difficult to determine the quality of consumer information. This situation can cause readers to become confused by offering an inconclusive depiction of the product's quality, and, therefore, decrease the usefulness of the review itself (Ghose and Ipeirotis, 2007; Yao et al., 2009). Based on the literature and previous research, we propose that consumers see the positive and negative aspects (i.e. benefits and costs, respectively) from online consumer reviews. The online consumer review as an important channel to obtain a product and service related information (Bounie et al., 2005).

In a similar manner, the present study developed the following hypotheses:

H5: Perceived benefits of online consumer review will positively affect attitudes toward online consumer reviews.

H6: Perceived costs of online consumer review will negatively affect attitudes toward online consumer reviews.

#### ***The effect of attitudes toward online consumer reviews on frequent usage behavior***

Attitude refers to the orientation of a person's cognitive and affective against some stimulus object or behavior (Fishbein and Ajzen, 1975). According to The Theory of Reasoned Action (Fishbein and Ajzen, 1975), intentions capture the motivational factors affecting a behavior, positing that as an individual's intentions associated with a behavior become stronger, the individual should be more likely to perform the behavior.

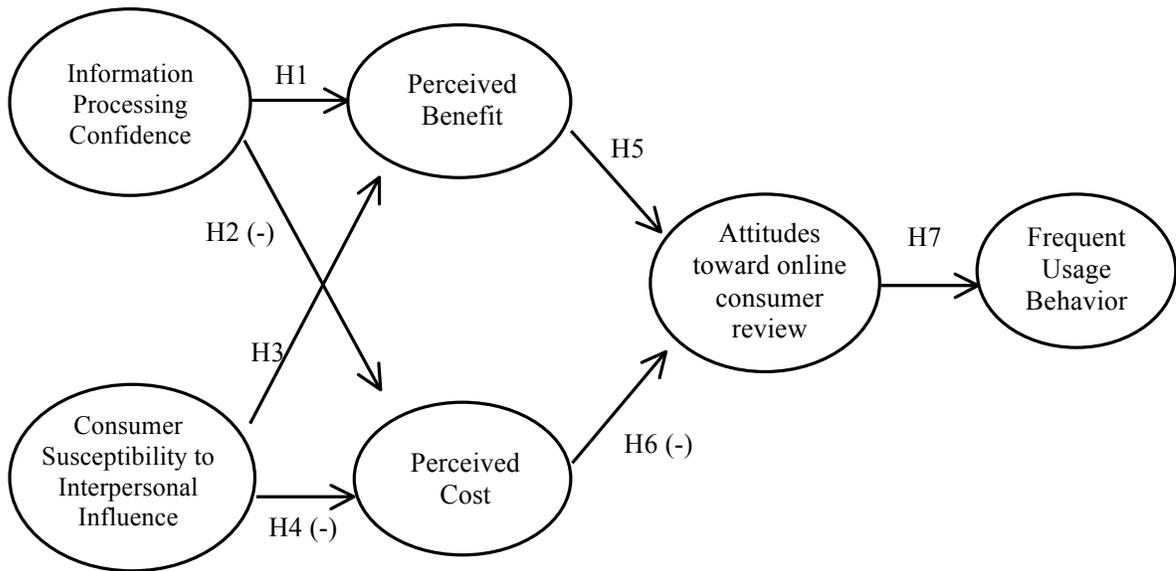
Previous research has examined the relationship between attitudes and behavioral intention in the context of online shopping (Chen and Tan, 2004; Heijden and Verhagen, 2004). Particularly with regard to obtaining online information, some researchs examining the relationship between attitudes and behaviors (Korgaonkar and Wolin, 2002; Wolin et al., 2002). Amblee and Bui (2007) serta Park and Lee (2008) have tested this relationship regarding online consumer reviews by showing the influence of reviews on product purchase intentions, but have rarely looked into the effects of consumers' attitudes on behavioral

intention or usage behavior with regards to the online consumer reviews. Therefore, based on the literature discussed above, it is presumable that favorable attitudes toward online consumer reviews will yield more frequent use of online consumer reviews, generating the following research hypothesis:

H7: Attitudes toward online consumer reviews will positively affect frequent usage behavior.

Based on the proposed hypotheses, the current study developed the research model shown in Figure 1.

Figure 1. Research Model



Source: Lee & Ma, 2012

The model posits the relationships among information processing confidence, consumer susceptibility to interpersonal influence, consumer perception of online consumer reviews (i.e. perceived benefit, perceived cost), attitudes toward online consumer review, and frequent usage behavior related to Zomato mobile application.

**METHODOLOGY**

**Sample and Data Collection**

This research uses descriptive research design, which use purposive sampling techniques. Data were collected by spreading paper-based survey with total samples of 155 respondents who are members of Zomato (popular online application

which provide food and beverage online reviews) which also digital natives who lives in area of Jakarta, Bogor, Depok, Tangerang and Bekasi (Jabodetabek) - Indonesia. Target population should registered as Zomato member and read Zomato application at least in the last 2 weeks. This research focusing on digital natives who is 18 – 29 years old. Structural Equation Modelling (SEM) were conducted to analyze the data using AMOS software.

**Measures**

The initial questionnaire was constructed based on the research model with consideration of the related literature. The questionnaire asked respondents to answer sets of questions based on seven-point Likert scale (strongly disagree to

strongly agree) and Semantic seven-point scale. The questionnaire consists of six variables, four demographic questions (age, gender, profession, budget), and ten behavioral questions were asked.

To fulfil the study's aim, a measurement scale was adopted and modified to the context of this study. Measurements for Information

Processing Confidence adopted from Weinberg and Davis (2005), Consumer Susceptibility to Interpersonal Influence adopted from Murali et al. (2005), Perceived Benefit, Perceived Cost, Attitudes toward online consumer review, and Frequent Usage Behavior were adopted from Lee and Ma (2012). All measurement were assessed by adopting the scale used by Lee and Ma (2012).

Table 1. Summary of Measurement Scales

Variable		Measurement
Information Processing Confidence (IPC)	IPC1	I am totally confident about my ability to judge messages coming from the online media
	IPC2	I am certainly able to think quickly
	IPC3	When I hear an argument being presented, I am quick to spot the weaknesses in it
	IPC4	I usually have to stop and think for a while before making up my mind on even in unimportant matters
Consumer Susceptibility to Interpersonal Influence (CSII)	CSII1	It is important that others like the products and brands I buy
	CSII2	I achieve a sense of belonging by purchasing the same products and brands that others purchase
	CSII3	I achieve a sense of belonging by purchasing the same products and brands that others purchase
	CSII4	To make sure I buy the right product or brand, I often observe what others are buying and using
	CSII5	I often seek out the advice of my friends regarding which products I buy
Perceived Benefit	PB1	My friends or neighbors usually give me good advice on what brands of products to buy
	PB2	Can help me to reduce risk of making a decision
	PB3	May help me be more knowledgeable in making informed decision
	PB4	May provide different opinions about the product that never considered
	PB5	Is more trustworthy than company-sponsored advertising because they are posted by peers
	PB6	Help me learn about products
Perceived Cost	PC1	May make me confused because of too much available information
	PC2	May make me frustrated because of too many different opinions
	PC3	Makes me difficult to make a decision because of inconsistent reviews
	PC4	Is not helpful because reviews seem not knowledgeable enough to write a review
	PC5	Is not descriptive enough to influence my purchase decision
	PC6	Is waste of my time
Attitudes toward Online Consumer Review (AOCR)	To me online consumer reviews are:	
	AOCR1	Bad – Good
	AOCR2	Worthless - Valuable
	AOCR3	Negative – positive
	AOCR4	Not Favorable – Favorable

Variable	Measurement	
Frequent Usage	FUB1	I often search through consumer reviews on the internet
Behavior (FUB)	FUB2	I refer to online consumer reviews whenever I need information on companies or goods
	FUB3	I read online consumer review frequently

**RESULT**

***Sample Characteristics***

Based on the paper-based questionnaires to respondents, this research obtained 155 valid responses, in this case is the complete answer of the respondents aged between 18 and 29 years old. The response of 155 respondents is 132 (85.2%) sample of respondents aged between 18-23 years, while 23 (14.8%) were aged between 24-29 years. In terms of gender, 89 (57.4%) of respondents were female and 66 (42.6%) were male. In terms of the average time spent each time you visit the site Zomato, 125 (81%) of respondents spend 10 minutes or less, 27 (17%) spend between 11 to 30 minutes, and only three people, or about 2% of respondents spent more than 30 minutes in each visit in Zomato.com.

***Construct’s Validity and Reliability***

The results of the first estimate of the measurement model indicates there are a number of indicators with a degree of validity that is not good, indicated by the value of the loading factor under 0.5. Second estimate of the measurement model excludes indicator of information processing confidence 4, Consumer susceptibility to interpersonal influence1, and

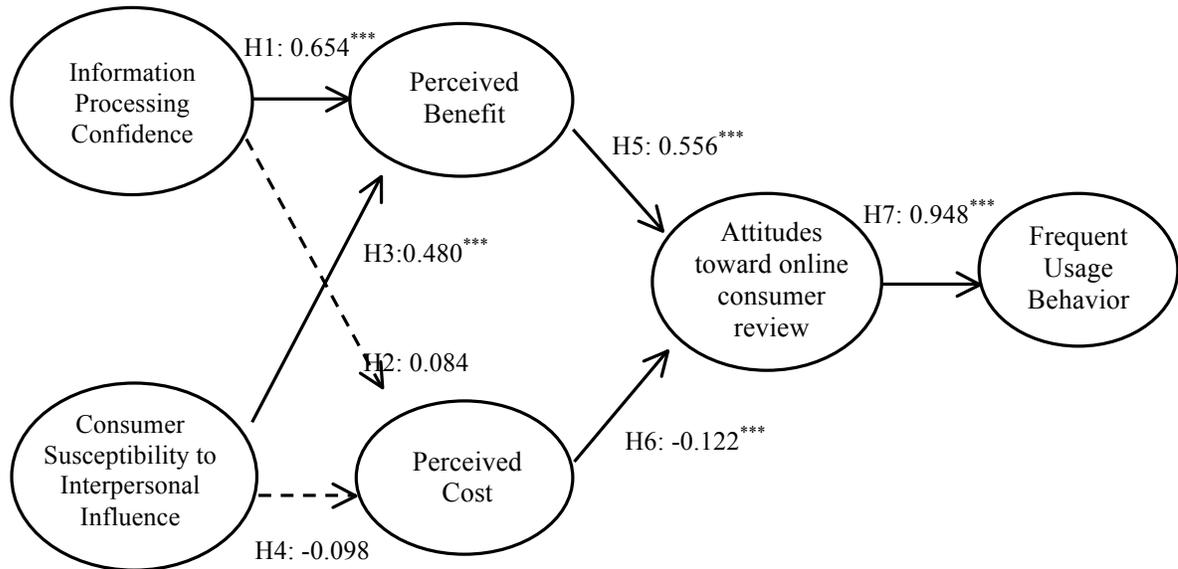
perceived benefits 4. Results measurement estimation model showed factor loading values ranged from 0.519 to 0.902 which indicating a fairly good validity of each indicator latent variable latent.

To assess the reliability of each construct reliability, we make a calculation of construct reliability. Value of construct reliability for each latent variable ranging from 0.727 to 0.865. Considering that all value of the construct reliability is above 0.7 it can be concluded that the instrument used to measure each latent variable has a good level of reliability. Furthermore, the second estimate of the measurement model shows normed Chi-square value is 1.394 (good fit), CFI is 0.943 (good fit) and RMSEA is 0.051 (good fit). Thus it can be said that the overall measurement model, has a goodness of fit.

***Structural Model and Hypothesis Testing***

The results of estimation structural model shows normed chi-square is 1.539 (good fit), CFI is 0.920 (good fit) and RMSEA is 0.059 (good fit). It can be concluded that all fit indices of observed model shows a good value. Regression coefficients and p-value for each path that was tested illustrated in figure 2.

Figure 2. Structural Model



Note: \*p<0.05; \*\*p<0.01; \*\*\*p<0.001

The estimation results on the relationship between information processing confidence and consumer susceptibility to interpersonal influence toward perceived benefits shows regression coefficient is 0.654 and 0.480 with p-value less than 0.001. This indicates that the H1 and H3 are supported by the data. Meanwhile, the results estimated in the relationship between information processing confidence and consumer susceptibility to interpersonal influence toward perceived costs both show p-value greater than 0.05. This means that there is insufficient evidence in this research to support the H2 and H4.

On the other hand, the estimation results on the relationship between the perceived benefits of online consumer reviews toward attitude indicate regression coefficient for 0.556 with p-value less than 0.001, which means supporting H5. Meanwhile, the relationship between the perceived costs of consumer online review toward the attitudes indicate regression coefficient of -0.122 with p-value less than 0.05. This means H6 is proven, that the higher of perceived costs will lead to the lower of attitudes toward consumer online review. Tests on the last hypothesis showed regression coefficient is 0.948 with p-value less than 0.01. This means H7 on allegations concerning the positive

attitudes toward online review to usage behavior supported by the data.

## DISCUSSION

### *Theoretical implications*

This research seeks to contribute to the re-testing model of Lee and Ma (2012) associated with the benefit and cost of online consumer reviews that are perceived by consumers. Tests focused specifically on digital native context or in the context of the generation often referred to as Generation Y or Millennials were born after 1980 (Markey et al. 2012). The context of digital native was selected as one answer to the limitations of previous research that do not accommodate differences in the demographic characteristics of the respondents (Lee & Ma 2012). Another reason related to the selection of digital native as an object of research is the basic characteristic of consumer online reviews that are in the digital environment. This condition is expected to show a different response patterns between the consumer digital native with previous generations.

In general the results of this research are consistent with results of previous studies which will confirm the positive effect between

perceived benefits to the consumer attitudes toward online review and subsequent impacts that positively influence of consumer attitudes toward online review to the consumer usage behavior towards online review. This research also confirms the perceived negative impact of perceived costs to the formation of attitudes toward online consumer reviews. Furthermore, these results also confirm the positive influence of information processing confidence and consumer susceptibility to interpersonal influence in shaping the perceived benefits.

The interesting thing about this research is the unproven of individual factors, in this case is information processing confidence and consumer susceptibility to interpersonal influence in the formation of perceived costs. This contrasts with the results of previous studies (i.e. Lee & Ma, 2012) which found empirical evidence for the relationship between information processing confidence and consumer susceptibility to interpersonal influence with the perceived costs. This research weakens the results of previous studies that found an empirical evidence of the link between consumer susceptibility to interpersonal influence with the perceived costs. If we referred back, actually did not exist a series of previous studies that conclusively prove that there is an influence of individual characteristics, in this case the consumer susceptibility to interpersonal influence toward perceived costs of the online review (Lee & Ma 2012).

Meanwhile, there is no evidence about the influence of information processing confidence to the perceived costs of an online review is an interesting thing to be discussed furthermore. Interesting facts on the results of this study showed that on average the respondents considered that the perceived costs of online review in the context of Zomato is 2.71 of a scale of 7, which means quite low compared with the value of 4 (the test results of one-sample t test indicated a significant difference under 4 with a p-value is 0.000 for the six indicators of perceived costs). This indicates that digital natives, especially in the age range 18-29 years did not significantly looking at the costs, in this case the psychological costs adding to the confusion, information inconsistency, and wasted time. Digital native has the knowledge and skill related to information technology (Bennett et al., 2008). Furthermore, they are

accustomed receiving information very quickly, they also like doing work in parallel (Prensky 2001). This of course does not mean the cost aspect is not exist in reality, however, digital native has an ability to manage technology and digital information which can reduce perception of such costs.

### ***Managerial implications***

This study provides a theoretical contributions in at least two aspects. First, the results of this study contribute to aspects of generalization on previous research results related to the effect of the benefit and cost of online consumer reviews that are perceived by consumers and their implications on the usage behavior of online reviews. Second, the results of this study to answer the call of previous studies to conduct studies related consumer response patterns of online review on a different demographic segments, in this case the additional facts obtained in the group of digital native who was born in the range of 1980-1994 (Bennett et al., 2008). The results of this study weakens the previous findings related to the impact of consumer susceptibility to interpersonal influence the perceived costs, and to confirm the absence of previous empirical facts on the relationship (Lee & Ma 2012). The research also reveals the fact of there are differences in response to the relationship between information processing confidences to the perceived costs. These findings confirm the idea that the digital native has the knowledge and expertise that is higher than the previous generation in terms of the management of information technology as well as their ability to perform in parallel processes (Bennett et al., 2008; Prensky 2001).

The research provides a number of practical implications for managing online review platform as well as the brand holder. Platform for managing online reviews can focus on efforts to provide higher benefits who targeting the digital native such as the versatility of the platform as well as the breadth and diversity of the content of the information provided. Yet another thing to note is the urgency to provide sorting and filtering facilities toward existing information content as well as reputation mechanism (King et al. 2014) to allow users to focus on the things they need and can help them to make a decision. This effort escalates the

benefits perceived by the user of the digital native while reducing the perceived cost perceived by users of previous generations. For brand holders, the results of this study suggest the potential for utilizing an online review platform either run independently or utilizing an online review service that has existed as a vehicle for communication and persuasion on consumers, especially in the segment and the next generation of digital native.

#### ***Limitations and Suggestions for Future Research***

This research is a replication of previous studies that examined only from the customer's individual factors, in this case the information processing confidence and consumer susceptibility to interpersonal influence as antecedents of perceived benefits and perceived costs. There's more opportunity for further research related with outside aspects of customer to drive perceived benefit or to reduce the perceived costs on user side. Aspects such as website quality (Kim & Niehm 2009) if the platform is a website, information quantity (Sivaramakrishnan et al. 2007) and information quality (Knight & Burn 2005) may be used as a starting point. Another thing that is also the potential to be further explored is the effect of the use of mobile platforms (Kim et al. 2015) compared to website platform as online consumer review vehicle.

This research only gives the facts in the context of digital native as the answer of previous studies to examine the effects of specific demographics on the pattern formation of the perceived benefits and perceived costs of online review platforms. There is still an opportunities for comparative testing between generations associated with the pattern formation of the perceived benefits and perceived costs online review platform along with its marketing implications. Another thing that might potential is testing specific demographics and culture as moderator antecedents and marketing consequences of perceived benefits and perceived costs of online review platforms.

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# THE EFFECT OF INTELLECTUAL CAPITAL AND BANK COMPLEXITY ON BANK CREDIT RISK: CASE STUDY OF BANK INDUSTRY AT INDONESIAN STOCK EXCHANGE

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## ABSTRACT

*Credit risk is the risk associated with the main activity of banks to distribute or lend funds to the community. Human capital, an essential element of Intellectual Capital, are very important in the process of credit risk management. Capability, knowledge, imaginative thinking and professional experience of bank employees to properly identified and analyze the possibility of problem from credit agreement. This study propose to examine the impact of Intellectual Capital and Bank Complexity on credit risk at bank industry in Indonesian Stock Exchange during 2012 until 2014. Employing panel data technique, the study finds that Intellectual Capital are associated with credit risk, while bank complexity can moderate the effect of Intellectual Capital on credit risk.*

**Keywords:** *Intellectual Capital, Bank Complexity, Credit Risk*

## INTRODUCTION

Risk is part of main activity of banks, and credit risk is one of those risk. Credit risk is the risk associated with bank main activity to distribute or lend fund to society (Tang et al., 2009). The Basel Committee design a framework for maintaining the stability of a bank, known as Basel I (1998) to Basel III (2010), focusing on four important parameters, namely Capital, Leverage, Funding and Liquidity. However, in the system economy based on knowledge and the use technology intensively, traditional financial and physical resources owned by the company becomes less important (Cañibano, Garcia-Ayuso, & Sanchez, 2000). Intellectual Capital (IC) became the driving force to gain competitive advantage and create a significant difference between the market

value and the book value of the company (Bontis, Wu, Chen, Cheng, & Hwang, 2005; Edvinsson, 1997; Yang & Lin, 2009). Studies conducted by Ocean Tomo in 2011 (Tomo) indicates that an increase in intangible assets in companies indexed on the S & P 500, from just 17% in 1975 to 80% in 2000, which shows the growth of the role of asset intangible in the current period.

Ulrich (1988) found three reasons for the importance of intellectual capital in the service industry are growing need for knowledgeable employees (human capital), the important to maintain a relationship with the consumer (customer capital), and the growing need to constantly learn and innovate (organizational capital). However, although the need for intellectual capital is increasing, especially in knowledge-based

sectors such as banks, the role of intellectual capital in managing the risk has not been addressed either by the regulator or previous researchers.

This paper aims to investigate the impact of intellectual capital on credit risk and the effect of bank complexity to their relationship. Bank industry from Indonesian Stock Exchange are the sample of this research. Using panel data from 2012 to 2014, this research proves that the Intellectual Capital and its components can affect bank credit risk management in Indonesia. This effect becomes stronger for bank with organizational complexity, and the opposite result for bank with product complexity.

## **FRAMEWORK OF THEORY AND DEVELOPMENT OF HYPOTHESIS**

### **Resource Based Theory**

Wernerfelt (1984) explains that in the view of Resourced-Based Theory, the company will excel in competition and get a good financial performance with the way they control, use and own their important strategic assets. (Riahi-Belkaoui, 2003) states that the potential strategies to improve the performance of the company is to unify the tangible assets and intangible assets.

Resourced-Based Theory is an idea that developed in the strategic management and competitive advantage of companies that believe that the company will achieve excellence if they have superior resources (Solikhah, Rohman, & Meiranto, 2010). Based on Resource-Based Theory approach can be concluded that the resources owned companies affect the performance of the company which will ultimately increase the value of the company.

### **Intellectual Capital Concept**

As a concept, intellectual capital refers to physical capital or non-capital related intangible capital with the knowledge and human experience and the technology used. (Bontis, 2001) stated that in general, the researchers identified three main constructs of intellectual capital is human capital (HC), structural capital (SC), and customer capital (CC).

Human capital (HC) represents the individual knowledge stock of an organization that is represented by its employees, and is a combination of genetic inheritance; education; experience; and attitude about life and business. Structural capital (SC) includes all non-human storehouses of knowledge within the organization. Included in this is the database, organizational charts, process manuals, strategies, routines, and all the things that make the company's value is greater than the value of the material. Customer Capital (CC) is the knowledge inherent in marketing channels and customer relationship developed through the process of doing business (Bontis, 2001).

Pulic (1999) developed a method VAIC™ to provide information about the value creation efficiency of tangible assets (tangible assets) and intangible assets (intangible assets) owned by the company. This model starts with the company's ability to create value added. Value added (VA) is the efficiency of human capital (HC), structural capital (SC) and capital employed (CE).

### **Bank Complexity**

A bank becomes organizationally complex when we have the need to control

many branches and has many financial products. Many factors cause the bank into a complex organization, among other acquisitions between banks. Bank acquisition resulted in an increasingly diverse business activities and geographic location are increasingly widespread. It is a challenge for management will be able to run well (Laeven, Ratnovski, & Tong, 2014).

Cetorelli, McAndrews, and Traina (2014) in the US shows that the banks in the US has expanded into a holding company, expand their organization into non-traditional bank business through the acquisition of specialized business fields already industry. This resulted in the role of the banks became more widespread with offers of products or services that were in nonbank industry.

### **Hypotheses**

Most studies have examined the effect of intellectual capital and its components on company performance as measured by profitability, market value, productivity and sales growth. (Pulic, 2000), using VAIC™, find a positive influence between intellectual capital and market value added (MVA) on a sample of 30 companies were taken at random from the FTSE during 1992 to 1998. A number of studies also have examined the effect of intellectual capital on the financial performance using this VAIC methodology. For example, Shiu (2006) and Wei Kiong Ting and Hooi Lean (2009) found a positive relationship between intellectual capital and ROA. Clarke, Seng, and Whiting (2011) found a direct relationship between intellectual capital and the performance of listed companies in Australia. Bontis et al. (2005) showed that the financial

performance of listed companies in Taiwan positively influenced by intellectual capital this year and the previous year.

In connection with the banking sector, researchers usually examine the effect of intellectual capital on the financial performance. Pulic (2002) examined efficiency and the performance of banks in Croatia during 1996 to 2000. Yalama and Coskun (2007) examined the effect of intellectual capital and its components on the financial performance of banks in Tuki period 1995-2004 and found that the need for IC greater than physical capital, Ismail and Karem (2011) examines the significant impact of physical capital and human resources on the performance of banks in Bahrain, but the study was not able to show the relationship between structural capital and bank performance. Most studies show a positive effect overall intellectual capital and human resources to the performance of the bank, but different results are found in the physical components of capital and structural capital.

While most research on intellectual capital and its components find a positive influence of intellectual capital on the performance of banks, and concluded that intellectual capital is a key driver in the new economy to gain sustainable competitive advantage, but no studies have examined the effect of intellectual capital to risk management of banks, Structural capital, which consists of non-human store of knowledge within the organization (Bontis, 2001), to support human resources to improve their efficiency and reduce the possibility of bank insolvency. Therefore, in theory it can be said that the higher the efficiency of intellectual capital (ICE) and efficient components, human capital

efficiency (HCE) and structural capital efficiency (SCE), the lower the credit risk and bank insolvency. Therefore, this study proposes research hypothesis as follows:

*H1: Intellectual Capital Efficiency (ICE) has a negative effect on bank credit risk*

*H1a: Human Capital Efficiency (HCE) has a negative effect on bank credit risk*

*H1b: Structural Capital Efficiency (SCE) has a negative effect on bank credit risk*

Increasingly complex organization of banks allows it experienced a wider systemic events. Surprises can be extended to various industries in the financial sector because of their affiliation to the many organizations, which may be caused due to contract debt and derivative contracts (Cetorelli et al., 2014). Therefore, this study proposes research hypothesis as follows:

*H2: Negative Effects of Intellectual Capital Efficiency (ICE) against the credit risk of banks will be moderated by banks complexity.*

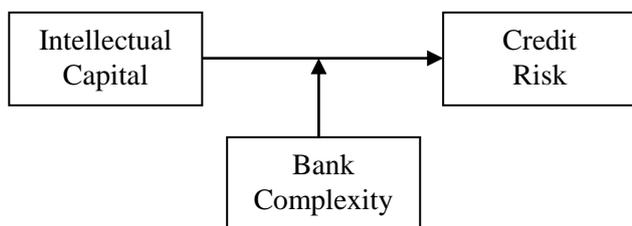


Figure 1. Conceptual Framework

## RESEARCH METODOLOGY

### Population and Sample

The population in this study are all companies listed in Indonesia Stock Exchange. The research sample is a banking company. Period of observations made is the year 2012 to 2014. Banking companies listed in Indonesia Stock

Exchange a total of 41 banking companies. Of the 41 companies, two new companies registered in 2015, one company is Islamic banking, and the two companies are no available data in the data stream, so the five banking companies were excluded from the study sample. Total samples were 36 banking companies. The financial data retrieved from the database data stream, while data on the number of branches taken from the annual reports of each company.

### Operational Definition and Measurement of Variables

**Credit Risk (CR)** is the risk associated with the activity of companies that emerged from the non-recovery of loans and advances. Ratio of NPLs to Total Loans is already commonly used in previous studies to measure credit risk (Fungáčová & Solanko, 2009). In this study, the credit risk is defined as: Credit Risk (CR) = Net NPLs / Net Loans.

**Intellectual Capital Efficiency (ICE)** using VAIC™ models of (Pulic, 1999) which is commonly used in previous studies. Based on the model VAIC™ this, ICE is the summation of Human Capital Efficiency (HCE) and Structural Capital Efficiency (SCE), namely:  $ICE = HCE + SCE$ .

**Bank Complexity** uses four banks complexity measurements were derived from previous research (Fields, Fraser, & Wilkins, 2004; Liu & Ryan, 2006). The first and second proxy is the number of branch offices (BO) and the number of ATMs (ATM) bank .Complexity can be seen from the complexity of the organization. The wider the organization of a bank, the more complex the control activities in the bank (Laeven et al., 2014). The third proxy is the ratio of commercial

and industrial loans (COMM%). Commercial loans are complex transactions because it generally takes collateral, is syndicated and non-transparent (Fields et al., 2004). The fourth is a heterogeneous proxy ratio loans (HET%). Based on research Liu and Ryan (2006), heterogeneous loans are commercial and industrial loans, direct financing lease, all other real estate loans, agriculture loans which require consideration of the bank manager.

To answer the hypothesis, we used three models of research as follows:

$$H_1 : CR_{it} = \beta_{0t} + \beta_1 ICE_{it} + \beta_2 \ln TA_{it} + \beta_3 NIM_{it} + \varepsilon_t \dots (1)$$

$$H_{1a} \text{ and } H_{1b} : CR_{it} = \beta_{0t} + \beta_1 HCE_{it} + \beta_2 SCE_{it} + \beta_3 \ln TA_{it} + \beta_4 NIM_{it} + \varepsilon_t \dots (2)$$

$$H_2 : CR_{it} = \beta_{0t} + \beta_1 ICE_{it} + \beta_2 COMPX_{it} + \beta_3 ICE_{it} * COMPX_{it} + \beta_4 \ln TA_{it} + \beta_5 NIM_{it} + \varepsilon_t \dots (3)$$

Where:

CR: *Credit Risk* = Net NPLs / Net Advances

ICE: *Intellectual Capital Efficiency* = HCE + SCE

HCE: *Human Capita Efficiency* = VA / HC

SCE: *Structural Capital Efficiency* = SC / VA

COMPX: *Bank Complexity*, measured by the number of branch offices (BO), number of ATM (ATM), ratio *commercial and industrial loans over total loans* (COMM%), ratio *heterogeneous loans* (HET%) and ratio *Nonperforming loans* (NPL%)

## ANALYSIS AND DISCUSSION

Table 1 shows the results of the study variables descriptive statistics. Assets have value (in thousands of rupiah) Mean amounted to 10.3 million with a minimum value of 45,000 and a maximum of 85.1

million. The mean value for the variable CR is 0.0180 with a minimum value of 0 and a maximum of 0.1225. For the mean value of the variable VAIC, HCE and SCE in sequence is 2.911, 2.392, and 0.518 with a standard deviation of 1.729, 1.622, and 0.229. The mean value of CAR is 0.1797 with a standard deviation of 0.1112. The number of branches on average are 356 branches with a minimum of 5 and a maximum of as many branches as many as 2615 branches.

**Table 1. Descriptive Statistic**

Variable	Obs.	Mean	Std. Dev.	Min.	Max.
ASSET	108	10.300.00	18.200.00	45.000	85.100.00
S*		0	0		0
CR	108	0.0180	0.0198	0	0.1225
VAIC	108	2.9114	1.7292	-7.3963	11.2736
HCE	108	2.3925	1.6225	-8.5138	10.3700
SCE	108	0.5189	0.2297	-0.4264	1.1174
CAR	108	0.1797	0.1112	0.0727	0.8627
BO	108	355.546	517.754	5	2615
HETLO	108	0.1524	0.1959	0	0.7644
AN					
COML	108	0.5539	0.3040	0	1.0071
OAN					

Table 2 shows the results of testing the correlation between variables. Seen that there is no autocorrelation between variables

characterized by the correlation value is not more than 0.75.

**Table 2. Correlation Test**

	CR	VAIC	HCE	SCE	BO	HETL	COMML	ASET	CAR
CR	1.00								
VAIC	0.02	1.00							
HCE	0.04	0.99	1.00						
SCE	-	0.51	0.40	1.00					
BO	0.07				1.00				
HETL	0.04	0.23	0.20	0.32	0.33	1.00			
COMML	0.05	0.22	0.20	0.25	-	-0.25	1.00		
ASET	-	-0.08	-	-	-	-	-	1.00	
CAR	0.04		0.04	0.29	0.08				1.00
	0.14	0.36	0.32	0.50	0.69	0.30	-0.08		
	-	-0.08	-	-	-	0.00	0.13	-0.37	
	0.26		0.06	0.16	0.11				

Table 3 shows the results of testing the hypothesis 1. The second column shows the results of equation 1 which examines the effect of the Credit Risk VAIC banking. Third and fourth columns show the results of equation 2 to examine the effect VAIC components, namely HCE and SCE, the Credit Risk banking.

In the second column, VAIC variable coefficient is negative (-0.0016) and significant (0.042) at the level of 0:05 to Credit Risk. This implies that by conducting an efficient Intellectual Capital, a bank will lower the credit risk, and the results of this test supports research that VAIC H1 will negatively affect banking Credit Risk. For the third column, the coefficient component HCE also is negative (-0.0001) and significant (0.031) at the 0:05 level against Credit Risk. It supports H1a HCE research that affect the banks Credit Risk. Likewise in the fourth column, SCE component coefficient is negative (-0.1661) and significant

(0.077) at the level of 0.1 to Credit Risk. It supports H1b that SCE Credit Risk negatively affect the banks.

Overall, the findings of this study indicate the importance of Intellectual Capital and its components in the management of credit risk in the Indonesian banking industry and by conducting an efficient Intellectual Capital can result in significant reduction in credit risk.

Table 4 shows the results of testing the hypothesis 2. The second column shows the results of the equation 3 that tested the effect of the number of branches (as a proxy for the complexity of the first bank) on the relationship between Intellectual Capital and Credit Risk banking. The third column shows the results of the test equation 3 Heterogeneous Loan ratio (as a proxy for the complexity of the bank) on the relationship between Intellectual Capital and Credit Risk banking. Whereas the fourth column shows the results of the test equation 3 Commercial Loan ratio (as a proxy for the complexity of the bank's third) on the relationship between

Intellectual Capital and Credit Risk banking.

Intellectual Capital and Credit Risk banking.

**Table 3. Empirical Test Results**

**Hypothesis 1**

CR	Equation 1	Equation 2a	Equation 2b
Constant	0.0029 (0.017)	0.0126 (0.025)	-0.0042 (0.080)
VAIC	-0.0016 (0.042)* *		
HCE		-0.0001 (0.031)* *	
SCE			-0.1661 (0.077)*
Log-Asset	0.0011 (0.054)*	0.0005 (0.038)* *	0.0011 (0.086)*
CAR	-0.4191 (0.023)* *	-0.4294 (0.020)* *	-0.4200 (0.021)* *
F	0.0361* *	0.0542*	0.0130* *
R square	0.0785	0.0704	0.0980
Adj. R square	0.0519	0.0436	0.0720
n	108	108	108

The second column in Table 4, the sign VAIC\*Log-BO negative interaction coefficient (-0.023) and significantly (0.048) at the level of 0:05. This means that the complexity of the bank in terms of number of branches affected the relationship between Intellectual Capital and Credit Risk banking. While in the third and fourth columns, interaction VAIC\*HETLOAN and VAIC\*COMLOAN showed nonsignificant results of the relationship between

**CONCLUSIONS**

This study aimed to examine the effect of Intellectual Capital and operational features in the credits of commercial banks listed on the Indonesia Stock Exchange. In the context of economic understanding, Intellectual Capital is considered as the main strength of the success of a business. It is closer to the truth in sectors dependent on intangible assets than tangible assets. The service sector is an important component in which the bank is expected to be influenced largely by the efficiency of existing employees in the company. This view is supported by empirical evidence is sufficient, however most of these studies examined the effect on profitability of the company. Risks, in particular credit risk, generally do not do the testing associated with the role of Intellectual Capital. Therefore, the study may be the first study to test this.

Large banks generally tend to have lower capital, funding less stable, more activity based on market and organizationally more complex than small banks. This indicates that the big banks have differences, it is likely more vulnerable, business model. The more complex a bank, it would likely create systematic risk. It is proving increasingly needed Intellectual Capital to manage the possibility of systematic risk that would disrupt the economy of the total.

This study proves that the Intellectual Capital and its components can affect bank credit risk management in Indonesia, particularly banks listed on the Indonesia Stock Exchange. This was strengthened when the bank has the complexity of the

organization, but not proven when the complexity of a bank is measured by the ratio of commercial product complexity and heterogeneous loan.

**Table 4. Empirical Test Results Hypothesis 2**

<b>CR</b>	<b>Equation 3a</b>	<b>Equation 3b</b>	<b>Equation 3c</b>
Constant	0.9513 (0.167)	0.0095 (0.748)	0.0070 (0.817)
VAIC	0.0086 (0.077)*	-0.0033 (0.120)	-0.0026 (0.369)
Log-BO	0.0162 (0.000)***		
HetLoan		-0.3925 (0.235)	
ComLoan			-0.0648 (0.659)
VAIC*Log-BO	-0.0023 (0.048)**		
VAIC*HETLOAN		0.0139 (0.163)	
VAIC*ComLOAN			0.0018 (0.705)
Log-Asset	-0.0058 (0.067)*	0.0010 (0.415)	0.0011 (0.377)
CAR	-0.0383 (0.034)**	-0.0441 (0.017)**	-0.0401 (0.034)**
F	0.0001***	0.0586*	0.0236**
R square	0.2244	0.0979	0.0802
Adj. R square	0.1864	0.0536	0.0352
n	108	108	108

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## **SUSTAINABLE BANKING BASED ON ENVIRONMENTAL SOCIAL AND GOVERNANCE (ESG) MODEL: STUDY ON ASEAN BANKING INDUSTRY**

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### ***ABSTRACT***

*In 2016, Era of Asean Economy Community has been enacted. Accordingly, the demand of information transparency has been increasing for market participants, especially investors to make investment decisions. SR as one of information source has received great attention in the non-financial sector, but in the financial sector, research is still limited, primarily related to cross country. In addition, the existing research just focused on determinant factors or consequences of SR. It is hard to find a model to combine determinant and consequence factors.*

*This research aims to analyze Environmental Social and Governance (ESG) Model on ASEAN banking industry. Model ESG was used to analyze determinants or antecedents and consequences or outcomes of Sustainability Reporting (SR). Determinant model observed two aspects; those are external stakeholder pressure (ESP) and internal governance mechanism (IGM). Outcome model observed consequences of SR disclosure to market-based performance (MBP).*

*There were 16 banks in ASEAN that disclose SR in 2011-2015, which could be research samples, they produce 79 observations. The analyses discovered that ESP and IGM have important role to support transparency through total SR disclosure to increase MBP. However, the study also found that the external stakeholders do not concern to environmental issues.*

**Keywords:** *sustainable banking, environmental social and governance sustainability reporting, external stakeholder pressure, internal governance mechanism, market-based performance*

## ORGANIZATIONAL SPONSORSHIP: BUSINESS INCUBATOR MODEL AND CONCEPTUAL DEFINITION REFINEMENT

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### ABSTRACT

*Studies relating to business incubator has been widely conducted, but the definition is very diverse. The business incubator concept has been criticized because of its inadequate theory. Previous studies of business incubator indicated that the knowledge of business incubator is not based on theory but only anecdotal. While recent studies of business incubator are more likely to suggest and develop a new theory rather than to strengthening the concept itself. Business incubator also divided into several types: University, Corporate, Government and NGOs.*

*This study has two objectives. First, to fill the gaps of business incubator studies by identifying the role played in the process of developing a new business. Second, this paper aims to answer the question about the exact definition of business incubator. The study conducted among four business incubators in Yogyakarta-Indonesia, such as: University, Government, Corporate and NGO.*

*This study explores the theoretical foundation of the business incubator. By using grounded theoretical approach and case study, the definition of business incubator has been refined. Business incubator can be explained by integrating several theories, such as: transaction cost economics, real option theory, resource-based view, schumpeterian innovation, network theory, business strategy and organizational adaptation. These theoretical approaches result business incubator as multi-dimensional that consisting of seven roles. The seven roles are efficiency, selection, resource, innovation, networking, strategic support and adaptation. These roles made it clear that the definition of the business incubator concept to be more comprehensive, so that there is no difference in the definition of the business incubator concept as well as among types of business incubator, but the difference is only in the dominant role played by the business incubator.*

**Keyword:** *Business incubator roles, new business, definition refinement, grounded theoretical approach*

### INTRODUCTION

Entrepreneurship is the key driver of economic development (Schumpeter, 1934). Entrepreneurial of new businesses have a positive impact on economic growth, innovation and job creation (Acs, 1992; Carree & Thurik, 2010; Stel *et al.*, 2005). On the other hand, the new business is also fragile and prone to failure (Headd, 2003). Business incubator has

a potential to generate new businesses. Because it is a business incubator that can act as agents of change to transform the economy from the base of large-scale manufacturing companies to new and large numbers of small businesses (Campbell, 1989).

Studies relating to business incubator has been widely conducted but the definition is very diverse, mostly focused on the facilities

and resources in an effort to develop new businesses (Allen & McCluskey, 1990; Brooks, 1986; Hackett & Dilts, 2004b; Merrifield, 1987; Plosila & Allen, 1985; Smilor, 1987a; Swierczek, 1992), only a few have defined business incubator as an institution which also seeks a new business that has an ability to survive and reduce the failure rate of its business (Amezcuca *et al.*, 2013; Campbell, 1989; Hisrich, 1988; Kuratko & LaFollete, 1987). The definition differences can result in different effects of the business incubator on new business survival. A previous research has identified an effect of business incubator on new business survival (Amezcuca *et al.*, 2013), while other studies have identified no effect of business incubator on new business survival (Mas-Verdú *et al.*, 2015; Schwartz, 2009, 2013). The failure of the new business incubator may cast doubt on the resource provider (such as banks, suppliers, distributors and established businesses) to invest in it (Tavoletti, 2013).

Previous studies have indicated that the knowledge of business incubator is not based on theory, but only anecdotal. So that the understanding of the functions of business incubators in general and the university support specifically in developing new technologies is just a beginning (Mian, 1996). The insufficiency of previous studies on business incubators are in the case of theory-based incubator classification, process models of new business and definitions of success between incubators and new business (Hackett & Dilts, 2004b).

Recent studies of business incubator are more likely to suggest and develop a new theory (Crawford *et al.*, 2015; Hackett & Dilts, 2004a; Markman *et al.*, 2005), rather than to strengthen the concept of business incubator itself. Markman *et al.* (2005) stated that the process of business incubators in relation to the function of its institution as technology transfer, commercialization of technology licensing strategy and its relationship to the business is relatively unexplored and less based on the theory. Many researches have been conducted descriptively and atheoretically approach, such as the extensive documentation of the various services provided by business incubator (Bøllingtoft & Ulhøi, 2005). Conceptual development and business incubator scale development that has been carried out is merely derived from a theory to study the uni-

dimensional measurements (Hackett & Dilts, 2008).

This study has two objectives, first to fill gaps in the study of business incubators by identifying the factors or the role played in the process of developing a new business. This is conducted by redefining the business incubator as well as conducting a review and integration of several theories that are relevant such as transaction cost economics (Williamson, 1973), real option theory (Dixit & Pindyck, 1994), innovation (Schumpeter, 1942), resources based view (Barney, 1991), network theory (Granovetter, 1983), strategic choice (Child, 1997), and organizational adaptation (Hrebiniak & Joyce, 1985). This would result in the roles of the business incubator models more comprehensively and multidimensional. Second, this paper aims to answer the question stated earlier about the exact definition of business incubator. Several studies conducted so far view on the characteristics of business incubator differently, while all kinds of business incubators have the same role in the economic development aspects (Phan *et al.*, 2005).

## **BUSINESS INCUBATOR AND THEORETICAL REVIEW**

The business incubator term is originally coined to describe the place to employ entrepreneurs rapidly before establishing a new business. Definition of business incubators varies in the literature (Cooper, 1985). The definitions can be divided into three focuses: 1) as a change agent in the transformation of the economy (Campbell, 1989), 2) as the facilities and services of business incubation (Allen & McCluskey, 1990; Brooks, 1986; Greene & Butler, 1996; Merrifield, 1987; Plosila & Allen, 1985; Rice, 2002; Smilor, 1987a; Swierczek, 1992), and 3) as the survival of the new business of business incubators (Amezcuca *et al.*, 2013; Hisrich, 1988; Kuratko & LaFollete, 1987). These focuses show that the definition of the business incubator concept is diverse and does not have a unified acceptable definition. This may be caused by the weak business incubator concept of various theoretical studies.

By focusing on these definitions, it can be concluded that a business incubator is an institution that serves as an agent of change to transform the economy through the

development of new businesses, by providing assistance or facilities of physical and non-physical resources, monitoring to reduce the failure rate of new businesses, as well as improving the chance to survive and grow. Facilities can be physical resources; a) share building and b) access/support for rapid capital, or non-physical resources: a) support, b) management and professional consultation and c) network.

Business incubator as an agent of change to transform the economy was developed based on the result of market failures. Markets that fail impede access to capital, knowledge and resources for small and new businesses (vonZedtwitz & Grimaldi, 2006). This view can be assessed from the perspective of Transaction Cost Economics (TCE) (Williamson, 1973). Furthermore, in developing new business, business incubators conducted the process of recruitment and selection of entrepreneurs. This selection process can be assessed from the perspective of real options theory. This theory states that the investment is made less likely or even not returned, and in a state of uncertainty (Dixit & Pindyck, 1994).

Business incubators serve assistance or facilities of physical and non-physical resources. These assistances can be assessed from the perspective of Resource-Based View (RBV) and innovation (Schumpeterian) perspective. Business incubators also take strategies related to new business development. This effort could be analyzed from a strategic business perspective. Business incubators develop inter-organizational networks that could be reviewed by network theory. Further Business incubators releasing new business in an environment that corresponds to the structure. Business incubators seek to improve the chance of survival and growth that can be assessed from organizational adaptation perspective.

Business incubator is an agent of change by developing a new business during a period of economic decline or technological development. New and small businesses assist to stabilize local economy and provide new economy of small businesses based activity. New small businesses create jobs and reduce unemployment. This business incubator is a sensible strategy in developing economies only if they are able to cumulatively help of the new

business surviving and accelerate the growth (Campbell, 1989).

#### **Type of business incubator**

The term business incubator in Merriam-Webster's Dictionary (2003) means: 1) an apparatus by which eggs are hatched artificially, 2) in medical term, it means an apparatus with a chamber used to provide controlled environmental conditions especially for the care and protection of premature or sick babies. In relation to the business, the incubator is created by both public and private institutions providing facilities for the newly formed business (nascent) (Greene & Butler, 1996; Hisrich, 1988; Plosila & Allen, 1985).

Business incubators aim to create munificent environments in developing new business (Amezcuca *et al.*, 2013; Phan *et al.*, 2005). Such facilities may include: a) share office space, b) support services, c) management and professional consultation, and d) access or support for rapid capital. In addition to the facilities to assist the creation of new businesses, a business incubator is also aimed to reduce the failure rate of new businesses (Campbell, 1989), as well as to increase the chance of survival and growth (Amezcuca *et al.*, 2013; Hisrich, 1988; Kuratko & LaFollete, 1987).

Studies of the business incubators have been differentiated by their types and roles (Amezcuca *et al.*, 2013; Vanderstraeten & Matthyssens, 2012). By their types, business incubators are distinguished to Business Accelerators, Research Parks, Science Parks, Knowledge Parks, Seedbeds, Industrial Parks, Innovation Centers, Technopoles, Networked Incubators (Vanderstraeten & Matthyssens, 2012).

By their roles, business incubators are distinguished to a buffering and a bridging (Amezcuca *et al.*, 2013). 1) As a buffering, a business incubator manages to protect an environment that allows new businesses to develop internal resources while reducing their dependence on the resource. The examples of such role are tax shelters, share office space, back office support, product development support, consulting services, small businesses capital lending and workforce training. 2) As a bridging, a business incubator serves intermediation connection that allows new businesses to acquire social capital and legitimacy for the purpose of building a

sustainable competitive advantage. The examples of such role are network services, structural incentives and programs that support early stage venture investment, science park co-location, membership and association. Business incubator concept in this study is analyzed from a variety of theories to perceive the factors or the role of business incubators so as to obtain a concept that can reinforce the differences or similarities among the various business incubators.

### **Business incubator and Transaction Cost Economics (TCE)**

The market failure theory was originally developed by Arrow (1969) and later became the basis of the Transaction Costs Economics Theory (TCE). The theory afterward was developed and called the Market hierarchy (Williamson & Ouchi, 1981). Some forms of market failure such as the public goods problem, the accuracy problem, asymmetry of information and the exchange of small groups as a result of the dominance of large companies. The problems of market failure are due to two factors: human factors (such as bounded rationality, opportunistic behavior and atmosphere) and transacting factors (such as uncertainty, small size and the limited information) (Williamson, 1973). Market failure theory suggests the vertical integration to overcome the problems of the cost of purchase and sale between the companies (Arrow, 1969).

The reason of business incubator developed is based on the result of market failures (von Zedwitz & Grimaldi, 2006). The failure of the market creates barriers to new businesses such as; access to capital, knowledge, resources and technology support, recruitment, marketing, advertising, public relations, administrative issues and rules. Business incubator is to be the solution because it acts as an umbrella in managing a premature business with the aim to address the market failure problems (Bøllingtoft & Ulhøi, 2005).

This theory offers a solution to the failure of the market by vertical integration. Business incubator is a form of vertical integration of the premature business. Businesses which are still weak and challenged by transaction costs can be helped through the support of both business incubators formed by the university and established companies. Thus

the business incubator is a change agent that plays a role in addressing market failures such as; the cost of information, limited capital flows, a lack of services, support and financing for small and new businesses (Campbell, 1989).

TCE approach provides additional understanding of the value of a business incubator offering efficiency in developing new businesses, as well as providing: credibility for businesses, diagnosis business needs, selection and monitoring, capital access provision, network access provision both from experts and the systems that support, as well as being a quick learner facilitator or problems solver (Hackett & Dilts, 2004b). Therefore, the first proposition of this research could be described as:

Proposition 1: Business incubators play a role in setting up a new business more efficiently

### **Business incubator and real options theory**

A real option theory is related to investments, defined as investments that are not returned, which is conducted under conditions of uncertainty (Dixit & Pindyck, 1994). This theory is based on three characteristics of the matter: 1) the investment cannot be partially or completely returned, 2) the uncertainty of the return on investment in the future, 3) the extra time in waiting for the benefits of the investment. In relation to decision-making, flexibility in conducting selection is at the possibility to cancel the initiative to invest rather than to replace other investments. Because of that, decision-makers should know which are said and which are not to be a real option (Adner & Levinthal, 2004). Real option is based on the assumption of the existence of uncertainty sources such as commodity prices or the results of the research project. Results from the uncertainty source will be revealed over time, at that time the manager will adjust their strategy (Bowman & Moskowitz, 2001).

In relation to the business incubator, this perspective views new business as identifying options, and then performing an infusion of resources and monitoring and helping as a follow up of the implementation of the options (Hackett & Dilts, 2004b). Although the options of new business are not based on the benefit from the investment, business incubator requires prospective new businesses that have been able to survive. This perspective can

explain why business incubators select new business while markets refused (McGrath, 1999). The options of new business is not based solely on investment gains, but the business incubators expect that new businesses are able to survive.

Proposition 2: Business incubators perform the role of selection of prospective new businesses developing a business that will survive

### **Business incubator and Resource Based View (RBV)**

This theory states that sustainable competitive advantage can be gained from the control of the organization's resources and capabilities that are valuable, rare, and inimitable perfectly and that cannot be substituted (Barney, 1991). However, over the development period the theory has been revised (Barney *et al.*, 2001). In the context of entrepreneurship, RBV with technology transfer from the university, some universities are more successful in developing new businesses (spin-out). Although the university can develop innovation, it cannot necessarily be able to sale in the market (Barney *et al.*, 2001).

Resources on entrepreneurial are viewed from the introduction to the market opportunities, the ability to manage resources and the creation of heterogeneous superior output on the market (Alvarez & Busenitz, 2001). Criticism is given to the opinions of small and new businesses that merely focus on business performance, as such performance focus is only unique for research in strategic management but not in entrepreneurship. Consequently, entrepreneurship is only focused on the discovery and exploitation of the opportunities that will benefit the new businesses (Shane & Venkataraman, 2000).

The definition of business incubators has been widely focused on giving resources (Allen & McCluskey, 1990; Brooks, 1986; Greene & Butler, 1996; Merrifield, 1987; Plosila & Allen, 1985; Rice, 2002; Smilor, 1987b; Swierczek, 1992). Resources in entrepreneur have actually been seen more from recognition of market opportunities, the ability to manage resources and also creation of superior heterogeneous output on the market (Alvarez & Busenitz, 2001). The focus on small businesses is to the survival of the business

rather than its performance (Castrogiovanni, 1996). The focus on the business performance is only unique on strategic management research and not on entrepreneurship. Therefore entrepreneurship focuses only on the invention and exploitation of the advantageous opportunities (Shane and Venkataraman, 2000). Proposition 3: Business incubators play a role in providing services or facility of resources to new businesses

### **Business incubator and innovation**

Innovation was originally developed by Schumpeter (1934), namely the creation of value through the process of technological change and innovation. Source of innovation includes the introduction of new products or production methods, the creation of new markets, the discovery of new sources of supply and the reorganization of the industry. Schumpeter (1942) introduced a creative destruction that is rents derived from technological change in self-employment, but will disappear when the innovation practiced is well established in economic life.

Entrepreneurial process is a set of activities through innovation by changing the combination of factors of production. Schumpeter emphasizes on innovation through a combination of resources (McGrath, 1999). Entrepreneurial will mess and move the market equilibrium through the products, production processes and new management techniques (Jacobson, 1992). Business incubators can be a means of innovation through product development, production processes and a new distribution system. The other innovation that is defined similarly to business incubator is a science park, a location that is focused on the development of new technologies (Ratinho & Henriques, 2010). From this perspective, then the next proposition is:

Proposition 4: Business incubators play a role in providing innovative training to new businesses

### **Business incubator and network**

Networking allows integration between an organization (business incubator or new business) (Granovetter, 1983). The goal of a business incubator is to increase entrepreneurial talent. Because the main drivers of a new business is the availability of funds and technological progress, and the entrepreneurs

themselves. A business incubator in this case seeks to maximize self-employment by providing services and support that complements the talents and resources expected to raise the potential of entrepreneurship. Thus the business incubator is a planned connector between entrepreneurs and commercialization processes (Bøllingtoft & Ulhøi, 2005).

Business Incubators provide a network access to gain knowledge and other resources that are not possessed by the incubator. The network could be 1) the network of business incubators (Baraldi & Havensvid, 2015) such as: universities, research institutions, other businesses, the players in the industry, government and services organizations (Scillitoe & Chakrabarti, 2010), and 2) the network of the new business itself (Bøllingtoft & Ulhøi, 2005). Based on this perspective, the next proposition is:

Proposition 5: Business incubators play a role in developing networks for new businesses

#### **Business incubator and strategic choice**

Strategic choice an active role in influencing the organizational structure (Child, 1997). Strategic choice is concerned with the new businesses exploitation of business opportunities. When selecting novelty process, the operation will be associated with the generalist strategic choice, but if the new businesses choose a different capability development, the specialist strategic choice can be an alternative. Both choices will have consequences: generalist strategy might be more conducive for the creation of value, while specialist strategy will be more conducive to improve performance, but in a short term (Larrañeta *et al.*, 2012; Vanderstraeten & Matthyssens, 2012).

Additionally, business incubators can also develop strategies both generalist and specialist. A business incubator with generalist strategy offers on-site services, in-depth business operations activities, new business personal contacts with various sectors or technology referred to the field of building service (Amezcuca *et al.*, 2013). Instead, a business incubator with specialist strategy is intended to make the new business activities in a particular sector or technology. Thus offering services in site, in-depth specific technology or sector service, as well as new business personal

contact with particular sectors or technology (Vanderstraeten & Matthyssens, 2012).

Proposition 6: Business incubators play a role in providing business strategy training for new businesses

#### **Business incubator and new business adaptation**

An adaptation of the new business depends on the environmental determinism and the strategic choice. Organizations that are fully determined by the environment are more easily to perish if it is not being able to adapt. Otherwise if the environment is less determinant, they can adapt by selecting the strategy (Hrebiniak & Joyce, 1985). Business incubators tend to be identified in areas with high levels of agglomeration but lower levels of business development. Science Park is an example of governmental infrastructure development to create opportunities for the knowledge and novelty of agglomeration through the creation of sustainable new businesses (Qian *et al.*, 2011). Novelty powerful capabilities will result in the formation of not only new businesses, but also high research and development. Silicon Valley is one example of Science Park that has become a new business and research and development connected at global level, because of its proximity to world-class universities and the largest consumer market in the world (Phan *et al.*, 2005).

Other environmental management efforts can be conducted by clustering. Clustering is businesses with the same type of high technology or value chain that is interested to form a group (cluster) together in the fields of science, then gradually will form groups that complement each other (Chan & Lau, 2005). Agglomeration and cluster indicate that the business incubator attempts to prepare new business to survive in their environment. Business location is important for new businesses because of the proximity to other businesses that will have a positive effect on the ease of network access (McAdam & Marlow, 2007). But on the other hand, environmental factors such as the level of business density (in the lens of population ecology) will contingent on the new businesses' survival (Amezcuca *et al.*, 2013). Levels of high and low density determine the survival of new business (Carroll & Hannan, 1989).

Proposition 7: Business incubators play a role in preparing a new business in order to adapt to the environment outside the incubator

## RESEARCH METHODS

This study developed the concept of a business incubator by using grounded theoretical approach. Hence the lack of business incubator theory, the inductive case study approach is an appropriate methodology in the development of the theory (Eisenhardt, 1989). Positivism case study is the most widely method used in the development of theory and exploration (Leppäaho *et al.*, 2015). The case study is one of the best methods of bridging the rich qualitative evidence in deductive research mainstream (Eisenhardt & Graebner, 2007).

The case study is a method to test the contemporary phenomenon in a real life context, especially when the boundaries between phenomenon and context do not seem firmly by using multi-source evidence (Yin, 1989). The reality is understood through scientific reflection to be definitive (Rynes & Gephart, 2004), in which the philosophy of the case study lies in the integration of theory and practice in real-life case studies (Rendtorff, 2014).

In this regard, the following research questions: 1) what factors or roles are shaping the model of business incubators? And 2) what is the role of these factors on the new business?

### Research approach

The case selection is an important aspect in the development of the theory of the case studies (Eisenhardt, 1989). Characterizing the case is the result of a process of case studies and also one of the fundamental theories (Dumez, 2015). Based on the definition of business incubator that was developed at the beginning, the unit of analysis includes business incubator is developed by universities, corporations, government and Non-governmental Organization (NGO). The selection of case study uses multiple cases because it provides more interesting and powerful evidences (Yin, 1989).

The focus of the analysis is aimed at the organizational level, namely business incubator managers and experts to explore the business

incubation process. Further analysis is performed at the level of individual businesses which refer to the businesses that have come out of the incubation process. To examine the role of the incubation process for new businesses, both viewpoints are compared one to another. Incubator managers and experts provide information about the internal functions in the incubator as implementation of the process, innovation, resources and systems (Vanderstraeten & Matthyssens, 2012). Analysis on the both levels is conducted by collecting data through in-depth interviews, observation and archives. It is expected to be a valid conclusion on a higher level of analysis.

### Research strategy approach

The research strategy is to conduct a semi-structured interview to each business incubator. The interviewees are incubator manager and staff who are actively running the incubator's internal processes. Repeated interview made to key parties. Each party was asked the other parties, both organization and network of incubators that may be interviewed. At this early stage the data are collected by using open-ended interviews and observations.

The key interviewees consist of five informants of Business incubator manager: university business incubators (Innovative Academy), corporation business incubator (Kampung BNI and Jogja Digital Valley (JDV)), government business incubators (Integrated business Service Centre/Pusat Layanan Usaha Terpadu (PLUT)), NGO business incubators (Business Development Services (BDS)), and 10 new businesses start-up (incubated businesses). This is conducted to gain more profound understanding and accuracy (triangulation) (Jick, 1979). Business incubator is divided into two focuses that is focusing on technology and non-technology. The technology-focused business incubators are Innovative Academy and JDV, while the rest does not focus on IT. Research triangulation is carried out to reduce biased interpretations (Bøllingtoft, 2007). The use of multiple data source, method and researcher will enhance the reliability and validity of a case study (Mathison, 1988).

### Analysis approach

The focus on case study analysis method is to reveal the facts and compare them

with the proposition (Rynes & Gephart, 2004). This is consistent with the focus of the case study that is to sharpen constructs conducted in two ways: 1) refining the definition of the construct and 2) developing evidence to measure the construct (Eisenhardt, 1989).

Under this method, the focus of the analysis requires a strategy. If the case study is without a strategy, the analysis will be difficult, otherwise it will produce both internal and external validities (Yin, 1989). This research analysis strategy uses pattern-matching logic, the logic of comparing empirical patterns based and predictions; if the ratio corresponds, the result will strengthen the internal validity (Yin, 1989).

Key insights that emerge from data analysis are factors or roles of business incubator models, namely efficiency, selection, resources, innovation, networking, strategic support and adaptation. The impact of the seven roles on new business is analyzed, the precise definition of a business incubator models is produced and then how these constructs are identified comprehensively is explain.

#### **BUSINESS INCUBATOR: CONCEPTUAL DEFINITION REFINEMENT**

The seven factors (efficiency, selection, resources, innovation, networking, strategic support and adaptation) are processes that occur in a business incubator. Figure 1 shows the factors that make up a business incubator. In the input process, a prospective new business that will enter into a business incubator must pass through a pre-selection process and they will gain efficiency in business development while passing the selection. Furthermore, new businesses selected will obtain various facilities, this section is called black box by Hacket and Dilts (2004b) but in fact it can be explained by several theories. In this part, new businesses will obtain resource munificence consisting of resources and facilities, innovation, networking and strategic support. At the output level the new business will obtain adaptation facility that is a stage of new businesses to enter a business environment.

#### **Efficiency**

Business incubator helps new business development and supports through capital access, network access and shorter learning

time. Business incubator improves entrepreneurial management capabilities and supports or accesses to capital that make the development of new businesses become more efficient. Thus the efficiency of business incubators is consistent with the concept of transaction cost economics (Williamson, 1975), that enables a business incubator for developing new businesses through assistance or facilities provided by the business incubator. Efficiency is achieved through the help for capital access. Business incubators introduce new businesses to potential investors or capital owner and provide capital assistance to new businesses.

New businesses often fail because of the insufficiency of high risk capital access and weak of managerial skills. Despite their special knowledge, they are often less skillful in businesses. The facilities offered by a business incubator can be a means to address these issues (Bøllingtoft & Ulhøi, 2005). By providing a business incubator for new business reputation so as to facilitate access to capital owners (Studdard, 2006), the business incubator can improve the efficiency of new business development (Smilor, 1987a).

Business incubators provide assistance and access to capital, as well as training in business management skills to new business, so that it will have managerial skill in running the business. Additionally, business incubators also provide facilities for new product development so that new businesses will have technical skills. Thus business incubators facilitate skills and capital access to overcome capital constraints and managerial skills, so that the development of new businesses is becoming more efficient.

Business incubators in the study, owned by University, corporation, governments or NGOs, all of which provide efficiency in new business development. Business incubators provide resources and capital access. It has been conducted in order that a new business is skillful to carry business managerial. Business incubators provide facilities for the development of new products so that new businesses will possess technical skills. Business incubators facilitate skills and access to capital for new businesses to overcome capital constraints and managerial skills, so that the development of new businesses becomes more efficient.

The presentation explains that the first proposition is supported that business incubator play a role in setting up new businesses more efficiently. Efficiency and selection are related to each other. More selective in selecting new business will help business incubators use available resources more efficiently. Similarly, to be more efficient, business incubators need to conduct the selection process in order for an investment to succeed.

prospective entrepreneurs to fill out a registration form and 2) the business plan, then 3) asking the prospective entrepreneurs to present their business plans. The next stage is the development stage. If the business incubators do not conduct right selection, it will affect the results of incubation in that prospective new businesses are not ready to commit to the business development efforts. This means that the resources and facilities

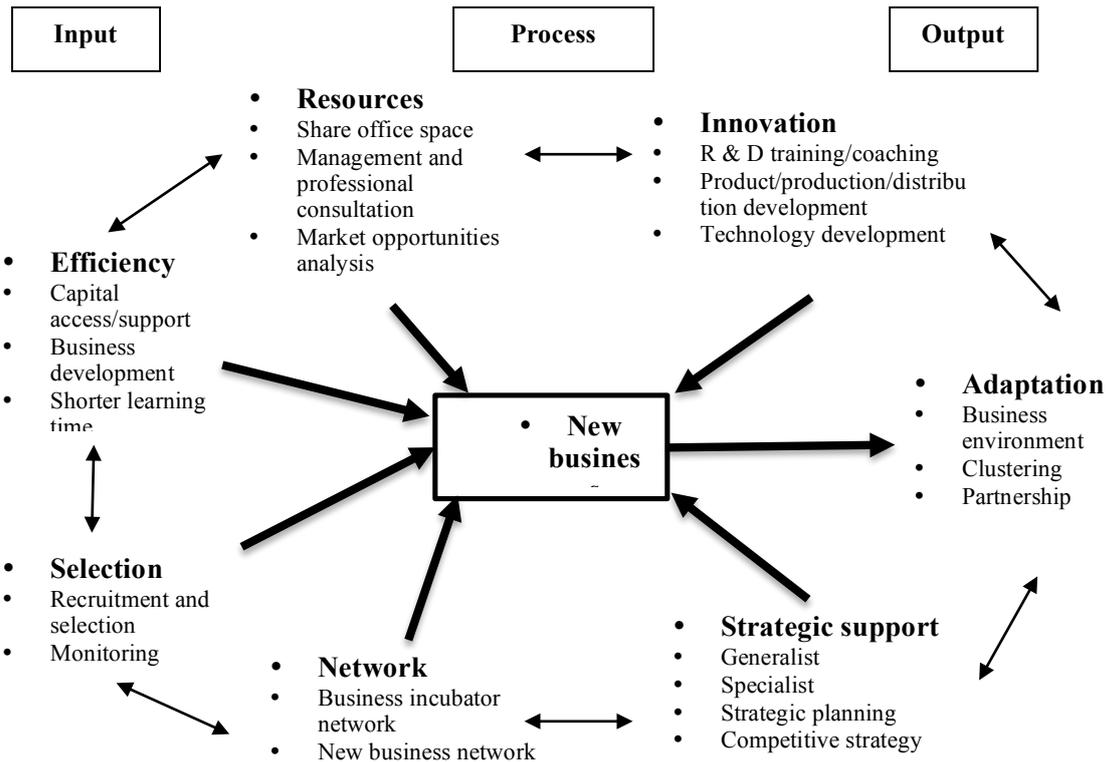


Figure 1. The role of business incubator model

### Selection

Business incubator conducts the selection process in finding a new business that will be incubated. Selection is conducted to obtain a candidate who has: ideas, the capacity of creating sustainable value in the future and growth, as well as the ability of rapid skills development (Grimaldi & Grandi, 2005). Performance that can be seen in the selection of the four characteristics are: management, market, and financial products (Hackett & Dilts, 2008).

Business incubators in this study generally perform selection to find the right candidate. Business incubators select them strictly in order to make the new business development become more efficient. The steps generally being taken are 1) asking the

provided by the business incubator will be inefficient. During the selection process and incubation, prospective entrepreneurs will continue to face the process of natural selection until they reach the phase out of the business incubator as the success of developing innovative products, a commitment to continue to fight for their business efforts and ability to overcome problems both inside and outside of themselves.

Integrated Business Service Centre (PLUT) is a business incubator developed by the government. PLUT generates new businesses and serves the needs or problems of small and new business. PLUT selects the candidate entrepreneurs by diagnosing the main problems faced by new business, because the problems reported by new business are not always the core/source of the real problems. For

example, new business reported that they are facing capital problems, but after being diagnosed the major problem lies in weak financial management or marketing that less effective etc. Based on the diagnosis, new business is put in a PLUT incubator and will receive training or mentoring assistance so that they can successfully run their business.

Business incubators belonging to universities and corporations conduct more rigorous selection. They hope new businesses and developed products are able to survive. Thus second proposition is supported, that the role of business incubators selection determines the new businesses that will be selected. The selection rule has been related to the interaction with the network developed by business incubators. The surviving new businesses will have greater opportunity in getting networks and participate in the networks.

### **Resource**

The main problem for small and new businesses is the lack of management skills and capital (Everett & Watson, 1998). The resource role could fulfill the skill needed by small and new business. The resource is one of the most widely discussed in the business incubator literature (Allen & McCluskey, 1990; Brooks, 1986; Greene & Butler, 1996; Merrifield, 1987; Plosila & Allen, 1985; Smilor, 1987b; Swierczek, 1992). Resources can be said as the core of the facilities and services in the business incubator. Actual resource in the business incubator is not capital merely, and many businesses prefer a business incubator that provides access to capital than the capital itself. Therefore, this paper excludes capital in resource factors because the capital or access to capital is an efficiency factor of new business development. Actual resource of new and small businesses is access to market opportunities (Alvarez & Busenitz, 2001; Shane & Venkataraman, 2000), management and professional consulting, and there is also a business incubator specialized in providing office space for new business.

In general, business incubators presented in this study have a great attention to resource facility. A university incubator like Innovative Academy and a corporate incubator like Jogja Digital Valley (JDV) both encourage product innovation and testing of market opportunities. In the testing, the process is

conducted repeatedly until certain products can be accepted in the market. In addition, new business is facilitated by a variety of consulting and training by bringing both management and professional experts. Business incubator developed by PLUT focuses more on resource factors. They focus more on the provision of consulting and training facilities relating to managerial, professional and market opportunities analyzes.

Generally, the business incubators in the study have a big concern on facility resources. University incubator such as Innovative Academy and corporations incubator such as Jogja Digital Valley (technology incubator), both to encourage new businesses to innovate products and test market opportunities. During the process, testing is conducted repeated until the product is certainly acceptable in the market. Besides, the new effort is facilitated with various consulting and management training both delivered by professional experts. The business incubators developed by PLUT, Kampung BNI and Business Development Service (BDS) focus more on the resource factors. Their focus is more on consulting and training facilities related to managerial, professional also market opportunities analyzes.

Based on the presentation, it is seen that third proposition is supported that business incubator play a role in providing services or resource facility for new businesses. The role of resource and innovation is interrelated one another. The business incubators resource will support innovation of the new business. The more innovative the new business is, the greater the demands on of business resource facility for new businesses.

### **Innovation**

Product innovation is a boost conducted by business incubators to new businesses. The new business is expected to create or modify product or production process, distribution and marketing of innovation is potential of value creation (Schumpeter, 1934). The study so far distinguishes between business incubators and science parks (McAdam & McAdam, 2008; Phan *et al.*, 2005; Ratinho & Henriques, 2010), in which mission and vision of operating procedures are often changeable (Phan *et al.*, 2005). In relation to innovation, actually no innovation differences between

business incubators and science park (Westhead, 1997). Both equally conduct innovation even though they put different focus depending on the strategy that directs the business by the incubators (Vanderstraeten & Matthyssens, 2012).

Innovative Academy belongs to the university, for example, is encouraging new businesses in creating a product, process, distribution, but it is not focused on the type of a particular product. Likewise, the JDV belongs to a corporation, product innovation has been conducted but it is more focused on digital products. PLUT, although it does not encourage new businesses to do innovation specifically, they provide consulting and training related to the new products. New businesses cannot be separated from innovation because it relates to liability of newness (Phan et al., 2005). This explains fourth proposition that business incubators play a role in providing innovation training for new businesses.

### **Network**

The network is formed by individual social interaction. Networking also allows integration between an organization (business incubator or new business) (Granovetter, 1983). Business incubators can help form a network. Incubation effort gives an opportunity to know each other and work with each other. Thus, business incubator becomes a liaison between the network activities (Bøllingtoft & Uhløi, 2005). The network is one of the effective means to promote product innovation of a new business (Antolín-López *et al.*, 2015).

Business incubators are aware of the importance of the network. They provide and pay attention to the network services for new business. A well-developed network is necessary among new business, business incubator, and between new business with resource providers (investors, suppliers, etc.). Since such network is important, business incubators improve relationships between new businesses and large businesses through partnerships. The partnership is believed to sustain the life of new business, while the network is a new business resource. It supports the fifth proposition that business incubators play a role in developing networks for new businesses. The whole business incubator in this study developed the concept of partnership

as networks. Furthermore JDV facilitates new business cooperation with big companies.

### **Strategic Support**

In addition to the five roles, the other important role is the strategic support. The strategy is one way of identifying business opportunities. This is conducted by connecting resources, networking and innovation (Hitt *et al.*, 2001). Business incubators drive new business to conduct generalist or specialist strategy (Larrañeta et al., 2012; Vanderstraeten & Matthyssens, 2012). This depends on the selection of the strategy undertaken by the business incubator itself (Vanderstraeten & Matthyssens, 2012).

Strategic support distinguishes focus of business incubator from one another. For example Innovative academy of university business incubator used generalist strategy. They gave option to the new business to develop the desired product. Conversely, JDV used specialist strategy that focused on digital products. Besides the two incubators with its strategic focus respectively, PLUT (government-owned incubator) also provide strategic support. PLUT and other business incubator also provides services and training relating to the competitive strategy of the business.

The focus of the specialist or generalist strategy differentiates one business incubator with another, but the role of incubator still remains the same. Thus, there is no difference between business incubators, science parks, and other types of business incubators except its strategic focus. Thus, the sixth proposition is supported that business incubators play a role in business strategy training for new businesses. JDV and Innovative academy (technology Incubator for example) has a big role in innovation compared to other business incubator.

### **Adaptation**

Adaptation of new business is the most important stage and become part of the role of business incubators to prepare for new business adaptation. Hrebiniak and Joyce (1985) stated that in order to adapt the organization, the relationship between the strategic choice and environmental determinism needs to consider. If the strategic choice is high while environmental determinism is low, the

organization will have a maximum strategic choice in conducting adaptation. Conversely, if the organization is in a high environmental determinism while the strategic choice is low, they will have minimal strategic choices in conducting adaptation. If the organization is in both high environmental determinism and strategic choice, strategic choices will face many obstacles. But if the organization is both low in environmental determinism and strategic choice, they will have to make changes in conducting adaptation.

The new businesses are particularly vulnerable to environmental influences so that they urgently need assistance in adapting. A business incubator in this role is functioned to assist adaptation of the new business. JDV for example, helps to facilitate the adaptation of new business through partnerships with companies that require product innovation to be developed. Kampung BNI assists adaptation by providing clusters for new and small businesses. The other business incubators help adaptation by providing consultancy and network access facilities. Similarly, PLUT conducts intensive monitoring to assist new businesses in order to be able to adapt to their

environment. Based on the analysis showed that the seven propositions developed has supported. Business incubators have performed seven roles in developing new business.

**DISCUSSION**

Business incubator has been called by various names while providing the same role in economic development (such as Business Accelerators, Research Parks, Science Parks, Knowledge Parks, Seedbeds, Industrial Parks, Innovation Centers, Technopoles, Networked Incubators) (Vanderstraeten & Matthyssens, 2012). The role consists of seven factors conducted by the business incubator is the insights that emerge from this paper. The role of the seven factors, namely efficiency, selection, resources, innovation, networking, strategic support and adaptation of the organization played by all types of business incubators is only distinguished from different proportions. Table 1 shows the seven roles played by business incubators developed by universities, corporations and governments but in different proportion.

Table 1. Role Focus of Business Incubators

<b>Business Incubator Type</b>	<b>Efficiency</b>	<b>Selection</b>	<b>Resource</b>	<b>Innovation</b>	<b>Network</b>	<b>Strategic support</b>	<b>Adaptation</b>
University: Innovative Academy	High	High	High	High	High	High	Medium
Corporation: Jogja Digital Valley	High	High	High	High	High	High	High
Kampung BNI	High	High	Low	Low	High	High	High
Government: PLUT	High	High	High	Low	High	Medium	High
NGO: BDS	High	High	High	Low	High	Medium	Medium

The role of business incubators can be seen from the perspective incubators and a new business perspective (see table 2). Efficiency indicates the role of economic development of a business incubator. It does not distinguish profit and non-profit business incubators, but based on its role in developing new business.

Then the business incubator acts as an agent of change in the conduct of economic transformation. The efficiency of the business incubation is derived from the provision of facilities and services of the incubator. However, the efficiency from the perspective of a business incubator is depending on the number of new business that has successfully

developed than those who failed. If the new business fails is larger than the success, then the role of business incubator becomes less efficient. Therefore, it is important for selecting the right candidate. Hacket and Dilts (2008) stated that in order to obtain a good performance of the selection, the selection process is based on the characteristics of management, market, products and finance.

Selection is an important step for the business incubator. To get a successful business development, business incubators should screen potential entrepreneurs who are committed to follow the process in the business incubator. For that, prospective entrepreneurs should prepare themselves to be able to fulfill the selection process run.

Table 2. The role of business incubators from the perspective of business incubator and new business

Perspective	Efficiency	Selection	Resource	Innovation	Network	Strategic support	Adaptation
Business incubator	Business incubator capable of producing a large successful business new business	<ul style="list-style-type: none"> <li>Recruitment and selection of candidates</li> <li>Monitoring the development process</li> </ul>	Provide share office space facilities, training/coaching consultation and analysis of market opportunities	<ul style="list-style-type: none"> <li>Provide R&amp;D training</li> <li>Product development, production and distribution process</li> </ul>	Business incubators provide network facilities	Business incubator strategy leads to a generalist or specialist	Preparing environments, clusters and business partnership
Business new business	The formation of new businesses efficiently through capital access and learning	<ul style="list-style-type: none"> <li>Prepare to be eligible to become a new business</li> <li>Follow the stages of the selection process</li> </ul>	<ul style="list-style-type: none"> <li>Facilities, training and consultancy has an impact on business development</li> <li>Obtain analysis of market opportunities</li> </ul>	Innovation facility impact on the development of products or production or distribution of new business	Networks impact on business development	Both generalist and specialist strategies impact on the progression of new businesses	Environment, clusters and partnerships help new business adaptation

Resources, innovation, networking and strategic support provided by the business incubator is intended to facilitate the development of new businesses. From the perspective of new business, resources, innovation, networking and strategic support are expected to impact effectively on new business development. In terms of adaptation, business incubators are working on making a new business to survive. Similarly, the new business expects the assistance after leaving the business incubator.

Based on the theoretical development and business incubator analysis, it shows that each of the theories is interrelated each other. Thus, there is no single priority theory in the

study of business incubators, but integration of various theories. Table 3 shows the degree of each business incubator role of the various theories. Various theory approaches suggest that business incubator is a unit of analysis at the organizational level. Based on this, the following definition of a business incubator can be proposed:

*Definition: Business incubator is an organization that works to develop new businesses efficiently by facilitating resources, innovation, networking and strategic support, as well as preparing a new business for adapting to the environment to reduce the failure rate of*

*new business as well as improving the chance to survive and grow.*

The concept of business incubators indicates the same role of all types of business incubator, only the focus on each factor or role that distinguishes the one and the other incubators. This concept has answered research

questions and gaps that missed from the previous studies. The concept of a business incubator can be drawn from a variety of perspectives of business incubator and new business.

Table 3. Theoretical Integration in the role of business incubators

	Efficiency	Selection	Resource	Innovation	Network	Strategic support	Adaptation
Transaction cost economics	High	Medium	Low	Low	Low	Low	Medium
Real option	Medium	High	Low	Low	Low	Low	Medium
Resource based view	Low	Medium	High	Low	Low	Medium	Medium
Schumpeterian innovation	Low	Low	Medium	High	Medium	Medium	Low
Network theory	Medium	Low	Medium	Medium	High	Medium	Medium
Business strategy	Medium	Low	Medium	Medium	Medium	High	Medium
Organizational adaptation	Medium	Low	Medium	Low	Medium	Medium	High

**CONCLUSION AND IMPLICATION**

Business incubator reviews have been criticized because of its inadequate theory. Contemporary studies seek to answer by offering new theories relating to the business incubator instead of developing a strong concept. This paper seeks to answer the needs of the business incubator concept development using cross-case analysis of various types of business incubator. This concept describes the business incubator as a multi-dimensional, consisting of seven roles: efficiency, selection, resources, innovation, networking, strategic support and adaptation efforts. This concept also offers an integrated view in terms of economic development. Business incubator is not viewed from a variety of types, but rather from the function or the role. Thus, the types of business incubators have the same role, but only the focus of each role is different.

The analysis showed that the role of business incubators cannot be viewed merely from one theory. By using a grounded theoretical approach development, it was found that the role of business incubators can be explained by integrating several theories, such as: transaction cost economics, real option theory, resource-based view, Schumpeterian innovation, network theory, business strategy

and organizational adaptation. Further studies will be more useful if examined from institutional theory, which is concerned with the legitimacy of business incubator itself and transfer the legitimacy of a business incubator to new business. Integrating entrepreneurship and resource munificence theory in the new business aspects will also to be more useful to deeper, in terms of individual entrepreneurs of new business. Further studies related to the methodological approach in studying business incubators and new business from the business incubator are needed.

This study has practical and policy implications. The practical implication for business incubator managers is that managers have deeper understanding the role played by the incubator, and which role is more dominant to perform. This will have implications for the selection and efficiency roles of developing new businesses. When the business incubator managers select for new businesses that are less correspond with the typical incubator, it will affect the suitability of the role of the services provided such as: resources, innovation, and strategic support. Technology-based business incubator for example will select new businesses which are able to meet the demands of the incubator and is ready to provide adequate resources, innovation, and strategic support. The suitability of the selection of new

business with the dominant role of business incubators is expected to increase the survival of new businesses.

The policy implication of the government is that business incubators are not always able to provide buildings or share office for new businesses. A building facility is one of the roles of resources. Business incubators have seven major roles contributing to the development of new businesses. Therefore the definition and seven business incubators roles in this study will facilitate the government in setting the right policies in an effort to encourage the acceleration of new business development through some supports to business incubators.

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## **HOW CAN THE FAMILY BUSINESS CULTURE OVERCOME THE TRILEMMA MANAGEMENT (LESSON LEARN FROM PEKALONGAN BATIK INDUSTRY, INDONESIA)**

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### **ABSTRACT**

*The objective of this paper is to describe how can the family business culture overcome the trilemma management: to achieve production quickly, cheaply and high quality. This research used the qualitative method and phenomenology approach based on the theory of organizational culture and social learning. Data collected by observation, interview and documentation. This study illuminates the cultural construct of batik family firm: intimacy, communication warm, hard work, long term orientation, and confidence. The trilemma management that occurs in the batik industry was able to overcome using the culture of family. Harmonious culture, cooperative and innovative encourage batik products at very competitive.*

**Keywords:** *Family Business Culture, Trilemma Management, Batik Industry.*

**JEL Code :** A11

### **INTRODUCTION**

Family's culture has in shaping a positive atmosphere within a company (Denison, Lief and Ward, 2004). The family power and family culture have a positive influence on the ambidextrous orientation in family firms and that higher levels of ambidextrous orientation lead to a better economic performance (Stubner, Blarr, Brands and Wulf, 2012; Erdem and Baser, 2010; Zachary, R.K, 2011).

Families and businesses provide resources to the entrepreneurial endeavors of family members in the form of social capital, human capital, and assets including both financial and physical capital. Social capital includes the interrelations between and among family members. For example, trust is a specific aspect crucial to entrepreneurial activity. Family businesses have an advantage over

non-family businesses due to the enhanced possibility of trust among family members. Human capital includes the human attributes of the individuals in the family such as personal time and energy, as well as emotional support (Danes et. al, 2008; see also Zachary, R.K, 2011)

Although the dominant role of the family values on these firms' cultures is accepted, the fact is too complex to explain with this effect one to one. The firm's cultural values affected intensively by the founder's personality and values in the beginning can be affected in time by other members of the family and other groups in the firm. In the other side, many factors such as the firm largeness, sectoral properties and socio-cultural environment's properties affect the firm values. Some values become in the first plan according to life cycle

of the firm. For example, ambition, reliability, responsibility, hard work, honesty and growth are the entrepreneur's values revealing mostly in the foundation of the firm. Values such as openness and ability can be concerned long-term survival and growth of the organization (Alvarez and Lopez-Sintaz, 2001).

Business trends put a company in a situation is no longer a dilemma but trilemma conditions. Not only an economic problem, profit and loss, the demands of consumer satisfaction that always want the goods with good quality, cheap and fast service turned out to be not only affects the company's corporate family at the level of small industry and middle. Many researchers have examined the relationship the company of family and work values. Job and family values of the firms attending to the research are in harmony with the values determined in family firm literature (Vallejo, 2011; Lorraine, Kellermans,

Eddlestone, and Hoy, 2010). innovative property is dominant in job values of the firms attending to their research and conservativeness in family values of them. This situation can lead to the perception that at the first sight economic and social values are contrast structures in family firms. Whereas it is seen that family firm which have accomplished to be eternal can manage the global-local dilemma successfully (Erdem and Baser, 2010).

### THEORETICAL FRAMEWORK

The conceptual framework guiding this research evolved from many fields of business as organization –organizational culture and social learning. The analysis about the role of family culture which built from culture construct and its influence to overcome their trilemma management as theoretical framework of this research on figure 1.

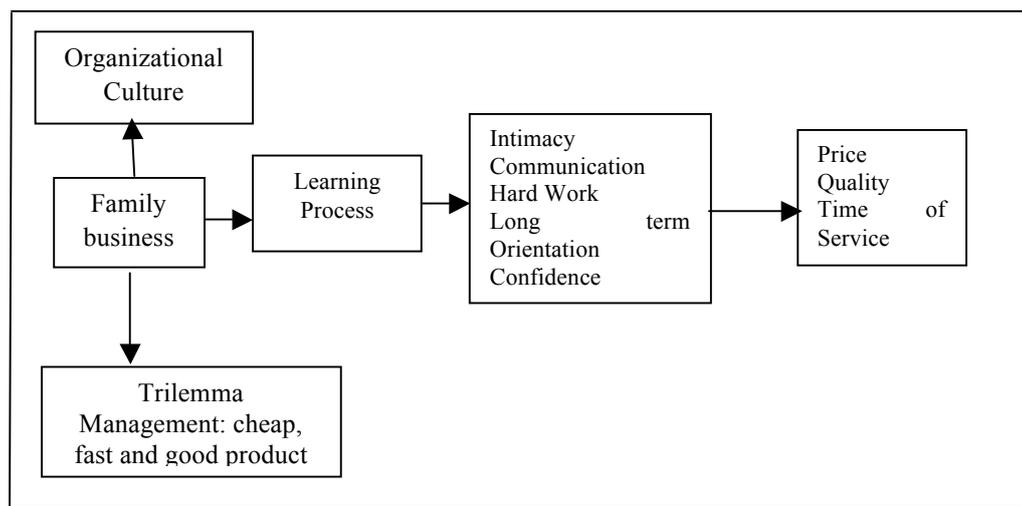


Figure 1. The theoretical framework of the research

### Family Business as Organizational Culture

The strategic activities in an organizational and cultural context within one unit is needed (Barlett and Ghoshal, 1990).

As research on family firms and work on theories of family firms has progressed, the concept of “familiness” as a multidimensional continuum has gained credence (Danes, Loy and Stafford, 2008). Familiness as ranging from synergistic to constrictive. Synergistic familiness would have beneficial effects on firm performance, but constrictive familiness

would have negative effects on firm performance (Habbershon, Williams, and MacMillan (2003).

### Industry as Social Learning

Rooted in the culture of an organization, market orientation is a resource that is difficult to imitate by competitors (Homburg and Pflesser, 2000). The organizational learning may help to design studies that focus on the actual pricing process (Moorman, 1995). With respect to market relationships as sources of value-informed pricing are however not

necessarily restricted to the dyads between buyers and sellers (Ingenbleek, 2007).

Family firms must strive for a culture that is explicit and open. Explicitness ensures that individuals are fully aware of what behavior is encouraged under the current culture, while openness encourages individuals to create and express new thought and ideas, which may question the firm's current culture (Hall, *et.al*, 2001).

**METHODOLOGY**

**Research Design**

The family business cases were studied through a research design which combined elements of grounded theory, ethnography, single case study and cross analysis (see Eisenhardt, 1989). In family firm researches, there are four analysis levels: individual, interpersonal/group, organizational and societal (Sharma, 2004). The aim of this

research is to explain family business culture-value based which carry on Pekalongan as the most fabulous region of batik industry in Indonesia, and how it can be used to overcome the trilemma management which consist of consumer orientation

**DISCUSSION AND CONCLUSION**

**Batik as social and economy endurances.**

Batik be one of the featured products based Regulation Of The Mayor 530/216, 2002. Pekalongan City Government Sets The 6 (Six) Regions Leading Products, besides the processing of fish, Convection, Weaving handloom, Handicraft Water Hyacinth and Natural Fibers.

**Table 1.** The Classification Business Actor

No.	Classification Business Actor	Total Business Unit
1.	Businesses that have IUI (Industrial Business License)	108
2.	Businesses that have TDI (Industrial Registration)	942
3.	Informal SMEs (Market Vendors, street vendors, etc.)	5.374
<b>Total</b>		<b>6.424</b>

Source: Department of Industry, Trade, and SMEs, Pekalongan City, 2015

From table 1, batik industry scattered in several categories of industry. One thing must be know that the relation between trader, maker which consists of employer and employee can be seeing clearly in *mbabar* business model of batik. Trader or the wholesaler is a businessman located outside from Pekalongan, example: Bali, Jakarta, Sumatra and other cities, he has the first order to big entrepreneur as the supplier for other different producer, until their employee. This is not ordinary patron-client relationship, their relation based on two main human interest: economic and culture. Another different thing we found that workplace and home are not different function anymore. The function of home has changed, because until this time, we can easily find that the people prefer to bring their work at home. Rationally, it's more flexible and convenient when they must

**Make Sure the Management Strategy**

combine the family responsibilities with their job. Even not only for make batik, they also can receive other job at their home, because job opportunity is scarce. A producer must take a strategy to gain the competitive advantage through seek a lower cost production. The business model of batik production represents not only the family kinship but also their neighbour. The positive influence of the involvement of family members in management offers more benefits than harm. With the stewardship perspective propose that involving family members in firm management allows family members to gain a better understanding of where the organization is headed, appreciate the challenges facing the firm, and make decision that they believe will maximize firm performance (Kellermen, Eddleston, Sarathy & Murhpy, 2010).

The construct of family firm culture in Pekalongan, first, intimacy that has closely

related to the suitability of individuals and organizations. Family firms suffer less from agency costs because ownership and management are in the hands of the family, and agent and shareholder have the same goals (Fama, 1980; Park and Shin, 2016).

Second, warm communication. At the workplace, the member family had to communicate with their worker in warm situation, we call it *rahat*, it's mean happy, talk each other and support between them. Strong families are good at communicating. This quality is closely related to the above qualities. Good communication takes time. They not only talk frequently, but they also know how to listen, thereby demonstrating mutual respect for all family members (Vallejo, 2008).

Third, hard work. Historically, batik not only as traditional man made or as social practiced but also about myth as belief that had strong relation with trust. By mystical culture, batik be trusted as medium of expression to conduct human world to god and goddesses world.

Fourth, long term orientation. Family business continuity requires togetherness of family and awareness to environment. To face the industrial change, its need to be aware for the family. It's important to get mentality such calmness, patient and positive thinking to adapt it. The spirituality force which try to make equality between spiritual and physical needy is very important not only for employer-employee in their relationship, but also to adapt the business change.

Patient also had been an implication for mystic expert, because patient was a key of happiness and love proved to God. This value lead a member of family to manage their firm. So, the leader must be clear regarding their own ethical beliefs and the ethical values of the approaches they adopt to change, in order to make a greatest good for the greatest stakeholder (Burnes & By, 2011). Fifth, confidence. The confidence of entrepreneurs is the main basis for business continuity.

#### a. Price

Family business are also often seen as very cost efficient (Anderson and Reeb, 2003). The price is, in fact, a multidimensional phenomenon and this multidimensionality hinges on the positive and negative aspects of price. There are

seven construct of consumers' price preceptions: value consciousness, coupon proneness, price consciousness, sales proneness, price mavenism, price-quality schema, and prestige sensitivity (Lichtenstein et.al, 1993).

Culture is the collective programming of the mind that distinguishes the members of one category of people from those another (Hofstede, 1980). The culture factors do have significant effects on price perception. Internal reference price has a consistent and negative effect on the overall price perception of both goods and services purchase and durable and non-durable goods purchase. However, the significant associations between price perception and overall price perception were only found in the services and non-durable goods purchase but not in the durable goods purchase. The culture also influencing the price perception (Meng, 2011).

Small and medium-sized For each industry, decision on pricing strategy is very hard. Ultimately when it faced with industry sustainability and customer satisfaction. To overcome pricing strategies managers use under different situations. The price decision system involves series of checks and balances and builds on formal and informal sources of information as well as the personal experience of the many individuals involved. Price objectives remain fairly constant over a longer period of time (Capon, 1975).

On the other hand, value-informed pricing have a big role in organizational context. It should be note that value-informed pricing is not taken for granted. Several implications for firms can be drawn.

#### b. Quality

The customers trade perceived price off against perceived quality, resulting in a "value perception" that is the basis of purchase intentions (Grewal, et.al. 1998). Improving the quality of an organization's products and services is fundamental to business success.

Quality has become a major strategic weapon for competing in a challenging environment. Small business owners and prospective entrepreneurs have a vital stake in quality control. Achieving high quality

standards is an attractive goal for most small business owner. It could have a positive economic impact on increasing sales, market share, profit or level of customer loyalty (Weinrauch and Natarajan, 1992). Quality is not an abstract generality, mere cheerleading, nor a popular buzzword that is now in vogue.

Employee structure of family business is unique in that there are both family and non family employees affecting firm culture where quality practices are executed (Danes, Loy and Stafford, 2008). There are eight different performance goals for quality programs: improved product quality; increased efficiency; improved customer service; cost reduction; improved decision-making; less defects; improved teamwork; and increased productivity.

#### c. Services

An important internal feature of family-owned firms is the nature of their employee structure; employees may include both family and non family employees. Another important internal feature is the feasibility of informal management practices and intuitive decision-making. Centralized decision making may enable a small firm to be quick, flexible, and responsive (Ellington, Jones, and Deane, 1996).

The research found that intimacy, communication warm, hard work, long term orientation, and confidence becomes foundation of management. The atmosphere was already building a work culture that is conducive for the business continuity batik. Business challenges are generally also experienced batik entrepreneurs. The consumer satisfaction at a cheap price, prompt delivery and product quality being a main problem in SMEs management. The trilemma management was able to overcome using the culture of family. Harmonious culture, cooperative and innovative encourage batik products at very competitive.

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## **EFFECT OF NON-FINANCIAL ASPECTS TO FINANCIAL STATEMENT FRAUD AND EARNINGS MANAGEMENT IN THE FAMILY BUSINESS**

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### **ABSTRACT**

*The world was shaken by the accounting scandals, which makes a family business that originally had the aotounding progress until finally they have business destruction (Agrawal & Sahiba, 2005; Brennan and McGrath, 2007; Bhasin, 2012). Research by Price Watherhouse Corporate (2014) showed that the prime priority in family business was business continuity (16%), business professionalism (13.2%) and profitability (11.9%). How non-financial aspects of the family business affect the financial statement fraud and earnings management? The indicator of non-financial aspects of family business was family control and influence, identification of family members with the firm, binding social ties, emotional attachment of family members, and renewal of family bonds to the firm through dynastic succession (FIBER). The research sampling techniques was random sampling. Data analysis used path analysis. This analyses showed that Non-financial aspects of the family business has an effect to the financial statement fraud through earnings management*

**Kata Kunci:** *family business, socioemotional wealth, financial statement fraud, earning management*

### **INTRODUCTION**

The world was shaken by the presence of several accounting scandals committed by Enron, Health South, Tyco, Wordcom (Agrawal & Sahiba, 2005) in the United States, HIH in Australia (Brennan and McGrath, 2007) and Satyam Computer Limited is happening in India (Bhasin 2012). The company evolved from a family business, until they are able to attract investors to invest in such companies. Accounting scandal which had been done by the company include earnings management and financial statement fraud, that finally make it bankrupt. Earnings management and financial statement fraud that destroyed the family business, should be prevented, if the business owner wants to survive in the long term, it may even be passed on to future generations.

Surveys by Price Watherhouse Corporate (2014) showed 95% of companies in Indonesia is a family business, and has contributed 25% to the GDP of Indonesia, with the presentation of the highest turnover in the range of 5-10 M (27%). The survey results also show a top priority in the Indonesian family business is business continuity (16%), business professionalism (13.2%) and profitability(11.9%). Based on the survey, the family company's goal is not only the financial aspects but also non-financial.

The results of several research in the field of family businesses, show that the main purpose of the family business was not only the financial aspects (Chrisman, Chua, & Sharma, 2005; Chrisman, Steier, and Chua, 2008), but also the aspect of non-financial (Gomez-Mejia,

Haynes , Nuñez-Nickel, Jacobson, and Moyano-Fuentes (2007); Gomez-Mejia, Makri, and Larraza Kintana (2010); Berrone, Cruz, Gomez-Mejia, and Larraza-Kintana (2010); and Gomez-Mejia, Cruz , Berrone, and De Castro (2011). All these reseach lead to the emergence of the theory of socioemotional wealth proposed by Gomez-Mejia et al. (2007), which was developed based on behavioral agency theory put forward by Wiseman and Gomez-Mejia (1998) and Gomez-Mejia, Welbourne, and Wiseman (2000).

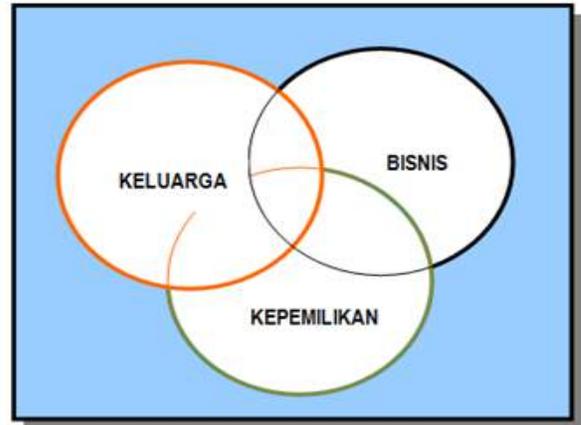
The objectives of non-financial in a family business was able to prevent the occurrence of earnings management and financial statement fraud. How was the influence of the aspect of non-financial was able to prevent earnings management and financial statement fraud. This paper aims to examine the influence of the non-financial aspects to the financial statement fraud through earnings management. The results of this study will be one approach to prevent financial statement fraud, especially through the practice of earnings management, which can cause the destruction of a family business.

#### LITERATURE STUDY AND HYPOTHESES DEVELOPMENT

##### Family business

The family business consisted of of two or more family members who oversee corporate finance (Ward, John L, Craig E. Arnoff, 2012). The family involved of business when there are at least two generations in the family, and they affect the company's policy (Donnelley, 2012). Family business when a family, or someone from the family, have at least 20 percent of the right to cash flow in the company either directly or indirectly, through the ownership of shares in both the public entity or private (Maryana, 2011). The characteristics of the family business in general is that family businesses: (1) owned by a family group single dominant with share ownership of more than 50% (2) perceived as a company, (3) managed by people rang that come from the owner's family the majority of shares (Westhead, 1997). Business consist of two types: (1) Family Owned Enterprise (FOE). Companies owned by

the family but managed by professional executives who come from outside the family circle. (2) Family Business Enterprise (FBE). The company owned and managed by members of the founding family. John Davis and Morris Taguiri (Hoover, 2000) states that there were three (3) elements of influence in the family business, as shown in Figure 1



Source: Hoover, 2000

Figure 1  
Three Elements of Family Business Taguiri

Based on these picture can be described as follows:(1) The family, success in the family was measured in terms of harmony, unity, and development of individuals who are happy with a solid self-esteem and positive. (2) Business, an economic entity in which success was measured not on self-esteem and interpersonal pleasure of the individual, but in the productivity and professionalism. So that the main measured of a person lies in contributing to the implementation of the strategy, achieving the target, and the profitability of the company. (3) Ownership, based on one's role in the investment in the company, the role of minimized risk, represent companies dealing with outsiders. These three elements was mixed together even the boundaries between the three blurred and invisible.

Many aspects of the family business was different from non-family business. The goals of family business not only financial but also non-financial was that underlie the development of the theory of wealth Socioemotional. Aspects

of non-financial in theory Socioemotional consists of five things: (1) family control and influence, (2) Identification of family members, (3) Binding social ties, (4) Emotional attachment of family members, (5) Renewal of family bonds to the firm through Dynastic (Berrone, Pascual, Cruz & Lois R Gomez-Mejia, 2012)

### **Earning management**

Earnings management was the accounting policies applied by the manager of financial. Accounting Standards would able to minimize the earning management (2006). Earnings management the financial numbers game (game of financial figures) were done through creative accounting as a result of looseness flexibility Practices principles issued by GAAP (Mulford and Comiskey, 2002). Don E Giacomono and Jodi L Bellovary (Diaz, 2013) describes the earnings management was the management's efforts to influence and manipulate reported earnings with accounting methods or changes in methods, recognition of transactions instantaneous non-recurring, suspend or accelerate expense or income, or other methods affect earnings. Scipper (2009), earnings management was intervention deliberately done by the management in the financial reporting process used for management purposes

Previous studies showed that 56% of family businesses carried out earning management in the form of a decrease in corporate profits (Lasdi, Lodovicus, 2008), other studies show that family businesses indicated using some earnings management strategies (Achmad, Subekti et al, 2006). Earnings management behavior will be made by the family business when the company's performance in good condition (Stockmans, Anenelis, Nadine, 2014).

### **Financial Statement Fraud**

Fraud was translated as an aberration, as well as errors and irregularities respectively translated as kekelioruan and irregularities. The difference error and irregularities done inadvertently, fraud done intentionally. Financial statement fraud (Rezaee, 2005) was attempt by corporations to deceive or mislead users of published financial statements,

especially investors and creditors, by preparing and disseminating materially misstated financial statements

The consequences of earnings management, usually the company would take action financial statement fraud (Dechow, 1996; Beneish, 1997; and Jones et al, 2008). The previous research showed that management likely to make a profit, because the company did not commit fraud there was no earnings management practices (Antigone, Johan & Barbara, 2010). The action was very attractive earnings management will lead to financial statement fraud (Marai & Vlandan, 2013). The results of the study in Indonesia showed that the earnings management of the company was likely to cause action financial statement fraud (Puspatrianti & Fitriany, 2014), these results differ from the study conducted by researchers previously showed that earnings management will be undertaken by the company are not always will result in financial statement fraud measures (Wijayanti & Ahmad, 2014).

### **Hypothesis**

Previous research explain, one of the aspects of the socioemotional wealth motivate the occurrence of earnings management for companies that have poor financial performance (Stocmans et al, 2010). Other studies have also explained that the socioemotional aspects of wealth, the family control and influence have an influence on the occurrence of earnings management (Martin et al, 2014).

Research conducted by Decow et al, 1996; Benes, 1997; Lee et al 1999 in (Parols & Barbara, 2010), show that earning management indicated to financial statement fraud. The companies with financial statement fraud indicated to earning management (Parols & Barbara, 2010). Another study conducted by Basley (1996), Unzun (2004), Farber (2005), Partner (2002) in Veronica (2005), Chen (2006), Wright (2003). Wilopo (2006) revealed that the worse implementation in good corporate governance (characteristic of the board and ownership structure, the Effectiveness of control, integrity management), all of which was indicators of aspects of the

socioemotional wealth has an influence on the occurrence of financial statement fraud. The hypothesis in this study was the aspect of non-financial family business will affect to financial statement fraud through earnings management as an intervening variable.

#### **RESEARCH METHODS**

This research was quantitative, where the subjects in this study was the owner or manager of the family business. This study used to primary data was obtained from questionnaires distributed to respondents, in this case the owner or manager of the family business. The sample in this study consisted of family business owners or managers of small and medium-scale enterprises (SMEs), who filled out a questionnaire. The sampling technique used was non-random sampling

This study has three variable, they are non-financial on socioemotional wealth aspect as independent variable, financial statement fraud as variable dependent and earnings management as an intervening variable. The indicators used in financial statement fraud is 1) Covering the inability to generate cash flows was good. 2) Eliminate the bad perception of the performance of the company 3) to obtain financing, refinancing or extension of financing, 4) covering the abuse / misuse of assets as well as maintaining the image of a reliable management (Diaz, 2013). These indicators are translated into six (6) questions in the questionnaire distributed to respondents. Earnings management measured by indicators 1) management's efforts to influence or manipulate earnings either with or changes in methods of accounting methods, 2) recognition of instantaneous transactions that do not recur, 3) suspend or accelerate expense or income, 4) use of other methods to affect earnings. For variable non-financial as variable independent will be measured through indicators within the dimensions of socioemotional wealth: (1) family control and influence, (2) Identification of family members, (3) Binding social ties, (4) Emotional attachment of family members, (5) Renewal of family bonds to the firm through Dynastic

Measurements were made questionnaire with questions according to the indicators above, the questioner in value by a Likert scale of five points (1-5). The results of the questionnaire will be analyzed with path analysis (path analysis).

#### **RESULTS AND DISCUSSION**

Central Java is a province of Indonesia, located in the central part of Java Island. The province is bordered by West Java province in the west, the Indian Ocean and Yogyakarta in the south, East Java in the east, and the Java Sea in the north. Its area is 32 548 km<sup>2</sup>, or approximately 25.04% of the size of the island of Java. Central Java province also includes the island of Nusakambangan in the south (near the border with West Java), and Karimun Java in the Java Sea. For administrative, Central Java province consists of 29 districts and 6 cities. District administration and city administration consists of 545 districts and 8,490 villages / wards. Data obtained from explaining existing family businesses in Central Java became the richest man in Indonesia, while some family business has also become a legend in Indonesia. A source of data in this study was a questionnaire distributed to respondents. The questionnaire was distributed to 200 respondents, namely the owner or manager of a family business in Central Java. A total of 142 questionnaires were returned, after the process turned out only 138 questionnaires can be used in the test data.

Family business in Central Java has many types of industries. The sample in this study shows that manufacturing was the most industry types of family business in Central Java's

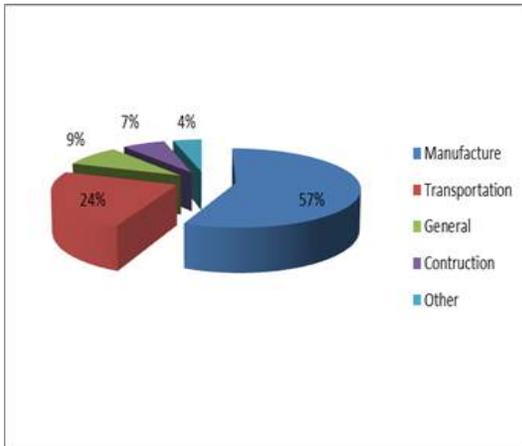


Figure 2  
The Type of Family Business Industries

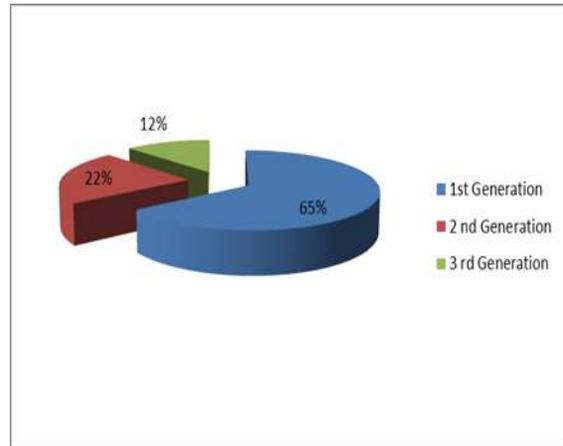


Figure 3  
The Generation of Family Business

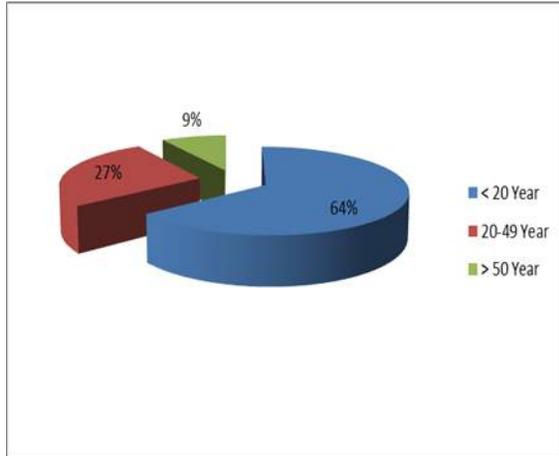
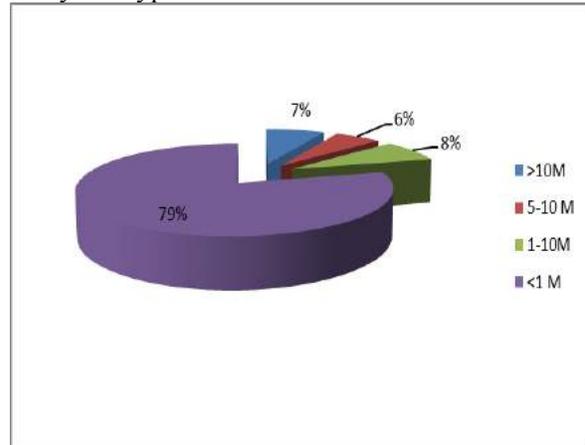


Figure 3  
Age of Family Business

In addition to the industries, the research also obtained data on the age of the company. Family business into the sample in this study has more than 50% more than 20 years; this means that the sample was a new family business so they needed good corporate governance. Good Corporate Governance, one of way to the family business to be survives.

Family business turnover of the sample in this study was ranged below 1 M; it indicates that the majority of companies sampled in this study is a type of SME.



Gambar 4  
Turnover of Family Business

The samples showed that most of the family's role in the family business than the owners they are also the management of the company. This data supports the type of business families sampled in this study are SMEs. Family business management done by founder or owner

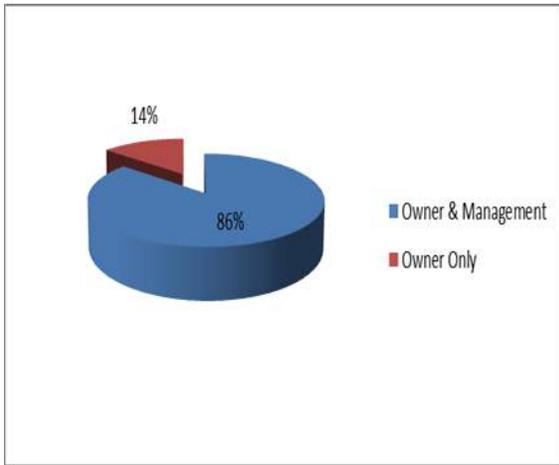


Figure 6  
Management in Family Business

The age of the majority owners of family businesses was 45-54 year, shows that business owners were the founder of the business. to maintain future of family business, it is necessary to prepare the next generation.

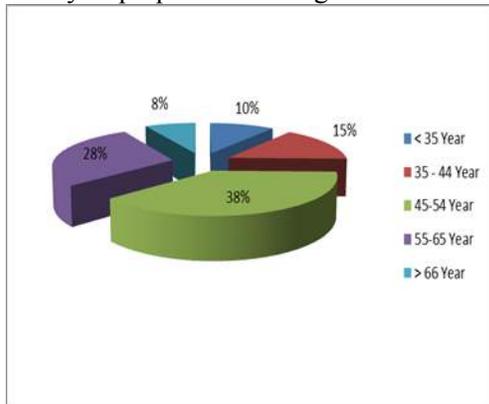


Figure 6  
Age Of Family Business Owner

**Validity and reliability**

Validity and reliability of items used to measure the accuracy of an item in the questionnaire, untu know whether the items in the questionnaire can accurately measure in accordance with the wishes and needs of researchers. The validity of test methods used in this study used to the corrected item-total correlation.

Test of reliability was used to determine the consistency of measuring instruments, measuring instruments used to reliable and consistent if the measurement is repeated.

Reabiitas test method used in this study with cronbach's alpha method. According sekaran (1992) the reliability of less than 0.6 are considered unfavorable, while 0.7 is acceptable, and above 0.8 excellent.

a. Non-Financial Business family Results validity and reliability for variable Non-Financial Business family, in each indicator was as follows:

Table 1  
Validity and Reliability of Non-Financial

Question	Criteria	Value	Explanation
I1	>0.4	0.901	Valid
I2	>0.4	0.903	Valid
Crosback			
alfa	>6	0.785	Reliable
B1	>0.4	0.870	Valid
B2	>0.4	0.872	Valid
Crosback			
alfa	>6	0.682	Reliable
E1	>0.4	0.881	Valid
E2	>0.4	0.888	Valid
E3	>0.4	0.817	Valid
Crosback			
alfa	>6	0.818	Reliable
R1	>0.4	0.930	Valid
R2	>0.4	0.808	Valid
Crosback			
alfa	>6	0.694	Reliable
F1	>0.4	0.584	Valid
F2	>0.4	0.584	Valid
Crosback			
alfa	>6	0.709	Reliable

Source: data processing  
b. Earning Management

The validity and reliability result for variable earnings management:

Table 2  
Validities and reliability of Earning Management

Question	Criteria	Value	Explanation
ML1	>0.4	0.891	Valid
ML2	>0.4	0.891	Valid
ML3	>0.4	0.795	Valid
ML4	>0.4	0.744	Valid
Crosback alfa	>6	0.835	Reliable

Source: Data Processing

Based on the results above shows that all the items in the list of questions for earnings management was valid and reliable

c. Financial Statement Fraud

The validity and reliability result for variable Financial Statement Fraud

Table 3  
Validities and Reliability of Financial Statement Fraud

Question	Criteria	Value	Explanation
FSF1	> 0.4	0.821	Valid
FSF2	> 0.4	0.593	Valid
FSF3	> 0.4	0.625	Valid
FSF4	> 0.4	0.798	Valid
FSF5	> 0.4	0.511	Valid
FSF6	> 0.4	0.475	Valid
Crizsback Alfa	>0.6	0.719	Reabel

Source: Data Processing

Based on the result, shows that all the items in the list of questions for Financial Statement Fraud were valid and reliable.

Normality test

Normality test data into a fundamental prerequisite in parametric analyzes including regression, because the data that will analysis should be normally distributed. Normality test used to determine whether a population of normal distribution of data or not. Data would be distributed normally if the significance level was greater than 0.05.

Table 4  
The Normality Test

Variable	Criteria	Value	Explanation
Financial statement fraud	Sig >0.05	0.12	Normal
Earning Management	Sig >0.05	0.26	Normal
Non-Financial Family Business	Sig >0.05	0.12	Normal

Source: Data Process

The results of normality test showed that the population of normal distribution of data and could be used for analysis of the next stage.

**Path Analysis**

Path Analysis method used large-scale data metric (interval). Because the data of this study was formless interval (ordinal shaped data), so that the data needs to be converted into a scale interval scale using Method of Successive Interval (MSI). Path diagram created by the relationship between the variables studied.

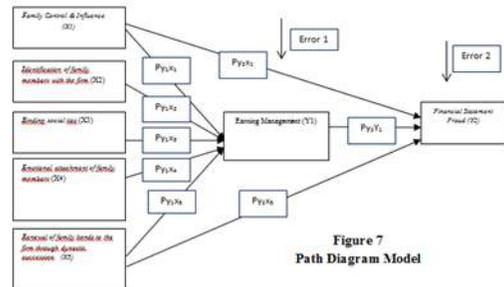


Figure 7  
Path Diagram Model

- X<sub>1</sub>: Family Control & Influence as independent variable
- X<sub>2</sub>: Identificación of family member as independent variable
- X<sub>3</sub>: Binding social ties as independent variable
- X<sub>4</sub>: Emotional attachment of family members as independent variables
- X<sub>5</sub>: Renewal of family Bonds to the firm through dynastic as independent variable
- Y<sub>1</sub>: Earning Management as intervening dependent variables

$Y_2$ : Financial Statement Fraud dependent variables

The diagram above has two lanes in the following equation:

$$Y_1 = PY_1X_1 + PY_1X_2 + PY_1X_3 + PY_1X_4 + PY_1X_5 + e_1$$

$$Y_2 = PY_2X_1 + PY_2Y_1 + PY_2X_5 + e_2$$

Path diagram above has two sub-structures to be used in further analysis. Result of first structure analysis shows that R Square was 0,115, so the coefficient of determination in this research was 11.5%, which also reflects the influence of variables in the non-financial aspects to earnings management. 88.5% was influenced by another variable out of the study. The results showed the significance of 0,028, where the figure is less than 0.05, it can be concluded that together non-financial aspects of the effect on earnings management.

Table 5

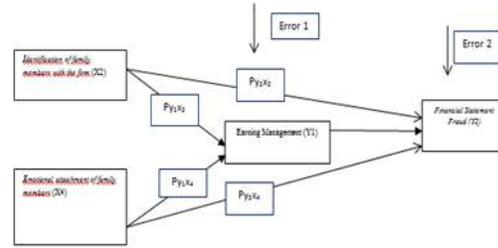
Relationships between Variable: Non-Financial - Earning Management

Non-Financial	Sig	Criteria	Result
F	0.505		No Effect
I	0.015	Sig<0.05	Significant Effect
B	0.572	Effect	No Effect
E	0.046		Significant Effect
R	0.598		No Effect

Source: Data Process

The results of the analysis explain that the variable of non-financial aspects has a significant effect on earnings management. The identification of family members with the firm and Emotional attachment of family members. The results need to be recalculated, because the only two aspects of the non-financial that affect earnings management. This research needs to eliminate other variables unrelated.

New path diagram model, which has eliminated the variables that are not related to earnings management show in this picture



Picture 2  
The New Path Diagram

The equation for the new path diagram model after adjusting the results of analysis in the first equation as shown by drawing the path diagram above was  $Y_2 = PY_2X_2 + PY_2Y_1 + PY_2X_5 + e_2$ . Results of analysis for sub-structure of the two shows the results of R Square shows the numbers 0138, so that the coefficient of determination in this study was 13.8%, which also reflects the influence of variables in the non-financial aspects and profit management to financial statement fraud, while the remaining 86.2% influenced by other variables outside of this study. The results showed the significance of 0019, where the figure is less than 0.05, it can be concluded that together aspects of financial and non-profit management influence on financial statement fraud. The results of the analysis of the effect of each variable, indicating the following results:

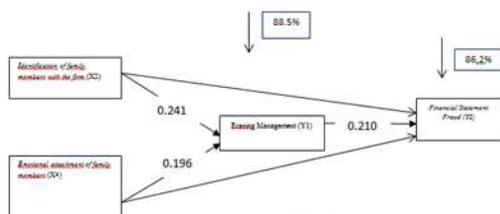
Table 6

Relationships between Variable: Non-Financial - Earning Management-Financial Statement Fraud

Non-Financial & Earning Management	Sig	Criteria	Result
I	0.081	Sig<0.05	No Significant Influence
E	0.209	significant	No Significant Influence
ML	0.036		Significant Influence

Source: Data Processing

The result of the above calculation shows that only earning management has significant influence on financial statement fraud. The new diagram models generated in this study appear in the image below



Gambar 3  
The Path Diagram

The result of path analysis explains that there was no direct influence between the identification of family members with the firm to financial statement fraud. Likewise Emotional attachment of family members does not have direct influence on the financial statement fraud. The second variable in the non-financial aspects only affect the financial statement through earnings management fraud. The net effect Identification of family members with the firm to financial statement fraud through earnings management was 0.050. While the influence of family members Emotional attachment to the financial statement through earnings management fraud was 0.041. Based on the above calculation that the hypothesis posed at the beginning of research that non-financial business financial statement fraud affecting the family through earnings been prevent

The results of the study support the research of Pazzaglia (2015); Guttardo (2015) and Martin (2016), which states that one of the aspects of socioemotional wealth influence the financial decisions of the company. The study conducted by The Jakarta Consulting Group also show the involvement of family members and family emotional ties will greatly influence the financial decisions a family business (Suanto, Hima, 2007). The study also revealed the issue of compensation of family members could also be conflicts between the family that requires a company earning management and ultimately take action financial statement fraud.

The family business if it wants to avoid the occurrence of earnings management and financial statement fraud, the involvement of family members as well as the emotional bonds between family members need to be strengthened so that decisions regarding financial will still be done properly as it should, and the family business would avoid the problem of earnings management and financial statement fraud.

## CONCLUSION

The incidence of financial fraud increased significantly in this decade. Financial statement fraud and earnings management is a financial decision made by the company, both are often identified as a major problem in financial fraud (Diaz, 2013). Financial statement fraud should be prevented, but the fact that there is currently a company that is free from fraud (Diaz, 2013). They has two main objectives which the family business family business purpose was not only the financial aspects (Chrisman, Chua, & Sharma, 2005; Chrisman, Steier, and Chua, 2008), but also non-financial aspects. Cracks was what will be used in the article to try to understand how the how the aspect of non-financial will influence the decision-financial in this case is the decision to commit acts of financial statement fraud and earnings management, results of this study will be one approach to prevent financial statement fraud, particularly through the use of earnings management, which can cause the destruction of a family business. Path analysis is used to analyze the data in a study conducted. According to analysis conducted hypothesis posed at the beginning of research that non-financial business financial statement fraud affecting the family through earnings management, has been proven. If you want to avoid the occurrence of earnings management and financial statement fraud, then a strong emotional bond of family members in the family business could be one of preventing the occurrence of earnings management and financial statement fraud.

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**THE ROLE OF AGENCY COST REDUCTION IN MEDIATING  
THE RELATIONSHIP BETWEEN CORPORATE SOCIAL  
RESPONSIBILITY WITH FIRM VALUE  
(Empirical Study On Manufacturing Company Listed in Indonesia Stock Exchange)**

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**ABSTRACT**

*The purpose of this study was to analyzed the effect of CSR on firm value. Firm value proxy with Tobin's Q. This research was taken because there are still differences between the researchs with each other. This research adding agency cost reduction as mediating variable. This research was not use stakeholder theory, but was applicated agency theory, signaling theory, and legitimacy theory. This study use WarpPLS 5.0. This study uses 63 samples of manufacture firms that listed in Indonesian Stock Exchange (IDX) during 2013 to 2015. The sampling method used for this study is purposive sampling. Type of the data used is secondary data. The result of the examine is that CSR positive influence to the firm value. Based on the results of the analysis found that the agency cost reduction is partial mediation between the relationship of CSR on firm value. Institutional ownership can't moderate CSR on ACR.*

**Keywords:** *Corporate Social Responsibility, Firm Value, Agency Cost Reduction, Institutional Ownership*

**1. INTRODUCTION**

One of the most significant corporate trend and debated during the last decade is the Corporate Social Responsibility (CSR). This is evidenced by many studies that examines the influence of CSR. Corporate social responsibility is not a new thing for companies in Indonesia. In Indonesia discourse on CSR started to emerge in 2001. Corporate social responsibility is required by law in Indonesia. It is listed in UU No.40 Year 2007 regarding Limited Liability Company (PT),

which regulates the company to carry out CSR (Agustine, 2014).

Research about the effect of CSR on the firm value has been conducted, but results vary. Putri and Raharja (2013) show that CSR has a positive and significant impact on the firm value. This result was supported by research from Harjoto (2011) which states that there is significant influence of CSR to increase the firm value. While Agustine (2014) showed that CSR does not significantly influence the firm value.

Agency theory see the CSR is the company's strategy as conflict resolution against the agency problem. According to the agency theory, CSR has the ability to reduce the information asymmetry that can reduce agency cost (Tristiarini, 2014). CSR activities that involve top management will reduce the opportunistic behavior of managers. CSR can be used as a solution to the conflict between the shareholders, and also can bring a company to maximize the value and performance of the company (Harjoto, 2011). This is supported by research of Jensen and Meckling (1976) which states that the reduction in agency costs will be followed by an increase in firm value. There is a possibility CSR can enhance firm value.

CSR is a corporate strategy that can be use as conflict resolution which reduce the agency problem. If agency problem decrease, it can reduce agency cost and enhance shareholder value. The research of Cheng et al (2011) examined that CSR can enhanced stakeholder engagement and asymmetric information can be reduced, thus reducing agency costs.

This study uses agency cost reduction as a mediating variable between CSR and firm value because theoretically, a decrease in agency costs will be followed by an increase in the value of the company. This study analyzes the CSR as a company's strategy to reduce conflict (conflict resolution). Based on the agency theory by assuming the hypothesis stated by Harjoto (2011) that the conflict-resolution hypothesis which states that companies use CSR as an activity to reduce the potential for conflict (agency problem) between top management and the various stakeholders including shareholders, which could ultimately increase firm value (Tristiarini, 2014).

The study also analyze the moderating effect of institutional ownership in relationship between the CSR and agency cost reduction. Institutional ownership can increased the monitoring of management (Tarjo, 2008). With the existence of monitoring, agency costs will be reduced, due to the influence of institutional ownership that acts as a monitor has a strong effect in the behavior of

the manager, which is able to reduce and prevent acts of opportunistic managers.

The research purpose is therefore five-fold: First, we would prove that CSR can increase firm value. Second, we would prove that CSR activities can reduce agency costs. Third, we would also like to examine that agency cost reduction has positive impact to firm value. Fourth, since earlier literatures have different result, the study was intended to fill up the research gap and to prove that CSR is positive increase firm value by agency cost resuction as mediator. Fifth, we also like to analyze the institutional ownership as moderating variable between CSR and agency cost reduction.

The rest of the paper is organized as follows: Section 2 reviews the literature, the hypotheses,. Section 3 presents the research methodology, and examine models. Section 4 presents our statistical results. Section 5 conclusion.

## **2. LITERATURE REVIEW**

### **2.1 Agency theory**

Jensen and Meckling (1976) argued that the agency theory explain the interests of management and shareholders are often contradictory, so it can be a conflict between the two (agency problem). This is because the manager has a personal interest, otherwise the shareholders disagree with them, since it would increase company's expenses and will lead to a decline in corporate profits and a decrease in dividends received. Conflicts of interest between managers and shareholders can be minimized with a monitoring mechanism to align the interests of such linked. However, with the mechanism led to a charge called agency cost.

One of agency theory's view is conflict resolution hypothesis which states that companies use CSR activities to reduce potential conflicts (agency problem) between managers and other parties including stakeholders, it could enhance shareholder value and reduce agency costs.

### **2.2 Signalling Theory**

Signaling theory states that every action contains information and create asymmetric

information. Asymmetric information is a condition where a party has more information than the other party (Pramastuti, 2007). Signaling theory boost the company to provide information to external parties. To reduce the asymmetry of information, the company must disclose information, like financial report and non-financial.

Signaling theory emphasizes that the reporting enterprise may increase the firm value through its reporting. The signal is expected to be accepted positively by the market that will affect to market performance and implementation of the firm value that is reflected in its share price (Drever et al, 2007 in Indrawan, 2011).

### **2.3 Legitimacy Theory**

Legitimacy theory reveals that the company continually strives to act in accordance with the limits and norms in society, on the efforts of companies trying to make its activities acceptable according to the perception of external parties (Deegan, 2000 in Febrina and Suaryana, 2011). CSR disclosure is an important thing to build, maintain and legitimize the company's contribution in terms of economic and political (Haniffa 2005 in Chritiyanti 2011 in Sinudhiptha, 2013).

### **2.4 Corporate Social Responsibility**

According to The World Business Council for Sustainable Development (WBCSD) in Kusumadilaga (2010), Corporate Social Responsibility is defined as the commitment of business to contribute for sustainable economic development, through cooperation with employees and their representatives, families, the local community and the general public to improve the quality of life in ways that benefit both its own business and for development.

UUPT also regulates the provisions on CSR. CSR regulated in UUPT Article 1 paragraph (3), in this case the CSR is referred as social responsibility and environmental which means that the company's commitment is to participate in the sustainable economic development to

improve the quality of life and environment that benefits to company and local community.

Meanwhile, some countries also have their own definition about CSR. The European Union (EU Green Paper on CSR) suggest that CSR is a concept of corporate social integrity and look to environmental concerns in their business operations and interaction with stakeholders that is based on volunteerism (Rosita, 2010).

CSR is a development of the concept raised by John Elkington in 1997, namely "The Triple Bottom Line". This concept is stated that in order for the company to maintain its continuity it is necessary to pay attention to 3P, not only profit, but also capable of contributing to society (people) as well as actively participate in protecting the environment (planet).

Thus, we can conclude that CSR is a social responsibility that is done voluntarily by the company on the environment and society as well as governments, aims to minimize the negative impact arising from the company's operational activities and contribute to sustainable economic development.

### **2.5 Institutional Ownership**

In the agency theory Jensen and Meckling (1976) states that institutional ownership has a very important role in minimizing the agency conflict that occurs between managers and shareholders. The existence of institutional investors are considered capable of being an effective monitoring mechanism in any decision taken by the manager. This is due to institutional investors involved in strategic decision making is not easy to believe the actions of earnings manipulation.

Institutional ownership is the shares' ownership of a company by the institution or institutions such as insurance companies, banks, investment companies, and other institutional ownership. Institutional ownership can boost a more optimal supervision and monitoring is important for management (Tarjo, 2008).

High level of institutional ownership will lead to greater scrutiny by the institutional investors that can deter opportunistic behavior of

managers. Increased institutional ownership has led to strict controls on the performance of management that automatically management would avoid the perverse principal. Robust control of the institutions of the companies will create a company to perform a wider social disclosure and were able to reduce agency costs.

## **2.6 Firm Value**

High value of the company will make the market (investors) believe not only on the company's performance today, but also on the company's prospects in the future (Khoiriyah, 2014). In general, financial factors are the main factors that affect the value of the company. However, non-financial factors also greatly affect the performance of companies that have an impact on the company's value in the eyes of investors. Now, CSR is one of the non-financial factors need to be considered by the company in an effort to enhance shareholder value.

The value of the company is an investor perception of the public company, which is often associated with stock prices (Sudjoko and Soebiantoro, 2007). High stock prices indicate the value of the company's high. High value of the company will make the market believe not only on the company's performance today but also about the company's prospects in the future (Hardiyanti, 2012). Because the company's main goal is to increase the firm value through increasing the owners or shareholders (Gapensi, 1996 in Wahidwati, 2002).

Herawaty (2008) stated that one of the alternatives used in assessing firm value is Tobin's Q. This ratio was developed by Professor James Tobin (1967).

Tobin's Q is a more rigorous measure of how effectively utilizing management resources are economical in power. This ratio can provide information rated the best, because Tobin's Q uses all elements of debt and equity shares of the company, not only ordinary shares and not only equities of companies incorporated but all the company's assets. By entering all company assets means the company is not only focused on one type of investor that is only investor in shares but

also to lenders as a source of financing the company's operations not only of equity but also from loans granted by the creditor (Sukamulja 2004 in Anggraini, 2013).

## **2.7 Previous Research**

Several studies have examined the influence of corporate social responsibility to corporate value has a different outcome (inconsistent), as well as research on the effect of CSR on agency cost and agency cost effect on firm value, and also the effect of institutional ownership on agency cost.

Nurlela and Islahudin (2008) conducted a study of non-financial sector companies listed on the Jakarta Stock Exchange (BEJ) in 2005. The results of this study indicate that the CSR variable does not affect the firm value. This moderating variable in this study is profitability and firm size. There is the addition of one independent variable in this study the managerial ownership.

Godfrey (2005) examined the relationship between corporate philanthropy to shareholder value. His research was CSR activities can curb the manager's opportunistic behavior and will reduce agency costs.

Research Wang (2010) show that the agency cost has a negative impact on the operating performance, firm value and stock returns. As well as research Fadah (2012) which gives results that agency costs significantly and negatively related to firm value. Research Naiker, et al (2005) and Xiao (2009) suggests the influence of agency costs on firm value.

Harjoto (2011) suggests that CSR positively affect firm performance and value. CSR can also be a conflict resolution for companies that would reduce agency cost. Cheng et al (2011) also found that CSR enhanced stakeholder engagement and information asymmetry can be reduced, thus reducing agency cost.

Putri and Raharja's research (2013) showed that CSR has a positive and significant impact on firm value. While managerial ownership as a moderating variable weaken the relationship between CSR to corporate value, managerial

ownership has negative effect on the relationship between CSR and firm value.

Rosiana, et al (2013) use companies listed on the Stock Exchange in 2008-2012 as samples. The results of this research was CSR has significant effect on firm value, and ROA is able to strengthen the influence of CSR on firm value. Sindhudiptha (2013) gives the result that financial performance (ROA) was not able to mediate the relationship between CSR and firm value.

Agustine (2014) stated that CSR doesn't have a significant impact directly against the firm value with the percentage of managerial ownership and profitability as moderating variable. Simultaneously, the interaction between the CSR and the percentage of management ownership, and the interaction between CSR and ROA have significant effect on the value of the company.

Faizal's (2004) research states that institutional ownership is able to suppress agency cost. Jennings (2002) suggests that institutional ownership is not able to monitor management because institutional investors are not the majority shareholder, so as not to increase the firm value.

## 2.8 Hypothesis

The hypothesis that will analyze in this research:

- H<sub>1</sub>: Corporate Social Responsibility positive and significant impact on Firm Value
- H<sub>2</sub>: Corporate Social Responsibility positive effect and significant impact on Agency Cost Reduction.
- H<sub>3</sub>: Agency Cost Reduction positive and significant impact on Firm Value.
- H<sub>4</sub>: Institutional Ownership Moderate The Effect of Corporate Social Responsibility on Agency Cost Reduction.

## 3. RESEARCH METHODS

### 3.1 Variable

This research use four variables:

#### 3.1.1 Exogenous Variables

CSR is measured by the following formula:

$$CSRDI = \frac{\sum Xi}{n}$$

CSRDI: Corporate Social Responsibility Disclosure Index

$\sum X_i$ : Number of items disclosed by the company

1 = if the "I" item disclosed; 0 = if the "I" item was not disclosed.

n: total number of items that should be disclosed (GRI 3.1), n = 83

#### 3.1.2 Variabel Moderating

Institutional ownership is measured in proportion to percentage of stock ownership by institutional (Haruman, 2008).

$$INST = \frac{\text{Number of Shares Institutional}}{\text{Number of Shares Outstanding}}$$

INST : Institutional Ownership

#### 3.1.3 Variabel Mediating

Mediating variables in the study is agency cost reduction.

- Agency cost reduction's value can be calculated with the following formula:

$$ACR = AC_{t-1} - AC_t$$

ACR: Agency Cost Reduction

AC<sub>t-1</sub>: Agency Cost previous year

AC<sub>t</sub> : Agency Cost of the current year

- Agency cost is proxied by operating expenses to ratio.

$$Agency\ Cost = \frac{SGA\ Expense}{Sales} \times 100\%$$

Agency Cost: Operating expenses to ratio

SGA Expense: Selling, General and Administrative Expenses (Operating Expenses)

Sales: Total of Sales

#### 3.1.4 Endogenous Variable

Endogenous variables in the study is firm value. Firm Value in this study is proxied by Tobin's Q.

$$Tobin's\ Q = \frac{EMV + D}{TA}$$

Tobin's Q : Firm Value

EMV : Equity Market Value, is obtained by multiplying the shares closing price

(end of the year) with total of shares outstanding at the end of the year.

D: The book value of total liabilities.

TA: Total Assets.

**3.2 Population and Sample**

The population in this research is manufacturing companies that listed in Indonesia Stock Exchange theres 145 companies with the observation period 2013-2015. The sample selection using purposive sampling method. The reason for using this method is to obtain a representative sample in accordance with the specified criteria.

Based on the sampling method was obtained by 23 companies manufacturing in accordance with the criteria of purposive sampling, but when testing, there are 2 companies that have data causes the outlier test results are not significant. The company has extreme data values or data values are different from the previous period. So it was decided to waive the two companies in this study. The number of companies sampled in this study is 21 companies with the observation period from 2013 to 2015. The following are sample based on the filtering table purposive sampling method.

**Table 3.1** Purposive Sampling

No	Note	Total
1	The manufacturing company listed on BEI until January 2016	145
2	Manufacturing companies are delisting/not listed on the BEI during the years 2013-2015	(6)
3	Manufacturing company that not serving the complete financial statements and in Rupiah during the observation period.	(37)
4	Manufacturing Companies that have a positive ACR value during 2013 -2015	(77)
5	Companies that not include information on relevant variables during 2013-2015	(2)
		23
	Outlier Data	(2)
	<b>Total Sample</b>	<b>21</b>

Sumber: [www.idx.co.id](http://www.idx.co.id)

Based on the above data filtering the obtained sample of 63 (21x3) companies listed on the Stock Exchange during the three periods of the years 2013 to 2015.

**3.3 Data Collection Methods**

Methods of data collection in this research is the study documentation. Method of documentation is done by collecting, recording and counting the data related to the research.

**3.4 Data Analysis Techniques**

Methods of data analysis used in this research is to use the program WarpPLS 5.0. By using structural equation model (SEM) with the mediating effect that the link between exogenous and endogenous construct through the variable liaison between. This means that the influence of exogenous variables on endogenous variables can directly but also through supporting or mediating

variable. Methods of data analysis used in this study are as follows:

**3.4.1 Regression Analysis**

Examine the effect of mediation using WarpPLS program uses the procedure developed by Baron and Kenny (1986). According to Baron and Kenny (1986) in Ghozali and Latan (2012) there are three stages of the model to examine the effect of mediation:

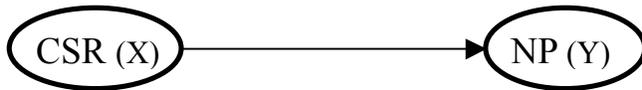
1. The first model, examine the effect of exogenous variables (X) on the endogenous variable (Y) and should be significant at p value. In this study, exogenous variables (X) is CSR and endogenous variables (Y) is firm value.
2. The second model, examine the effect of exogenous variables (X) on mediating variables (M) and should be significant at p value. In this study exogenous variables (X) is

CSR and mediating variables (M) is Agency Cost Reduction.

- The third model, examine the simultaneous effect of exogenous variables (X) and mediation (M) against endogenous variable (Y). In the final phase of examine is expected to exogenous variables (X) to endogenous (Y) is not significant, while the effect of mediating variables (M) against endogenous variable (Y) should be significant at p value.

Next, to examine whether moderating variables able to moderate the relationship between CSR and agency cost reduction is to include moderating variables that institutional ownership between CSR with ACR. In this phase of examine is expected moderating variables significant at  $P < 0.1$  with a positive coefficient.

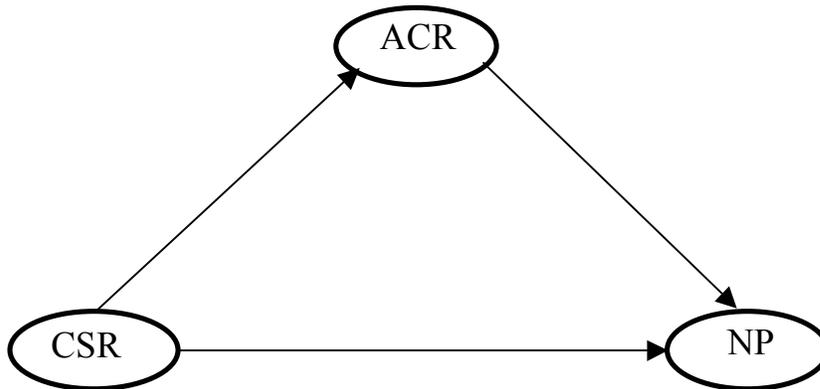
**Figure 3.1**  
Path Analysis First Model



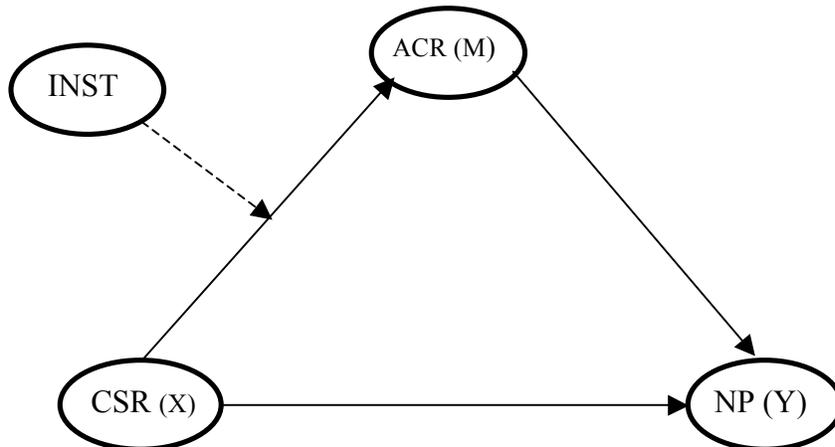
**Figure 3.2**  
Path Analysis Second Model



**Figure 3.3**  
Path Analysis Third Model



**Figure 3.4**  
Path Analysis of the Moderating



For significant value in PLS there are three categories: (1)  $p < 0.01$ ; (2)  $p < 0.05$ ; (3)  $p < 0.1$ . If the results give the p-value of data in accordance with a significant level, then the test results was significant, if greater then insignificant.

**3.5.2 Hypothesis Testing**

**3.5.2.1 Structural Model (Inner Model)**

Structural models or inner models is evaluated by looking at the value of p, if  $p < 0.1$ , then the hypothesis is accepted, but if  $p > 0.1$ , then the hypothesis is rejected. B value is used to look at the direction of the relationship influence of exogenous variables on endogenous variables.

**4. RESULTS AND DISCUSSION**

**4.1 Results**

**Table 4.1** Path Analysis Mediation

	$\beta$	P Value
<b>Model 1</b>		
CSR → NP	0.502	< 0.001*
<b>Model 2</b>		
CSR → ACR	0.281	0.008*
<b>Model 3</b>		
CSR → ACR	0.281	0.008*
ACR → NP	0.181	0.066**
CSR → NP	0.448	< 0.001*

\*Significant at  $p < 0.01$   
 \*\* Significant at  $p < 0.05$   
 \*\*\* Significant at  $p < 0.1$

**Table 4.2** Path Analysis Moderation

	$\beta$	P Value
CSR → ACR	0.281	0.008*
ACR → NP	0.181	0.066***
CSR → NP	0.448	< 0.001*
INST*CSR → ACR	-0.009	0.470

\*Significant at  $p < 0.01$   
 \*\* Significant at  $p < 0.05$   
 \*\*\* Significant at  $p < 0.1$

Hypothesis testing is done by looking at the value of  $\beta$  and p value. Directions relationship of exogenous variables on endogenous can be seen in  $\beta$  the table. Positive values in this table show the positive influence and vice versa. If  $p < 0.1$  means that there is a strong influence (significant) between the exogenous variables on endogenous and vice versa.

Based on the known value of  $\beta$  table 4.4 on the first model for CSR variables on corporate value is 0502 with  $p < 0.001$  significant at  $p < 0.01$ , respectively. The results of this study indicate that CSR is positive and significant effect on firm value. Thus  $H_1$  is accepted.

In Table 4.4 in the equation are two known values for the variables  $\beta$  CSR is terhadap ACR 0281 with ap value of 0.008 which is significant at  $p < 0.01$ , respectively. The results of this study indicate that CSR is positive and significant effect on the ACR. Thus  $H_2$  is accepted.

At the same table for the equation 3 known  $\beta$  value for the variable ACR to firm value is 0181 with 0066 p values were significant at  $p < 0.1$ . From these results indicate that the ACR positive effect on the value of the company, the  $H_3$  is accepted.

In Table 4.3 moderation institutional ownership has a negative coefficient value 0.009 and p value 0.470. The results show that institutional ownership and no significant negative effect in moderating the relationship between CSR with ACR. This means  $H_4$  rejected.

**4.2 DISCUSSION**

1.  $H_1$  is accepted. This is consistent with agency theory that suggests that CSR has the ability to enhance shareholder value. In line with the signaling theory and legitimacy theory. Currently, the government requires that companies undertake CSR activities. It is not only an obligation alone, but provides many benefits for various parties.

First, society and environment helped by the company's CSR activities. In addition to social purposes, CSR can provide a positive impact for the company, with the increase in corporate image in the eyes of the public. Second, many investors who will invest in companies that implement CSR activities. Investors will be interested to invest in companies that

have a good image in the community. Third, the increased value of the company. The company's value can be reflected in its share price. If the high value of its stock could be said that the company also good value.

The results are consistent with research conducted by Rosiana, et al (2013), Putri and Raharja (2013) which states that CSR has positive and significant effect on firm value, and also Harjoto (2011). This study does not correspond with the research Nurlela and Islahuddin (2008), Sindhudiptha and Yasa (2013) and Agustine (2014) stating that CSR does not significantly influence the value of the company.

2.  $H_2$  is accepted, the results indicate that the presence of CSR activities could reduce opportunistic behavior of managers, capable of reducing agency cost. Harjoto (2011) revealed that there are other strategies to reduce agency cost, ie with CSR. According to the agency theory, CSR has the ability to reduce the information asymmetry that can reduce agency costs (Tristiarini, 2014), with the involvement of top management in CSR activities will reduce the opportunistic behavior of managers.

CSR is a conflict resolution that is able to reduce the agency problem. The results of the study according to research conducted by Godfrey (2005) and Cheng et al (2011) which states that the CSR is able to reduce information asymmetry and reduce agency cost.

3.  $H_3$  is accepted, These results indicate that any increase in ACR will enhance shareholder value. In view of agency theory, by reducing agency costs, there will be an increase in the value of the company.

The results of this study are supported by Jensen and Meckling (1976) in his research that found a decrease in agency costs will be followed by an increase in

the value of the company as well as research Naiker, et al (2005), Xiao (2009) and Wang (2010). The results are consistent with research conducted by Harjoto (2011) that the reduction in agency costs will be followed by the increasing value of the company. The increasing value of the company is reflected in the stock price increases.

4.  $H_4$  is rejected, which means institutional ownership was not able to moderate the relationship between CSR with ACR.. There are several reasons why institutional ownership has not been able to moderate CSR relationship with ACR.

First, institutional shareholders is not the majority shareholder in the company. This is according to research Jennings (2002) which states that an institutional investor is not the owner of the majority and is unable to monitor the performance of the manager as well. Thus, the opportunistic behavior of managers can not be constrained by institutional investors.

Furthermore, institutional ownership has not been able to moderate CSR relationship with ACR. This is possible because companies that their operation touch to natural resources required to conduct CSR activities in accordance with Law 40 of 2007 on UUPT, so that the size of institutional ownership does not affect the relationship CSR with the ACR.

5. The test results indicate that the agency cost reduction partially mediate the relationship with CSR and firm value. CSR has indirect effect on firm value. Agency cost reduction serves as a partial mediation in the relationship between CSR and corporate value. Because when entering mediating variable, p value of CSR to the firm value remains significant but the coefficient value decreases.

So The Conflict Resolution Hypothesis that proposed by Harjoto (2011) proved to be true, that in addition

to increasing the value of companies, CSR is also able to reduce agency costs. The conflict resolution hypothesis states that companies use CSR as an activity to reduce the potential conflict between the various parties, including shareholders, thereby increasing the value of the company.

## **5. CONCLUSION**

### **5.1 Conclusion**

Based on the results of research and interpretation of research results, some conclusions can be drawn as follows:

1. CSR positive and significant effect on firm value. This means that the size of CSR disclosure will affect the intensity of firm value. The greater CSR that company disclose will increase firm value and vice versa. This is in line with the signaling theory and legitimacy theory which states that the disclosure of corporate social responsibility can increase the value of the company.
2. CSR positive and significant effect on agency cost reduction, which means that the CSR disclosure can reduce agency cost. This is according to research conducted by Godfrey (2005) and Cheng et al (2011).
3. Agency cost reduction positive and significant effect on firm value. Any reduction in the agency cost will be followed by an increase in firm value. This is consistent with the viewpoint of conflict resolution in the agency theory. The results are consistent with research Harjoto (2011).
4. The institutional ownership has not been able to moderate the relationship between CSR and agency cost reduction.
5. Agency cost reduction partially mediate the relationship CSR and firm value. Conflict resolution hypothesis by Harjoto (2011), that CSR can be a strategy to increase the value of the company, at the

same time can reduce agency costs. Thus, conflict resolution hypothesis proposed by Harjoto (2011) proved to be correct. ACR is not the only mediator relationship between CSR and corporate value, but there are other factors.

### **5.2 Suggestions**

Suggest can be given from the research that has been done is:

1. Future studies may use other proxies to measure the research variables.
2. Future studies may use other variables that may mediate the CSR with the value of the company, which has not been included in this study. And can use as a managerial ownership variable moderation in the relationship between CSR with ACR.
3. Future studies should extend the research sample, research data, such as using research observation period that is longer and using all companies go public to generate better research.

### **5.3 Limitations of Research**

In studies that have been done there are some limitations that may affect the results of the study include:

1. Limited research use only the Standard CSR Disclosures GRI in reducing agency costs and enhance shareholder value.
2. The number of samples obtained relatively small at only 63 samples of the observation period 2013-2015 manufacturing company.

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## LUXURY SALES TAX DECREASE AND IMPACT ON INDONESIAN HOUSEHOLD' CONSUMPTION HABIT

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### ABSTRACT

*On July 9, 2015, Indonesia Government conduct the elimination of luxury sales tax on 33 imported goods. This is due to 33 imported goods is not a luxury anymore because it is already used by most Indonesian people. The elimination of the luxury sales tax is expected to increase merchant sales. The increased of merchant sales will have a positive impact for producers and governments. This study aims to determine whether there is influence public perception regarding the elimination of luxury sales tax on the household' consumption habit.*

*This research was conducted in Sidoarjo and Surabaya using questionnaires and were tested using multiple regression. The results show that increase of household' consumption after the elimination of luxury sales tax. This can be caused by the positive public perception of the elimination imported goods that luxury sales tax exemption would increase public interest in household electronic goods imports.*

**Keywords:** LST, decrease, consumption, household

### INTRODUCTION

The elimination of some objects on the luxury sales tax (PPnBM) on July 9, 2015 has reap the reaction of people. But it does not make the government to cancel the elimination plan on 33 imported goods. The 33 items, namely TV, refrigerator, water heater, washing machine, air conditioner, video recorder, camera, gas stove, projectors, dishwasher, dryer, microwave, fishing rods, golf clubs, tools diving, surfboard, rifle for shooting, piano, musical instrument electrical, handbags, clothing, watches, saddles for equestrian, precious metals, gold, carpets, crystal, chairs, mattresses, bedroom lamps, porcelain and tiles (Ario, 2015).

There are some reasons that become the background for the elimination of 33 items on luxury sales tax according to Ario (2015). **First**, the rapid technological

developments make certain item becomes no longer a luxury and can be consumed by all of society. **Second**, the government wants to raise the people's purchasing power. The elimination of 33 items on luxury sales tax will increase people's purchasing power. If sales increase, it will bring a positive impact to the producers and the government. **Third**, encourage the growth of the industry or the goods are produced domestically. If the domestic goods subject to luxury sales tax then this is hampering the competitiveness of the product. So that there is a declining interest in the public purchasing of goods in the country. **Fourth**, improve the level of compliance of taxpayers (WP) to be more conscious of paying taxes so expect nothing else is trying to avoid tax. **Fifth**, reducing the tendency for people who often go abroad. If 33 items remove on luxury sales tax, the community's desire to shop abroad

will decrease because the price of goods sold in the country is no different with the goods sold abroad. This can increase the domestic foreign exchange in Indonesia.

Based on this background, authors wanted to investigate the phenomenon of elimination of 33 items on luxury sales tax and their impact on household consumption habit in Sidoarjo and Surabaya Southern.

## **LITERATUR REVIEW**

Luxury goods sales tax is an imposed tax on goods that are considered Luxury in Indonesia. Criteria for luxury goods according to Regulation no. 42 of 2009 regarding the third amendment to the regulation no. 8 of 1983 on value added tax on goods and services, and also luxury good sales tax, namely:

1. Goods that are not included in a basic need
2. Goods that are consumed by a particular group or community
3. In general, the goods are consumed by higher income group or community
4. The goods are consumed to indicate a status

When an item is included in the four criteria above, then the selected goods can be classified as Luxury taxable goods. It is mandatory that the goods will be imposed by the luxury goods sales tax. According to Waluyo (2010) the luxury goods sales tax characteristics, among others (Waluyo, 2010):

1. The imposition of the luxury goods sales tax occurs only once, that is during the delivery of goods from the businessman of the manufacturer or producer who produces Luxury taxable goods or during the import process, it is considered Luxury taxable goods.
2. It is necessary to control the consumption patterns on the Luxury taxable goods
3. The need for protection for the small traditional producers

4. The need for securing the revenue intake for the government, then during the process of delivery of Luxury taxable goods by the manufacturers or importers, there will be value added tax (VAT) and also luxury goods sales tax.

According to the regulation no. 42 of 2009 on third amendment to regulation no. 8 of 1983 on Value Added Tax on Goods and Services and Luxury Goods Sales Tax, Sales Tax rates on Luxury Goods are as follows: (a) The lowest sales tax rate on luxury goods is 10% (ten percent) and the highest is 200% (two hundred percent), (b) Exports of luxury goods are taxed at the rate of 0% (zero percent). The Luxury goods sales tax rate are multiplied by the imposition of luxury sales tax base. Tax imposing base is the basis used for calculating the tax due, in the form of Sales Price Total, Import Value, Export Value, or other value specified by Ministry of Finance.

## **RESEARCH METHOD**

### **Sample selection**

The population of this study is household in Sidoarjo and Surabaya Southern. Sample selection is based on purposive sampling. Household criteria used as a sample in this study is the household has one of 33 imported goods are exempted from luxury sales tax.

### **Data Collection**

The data collection in this research is done by the study of literature, distributing questionnaires, and interviews. **Literature Study:** study of previous researches is to support the objectives of the research. Sources of literature that will be used in this study came from books, journals, articles, government regulations, results of previous researches and other related data. **Questionnaire Distribution:** The questionnaire distributed to household in Sidoarjo and Surabaya Southern. Respondents are totaled 100 respondents which all respondents have one of 33 imported goods are exempted from luxury sales tax. **Interviews:** Interviews conducted in this research were to household. This is conducted to

explore the views of household on the elimination of 33 item from luxury sales tax.

**Research model**

The research model is simple regression. The independent variable is household perception on the elimination of 33 items from luxury sales tax (HP). The dependent variable is household consumption habit (CH). The model used in this study are as follows:

$$CH = a + b_1HP$$

Where:

CH= Household consumption habit

HP= Household perception

**RESULT AND DISCUSSION**

**Overview of Research Subjects**

The data collection is done by distributing questionnaires to household in Sidoarjo and Surabaya Southern area. Respondents' Criteria used in this research the household has one of 33 imported goods are exempted from luxury sales tax. There were 120 questionnaires distributed, and 20 of them could not be used in this study.

Table 1. Questionnaires Distribution

Description	Amount	Percentage
Distributed questionnaires	120	100%
Questionnaires returned incomplete	(11)	(9.17%)
Questionnaires were unusable	(9)	(7.5%)
<b>Total used questionnaire</b>	<b>100</b>	<b>83,33%</b>

Source: Data Processed (2016)

**Characteristics of Respondents**  
**Gender**

The gender of the respondents in the study were classified into two groups, namely women and men. For more details, it will be presented the characteristics of respondents by gender in the table below:

Table 2. Descriptive Data Gender respondents

Gender	Total	Percentage
Female	68	68%
Male	32	32%

Source: Data Processed (2016)

From 100 respondents, 68 respondents or 68% were female and 32 respondents or 32% were male. Based on this data, it can be concluded that the female respondents used in this study more is more dominant.

**Age**

The respondent's characteristics description in their age gives an idea of the respondent's age in this study. Below is the age distribution of respondents used in this study.

Table 3. Descriptive Data Age respondents

Age	Number	Percentage
17-23 yrs	26	26%
24-30 yrs	38	38%
31-39 yrs	17	17%
40-49 yrs	9	9%
>50 yrs	10	10%

Source: Data Processed (2016)

Based on the above data, most of the respondents are 24-30 years old or 38%. Based on this data, it can be concluded that most respondents used in this study is aged between 24-30 years old.

**Residence Area**

The residence area of the respondents in this study were classified into two groups, namely Sidoarjo and Surabaya Southern. For more details, it will be presented the characteristics of respondents by residence area in the table below:

Table 4. Descriptive Data Residence Area respondents

Area	Total	Percentage
Sidoarjo	53	53%
Surabaya Southern	47	47%

Source: Data Processed (2016)

From 100 respondents, 53 respondents or 53% have residence area in Sidoarjo and 47

respondents or 47% have residence area in Surabaya Southern. Based on this data, it can be concluded that most of respondents used in this study have residence area in Sidoarjo.

**Descriptive Statistics**

The first data processing conducted is to analyze the results of respondents' answers to each questionnaire statement, after knowing the characteristics of the respondent. The data processing is conducted on each variable based on the respondents' statement whether they answer strongly disagree to strongly agree. Descriptive statistics were used to give an overview of the data in the study (Ghozali, 2006). The descriptive statistical results will be explained based on the calculation of the mean of each variable.

Each variable has a value of the average or mean that it will be categorized based on the interval and a description of each class. Limitation of the interval is using five Likert scale derived from the value added by the results of the class interval. The following are the categories and their interval values can be seen in Table 5

Table 5. Interval Category Value

Interval	Category	Description
1.00 - < 1.80	1	Very Low
1.80 - < 2.60	2	Low
2.60 - < 3.40	3	Adequate
3.40 - < 4.20	4	High
4.20 - < 5.00	5	Very High

Source: Processed Data (2016)

**Descriptive Statistics on Household Perception Variable**

The results of descriptive statistics household perception variable presented in Table 6 below.

Table 6. Descriptive Statistics Results on Household Variable

No	Statement	Mean
1	The elimination of luxury sales tax gives benefit for society	3,07
2	The elimination of luxury sales tax affects the price of imported household electronic equipment sold in the market	3,14

3	The elimination of luxury sales tax more suitable for use in household electronic equipment imported for less than Rp 5.000.000,00	2,90
4	The elimination of luxury sales tax makes the price of household electronic equipment imports more competitive	2,98
<b>Total</b>		<b>3,02</b>

Source: Processed Data (2016)

Descriptive statistics results indicate the average value on household perception variable, and it reached 3.02, which is included in the adequate category. This indicates that most respondents give neutral response to the elimination of 33 items on luxury sales tax.

**Descriptive Statistics Household Consumption Habit Variable**

The results of descriptive statistics household perception variable presented in Table 6 below.

Table 7. Descriptive Statistic Result on Household Consumption Habit Variable

No	Statement	Mean
1	The elimination of luxury sales tax increase interest in the purchase of household electronic equipment import	3,18
2	After the elimination of luxury sales tax, I choose to buy electronic equipment imported household	2,81
3	My buying interest towards household electronic equipment imports increased after the elimination of luxury sales tax.	2,87
4	After elimination of luxury sales tax I am more interested in the electronic equipment household electronic equipment imports than domestic household	2,78
5	After elimination of luxury sales tax, I am more interested in household electronic goods import	2,88
6	The elimination of luxury sales tax of the import equipment influence on the selection of household electronic equipment	2,98
<b>Total</b>		<b>2,92</b>

Source: Processed Data (2016)

Descriptive statistical results shows the mean value for the convenience of payment principles is 2.92, which is included

in the adequate category. This indicate that most of the respondents gave a neutral response in which the elimination luxury sales tax on 33 items did not significantly affect the level of their consumption.

### Simple Regression Results

This study uses t-test to determine whether the independent variable affect dependent variables (Ghozali, 2006). A independent variable has significant affect if sig <0.05. Based on t-test results, we found that independent variable (household perception) did not significantly affect the dependent variable (household consumption habit). It can be seen at a significance value is 0,304. Therefore, household perception on elimination of luxury sales tax on 33 items has no effect on household consumption habit.

### CONCLUSION

The implications of this study emphasize that the elimination of luxury sales tax on 33 items is still not effective because this regulation cannot increase the people's purchasing power. Based on the descriptive statistic most respondents give neutral response to the elimination of luxury sales tax on 33 items and also most of the respondents gave a neutral response in which the elimination luxury sales tax on 33 items did not significantly affect the level of their consumption. This can be caused the 33 goods are not essential goods for most of people. Based on this result, government should not only elimination luxury sales tax on 33 items, but also elimination tax on essential goods.

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## **VOLUNTARISM AND BUSINESS SUSTAINABILITY IN GOODS AND SERVICES TAX COMPLIANCE**

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### ***ABSTRACT***

*This paper proposes factors contribute to Goods and Services Tax compliance among corporate taxpayer in the Malaysian new indirect tax environment. A few factors of voluntarism from the industry and enforcement from the government contribute to compliance level among corporate taxpayers. Factors such as taxpayer's knowledge, attitude and self-monitoring, technology being use, audit probability and enforcement policy will be discussed here. Data were gathered from 379 small medium enterprise companies in Malaysia after a year of its implementation. Descriptive analysis indicates that efforts from the companies which are their internal part play a main role in order to comply with GST. It is due to their efforts are very important for corporate sector to sustain their business in the long run. The implications of these findings are further elaborated.*

*Keywords: Goods and Services Tax, business sustainability, voluntarism, enforcement, small medium enterprise*

## **A STUDY OF CONSUMER BEHAVIOR FOR HALAL PRODUCT**

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### ***ABSTRACT***

*The aims of this study is to the preliminary studies determine the characteristics of the consumers of halal products and determine dimensions within factor that influence consumers to purchase products with Halal certified. Research done by finding respondents with purposive sampling techniques with samples by selecting a Muslim respondents who bought ready meals, visiting fast-food restaurants and buy food products of SMEs who live at the Region Jabodetabek with the number of 162 respondents. The analytical tool used is a factor analysis using six dimensions of variable. Including perceived value, brand credibility, consumer loyalty, brand loyalty, trust, purchase intention and religious orientations were extraction the the Varimax factor analysis and get 5 sets a new factor for respondents in the product category of instant food and fast food and 6 new factor for SMEs food product.*

**Keywords:** *Consumer behavior, Halal certificate, purchase intention*

### **INTRODUCTION**

Lifestyle of the Islamic society is now more clearly its trend among Indonesian society today. The results of the last population census conducted by BPS in 2013 stated that 87% of Indonesian people are Muslim and over time that number increases definitely. These conditions make the people of Indonesia are a potential market for products who has the requirements for the consumption of the Muslim community. The government of Indonesia wants using this situations to make Indonesia as the center of marketing halal products in the world must be supported with a complete knowledge of Indonesian consumer behavior, given that its market is expanding rapidly.

Muslim communities market share in Indonesia for the categories of food and beverages has significant potential in the amount of \$ 197 billion, \$ 5 billion for drugs and \$ 1.1 billion

personal care / cosmetics. This market requires a deep knowledge of how consumers make a decision to select the products that will be used in everyday life. This knowledge is important because in the process of decision making products the consumer goods group is in the category of quick decisions by consumers, these conditions require that the company designing marketing activities that could influence the decision consumers, to choose products.

Muslim consumers have specific criteria in consuming food and beverages. This condition needs special concern by the producers to participate in creating products that fit the needs of the Muslim community. The existence of a halal certificate is still the only attribute that can be used by manufacturers in the conduct of information to consumers that the product is the product is not classified as a product that is forbidden according to Islam. There are currently based on data LPOM MUI, from 2010-2015

Number of halal certificates that have been issued 35.962 and it contains of the number of 309.111 products (<http://www.halalmui.org/>, 2016). The amount of Halal certificate number in 2009 was 470 and 1.550 certified halal-certified products, from the data shown a significant increase. Increasing the number of products and halal certificates must be followed by consumer knowledge on halal products, departing from these conditions, this study will also map the Indonesian Muslim consumers in the process of consumption of halal products.

The first purpose of this research is mapping the characteristics of the consumers of halal products and the second is to determine factors that influencing consumer decision to buy Halal product.

## **THEORETICAL FRAMEWORK**

### **1. The consumer Behavior**

Social influence in consumer behavior consists of a reference group, family, and the role and status in society. Reference Group serves as a point of comparison or reference directly or indirectly in the formation of attitudes or consumer behavior. Family members of the family have a strong influence on the behavior of buyers. Marketers interested in the role and influence of husbands, wives, and children in the purchase of goods and services vary. Roles and Status, each role brings status which describes a general appreciation of the role of the community. (Aziz & Vui, 2012).

### **2. Religious Orientation**

Religious Orientation owned by consumers are expected to have an impact on the decision-making process by customers. The decision making process is currently more influenced by social norms and influence on brand choice. At a certain time customers will build brand loyalty that is being experienced does not contradict belief religion. Brand- brand considered related by religious rules will not get the positive attention of customers. These conditions make the religious orientation can be a mediator variable in the relationship between trustworthiness, perceived quality, brand and consumer loyalty, (Ambali & Bakar, 2014).

### **3. Perceived Quality**

Perceived Quality is the customers' perception of quality and superior product relative to competitors. Often Perceived Quality is hard to determine given the result of perception and judgment of the customer, a basis of differentiation and positioning of products, generating a premium price, as well as appeal to retailers and distributors. If the brand has a good perception it will be the basis for the existence and expansion of the brand. Dimensional performance of the product and service, which covers Product (performance, features, conformance with specification, reliability, durability, serviceability. Service (tangibles, responsiveness, competence, reliability, assurance, empathy) (Sumarwan, Fachrodji, Nursal, & Nugroho, 2011)

### **4. Brand**

Brand as a name, term, sign, symbol, or design, or a combination of all of them, intended to identify the goods or services of a seller to a group of sellers and to differentiate them from competitors' goods or services. (Ahmad, Borham, & Hasim, 2011) . Brand plays an important role that requires a unique product identity services company, which is different from competitors. Consumers face a lot of products and services in the market, and they do not have specific information about products and services. This creates uncertainty in the minds customers, (Sheeraz, Iqbal, & Ahmed, 2012).

### **5. Brand Credibility**

When the information is available in the market do not occur imperfections or asymmetric information consumers will seek to obtain their information about a brand. In this type, the brand can serve as a symbol or a signal, and the signal must be credible or trustworthy. Brand Credibility as a trust that contains product information contained in a brand, which require "consistency in delivering what it promises". The concept of credibility has two main dimensions, namely trustworthiness and expertise Trustworthiness is that a brand is willing to deliver what is promised, while the expertise to explain that the brand is able or unable to deliver what was promised (Erdem, Swait, & Valenzuela, 2006) .

**RESEARCH METHODS**

This study employed the survey research methodology from 162 respondents around Jakarta, Bogor, Depok, Tangerang and Bekasi (JABODETABEK) base on nonprobability sampling. Research surveys were used to quantitatively the level of agreement of statement of reason why the choose Halal Product. The questions were prepare using five point Likert scale questionnaires. The five anchors that were used in the questionnaires were (1) Strongly disagree (2) disagree (3) Neutral (4) agree (5) strongly agree. The populations of this research are unknown but the respondents of this research are people who were buying instant food, visiting the fast food restaurant and purchase the food product from SME. The Factor Analysis is use to determine the an interrelationship new group of factor the influencing the consumer decision choosing the Halal product, so that it can be made one or several sets of variables are less than the amount of the initial variables.

**RESULTS AND DISCUSSION**

Analysis on the respondent demographic profiles as in Table 1 below reveal that majority of respondents were male, 84 (54%), while for the age category, the number of respondent with age above 21 years and between 21-25 years of 54%, was the highest . Most of the respondents were single 117 (72%) respondent. In term of level of education 68 (42%) respondents has high school diploma and 75 (46%) respondent already graduated from university. Most of the respondent are worker 89 (55%) and 50 (33%) were students. 60 Respondent (37%) have spent not more IDR 4.500.000/ month for domestic needs, 55 respondent ( 34%) spent between IDR 4.500.000-5.000.000/ month and 33 (20%) respondents spent IDR 5.000.000-10.000.000.

**Table 1. Demographics Variables**

Demographics Variables	Gender				Frequency	%
	Male	%	Female	%		
<b>Marital status</b>						
<b>Married</b>	15	18%	29	37%	44	27%
<b>Single</b>	68	81%	49	63%	117	72%
<b>Other</b>	1	1%	0	0%	1	1%
<b>Frequency</b>	<b>84</b>	<b>100%</b>	<b>78</b>	<b>100%</b>	<b>162</b>	<b>100%</b>
<b>Occupation</b>						
<b>Unemployed</b>	6	7%	8	10%	14	9%
<b>Student</b>	32	38%	18	23%	50	31%
<b>House Wife</b>	0	0%	9	12%	9	6%
<b>Worker</b>	46	55%	43	55%	89	55%
<b>Frequency</b>	<b>84</b>	<b>100%</b>	<b>78</b>	<b>45%</b>	<b>162</b>	<b>100%</b>
<b>Highest Level of Education</b>						
<b>Junior High School</b>	2	2%	4	5%	5	3%
<b>High School</b>	49	58%	19	24%	68	42%

<b>Diploma</b>	4	5%	5	6%	9	6%
<b>Degree</b>	27	32%	48	62%	75	46%
<b>Master</b>	2	2%	2	3%	4	2%
<b>Frequency</b>	<b>84</b>	<b>100%</b>	<b>78</b>	<b>100%</b>	<b>162</b>	<b>100%</b>

**Monthly spending**

<b>IDR 20.000.001-IDR 25.000.000</b>	3	4%	1	1%	4	2%
<b>IDR 15.000.001-IDR 20.000.000</b>	0	0%	2	3%	2	1%
<b>IDR 20.000.001-IDR 25.000.000</b>	4	5%	4	5%	8	5%
<b>IDR 15.000.001-IDR 20.000.000</b>	18	21%	15	19%	33	20%
<b>IDR 4.500.001-IDR 5.000.000</b>	27	32%	28	36%	55	34%
<b>Bellow IDR 4.500.000</b>	32	38%	28	36%	60	37%
<b>Frequency</b>	<b>84</b>	<b>100%</b>	<b>78</b>	<b>100%</b>	<b>162</b>	<b>100%</b>

**(1) Halal Purchase Intention dimensions  
For Food Product**

Consumer decision process for halal product intentions can be vary depending on the product that they consume. Three group were conduct on this research from the answer of respondent for instant food product, fast food restaurant and food product from SME. Twenty three indicators were using in this research from perceive value, brand credibility, consumer loyalty, brand loyalty, purchase intentions and religious variables.

Table 2 depicts the finding for factor analysis on the twenty three indicator. Using SPSS, a principle components extraction was done to find a pattern to preliminary Halal Purchase Intentions dimensions. The KMO and Bartlett test was 0.844 greater from the required of 0.5 for a satisfactory for factor analysis to be proceed further and suggested 5 new dimensions.

**Table 1 KMO and Bartlett's Test for Instant Food Product**

<b>KMO and Bartlett's Test</b>	
Kaiser-Meyer-Olkin Measure of Sampling Adequacy.	.844
Bartlett's Test of Sphericity	Approx. Chi-Square
	df
	Sig.
	1775.793
	253
	.000

**Table 2 Varimax Rotated Matrix for Instant Food Product**

	<b>INSTANT FOOD PRODUCT</b>				
	1	2	3	4	5
PV1.F	.520				
PV2.F	.730				
PV3.F	.701				

PV4.F			.542
BC1.F			.653
BC2.F	.778		
BC3.F	.723		
BC4.F	.591		
CL1.F		.683	
CL2.F		.465	
BL1.F		.556	
BL2.F		.642	
BL3.F		.665	
BL4.F		.478	
BL5.F		.631	
TR1.F			.657
TR2.F			.779
TR3.F			.732
TR4.F			
PI1.F	.485		
PI2.F		.707	
PI3.F		.468	
RO.F			.779

**Table 4 Interpretations Matrix for Instant Food Product**

No	Faktor	Nilai	Indikator	Interpretasi
PV1.F		.520	Very good quality of food	Quality assurance
PV2.F		.730	Very good service	
PV3.F		.701	Food quality assurance	
BC2.F	1	.778	Brand choice of food products has the ability to provide the promised services	Brand preference
BC3.F		.723	Brand of food products have been providing services as promised	
BC4.F		.591	The brand of this food product can be trusted	
PI1.F	.485	Willing to buy / consume this food in the future		
CL1.F		.683	This is the best choice for me	Brand preference
CL2.F		.465	Has plans to continue to visit / buy these food products	
BL1.F		.556	Switching to other brand because of the price factor	
BL2.F	2	.642	Habitually choosing this brand	Brand preference
BL3.F		.665	Choosing the products because satisfied	
BL4.F		.478	Liking all the variant of this brand	
BL5.F	.631	Have recommend this product to someone		
PI2.F	.707	I always choose this brand if I want the kind of the this food products		
PI3.F	.468	Willing to buy this food products in no longer time		

TR1.F		.657	Have full trust to the producer of this brand	Trust
TR2.F		.779	This company is honest to do they business	
TR3.F	3	.732	Fully Trusted company who has this brand	
TR4.F		.596	Trust this company with all the resources	
PV4.F		.542	This company is sincere doing their business	Product Image
BC1.F	4	.653	This brand remain me of someone who professionally in the culinary business	
RO.F	5	.779	Refusing food products were not treated in my religious beliefs	Religiosity

**(2) Halal Purchase Intention dimensions For Fast Food Restaurant**

Table 5 depicts the finding for factor analysis on for the fast food restaurant. Using SPSS, a principle components extraction was done to find a pattern to preliminary Halal Purchase Intentions dimensions. The KMO and Bartlett test was 0.845 greater from the required of 0.5 for a

satisfactory for factor analysis to be proceed further and suggested 5 new dimensions. The amount of the new dimensions are the same in instant food but it has deferent indicator for each new dimensions.

**Table 5 KMO and Bartlett's Test for Fast Food Restaurant**

<b>KMO and Bartlett's Test</b>		
Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.845
Bartlett's Test of Sppatjan hasil hericity	Approx. Chi-Square	1768.414
	Df	253
	Sig.	.000

**Table 6 Varimax Rotated Matrix for Fast Food Restaurant**

	Fast Food				
	1	2	3	4	5
PV1.R	.739				
PV2.R	.714				
PV3.R	.705				
PV4.R		.545			
BC1.R					.782
BC2.R	.712				
BC3.R	.625				
BC4.R	.544				
CL1.R			.664		
CL2.R				.663	

BL1.R		.553	
BL2.R		.655	
TR1.R	.657		
BL5.R		.578	
BL4.R	.481		
BL3.R		.652	
TR2.R	.764		
TR3.R	.738		
TR4.R	.697		
PI1.R			.501
PI2.R		.712	
PI3.R			
RO.R			-.716

**Table 7 Interpretations Matrix for Fast Food Restaurant**

No	FAKTOR	Nilai	Indikator	Interpretasi
PV1.R		.739	Very good quality of food	
PV2.R		.714	Very good service	
PV3.R		.705	Food quality assurance	
BC2.R	1	.712	Brand choice of food products has the ability to provide the promised services	Quality assurance
BC3.R		.625	Brand of food products have been providing services as promised	
BC4.R		.544	The brand of this food product can be trusted	
PV4.R		.545	This company is sincere doing their business	
TR1.R		.657	Have full trust to the producer of this brand	
BL5.R	2	.481	Have recommend this product to someone	Trusted company
TR2.R		.764	This company is honest to do they business	
TR3.R		.738	Fully Trusted company who has this restaurant	
TR4.R		.697	Trust this company with all the resources	
CL1.R		.664	This is the best choice for me	
BL1.R		.553	Switching to other brand because of the price factor	
BL2.R	3	.655	Habitually choosing this brand	Product loyalty
BL4.R		.578	Liking all the variant of this restaurant	
BL3.R		.652	Trusted producer	
PI2.R		.712	I always choose this restaurant if I want the kind of this food	

PI3.R		.406	Willing to buy this food products in no longer time	
CL2.R		.663	Has plans to continue to visit / buy these food products	
PI1.R	4	.501	Willing to buy / consume this food in the future	Conformity
RO.R		-.716	Refusing food products were not treated in my religious beliefs	
BC1.R	5	.782	This brand remain me of someone who professionally in the culinary business	Brand association

**(3) Halal Purchase Intention dimensions For SME. Product**

Table 8 depicts the finding for factor analysis on for the fast food restaurant. Using SPSS, a principle components extraction was done to find a pattern to preliminary Halal Purchase Intentions

dimensions. The KMO and Bartlett test was 0.811 greater from the required of 0.5 for a satisfactory for factor analysis to be proceed further and suggested 6 new dimensions.

**Table 8 KMO and Bartlett's Test SME. Product**

<b>KMO and Bartlett's Test</b>		
Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.811
Bartlett's Test of Sphericity	Approx. Chi-Square	1680.090
	df	231
	Sig.	.000

**Table 9 KMO and Bartlett's Test for SMe Product**

SMe Products						
	1	2	3	4	5	6
PV1.U				.801		
PV2.U				.827		
PV3.U				.744		
PV4.U	.377					
BC4.U			.578			
BC2.U			.709			
BC3.U			.643			
CL1.U		.596				
CL2.U		.540				
BL1.U					.699	
BL2.U					.704	
BL3.U					.530	
BL4.U			.516			
BL5.U					.479	
TR1.U						
TR2.U	.762					
TR3.U	.798					
TR4.U	.715					
PI1.U		.423				
PI2.U		.728				
PI3.U		.657				
RO.U						.787

**Table 10 Interpretations Matrix for for SMe Product**

No	Faktor	Nilai	Indikator	Interpretasi
PV4.U		.377	This company is sincere doing their business	
TR1.U		.522	Have full trust to the producer of this brand	
TR2.U	1	.762	This company is honest to do they business	Trusted Company
TR3.U		.798	Fully Trusted company who has this brand	
TR4.U		.715	Trust this company with all the resources	
CL1.U	2	.596	This is the best choice for me	Repeat customer

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CL2.U		.540	Has plans to continue to visit / buy these food products	
PI1.U		.423	Willing to buy / consume this food in the future	
PI2.U		.728	I always choose this brand if I want the kind of the this food products	
PI3.U		.657	Willing to buy this food products in no longer time	
BC4.U		.578	The brand of this food product can be trusted	
BC2.U		.709	Brand choice of food products has the ability to provide the promised services	Trusted brand
BC3.U	3	.643	Brand of food products have been providing services as promised	
BL4.U		.516	Liking all the variant of this brand	
PV1.U		.801	Very good quality of food	
PV2.U	4	.827	Very good service	Product Assurance
PV3.U		.744	Food quality assurance	
BL1.U		.699	Switching to other brand because of the price factor	
BL2.U		.704	Habitually choosing this brand	
BL3.U	5	.530	Choosing the products because satisfied	Loyalty
BL5.U		.479	Have recommend this product to someone	
RO.U	6	.787	Refusing food products were not treated in my religious beliefs	Conformity

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**Table 9 KMO and Bartlett's Test for SMe Product**

	SMe Products					
	1	2	3	4	5	6
PV1.U				.801		
PV2.U				.827		
PV3.U				.744		
PV4.U	.377					
BC4.U			.578			
BC2.U			.709			
BC3.U			.643			
CL1.U		.596				
CL2.U		.540				
BL1.U					.699	
BL2.U					.704	
BL3.U					.530	
BL4.U			.516			
BL5.U					.479	
TR1.U						
TR2.U	.762					
TR3.U	.798					
TR4.U	.715					
PI1.U		.423				
PI2.U		.728				
PI3.U		.657				
RO.U						.787

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## THE EFFORTS REDUCING STREET - CHILDREN THROUGH CHILDREN PARENTING AND CASE SOCIETY – BASED

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### **ABSTRACT**

*Nowadays, the growth of street-children in Indonesia is increasing. Especially in big cities, Bandung is one of the examples, which would be very easy to see street-children in various places. Traffic light, railway station, bus station, traditional market, trade center, department store, etc. It happens not only because of economic pressure or poverty as a major factor, but also because of the parents as a major factor, but also the parent's encouragement. Based on these facts, various efforts have been made. Integrated service center of a woman and children parenting care (P2TP2A), society-based. In an effort reducing the number of street children in West Java and especially in Bandung. The aim of the study is to determine the efforts reducing the number of street-children in West Java and especially in Bandung produced by the implementation of PPABM program against the decreased number of street-children. Analysis of the data for review the effect produced by the PPABM program reducing the number of street-children using a descriptive approach in implementation of opportunities, with threat's opportunities, weakness and strength (TOWS). The study conducts in coaching area of Sekolah Cermat, Citepus Bandung With a total of 49 street-children. Based in the results found that the number of street-children decreases after the PPABM program has been implemented.*

**Keywords:** Sekolah Cermat, PPABM, Street-Children and TOWS

### **INTRODUCTION**

Rampant number of street children in Indonesia is a fact of undeniable social issues, without exception in cities-big cities in Indonesia namely one in Bandung. Street children are complex social problems associated with other social problems, especially poverty. Handle street child is not simple, so prevention is done cannot be simplified and the need to be maximized.

According to the Act No. 23 In 2003, the so-called neglected child is unfulfilled needs fairly, whether physical, mental, spiritual, and social. In this case, the role of government is needed as mandated in Article 4 UUD 1945 "poor and abandoned children reared by the state." Children's rights that were previously only in the form of Presidential Decree No.36 / 1990. This legislation aims to create an eye the lives and livelihood of children to ensure the

growth and development of the fair, both mentally, physically, spiritually, and socially.

In accordance with the principal task of which is owned by the Department of Social Bandung contained in local regulations Bandung No. 24 of 2012, article 13 paragraph 1 of coping with social welfare issues (POM) states that: the eradication of social welfare issues made through the business-social welfare, social entrepreneurship and including the development potential of the source system welfare but legal instruments and policy is not implemented well,

the reality shows that the rights-rights enshrined in the convention of children's rights and the laws that govern them have not fully get by street children. Parents are the main parties to provide the right - the right to his son but the economic conditions that do not support the government's role in particular through the Office of Social Affairs is obliged to provide rights-rights that should be obtained by a child.

The data issued by the Department of Social Bandung PMKS particular regard to the number of street children is as follows:

**Table 1. PMKS**

No	PMKS	Total	Unit
1	Childhood Neglected	354	People
2	Homeless child	5848	People
3	Children in Conflict with the Law	57	People
4	<b>Street children</b>	<b>2162</b>	<b>People</b>
5	Disability Children	1060	People
6	Child In Need of Special Protection	151	People
7	Elderly Neglected	2108	People
8	Disability	5069	People
9	Prostitutes	319	People
10	Bum	618	People
11	Beggar	766	People
12	Scavengers	388	People
13	Minorities	153	People
14	Former inmates of correctional institutions	153	People
15	People with HIV / Aids	2690	People
16	Victims of drug abuse	103	People
17	Troubled migrant workers social	17	People
18	Victims of natural disasters	111	People
19	Social disaster victims	0	People
20	Women prone to socioeconomic	3487	People
21	Poor family	78751	Families
22	Family psychological problems	2603	Families

**Source: Data PMKS Bandung City**

Seeing the condition that the number of street children reached 2,162 in the city, certainly not a problem that is light and very alarming if left unchecked. Given the fact that not even stands idly instead we rely on government to solve social unexplained exist, but we must work together in tackling the reduction of the numbers of street children so that the problem can be tackled outbreak street children.

As for the real step taken is consistent with that made by the Sekolah Cermat in cooperation with P2TP2A intensely conduct regular training to street children in the city of Bandung, especially in Bandung, West Java. In the guidance in focusing on children aged 4-16 years, the main targets being the target of the School Meticulously are street children (Laskar Hamka) and the children from family's poor (Laskar Natsir) that could potentially become street children, without exception also parents as the first education for children's.

Coaching strategies that do Sekolah Cermat is to provide guidance regularly every week, by touching the realm of soft skills, knowledge and PPABM program that includes self-concept, communication, growth and development.

**LITERATURE REVIEW**

Here we discuss some knowledge of Sekolah Cermat, P2TP2A, PPABM, and Children Street.

**Sekolah Cermat**

Sekolah Cermat PW KAMMI (Indonesian Muslim Student Action Union), West Java was established on October 28 2013, originated from concern KAMMI against social problems, particularly the problems of street children. Sekolah Cermat as LSO (Semi-autonomous Institution) engaged in social and educational, the main targets being the target of this school are street children and children from poor families who could potentially become street children.

**Visions :**

Establish the identity of human beings who are intelligent, independent, and character.

**Mission :**

1. Feeding beings through formal and non-formal
2. Develop your own potential through education based on interests and talents
3. Forming a human character through moral education
4. Establish an independent person financially

**Student Of Sekolah Cermat :**

Laskar Hamka: composed of street children. Profession average, not the school, buskers and beggars. The number of children less than 46 people per September 2015-February 2016 with an age range of 4-16 years.

Laskar Natsir: composed of children orphans vulnerable to street children, the number of children less than 89 people per September 2015 to February 2016. The age range of 4-16 years (pre-school to junior high) Guidance in this meticulously school included:

1. Learning activities in a mosque school learning Habiburrahman Lanud Hussein and Al - Fajar.
2. Field Trip as a refreshing event for children.
3. Competition intern School Quiz
4. Exercise traditional music instrument (Angklung)
5. Exercise percussion
6. Exercise Football

For a schedule of Laskar Hamka (street children) and Laskar Natsir (poor children) is held separately. Sekolah Cermat students come from Jln Citepus I, II, III RW 05, 06 and 10 Kel.Padajaran Cicendo district of Bandung.

**Aim's of Sekolah Cermat :**

The goal is as follows:

1. Contribute to our brothers in need
2. Scatter symbols of goodness to the society.
3. Increase gratitude to Allah SWT

4. Growing awareness and public participation in efforts to develop a love for his fellow human beings
5. Establish a character.
6. Establish an intelligent human being, independent and skilled.

**Coaching Schedule:**

**Laskar Natsir**

Day : Sunday

Time : 13:30 to 17:30 pm.

The place : Masjid Al - Fajar (Kp. Bandara Husein Sastranegara, Jl. Kapten Natanegara, Cicendo, Bandung City)

**Laskar Hamka**

Day : Wednesday and Thursday

Time : 15:30 to 17:30 pm.

The place : Masjid Habiburahman (Kp. Bandara Husein Sastranegara, Jl. Kapten Natanegara, Cicendo, Bandung City)

**P2TP2A and PPABM (Community-Based Child Protection Care)**

P2TP2A is an integrated activity center who provided services to women and children victims of violence, which includes the Information Services, Psychological and Legal Consultancy and Assistance. West Java province with the largest population in Indonesia, supporting the social issues is not that simple. Women who occupied half of the population have specific problems that vary according to the geographical conditions in West Java, which is directly adjacent to the capital of the State.

One of the problems that concern the government was rampant cases of violence and human trafficking (trafficking) against women and children. It did not escape from the social and cultural backgrounds that exist in West Java. Poverty, economic problems, lack of education, a shift in the moral, social and cultural issues, lifestyle and the growing number of people who narrowed the field work, make women and children vulnerable to trafficking and violence problems.

Based on the problems need to be formed Integrated Services Center for Women and Children is an answer that is expected to provide a way out of the empowerment of women and children. This institution was born reinforced by West Java Governor Regulation No. 15 Years 2010 regarding gender equality and child protection as part of efforts to protect human rights, especially women and children.

Seeing the purpose of the establishment of P2TP2A turned out in line with the program carried out by the School Meticulously, then it makes the P2TP2A cooperation program with the School Carefully. In maximizing cooperation between P2TP2A and Sekolah Cermat namely in alleviating the number of street children P2TP2A contributed not only in terms of funding but also PPABM program (Care and Community-Based Child Protection) which is a program that includes care in the realm of self-concept, communication, growth and development.

**Street children**

There are two dimensions that can be used to determine the street children: The level of family involvement and the number of aberrant behavior. According to Cosgrove, street children are; any individual in the age of majority whose behavior is contrary to the norms of society, and that is the main support for its development needs is not a family or a replacement family. Cosgrove definition assumes many cultural consistencies, but substitute family aberrations inherent in the particular culture. For example, how do we deal to the fact that in many cases the lives of street children healthy-both physically and emotionally from the lives of children living at home diverged? (Cosgrove, 1990).

PBB has its own definition of street children: "girl or boy ... for anyone who was on the road in the broad sense to the word (including the place stayed empty, desert, etc.) has been making a living or livelihoods, and who is inadequately protected, supervised, or directed by adults who are responsible for it. (International Catholic Children's Bureau, 1985, p. 58).

Some definitions of street children, making children who are in the streets to get

off the stage of street life. Among street, child is defined as the process of moving from home to the streets starting with a slow but progressive amount of time away from home until there is acceptance thoroughly to life of the streets and their culture. (Aptekar 1988 Visano 1990)

There are two additional facts that warrant attention in defining street children. The first is their age range, and the second is their sex, street children in developing countries, mostly male sexed another case of developed countries that there are similarities between the amount gender male and female (Aptekar 1994).

Children rarely start life in the streets before the age from 5 years (Gutierrez, 1970). When their body image changed to that of an adult, they are forced into criminal behavior or into the same type of work performed other poor adults to survive. The reason is that small children are considered worthy of receiving alms, but when they are considered mature enough they considered dangerous and so difficult to get alms from the public. There are cultural differences for this phenomenon. (Aptekar 1994)

UNICEF (1984) describes three main categories: children at risk took to the streets, street children, and children in the street. (A) 'children at risk', those who stayed with the family but working on the streets to supplement the family income; and (b) 'street children, those who live and work on the streets without any family support. (C) 'child in the street', people who have some family support, but work on the streets; (UNICEF, 1984, UNICEF, 1986, Lalor.KJ 1999, Kombarakaran. F. A 2004, Lusk, 1992).

For these children who live with their families, the way of life is part of a family strategy to get out of rural poverty. Although children expressed frustration in being compelled to work, they feel that their parents love them and care for them. (D'Lima & Gosalia, 1992). Street children tend to be in large, poor families in which both parents work to provide immediate needs of their families. (Blanc-Szanton, 1994; Manimekalai & Kunjammal, 1999). For 'street children, family instability, such as a divorce or death of parents and family disharmony, reported to be the main reason for running away from home. (D'Lima & Gosalia, 1992). Seek employment,

family poverty and the desire to enjoy the glamor of city life (D'Lima & Gosalia, 1992; Rane & Shroff, 1994) Is an additional reason for children to make their way home

A subcategory of street children in UNICEF typology is that "abandoned children." This category includes orphans, children who run away from home, refugees, and others who do not have significant contact with caregivers. In terms of lifestyle activities and everyday, abandoned children are very similar to street children. The difference is all to do with the family that has been disconnected, either through death, displacement, or abandoned. On the other hand, street children have occasional contact with their families. Of all the street children, which is included in the category is the smallest abandoned. Only about 5% to 10% of street children belong in the group of street children. (Tacon, 1992, Lalor.K.J. 1999, Alia.M, Shahabb.S, Ushijimaa H, & Aime de Muynckc 2004).

Some children work in the informal sector. (Wright, Kaminsky, & Wittig, 1993): Peddle merchandise and get into traffic jams, peddling their wares on buses and trains, in front of the hotel and the mall. On the street, they became shoeshine, wash and keep the car, sell trinkets, collecting recycling, selling newspapers and often times they change jobs become beggars profit making money. (UNICEF, 1997; Krueger & Richter, 1997; SPARC, 1999, Stephenson.S 2001).

## **TOWS**

TOWS stood threats, opportunities, weaknesses, and strengths. This analysis is commonly used by businesses and even venturing into fields other than business because the benefits greatly from an analysis to make improvements to the planning and strategies to achieve in the future (Wehrich, 1982a). Initially introduced as a TOWS matrix formulation of corporate strategy, but over time, TOWS matrix is used as a framework for career development strategy for individual (Wehrich, 1982b).

TOWS is a device commonly used in systematically identifying the internal strengths and weaknesses, opportunities and threats in the external environment that will be used in formulating an appropriate strategy. It is based

in the assumption that an effective strategy is a strategy that maximizes the strengths and opportunities, minimize weaknesses and threats (Wehrich, 1993). Basically, TOWS matrix has four strategies as shown below:

<b>Internal</b>	<b>Strenght (S)</b>	<b>Weaknessess (W)</b>
<b>Eksternal</b>	<b>Strategi SO</b>	<b>Strategi WO</b>
<b>Opportunities (O)</b>	<b>Strategi ST</b>	<b>Strategi WT</b>
<b>Threats (T)</b>		

**Image 1. Matriks TOWS**

TOWS matrix consists of four types of strategies, namely.;

- 1) S-O strategy uses internal strength to take advantage of opportunities.
- 2) W-O strategy that improves internal weaknesses to exploit external opportunities. For example, have the community empowerment program (opportunity), but seasonal street children from out of town more (threats). W-O Strategy hold inter-regional cooperation in tackling street children.
- 3) Strategies S-T utilize an internal strength to suppress external threats. For example, many LSM that cares for street children (strength) to deal with human trafficking on street children (threats).
- 4) W-T strategy is defensive tactics to minimize internal weaknesses to overcome external threats. A preferred strategy is to increase the role of communities and LSM and youth organizations to be more active social conducting positive activities.

In formulating alternative strategies, not all strategies are developed within the TOWS matrix but selected over the course will be applied. TOWS matrix can be used as a tool to assess the impact of environmental factors as the existence to the phenomenon of street children. It can identify their strengths, weaknesses, opportunities and threats in a systematic way, to manage and generate

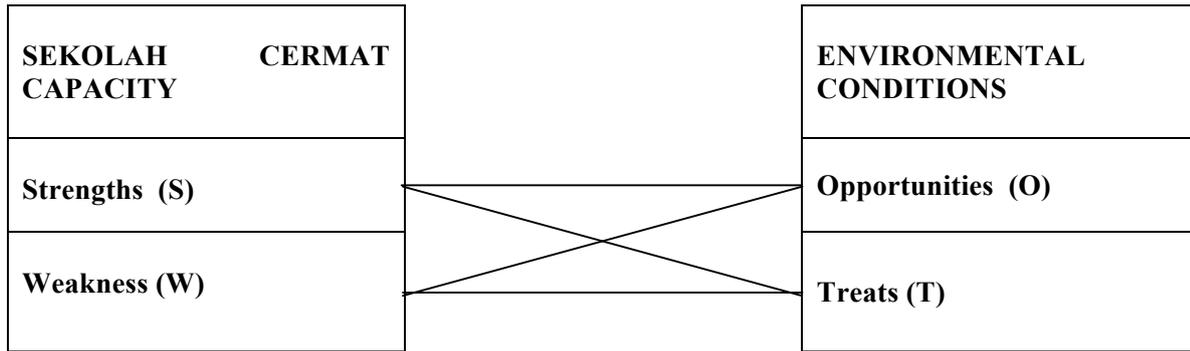
strategies that qualified. TOWS matrix will force all parties to think more creatively in dealing with the phenomenon to the existence of street children.

**TOWS Sekolah Cermat**

Designing a program would seem ideal if known in advance their strengths, weaknesses, opportunities and threats / constraints which in this case is commonly known as TOWS analysis. Strengths, weaknesses, opportunities and threats if understood and used as the foundation will get a proper solution in getting a strategic planning. If it is associated with a problem finding a coaching model for street children, then obtained strategic planning services in the form as the coaching model that is right for the program targets street children.

Hesel Nogi S, Tangkilisan (2003: 21) argues Identifikasi the analysis TOWS: strengths (strengths), weakness (weakness), opportunities (opportunities) and threats (Threats), is the center of the strategic planning process that involves the development of strategies to respond to threats and external opportunities by exploiting the strength and avoid or improve internal weaknesses. TOWS first approach.

To analyze the competitive environment To identify opportunities and potential threats then confronted with internal strengths and weaknesses. TOWS approach by Hesel Nogi S, Tangkilisan described:



**Image 2. Analisis TOWS**

Statement is:

1. External Factors, which form the opportunities and threats or obstacles from the outside either from society or government institutions.
2. Internal factors, which form the strengths and weaknesses of the kind of street children as well as for institutions that deal.

As for the internal and external factors (Threats, Opportunities, Weaknesses, Strengths And) Schools Quiz in his effort on the handling of street children is as follows:

**Treats**

1. Competitors of similar schools
2. A supportive environment for the child fell back to the streets
3. Lack of government support
4. The low trust society to Output
5. Carefully school-community culture of giving (to street children)

**Opportunity**

1. Support relevant stakeholders
2. Support high society
3. Children Street localized community
4. High Hopes

**Weaknesses**

1. The lack of quantity (amount) of human resources, employee or personnel possessed School Quiz
2. Lack of facilities and infrastructure
3. Minimum discipline students

**Srenght**

1. Vision and mission in accordance with the local government
2. Power of the competent
3. Operational funds remain.
4. Lessons varied
5. Process Communication smooth
6. Supervision and systematic evaluation
7. Good Leadership principals
8. Characteristics of school and strategies which are considered appropriate.
9. Preliminary intensively in progress (learning) pupil
10. The school has a responsibility for planning programs conducted by school personnel.
11. Climate friendly school

**RESULTS**

**TOWS Analysis**

Based on the internal strength is the vision and mission suitability to the conditions, the implementation of the mission in order to achieve the vision and commitment among stakeholders in the prevention of street children. Internal strength and the opportunities that come from external organizations will create S-O a strategy. From interviews with informants who commitment both among stakeholders with regard to tackling child the way the Sekolah Cermat.

Well as their government's cooperation in this regard P2TP2A in order to carry out activities in the framework of efforts to address the number of street children to the city is a good opportunity as evidenced by a vision and mission suitability in the prevention of street children. So the vision and mission in the prevention of street children can be used as a cornerstone in the prevention of street children, accompanied by

commitment among stakeholders. Aside from it is also supported by the Power of the competent, operational funds remain, Learning varied, Process Communication seamless system of supervision and evaluation, leadership principals well, characteristics of the school and its strategy which is appropriate, do forecasts intensively on progress (learning) students. School has responsibility for planning programs conducted by school personnel, and school climate friendly is the basis for exploiting the opportunities that exist in the external sphere.

Threat arising from the external environment is the lack of community involvement in the prevention of street children who community culture of giving (to street children), a competitor of schools similar, supportive environment children to get back down to the streets, lack of government support, and low trust society against Output Sekolah Cermat. The threat comes from the external environment is an obstacle that will interfere with the internal forces that have in tackling street children. S-T strategies appear to take advantage of existing opportunities to avoid the threat coming from the external environment within the organization. S-T strategy taken is to utilize their existing strengths in the school carefully. The weakness of the internal environment in the prevention of street children is the lack of quantity of human resources. Employee or personnel owned Sekolah Cermat, lack of infrastructure and lack of budget Sekolah Cermat in tackling street children and the lack of discipline of students. The weakness of the internal environment can be minimized or overcome by taking opportunities from the external environment. W-O strategy appear to overcome the weaknesses derived from the internal environment to take advantage of opportunities that exist in the external environment Strategy that can be taken is the use of the opportunities that exist in the external environment Sekolah Cermat.

W-T strategy, which this strategy appears to minimize weaknesses in the internal environment, namely by avoiding threats in the external environment within the organization. In the prevention of street children to the city of Bandung, W-T strategy is carried out by their maximum

cooperation from all parties, be it the public or relevant stakeholders. As for the strategy of the TOWS matrices are:

### **1. S-O Strategy**

S-O strategies sourced from strengths and Opportunities, which was created with the strategy of using force to take advantage of existing opportunities. The strategy should be applied is harnessing the suitability of the vision and mission in the prevention of street children who are used as a basis in the prevention of street children, apart from it is also supported by the Power of the competent, operational funds remain, Learning varied, Process Communication smooth, system supervision and evaluation, leadership principals well, characteristics of the school and strategy as well, do forecasts intensively in progress (learning) students. School has responsibility for planning programs conducted by school personnel. Climate school friends form the basis for the use of the opportunities that exist in the external sphere.

Their suitability in the use of force in the prevention of street children is expected to be able to take advantage of opportunities that are an opportunity to support the implementation of the reduction of street children to the fullest. Sekolah Cermat is expected to give special attention to remove street children from the streets by organizing skills, and training programs according to the needs of street children to be more creative and self-sufficient, such as through parenting and community-based child protection, crafts, sports, arts, formal learning, etc.

### **2. S-T Strategy**

S-T Strategy sourced from strengths and threats, which is a strategy that is created by using the power of the internal environment to address threats emanating from the external environment. Despite facing a threat, the organization still has the power internally. The strategy should be applied is S-T strategy appears to take advantage of existing opportunities to avoid the threat coming from the external environment of the

organization. S-T strategy taken is to utilize the role of the community to be involved in the response to street children. Involvement can be done by the public one with no habit of giving money to street children and beggars in the streets. It is seen as an alternative solution that is effective in minimizing the growth of street children and beggars. The habit of giving money is the reason why street kids activities and working on the streets. In addition, it is also necessary for optimal business can compete with similar schools, an effort so that children choose not to fall back to the road, maximize government support and increase community confidence in the Sekolah Cermat.

Conversely, lack of community involvement and opportune stakeholders can influence the success of Educational programs Sekolah Cermat becomes less effective and maximum, then it is essential that opportune stakeholders are empowered to help the success with the program of the Sekolah Cermat in tackling social problems, especially street children.

### **3. W- O Strategy**

W-O strategy is sourced from Weakness and Opportunities, where W-O is a strategy that was created to minimize the weaknesses to exploit opportunity's strategy that can be taken is to increase the quantity of human resources? In addition, other strategies are created is by proposing a budget increase in the response to street children. Sekolah Cermat lack of budget allocated in the prevention of street children will not run optimally.

This strategy, the weakness coming from the internal environment is the quantity of human resources, which is owned by the Sekolah Cermat inadequate can be minimized through the use of the opportunities that come from the external environment, namely their desire P2TP2A in the prevention of street children with the program PPABM and support of high society, Kids street localized, high hopes the community will provide a great

opportunity in the prevention of street children.

### **4. W – T Strategy**

W-T strategy sourced from Weakness, and Threats are directed at the defense tactic venture far to internal weaknesses and avoid external threats. Weakness is sourced from the internal environment then minimized and is also used to avoid threats from the external environment that exist in the prevention of street children in the city of Bandung. Strategy that do is minimize the weaknesses that exist within the scope of internal and further maximization of the various stakeholders.

The strategy is to minimize the weakness coming from the internal environment and avoid the threats that come from the external environment. Cooperation with various stakeholders aimed at can equally perform countermeasure's street children.

## **CONCLUSION**

Conclusion, of the strengths and weaknesses derived from the internal environment Sekolah Cermat, opportunities and threats that come from the external environment Sekolah Cermat itself. Opportunities and strength are a supporting factor, while threats to be an inhibiting factor in the implementation of prevention of street children.

### **Internal environment**

#### **1. Srenght**

- a. The existence of a common vision and mission of the Sekolah Cermat and the vision and mission of P2TP2A regarding the prevention of street children to the city of Bandung.
- b. competent teaching staff.
- c. Operational funds remain
- d. Learning varied
- e. Communication Process
- f. The system of supervision and evaluation
- g. school leadership.
- h. School characteristics and strategy

- i. Estimated intensively in progress learning students
  - j. Schools have the responsibility for planning programs conducted by school personnel
  - k. School climate friendly.
2. Weakness
- a. The quantities of human resources are inadequate in tackling street children
  - b. Lack of facilities and infrastructure
  - c. Miniminy discipline students.

#### External environment

1. Opportunity
- a. Stakeholder Support Related
  - b. Support high society
  - c. Street children are localized.
  - d. Expectations are high society.
2. Threat
- a. Competitors from similar schools
  - b. Environment that supports children to get back down to the road
  - c. Lack of government support
  - d. Low trusted the community for Sekolah Cermat
  - e. Culture of giving (to street children)

#### Recommendation

The following will put forward some suggestions in order to increase success in the implementation of the reduction of street children. The suggestions put forward are as follows:

1. Vision and mission are appropriate for the prevention of street children in order to serve as a cornerstone in the prevention of street children accompanied commitment among stakeholders.
2. To increase the participation and involvement in the community to be involved in the response to street children.
3. In order to achieve the vision and mission in the prevention of street children, Sekolah Cermat should be able to perform additional quantity of human resources who have the competence to take advantage of the government's desire Bandung in tackling street children.

4. Maximize existing strengths in the school's internal closely accompanied the precision in read the opportunities that exist in the external Sekolah Cermat, which is in the prevention of street children.
5. Carefully minimizing weaknesses and threats, especially in the prevention of street children.

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## **THE EFFECT OF ISLAMIC WORK ETHIC ON EMPLOYEE SATISFACTION: A CONCEPTUAL MODEL AND REVIEW LITERATURE**

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### ***ABSTRACT***

*The problem of ethics and value systems associated with the work has attracted the attention of researchers in the 21st century. Many events in the corporate moral fraud that led to dissatisfaction of employees will ultimately have an impact on overall company performance. It is therefore important to investigate the effect of employee moral ethics on organizational performance. This study aims to develop a conceptual model on the relationship between Islamic Work Ethic on performance of microfinance institutions (BPR). This research is expected to provide insight into the extent to which the implementation of the work ethic in the organization of Islamic financial institutions. The work ethic in Islam was expected to cover all aspects of life of employees in the organizational environment within which organizations are working hard to establish a code of ethics and culture to assist employees in carrying out and understand their ethical responsibilities and employee satisfaction, which therefore enhance organizational performance. This study explores the literature relevant to the Islamic Work Ethic and its relation to the notion of employee satisfaction and organizational performance.*

*The dimensions of Islamic Work Ethics used questionnaires to validate the practice of employees towards the implementation of the Islamic Work Ethics. Islamic Work Ethics profiles are given attention as universal values that apply in every organization of work. The expected results of this study support the notion that implementing an Islamic work ethics will improve employee satisfaction. Further studies of this research is also expected that the work ethic of Islam will drive the organization's culture and making the organization work better job.*

**Keywords:** *Islamic Work Ethics, Employee Satisfaction, Organizational Performance*

## **BUSINESS ETHICS AND COMMUNICATION OF NON-HALAL CERTIFIED PRODUCT IN CREATING PERCEPTION OF HALAL**

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### ***ABSTRACT***

Cosmetic market condition in Indonesia experienced a significant change in the last 5 years, cosmetic market began to be filled with cosmetic products labeled as halal. The consumption behavior of consumers also change, for example in choosing a cosmetic product, some consumers began to notice a halal label on the product, the condition force manufacturers or brand holders to adapt with current situation, one of the things done by the manufacturer or brand holders through product communication via TVC, often we hear the word "Halal" is mentioned or utilize a model with hijab in order to create the perception of "Halal". In practice, not all of these products are already equipped with a halal certificate. Communication practices to non-halal certification product intersect with philosophy deontological ethical, this paper addressed issues about the current practices of intention to create halal image through TVC for non-certified halal cosmetic based on a theoretical point of philosophy deontological ethics.

**Keyword:** *Halal cosmetic, ethics, deontology, TVC*

### **INTRODUCTION**

The condition of Muslim women consumers in Indonesia changed significantly in the last 5 years, one of these changes can be easily seen from the fashion and lifestyle. Fashion relate to the way Muslim women dress today, which is very easy for us to find women with Muslim dress and use the hijab. Previously hijab is a symbol of obedience to a Muslim towards the shari'ah of Islam, has now become a symbol of a lifestyle shift in fashionable dress and style (Beta, 2014)

Lifestyle changes associated with increased awareness of the halal status can be found on the electoral process products for consumption, including cosmetics and personal care. When consumers have started checking the certification or halal logo on the product, if previously consumer focus only on Expiry Date (period of validity of the consumption of a product), currently majority of consumers have started paying attention and checking the halal logo on products, including whether the halal certificate is issued by a credible committee such as MUI.

Changes that occur at this time inevitably brings the impact of changes in market conditions, the means and ways to communicate to the target consumers, especially if the main target Muslim

women, eventually forced the manufacturer or brand holder to think best efforts to build confidence and attract Muslim woman.

When awareness of halal products increased, as manufacturers compete to meet the requirements of halal, but in practice not all products can be directly included halal certification, this is due to the requirement to obtain halal certification covers many aspects and must pass through a long process.

Various things are done by the manufacturer or brand holder to anticipate the conditions, one of them through communications media such as TVC, the use of female models with hijab become one of the efforts to impress halal or to be perceived halal in order to meet requirement from halal concern consumers.

### **The hijabers Phenomenon**

Hijabers definition, young women who use head scraft (veil) expressed her "cheerfulness" and "Colors" in the Islamic religion. They are active social media users, utilizing social media as a reference to make the construction of their identity in their fashion and style (Rocamora, 2011)

Hijabers community is a group of women who dress very fashionable and Islamic, they are made up of teenagers and young adults. The appearance of their dress is very different to most women who wear Muslim clothing, because model of the clothes they wear very stylish and fashionable, ranging from hoods, clothes to shoes, bags, which are pleasing to the eye (Pakuna, n.d.)

Community Hijabers not only put the hijab as a form of high levels of a person's faith or obedience, more than that she also put a veil or hijab as a fashion (Pakuna, n.d.)

### **New Trend Beautiful with "hijab"**

Along with the raise of civilization and technology has brought changes in various aspects of the life, one of them is a lifestyle change. Lifestyle changes that occur in the community is likely to have great influence

among women. That influence, among others, can be viewed in terms of the hijab among the public. Look beautiful, do not miss the model or the current trend, is a social phenomenon that is caused by the rapid development of a culture of consumerism. Hijabers, giving the impression and Muslim identity as a modern Muslim figure (Beta, 2014)

### **Paradigm Shift**

The paradigm of the intellectual discipline is the way people perceive themselves and their environment which will influence the thinking (cognitive), attitude (affective), and behave (conative).

The phenomenon of increasing halal awareness halal to Indonesian woman is the embodiment of the process of undergoing a paradigm shift toward religious values.

In the cognitive side, In the era of 'Islamic awakening', (urban) modern Indonesian Muslims seek moral certainty, spirituality, and piety supports the commodification of Islam as a way to articulate their identities, they enjoy more personal Islam, by rational considerations and pluralistic.

In the affective side, the impact of the paradigm change is the increasing awareness about halal products are consumed not only for food but also for everyday use such as cosmetics or personal care.

In connative, started to increase awareness of the use of cosmetic products halal particular on Muslim women in Indonesia makes them more likely to choose products with halal label when shopping.

### **What is a Halal Cosmetics?**

Definition of halal cosmetic products according LPPOMMUI are as follows:

1. Does not contain pork DNA and materials traditionally derived from pigs.
2. Does not contain prohibited ingredients such as; material derived from human organs, blood and dirt.

3. All material derived from animals slaughtered by Islamic law.
4. All storage, point of sale, processing and transportation should not be used for pork; if ever used for pork or other goods that are not halal, at first step must be cleaned with the procedures set forth by the Islamic Shari'a.

### **Communications products to create the impression of "Halal"**

TVC campaign via the media is one way that is still considered the most effective and influence consumers in Indonesia, this is due to the extensive TVC coverage and ability to reach a wide audience both in the region and all target segment.

Today's TVC of cosmetic products and personal care, some are packed with creating halal perception, which aim for the target audience they are halal concern consumer, they have to believe that the product is halal thus they want to use without any doubts.

### **The relationship between business ethics VS efforts to win halal concern consumers**

Business ethics is a specialized study of moral right and wrong that concentrates on moral standards as they apply to business institutions, organizations and behavior (G. Velasquez(Anderson University), 2001)

In the context of the relationship between business ethics by the efforts of the manufacturer or brand owner to win the hearts of halal concern women consumers can be assessed through Deontological and Teleological theory.

Deontological aspect, provides a moral obligation for producers and brand holders to realize the formal halal approval for its product, before the formal certificate is issued.

Aspects teleological, good size and poorly assessed having viewed the results of the action, on the side of the manufacturer or brand holder, this practice can help drown out the doubts of

consumers towards the product so that the consumption of the products will still occur and help from the business side, on the side of the consumers doubt be missed and product consumption can be continued.

## **THEORITICAL FRAMEWORK**

### **Ethics**

Ethics (Ancient Greek: "ethikos", meaning "arising from habit") is the main branch of philosophy that studies the value or quality becomes a study on standards and moral judgments. Ethics includes the analysis and application of concepts such as right, wrong, good, bad, and responsibility. St. John of Damascus (7th century AD) put ethics in the study of practical philosophy (practical philosophy).

Ethics begins when people reflect on the ethical elements in the spontaneous opinions, a reflection that we will feel, partly because of ethical opinion we are not infrequently different from the opinions of others. That's necessary ethical, that to find out what should be done by humans.

Methodologically, not every case assess the actions can be regarded as ethical. Ethics requires a critical attitude, methodical, and systematic reflection. That's why ethics is a science. As a science, the object of ethics is human behavior. However, unlike other sciences are also examining human behavior, ethical perspectives normative. That ethics viewed from the point of good and bad to human actions.

Ethics is divided into three main parts: meta-ethics (study of the concept of ethics), normative ethics (the study of ethical value determination), and applied ethics (study of the use of ethical values).

### **Deontology**

Part of axiology in Ethics also called ethics rules where size is good or bad is measured directly from the physical action. There will be a moral value only during human acting on the basis of

the liability. Famous figure known for this theory is Kant (1724-1804).

Deontological divided into two namely:

1. Deontological action, to do something as a moral burden felt as a liability.
2. Deontological rule, do something for the liabilities will rule.

### **Teleology**

Part of the Ethics axiology in which the good or bad size measured and as a result of an action. Also known by the concept of utilitarianism. Divided into two thought namely:

1. Personal Utilities (Bentham, 1742-1832)
2. Social utility (1806-1873)

Greatest concept of happiness for the greatest number of people

### **Halal Awareness**

Consciousness (awareness) is the ability to understand, feel, and become aware of the event or something. It is a concept of the understanding and perception of the event or object.

There are various factors that can influence consumer awareness about halal, for example, the availability of halal cosmetics is also a factor that consumers can buy Halal cosmetics (Ismail, Othman, Rahman, Kamarulzaman, & Rahman, 2016). Intention to use the halal cosmetics and personal care products based on race and awareness. (Teng & Wan, 2016)

The empirical evidence as evidenced by (Lada, Tanakinjal, & Amin, 2009) in their study on halal products confirms a positive attitude with regard to the desire to choose halal products.

### **Promotion**

Promotion, also known as marketing communications is one of the theories about the 4P marketing mix, according to (Grönroos, 1995) marketing mix has the ability to strengthen the position of a company in competition. Promotion is also the most useful marketing tool that can affect the purchase desire of consumers. (Kotler & Armstrong, 2008).

### **Purchase Intention**

Purchase Intention shows the desire of customers to make repeat purchases (Assael, 1992). Another definition of the Purchase Intention is a tendency to buy a brand, and generally based on the correspondence between the purchase motive or characteristic brand attributes that may be considered (Belch & Belch, 2003).

According to (Till & Busler, 2000) purchase intention can be measured by the dimension of the plan Likely consumer purchase of a product, would definitely refers to the certainty of consumers in a product, and a probable reference to the possibility of consumers into buying a product

### **CONCLUSION**

The use of female models with hijab to create the impression of halal products that have not yet put on halal certification can be viewed from the standpoint of the following:

For manufacturer or cosmetic brand holders, Deontological action is one aspect that will be affected in do something for moral burden felt as an obligation, in this context, morally manufacturer or brand holder must have an obligation and a desire to perform verification or proof that halal perception or message created is true. On the side of the Deontological rule, the manufacturer or brand holder has an obligation to comply with existing regulations fulfilling obligations and requirement of halal status.

Teleological, good or bad size measured and as a result of an action. Also known by the concept of utilitarianism. In this case the manufacturer or brand owner can use the approach of social utility (J.S Mill, 1806-1873), communication by delivering image of halal can be seen in two aspects as follows:

- The positive side: Removing doubts for product consumption, As long as manufacturer or brand holders believe if they can guarantee halal status for their products, and fulfill halal requirement, the

communication aims to remove doubts and early socialization products to target consumers.

- Negative side: manufacturer or brand holder open an opportunity to plunge consumers on the use of a product that has not been officially validated halal which will ultimately impact on the target consumer believes and religious values, if it proves that the product does not meet halal requirements.

Taking ethical business principles, this practice comes into contact with the following principles of business ethics:

1. Honesty in Public Communication  
Communication via TVC by using a model with hijab creates a moral obligation to guarantee its halal-ness. From the side of the manufacturer or brand owner, communication with the goal to build halal perception can only be fulfilled when empirically the product is compliant halal, it is a form of moral responsibility towards the consumer. Honesty in communicating can be classified into the realm of action of deontological theory.
2. Integrity, Integrity is the responsibility of the product manufacturer or brand holder, they should fulfill the requirements of halal, although it takes time for processing the certification, it is a manifestation of high moral values to consumers. The fulfillment of the requirements in the form of halal certificates could be included in the realm of deontological rules.

If eventually found manufacturer or brand holder can not meet the requirements of point number 1 and 2, it means that halal concern consumers will be harmed because of using a product that does not comply with halal requirements they need, in this condition the manufacturer or brand holder has violated the ethical aspect deontology of business actions and deontology rules.

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## ANALYSIS OF SOCIAL CAPITAL EFFECT THROUGH ISLAMIC MICROFINANCE ON REPAYMENT BEHAVIOR OF SHRIMP FARMERS (CASE STUDY: KEMITRAAN USAHA BERSAMA)

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### **ABSTRACT**

*This study aimed to describe the background, systems, and unique value of Kemitraan Usaha Bersama as the program that implements group-based Islamic financing, to analyze the effect of program on the repayment behavior of its members, and to outline the strategies of Islamic microfinance-based group implementation for coastal societies based on the result of analyses supported by the related literatures. Using descriptive analysis and PLS SEM with theory of planned behavior (TPB) approach, the result showed that Kemitraan Usaha Bersama program has several advantages, such as the fulfillment of sharia compliance in the funding model, the group based financing that trigger the formation of social capital, the model of farmer insurance reflected from the mechanism of CRU ( Reserve ratio of Business), and the right form of financing that directs to productive purpose. The results of SEM analysis proved that this Program significantly influences the repayment behavior of members indirectly through TPB Elements. Then, the strategies of integrated microfinance scheme that can be formulated for Coastal Societies are the application of the profit sharing in microfinance model, the integration of zakat collection between microfinance and zakat institution for coastal societies, implementation of Islamic insurance system for fishery sector, application of group-based financing, as well as research and assistance for them. As recommendation, commercial bank should think over a partnership with sharia microfinance that apply group-based financing for its linkage program and it should be a consideration for microfinance institution to apply integrated financing schemes as Kemitraan Usaha Bersama applied*

**Keywords:** *Islamic microfinance, PLS SEM, repayment behavior, social capital*

### **INTRODUCTION**

#### **1. Research Background**

Indonesia is a maritim country that posses great potential in the fisheries sector. It can be understood from the fact that Indonesia is the largest archipelagic state in the world which has 17,504 islands and coastline length of 104,000 km (Bakosurtanal 2006). The total area of seaitself is around 3,544 million km<sup>2</sup>, or approximately 70% of the territory of Indonesia

(DitjenP2HP 2011).This geographical conditions show that Indonesia has a large fishery resources.In fact, contradictive condition happened with coastal societies as main actors of fisheries sector compared to its potential. In 2011,the Central Statistics Beaureau (BPS) recorded the number of poor fishermen in Indonesia reached 7.87 million, or about 25.14% of its total poor population (Jannah 2014).

One of the reasons for this condition is inaccessible of the coastal societies to access financial services. The absence of the productive

capital has become one of problem faced by coastal societies in Indonesia. There is a reciprocal relationship between the poor associated with access to capital. The coastal societies couldn't access the capital because they are poor, and as they are not able to access it they remain poor. One reason of the inaccessibility of capital facilities are the collateral requirements that must be met by borrowers who want to get access to credit. While the majority of coastal societies in Indonesia are generally poor and it's difficult for them to fulfill this collateral. Thus, it's needed for a breakthrough to address the 'gap' between credit access with coastal societies.

Related to fulfillment of collateral, group financing model adopted by a number of microfinance institutions provide alternatives in dealing with this problem. According Sanrego and Antonio (2013), interpersonal relations and cooperation among members of the group could be 'social collateral' (social capital), which replace the collateral for the poor. This innovation was able to expand access to capital for the poor, just like what happened in Grameen Bank.

Nobel awards received by the Grameen Bank or Village Bank in Bangladesh in 2006 could become a role model for microfinance institutions in Indonesia. According to its annual report, the Grameen Bank had total assets of US \$ 2.301 billion, 6.7 of 8.54 million customer finance portfolio amounted to US \$ 1.046 billion, and the growth rate of the financing portfolio amounted 5.06% (Grameen Bank, 2014). The existence of Grameen Bank proves that the funding given to the group (Group Lending Model) is able to reach small communities by utilizing social capital on it. Social capital is an interesting issue that is much discussed and studied in recent years. For example, the World Bank in its annual report titled *Entering the 21st Century* revealed that the level of social capital has a significant impact on the development process (World Bank 2000). Great attention to the role of social capital are increasingly directed at the problems of local

economy development (Tonkiss 2000), including in terms of poverty reduction, because these things will be much easier to accomplish and it costs little with social capital on it (Grootaert and van Bastelaer 2001a, Narayan and Pritchett 1999b). According Syahra (2003), social capital could be applied to accelerate the improvement of community empowerment as one of the important steps to achieving success in the field of economic development. The basic principle of social capital is that only groups of people who have a set of social and cultural values that respect the importance of cooperation can advance and develop their own strength.

Apart from such practices, Sharia Microfinance Institutions (SMFIs) is another institutional innovation being designed to have soundness of lending technology (base on Islamic teachings) of group lending model (GLM) that could ascertain the poor to have an access to the financial services (Sanrego and Antonio 2013). One of sharia-based financing advantage compared with conventional practice is the existence of risk sharing, which means the risk of a business can be borne not only by the borrower (the fund manager), but also by investors. Islamic financing mechanisms, particularly contract-based profit-sharing will trigger the fund managers to maximize their business.

According to Effendy (2013), both of sharia and conventional microfinance institutions (MFIs) have a positive role in poverty alleviation. However, the effect of Islamic financial institutions is slightly better than conventional financial institutions. Filtration systems used by Sharia MFIs have a significant impact on the ability of Islamic MFI credit to avoid the risk of failure faced by conventional MFIs, as well as client business development.

Financing model applied by Grameen Bank has been widely imitated and developed in Indonesia. Even so, the existing models have been modified by the application of Islamic financing models based group. One of the main modifications formulas has been applied by a financing program for shrimp farmers operating

in the district of East Rawajitu, namely the Program Usaha Bersama. A program initiated by a number of farmers in the region is designed to manage access of capital for shrimp farming. Therefore, this study will describe and analyze the possibility of the program to create the effect of social capital that significantly affect the success of the financing granted, especially in clients' repayment behavior.

Thus, application of the model of Islamic finance-based groups in the fisheries sector may be one of the alternative that can be applied because of the characteristics of farmers who generally still has good cultural kinship and strong mutual cooperation, and the inability of farmers to provide collateral on the financing undertaken by financial institutions. Karlan (2001) concluded that social capital proved to reduce moral hazard and errors resulting from personal negative shock.

## **2. Problem Statement**

In order to portray the type of mechanism or strategy that has been applied by this program to ensure the soundness of their loan repayment performance, thus purposes of this research are formulated as follow :

1. Describe the background, system, and unique values embedded in Kemitraan Usaha Bersama Program.
2. Analyze the effect of program on the repayment behavior of its members,
3. Outline the strategies for Islamic microfinance-based group implementation for coastal societies (shrimp farmer) based on the result of analyses supported by the related literatures.

## **THEORITICAL FRAMEWORK AND STUDY LITERATURE**

### **1. Definition of Social Capital**

Ohara (2008) in Sanrego & Antonio (2013) defines the value of social capital as the functioning of social relationship and networks

in the achievement of group's interest. Hence, the importance of interrelationship is emphasized further through defining social capital as a durable process of communication and interaction within the community that can establish and promote networks, trust, social obligation and practices.

Social capital in society includes the institutions, relationships, attitude and values that govern interactions among people and contribute to economic and social development. Social capital, however, depends not only on the number of institutions that support the community (structural social capital), but also makes them bond together. This includes values and shared rules for social conduct expressed in personal relationships, trust, and a sense of responsibility, which makes the society more than a collection of individuals, also called cognitive social capital (Bastelaer, 2000).

There are several indicators that could be used to measure social capital. Karlan (2001) determined the effect of social capital on repayment rate and the level of saving by using several indicators, namely the heterogeneity of cultural, geographical spread, and identification strategies. Bastelaer and Leathers (2006) used several indicators of social capital, namely the size of the group, age of group, and the stability of its members, geography (distance), joint responsibility, types of penalties applied, training in a group, and interpersonal networks to determine the factors that affect good repayment rate for borrowing seed in Southern Zambia. While Grootaert (1999), measured social capital with six indicators, namely the number of members in the community, the internal heterogeneity of associations (age, sex, education, religion, etc.), presence in the meeting, activeness in making decisions, payment of the rights of the institution to the community or state, and the purpose of the community.

**2. Definition of Sharia Financing**

According to Undang-Undang No. 21 Tahun 2008 about Islamic Banking, financing is the provision of funds or bill equivalent with the form of the profit and loss sharing in the form of *mudharabah* and *musyarakah*, leasing transactions in the form of *Ijarah* or hire purchasing in the form of *Ijarah muntahiya bittamlik*, purchasing transactions in the form of *murabaha*, *salam*, and *istishna'*, debt transaction in the form of receivables *qardh* and leasing service transaction in the form of *ijarah* for multiservice transactions based on agreement between Islamic Bank and / or the Sharia Business Unit (UUS) and other parts that obligates the part required financing and / or given the facility of funds to repay the funds after a certain period of time in exchange *for ujarah*, without compensation, or profit sharing.

**3. Theory of Planned Behavior**

Theory of planned behavior is a theory developed in 1988 by Icek Ajzen and Martin Fishbein to study the attitude toward the behavior. Based on this theory, the most important determinant of a person's behavior is the intention to behave. It is

based on the assumption that humans are rational and use of information that is possible for him, systematically. People think of the implications of their actions before they decide whether to do or not do certain behaviors (Achmat 2010).

The intention is assumed to catch the motivational factors that influence a behavior; the intention indicates of how much people will try, how much effort will be planned to be used, in order to show the behavior. The general rule is the stronger the intention to show the behavior, then it should be the more likely to appears in behavior (Ajzen 1991). Intention to behave itself is a function of the individual's attitude toward behaviors (Attitude toward Behaviour / ATB), subjective norms (Subjective Norms / SN), and perceived behavioral control (Perceived Behavioral Control / PBC) as shown in Figure 1.

Attitude is positive or negative beliefs to display a behavior-belief or beliefs. An individual will intend to show a certain behavior in a positive way when he assess it positively. Attitude is determined by individual beliefs about the consequences of showing a behavior (behavioral beliefs), weighted based on the evaluation of the consequences (outcome evaluation). Attitude is believed to have a direct influence on the behavior and intentions

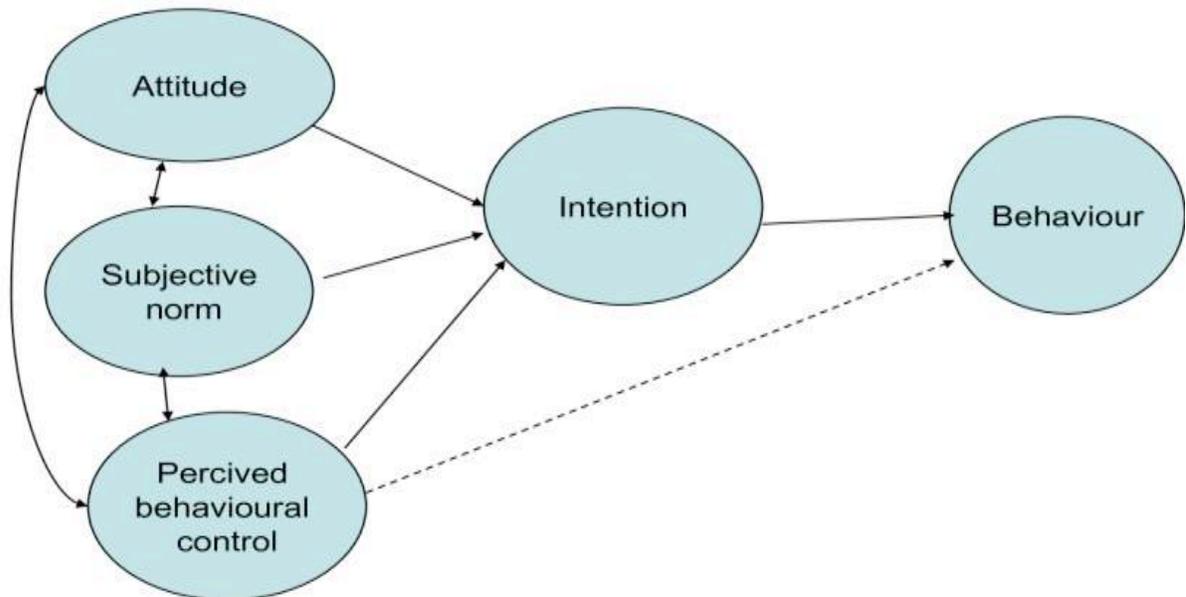


Figure 1 Theory of Planned Behavior

associated with subjective norms, and perceived behavioral control (Achmat 2010).

Subjective norm is defined as the individual's perception of whether the important person for the individual think behavior should be done or not. Contribution of opinions from each referral given is weighted by the motivation that an individual must comply with the desire of the referral (Furneaux 2005).

PBC (perceived behavioral control) refers to the person's perception of the ease or difficulty showing behavior (Ajzen 1991). PBC designate the degree to which an individual feels that whether he perform a behavior or not is under control. People don't tend to form a strong intention to show a certain behavior if he believes that he does not have the resources or the opportunity to do so even though he has a positive attitude and he believes that others are important to him will agree. PBC can influence behavior directly or indirectly through intention (Achmat 2010).

Furthermore, Ajzen (1991) explained that the PBC has an important role in the Theory of Planned Behavior. PBC give effect to the intention and behavior. According to this theory, in addition to affect intention, PBC can also affect the behavior directly.

#### **4. Study Literature**

Various studies discussed social capital and its influence on various aspects of the economy. Some of the research related to the influence of social capital at the microfinance. Basargekar (2010) found that microfinance program implemented by organizations was able to create social capital which has the effect of empowering members of the program. The results showed that the creation of social capital is not an automatic result and organizations must implement certain policies such as capacity building programs, develop decision-making, and others. According to Kurnia (2007), indicators of social capital that significantly influenced the repayment rate is the relationship between members, the distance between the

members' home, beliefs, membership status, number of meetings, and the distance between the client's home with microfinance institutions. Differences with the group credit personal loans related to the indicators of social capital are the level of trust given to the higher group.

Feigenberg, et al (2010) provided experimental evidence of interaction of social and economic benefits in the context of microfinance. Increasing the frequency of mandatory meeting in the entire group of borrowers was able to produce consistent changes in social ties among clients. The results showed that an increase in social interaction among its clients for more than a year later was associated with improvements in informal risk sharing and a decrease in financing failure. The next field experiment provided direct evidence that the more frequent the interaction happens, it would further enhance economic cooperation among its clients. Loan groups were capable of achieving a low failure rate without collateral, and this is not only because it uses existing social capital, but also because loan groups built social capital among participants.

## **RESEARCH METHODOLOGY**

### **1. Population and Sample**

The research was conducted at Kemitraan Usaha Bersama Program that operates in the District of East Rawajitu, TulangBawang Regency, Lampung Province. This study uses primary data and secondary data that are both quantitative and qualitative. Primary data were obtained from in-depth interviews with key informants and respondents. There are 3 Informants in this study. One of them is from the management of Kemitraan Usaha Bersama and the rest is from P3UW as external parties of the program. The respondents consisted of 35 members of the program. Secondary data were obtained from the Ministry of Fisheries and Maritime Affairs, the Central Bureau of Statistics, books, journals, theses related and other data that support the availability of data.

**2. Data Collection Technique**

The instruments used to collect data were formulated in the form of a list of questions and questionnaires in order to conduct structured interviews with respondents. Questionnaire model consists of a list of open and closed questions. Open questions addressed to the informant and intended to get answers openly in accordance with their views and conditions.

The closed questions are questions that have been determined all of the alternative answers. Closed questions model uses a Likert scale of 1-5, measurements used to give a specific weight to each answer statement. Likert scale used to measure attitudes, opinions and perceptions of a person or group of people on social phenomenon. In this study, scoring of a Likert scale questionnaire refers to the five alternative answers according to Table 1.

Table 1 Likert Scale

Strongly Disagree	1
Disagree	2
Undecided	3
Agree	4
Strongly agree	5

**3. Data Analysis**

**Descriptive Analysis**

Descriptive analysis is an analysis that describes the data that will be made either individually or as a group. The purpose of descriptive analysis to create a systematic overview of data on factual and accurate information on the facts and the relationship between the phenomenons investigated or researched (Akdon and Riduwan, 2009). Descriptive analysis in this study is used to explain about the research location and Kemitraan Usaha Bersama Program.

**Analisis Structural Equalling Model (SEM)**

According to Chin in Ghazali and Latan (2015), Structural Equation Modeling is a second generation multivariate analytical techniques that combines factor analysis (factor analysis) and path analysis (path analysis) to enable

researchers to test and estimate the simultaneous connection between multiple latent independent variables and multiple latent dependent with many indicators and can test the model with a mediator and moderator effects, in the form of nonlinear models and measurement error.

PLS SEM analysis usually consists of two sub-models of the measurement model or often called outer models and structural models or commonly called inner models. The measurement model shows how the manifest variables represent latent variables to be measured. While the structural model shows the estimated force between the latent variables or constructs.

Outer models analysis is conducted to test the validity and reliability of research instrument. A research instruments is valid only if it's able to measure what is intended to measure and reliable if

it's consistent in measuring what is intended to measure. The tests on the model validity are conducted by checking at the outer loading factor values, AVE, communality, and cross loading. While assessments of model reliability are consist of the cronbranchapha and composite reliability calculation.

Structural models analysis with PLS SEM is started by looking at the value of R-Squares for any endogenous latent variable as the prediction strength of the model structural. The interpretation is same as the interpretation of OLS regression. Further evaluation is done by looking at the model significance values to see the influence between the variables that could be done with bootstrapping procedure. Values of significance level commonly used (two-tailed) are t-value of 1.65 (significance level = 10%), 1.96 (significance level = 5%), or 2.58 (significance level = 1%) (Ghozali and Latan 2015).

member characteristics and family economy indicators is also added in a research instrument.

Table 2 Indicators of PLS SEM Variable

Latent Variable	Code	Variable Indicator	Source
Family Economy	EK1	Dependant (person)	Sanrego and Antonio (2013)
	EK2	Expenditure (million rupiah)	
Member Characteristic	KR1	Age	
	KR2	Education	
	KR3	Experience (year)	
	KR4	Period as member	
Usaha Bersama Program	UB1	Roles of participants in group	
	UB2	Assessment of participants on the benefit program	
	UB3	Assessment of participants on the field officer	
	UB4	Assessment of participants on financial services	
	UB5	Assessment of participants to other participants	
Attitude	SK1	Dicipline attitude	
	SK2	Trust from other within group	
	SK3	Repay loan isn't burden	
	SK4	Economy increase	
Subjective Norm	NS1	Influence from family	
	NS2	Influence of neighbours	
	NS3	Influence of other members	
	NS4	Influence of field officer	
Repayment Intention to Repay	RB1	Repayment Frequency	
PBC	NM1	Follow important people	
	NM2	Adher to religion	
	NM3	Fulfill the norm/rules	
PBC	KM1	Confidence to repay the loan	Hidayat (2010)
	KM2	Repay the financing isn't difficult	
	KM3	Controllability to repay the loan	
	KM4	Repay the loan only based on respondents willingness (external factors have no influence)	

#### 4. Research Framework

PLS SEM model in this study is based on the Theory of Planned Behavior approach. According to this theory, the most important factors of a person's behavior is the intention to behave. Intention itself is a function of individual attitudes toward behaviors, subjective norm, and the Perceived Behavioral Control. Therefore, the latent variables used consisted of Kemitraan Usaha Bersama Program (UB), attitude (SK), subjective norm (NS), perceived behavioral control (KM), intention (NM), and the repayment behavior (RB) as described in Table 2. Each latent variable is measured by using the indicators. In addition to the main variables,

#### 5. Research Hypotheses

Based on previous concept, the alternative hypotheses (H1) in this research are as follows:

1<sup>st</sup> H1: Kemitraan Usaha Bersama, member characteristic and family economy significantly affect member attitude.

2<sup>nd</sup> H1: Kemitraan Usaha Bersama, member characteristic and family economy significantly affect subjective norm.

3<sup>rd</sup> H1: Kemitraan Usaha Bersama, member characteristic and family economy significantly affect perceived behavioral control.

4<sup>th</sup> H1: Attitude, subjective norm, and perceived behavioral control significantly affect intention to repay the financing.

5<sup>th</sup> H1: Intention to repay the financing significantly affects repayment behavior.

6<sup>th</sup> H1: perceived behavioral control significantly affects repayment behavior.

**ANALYSIS RESULT**

**1. Description of Kemitraan Usaha Bersama**

Dipasena is a shrimp aquaculture area located in East Rawajitu District, TulangBawang Regency, Lampung with 16,250 hectares on width. This area is divided into eight villages, namely BumiSentausa, Bumi Dipasena Utama, Bumi Dipasena Agung, Bumi Dipasena Jaya, Bumi Dipasena Mulia, Bumi Dipasena Makmur, Bumi Dipasena Sejahtera, and Bumi Dipasena Abadi. Every village is consisted of 2 blocks and each of them is divided into 6 subblok (equivalent with RW). Dipasena was operational area of P.T. Dipasena Citra Darmaja partnership formerly. However, as the company went bankrupt, Dipasena is managed independently by the farmers there.

Over the past few years, Dipasena farmers got major problem related to shrimps cultivation. This is mainly due to difficulty in getting access to capital from financial institutions for the cultivation, in addition to the lingering illness of shrimp aquaculture. The absence of capital is caused by the difficulty for farmers which are poor in majority to provide required collateral for shrimps' cultivation. These constraints led to

The program, called Kemitraan Usaha Bersama then, has a working structure that provides services in the following fields, namely:

- a. Operations and Marketing. The services provided in this area include:
  1. Cultivation, harvesting and post-harvesting.
  2. Consulting services to partners and farmers regarding shrimp cultivation.
  3. Maintenance of production facilities.
- b. Finance and others. The service provided in this area include:
  1. Administration and investment.
  2. Transaction management for farming and non-farming field.
  3. Administration for supporting facilities of production.

Kemitraan Usaha Bersama applies group-based financing on its operation. The farmers who want to be a member and receive funding must have a group that consists of at least eight people in one subblock (RW). Thus, the financing is granted to the group, not to individuals. In addition, each member also has to invest in the beginning with a certain range. Therefore, the farmers in this program have two roles, both as investor and client. Furthermore, the capital collected among farmers is managed to be used at its optimum. In order to finance all of the members, Kemitraan Usaha Bersama management implements financing in rotation

Table 3 Comparison Between Self Financing and Programmed Financing

Source of Capital	Number of Farmers	Capital per Period for Each Farmers	Total Capital	Note
Self Funding	8	Rp 40.000.000	Rp 160.000.000	Each of farmer fund his business himself
Usaha Bersama	8	Rp 5.000.000	Rp 40.000.000	Capital is rotated/used by turn within the groups

the decreased of farmers' productivity.

This problem, then raised initiative from a group of shrimp farmers in BumiDipasena Jaya to design anintegrated business system of shrimp farming from the upstream (procurement of saprotam/farming input, capital and investment) to the downstream (harvesting and marketing).

within the group.

One of the main advantages for farmers who join Kemitraan Usaha Bersama is the efficiency of capital. As members, farmers are no longer need to fully finance his shrimp cultivation, but simply by accessing the fund that has managed the management of program. Illustration of this

comparison are described in Table 3, assuming the capital needed for shrimp farming is Rp 40,000,000, - for one period of cultivation. Based on the table, it shows that by becoming a member of Kemitraan Usaha Bersama, the farmers spent less capital than used their own capital individually.

On its management, the capital given to the farmers isn't by money, but in the form of saprotam (input for shrimp cultivation) such as shrimp seed, shrimp feed, and fertilizer. It's given regularly based on the needs of farmers during cultivation period. The purpose of this

grams of gold. When it's less than that, the member is charged by infaq with 1% of its gross profit.

In order to deal with the investment guarantees problem, management of program set CRU (Reserve of Business Ratio) fund, which is imposed on members who succeed in their business. The CRU ratio itself is 10% of farming-business gross profit. This fund is used to cover the losses from failed members in the business, so that they don't bear the loss and capital isn't reduced. The CRU mechanism is a form *tabarru* (bear each other) and *ta'awun* (help

Profit Sharing Calculation		
1. Net Profit		
	Revenue	: A
	Cost	: B
	Gross Profit (A-B)	: C
	CRU (10%*C)	: D
	Zakat (2,5%*C)	: E
	Net Profit	: F
2. Profit Proportion for each party		
	Farmer	: (80%*F)
	Investor	: (15%*F)
	Management	: ( 5%*F)

Figure 2 Profit Sharing Calculation

mechanism is to ensure that the capital provided is used for productive purposes and facilitate the partners so that they are no longer need to think about procurement of saprotam.

In addition, Kemitraan Usaha Bersama also applies profit-sharing system based on Islamic teaching. Profits are shared between the investors, management, and farmers. The program is committed on welfare of farmers in the partnership. The ratio of profit is set on 80% for farmers, 15% for investors, and 5% for the management of the partnership and it's based on net profit of the farming-business.

Kemitraan Usaha Bersama also shows commitment in enforcing the sharia compliance with imposing zakat for farmers at the end of every business period. The amount of zakat is according to money zakat. That means the zakat will be charged if the value of the farming-business gross profit reach the equivalent of 85

each other) among farmers.

The overall calculation of profit loss system in Kemitraan Usaha Bersama Program is described in figure 2. Based on the picture, total revenue of farmers' business is deducted by operating costs of cultivation to get gross profit, which further reduced again by CRU pieces (10% of gross profit) and zakat (2.5% of gross profit). The result of this reduction, called net profit, is then shared with a percentage of 80% for farmers, 15% of investors, and 5% for management.

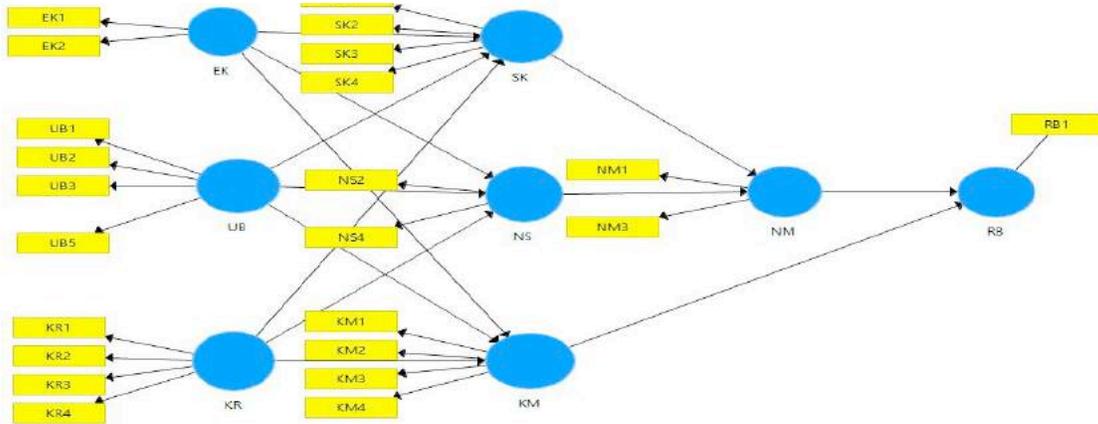
## 2. Analysis of Program Effect on Repayment Behavior of Shrimp Farmers

### Questionnaire Test

The analysis for model is started from checking the validity and reliability of the questionnaire. It was conducted by the validity and reliability test. Validity test is intended to

than the critical r product moment or more than 0.60.

Figure 3 Early Specification Model



assess the ability of an instrument (questionnaire) to measure what to be measured. Tests were conducted on 30 respondents. An instrument is valid if the instrument is capable to quantify data and variables properly. An instrument is valid if the r value is more than r table at the significant level of 5%, 0,361 (r table at n = 30 and  $\alpha = 0.05$ ). With valid results, it means that the respondent understands the intent of each question asked by researchers in the study questionnaire.

While the reliability test is used to determine

Based on the tests result, 4 indicators, namely UB4, NS1, NS3, and NM2 is dropped from the model because it didn't meet the criteria of valid and reliable. Thus, the PLS model SEM for this study are as in Figure 3.

Distribution of Respondents Assessments

Table 4 shows the distribution of respondents' perception for Kemitraan Usaha

Table 4 Distribution of Respondents Perception on UB Variable

Indicator	Score					Total Of Respondents (Person)
	Very bad	Bad	Mediocre	Good	Very Good	
	1	2	3	4	5	
UB1	0	2	10	9	14	35
UB2	0	0	8	17	10	35
UB3	1	4	8	15	7	35
UB5	0	5	1	16	13	35

whether the questionnaire provides consistent result or not, by using Cronbach  $\alpha$ . In this technique, the instruments tested on a group of respondents and the results processed with SPSS version 16.00 for windows software. Alpha method is compatible for use on score scaled form 1 - 5. The significance test is performed at a significance level of 0.05, which means that the instrument is reliable if the alpha value is more

Bersama Program. The indicators used are roles of respondents in group (UB1), the program benefits (UB2), the performance of field officers (UB3), and the role of other members for the

respondents in the group (UB5). Positive ratings (very good and good) was given by 68% of respondents to the indicator UB1, 77% of respondents to the indicator UB2, 63% of respondents to the indicator UB3, and 83% of respondents to UB5 indicator.

Overall, most of respondents agreed that the performance of the program is quite good. Management through field officers always supervise and advise the members not only in financial matters, but also in the case of shrimp farming in order to comply with the rules given SOP. While the benefits of the program are especially in terms of easy access to capital as well as

fair shares of the outcome.

Table 5 Distribution of Respondents Perception on SK Variable

Indicator	Score					Total of Respondents (Person)
	Strongly disagree 1	Disagree 2	Not decided 3	Agree 4	Strongly Agree 5	
SK1	0	1	5	20	9	35
SK2	0	5	1	18	11	35
SK3	0	2	10	13	10	35

—Table 6 Distribution of Respondents Perception on NS Variable

On the other hand, social ties in the group are

Indicator	Score					Total of Respondents (Person)
	Strongly disagree 1	Disagree 2	Not decided 3	Agree 4	Strongly agree 5	
NS2	0	3	9	18	5	35
NS4	1	5	12	12	5	35

one of main principles of financing in order to succeed. Members aren't only triggered to succeed in their own business, but also supervise and support to the other members to achieve success. Interaction between members not only take place in the formal meeting of the group, but also in various forms and informal occasions, such as discussions about shrimp farming and mutual cooperation when one member is in harvest. These interactions are social capital within the group so that it's expected to make financing more successful.

Table 5 shows the distribution of respondents' perception for the attitude variables. The indicators consists of the respondent disciplined attitude (SK1), the trust of the other members for the respondent (SK2), the burden of financing repayment (SK3), and family economy improvement (SK4). Positive ratings (agree and

strongly agree) was given by 83% of respondents to the indicator SK1, 83% of respondents to the indicator SK2, 66% of respondents to the indicator SK3, and 51% of respondents to the indicator SK4.

Based on those results, the majority of respondents felt that Kemitraan Usaha Bersama is able to trigger them to be disciplined in

running the business in order to succeed financing. It is inseparable from the profit

sharing system applied in the program. Members

receive a large portion with 80% and it's calculated from the net profit (profit sharing) of business, not from the total revenue (revenue sharing). The pieces were subjected to the calculation of net income was not burdensome. With this large portion, the members were motivated to improve their productivity and succeed in the business. Another motivation for members is related to the other members trust. In Kemitraan Usaha Bersama Program, CRU mechanism applied to cover losses of failed members creates pressure to them. It means that members feel embarrassed if they failed to repay financing because they feel like a burden to the group. This mechanism is also able to prevent them from moral hazard act because they are not only watched by the management, but also by the other members of their group.

Table 6 shows the distribution of respondents' perception for the subjective norm variable. In this case, subjective norm refers to members' perceptions about the the influence strength of the people around him who became a reference, such as family, friends, neighbors, and the field officers who motivates him to pay off the financing. Assessment consists of scoring the influences from neighbour indicators (NS2), and the field officers (NS4). Positive ratings (agree

increase the value of social capital within the group. This is according to research conducted by Bastelaer and Leathers (2006) that the smaller the group, the stronger the interaction that indicates the existence of social capital significantly influence the rate of repayment of loans.

Tabulation result of NS4 indicates that quite a lot of respondents who feel the management has not given adequate influence to the success of

Indicator	Score					Total of Respondents (Person)
	Strongly disagree	Disagree	Not decided	Agree	Strongly agree	
	1	2	3	4	5	
KM1	0	3	2	15	15	35
KM2	2	13	16	4	0	35
KM3	0	8	4	14	9	35
KM4	7	16	10	2	0	35

and strongly agree) was given by 66% of respondents to NS2 indicator, and 48% of respondents to NS4 indicator.

East Rawajitu district as operation area of Kemitraan Usaha Bersama Program is a region of shrimp farmers so that people have a

the financing. Therefore, it needs for more intensive meetings between management and members so hopefully it will stimulate members in the success of the financing.

Table 7 shows the distribution of respondents'

Table 7 Distribution of Respondents Perception on KM Variable

homogenous profession there. This homogeneity creates the strong social ties in the society. In addition, the same profession also triggers routine informal interactions between inhabitants, especially to the nearby neighborhood. This led to various decisions of farmers in managing their business, including in the success of financing, are influenced by recommendation from the nearest neighbour. According to this condition, the management should be

perception for Perceived Behavioral Control (PBC) variable. The indicators consist of the respondent's confidence to repay financing (KM1 and KM2) and the controlability to repay financing (KM3 and KM4). Positive ratings (agree and strongly agree) was given by 86% of respondents to the indicator KM1, 11% of respondents to the indicator KM2, 66% of respondents to the indicator KM3, and only 6% of respondents to the

Table 8 Distribution of Respondents Perception on NM Variable

Indicator	Score					Total of Respondents (Person)
	Strongly disagree	Disagree	Not decided	Agree	Strongly agree	
	1	2	3	4	5	
NM1	0	2	15	15	3	35
NM3	0	2	15	15	4	35

able to narrow the scope of the group so it could trigger more intensive communication in order to

indicator KM4. Based on the results, it can be

Table 9 Distribution of Respondents Perception on RB Variable

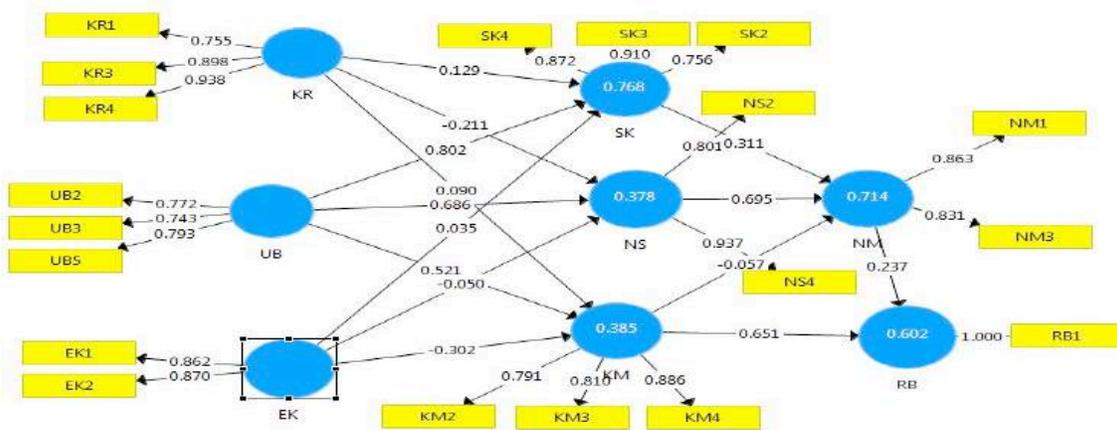
Indicator	Score					Total of Respondents (Person)
	Very low	Low	Mediocre	High	Very high	
	1	2	3	4	5	
RB1	0	7	2	17	9	35

concluded that the value of respondents PBC is still relatively low, especially on KM2 and KM4 indicators.

In this research, PBC is the measured directly. There are two aspects to consider: first,

for further research on natural factors and price fluctuation could be taken to give recommendations for farmers to increase productivity.

Table 8 shows the distribution of respondents'



Parameter	Rule of Thumb	Result
Loading Factor	>0.70 for Confirmatory Research >0.60 for Exploratory Research	All Loading factor indicator value >0.7
AVE	>0.50 for Both Confirmatory and Exploratory Research	All AVE variable >0.50
Communality	>0.50 for Both Confirmatory and Exploratory Research	All communality value >0.50
Cross Loading	>0.70 for Both Confirmatory and Exploratory Research	All of cross loading value >0.70
Cronbach's Alpha	>0.70 for Confirmatory Research >0.60 for Exploratory Research	All of cronbach's alpha value >0.60
Composite Reliability	>0.70 for Confirmatory Research >0.60 for Exploratory Research	All of composite reliability value >0.60

how much the person has control of a behavior (controllability), and secondly, how confident the person feels able to perform a behavior (self-efficacy) (Hidayat, 2010). Measuring the ability and the control of Kemitraan Usaha Bersama Program members to repay their financing means how capable and how much control they have in the success of their business. In recent periods, the unstable nature and shrimp price fluctuation become major problems faced by Dipasena farmers in general. Both of these external factors caused difficulties for farmers to control the shrimp cultivation even if they have set shrimp farming based on its SOP. Therefore, the need

perception for intention variable. The indicators consist of scoring for commitment with the most important people (NM1) indicator and adherence to the norms and rules of the program (NM3). Positive ratings (agree and strongly agree) was given by 51% of respondents for the NM1 indicator and 54% of respondents to NM3 indicator. Based on this results, it can be concluded that in general the level of the intentions of the respondents is still not optimal. This indicates the need for efforts on the part of management to improve program performance in order to optimize the intentions of members to repay the financing.

Table 9 shows the distribution of respondents' perception for repayment behavior variable. In this case, repayment behavior was measured by checking at the history of repayment rate of the respondents. The more they repay the financing, the higher score given. According to the table, 74% of respondents have high frequency on repayment behavior (frequent and very frequent). In other word, Kemitraan Usaha Bersama Program is quite successful in creating systems that led to high repayment rate of its clients.

#### Analysis of Structure Equaling Model

##### Outer Model Test

The assessment of the outer models is conducted by measuring the validity and reliability of the model. Based on this test, 4

##### Table 10 Result of Outer Model Analysis

indicators, namely KR2, UB1, SK1, KM1 were dropped from the model because it doesn't meet the validity and reliability criteria. Thus obtained a final model that leaves 19 indicators as illustrated on figure 4.

The tests on the model validity are conducted by checking at the outer loading factor values, AVE, communalities, and cross loading. While testing of model reliability is undertaken by calculating the value of cronbranch alpha and composite reliability. The result of validity and reliability assessment are as shown on table 10.

##### Hypotesis Test

Then based on PLS SEM analysis, detailed are the hypothesis tests from statements that mentioned before:

#### Figure 4 Respesification of PLS SEM Model

##### 1<sup>st</sup> Hypotesis

H<sub>0</sub>: Kemitraan Usaha Bersama, member characteristic and family economy insignificantly affect member attitude.

H<sub>1</sub>: Kemitraan Usaha Bersama, member characteristic and family economy significantly affect member attitude.

According to the results analysis, Kemitraan Usaha Bersama Program is the only variable that significantly affects attitude at significant level

of 1%. T hit value 10.56 is more than t table at 2.58 so H<sub>0</sub> is rejected for Kemitraan Usaha Bersama variable. With a coefficient of 0.80, meaning that for every 1 additional effort is estimated the program will improve the attitude of members in repaying the financing by 80% reflected in the three indicators, namely: 1) repaying financing in accordance with the program will gain the trust of the other members within the group; 2) repay the financing won't hamper the family economy (burden); 3) repaying the financing will improve the family economy. Therefore, there's a need for evaluation that could be useful to improve the development of Kemitraan Usaha Bersama

Program.

##### 2<sup>nd</sup> Hypotesis

H<sub>0</sub>: Kemitraan Usaha Bersama, member characteristic and family economy insignificantly affect subjective norm.

H<sub>1</sub>: Kemitraan Usaha Bersama, member characteristic and family economy significantly affect subjective norm.

Based on the analysis of SEM, Kemitraan Usaha Bersama Program significantly affect the subjective norm on the significant level of 1%, while the characteristics of the member and family economy has no significant effect on it. Kemitraan Usaha Bersama Program coefficient of 0.69 indicates that each 1 additional effort estimated in the program will have a positive impact on the

improvement of subjective norm by 69%. The necessary recommendation is the need for regular meetings between management and members so hopefully it will stimulate members in the success of the financing.

##### 3<sup>rd</sup> Hypotesis

H<sub>0</sub>: Kemitraan Usaha Bersama, member characteristic and family economy insignificantly affect PBC.

H<sub>1</sub>: Kemitraan Usaha Bersama, member characteristic and family economy significantly affect PBC.

Analysis of SEM shows that Kemitraan Usaha Bersama program and family economy significantly PBC on the significant level of 5%, while the characteristics of the members insignificantly affect the PBC. Kemitraan Usaha Bersama Program coefficient of 0.52 means that for every 1 additional effort estimated in the program will have a positive impact on improving the PBC by 52%. In its implementation, the Program has set rules related to shrimp farming. One of them is that the shrimp cultivation should be based on SOP. By following these terms, the members are expected to perform the farming activities well and thus it could lead to positive impact on the business success.

#### 4<sup>th</sup> Hypothesis

H<sub>0</sub>: Intention is insignificantly affected by attitude, subjective norm, and PBC

H<sub>1</sub>: Intention is significantly affected by attitude, subjective norm, and PBC

SEM analysis result shows that attitude and subjective norm significantly influence the intention at significant level of 5%, while the PBC has no significant effect on the intention. Attitude coefficient of 0.31 means that for every 1 additional effort of attitude improvement estimated will have a positive impact on increasing the intention to repay the financing by 31%. Positive attitude believed by members is able to trigger their motivation to contribute in advancing the program. This contribution is reflected on members' compliance with the program and maximum efforts on the success of the financing.

While subjective norm coefficient of 0.69 means that for every 1 additional effort estimated to improve the subjective norm will have a positive impact on increasing the intention to repay the financing by 69%.

#### 5<sup>th</sup> Hypothesis

H<sub>0</sub>: Repayment behavior is insignificantly affected by intention to repay

H<sub>1</sub>: Repayment behavior is significantly affected by intention to repay

Based on the SEM analysis, intention significantly affects the repayment behavior at the significance level of 5%. Intension coefficient of 0.24 means that for every 1 additional effort of the intention estimated have a positive impact on improving repayment behavior by 24%.

According to those hypotheses, it can be concluded that Kemitraan Usaha Bersama indirectly influences repayment behavior of its members through TPB elements. That's inseparable from the social capital value which is formed in its system as explained before. This result is relevant with Sanrego and Antonio (2013) that affirmatively social capital influence loan repayment behavior and accordingly against those that view the merits of group lending (relative to individual lending) solely through its innate properties as a joint liability contract, where social capital plays little or no role.

#### 6<sup>th</sup> Hypothesis

H<sub>0</sub>: Repayment behavior is insignificantly affected by PBC

H<sub>1</sub>: Repayment behavior is significantly affected by PBC

Based on SEM analysis result, PBC affects repayment behavior significantly at the significant level of 1%. PBC coefficient of 0.65 means that for every 1 additional effort of PBC estimated have a positive impact on repayment behavior by 65%. This proves that the PBC has a direct influence on behavior and not through intention.

### **3. Strategies of Integrated Microfinance Schemes for Coastal Societies**

What described previously about Kemitraan Usaha Bersama Program has given us a demonstration on how to manage a financing that fulfill sharia compliance and farmer characteristic. Furthermore, there's a need to redefine right strategy to form a model of Islamic

financing that fitted to shrimp farmers and coastal societies in general. Then, several formulas are set based on empirical findings on Kemitraan Usaha Bersama Program supported by relevant literature. The strategies are as follows

1. Application of Profit Loss Sharing Schemes Based on Islamic Teaching for Coastal societies

One of alternative financing system for coastal societies that could be implemented is Islamic financing system. Then, profit loss sharing scheme is more recommended to apply because it can boost the economy in the real sector and contains the fairness value, especially at the distribution of profits and losses between parties involved. In addition, according to Anjani (2013) practice of business scheme based on sharia teaching actually have long applied by farmers in Indonesia such as *maro* and *mertelu* system. This makes the application of Islamic financing seems not to be difficult for farmers and provides fairness to them. Furthermore, this profit-sharing scheme should be the actual profit based, not revenue based or profit projection based that is still used by some Islamic microfinance institutions today. Profit sharing should be based on the net profit and it's calculated after the results of the business. This is consistent with the Anonymous (2005) statement that the Islamic financing transaction must calculate the results after the end of the period. This means that the Islamic financing, the gains is made after real calculation and not based on the speculative one.

2. Zakat Collection of Coastal societies

The second feature that should be added to the Islamic microfinance model is the collection of zakat for fishery products from coastal societies. It could be undertaken by deducting the profit for zakat directly before it's shared between the investors, farmers and management if the net result of business reaches at

least same with zakat limit (*nisab*). This is to ensure parties involved in the financing fulfill its zakat obligation. What is practiced by Kemitraan Usaha Bersama Program proves that it's possible to do.

The direct deduction for zakat will facilitate the task of the zakat institution (BAZ and LAZ) to direct local farmers for paying zakat through institution. It is inseparable to the fact that there are still many *muzakki*, even for farmers who do not distribute their zakat through institutions, but to give it directly to *mustahik*. This is similar with Hussin et al (2013) that there is still a lot of zakat payers who do not distribute their zakat through institutions, but directly to *asnaf*.

3. Implementation of Farmer Insurance Based on Islamic Principle

Farmers face a variety of risks that can result on the failure of his business. Losses arising from a failed cultivation will have a direct impact to the welfare of farmers and their families. Therefore, there is a need for an appropriate mechanism to protect farmers from the losses. One such mechanism is the sharia insurance. As discussed before, CRU scheme of Kemitraan Usaha Bersama is an alternative to protect the shrimp farmers from the losses that may happened in their business. At this mechanism, the CRU fund is imposed on members of Kemitraan Usaha Bersama that succeed in their business. This fund is collected then to cover the losses of the failed members, so that they won't bear the loss. This schemes could be one of the demonstration how sharia insurance can be applied to farmers.

In addition, other strategies that might be made by Islamic microfinance institutions for shrimp farmers and coastal societies in general are as follows

1. Implementation of Group-Based Financing

In Kemitraan Usaha Bersama, a group-based financing plays an important role in maintaining the sustainability of the program. Group-based financing is able to attain a strong social capital among its members, which is reflected in the form of mutual monitoring and provide support in order to achieve success between members of the group. The existence of social capital in these programs significantly affect the repayment behavior of members, which means the better the performance of the management of the program, the more it will succeed the financing. In fact, group-based financing is capable to provide alternatives for addressing the collateral problem in financial service so that it could be more inclusive for coastal societies.

2. Research and Assistance

One of the main problems still faced by shrimp farmers of Dipasena is the difficulties to handle external problems that threaten cultivation process, such a natural conditions and shrimp disease. Another external problem is the shrimp price-fluctuation. If these threats are not addressed, it will result in a failure of their business. Furthermore, this failure also could lead to non performing financing faced by microfinance institution. It may be implicated on the decreased of program ability to provide capital for its members, although there are CRU used to cover this failure. Therefore, there is a need for further research and assistance undertaken by the government and academics to givesolutions for farmers regarding to these issues.

Based on the analysis result discussed in previous chapter, it revealed that Kemitraan Usaha Bersama program has significant effect on attitude, subjective norm, and perceived behavioral control improvement. Then, these factors are able to encourage members' intention positively and hence could increase financing success. In other words, it can be concluded that Kemitraan Usaha Bersama significantly influences repayment behavior of its members indirectly through the TPB elements. That's inseparable from the social capital value that embedded on it, which plays important role in this case. It becomes the key of group-based financing success. With more effort of the program improvement in creating social capital, it's believed that members' performance will get better in business reflected from the increase of repayment behavior.

Another important point from Kemitraan Usaha Bersama is unique values on its system. Those are the fulfillment of sharia compliance in the funding model, the group based financing that trigger the formation of social capital, farmers sharia-insurance model reflected from the mechanism of CRU (Reserve of Business Ratio), and the right form of financing that direct to productive purpose.

Finally, several strategies could be undertaken for coastal societies in order to give them inclusive and integrated financial service. Implementation of islamic-based financing, includes zakat collection through microfinance and sharia insurance system for coastal societies are some parts of them, while the others consist of the application of group-based financing as well as further research and assistance.

**2. Recommendation**

According to the conclusion mentioned before, there are some recommendations that may be useful for Islamic financial sector, coastal societies empowerment, and any related research in the future:

1. Financial institution such a commercial bank should consider a partnership with

**CONCLUSION AND RECOMMENDATION**

**1. Conclusion**

- sharia microfinance that apply group-based financing for its linkage program
2. It should be an integration between zakat institution and microfinance that gives financial services to coastal societies to set an effective zakat collection
  3. Government and related institutions must give support and assistance for coastal societies in case of its empowerments and economy improvement
  4. It's recommended for microfinance, which is concerns on coastal societies segment in particular, to replicate integrated system of its financing as demonstrated by Kemitraan Usaha Bersama
  5. There should be any further research particularly associated with instability of fisheries and aquaculture environment as well as price fluctuation problem faced by coastal societies

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## **A REVIEW OF RESEARCH ON INDONESIAN SMEs: STATUS TODAY AND FUTURE OUTLOOK**

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### **ABSTRACT**

*Almost all researchers of the Small, Medium Enterprises (“SMEs”) in Indonesia are doing research about literature, policies, processes, and strategies. Along with the research context of SMEs, this study looks at research that have existed for the last five years, i.e. from the year of 2010 to 2016, both conducted by many Indonesian researchers, researchers abroad, agencies of foreign aid, or by association and ministries that are interested in the development of SMEs in Indonesia. Can the Indonesian researchers create concepts based on the work of SMEs that are not only acceptable nationally but also universally, given that the number of SMEs is plentiful? These future research that Indonesian management research should move from an “Indonesia-based perspective to an Indonesia-driven perspective”. Future studies should go beyond this by asking the ‘why’ and ‘how’ questions to advance SMEs theory development. There’s a huge opportunity to achieve it, giving so many SMEs research to focus on studying on 'strategic entrepreneurship'; on the function of strategic management in SMEs and national economic growth. This paper aims to identify themes, trends, research philosophies, methodologies, and methods used in SMEs studies, by comparing previous research themes and models of SMEs research. Then we discussed the future directions SMEs research by highlighting the contributions and shortcomings.*

**Keyword:** *SMEs, entrepreneur, entrepreneurship, strategic entrepreneurship.*

### **INTRODUCTION**

The development of management theory is growing rapidly, which is also marked by the development of the Asian economic, as a new source in the development of science. The Asian economic evolution that has started since Japanese’s economic revival has highlighted the development of management theory. On the other hand, China, South Korea and other growing Asian countries are still not able to make a significant contribution as Japan.

Japan can break through the expertise of European countries and the United States in contributing to the development of organizational theory, namely through the idea of "Just in Time" that was driven by the car manufacturer Toyota Motor in the 1970s. Toyota operations always keep raw material

inventory in a state minimum in order to reduce production costs. Another Japanese researcher is Kaoru Ishikawa (1985) through the concept of "The Total Quality Control" emphasizing the provision of long-term customer satisfaction (Watson, 2004).

In Asia however, only Chinese companies are able to become the possible founder of new methods in organization management in the future, which is expected to be applied not only in China but also in the global business environment as a universal concept. These days, many Chinese companies issues new ideas in business, such as Alibaba – the biggest e-commerce company in the world, Tencent who issued the WeChat application that can now be used as a messaging application and also as a technology-based financial application that

allows the user to transfer money from one WeChat owner to the other, and many more.

Meanwhile, many researchers in Indonesia are still too far away from the producing or creating a concept of science that is based on business practices in Indonesia, but it is more than just following or using growing theories that are already publically accepted. Business growth in Indonesia is often decorated by the development of industries and Small, Medium Enterprises (“SMEs”). The SMEs sector is one of the reasons of economic prosperity in Indonesia through its sustainable growing entrepreneurship. Ever since the start of Asian financial crisis in the 1997/98: the role of Indonesian SMEs in the Indonesian economic growth increases slowly.

There are many kinds of literature that connects the success of ‘entrepreneurship’ with a country’s economic prosperity. An environment that allows the company to establish and start their own business easily is an important factor in the creation of a superior company, a continuingly successful and growing company that will bring added value to the success of the overall economy. Richard Cantillon (1755), is the first person to elaborate how these entrepreneurs are brave risk-takers. Meanwhile, Joseph Schumpeter (1911) sees these companies as carriers of innovation and as the growth engine (Philipsen, 1998).

### **SMEs AND ENTREPRENEURSHIP**

The definition of Small, Medium Enterprises (“SMEs”) is taken from Government Regulations No: 8/2008 which defined that small and medium business as independent business activity that is done by individuals or business entity that does not become small company or other company’s franchise or is controlled or becomes a permanent part directly or indirectly from medium companies or big companies’ business unit. The net value of both of these types of businesses are also defined as follows: Based on the Government Act No. 20, year 2008 on the "About Micro, Small, and Medium

Enterprises", the definition of net worth and sale of micro-enterprises as a business unit with total assets below IDR 50 million and earning less than IDR 300 million. While the definition of net worth and sales of small firms as a business unit with total initial assets of IDR 50 million to IDR 500 million, does not include land and buildings, or with an annual sales value of IDR 300 million to IDR 2.5 billion. While medium-sized enterprises have total business unit initial assets of IDR 500 million to IDR 10 billion and maximal annual sales value up to IDR 2.5 billion to IDR 50 billion.

The symptom in the increase of the SMEs can be seen in the year of 1970s, Indonesia experienced the era of high economic growth and a rapid shift in the structure of the agricultural sector to non-agricultural sector, and labor migration from rural to urban areas is one of the consequences. The excessive labor force is driven and keen to find a job in the city, the push factor in the village and pull factors in the city affect the migration of villagers to relocate.

An integrated policy that aims to bolster the internationalization Indonesian SMEs need to be assessed. The 4<sup>th</sup> Industrial Revolution era encouraging the Indonesia SMEs to focus on shifting and bringing the open innovation incorporated into their operation and meet the international standard by creating policies and exact law regulations. Meanwhile, government policy on entrepreneurship is a factor on entrepreneurship development, where government policy on entrepreneurship and regulation on SMEs are closely related. For that, regulations providing benefits are to be shifted towards SMEs that provide many employments.

The available government policies solution today could not be used to solve old problems in the SMEs in Indonesia. Nasip & Pradipto (2016) proposed that the alternative solutions to new ways to cope with the realization of formalization as part of supporting the Indonesia SMEs are with the concept of utilitarianism cost-benefit analysis (Nasip & Pradipto, 2016).

## **CONCEPTUALIZATION OF ENTREPRENEURSHIP MANAGEMENT**

Are there aspects of entrepreneurship that are essential to be learned? Modern literature about entrepreneurship suggests that it requires diverse skills/characters to become an entrepreneur (Lazear, 2005). Entrepreneur classical theory starts on entrepreneurship on personal character, especially in terms of ability to innovate (Schumpeter, 1934) and bear the uncertainty and risk (Cantillon, 1755; Kihlstrom & Laffont, 1979; Knight, 2002). Entrepreneurship is comprehensive and has several components of important characteristics and is still continue to be studied to the extent in which they can be learned. On the other hand, the managerial ability is more likely to be learned.

Entrepreneurship characters are a hard concept to explain and are complicated to reach a general agreement among the researchers, which becomes its own challenge until now. One of the inconstant aspects can also be felt where university entrepreneurship courses are taught in many universities in America. Michigan University is one of the universities that first introduce entrepreneurship course in the year of 1927, followed by Harvard Business School in 1947. In America right now, there are more than 2,700 entrepreneurship programs (entrepreneurships.com, 2015) that are offered, like how to start a business, managing assets and cash flow, designing a product, computer, and e-commerce, as well as studying about business law structure. But the definition of entrepreneurship in every university differs, and there is no consensus about how entrepreneurship should be taught as the academic discipline. One of the reasons is that there is no textbook that becomes the reference to the entrepreneurship subject. "Lean Startup" method that was created by Eric Ries (2011) is the only best-seller book about entrepreneurship and has been adopted widely by the academic supporters (Ries, 2011).

A successful SMEs is dependent to their entrepreneur in order to study, adapt and control

the situation over the changes in the internal and external environment that are changing very rapidly. This will become essential for SMEs to achieve competitive advantage over their companies in picking the chosen market with the available supply now, especially in the effort to exploit opportunities in the future. Management strategic capabilities in the continuously changing environment like right now is also essential for SMEs. A changing environment is the start of understanding the management strategy in doing SMEs in the point of view of an entrepreneur.

Entrepreneurship process starts when the entrepreneur recognizes the new commercial opportunities and exploit it. In the beginning, the skills to recognize commercial opportunities is more important than the skills of business strategy, making plans, finding capital, building up the team, or making connections. Once the entrepreneur identified the commercial opportunities, they need to be able to count the appropriate amount of sources in order to keep the said opportunities in achieving the company's objective. The next stages concern about the capabilities of planning, organizing, mobilizing and supervising, so that the company can go on well. In the end, the next stage is how the entrepreneur navigate the business so that they will achieve sustainable growth and thus, SMEs entrepreneur need the skills of management strategy.

Management strategy skills can be used to build new products and services, and even to enter new market. In another word, successful SMEs entrepreneur need the capabilities to organize and manage the activities regarding innovation activity and the changes of the external and internal environment. This is the strategic management field that in the beginning happened in a large-scale business and not on the scale of SMEs. This new overlapping field is called as 'strategic entrepreneurship' in many academic literatures.

## **CONCEPTUALIZATION OF STRATEGIC ENTERPRENEUSHIP**

A better theory of development in the future for research of SMEs in Indonesia need to expand to its understanding of SMEs in the country. Another area where greater theoretical development is a strategic management. Combining this insight with the interaction of SMEs operation and strategic management appears to be a particularly rich area of potential theory development.

Strategic entrepreneurship theory is said to be the theory that studies the performance of the company to become better, the theory that is built for the company to be identified as a chance and built to reach a competitive benefit (Hitt et al., 2002). There is research where entrepreneurship theory and strategic management theory are both interlinked, where academics focus on the process so that they can adopt and exploit the opportunities available. Even though the two entrepreneurship and strategic management academics have divided path, each of them still stand independently (Hitt et al., 2002), while in other research, their path is recommended to be integrated into two fields (Venkataraman & Sarasvathy, 2000).

Both disciplines care about the value creation that is known as the main goal of the organizations. Entrepreneur actions and decision are based upon strategic management that can create and add value individually, however when they combine, then the additional value will be bigger. The research on strategic management is often creating the image that the concept of entrepreneurship can be done as a part of strategic management concept. At this moment, integration of both fields is caused by 1) researchers utilizing both fields of research where the company's performance is used as a dependent variable; 2) the emergence of new economy as well as the increasing dynamic competition force entrepreneurs to act flexibly and quickly; and 3) the paradigm that changes in strategic management field where the organization is faced on new dynamic and all organization that

operates just like a unit of "entrepreneurial" (Venkataraman & Sarasvathy, 2000).

One of the things that make sure the relation between entrepreneurship concept and strategic management is the search of business opportunity. Business opportunities are the main aspect of entrepreneurship and strategic management, and in this case, SWOT analysis is used to grasp the business opportunity. Companies create a value by identifying the external environment and then build competition continuously by taking the advantage of it (Hitt et al., 2002). There are six fields where it is naturally part of entrepreneurship and strategic management, that is; 1) innovation, 2) business network, 3) internationalization, 4) organization studies, 5) top management team and governance, and 6) growth (Covin & Miles, 1999; Hitt et al., 2002; Ireland, Hitt, Camp, & Sexton, 2001).

Integration territory between entrepreneurship and strategic management of the business is expected to answer the challenges of the future that are changing very rapidly. The integration's area that is referred to as strategic entrepreneurship can be considered as a new approach in the management literature, which is expected to bring a new perspective in order to achieve competitiveness. Competition, innovation, the speed of technology, adaptation and flexibility catalyst makes the business environment more complex.

Cooper (1979) is the first person to put start-ups in the field of strategic management by investigating relationships between entrepreneurs' characteristics, venture strategic, and company's performance. According to Cooper, some strategic management researchers must learn about built companies and start-ups that are growth oriented. This is then what differentiates between "Entrepreneurs" and "company managers" (Carland, Hoy, Boulton, Carland, & Carland, 1984). Meanwhile, research regarding SMEs and strategic management theory start to grow, especially ones that are related to company's performance (Capon, Farley, & Hulbert, 1994). SMEs is said to be unique in terms of strategic management,

as the concept was first introduced to big companies and are not suitable for SMEs. SMEs units are successful in the identification of entrepreneurial opportunities, though they are ineffective in terms of building and creating growth that is continuously competitive, which is already own by big companies (Ireland et al., 2001).

## SCOPE OF THE REVIEW

The study was done to dig deeper regarding the journal publication of SMEs sector growth in Indonesia. Some researchers are done with international research publication, the business magazine, SMEs information from government output, SMEs research by universities, and are mainly focusing on published research publication. Research methodology (Saarikoski, 2006) and supported by similar methodology done by Fredberg, Elmquist, and Ollila are used through internet research by Google, Google Scholar, ScienceDirect, and ResearchGate (Fredberg, Elmquist, & Ollila, 2008; Saarikoski, 2006). The research is done by strings; '*Jurnal UKM*' (SMEs Journal), '*Jurnal UKM*' (Micro, SMEs Journal), '*Riset UKM*' (SMEs research), '*Riset UMKM*' (Micro, SMEs research), '*Penelitian UKM*' (SMEs Study), '*Penelitian UMKM*' (Micro, SMEs Study), '*Jurnal tentang UKM*' (SMEs Journal), '*Jurnal tentang UMKM*' (Micro, SMEs Journal), '*Riset UKM dan Penelitian UKM*' (SMEs research and study), and '*Riset UMKM dan Penelitian UMKM*' (Micro, SMEs research and study). The search can also be done by double string (" ") to differentiate reference letters that are used by most researchers.

The search result from Google and Google Scholar by using keyword '*Penelitian UKM*' and the usage of double string (" "), produce 226,000 hits that are published in Indonesia and 249,000 hits that are published around the world, this is the biggest hit on keywords regarding SMEs. The second biggest is '*Jurnal UKM*' (SMEs Journal) and '*Jurnal tentang UKM*' (SMEs Journal) by using double string,

reaching up to 130,000 hits and 189,000 hits respectively for the publication that is published in Indonesia and worldwide. On the other hand, the search on ResearchGate, using keyword '*Riset UKM and Penelitian UKM*' (SMEs Research and Study) produced the largest hits of up 100.

The study also uses the additional string search 'pdf' that is added at the end of the keyword, where the purpose of the search is to find the ones that are in pdf format. The search with additional 'pdf' produces 94 hits, 77 hits as the biggest for keyword '*Penelitian UKM*' (SMEs Study) in Google, and 9 hits in Google Scholar. The search with additional string word 'pdf' in ResearchGate is irrelevant. The method to select samples in this research follows the method done by Bruton & Ming-Lau (2008). The chosen period of time to review is until the month of March 2016. The first task is to identify all the relevant and newest research about SMEs in the available online publication, which in total resulting of 238 research. The journals that are essential and can be included are the articles that specially discuss a few aspects of operational and SMEs in Indonesia, which in total resulting of eighty-five journals based on Simpeh entrepreneurship category.

After the consensus is reached, the author sends the list of all the articles that was identified for three knowledgeable people for the research of Indonesian SMEs. These people were asked to look through the articles in the sample and to identify all the relevant articles with the entrepreneurship theory that was initiated by (Simpeh, 2011), also included inside are the articles that did not qualify into entering the list or the article. Article classification is based similarly as illustrated in the figure 1. These articles have to fit into six entrepreneurship theories that become the base of empirical studies that has been studied by many academics in this entrepreneurship research. The six theories are linked to economic knowledge, psychology, sociology, anthropology, and management i.e. opportunity based theory and resources based theory.

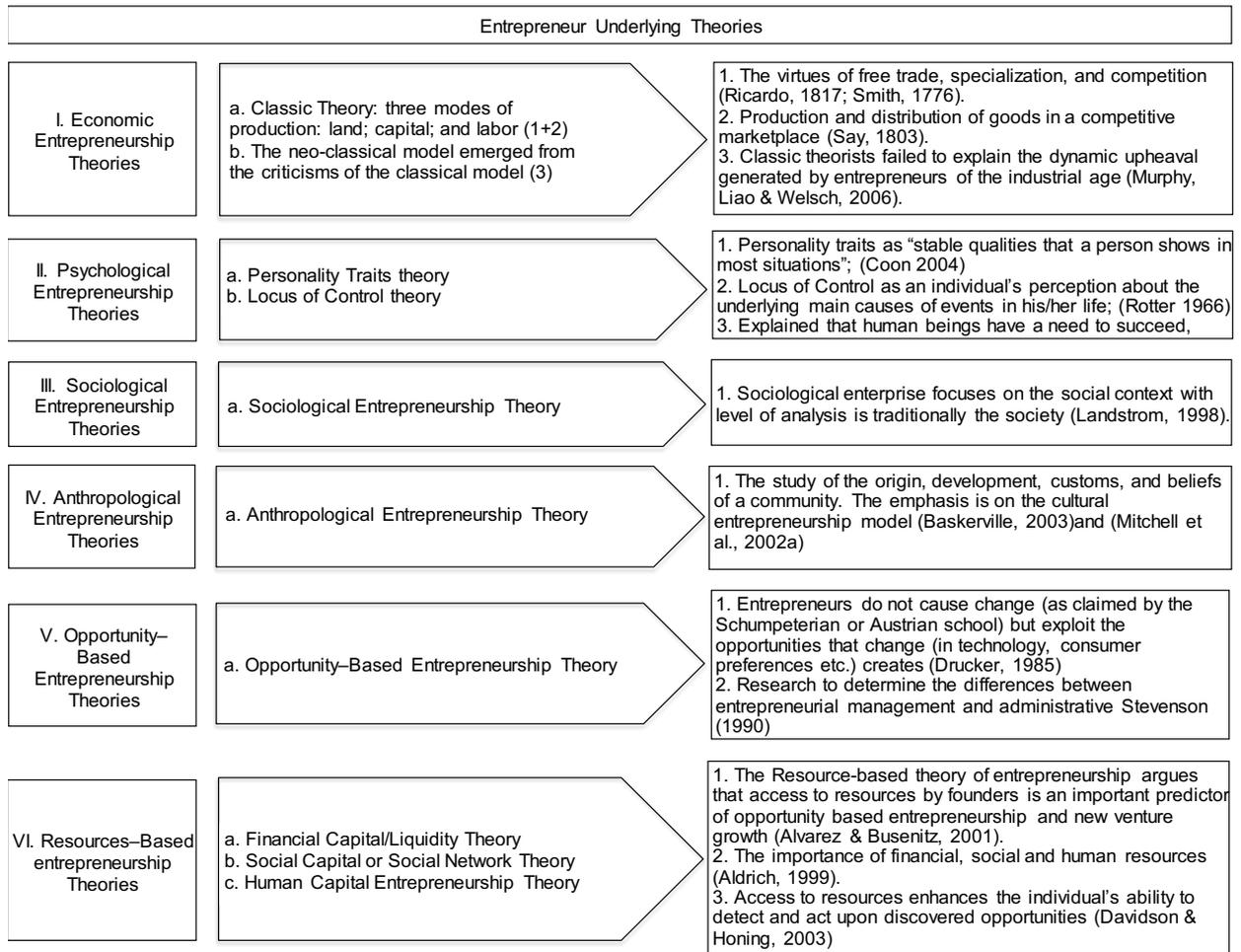


Figure 1. Theory of the field of entrepreneurship

**OBSERVATION TOPICS**

There are two topics: ‘entrepreneurship’ and ‘strategic entrepreneurship’ that are examined in the selected eighty-five articles. Author and independent evaluator once again identify and check every article that is connected and are categorized into one of the theories, that are “entrepreneurship theory” or “strategic

entrepreneurship theory”. To systematically classify the handled article, each author reads through the article and categorizes it dependently using areas to become the main topic for each theory based on the discussed integration area (figure 2), the author then compares and select every classification on consensus.

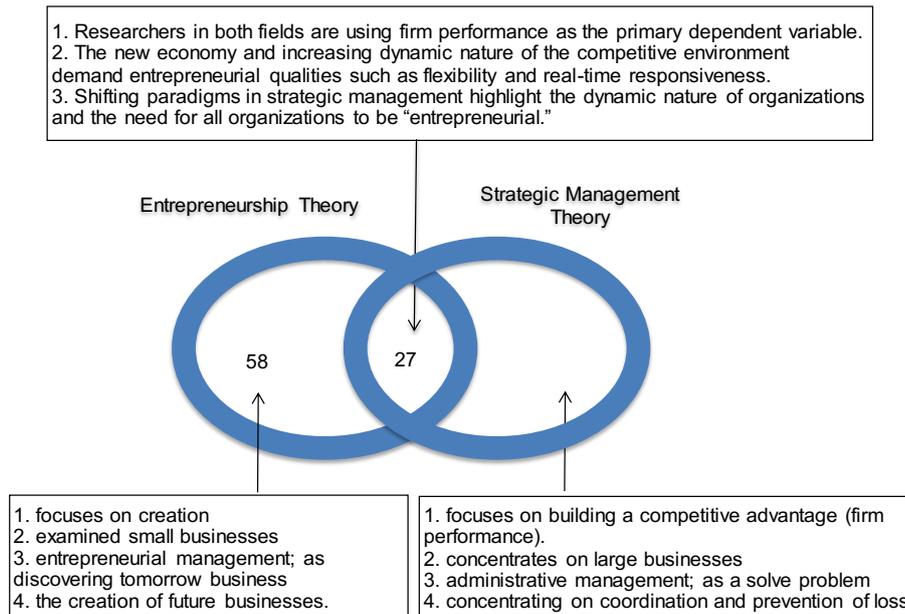


Figure 2. modified from Strategic Management book (Hitt, Ireland, Camp, & Sexton, 2002)

The articles that were in 'entrepreneurship' topics cover 1) focus on creation, 2) examined small business, 3) entrepreneurial management; as discovering tomorrow business, and 4) the creation of future business. On the other hand, the articles were in 'strategic entrepreneurship' topics cover 1) business performance, 2) competitive environment, and 3) dynamic organization. We found that only twenty-seven articles that study SMEs through business performance as the dependent variable in the SMEs research. It shows the existing relationship between entrepreneurship theory and strategic management that was recommended by Venkataraman & Sarasvathy, (2000). The rest of them fall into 'entrepreneurship'.

#### OVERVIEW OF EXISTING LITERATURE

To keep the quality of this study, the search of research publication only focuses merely on contemporary research works including development practice on SMEs. The biggest result from keyword search that is used 'Penelitian UKM' (SMEs Study) and 'Riset UKM dan Penelitian UKM' (SMEs Research

and Study). The methods that are used in this study includes the following steps:

1. Mapping published journals on entrepreneurship theories and SMEs where its publications are partly taken from Google, Google Scholar, ResearchGate, and ScienceDirect.
2. Mapping structures and theories that are used in such publications especially those that are categorized and chosen in six entrepreneurship theories (Simpeh, 2011).
3. Identification of research themes, research methodologies, research method and research approach that are used in published research (Kuckertz, 2013), especially those that are interlinked to entrepreneurship theories and/or strategic entrepreneurship theories (Hitt et al., 2002).
4. Accumulation of the most widely used keywords taken in the publication of SMEs research.

The debate upon study settings may arise, however, this study does not observe the conceptualization process one by one from the existing research journals, it sees many different themes of published journal in a broader view to

see the relevance in practice and universally. With the rising popularity of SMEs terminology, many researchers try to make several models, especially ones related to external parties such as government, the non-profit organization, business association, training center and universities. Many researchers depend on companies' performances, efficiency in productions, process, services, and organizational structure. Some other researchers try to retest many obstacles that must be solved by the SMEs entrepreneurs, especially the challenge to push forward and improve performance and the consequences of applying government's regulations. Others research about companies' orientations, leaders' role, business owner's motivation and individual competition in organization and organization's competency.

#### **MAJOR RESEARCH ISSUES AND FINDINGS**

Kuckertz conducted a research in entrepreneurship topics to investigate identification of essential and upcoming topics and upcoming methods in entrepreneurship research in 2013. Especially on research methods are constantly evolving in entrepreneurship theory to find out an essential method every entrepreneurship researchers needs to understand and a new or neglected method with the potential to produce new insights. He found that there are fourteen categories with plethora sub-categories. The fourteen categories are as follows:

1. Entrepreneur process

2. The economics of entrepreneurship
3. Psychology
4. Geography
5. International entrepreneurship
6. Entrepreneurship education
7. Corporate entrepreneurship
8. Entrepreneurship as such
9. Entrepreneurial opportunities
10. Entrepreneurial finance
11. Social entrepreneurship
12. Family firms
13. Entrepreneurship/innovation interface
14. Entrepreneur behaviors

Meanwhile, he also found that the quantitative methods are dominant compared with qualitative, mixed and others.

Based on our literature review of eighty-five articles up to March 2016, some themes emerged as explained more details on figure 3, which describe the number of keywords that are processed through software cloud generator ([www.jasondavies.com/wordcloud/](http://www.jasondavies.com/wordcloud/)). There are some dominant keywords which are SWOT, handicraft, and strategy, followed by performance and innovation, which shows that the used keywords come in every SMEs scientific journal publication. The idea that appears inside SMEs scientific publication comes from many various aspects, but the appearance of the dominant keywords shows that the research focus on the 'Handicraft' SMEs and the strategic management territory show that publication in the area of strategic entrepreneurship focuses on things that are called "SWOT, Performance, Innovation & Strategy."



Figure 3. wordcloud result

The collected data have been classified into research methodology, research themes, research method and research approach. The figure 4 shows that the data collected for Research Methodology classification. This study uses the methodology category that introduced by Bolivar, Munoz, and Hernandez (2010). This study found that from eighty-five articles in regard to the Indonesian SMEs, the research methodology used by the researchers/scholars is dominated in using 28% of 'evaluation research', and 20% of 'comparative analyses, then followed by 19% of 'case study'. The rest of the articles are using 'action research', 'factorial analysis research' and 'feasibility study' methodology. Most of the SMEs research in Indonesia are connected to social programs/activities. Evaluation research is one of the most appropriate methods that use standard social research methods for evaluative purposes, and as an assessment process that able to evaluate the social programs. The constant comparative analysis is the second method that Indonesia researcher deployed; the main function is to analyses the data line by line. Up to the point, Indonesian researchers are building the notes to capture the concepts and the relationships of all the variable.

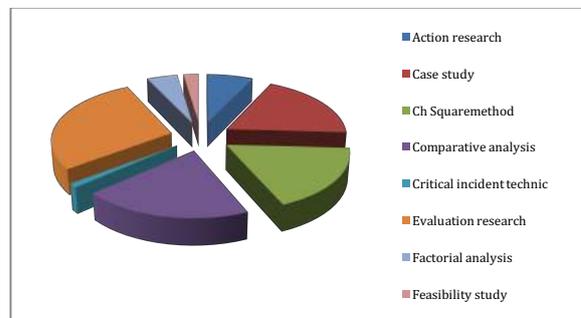


Figure 4. Result of research methodology keyword

Figure 5 show the Research Themes classification. This study uses the themes category that was introduced by Prof. Dr. Andreas Kuckertz (2013). As shown in the chart below, 'entrepreneurial process' is the most dominant themes that used by the researchers/scholars for their research, which is 33% of eighty-five articles that studied in this paper. The second dominant theme is 'entrepreneurship as such', which is 16% of the eighty-five articles. The entrepreneurial process consists of topics of entrepreneurial marketing, business models, human resources management, business performance and strategy. Those are the topics that mostly of Indonesian researchers are investigate. Meantime entrepreneur as such consists of history, gender, .....preneurship and others.

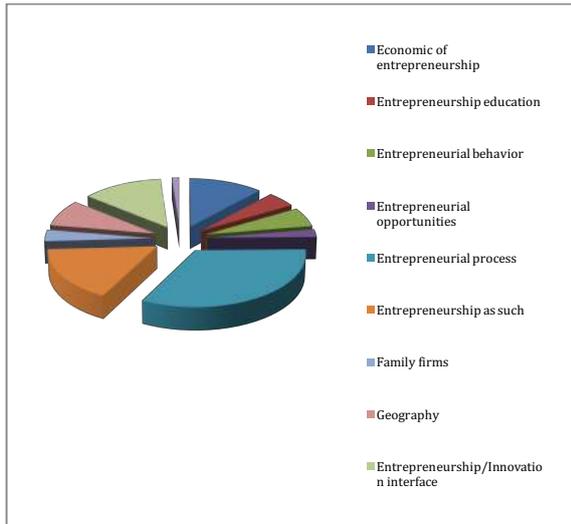


Figure 5. Result of research themes keyword

The collection data show that Research Method as illustrated from figure 6, which the most favorite research method that is used by researchers/scholars is ‘qualitative method’, which is 49% of eighty-five articles. The second favorite research method is by using ‘mixed method’. Qualitative method is alleged to be merely storytelling, full of narratives and personal impression of the researcher. Stories are the data with a soul. Many Indonesian researchers starts with a topic instead of a problem or a hypothesis or a literature review. They define their problem or their main concern about the topic then they see and check how and where its fits in the literature or grand theory. Mixed method is qualitative method coupled with the small quantitative is secondly used by mostly researcher due merely to the fact that Indonesia has a weak enforcement of legal requirements on the quality and nature of the information released to the public so far.

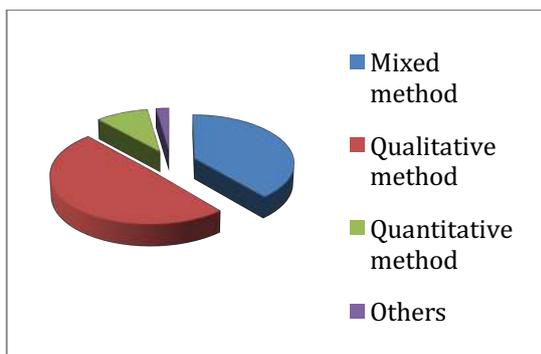


Figure 6. Result of research method keyword

Finally, as illustrated in figure 7, the Research Approach for SMEs research used by most of Indonesian researcher/scholars show that ‘questionnaire’ is the dominant approach that was used and followed by the ‘literature’ approach. Meanwhile, some other journals used ‘survey’ and ‘interview’. The questionnaires are standard. All the respondents’ area asked exactly the same questions in the same order and the results tend to consistent. It’s easy and reliable, those are the arguments that mostly Indonesians researcher like. The literature method is conformity with other findings that Indonesian researchers prefer most on qualitative and/or mixed method.

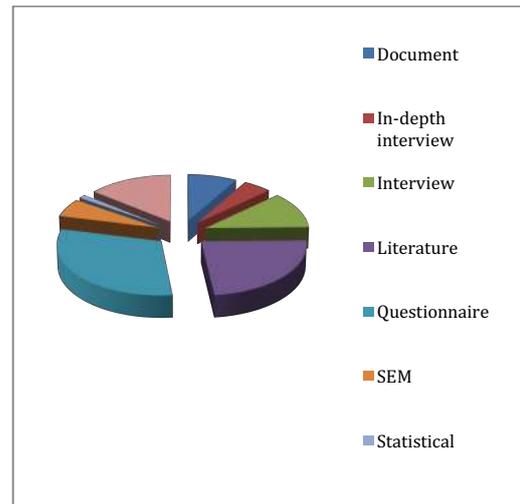


Figure 7. Result of research approach keyword

Out of eighty-five journals that were investigated from ‘Science Direct’, ‘Research Gate’ and ‘Google Scholar’, it shows that twenty-seven journals talk about ‘strategic management’. The figure 8 below shows that the journal published in the year of 2012 is dominated by journals from ‘Science Direct’, and followed by journals from ‘Research Gate’. That result is supported by the “International Conference on Small and Medium Enterprises” with the themes of ‘Innovation and Sustainability in SME Development (ICSMED 2012). Selection and reviewer under the responsibility of Parahyangan Catholic University. Meanwhile, in the year 2015, the

biggest conference was held in several countries. From twenty-seven journals that were taken by three research online publication that loads the topic about 'strategic entrepreneurship', the pattern is similar to what happened in all the journals talking about SME. Research methodology, research theme, and research method are 'evaluation research', 'entrepreneurial process', and 'qualitative method'. Meanwhile, the research approach is slightly different to the pattern of the whole journals that is using 'literature review' and not questionnaire.

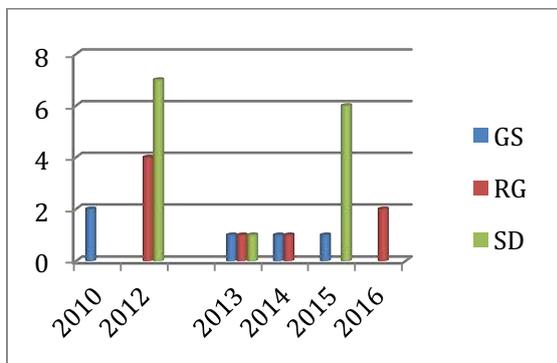


Figure 8. Strategic Management Publication

### FUTURE DIRECTION OF SMEs RESEARCH

In SMEs published research, a characteristic that sticks to SMEs becomes the resource of research seek by many researchers. SMEs characteristics that are mostly investigated are the limited mastery of knowledge including knowledge about products, technology, marketing, finance, and accountancy, including policy and existing policies. However, only a few of SMEs have become the pioneer of innovation, including innovation in the use of technologies, and most of them have an existence of barriers in their operation. With more and more growth of new SMEs, basic research that links between the presences of SMEs units with the theory of entrepreneurship continues to grow and evolve in several universities and research centers spread across Indonesia. On the other hand, the research unit of SMEs taking the theory of

strategic entrepreneurship theories also began to increase; given the external environment affecting SMEs is very dynamic. The many studies linked to other management theories, such as marketing, human resources, and operations. Increased opportunities and the role of SMEs in many sectors challenge and push SMEs to expand in marketing their products abroad. SMEs research publications based on activity internationalization of SMEs also began to be found.

With the development of the business and continuing discovery of new technologies in the field of industry, the researchers must already complete SMEs research by applying the function of strategic entrepreneurship theory in the SMEs. The role of strategic entrepreneurship theory can encourage the creation of a better business unit performance, so as to achieve competitiveness and will be a part that cannot be separated from the development of SMEs in the future. Starting to view SMEs as the pioneer to the birth of innovation and technology, will give an aggregately huge impact for the development of SMEs in the country. It is expected that publication of innovation and technology in the area of SMEs research had to be developed. This study attempts to develop a framework for the practice of SMEs in future research, that include products, processes, services, SMEs organizational and last but not least are government policies which are associated with the start of a new round of free trade developments that introduced in Indonesia.

That is why, to answer the questions about the research framework of SMEs in the future, we should have answered a few questions as follows; who will be the customer/end user of the publication of research on SMEs, entrepreneurship theory publications and publication of a strategic theory of entrepreneurship?, who might be interested?, the one who takes benefits or who may become customers as follows: 1) the potential entrepreneurs who do business directly, 2) SMEs policy makers and stakeholders, and 3) the researchers who have career themselves.

SMEs future research should also pay attention to the external environment that is very dynamic, affecting SMEs businesses in Indonesia. So hopefully by the huge number of SMEs units in Indonesia, the researchers/scholars are expected to contribute to creating a concept/theory that is not only applicable in Indonesia but can also be universally accepted.

### **BETTER THEORY DEVELOPMENT**

The development of research publications on SMEs research in Indonesia will depend on the environment where SMEs grow. Many factors that cause the emergence of new entrepreneurs, and statistical data of SMEs growth within the past five years that can be seen in many government agencies data. The latest growth is caused by the boost of availability of Internet's infrastructure. Some factors can be identified to push SMEs forward and what will be the main focus of SMEs research in the future are:

1. Free Trade Agreement ("FTA") between Indonesia and ASEAN countries and other countries. This matter will hopefully improve Foreign Direct Investment ("FDI"), which may lead to the increasing demand of supporting goods from small units such as SMEs. Business opportunities that are increasing due to FDI will be the focus of future SMEs research, including research on the increasing of SMEs formalization or the shaping from informal.
2. FDI's characteristic coming from overseas linked directly to SMEs growth will also be the focus of research along with open innovation within SMEs.
3. The concept of remote office that has become the trend in many big cities will ease entrepreneurs to build SMEs.
4. The growing trends and government incentives on SMEs; whether it is governance offices that are involved in

policymaking or through fiscal incentives and promotion incentives.

5. FTA does not only improve opportunities nationally but also internationally. The ease of tariffs and customs, reduced obstacles for trade and the improved technology, pushes Indonesian SMEs to take opportunities overseas. The research base on entrepreneurship internationalization has been much desired.

In the academic world, researchers, academics, and students are the main pushing factor of SMEs growth in some study majors and center of SMEs research spread in many Indonesian universities. Good teamwork with the biggest national center of SMEs development and the push from the government through research funding and citizens' dedication create 'Triple Helix' as a part of something important in the research development of SMEs. Up until now, there are many journals publications regarding SMEs, and to entrepreneurs, this will help their company in terms of ideas framework/knowledge and theory as well as general strategy. SMEs research publications also become the pushing factor for economic development indirectly, because through research, academics can provide good input to state administrators and policymakers.

SMEs research that moves towards specialization will continue, where researchers will concentrate much on certain topics, such as international entrepreneurship, strategic entrepreneurship, venture capital, SMEs technology, etc. Researchers on SMEs are more desirable and will have the different approach.

### **CONCLUSION AND RECOMMENDATION**

The additional value-added of the performance of the manufacturing sector in Indonesia continued to decline from year to year. Plus, Indonesia must pass through the Asian financial crisis of 1997/98 which destroyed the

foundation of the economy. As a result, additional new workforce might not be used well into the formal sector and it was increasing jobs in the SME sector. The data from the Central Statistics Biro in early 2016 support many opinions of the earlier researchers, that SMEs occupies the greatest position in the Indonesian industry, namely over 83% of the total number of companies in Indonesia.

There are lots of SMEs practices that can be analyzed properly into the business ethic, human relationships – ethnic, community, race, and religion. Also included are the management conflicts, organizational learning and even the development of human creativity. So, there are lots of models connected to psychology, motivational theory, organizational behavior of the action of ‘Economic Cooperation’, ‘Economic Independent’ and ‘Economic Syariah/Muslim’. Using the local paradigm will help understand lots of paradoxes and contradiction of businesses in Indonesia.

The majority of business management researchers are included in the SMEs research, SMEs practices, business consultant, speaker, and coaches tend to use management tools and models that are made in developed countries. All these management models & tools may be easily accepted especially within Indonesian communities that are educated with the ‘western’ ideas, embedding the occidental mindset within them. This is the paradox here, although ‘western’ ideas are accepted, but many Indonesian SMEs practices are influenced by indigenous cultural. This is the source of many conflicts with the way ‘western management model’ come out there. Simply, Indonesian SMEs practices can be different with western SMEs, and accordingly many Indonesian researchers required to further explore their perceived differences in the business models.

It seems that the argument which stated that Indonesia, and even Asia, fails to develop a relevant theory related to the existing positive business practices. There are lots of business practices that do not match the culture until it causes the research to lose their opportunities in making new theories that were taken from

dynamic capabilities of the entrepreneurs and their citizens in reaching the competitive advantages in the future. It becomes a challenge to the academics, researchers, management and business practices. This becomes the main task for them to see through the foundation of the country, various culture, citizens, philosophies that inspire and create management ideas rather than importing ideas from other places that might only match its origin. Philosophies of Economic Pancasila, Cooperation, Economic Syariah, Entrepreneurship and Strategic Management can be seen a lot in Indonesia, but only have little uses and shows it as a part of business management paradigm in Indonesia.

Bruton and Ming Lau (2008), found that Asian researcher has often employed “resource based view, institutional theory, and transaction cost theories which are also widely employed in studies of mature economies, e.g. culture theories and institutional theories”. They also found that Asian researchers typically employed “the culture to analyses in national differences and explain new phenomena on its”. On the other hand, they tend to use “an institutional theory in all international business research”. Although culture is clearly part of institutional theory, the institutional theory also addresses other institutions such as professional standards and legal requirements.

Therefore, this future research that Indonesian SMEs researchers are going to look at should move from an “Indonesian-based perspective to an Indonesian-driven perspective”. Future studies should go beyond this by asking the ‘why’ and ‘how’ questions to advance theory development. Given so abundant SMEs in Indonesia, next is “theoretical contextualization of the research in SMEs”, the researcher requires to focus more on the Indonesian context and develop new theories that will help to shift the management research paradigm. Better research designs are now related to multi-levels in SMEs organization, the use of multi-level research design and analytical methods is clearly needed. There is a need to understand how issues impact Indonesian’ SMEs as a whole and how they

differ among themselves - within SMEs comparisons (industry, size, age, etc.).

Indonesian researchers mostly used a qualitative method – often based on surveys, questionnaires and a small part in non-qualitative methods. This is particularly the case in Indonesia that has a weak enforcement of legal requirements on the quality and nature of the information released to the public so far. Indonesian SMEs spreads in a lot of places through the high amount of cultures and routines, with the high level of education that are uneven including in the influence uncertainty & globalization from the information side is a challenge on its own. Moreover, with the limited government regulations in reaching them – this condition is a challenge for all the Indonesian researchers, especially SMEs researchers.

Eric Ries (2012), found out that new start-up companies that tend to be SME companies must apply a management as a key that must be done by the SMEs no matter what. However, the available management principles are no longer qualified to be applied. SME companies must start to count the uncertainties that are extreme in doing its business; strategic choices must be done in the future. Strategic choices, business performance through competitive advantages, using administrative management as the solution and reduce the probability of lost has been the focus area conducted by the strategic management theory (Hitt et al., 2002). Future research should be conducted to examine the results of the integration of these two theories i.e. strategic entrepreneurship theory by incorporating the strategic activities in the SMEs operation & management. Future research on Indonesian SMEs must also include extreme environmental changes, in this case, is the enactment of the free market that has started being applied. Several research recommendations must be done as follows:

1. Future researcher may need to improve the current understanding of strategic management in Indonesian SMEs.
2. The focus of future researchers may be in the nature of entrepreneur innovation

and the extent to which strategic management is embedded in Indonesian SMEs.

3. Future researchers may investigate how entrepreneurs' change characteristics during their growth phases, and particularly what strategic entrepreneurship implication can be derived.
4. Future researchers could attempt to survey open innovation, network, internationalization, organizational learning, top management teams and governance and growth to create wealth in broader samples of Indonesian SMEs in more detailed and exploratory way.
5. Focus of future research could be on the requirement of strategic entrepreneurship on differences in culture, structure and decision making among partners of different sizes and sectors.
6. Future studies may incorporate findings of different strategies in improving the business performances for Indonesian SMEs.
7. Future researchers could have focused on identifying different opportunities within dynamics environment opportunities which could be segmented due to FTA.
8. Future research could pay more attention to the inflows & outflows of knowledge within Indonesian SMEs.

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**PACKAGING INOVATION IN ASIAN ECONOMIC COMMUNITY (AEC) –  
THE IMPORTANCE OF PACKAGING INOVATION FOR SMALL AND  
MEDIUM ENTERPRISES (SMES)**

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***ABSTRACT***

*In the competition of the AEC, Indonesia ranked the fourth position in term of contribution of exports in intra-Asean trade. Still below Singapore, Malaysia, and Thailand. SMEs are widely spread in Indonesia various type of production have not been able to compete globally, and one of contributing factors is packaging of inovation products not spread throughly, whereas as is known the large number of SMEs in Indonesia would make a great impact on Indonesia in Asean competition, in condition Indonesia is coming out of comfort zone create and innovate the packaging of the product. The aim of the study is to determinine the importance of packaging inovation for SMEs's product in Indonesia to compete nationally and global as well. Analysis of the data to review the importance of packaging inovation for SMEs using a descriptive approach and implementation of opportunities, with threats opportunities, weakness and strength (TOWS). The study in DISPERINDAG (Dinas Perindustian dan Perdagangan) West Java. The research is about the spread of SMEs in West Java along with packaging innovations which has been done. The findings of the study indicates that's is importantt for SMEs innovating the products in order to compete both nationally and globally.*

***Keywords:*** *Packaging Inovation, Small and Medium Enterprises (Smes), OWS, MEA*

## EMPLOYING OPEN INNOVATION WHERE SMEs NEED IT MOST, THE INDONESIAN PERSPECTIVE

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### ABSTRACT

*The Indonesian SMEs is forced to face the hard and brutal competitions through the implementation of ASEAN Economics Community as one single market and free trade agreement, causing reduction of market obstacles in neighboring countries. Innovation is the key to winning over the harsh competition, whereby nowadays 'open innovation' is the key lead in companies' managerial supervision in terms of profitability and sustainable growth. This study introduces implication findings from the application of 'open innovation' on SMEs entrepreneurs as successfully proposed by Henry Chesbrough a decade ago. The evidence will be useful as an input for Government through its policy, companies' associations, and SMEs entrepreneurs themselves, in order to give useful contributions toward their business and aggregated national economy. The empirical investigation is based on a sample selection of Indonesian SMEs those were got the government grants and has collaborated already with other institution such as a university and an association. In the present of two keys external components i.e. government grants & technological development has been adopted by Indonesian SMEs, this study investigates whether R&D capacity coupled with significant Managerial Structure and Competencies were the key factors that contribute to developing the innovation capability and export performance of SMEs.*

**Keywords:** business performance, open innovation, SMEs

### INTRODUCTION

As discussed in many areas, the ASEAN Economics Community ("AEC") emerged in 2016 without any boundaries, which causes all ASEAN companies to compete with each other in a single ASEAN market. As ASEAN go from emerging to surging, Indonesia is destined to play a central role, representing almost 40 percent of the region's economic output as a member of the G20. Indonesia has a pivotal market and has the lion's heart in AEC role, undeniable trends like urbanization and consumerism will absolutely put us in the spotlight. In addition to AEC, In August 2015 Indonesia combine with other 9 ASEAN members have established the 'Regional

Comprehensive Economic Partnership ("RCEP") together with six countries, which are Australia, New Zealand, People Republic of China, India, Japan, and Korea. In another place, the accord of Trans-Pacific Partnership ("TPP") with the US and the other 10 Pacific-Rim nations has been signed and become largest regional trade accord in history. However, the debate around RCEP, TPP and include AEC has mostly concerns on Indonesia's readiness to consider on so many international standards required by the agreements. When compared to neighboring countries such as Singapore, Malaysia, and Thailand, Indonesia is often perceived to be lacking in competitiveness in terms of infrastructure and human resources. In global

competitiveness 2015-2016 as stated on World Economic Forum 2016, Indonesia is ranked at 37 (2015-2016 ranking) out of 140 countries, which slightly fell 3 steps from ranked at 34 (2014-2015 ranking) at last year position.

Pros and cons over the benefits of having access to markets of opponent countries and potential costs may come from joining due to the increase in competition and market regulation. Under free trade partnership especially TPP, Small Medium Enterprises (“SMEs”) will receive so many support to penetrate the USA market. The TPP will also increase cooperation between different business sectors in many areas such as production and supply chain, connect the business activities as well as contact the end clients. At the end, it will reduce poverty and increase the development in Human Resources. Diversification in the business sectors under the free trade partnership will create huge opportunities in new markets at domestic and abroad for SMEs. The potential business sectors that are more likely to get gains are information technology sectors, e-commerce, and financial services that are suitable for Indonesian middle class.

The definition of small business is taken from Government Law No:8/2008, stating that small and medium enterprise (“SMEs”) as independent business activities which are done by the individual or business entity that has not become a subsidiary or a branch of other company or being controlled or be a part either directly or indirectly from Medium or Large Business Enterprises. Indonesian SMEs has faced similar problems as other big businesses. These hard and brutal competitions are also forcing many Indonesian SMEs to prepare such “Pre-Mortem” through radical changes in their business operation, and through “Pre-Mortem”, SMEs identify what could kill them in the next five years and take appropriate action (Klein, 2007). Most of SMEs in Indonesia forget to implement such thing in a very simple way. The rigorous battling to survive through this competition is becoming SMEs’ day-to-day activities. Whether they are ready or not,

willing or not – they need to prepare to be able to win the war.

Coupling with these new competitions, Indonesian SMEs also need to face abundant obstacles like other modern companies have. The business model needs to rebalance frequently, as the company needs to survive and look at the sustainable growth in the future. Merely due to customer changes and the introduction of the disrupted technology, such as digital technology, has changed the business landscape dramatically and put directly in front of SMEs. Again, our SMEs has been forced to prepare flank attack competition from this new competition, prepare tough and aggressively from the current competitors as well as preparing competition from their own clients. Only the SMEs who are prepared to continuously innovate their products and their services, as well as their processes using technology innovation are able to win the competition.

### **Free Trade Agreement and Innovation**

The effect of Free Trade Agreement (“FTA”) towards the innovation of SMEs in Indonesia cannot be avoided. The question that must be answered is whether FTA develops ‘innovation’ for SMEs or not. Can FTA provide ‘benefits’ for the SMEs? A Similar question that must also be answered is whether the government regulations in the liberating market and investment will increase the innovation of SMEs and are they able to compete globally. One of the relationships between FTA and innovation is through import and direct investment by the foreign investors – Foreign Direct Investment (“FDI”). The removal of trading barriers in free-market will surely increase competition in the domestic market, decreasing company’s market share or even reduce the profit of the companies in the nation. This is a challenge for the domestic companies to increase their efficiency (ASEAN Secretariat, 2011). On the other hand, as stated above, FTA can open up many ‘opportunities’ for companies or SMEs in increasing relationship between companies within the free-trade region

as a global supply chain and become a part of the world's main production.

Thus, the relationship between FTA and innovation should have positive impacts. The most real and most direct effect on increasing export and import is the increase in innovation that is done by companies especially in the form of R&D, patent, trademark, licensing through tight competition, technology transfer, learning, and spillovers. The effect on the increase of trading and investment in innovation, according to (Onodera, 2008) OECD Trade Policy Working Paper No. 72, 07-Aug-2008.

### **Novelty of Open Innovation**

The innovation has been shifted from closed to open dimension. A decade ago, Henry Chesbrough (2003), the author and the father of Open Innovation said that the key elements of "Open-Innovation" model posts are that important inventions were coming from the inside and the outside of the firm. Open innovation is clear defined as "the use of inflows and outflows of knowledge to spurs the innovation, as well as to develop the markets". These ideas should then be commercialized both using the current business model and with alternative business models (Chesbrough, 2003).

By using external and internal actors and information for successful value creation, enterprises must look beyond their organization's capabilities because open innovation is claimed to be the new type of innovation. Primarily, there is evident from this longitudinal study; open innovation has so far been adopted mainly in high-tech and multinational enterprises. There is evidence that a few studies have demonstrated that open innovation also exists in the SMEs (Wynarczyk, 2013).

Open innovation is becoming a popular issue in innovation management. Moreover, open innovation is increasingly taking a lead in enterprise management in terms of sustained organization and profitability. There are two main standpoints that they split into two i.e. the

scholar who emphasize novelty of open innovation and superiority over the closed one and the scholars who critics and questions the novelty of open innovation by pointing to previous theories and ambiguity of the term of open innovation (Altmann & Li, 2011). There are many supports for the ones who moved from close innovation into open innovation (Enkel & Gassmann, 2010). On the other hand, there are arguments stating that the open innovation concept can be traced even before they were labeled as "Open Innovation" (Huizingh, 2011; O'Reilly, 2010). The researchers has been divided into two schools, the ones that are in "favor" and the ones that are "against", hence Altman & Kampe (2010) considered that the rising popularity of open innovation have led to many misinterpretations of any open business event or industry collaborative as Open Innovation, adding an element of confusion about what open innovation is and its perceived novelty (Altmann & Li, 2011).

The "open-innovation firm" and "closed-innovation firm" are arriving as the result of the consequence of "innovation practices" implemented within the organization. Although the definition of open innovation is widely recognized by most businessmen and researchers, the practices of open innovation were not merging yet. The core in open innovation processes consist of "Inbound process", "outbound process" as well as "coupled process" was defined by Engkel et al. (2009) that may lead the important impacts on company's business performance. On the other hand, the key of internationalization, as the one of the most significant measures of business performance and the competitiveness of SMEs is an "Exporting capability". An "inbound process" is based on the capability of the company to adds on its own knowledge-based through internal networks with their suppliers, customers and/or collaboration with other external institutions (e.g. university or associations). Meantime the "outbound process" refers to creating and increasing the profits by transferring innovative ideas to outside by selling or licensing out intellectual

property (“IP”).

Most researchers discuss the adoption of open innovation strategies in the form of practices and applying on innovation technologies. They focus on ‘inter-firm cooperation’, ‘cooperation with intermediary institution’, ‘cooperation with research organization’, ‘management attitude’, ‘planning and external orientation’, ‘R&D alliances’ and finding the effect of open innovation strategies on SMEs. Meanwhile, O’Regan et al. (2006) has found out that ‘strategy’, ‘organizational culture’, ‘leadership’, and ‘innovation’ has a big role in becoming in innovation (O’Regan, Ghobadian, & Sims, 2006). Laforet (2007) argued that ‘size’, ‘strategy’ and ‘market orientation’ plays a bigger role in achieving innovation (Laforet, 2007). Especially in the SMEs, the entrepreneur level has increased in the implementation of open innovation strategies. The component of management aspect, indicators, and technological innovation are widely measured. The four factors that are related to foreseeing the entire management and to measure open innovation successfully are objective market acceptance, subjective market acceptance, financial performance, and product-level-measures (Huang, Soutar, & Brown, 2004).

### **Open Innovation in Indonesia SMEs**

Gassmann, Enkel and Chesbrough (2010), found that one of the future trends of Open Innovation, which has been identified stated that Open Innovation had shift from large firms to SMEs. They thought that some SMEs are able to handle their ‘liability of smallness’ by catching up their innovation process (Keupp & Gassmann, 2009; van de Vrande, de Jong, Vanhaverbeke, & de Rochemont, 2009). The affordable technology can make the core competence for those SMEs. Implementation of open innovation that has been successful in enterprises often comes with arguments about the critical challenges for the development of SMEs (Lazarotti, 2008). SMEs can be classified openly to the implementation of open innovation due to their size and nature. The

challenging competition and more demanding customers have become a motivation for SMEs.

The study conducted by PPM School of Management’s Center for Innovation and Collaboration (Jakarta Post, 11th Dec, 2014), revealed that Indonesia’s competitiveness is believed to have competitive edge on a bigger stage in the lead-up to implementation of the ASEAN Economic Community (“AEC”), as the country has the chance to develop innovations in its area of expertise. Indonesia needs to reorient its focus on human resources based, which would emphasize individuals as innovation agents. The new administration needs a huge amount of innovative and creative research to implement it to the SMEs sectors.

Innovations within SMEs in Indonesia are not those that happen within big companies, the innovation is not practiced and implemented in their daily activities nor is it stated in their business plan. It is the innovation that has not been implemented into their routines or cultured within their organization. The innovation has only happened through several stakeholders. The innovations rooted through individuals who think that innovation will be useful for their companies. Indonesian’ SMEs are typically born, grow and expand to export operation from small company establish in such cluster are usually in Jogjakarta, Cirebon, Trangsan-Solo, Tangerang & many other places in Indonesia. Innovation in Indonesian SMEs is not truly daily practices & mindset, hand-to-hand and melting down in their organization and only takes place through a few of stakeholders.

The innovation sparks through the individual who thought that it would useful for the company. These individuals mostly come and gain experiences from the big company. Therefore, Maverick style is very dominant in the Indonesian’ SMEs afterword. Trial & error activities in their product innovation probably became the management view’s combine with tight measure of performance for every manager to operate the business unit. The advantages of the maverick style can be defined as 1) Maverick Style Innovation create low cost and measurable investment, 2) Innovation can

take short time and easily to measure financially, and 3) People in Indonesian' SMEs are coming from different education, behavior & culture. It is difficult to involve everyone into the process. On the other hand, the disadvantages can be drawn as 1) Innovation is "Discipline", not just process. By implement continuously innovation, the company can get benefit from hard competition. Doing "Maverick-style" can be one-off innovation happened in the organization. "Trial & Error" will dominate the process as well as the final products as result of those innovations, 2) Innovation takes place only when maverick person is available and such complicated implementation can happen if most of the people involve rejected his/her idea, and 3) Continuously innovation will probably erode the financial ability.

## **METHODS**

The research strategy used in this paper is case studies, subsequently detailed information that provides sampling using primary data. The result will use multi layers data in order to identify the phenomenon of change. The rationale decision to choose case studies is based on the ability to replicate analysis in order to obtain either the confirmation of the theoretical existence or contrasted findings of selected cases. The primary data is the questionnaire ("questionnaire"), and in this case, the research instruments were distributed directly to the business actors randomly. The questionnaires are the standard; the respondents are asked exactly the same questions in the same order and the results tend to consistent. It's easy and reliable. Meanwhile, the comparative analysis is employed as the main function to analyze the data line by line to capture the concepts and the relationships all variables.

This paper will assess the practices, especially on "Export Capability" of Indonesian SMEs as a proxy of international competitiveness of SMEs. This paper will not analyze the present of a few of external key

components, government grants & technological development had adopted by Indonesian SMEs already. But instead, this paper analyzes whether the "Exporting Capability" of SMEs in Indonesia is affected by the cumulative effects and interrelationship two key internal components, i.e. R&D capacity and managerial structure and competences that ability to contribute to the development of innovation capability and export performance of SMEs. Hence, this paper adopted the general assumptions that two key external factors, i.e. open innovation practices and the ability of the firm, attract government grants and technological development has been embedded by Indonesian SMEs even though on a small portion.

As Henry Chesbrough (2003), stated that "Open-Innovation Companies" is able to use purposive inflows & outflows of knowledge to accelerate internal innovation, and to expand the markets. Putting these samples of the study that were taken from the company that has received lots of good deeds from the government, nation's company (BUMN) association and even a few of them have done a collaboration with several universities to held a management or marketing training. The form of aids that has been given is not only training but also the free exhibition, cash loan, and also loan to buy machinery or even a gift in a form of production equipment. Thus, according to the Chesbrough definition (2003), these company samples that has been used in this study can be categorized as the company that has done an open innovation practice and can be considered as open innovation SMEs. This study is conducted merely to investigate whether after these companies can gain help, this will develop the companies' capabilities to increase their export capabilities.

Hopefully, this paper will have the impact that can measure and predict open innovation capability and export performance of SMEs. The use of Export Capability for SMEs will be the keyword difference for this paper. This paper aims to assess the effects and challenges that arise from two key components on Export Capability as a proxy of international

competitiveness of SMEs as well as on their SMEs business performance. There are interrelationships between two key components: 'Internal Context' that we need to estimate & investigate.

- H1. In the present of Government Grants & Information Technology (Development) implementation as well as open innovation practices, this study is going to analyze whether the SMEs competitiveness of innovative is "Exporting" as a proxy business growth performance are affected by two components that are R&D capacity and Management Structure & Competences. The hypothesis of business performance is therefore evaluated by using empirical data that involves customers, employees & customers as the media to assess SMEs business performances as the independent variable.
- H2. To evaluate whether after controlling H1, there is any significant difference between the SMEs those are able to "Export Capability", as a means of survival, growth and gaining the position over domestic-oriented SMEs. Export capability or Internationalization is going to discriminate both of them. Additionally, the organization performance of each SMEs will be grouping.

Primary data of this paper are achieved through closed and open-ended questionnaire. The research populations are SMEs that are listed within 'associations'. Research samples are determined based on purposive sampling by criteria (a) registered with training program and

promotion subsidy from government, whether it is from association, local government, or central government or government-related companies, (b) included in the criteria and characteristics of SMEs according to Government Regulation no.9/2008, (c) the company has operated and run for a minimum of two years before the survey is taken. The denomination of 'open SMEs' is simply based on our surveyed firms actively participated in received support ('inbound process') from other firms or association or government that resulted in innovations, commercialization and/or new product development at the time of survey conducted.

The locations of two research samples were taken in three places: Kunming, Nanning & Bandung. Two samples were taken in Kunming, Yunnan-PRC, and Nanning, Guangxi-PRC who attend the exhibition that was subsidized by the Ministry of Commerce. These SMEs are grouping into the companies that already implemented exporter activities or internationalization as one of open innovation practices. While the other samples were taken under the coordination and guidance of PT. "T" who are running business competition training and workshop on 27-29 October, 2016 in Bandung, Indonesia. For the purpose of this publication the PT. "T" names have been changed to maintain confidentiality and to provide a descriptive title. These SMEs are grouping into the companies that already implemented marketing or management strategies activities (new product or new service development) as one of open innovation practices application. Below are a few obstacles faced by these SMEs upon receiving the grants and collaborations with other institution therefore they cannot able to spur the innovation within their operation.

**Table 1.** Statistical Descriptive of Main Obstacle of Open Innovation

1	Limited Budget or Fund	1.5263	1.3098
2	Limited Loan	1.3684	1.2175
3	Resulting in High Cost	1.2105	1.2554
4	High Risk on Innovation	1.0526	1.1377
5	Hard to Find Partner	0.9737	1.0777
6	Uncertainty Demand of Products	0.9737	1.0777
7	No Skilled Resources	0.8684	1.0180
8	Competitors Dominate the Market	0.8684	0.9911
9	No IT Technology	0.8421	0.9733
10	No Marketing Staff	0.7368	0.8601

Value: 0=Null, 1=Low, 2=Medium & 3=High

The first samples were taken from the Indonesian SMEs exhibitors that attended the 24th China Kunming Import and Export Fair (Kunming Fair) 2016, which was held on June 12-16, 2016 in Kunming Dianchi International Convention & Exhibition Center (KDICEC), People's Republic of China. The total of 17 questionnaires was distributed but only 12 exhibitors returned back the paper (responds rate 70.59%). The second questionnaires were distributed among the Indonesian SMEs delegation at the 13rd China Asean Expo (CAEXPO) 2016 in Nanning, Guangxi at 11-14 September 2016, in CAEXPO International Convention & Exhibition Center, People's Republic of China. The total of 29 questionnaires were distributed to furniture & accessories companies but only 12 exhibitors returned it back (responds rate 41.38%). The last questionnaires were distributed among the SMEs under the guidance of PT. "T" that was done in Bandung, Indonesia. The total of 35 questionnaires was distributed and only 14

companies returned back (responds rate 40%).

This study was built on the theories of conceptual while developing a structural model to look at the variables that affect the export capability strategies, which bolster the sustainability of business performance. The first step is determining the variables involved in open innovation strategies based on our framework, and then test the model of the relationship between variables in conjunction between the open innovation strategies and export capability. The variables involved in this study consisted of two independent variables and one dependent variable. Both independent variables are the R&D Capacity (RD) and Management Structure & Competences (MSC) that are available in the current environment and Internationalization/Exporting Capability (IE) as a proxy for Sustainable Growth Performance. Hypothetical models describe the relationship between these variables as shown in figure 1.

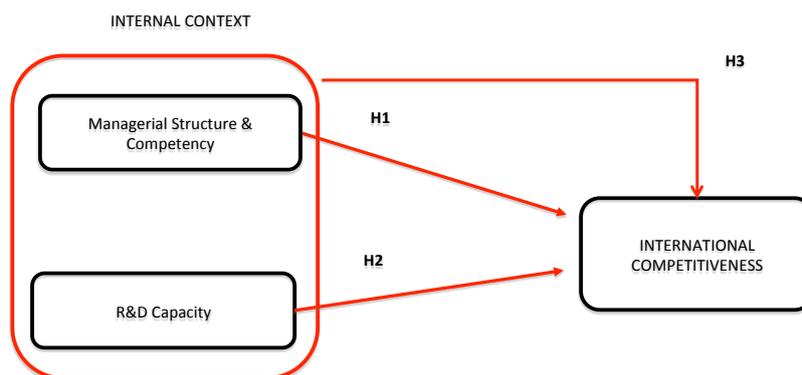


Figure1. Research Model

The data in this study consisted of qualitative data. This paper will be limiting the research within the context of International Competitiveness for open innovation strategies for Indonesian SMEs to provide better products (product innovation) and services (service innovation) through better processes (process innovation) as well as technologies (technology information). Another limitation is the context of the keys internal components that are available during the period of study. Overall, this paper develops under the assumption that all the open innovation practices in Indonesian SMEs need to identify and implement it.

## RESULT AND DISCUSSION

The research results show that all open innovation practices in Indonesian SMEs were involved in “inbound” open innovation processes only. Some SMEs were involved in knowledge and information exchange, collaborative R&D, new product development, and marketing of new product(s). Unopportunity “outbound” and “coupled” open innovation processes were not popular among the Indonesian SMEs – for example, Selling and franchising out intellectual property (IP), joint patenting, cross-shareholding and joint venture. The joint activities with suppliers and customers were mainly in the areas of marketing and new product development.

Open Innovation Practices do not depend on R&D Capacity and Management Structure & Competences only but on the cumulative of several related Intra organization components.

Below is the form of Open Innovation Practices collaboration between company and suppliers, customers & local institution such as business associations and university. It can be seen in the figure 2, open innovation practices that were done by the SMEs in their businesses to hold a new product launching, new products, and increase efficiency in new fabrication process were dominant.

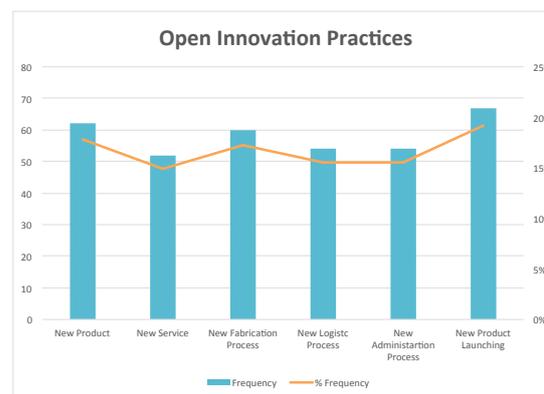


Figure 2. Open Innovation Practices

On the other hand, the most component R&D Capacity in Indonesian SMEs is the availability of an Internal R&D, External R&D or Outsourcing and Purchase New machine, Software or Other Equipment as shown in figure 3. The availability of an Internal R&D is absolute needed for companies under their operation to develop new products and services. Cohen & Levinthal (1990), in the concept of “absorptive capacity” saw that investigation in internal R&D is the main key to access and utilize the knowledge of external and technology. The concept of “absorptive capacity” is the concept that competing with the

open innovation concept. While external R&D or outsourcing are the concepts, where the company good innovations are new products and services or the new process, through the third party while doing job outsourcing. The sales of new machinery, software, and equipment can also improve the company's innovation skills.

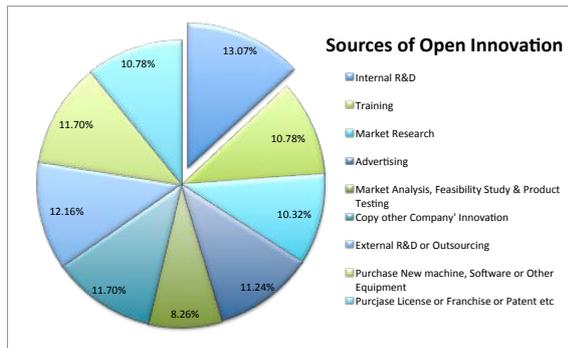


Figure 3. Sources of Open Innovation

The summaries of the three core open innovation processes: **The outside-in process**, that is an enriching the company's own knowledge base through the integration of suppliers, customers, and external knowledge sourcing can increase a company's innovativeness. "R&D capacity and Management Structure & Competences" were believed to enable SMEs to enhance their innovation capability.

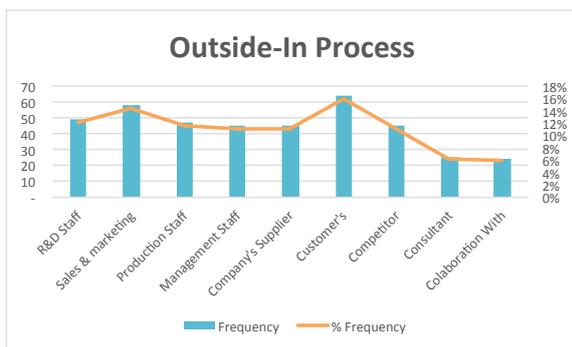


Figure 4. Outside-in Process: Core Open Innovation

The **outside-in process** can be made into the main competence for SMEs' companies' skills in open innovation. Meaning that SMEs chose to invest on cooperating with the supplier, customers, and outsiders, such as

government and universities integrating the external knowledge that was achieved. Open Innovation Practices coupled with Government Grants & Technological change does not depend entirely on a firm's R&D capacity but on the cumulative effects of others several related intra-organizational factors. The open innovation indeed needs the management and organization in the innovation processes which in circumstances become more intense. Meanwhile, Managerial Structure and Competency of the organization is changing over time especially in introducing and implementing the modern management techniques and searching for getting the benefits from opening the opportunities from open innovation practices.

Base on the figure 4, Indonesian SMEs tend to cooperate with customers, where the cooperation can be used to develop design-making, design quality and product quality that the customers wanted. This cooperation also increases their skills in innovating, such as developing new products together. In another word, customers are integrated as the source of valuable information and use their competence in developing a new product. Integrating the source of external information and the companies' competence in their effort to start innovation process can become the company's main competence.

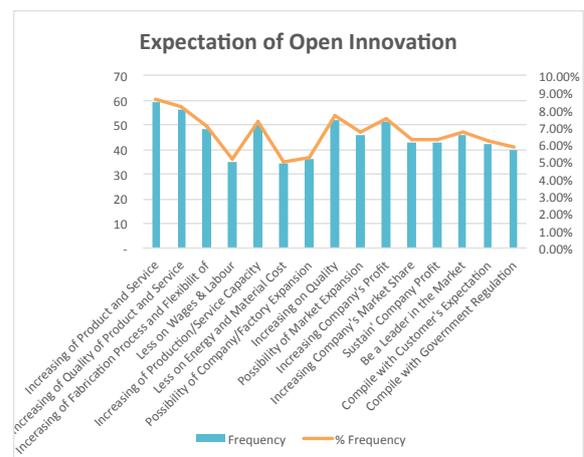


Figure 5. Expectation of Open Innovation Result

Meanwhile, as the stated from Figure 5, the real result of open innovation practices that

is desired by Indonesian SMEs is increasing product & services, increasing production & service quality, increasing company profit and increasing quality after achieving government's aid and collaborating with other institution.

**The inside-out process**, earning profits by bringing ideas to market, selling IP and multiplying technology by transferring ideas to the outside environment. Companies that chose "the inside-out process" as a process in the company that focuses on the effort to bring out ideas and innovation to the market in order to achieve quicker advantage compared to those they can do through internal development. Companies decided to bring out the company's limitation to produce advantages in licensing IP and/or switching technologies, such as transferring ideas to the companies.

**The coupled process**: coupling the outside-in and inside-out processes by working in alliances with complementary partners in which give and take is crucial for success. All the three core processes represent an open innovation strategy, but not all are equally important for every SMEs. This paper assesses the business performance and competitiveness of innovative SMEs using a proxy of "exporting", as a key measure of internationalization.

## RESEARCH FINDING

The empirical results presented below are based on both univariate & multivariate analyses. The correlation and regression were conducted using the excel spreadsheet to test hypotheses as well as assessing the significant differences and level of relationships between the variables used in two sub-samples, 'exporting capability' and 'no exporting capability' firms. Regression analysis has been undertaken to confirm two hypotheses (H1 & H2) above, in order to assess the interrelationship between two key internal components and their cumulative effects on export capability.

on univariate technique, namely 't'-test has been checking for testing the statistical

significance of different between the mean values of the two group and thus to test the individual discriminating power of the ratios between the groups. The empirical studies found that two mean values of two variables are significant at 0.05 level of significant. The 't' value of two variables is greater than the tabulated 't' value, i.e  $3.3080 > t_{0.05}$  and  $2.8816 > t_{0.05}$  for "R&D capacity" and "Number of Staffs/Manager of Sales and Marketing" as a proxy of "Managerial Structure and Competency".

After analyzing and recognizing discrimination and predictive power on the univariate basis, an attempt has been made to test the under mentioned hypothesis on the basis of multivariate analysis. An attempt to derive a linear combination of the variables characteristics which best discriminate between the groups. Once the value the discriminant coefficients are determined, it is possible to calculate discriminant to one of the groups based on the score. The essence of the procedure is to compare the score of an individual firm with that of the alternative group. In this manner, the firm is assigned to the group it most closely resembles.

## Export Capability Discriminant

The overall regression shows the direction of the influence of each object of research. The regression coefficient that has a positive sign means "R&D Capability", and "Managerial Structure and Competency" have positive effects on export capability. The equality has 'R-value' or correlation coefficient of 0.3980; Adjusted R square of 0.3636; F value of 11.5710 with 0.0001 significance level. The significance value less than 0.01 or 1% show that these results have the ability to show that "R&D Capability", and "Managerial Structure and Competency" have the effect on "Exporting Capability".

On the individual variable view, the "Managerial Structure & Competency" has a significance level of 0.0022 with a "t" value of 3.3080, it is less than 0.01 or 1%. This means that "Managerial Structure & Competency" has

a significant effect on export capabilities for Indonesian SMEs. “Managerial Structure & Competency” plays an important role in influencing the operation. The number of manager and staffs of sales & marketing are taking the pivot role for the SMEs as an agent of change or important broker between the company and the markets. Most of them were given the best advice for the company to meet the customers’ perceived value of the company’s products or the services. Most of the knowledge had been fully absorbed by the company. Secondly, the level of significance of R&D Capacity amounted to 2.8816 with a “t” value of 0.0067, it is greater than 0.01. This means that the R&D Capacity had a significant effect on export capabilities. Based on the empirical findings, this paper found that these results are consistent with research conducted by Pooran Wynarczyk (2013).

The Z-score (0.6204) reveals that a significantly predictive value of 76.32% for the SMEs who has “exporting capability” and on the other hand has the predictive value that are even significantly higher with a percentage of 92.86% for those who owns no “exporting capability”. It shows that the two keys of internal components “R&D Capacity, and Managerial Structure and Competency” has a very strong relationship with the ‘exporting capability’ as a proxy of international competition or business performances.

Based on the results of the study, it can be summarized as follows: 1) “Managerial Structure & Competency” has a significant effect on “Export Capability” as a proxy of International Competitiveness. Testing results of significance level are smaller than the standard significance, 2) The “R&D Capacity” has the significant effect on “Export Capability” as a proxy of International Competitiveness. Results of testing the significance level are greater than the standard significance, 3) “Managerial Structure & Competency” and the “R&D Capacity” have a significant effect on “Export Capability” as a proxy of International Competitiveness. Results of testing the significance level are smaller than the standard significance.

This study only tested two key internal components i.e. the “Managerial Structure & Competency” and the “R&D Capacity” as the independent variables, and “Export capability” as the dependent variable, so the author considers that the addition of new variables for future research is needed. Subsequent research may consider other independent variables that are not included in this study.

## DISCUSSION

The world is fundamentally changing, companies including the Indonesian SMEs could make a choice depending on how they view the world and more importantly is the expectation of how Indonesia SMEs should behave and react to customers’ needs. Technology has transformed how customer acts, share information and understand the world, and has given consumers power like it has never done before. In this circumstance, all SMEs that have unprecedented experience have to change to a new environment in which they must now work harder on it. Only through open-innovation, Indonesian SMEs are able to survive and win the competition. The liberating market and investment have a positive impact especially in increasing the innovation of Indonesian SMEs in another part of the world.

Ari Kuncoro (2014) stated that there is a positive correlation between new investments in machinery and R&D activities, purchase of new machinery can be categorized as innovation process, thus producing new R&D activities in order to adapt to such new machines and the new R&D activities will bring better production process (Kuncoro, 2016). Government's regulation implication upon import activities of machinery and R&D activities pushes companies in Indonesia to start innovation process and push these companies to start R&D that in the end leads them to be able to compete globally.

There is a relation between trading and innovation. One of the obvious, that technological innovation creates competitive advantages within trading. The discrepancy

between emerging and advanced countries' technology, is in trade and. Advanced countries tend to export high-tech products compared to emerging countries. Companies that have innovation will do export, foreign investment, or technological licensing that they own to exploit the benefit of innovation that has been found. Therefore, within the free trade, this will be advantageous to companies that innovate compare to those that do not.

AEC will create bigger market than before, and thus creating companies that innovate to benefit from their own innovation. Free trade and foreign investment affect companies in innovation in many aspects such as employee involvement, external participation, R&D outsourcing, patent licensing, and intellectual property copyrights.

On the other hand, the relationship between FTA as well as single market AEC and innovation are supposed to be '+' positive. The only '-' negative effect is coming from the scale of the economy since imports can lead to the decrease of the scale of economies. Then scale of economies can be improved if inefficient manufacturers are weeded out in the long run as well as in the medium term if manufacturers are able to increase the exports. Meanwhile, the competition generally enlarged the motivations for manufacturers to innovate. Unfortunately, for manufacturers, which are far below the technology curve, the sudden increase in the competition can decrease innovation. Indeed, the real and direct effect of the increase of export and import is the increase of innovation done within company especially R&D sector, the increase of 'patent', 'trademark', 'license' through tight competition, technology transfer, studies, and spill-overs. Osamu Onodera (2008), on an article in OECD no. 72, sees many effects of trading and investment in innovation.

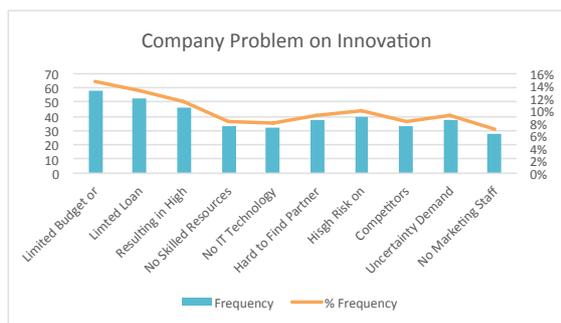
Given the aspects of "the internal and the external keys components" are arising from the result of how liberating the trade between the countries are, the paper also need to check the relationship and 'how important' those connections. At the end, we hope that the result can measure and predict those correlations that

will lead us to know further about "Open Innovation Practices" and "Exporting Capabilities of SMEs" and/or "Market Domestically" on Indonesia SMEs.

## **CONCLUSION**

This paper assesses only "the internal keys components" of open innovation practices for Indonesian SMEs due to the fast changing environment. The 'Innovation Opportunity Framework' must be developed by Indonesian SMEs using aspects of 'the internal keys components & the external keys components' on regular based, given that the current and future business environment landscape. By keeping these 'the internal keys components & the external keys components' of SMEs on open innovation in mind, the innovation opportunity framework needs to be performed under AEC implementation.

In order to survive, the Indonesia SMEs must improve their own innovation activities, either in the form of new product, new service, new process or new technology to satisfy its own customers. But on the other hand, increasing innovation activities upon integration requires more resources to provide, that in the scale of economic will probably not suit (the domestic market's demand). There will probably be companies that are doing a very small amount of innovation. The best example of this situation can be seen as the producers of furniture and household appliance in Indonesia are in a better trade-off to stop their manufacturing and profitability just to be a merchant or become an extension of the same industry of the SMEs from China. On the other hand, the opening of export markets causes many Indonesian SMEs to easily export their merchandise, licensing their copyright and investing out in the form of an outward FDI to other countries.



**Figure 6.** List of Problems on Innovation

The second responsible party that boosts the Indonesian innovation is the governments (regional and national) beside entrepreneurs. Indonesian governments have implemented many regulations to promote innovation including within R&D, intellectual property, education, market labor, the stock market, as well as product market. The Indonesian government has also realized that encouraging business environment to innovate is the most important aspect. Public regulation, and open trading regulation as well as investment regime, is an important aspect of existing innovation, that is possible for incoming technology, increasing compositions and opening new markets for entrepreneurs. International trading and foreign direct investment are very important to the business environment in Indonesia as a way to exploit innovation.

In the future, the government is expected to enact and take a lot more aggressive role in maximizing the presence of the entrepreneurs of SMEs because the economics of Indonesia are becoming more open. The economic cooperation and trade liberalization should be able to improve the ability of the Indonesian SMEs for innovation so that it can compete fairly. The government's policies on the entrepreneurs of SMEs, which are currently taking more than 90% of the Indonesian workforce, should be considered as a national policy. Furthermore, the policy on FTA should also provide long-term benefits aspects especially with respect to the transfer of technology that must occur, in which there is the ability of The Indonesian SMEs to grow and create innovation in the form of the ability to

set up R&D by themselves, or in collaboration with other outside parties.

In the World Economic Forum 2016 ranking on countries performance on innovation and sophistication factors, Indonesia is ranked number 37, three steps down last year's rank: number 34. Indonesia as the biggest country in Southeast Asia has its innovation that has become the proof of increasing competitive ability. Government spending from Gross Domestic Product is categorized as a very low, and without further innovation, Indonesia cannot grow any further. Indonesia's public spending for research and development as part of Gross Domestic Product for the year 2005-2014, in comparison to other ASEAN countries, is the lowest around 8%, comparing with the Philippines 11%, Vietnam 19%, Thailand 39%, Malaysia 113% and Singapore 200% (world bank).

In the last five years, many factors that cause the emergence of new technology entrepreneurs, is caused by the boost of Internet improvement. Some factors can be identified to push Indonesian SMEs forward especially with the availability of single market of AEC: 1) AEC will improve FDI, which may lead to the increasing demand of supporting goods from small units such as Indonesia SMEs, the business opportunities will increase due to FDI, 2) FDI from overseas linked directly to competition of business and affected the Indonesian SMEs growths, 3) AEC will ease of tariffs and customs, reduced obstacles for trade and the improved technology, pushes Indonesian SMEs to take opportunities overseas.

## FUTURE RESEARCH

The future study will still continue to explore a better framework for the practice of Indonesian SMEs that is associated with a new round of free-trade developments, 1) future studies may incorporate findings of different strategies in improving business performances for SMEs in Indonesia; 2) future study could be focused on identifying different opportunities

and challenges within dynamics environment;  
3) future researcher could pay more attention to the inflows & outflows of innovation within Indonesian SMEs and other parties.

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**EXPLORING WORKPLACE MOTIVATIONAL FACTORS PERCEIVED  
BY GENERATION Y TO WORK AS FUTURE TALENT IN COMPANIES IN  
INDONESIA**

**(A CASE STUDY OF UNDERGRADUATE STUDENTS IN GREATER  
JAKARTA AREA)**

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***ABSTRACT***

*As Generation Y (Gen Y) in Indonesia continues to grow and become a stronger and larger force in the workplace but tend to switch job frequently in the first three-years, executives and managers in companies should handle this cohort properly. Globalization, a competitive labor-market, and economic situations makes companies eager to motivate and retain their employees/talent as a key success to achieve short and long term objectives. Knowing Gen Y's unique characteristics and how to handle them properly provides competitive advantages for a company to achieve a strategic position. Therefore, two-factor theory (Herzberg-Theory) was examined and explored as the fundamental theory for this research.*

*This research applied a quantitative method. Reliability and validity tests were conducted. A Pearson correlation was utilized to identify which component of motivator and hygiene factors was perceived the most by Gen Y. An independent t-test was used to find out whether there is any significant difference in perception of motivator and hygiene factors. Lastly, a one-way ANOVA was utilized to find out the significant differences within several groups.*

*This research found that work itself is one of the components of motivator factors and salary is one of the components of hygiene factors perceived the most by Gen Y. There is significant difference in their perception of motivator and hygiene factors.*

*In conclusion, companies might motivate and retain their Gen Y employees by providing challenging job assignments and offering competitive jobs and salaries. They also perceive motivator factors are more important than hygiene factors. Therefore, companies must consider the motivator factors in developing rules and policies.*

**Keywords:** *Gen Y undergraduate students, Herzberg theory, hygiene factors, job motivation, motivator factors.*

**INTRODUCTION**

A growing population of generation (Gen) Y employees is rapidly entering the workforce joining the aging Gen X employees. Three out of four workers universally will be Gen Y by the year 2025 (Schawbel, 2012). PricewaterhouseCoopers (PWC) stated that the Generation Y population will reach 50% of the global workforce (Pizzi & Pesati, 2012). As a consequence of the rapid growth of Generation Y employees, this generation will reshape many aspects of life in the workplace. Generation Y, those who were born between 1980 and 2000 (Hatfield, 2002), is also known as Generation Next, the Echo Boomers, the Nexters, and the Millennials (Hatfield, 2002); (Kogan, 2001); (Markley, 2002); (Pekala, 2001).

In ASEAN, the workplace is nearly dominated by Generation Y which accounts for approximately 289 million (FrontierStrategyGroup, 2015). The Millennials are dissatisfied with extremely hierarchical workplaces and they tend to shape their own work environment which leads to demand for a

flexible workplace and engaging job assignment for ASEAN’s future workplaces (Allen *et al.*, 2014). ASEAN is also considered as one of the fastest growing working age populations in the world with a growth rate of 14.4% (Allen *et al.*, 2014). It is expected 50 million people will be ready to enter the workplace between 2010 and 2020. More and more younger workers entering the workplace will push workplace evolution with their own unique work styles, preferences, and expectations (Allen *et al.*, 2014).

In 2013, the Indonesian labor force population was estimated at more than 118 million (Anon, 2014). Table 1 shows the labor force in Indonesia for the past twelve years with five year intervals (2003, 2008 and 2013). Interestingly, Gen Y employees were the second largest group of employees in the workplace (29.41%) after Gen X employees (38.17%) in 2008. Meanwhile, the baby boomer employees were entering their retirement period and they only accounted for 24.28%. Gen Y employees continued growing and became the predominant group of employees in the workplace in 2013 (42.30%).

**Table 1:** Indonesian Labor Force Population, 2003, 2008, and 2013 by generations

<b>Generation</b>	<b>2003</b>	<b>2008</b>	<b>2013</b>
Traditionalist (1922-1943)	7,115,654 (7.84%)	0 (0.0%)	0 (0.0%)
Baby Boomers (1943-1960)	31,317,727 (34.50%)	24,901,867 (24.28%)	15,714,930 (14.18%)
Generation X (1961-1980)	37,578,019 (41.39%)	39,140,248 (38.17%)	39,516,276 (35.66%)
Generation Y (1980-2000)	14,773,517 (16.27%)	30,165,483 (29.41%)	46,867,008 (42.30%)
<b>Total</b>	<b>90,784,917</b>	<b>102,552,750</b>	<b>110,804,041</b>

Source: Anon (2014)

Gen Y employees are entering the workplace and bringing along their unique values and expectations to their employers who have not had prior understanding of hiring and managing Gen Y employees (Ng & Gossett, 2009). Furthermore, the needs of Gen Y employees are more diverse than that of earlier generations. Their population is significantly larger than Baby Boomers, and they are identified as more motivated or

ambitious than Generation X. Lastly, they are more knowledgeable on technology than any of their predecessors (Wall, 2004). Dramatic changes of generations in the workplace should properly and accurately be handled by companies and managers in order to survive and retain key employees.

Today’s human resource practitioners face challenging issues. The companies need to

motivate and retain their employees because of globalization, market forces, economic trends, competitive labor market, and additional forces (Cragg, 2007). A study of employee motivation in corporation or companies was conducted with the sole purpose of improving employee productivity to achieve corporate or organization goals. The companies are able to attract and retain Gen Y employees by aligning and adjusting Gen Y employees' personal needs toward companies needs as stated by Eisner (2005).

It is the management duty to give advantages to the stakeholders relating to motivation and retention of employees (O' Malley, 2000). Retention is highly associated with employee turnover in companies; data showed that one of the major factors contributing to high voluntary employee turnover is lack of employee motivation (Abbasi & Hollman, 2000). Employee motivation leading to employee retention and organization performance has to be pursued to highly motivate the workforce through effective and active management approaches (Holt *et al.*, 2003).

A survey conducted by Boston Consulting Group (BCG) - along with the World Federation of Personnel Management Association (WFPMA) - found that managing talent is top ranked among 22 key critical human resource topics globally of their survey (Strack *et al.*, 2012). Talent is quite scarce, expensive, and difficult to retain in emerging economies countries (Dewhurst *et al.*, 2012). This is strengthened by the statistical data from McKinsey that shows about 30-40% senior managers switch company in multinational companies per year, which is equal to five times the global average (Dewhurst *et al.*, 2012).

## **LITERATURE REVIEW**

### **1. Generation Defined**

A generational cohort is defined as a group of individuals who share the same experience both socially and historically in the collective generational framework (Howe & Strauss, 1991). Furthermore, a generation is a cohort of individuals who have been through the same

events, situations, culture which shared a function providing them with communal memory (Eyerman & Turner, 1998). Each particular generation is associated with shared beliefs, values, morals, and perceptions that differ from other generations. Multiple generations have played a role in the current workplace including traditionalists, baby boomers, generation X, and generation Y.

### **2. Generation Y**

Gen Y were born between 1980 and 2000 and now they continue to enter the workplace. They are confident, sociable, civic duty-minded, street smart, optimistic, diverse, high achievers, and have high morale (Zemke *et al.*, 2000). Unsworth (2008) defined the characteristics of this cohort as multitasking, technology-savvy, and fun-seeking. The most popular career choices for them includes computer-related fields, business, education, law, medicine, and psychology (Zemke *et al.*, 2000). Zemke *et al.* (2000) further explained that they are more than happy to work side-by-side with committed coworkers.

### **3. Motivation**

According to Gibson *et al.* (2012: 126): "Motivation is any force acting on an employee that initiates and directs behavior". Human motivation is indicated by an understanding and knowledge of potential and expected outcomes and the knowledge of fundamental relationship among related environmental components (Mayes, 1978). Likewise, research on individual and group motivation at work (Ellemers *et al.*, 2004: 472) concluded that individual needs and goals are the principal sources of motivation of an individual. The concept of motivation is basically a drive that pushes someone to do more in order to gain more or to do more intensely. A fundamental motive in understanding motivation is to contribute a significant impact and excellent performance because of high levels of motivation (Gibson *et al.*, 2012: 127).

### **4. Herzberg's Two-Factor Theory**

Frederick Herzberg developed motivation theories called two-factor theory that was

comprised of job satisfaction (and motivators) and job dissatisfaction (Herzberg, 1987). These two factors are also known as hygiene (dissatisfier) - motivator (satisfiers) and extrinsic (dissatisfier) – intrinsic (satisfier), (Gibson *et al.*, 2012).

Herzberg further defined extrinsic and intrinsic factors. Factors that motivate employees coming from outside are called extrinsic motivation, whereas intrinsic motivation is motivation factors or variables which are coming from inside (Medinilla, 2012). He elaborated that both job satisfaction and job dissatisfaction operate independently (Medinilla, 2012). In other words, a significant increase in any of these two factors does not mean a significant decrease in other factors.

The extrinsic (hygiene –dissatisfier) factors include company policies, supervision, relationship with supervisor(s), relationship(s) with peers, relationship with subordinates, working conditions, salary, personal life, status, and job security. The existence of these factors may not essentially have an impact on the satisfaction of the employees, however, the absence of these factors may result in dissatisfaction (Gibson *et al.*, 2012). Hence, the purpose of hygiene factors is to keep down the level of non-dissatisfaction as much as possible.

The intrinsic (motivator – satisfier) factors are comprised of the work itself, recognition, feeling of achievement, opportunity for growth, opportunity for advancement, and increased responsibility. Unlike extrinsic factors, the lack of the intrinsic factors does not verify exceptionally on dissatisfaction, however, the presence of these factors will lead to good job performance because of a strong and high level of motivation of employees (Gibson *et al.*, 2012).

The strength of Herzberg's theory is most of the variables, both hygiene and motivator factors, are under the control of managers such as working conditions, salary, benefits, policies, recognition, and challenging work or job assignments. Herzberg identified that these factors might benefit the manager to improve job satisfaction and to reduce job dissatisfaction of the employees. Herzberg's theory also has some

weaknesses including limited samples tested and simplification of job satisfaction (Gibson *et al.*, 2012). The nature of Herzberg's study was testing 200 American accountants and engineers. Since the number of the sample was only limited, many questions arose such as the justification for the generalization of the theory to be applied to other occupations across cultures, countries, norms, and values in society.

In addition, due to the limited number of sample, there are other critics that focus on the simplification of job satisfaction. Herzberg theory simply said that by changing the variables of motivator or hygiene factors, managers or companies can change the job satisfaction of the employees. In reality it might not be that simple to change the job satisfaction of the employees. Motivation and job satisfaction study is quite complex and there are many variables that are involved and contribute to job satisfaction and motivation of employees.

## **5. Hypothesis Development**

Based on the discussion above, the first research question of this study is: "which motivator factors are perceived the most important by Gen Y undergraduate students to work as future talent in companies in Indonesia?" Therefore, the first hypothesis is:

H1: There is a relationship of each component of motivator factors to work as future talent in companies in Indonesia as perceived by Gen Y undergraduate students.

The second research question is: "which hygiene factors are perceived the most important by Gen Y undergraduate students to work as future talent in companies in Indonesia?". Thus, the second hypothesis is:

H2: There is a relationship of each component of hygiene factors to work as future talents in companies in Indonesia as perceived by Gen Y undergraduate students.

The third research question is: "which factors are perceived more important between motivator factors and hygiene factors that motivate undergraduate generation Y students to work as future talent in companies in Indonesia?". Hence, the third hypothesis is:

H3: There is difference of perception in Gen Y undergraduate students regarding motivator factors and hygiene factors to work as future talent in companies in Indonesia.

The framework for this research can be seen in figure 1.

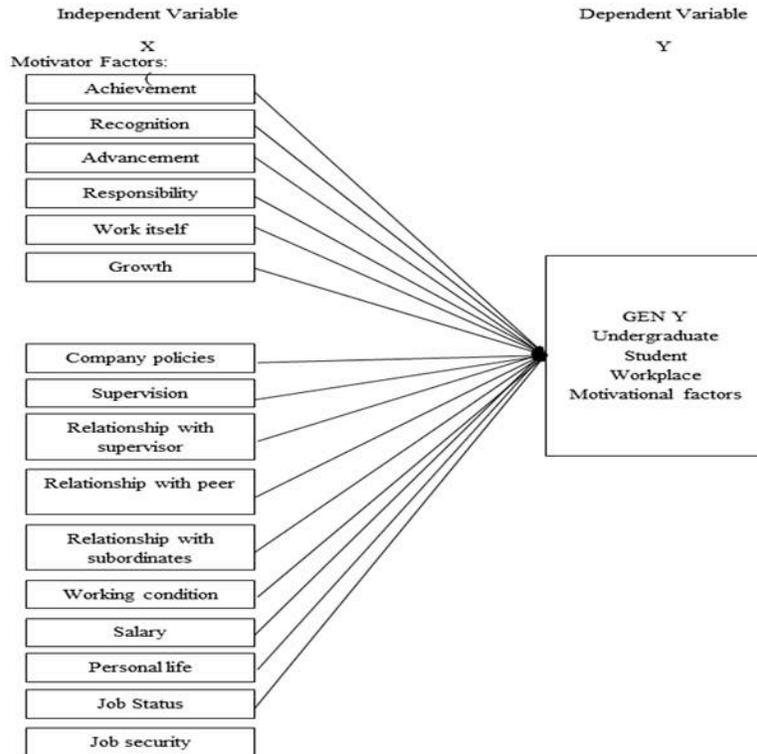


Figure 1. Research Framework

**RESEARCH METHODOLOGY**

The nature of this research is an explanatory study intended to discover and examine which workplace motivational factors that most affect generation Y undergraduate students. Furthermore, this research is intended to discover which variables are perceived more important by generation Y undergraduate students to work in companies in Indonesia.

The unit of analysis of this research is generation Y undergraduate students who are currently studying in the final year (3rd or 4th year) and have prior internship experience or working experience. The reason for choosing students who are in the final year is because they are looking for a job, have internship experience, and have perception and expectation of the work, industry or job that they are going to choose.

The sampling method is non-probability sampling specifically purposive sampling and quota sampling. The reason for choosing purposive sampling is because this sampling method allows the researcher to use judgment to select the samples that are perceived as having the capability to answer the research questions and to meet the objectives of this research (Saunders *et al.*, 2009). Additionally, quota sampling allows the researcher to limit the respondents from each field to reach a certain quota of respondents as a sample that represents the population (Saunders *et al.*, 2009).

The targeted number of respondents was 200. These respondents represented four universities. Prior to the distribution of the questionnaire, there was a pre-test survey to 40 respondents to ensure that the items listed in the questionnaire were a reliable tool. Cronbach’s Alpha and KMO were used to measure reliability and validity

respectively. The parameter was set up in order to ensure all respondents are Gen Y by providing a question on the respondent's age in the questionnaire.

The language used in the questionnaire is Bahasa Indonesia, since Bahasa Indonesia is the official national language of Indonesia where the research was undertaken. Besides that, using Bahasa Indonesia will allow a clear understanding for all respondents in answering all questions listed in the questionnaire, and lastly not every Indonesian undergraduate student has good knowledge of English.

**FINDINGS AND DISCUSSION**

The questionnaires were distributed to 214 Gen Y undergraduate students in four universities in Jakarta: BINUS University International, Pelita Harapan University, BINUS University, and Atma Jaya University. All respondents in this research must have fulfilled the criterion of having internship experience; hence, those who answered "NO" in the filter question of internship experiences were excluded from this research. Additionally, incomplete answers of the questions were excluded from the research. After going through several screenings of samples, it was found that 19 completed questionnaires were excluded and classified as invalid data. Therefore, this research has 195 valid respondents.

The data was then analyzed using three data analysis methods that included Pearson correlation, independent t-test, and one-way ANOVA. The result of Pearson Correlation on motivator and hygiene factors can be seen in tables 2 and 3.

H1: There is a relationship of each component of motivator factors to work as future talent in companies in Indonesia as perceived by Gen Y undergraduate students.

Table 2 presents the rank of Motivator factors perceived the most by Gen Y under graduate students that were tested using Pearson Correlation. The explanations are as follow:

**Work itself** - H0 is accepted because the p-value is 0.000 which is lower than 0.05. Thus, there is relationship between work itself and workplace motivational factors to work in companies in Indonesia as perceived by Gen Y undergraduate students. Moreover, the value of the Pearson correlation is 0.253 (positive). It means the more Gen Y undergraduate students enjoy the work, the more motivated they are.

**Growth** - There is relationship between growth and workplace motivational factors to work in companies in Indonesia as perceived by Gen Y undergraduate students. The p-value from this equation is 0.010 which is lower than 0.05. Subsequently, H0 is rejected. Moreover, the value of Pearson correlation is 0.185 (positive) meaning that the more self-growth the Gen Y undergraduate students feel, the more motivated they are to work.

**Table 2:** The Result of Pearson Correlation on Motivator Factors

Motivator Factors	Perceived the most n = 195		
	Correlation	Sig	Rank
1. Achievement	0.091 or 9.1%	Sig = 0.205 Sig > 0.05	-
2. Recognition	0.179 or 17.9%	Sig = 0.012 Sig < 0.05	3 <sup>rd</sup>
3. Advancement	0.179 or 17.9%	Sig = 0.012 Sig < 0.05	3 <sup>rd</sup>
4. Responsibility	0.090 or 9%	Sig = 0.208 Sig > 0.05	-
5. Work itself	0.253 or 25.3%	Sig = 0.000 Sig < 0.05	1 <sup>st</sup>
6. Growth	0.185 or 18.5%	Sig = 0.010 Sig < 0.05	2 <sup>nd</sup>

**Recognition** - The p-value from this equation is 0.012 which is lower than 0.05. Consequently, H0 is rejected. There is a relationship between recognition and workplace motivational factors to work in companies in Indonesia as perceived by Gen Y undergraduate students. Additionally, the value of Pearson correlation is 0.179 (positive) meaning that the more work recognition the Gen Y undergraduate students have, the more motivated they are to work.

**Advancement** - The p-value inferred from this equation is 0.012 which is lower than 0.05. Consequently, H0 is rejected. There is a relationship between advancement and workplace motivational factors to work as future talent in

companies in Indonesia as perceived by Gen Y undergraduate students. Additionally, the value of Pearson correlation is 0.179 (positive) meaning that the clearer and fairer the career path the companies have, the more motivated they are to work.

H2: There is a relationship of each component of hygiene factors to work as future talent in companies in Indonesia as perceived by Gen Y undergraduate students.

Table 3 presents the rank of hygiene factors perceived the most by Gen Y undergraduate students that were tested using Pearson Correlation.

**Table 3:** The Result of Pearson Correlation on Hygiene Factors

Hygiene Factors	Perceived the most n = 191		
	Correlation	Sig	Rank
1. Company policies	-0.149 or (-)14.9%	Sig = 0.037 Sig < 0.05	3 <sup>rd</sup>
2. Supervision	0.106 or 10.6%	Sig = 0.142 Sig > 0.05	-
3. Relationship with supervisors	0.122 or 12.2%	Sig = 0.089 Sig > 0.05	-
4. Relationship with peers	-0.052 or (-)5.2%	Sig = 0.473 Sig > 0.05	-
5. Relationship with subordinates	0.116 or 11.6%	Sig = 0.160 Sig > 0.05	-
6. Working condition	-0.066 or (-)6.6%	Sig = 0.359 Sig > 0.05	-

**Table 3:** The Result of Pearson Correlation on Hygiene Factors

Hygiene Factors	Perceived the most n = 191		
	Correlation	Sig	Rank
7. Salary	0.270 or 27%	Sig = 0.000 Sig < 0.05	1 <sup>st</sup>
8. Personal life	0.141 or 14.1%	Sig = 0.049 Sig < 0.05	4 <sup>th</sup>
9. Job status	-0.180 or (-)18%	Sig = 0.012 Sig < 0.05	2 <sup>nd</sup>
10. Job security	-0.013 or (-)1.3%	Sig = 0.855 Sig > 0.05	-

**Company policies** - There is a relationship between company policies and workplace motivational factors to work in companies in Indonesia as perceived by Gen Y undergraduate

students. The p-value from this equation is 0.037 which is lower than 0.05. Subsequently, H0 is rejected. Moreover, the value of Pearson correlation is -0.149 (negative) meaning that the

stricter (less flexible) the company policy is, the less motivated Gen Y employees are to work.

**Salary** - The p-value from this equation is 0.000 which is lower than 0.05, hence, H0 is rejected. There is a relationship between salary and workplace motivational factors to work in companies in Indonesia as perceived by Gen Y undergraduate students. The Pearson correlation value is 0.270 (positive) meaning the more salary Gen Y undergraduate students earn, the more motivated they are to work.

**Personal life** - The p-value from this equation is 0.049 which is lower than 0.05, hence, H0 is rejected. There is a relationship between personal life and workplace motivational factors to work in companies in Indonesia as perceived by Gen Y undergraduate students. The Pearson value is 0.141 (positive). It means the more balanced

personal life Gen Y undergraduate students feel, the more motivated they are to work.

**Job Status** - The p-value from this equation is 0.012 which is lower than 0.05, hence, H0 is rejected. There is a relationship between job status and workplace motivational factors to work in companies in Indonesia perceived by Gen Y undergraduate students. The Pearson value is -0.180 (negative). It means the less job status Gen Y undergraduate students have, the more motivated they are to work.

The results of the t-test, and ANOVA can be seen in tables 4, 5 and 6.

H3: There is a difference of perception in Gen Y undergraduate students regarding motivator factors and hygiene factors to work as future talent in companies in Indonesia.

**Table 4:** The Result of Independent Sample T-test

No	Dependent Variable	Independent Variable	P-Value	Result	Interpretation
1	Motivator Factors	University Program	0.045	Reject H0	There is a significant difference between Gen Y undergraduate students who have been studying in an international program and those who have been studying in national programs in perceiving motivator factors to work as future talent in companies in Indonesia.

**Table 4:** The Result of Independent Sample T-test

No	Dependent Variable	Independent Variable	P-Value	Result	Interpretation
2	Hygiene Factors	University Program	0.000	Reject H0	There is a significant difference between Gen Y undergraduate students who have been studying in an international program and those who have been studying in national programs in perceiving hygiene factors to work as future talents in companies in Indonesia.
3	Motivator Factors	CGPA	0.071	Accept H0	There is no significant difference between Gen Y undergraduate students who have CGPA more than three and less than three in perceiving motivator factors to work as future talent in companies in Indonesia.
4	Hygiene Factors	CGPA	0.461	Accept H0	There is no significant difference between Gen Y undergraduate students who have CGPA more than three and less than three in perceiving hygiene factors to work as future talent in companies in Indonesia.

**Table 5:** The Result of Paired Sample T-test

No	Dependent Variable	Independent Variable	P-Value	Result	Interpretation
1	Motivator Factors, Hygiene Factors	International Program	0.001	Reject H0	There is a significant difference among Gen Y undergraduate students who have been studying in an international program in perceiving motivator factors and hygiene factors to work as future talent in companies in Indonesia.
2	Motivator Factors, Hygiene Factors	National Program	0.000	Reject H0	There is a significant difference among Gen Y undergraduate students who have been studying in a national program in perceiving motivator factors and hygiene factors to work as future talent in companies in Indonesia.
3	Motivator Factors, Hygiene Factors	CGPA less than three	0.001	Reject H0	There is a significant difference among Gen Y undergraduate students who have a CGPA of less than three in perceiving motivator factor and hygiene factors to work as future talent in companies in Indonesia.
4	Motivator Factors, Hygiene Factors	CGPA more than three	0.001	Reject H0	There is a significant difference among Gen Y undergraduate students who have a CGPA of more than three in perceiving motivator factors and hygiene factors to work as future talent in companies in Indonesia.

**Table 5:** The Result of Paired Sample T-test

No	Dependent Variable	Independent Variable	P-Value	Result	Interpretation
5	Motivator Factors, Hygiene Factors	Gen Y undergraduate students	0.000	Reject H0	There is a significant difference among Jakarta Gen Y undergraduate students in perceiving motivator factors and hygiene factors to work as future talent in companies in Indonesia.

**Table 6:** The Result of ANOVA

No	Dependent Variable	Independent Variable	P-Value	Result	Interpretation
1	Motivator Factors	Universities	0.078	Accept H0	There are no significant differences among students in BINUS International University, Pelita Harapan University, BINUS University, and Atma Jaya University in perceiving motivator factors to work as future talent in companies in Indonesia.
2	Hygiene Factors	Universities	0.000	Reject H0	There are significant differences between BINUS International University, Pelita Harapan University, BINUS University, and Atmajaya University in perceiving hygiene factors to work as future talent in companies in Indonesia.

3	Motivator Factors	CGPAs	0.000	Reject H0	There are significant differences among Gen Y undergraduate students who have a CGPA of less than 2, 2.00-2.5, 2.51-3.00, 3.01-3.5, or more than 3.51 in perceiving motivator factors to work as future talent in companies in Indonesia.
4	Hygiene Factors	CGPAs	0.187	Accept H0	There are no significant differences among Gen Y undergraduate students who have a CGPA of less than 2, 2.00-2.5, 2.51-3.00, 3.01-3.5, or more than 3.51 in perceiving hygiene factors to work as future talent in companies in Indonesia.

**CONCLUDING REMARKS**

This research aims to explore the work motivational factors perceived by Gen Y undergraduate students to work in companies in Indonesia. The fundamental work motivational theory used in this research is Herzberg’s Two-factor theory (motivator factors and hygiene factors). There are three research questions as

stated previously, and this research utilized a Pearson correlation, independent sample t-test, paired sample t-test, and ANOVA to answer the three research questions. The results are shown below.

1. Which motivator factors are perceived the most important by Gen Y undergraduate students to work in companies in Indonesia?

**Table 7: Summary of Significant Motivator Factors**

Motivator Factors	Perceived the most (n = 195)		
	Correlation	Sig	Rank
1. Work itself	0.253 or 25.3%	Sig = 0.000 Sig < 0.05	1 <sup>st</sup>
2. Growth	0.185 or 18.5%	Sig = 0.010 Sig < 0.05	2 <sup>nd</sup>
3. Recognition	0.179 or 17.9%	Sig = 0.012 Sig < 0.05	3 <sup>rd</sup>
4. Advancement	0.179 or 17.9%	Sig = 0.012 Sig < 0.05	3 <sup>rd</sup>

Table 7 shows the rankings of the significant components of motivator factors that affect work motivation perceived by Gen Y undergraduate students to work in companies in Indonesia. Work itself is perceived as the most important component of motivator factors. The correlation value is 0.253 or 25.3%. Work itself describes the level of liking or dislike toward the job affecting work motivation. The implication is the more

Gen Y employees enjoy their work, the more motivated they feel.

The second most important component of motivator factors is growth (18.5%), followed by recognition and advancement (each share the same value of 17.9%).

2. Which hygiene factors are perceived the most important by Gen Y undergraduate students to work in companies in Indonesia?

**Table 8:** Summary of Significant Hygiene Factors

Hygiene Factors	Perceived the most (n = 195)		
	Correlation	Sig	Rank
1. Salary	0.270 or 27%	Sig = 0.000 Sig < 0.05	1 <sup>st</sup>
2. Job status	-0.180 or (-)18%	Sig = 0.012 Sig < 0.05	2 <sup>nd</sup>
3. Company policies	-0.149 or (-)14.9%	Sig = 0.037 Sig < 0.05	3 <sup>rd</sup>
4. Personal life	0.141 or 14.1%	Sig = 0.049 Sig < 0.05	4 <sup>th</sup>

Table 8 shows that salary is the most important factor perceived by Gen Y undergraduate students with the value of Pearson correlation (0.27) which is the highest among these hygiene factors. The second most important component of hygiene factors is job status (-0.18), followed by company policies (-.149), and lastly personal life (0.141).

3. Which factors are perceived more important between motivator factors and hygiene factors that motivate employees to work in companies in Indonesia as perceived by Gen Y undergraduate students?

The information inferred from table 9, contains the data of the mean for both motivator factors and hygiene factors perceived by Gen Y undergraduate students in Greater Jakarta Area to

work in companies in Indonesia. The mean of motivator factors is 4.59993 whereas the mean of hygiene factors is 4.3564. These means imply that there is a little bit of difference in perception of motivator and hygiene factors by Gen Y undergraduate students. Gen Y undergraduate students in Greater Jakarta Area perceive the motivator factors are more important than the hygiene factors.

For deeper understanding, this research also examined several groups inside the Gen Y undergraduate students that were grouped into students who are studying in international programs, national programs, have a CPGA of less than three and have a CGPA of more than three. The means of motivator and hygiene factors are presented in table 9 below.

**Table 9:** The Means of Motivator Factors and Hygiene Factors

No	Group	Mean of Motivator Factors	Mean of Hygiene Factors
1.	Gen Y undergraduate students who are studying in international programs	4.6624	4.4713
2.	Gen Y undergraduate students who are studying in national programs	4.5191	4.2330
3.	Gen Y undergraduate students who have a CGPA of less than three	4.6304	4.3348
4.	Gen Y undergraduate students who have a CGPA of more than three	4.5602	4.3757
5.	Gen Y undergraduate students in Greater Jakarta Area	4.5933	4.3564

It can be seen from table 9 that the means of motivator factors are higher than that of hygiene factors for the four groups of Gen Y undergraduate students. It means that motivator factors are perceived as more important than hygiene factors by Gen Y undergraduate students.

In conclusion work itself is perceived as the most important motivator factors perceived by Gen Y undergraduate students; salary is perceived as the most important hygiene factor perceived by Gen Y undergraduate students, and motivator factors are perceived more importantly

than hygiene factors by Gen Y undergraduate students.

### **MANAGERIAL IMPLICATIONS**

The population of generation Y is growing and entering today's workplace rapidly, and they come to the workplace bringing their unique characteristics. Therefore, it is imperative for companies to understand the characteristics and behavior of this cohort in order to motivate them properly at work.

Nowadays, many companies continue growing stronger and larger, yet some companies are shutting down their business. The challenges faced by the companies regarding understanding their employee motivation should be a main concern, as the employee is an asset for the sustainability of the company. The company should be able to cope, change, and evolve in facing these challenges by understanding the motivations of Gen Y undergraduate students to work as future talent in companies in Indonesia.

After knowing what component of motivator factors and hygiene factors that are perceived the most by Gen Y undergraduate students, the company can implement strategies to motivate them. Besides that, the company can retain its employees to stay longer as human assets.

Work itself is perceived as the most important component of motivator factors by Gen Y undergraduate students. Managers or companies can implement several strategies to attract and motivate Gen Y to work such as by giving challenging work assignments, interesting work assignments, and most importantly place them in the position they enjoy or feel a passion for. Furthermore, project-based work assignments can be implemented as opposed to individual work assignments. The challenges from the project-based work assignments and interaction with other team members can give the Gen Y undergraduate students a new work atmosphere and experience in the workplace.

Growth is perceived as the second most important component of motivator factor influenced Gen Y undergraduate students to work in companies in Indonesia. A survey conducted by Adecco found out that 68% of recent

graduates identified good opportunities for growth and development as one of their top professional priorities (Goudreau, 2013). The company might offer their Gen Y employees funding for their continued education or allow them to attend industry-related conventions or seminars. Furthermore, the company might provide training for certain skills that might help Gen Y undergraduate student in performing their job assignments better.

Advancement is the third most important component of motivator factors for Gen Y undergraduate students. Providing a clear career path and offering a realistic career advancement are the strategies that a company might implement. The Bank of Indonesia has reshaped their human resources policies regarding advancement. They shorten the advancement period from a four-year to a two-year promotion period for Gen Y employees who perform well.

Recognition is the last component of motivator factors that is perceived the most important by Gen Y undergraduate students. As Gen Y employees crave for interaction and acknowledgment (Gregorio, 2013), it is important to put more effect in recognizing every well performed assignments. Simple practices in the workplace such as acknowledging their effort to other employees or giving them feedback as a sign that the employer is paying attention to their work might be an effective practice to keep them motivated in the workplace. Furthermore, the key to implementing these strategies is to be present and be consistent in recognizing their efforts and work achievements.

Salary is proven as the most important component of hygiene factors perceived by Gen Y undergraduate students. The more salary they earn, the more motivated they are to work in companies in Indonesia. Based on this finding, companies are able to motivate them by offering a competitive salary or wage. Companies might set key performance indicators (KPI) for them based on their job description. Moreover, if they can perform and meet all the criteria listed in their KPI, the company might reward them.

Job status is the second most important component of hygiene factors as workplace

motivation factors perceived by Gen Y undergraduate students. This finding is the result of the mindset of Gen Y undergraduate students during their internship period. As they are only an intern in the companies, they may think they do not want to take more responsibility for work assignments. They do not want to take the risk of under-performing the assignment. The company might first give Gen Y undergraduate students less meaningful job assignments. As they gain more confidence in performing their task and duties, the employer might give them more meaningful jobs.

Company policy is the third most important component of hygiene factors as the workplace motivation factors perceived by Gen Y undergraduate students. Flexible company policies might be further developed and proposed to give special treatment for Gen Y employees such as allowing them to wear comfortable clothing at work and allowing them to finish or solve their job assignment in their own way. International Business Machines (IBM) in Indonesia has developed flexible company policies on benefits for Gen Y employees. IBM recognizes the needs of each Gen Y employee in the company and offers benefit based on their needs.

Personal life is the last component of the hygiene factors that is perceived most important by Gen Y undergraduate students. Gen Y undergraduate students are fully aware that they will spend the majority of their time working in the office, therefore, they demand work-life balance. They believe that work is part of their life, however, they do not live to work (Williams, 2013). Flexible working hours, offering remote work options might be the best practice to be implemented in the workplace.

Once the companies have understood which component of motivator factors and hygiene factors is perceived the most by Gen Y undergraduate students, the next question is which of these factors are perceived more. This research confirms that Gen Y undergraduate students perceive motivator factors more importantly than hygiene factors. Even though the mean difference between motivator factors

and hygiene factor is insignificant, this can provide an insight for companies that might emphasize more on motivator factors compared to the hygiene factors. Furthermore, companies should take into account the motivator factors in developing the company's rules.

## **RECOMMENDATIONS**

This research provides several recommendations for further research regarding Generation Y and work motivational factors. These recommendations are proposed for a better outcome and deeper insight for future research.

This research used a quantitative study to gain the data and insight due to time constraints. On the other hand, using a qualitative study will allow the researcher to gain a deeper understanding and insight that might not have been found or explored before. The combination of qualitative (interview or focus group discussion) and quantitative (survey or questionnaire) methods will provide better outcomes.

Examining more than one sample might discover new insights as well. Future research might explore the perspective of Gen Y undergraduate students, Gen Y employees, and the company's perspectives. Different samples allow the researcher to come up with several perceptions and ideas in bridging the discrepancies among the group of samples.

This research was limited to 195 respondents in four universities in the Greater Jakarta area. A larger number of respondents will lead to a more representative population to observe if the future research still uses a quantitative method. Future research might conduct the study in other big cities or regions in Indonesia. As Indonesia is rich with many cultures, traditions, and local wisdom, these factors might influence how Gen Y perceives work motivational factors.

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**THE INFLUENCE OF PERCEIVED ORGANIZATIONAL SUPPORT,  
JOB SATISFACTION AND ORGANIZATIONAL COMMITMENT TOWARD  
ORGANIZATIONAL CITIZENSHIP BEHAVIORS  
(A Study of Permanent Lecturer at Lambung Mangkurat University, Banjarmasin)**

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**ABSTRACT**

*The study of lectures behaviors in performing their role is very interesting to be done because it has a direct bearing on the success of the higher educational process in producing high quality human resources. This kind of responsibility is quite possible to emerge a behavior that exceeds the job role. Profession as a lecture does not only require knowledge mastery, but also specific skills (such as interpersonal and good communication skills). Lecturers' flexible working hours which are often demanded reinforce the reasons why organizational behaviors which exceed in-role behaviors in the form of organizational citizenship behaviors (OCBs) are likely to emerge. The purpose of this research is intended to obtain the empirical findings of: (1-3) The influence of perceived organizational support on lecturers' job satisfaction, organizational commitment, and organizational citizenship behaviors; (4-5) The influence of job satisfaction on lecturers' organizational commitment and organizational citizenship behaviors; and (6) The influence of organizational commitment on lecturers' organizational citizenship behaviors. The population in this research is all of ULM permanent lecturers. Respondents are taken from 4 academic ranks which represented by Asisten Ahli (Instructor), Lektor (Assistant Professor), Lektor Kepala (Associate Professor), and Guru Besar (Professor). 130 samples were collected by using a proportional-stratified random sampling. Partial Least Square (PLS) method was used to analyze the data. The results showed that POS has significant effect on lecturers' job satisfaction; POS has no significant effect either on lecturers' organizational commitment or organizational citizenship behaviors; job satisfaction has significant effect on lecturers' organizational commitment but has no significant effect on OCBs; and organizational commitment has significant effect on lecturers' OCBs. The implications and further research are discussed.*

**Keywords:** *Perceived Organizational Support, Job Satisfaction, Organizational Commitment, Organizational Citizenship Behaviors.*

**1. INTRODUCTION**

Several studies in the field of higher education states that the existence of a lecturer is one of the factors determining the success rate of students in the process of transformation of science and technology as well as ethical and moral internalization. The existence of a lecturer is expected to encourage students to study in earnest and optimize the capabilities themselves, although it depends on student willingness himself. Therefore, the improvement of services, knowledge, direction

and guidance of lecturers to their students often become public attention.

Some of the educational issues that often arise such as inadequate qualifications and competence of lecturers, a low level of lecturer's welfare, low degree of work ethic and commitment to the profession and a lack of public recognition to profession of lecturers. As revealed by Danim (2002: 18), quite often lecturers receive initial training in inadequate quantities, given the task of carrying out the complex work with little formal assistance, accept low prestige of the

profession, a lot of condemnation and under the auspices of an institution that is less take effect. In the environment of higher education organization, in particular, there are various issues related to some aspects of lecturers' situational characteristics (Herawati, 2003: 22-23). According to Herawati, the teachers often perceive their work as a lecturer does not require specific skills and most of lecturers prefer to meet the need to be accepted by the social environment rather than perform optimally. In addition, the lecturers perceive they have limited authority in performing their duties.

In the context of organizational behavioral sciences, various problems faced by lecturers can be associated with the demanding roles it faces, a lack of resources, as well as the limitations of what is expected to be obtained on the job. These problems become an obstacle to the realization of one of the three important roles a lecturer in the organization, in particular the extra role behavior, better known by the term organizational citizenship behaviors (OCBs).

The discussion about OCBs would not be separated from the concept of organizational support to its employees as one of the factors that influence the formation of such behavior. To foster organizational citizenship behaviors (OCBs) or a good extra role behavior of every member of the higher educational organization (the lecturers), adequate organizational support to each individual lecturer is needed. Perceived Organizational Support implies the extent to which an organization is considered to appreciate the values of employee contributions and cares about their welfare. In addition, to encourage every member of the organization showed good behavior with extra role, the attitudes associated with the work itself (work-related attitudes) should be considered also. Greenberg and Baron (2003) mentioned that the attitudes related to work such as job satisfaction and an employee commitment to the organization that hired him/her.

Kreitner and Kinicki (2003: 274) state that organizational commitment reflects the state in which an individual identifies himself with the organization and bound by its objectives. Employees who are committed to the organization and work in general have a tendency to believe that the work is central to

their lives. They believe that work is a tribute. They are also easily show stand against laziness (Lapierre, 2001). Employees who are committed to their organization or professions feel that the work satisfies their needs. Employees who have a commitment to the organization have a high level of involvement to organizational values and goals. In addition, when members of the organization feel well-treated and receive proper support from organization then he will feel satisfied and a sense of obligation to reciprocate good treatment from the organization will exist. The job satisfaction within themselves and a sense of commitment to the organization will encourage them to work beyond their formal role.

The impact of low perceived organizational support resulting in low satisfaction which in turn cause low degree of lecturer commitment to the organization. Ultimately, in these conditions, organizational citizenship behaviors within each faculty member are much less likely to appear.

Based on the problem formulation, the research questions that arise are:

1. Does perceived organizational support have significant influence on job satisfaction of ULM lecturer?
2. Does perceived organizational support have significant influence on organizational commitment of ULM lecturer?
3. Does job satisfaction have significant influence on organizational commitment of ULM lecturer?
4. Does job satisfaction have significant influence on organizational citizenship behavior of ULM lecturer?
5. Does organizational commitment have significant influence on organizational citizenship behavior of ULM lecturer?
6. Does perceived organizational support have significant influence on organizational citizenship behavior of ULM lecturer?

### **Research Target**

The target of this study was to obtain empirical evidence to explain the relationship between perceived organizational support and organizational citizenship behavior through the creation of job satisfaction and organizational commitment. The existence of empirical

evidence will become the basis to give certain recommendation to the leader of the university and faculty in formulating organizational policies related to organizational support provided to the lecturers so they may increase job satisfaction and organizational commitment and encourage the emergence of positive organizational citizenship behavior among lecturers in favor of efficiency, effectiveness and organizational creativity.

### **Research Urgency**

The urgency of this study can be mentioned as follows: (1) Providing additional empirical evidence regarding the importance of organizational support as a basis for improving lecturers' job satisfaction, organizational commitment and organizational citizenship behaviors; (2) There have been no similar studies ever conducted in ULM with totally the same variables so this research is expected to be feasible.

### **Contributions**

This research is expected to contribute in the development of science and technology, especially in the theoretical aspects for the development of Management, especially in the field of Human Resources management and Organizational Behavior in Indonesia, through the understanding of the importance of the organizational support and its consequences to job satisfaction and organizational commitment to foster positive organizational citizenship behavior among lecturer in higher educational organizations and is expected to be able to explore new approaches with regard to all aspects.

## **2. LITERATURE REVIEW & HYPOTHESES DEVELOPMENT**

This section describes the theories and concept used to develop the research model and hypotheses. The theories used in this study are the social exchange theory and organizational support theory. The concepts used in this study are:

### **Perceived Organizational Support**

Perceived Organizational Support is defined as an employee perceptions regarding the extent to which the organization gives support to employees and the extent of the organization's readiness to provide assistance

when needed (Pack, 2005). According to Eisenberger and Rhoades (2002), POS refers to the perception of organizational support of employee perceptions regarding the extent to which organizations value their contributions and cares about their welfare. If the employees consider they receive high level of organizational support then the employee will unite the membership of the organization into their identities and then develop a relationship and a more positive perception about the organization. With the united of membership in the organization with the identity of the employee, the employee will feel as part of the organization and feel a responsibility to contribute and give their best performance for the organization.

### **Job Satisfaction**

Job satisfaction according to Wexley and Yukl as quoted by As'ad (2003: 104) is "the way an employee feels about his/her job". The meaning of the statement is that job satisfaction is one's feelings toward his work. Weiner (1982) stated that job satisfaction is an attitude towards work-related conditions, facets, or aspects of the job. Vroom as quoted by As'ad (2003: 104) noted that job satisfaction as a reflection of the positive attitude. In a broad sense, Jernigan *et al.* (2002) reported that job satisfaction is defined as one's sense of satisfaction not only with the work but also with the larger organizational context within work exists. Thus, job satisfaction is not only related to satisfaction with work itself but also related to the broader organizational context related to the job.

### **Organizational Commitment**

According Aldag and Reschke (1997), organizational commitment is defined as the strength of an individual's identification with, involvement in, and attachment to the organization. It means that, the organizational commitment is defined as the power of the individual to identify, engage and committed to the organization. The development of research on the construct of organizational commitment gave rise to various views, such as a consensus on organizational commitment in a multidimensional context. For example, Allen and Meyer (1990) introduces the construct of organizational commitment in three dimensions, namely (1) affective

commitment as an emotional attachments to organizations where employees identify themselves to the organization and enjoy the membership of the organization; (2) continuance commitment is related to the costs occurred when leaving the organization, and (3) normative commitment, as a feeling of responsibility to remain in the organization.

#### **Organizational Citizenship Behavior**

Definition of organizational citizenship behavior according to Organ *et al.* (2006: 8) is the employees extra-role behavior in a working group that like to do other tasks beyond their main tasks as contained in the job description, explicit action is not recognized by the formal system of the company, but it can improve the overall efficiency and effectiveness of the organization. In line with the opinion from Organ, Jacqueline *et al.* (2004) defines organizational citizenship behavior as extra-role behavior as the actions of employees to perform additional tasks in a working group that is not officially requested by the company but is the desire of the employee and worked voluntarily as a form of employee assistance to the organization.

According to Podsakoff *et al.* (2000), OCB is a profound individual contribution exceeding the demands of a role in the workplace and has impact on performance assessment. OCB involves some behavior includes behavior of helping others, volunteering for extra duties, and adherence to the rules and procedures in the workplace. From an organizational point of view, OCB is necessary because the behaviors included in the OCB improve resource utilization and reduce the need for more formal control mechanism and does not require a lot of expense (Organ, 1999; Podsakoff and McKenzie, 1996).

Seven (7) types of extra-role behavior or organizational citizenship behavior according to Organ *et al.* (2006: 297), namely: (1) helping behavior, (2) sportsmanship behavior, (3) organizational loyalty behavior, (4) organizational compliance behavior, (5) individual initiative behavior, (6) civic virtue behavior (sincerity), and (7) self-development behavior.

This section briefly describes the hypothesis formulation of this study with the theoretical basis or the general underlying concept which taken from previous empirical

studies to strengthen the hypotheses formulation. Here is the elaboration of the hypotheses formulation in this study.

#### **Perceived Organizational Support and Job Satisfaction**

Perceived organizational support is defined as an employee perceptions regarding the extent to which the organization gives support to employees and the extent of the organization's readiness to provide assistance when needed (Pack, 2005). According to Eisenberger and Rhoades (2002), the perception of organizational support refers to employee perceptions regarding the extent to which organizations assess their contributions and cares about their welfare. In a POS there are elements of fairness, respect, attention to the lives of workers and consider the objectives and values of employees (Eisenberger *et al.*, 1986). Perception of organizational support is likely to increase if organizations implement a good reward system, provide opportunities for advancement and implement positive policies in the workplace. Because job satisfaction is a form of emotional response to a situation that reflects the work, performance assessment, or work experience (Locke, 1976; at Brooke, Jr. *et al.*, 1988), the perception of the organizational support workers will have an effect on job satisfaction.

Several studies have found a positive relationship between POS and job satisfaction e.g. Liu (2004) and Wulani (2004) and a meta-analysis conducted by Riggle *et al.* (2009) which confirmed the findings related to POS with attitudinal outcomes. Similar results were also found in a study conducted by Beheshtifar *et al.* (2012), Kuo *et al.*, (2015) and Kurtesis *et al.* (2015). Based on the above explanation, it is predicted that the lecturers who have a high perception of the support organizations tend to have high job satisfaction. In accordance with these predictions, research hypothesis that can be formulated is:

H<sub>1</sub>: Perceived organizational support significantly influences ULM lecturers' job satisfaction.

#### **Perceived Organizational Support and Organizational Commitment**

Organizational support theory is used to describe the employee's emotional attachment

to the organization. When employees feel that they provided with good support from the organization, the employee felt responsible for replying to their organization. The obligation feeling increases employee commitment to the organization (Eisenberger, 2001). In line with the organizational support theory, commitments identified as the impact of employee perceptions regarding organizational support (Rhoades, 2001). This relationship is proven through research conducted by Rhoades (2001) using a sample of employees from various organizations. This study found that employees who feel that they have the support from the organization have a sense of meaningfulness in their selves. This increases the commitment on the employee. This commitment ultimately encourages employees to help the organization achieve its goals and improve their performance expectations that are noticed and appreciated by the organization.

The organizational support theory also assumes that perceived organizational support produce a feeling of obligation for employees to help the organization achieve its goals, keep remaining to the organization and safeguarding the welfare of the organization. Perceived organizational support has positive outcomes for employees and organizations. Perceived organizational support assumes that employees establish a common belief that an organization concerned with the existence and well-being of employees are personally and appreciate the contributions of the employees in the organization. Thus, employees feel that they must repay to the organization for the benefits given to them by giving profitable contribution to the organization.

Basically, lecturers who consider that organizational support organization is available at any time if required and enforced in a fair and reasonable way likely to have a high perception of organizational support. Various experiences lecturers received and experienced during their devotion to their institution will affect their job satisfaction. The larger the organizational support given to him and the more aspects of work that meets his expectations then lecturers' job satisfaction will be higher. Empirical studies that find positive and significant relationship between perceived organizational support to job satisfaction conducted by LaMastro (2000),

Liu (2004), Wulani (2004), Liu (2009), Ekawati and Andini (2008), Riggle *et al.* (2009), Beheshtifar *et al.* (2012) as well as Kurtessis *et al.* (2015).

Based on the above, it can be predicted that the higher the perceived organizational support, the higher the lecturers' job satisfaction. In accordance with the predictions, research hypothesis that can be formulated is:

H<sub>2</sub>: Perceived organizational support significantly influences ULM lecturers' job satisfaction.

### **Job Satisfaction and Organizational Commitment.**

The relationship between job satisfaction and organizational commitment can occur when members of the organization has a high level of satisfaction within the organization so that they have the attitude, confidence and trust and a positive perception of the organization. Employee's job satisfaction on various aspects of the work leads to the emergence of a strong commitment to the organization that hired him. Someone who feels satisfied in his work showed a positive attitude and behavior towards the organization. Workers who are satisfied demonstrate greater commitment compared with workers who are not satisfied. Workers who are satisfied have greater commitment that can be seen from the sense of ownership to his organization. He identifies himself as part of the organization and increasingly tied to the organization. Even more when there is a match between his values and organizational goals. This of course reinforces the worker loyalty towards the organization. Closer attachment to the organization, bigger a sense of ownership and the more suitability the organization's values with the worker's values is an indication of a person's affective commitment. It means worker's perceived job satisfaction increases his affective commitment.

In addition, someone who satisfied with his work increasingly obliged to serve the organization. Organization has provided services and met the needs of their employees so this raises a person's desire to provide feedback to the organization. Reciprocity may include the implementation of obligations, loyalty, and better performance. Workers who really satisfied demonstrate its commitment to

the organization not only based on his needs (continuance commitment) but also based on obligation (normative commitment) and the desire to achieve the goals of the organization (affective commitment). If the normative and affective commitment increase due to the perceived satisfaction then one no longer think of his needs but more on his devotion to the organization.

Several previous studies concluded job satisfaction as an antecedent to organizational commitment (Moorman *et al.*, 1993; Lok and Crawford, 2001, Lee *et al.*, 2006; Dickinson, 2009; Warsi *et al.*, 2009, Zeinabadi, 2010; Ismail, 2011; Mehradi, 2012; Aslam, 2012; Sambung, 2012; Ngadiman, 2013, and Amos *et al.*, 2015). Based on description above, it can be predicted that the higher lecturer's job satisfaction on various aspects of his work, the higher the lecturer's organizational commitment. In accordance with the predictions, research hypothesis that can be formulated is:

H<sub>3</sub>: Job satisfaction significantly influences ULM lecturers' organizational commitment.

### **Job Satisfaction and Organizational Citizenship Behaviors.**

According to Organ *et al.* (2005), individuals who experience job satisfaction in the organization personally perform better. Robbins (2006) similarly states that a satisfied employee has a greater tendency to speak positively about the organization, helping colleagues, and make their job performance beyond the normal forecast, as well as more obedient to the call of duty.

There is a variety of evidence for a positive relationship between OCB and job satisfaction. William and Anderson (1991) found a positive relationship between extrinsic and intrinsic job satisfaction to each dimension of OCB. Instead, Lee and Allen (2002) found that intrinsic job satisfaction is positively related to OCB-O but not with OCB-I. In the context of higher education in Malaysia, Ahmad (2006) found that 4 (four) work attitude namely organizational commitment, job satisfaction, procedural fairness, and distributive justice has a direct positive influence on academician organizational citizenship behaviors.

Furthermore, a study among nurses in a health care institution (Othman, 2002) found that job satisfaction, organizational commitment and ethical climate had a relationship with OCB. Kuehn and Al Busaidi (2002) in their research drew the conclusion that the most influential variables on OCB compared with other variables used in the study were job satisfaction and normative commitment.

This is supported by research conducted by Jahangir *et al.* (2004) which found that employees with high job satisfaction featuring extra-role behavior (OCB) better. Other research results that support the above description are Bateman and Organ (1983), William and Anderson (1991), Bolon (1997), Konovsky and Organ (1996), Wagner and Rush (2000), Yoon and Suh (2003) Begum (2005), Kim (2006), Virela *et al.* (2006), Vandick *et al.* (2008), Foote and Ping Tang (2008), and Vilela *et al.* (2008).

Research conducted by the citizens of Oman found that there is a consistent positive relationship between job satisfaction and OCBs in Oman community. Other empirical studies that found significant relationship between job satisfaction and OCBs conducted by Moorman *et al.* (1993), Moorman and Lyn (2002), Wulani (2004), Lee *et al.* (2006), Nur and Organ (2006), as well as Zeinabadi (2010). In addition, Mohammed *et al.* (2011), Ngadiman (2013) and Rahman *et al.* (2014) also found a significant relationship between job satisfaction and OCBs lecturers in higher education environments.

Based on the description above, it can be predicted that the higher lecturer's job satisfaction on various aspects of his work, the higher the lecturer's organizational citizenship behavior. In accordance with the above predictions, research hypothesis that can be formulated is:

H<sub>4</sub>: Job satisfaction significantly influences ULM lecturer's organizational citizenship behavior.

### **Organizational Commitment and Organizational Citizenship Behaviors.**

Organization needs to get lecturers' organizational commitment of their lecturers by giving assistance and support to the lecturers in conducting self-actualization and achieving all their goals. The support can be

given by organization such as providing training for lecturers to broaden their skills and solve problems in the workplace, ensuring their work and gave power to the lecturers to plan and inspect the work itself, as well as help lecturers to continue their education and personal development. The supports in helping lecturers' self-actualization contributes in building lecturer's commitment and loyalty to the university which have impact on performance improvement. In this case the lecturers who have a strong commitment towards the organization tend to show positive OCBs among colleagues.

A number of empirical studies which describes the influence of the components of organizational commitment on OCBs, conducted by Meyer and Allen (1991) which found that affective organizational commitment has relationship with OCBs, while continuance commitments has no relationship with OCBs. The research was supported by Morrison (1994) which stated that among the components of organizational commitment (affective, normative and continuant), the most dominant influence is affective commitment. Instead, Kuehn and Al Busaidi (2002) in his study actually drew the conclusion that the most influential variables on OCBs compared with other variables used in the study were the job satisfaction and normative commitment. In general it can be concluded that both affective, normative and continuance commitment obviously have effect on the emergence of OCBs.

Other empirical studies that prove the existence of a significant relationship between organizational commitment with OCBs among other research are Lyn and Moorman (2002), Wulani (2004), Liu (2009), Lee *et al.* (2006), Nur and Organ 2006), Geh (2009), Noor (2009), Tan *et al.* (2009), Zeinabadi (2010), Mohammad *et al.* (2011), Ngadiman (2013), and Rageb *et al.* (2013). Based on the description above, it can be predicted that the higher lecturer's organizational commitment to his institution, the higher lecturer's organizational citizenship behavior. In accordance with the predictions, research hypothesis that can be formulated is:

H<sub>5</sub>: organizational commitment significantly influences ULM lecturer's organizational citizenship behaviors.

### **Perceived Organizational Support and Organizational Citizenship Behavior.**

Perceived organizational support is defined as an employee perceptions regarding the extent to which the organization gives support to employees and the extent of the organization's readiness to provide assistance when needed (Pack, 2005). According to Eisenberger and Rhoades (2002), the perception of organizational support refers to employee perceptions regarding the extent of organization values their contributions and cares about their welfare. If the employee considers high level of organizational support then the employee is willing to unite their membership as a member of the organization into their identities and then develop a relationship and a more positive perception to the organization. The united of employee membership in the organization with the employee identity, make the employee feel as part of the organization and have a responsibility to contribute and deliver their best performance for the organization. This allows the emergence of the relationship between POS and OCBs.

Shore and Wayne (1993) found that POS becomes a predictor of OCBs and positively related to performance and OCBs. Workers who feel supported by the organization, provide reciprocal and lowering the imbalance in the relationship to engage in citizenship behaviors. Miao (2010) and Chiang *et al.* (2012) also found a significant relationship between the POS with the OCBs. Chiaburu *et al.* (2015) state that there is a significant positive relationship between the POS with OCBs where the level of the relationship between these two variables depends on the particular cultural setting.

Based on the study of theoretical and empirical studies as described above, it can be predicted that the higher the perceived organizational support at the higher organizational citizenship behavior professor. In accordance with the predictions, research hypothesis that can be formulated is:

H<sub>6</sub>: Perceived organizational support significantly influences ULM lecturers' organizational citizenship behaviors.

## **3. RESEARCH METHOD**

### **Research Design**

This study is an explanatory (causality) study that aims to find explanations of the relationship between variables using hypothesis testing which results can be used as a basis for generalization (Sekaran, 2003: 126). Primary data was collected using questionnaire survey technique.

### **Population, Sample Size and Sampling Techniques**

The population in this study is all of 1022 ULM lecturers whose status as Civil Servants that spread across 10 faculties with 54 courses within the Lambung Mangkurat University. Sample size in this was 130 lecturers selected through proportional-stratified random sampling.

### **Research Variables Classification**

Based on the pattern of causality in Figure 1, the various latent variables used in this study can be classified as follows: independent variable (exogenous) represented by perceived organizational support; mediating variables (intervening) is represented by job satisfaction and organizational commitment; while the dependent variable (endogenous) represented by organizational citizenship behaviors.

### **Research Instruments**

This study used survey methods with questionnaire instrument to collect data. Statements in the questionnaire were made in a close-ended questionnaire consist of 5 (five) points Likert Scale.

## **4. ANALYSIS & DISCUSSION**

Respondents in this study consisted of Chairman of the Program or Head of Department who was taken as a separate sample to give an assessment to OCBs of ULM lecturers' as his/her subordinate. Lecturers selected as respondents are the source of the data as well as the subject of the study. The Chairman of the Program or Head

of Department is taken as data source also. Chairman of the Program and Head of Department is the direct supervisor of the subjects studied so they formally authorized to provide an assessment to the lecturers who become their subordinates and it is expected that the assessment from immediate supervisor towards the lecturers can be more objective compared to lecturer's self-assessment on their OCBs. The unit of research analysis was done at the individual level.

All of the 130 questionnaire were returned, giving a 100% response rate and all of them were fit for use in our analysis. Table 1 presents a description of this study samples' characteristics. The description of the samples characteristics provides an overview of the faculty of origin, gender, academic qualification, academic rank, and tenure. Based on this description, there is no missing value in the sample.

### **Characteristics of Samples**

The representation of survey respondents based on faculty of origin can be seen in Table 1 which shows that the majority of samples came from FKIP. 73 out of 130 respondent (56.15%) are female, 105 out of 130 respondent (80.77%) have an master (S2) degree, 51 out of 130 respondent (39.23%) hold their academic rank as Assistant Professor (Lektor) and 31 out of 130 respondents (23,84%) have work tenure less than 10 years.

To ensure face validity and content validity referred to the initial questionnaire was reviewed in advance by 5 senior lecturers of Organizational Behavior course and also have been reviewed by the Promoter and co-promoter of the author, followed by a pilot test with 30 participants. Their comments and suggestions were used to improve the final version of the questionnaire.

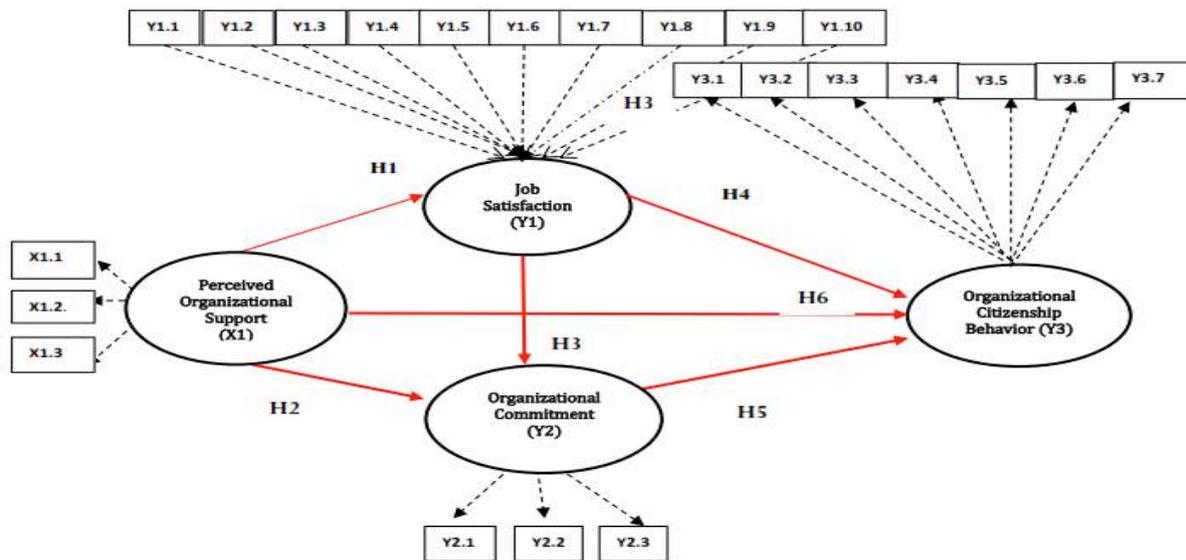


Figure 1. CONCEPTUAL MODEL

**Notes:**

- : Latent Variable
- : Indicator (Manifest Variable)
- ▶ : Dimensional Relationship
- ▶ : Causal Relationship

**X1 : Perceived Organizational Support**  
 X1.1 Fairness  
 X1.2 Supervisory support  
 X1.3 Organizational rewards and job conditions

**Y2 : Organizational Commitment**  
 Y2.1 Affective Commitment  
 Y2.2 Normative Commitment  
 Y2.3 Continuance Commitment

**Y1 : Job Satisfaction**  
 Y1.1 Satisfaction on achievement  
 Y1.2 Satisfaction on recognition  
 Y1.3 Satisfaction on work itself  
 Y1.4 Satisfaction on responsibility  
 Y1.5 Satisfaction on advancement  
 Y1.6 Satisfaction on company policy  
 Y1.7 Satisfaction on administration  
 Y1.8 Satisfaction on supervision  
 Y1.9 Satisfaction on interpersonal relations  
 Y1.10 Satisfaction on working conditions

**Y3 : Organizational Citizenship Behaviors**  
 Y3.1 Helping behavior  
 Y3.2 Sportsmanship behavior  
 Y3.3 Organizational loyalty behavior  
 Y3.4. Organizational compliance behavior  
 Y3.5. Individual initiative behavior  
 Y3.6 Civic virtue behavior  
 Y3.7 Self-development behavior

TABLE 1. CHARACTERISTICS OF SAMPLE

No.	Faculty of origin	Sample Size	Gender		Academic Qualification		Academic Rank				Tenure (years)					
			M	F	S2	S3	AA	L	LK	GB	< 5	< 10	< 15	< 20	< 25	> 25
1.	FKIP	25	13	12	20	5	5	9	11	1	6	3	0	0	9	7
2.	HUKUM	7	5	2	7	0	1	2	4	0	1	2	1	0	2	1
3.	EKONOMI	14	5	9	12	2	2	6	6	0	1	1	3	1	5	2
4.	FISIP	9	5	4	9	0	1	5	3	0	0	3	1	2	2	1
5.	PERTANIAN	14	7	7	6	8	1	4	7	2	0	3	2	0	7	2
6.	KEHUTANAN	9	6	3	3	6	0	3	5	1	0	0	4	3	2	0
7.	PERIKANAN & KELAUTAN	10	4	6	9	1	2	2	6	0	0	1	2	3	3	1
8.	TEKNIK	15	8	7	13	2	6	5	4	0	3	6	2	3	1	0
9.	KEDOKTERAN	15	1	14	15	0	6	6	3	0	0	7	6	2	0	0
10.	MIPA	12	3	9	11	1	4	6	2	0	0	5	6	1	0	0
TOTAL		130	57	73	105	25	26	51	49	4	11	31	27	15	29	16

Source: Data processed (2016)

Notes: M = Male; F= Female, S2= Master degree; S3 = Doctorate degree, AA = Asisten Ahli (Instructor), L= Lektor (Assistant Professor); LK=Lektor Kepala (Associate Professor); GB=Guru Besar (Professor)

Based on the outcome of the PLS measurement model in Table 2, the empirical model tested in this research has fulfilled the criteria of the validity and reliability tests. Job satisfaction measurement is considered as formative construct having ten (10) indicators whereas the other constructs are considered as reflective constructs. The reason of considering job satisfaction as a formative construct based on the understanding that someone's satisfaction to his/her workplace is the sum of the satisfaction he/she might experience towards various aspects of his/her job. In this case, the

indicators of job satisfaction construct drawn from the Herzberg's Motivator-Hygiene theory. PLS provides the facility to test formative construct. The validity test was conducted by examining T as bootstrap results in outer weight outcomes. The formative indicators are considered valid if the T-statistic values > 1.64 (Jogianto, 2011). The validity test for formative construct has been done in accordance with the application of PLS analysis procedure.

TABLE 2. TEST RESULTS OF PLS METHOD OF MEASUREMENT MODEL

	AVE *	Composite Reliability*	R Square	Cronbach's Alpha**	Communality*
X1	0.723942	0.886688		0.807189	0.723942
Y1			0.619347		0.449345
Y2	0.572551	0.800206	0.292613	0.625695	0.572551
Y3	0.648804	0.927869	0.383400	0.909085	0.648805

Source: Data processed (2016)

Note: \* Valid if AVE and or Communality > 0.5

\*\* Reliable if Composite Reliability or Cronbach's Alpha > 0.6

This study examines six main hypotheses. Hypothesis testing using the Partial Least Square method were evaluated through the significance parameter of the t-statistics. Table 3 presents the results of the hypothesis

testing using the Partial Least Square techniques.

TABLE 3. TEST RESULTS OF PLS METHOD OF STRUCTURAL MODEL

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	Standard Error (STERR)	T Statistics (O/STERR)	P-Value	Result
X1 -> Y1	0.78699	0.78801	0.04017	0.04017	19.59293	0.00000	Supported
X1 -> Y2	0.05368	-0.00806	0.15752	0.15752	0.34077	0.73328	Rejected
X1 -> Y3	-0.07158	-0.10627	0.13386	0.13386	0.53475	0.59282	Rejected
Y1 -> Y2	0.49768	0.58641	0.16538	0.16538	3.00940	0.00262	Supported
Y1 -> Y3	0.22841	0.29790	0.15791	0.15791	1.44643	0.14806	Rejected
Y2 -> Y3	0.50872	0.48531	0.08369	0.08369	6.07894	0.00000	Supported

Source: Data processed (2016)

Based on the results of the hypotheses testing, it can be concluded that 3 of 6 hypotheses were statistically significant. The results were able to explain the link among POS, job satisfaction, and organizational commitment as the antecedents of OCBs. This study examined a conceptual model of lecturers OCBs. The finding of this study is considered to be important by providing additional empirical evidence regarding the importance of organizational support as a basis for improving ULM lecturers' job satisfaction, organizational commitment and organizational citizenship behaviors. The following section is intended to discuss the results of this study with detail.

**The analysis of hypothesis 1** which states that POS influences job satisfaction. This hypothesis was statistically supported by the study findings. This finding is consistent with the opinion of Shore (in Rhoades, 2001) which states that job satisfaction is directly influenced by the employees' perception of the organization. Employees who have a positive perception of organizational support feel more satisfying job. POS contribute to overall job satisfaction for POS socioemotional needs of lecturers, raising expectations of performance-reward, and indicate the availability of assistance when needed. The results also support the idea of Baron and Greenberg (1990), which identifies factors that cause job satisfaction that organizational factors, company-specific policies and perceptions about the quality of supervision (perceived quality supervision). These three factors are included in the dimensions of POS in the ULM environment.

The results of this study also consistent with a set of previous research of Chiang *et*

*al.* (2012), Rhoades and Eisenberger (2002), Liu (2004), Wulani (2004), Liu (2009), Ekowati and Andini (2008), Riggle *et al.* (2009), Beheshtifar *et al.* (2012), Kuo *et al.*, (2015) and Kurtesis *et al.* (2015) which found a positive relationship between POS and job satisfaction, which means if the POS increases, job satisfaction increases, and vice versa. POS variable in this study was measured by three indicators, namely fairness, supervisory support, and organizational rewards and working condition. Of the three indicators as a reflection of the POS, the average value of the highest response was on the dimensions of fairness (3.71), followed by supervisory support (3.29) and organizational rewards and working condition (3.21). Higher responses to the dimensions of fairness indicate that ULM lecturer prioritize their application of any element of fairness in the implementation of policy made by the faculty and the university.

**The analysis of hypothesis 2** which states that Perceived Organizational Support influences organizational commitment. This study found that ULM lecturers' Perceived Organizational Support did not positively influence their organizational commitment. It means that hypothesis 2 was not statistically supported. This finding is not consistent with the opinion of Eisenberger *et al.*, 1986 which stated that the Perceived Organizational Support affects the level Organizational Commitment. The results of this study is not consistent with some of the studies that found a significant correlation between the POS with affective commitment as practiced Shore and Tetrick (1991); Shore and Wayne (1993); Wayne *et al.* (1997); and Randall *et al.* (1999) and not consistent with a finding of Wayne *et*

*al.* (1997) which states that there is a positive correlation POS with normative commitment. Supposedly, when organizations make investments and to give recognition to their workers, they boost a strong social exchange relationship (Wayne *et al.*, 1997). Furthermore, the result of this study is not consistent with the findings of Liu (2004) who claimed that the high POS will result in low turnover intentions, the emergence of a desire to avenge the organization with better performance, increased organizational commitment and OCBs. The study is not consistent with the research of Lew (2009) who discovered the role of POS to the sense of responsibility, affective commitment and the low turn-over at private colleges in Malaysia. Furthermore, the results of this study do not support a finding Chiang *et al.* (2012), Eisenberger *et al.* (1990, 2001), Liu (2004), Wulani (2004), Liu (2009), Ekowati and Andini (2008), Riggle *et al.* (2009), Beheshtifar *et al.* (2012) as well as Kurtessis *et al.* (2015).

The inconsistency of this study findings compared to previous empirical research is due to organizational support provided by the university to the lecturers which still considered as minimal. Related to RI Law No.14/2005 on Teachers and Lecturers and PP 37/2009 which states that the lecturer as professional educators and scientists, the university leader should provide maximum support to the implementation of the tasks of lecturers such as transform, develop and disseminate science and technology and the arts through education, research and community service. Besides the institutional support of the profession of lecturers can be administered in the form of procurement and increased employment/academic activities, an additional source of income, increased expertise, proficiency/skill that meet quality standards as a profession, improvement of academic qualifications, as well as increased competence and responsibility for the execution of tasks as a professional lecturer. In addition, the organizational support from university leader should be guarantee for the fulfillment of the rights of lecturers in earning an income above the minimum necessities of life and health insurance; promotions and awards; protection of intellectual property; chance to improve their competences;

academic freedom, academic forum and scientific autonomy, freedom in giving graduation ratings of students and the freedom of joining association of professional organizations. On the other hand, the fulfillment of the various rights of the lecturer claimed responsibility for the lecturer in the form of an obligation to implement Tridharma Perguruan Tinggi; plan, implement and evaluate the teaching and learning process (PBM); promoting and developing academic qualifications; act objectively and not discriminative; upholding the legislation, codes of ethics, religious values and ethics; as well as preserving the unity and integrity of the nation. The result of this study explains that the relationship between POS and organizational commitment should be done through the mechanism of job satisfaction formation. That is, the effect of POS on lecturer organizational commitment can only occur through the role of job satisfaction.

**The analysis of hypothesis 3** which states that job satisfaction influences organizational commitment. This hypothesis was statistically supported by the study findings. This finding is consistent with the study of Moorman *et al.*, 1993; Lok and Crawford, 2001, Lee *et al.*, 2006; Dickinson, 2009; Warsi *et al.* (2009), Zeinabadi, 2010; Ismail, 2011; Mehradi, 2012; Aslam, 2012; Sambung, 2012; Ngadiman, 2013, and Amos *et al.* 2015) which showed that job satisfaction is an antecedent to organizational commitment. The relationship between job satisfaction and organizational commitment can occur when members of the organization has a high level of satisfaction within the organization so that they have the attitude, confidence and trust and a positive perception of the organization who hired him. Their employees' satisfaction on various aspects of the work led to the emergence of a strong commitment to the organization that hired him.

The result of this study is also consistent with the study of Pounder and Reyes (1993) in Mastro (2003) which states that the level of commitment of teachers is directly proportional to the satisfaction they feel at work. Related to this result, a lecturer who was satisfied in his work showed a positive attitude and behavior towards the organization. Satisfied lecturers demonstrate greater commitment compared to dis-satisfied group.

Satisfied lecturers' commitment can be seen from higher sense of belonging to the organization. He identifies himself as part of the organization and increasingly tied to the organization. Even more when there is a match between his values and goals of the organization where he works. This of course reinforces lecturer's loyalty towards the organization. Closer attachment to the organization, higher a sense of belonging and more suitability of the organization's values with the lecturer's values is an indication of increased lecturer's affective commitment. Thus, the perceived job satisfaction increased lecturer's affective commitment.

Additionally, a lecturer who satisfies with his work has more obliged to serve the organization. Organization has been providing services and meeting the needs of lecturers to feel satisfied and happy. This raises a person's desire to provide reciprocal to the organization. Reciprocity may include the implementation of obligations, loyalty, and better performance. If the increase of obligation to serve the organization caused by the satisfaction he felt, meaningful job satisfaction increases lecturer's normative commitment. Lecturers are completely satisfied not only to work to meet their needs. He will show his loyalty, sacrifice, dedication and increasingly obliged to defend the values and goals of the organization as well as trying to perform a better performance. This shows that job satisfaction is directly proportional to the affective and normative commitment. The greater the job satisfaction of the lecturers, the higher the affective and normative commitment will. Satisfied lecturers demonstrate their commitment to the organization not only based solely on their needs (continuance commitment) but also based on obligation (normative commitment) and the desire to achieve the goals of the organization (affective commitment).

**The analysis of hypothesis 4** which states that job satisfaction influences organizational citizenship behaviors. This study found that ULM lecturers' of job satisfaction did not positively influence their organizational citizenship behaviors. It means that hypothesis 5 was not statistically supported. This finding is not consistent with the study of William and Anderson (1991) who found a positive relationship between extrinsic and intrinsic job satisfaction with each dimension of OCBs.

In addition this study also did not support the results Ahmad (2006) which states that the four (4) working attitude that organizational commitment, job satisfaction, procedural fairness, and distributive justice has a direct positive influence on the behavior of academics citizenship. Furthermore, the result of this study is not consistent with Othman (2002) which found that job satisfaction, organizational commitment and ethical climate has a relationship with OCBs.

The results of this study is also not consistent with the findings of Moorman *et al.* (1993), Moorman and Lyn (2002), Wulani (2004), Lee *et al.* (2006), Nur and Organ (2006), Zeinabadi (2010), Muhammad *et al.* (2011), Ngadiman (2013), Rahman *et al.* (2014) and Sambung (2012) that found a significant relationship between job satisfaction and OCBs-O on the faculty in higher education environments. The result of this study explains that there is no direct relationship between job satisfaction and OCB but the relationship may occur through the role of organizational commitment. It is found that high job satisfaction cannot automatically lead to good OCBs but should be done through the creation mechanisms of organizational commitment that led to the emergence of positive OCBs.

**The analysis of hypothesis 5** which states that lecturer's organizational commitment influences their OCBs. This hypothesis was statistically supported by the study findings. This finding is consistent with the study of Meyer, Allen and Smith (1993) states that organizational commitment has a positive correlation with the type of behavior OCBs. Organizational commitment is basically seen as the engagement and loyalty displayed by an employee to his institution. Such loyalty associated with the context of this research implies that a lecturer with high organizational commitment is certainly willing to work beyond their formal burden of tasks. Lecturer with high organizational commitment will raise a behavior that exceeds its in-role (extra-role/OCBs).

The results of this study showed similarities with the findings of other studies that assess the role of organizational commitment component which has dominant influence on OCBs. Research conducted by Meyer and Allen (1991) concluded that the

shape of affective organizational commitment has a very close relationship with OCBs, while continuance commitment it is not related to OCBs. The results of this study also have similarities with the research findings of Morrison (1994) which states that affective commitment has the dominant influence to OCBs. Based on the responses obtained from respondents in this study, it is known that they gave highest response on affective commitment, followed by normative commitment and continuance commitment.

The result of this study is not consistent with the study results of Kuehn and Al Busaidi (2002) which concluded that the most influencing variable on job satisfaction and OCBs is normative commitment. In general, the result of this study provides support to some previous empirical studies that found the existence of a significant relationship between organizational commitment to OCBs such as Moorman and Lyn (2002), Wulani (2004), Liu (2009), Lee *et al.* (2006), Nur and Organ (2006), Geh (2009), Noor (2009), Tan *et al.* (2009), Zeinabadi (2010), Mohammad *et al.* (2011) and Ngadiman (2013).

**The analysis of hypothesis 6 which states** that perceived organizational support influences organizational citizenship behaviors. This study found that ULM lecturers' perceived organizational support did not positively influence their organizational citizenship behaviors. It means that hypothesis 6 was not statistically supported.

This finding is not consistent with the study of Shore and Wayne (1993) which found that the POS becomes a predictor of OCBs and positively related to performance and OCBs. Furthermore, the results of this study is not consistent with Liu (2009), Miao (2010), Chiang *et al.* (2012), Yulianti (2015), and Chiaburu *et al.* (2015) who found a significant relationship between the POS with the OCBs.

The result of this study explains that the relationship between POS and OCBs must be through the mechanism of job satisfaction and organizational commitment creation.

## 5. CONCLUSION

a. The results of this study explain that ULM lecturers' POS contribute significantly in establishing or improving their job satisfaction. Lecturers' high perception on the fairness of support provision and

rewards to high performance given by the organization and comfortable working conditions as well were proved to contribute significantly to their job satisfaction.

- b. ULM lecturers' job satisfaction was proved to significantly influence their organizational commitment. It can be explained that lecturers' satisfaction on various aspects of their work formed their general job satisfaction, which in turn encourages the creation of a high commitment to the organization.
- c. ULM lecturers' organizational commitment was proved to significantly influence their OCBs. The result of this study explains that ULM lecturers' organizational commitment has important and significant contribution in the formation of their OCBs. ULM lecturers' organizational commitment which measured on the basis of indicators of affective, normative and continuance commitment was proved to influence the existence of their OCBs.
- d. These study findings can be used as a source of information for policy makers in ULM Banjarmasin regarding to their efforts in improving ULM lecturers' OCBs through the improvement of ULM lecturers' perceived organizational support (POS), job satisfaction and organizational commitment as well. Based on these findings, such improvement to the existing policies that have been implemented related to the lecturers' interests and rights can be conducted.
- e. The results of this study support the theory of Social Exchange advanced by Peter M. Blau (1918-2002), and a series of theoreticians who move in the realm of the theory of 'social exchange'. Social exchange theory raises autonomy of individuals and their interaction with the social structure. The most important features of social exchange theory lay in its analysis of social relations by cost and reward. Blau concept of the social exchange is limited to the behavior that resulted in discipline or reward, which means that the behavior will stop when the perpetrator assumes that he will not be rewarded again. Blau stated that a tug of war between the fundamental social actors

that caused the social exchange theory. This is reflected through the ULM faculty job satisfaction according to Blau is a consequence of the perception of professors regarding organizational support he felt while working at educational institutions Unlam. Their high perception about the organizational support boosts lecturers' organizational commitment (normative and affective) that is reflected in the positive behavior of OCB lecturers to the institution, colleagues and themselves.

## 6. RECOMMENDATION

Based on the results and conclusions obtained in this study, some suggestions are proposed as follows:

- a. To improve the POS, the organization may implement a fair system of reward and punishment, provide career advancement opportunities equitably and fairly and enact positive policies in the workplace as well.
- b. To increase job satisfaction, the university administrator needs to pay attention to things or indicators that have a score lower as the award given by the leadership, organization and management in employment, policies that exist in employment, promotion at work, as well as clear career path within the work. In addition, for job satisfaction among faculty can be increased, the faculty and the university must find ways to recognize the contributions of faculty through awards on an annual basis and pursue cultural communication more transparent, which in particular can improve consensus among lecturers in various subject to the priority of education, teaching and research. Their understanding of the underlying factors of job satisfaction of the lecturers can direct the administrator to develop more workable initiatives to improve the lecturers' morale and commitment.
- c. To improve organizational commitment can be done by holding a job evaluation to see how willing the faculty in working optimally. Job evaluation can be used to find flaws conducted by lecturers so as to provide guidance and insight to the lecturers can be given in order to maximize their skill, knowledges and

abilities to run their profession better. Furthermore, the college officials should be able to encourage the lecturers to participate actively in the decision making process so that the opinions and will of the lecturers can be transformed into concrete action has gained the recognition of all the academic community.

- d. The effort to improve the OCBs lecturers should be considered two (2) main factors: internal factors and external factors of the lecturers. Internal factors comes from within the faculty of employees such as the lecturer's moral itself, lecturer satisfaction on his job and organization, lecturer's desire and positive attitude toward his work and organizations. While the external factors such as the improvement of the management system, the system of leadership and organizational culture.
- e. Further research is recommended to conduct a review of the variables that inconsistent with previous studies. Further understanding to the theories associated with indicators of perceived organizational support, job satisfaction, organizational commitment and OCBs is needed. In addition, the unit of analysis should also be expanded and not only focused on one university to generalize the results.

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## APPLYING GOOD CORPORATE GOVERNANCE TOWARDS EFFECTIVE CORPORATE SOCIAL RESPONSIBILITY: CASE STUDIES IN INDONESIAN BUSINESS PRACTICES

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### **ABSTRACT**

*This qualitative research purposes to find major constructs to be used in building an effective model of Corporate Social Responsibility (CSR) for Indonesian business practices based on legal regulations in alignment with Good Corporate Governance. CSR is considered as a system consisting of inputs, process, outputs, and feedback mechanism. Applying a purposive sampling technique, this research takes eleven companies as the samples representing the four clusters, i.e. Cluster I - Natural resource-based, state-owned firms, Cluster II - Natural resource-based, non state-owned firms, Cluster III – Non natural resource-based, state-owned firms, dan Cluster IV – Non natural resource-based, non state-owned firms. Primary data is gathered by conducting in-depth interview. Data analysis comprises of individual case study of the eleven companies and cross-case analysis of the four clusters. The findings of this study are included into middle-range theory. The middle-range theory consists of similar constructs that can be applied to all samples within the cluster. The result might bring an implication for further research to prove relationships among the constructs by applying quantitative methods.*

**Keywords:** *Good Corporate Governance, Corporate Social Responsibility*

### **INTRODUCTION**

It is commonly understood that a business consists of profit-motive activities that aim to reach financial profit as the main goal. However, every company in the world cannot avoid its responsibility to society and environment, because it coexists and is a part of the

community. Countries are now conscious to regulate it, as well as Indonesia. Indonesian government has issued some regulations regarding Corporate Social Responsibility (CSR). The main regulation is Law No. 40/2007, Article 74. This law is applied for limited companies in Indonesia. According to this law, all limited companies those conduct business in the field or

in the area in which directly related with natural resources are required to implement social and environmental resources. It is a general rule regarding CSR in Indonesia. In terms of investment, Indonesian government has stated in Law No. 25/2007 that all investors – either local or foreign – who invest for running business in Indonesia have an obligation to implement CSR initiative in their business practices. The legal aspect of CSR in Indonesia is then explained in more detail in Government Regulation No. 47/2012 regarding Social and Environmental Responsibilities of Limited Liability Companies. Article 2 in this regulation mentions that every company, as a legal subject, has responsibilities to society and environment. It shows that the obligation to run CSR is not only for the companies that deal with natural resources, but also for all business sectors.

The formers of the Indonesian Law and Regulation of CSR argue that if CSR is not set in a legislation which includes the issue of sanctions for companies that do not implement CSR, it will lead to difficulties in implementation and create legal uncertainty. It is also difficult to apply CSR if it only depends on the level of morality of company's owners as the moral obligation is difficult to impose its power. Therefore, CSR should be interpreted as a legal instrument and there should be sanctions for company's owners who do not run a CSR with the aim to anticipate or mitigate unscrupulous or unethical business practices. It is appropriate that CSR was imposed as an obligation that must be undertaken by a company. CSR is an implementation of Good Corporate Governance (Suastuti, 2014).

According to Economy Paper written by Hasibuan-Sedyono (2006) for Corporate Social Responsibility in The APEC Region about current status and implications of Indonesia, it is mentioned that recently CSR becomes a popular topic, but the understanding of CSR itself is relatively still poor and fragmentary. CSR is frequently seen as simply philanthropic acts or cause-related marketing or public relations. There is still a contrary perception about shareholders versus stakeholders, that shareholders are more important than stakeholders. It is also commonly

considered that CSR is a cost instead of an investment. However, there is a belief that CSR will become progressively important in five years. According to an article that is published by A+ CSR Indonesia, a social enterprise that is actively involved in CSR issues, the development of discourses and practices on CSR and corporate sustainability are very fast in Asia. Within two consecutive years, in 2011 and 2102, joint research conducted by MIT Sloan Management Review and the Boston Consulting Group found that this region is the area of rapid growth for the sustainability movement. Thus, it is important to carry out some reality assessments in the countries within this region. Especially in Indonesia, the discussions on the development of CSR are quite rampant. Most of them are focused on a specific issue, e.g. regarding the obligation of CSR through regulations. Among the most frequently matters discussed in Indonesia is how the company conducts its CSR, especially their success of conducting it. It brings benefits and spirit, as it leads to a confirmation that opportunities can indeed be realized. However, on the other hand, the dominant discussions have also provided inaccuracies in the facts. The challenges faced, and how the company and its stakeholders conquer the challenges, are not well recognized by the public in Indonesia (A+ CSR Indonesia, 2013).

Therefore, it is important to conduct a study of CSR effectiveness in Indonesian business practices based on the existing legal regulations. CSR is a part of business activities, and company is a rational entity that operates the business. CSR should be regarded as a rational program and conducted systematically in managerial procedures. This study regards CSR as a system that links socially responsible investment and business sustainability into management functions, i.e. planning, organizing, actuating, and controlling. Thus, this study is conducted to answer the following research questions: (1) *What are the major constructs to be used in building a model of Corporate Social Responsibility (CSR) effectiveness for Indonesian business practices?;* (2) *How do the companies conduct their CSR*

*within Indonesian business practices based on Good Corporate Governance?*

## **LITERATURE REVIEW**

CSR formed of shareholder theory, agency theory, and stakeholder theory as the underlying theories. The three theories are interrelated and explained further into a concept of good corporate governance (gcg). To maintain the sustainability of a company, it should maintain harmonious relationships and avoid conflicts of interests among all stakeholders. It necessarily needs a rule as the guidance. Freeman (2001) regards the rule as the principle of governance. It refers to the principle which contains procedures for determining the rule of the game that have been established and agreed upon all parties (stakeholders) in the business practice.

In this study, CSR is regarded as a system. Based on systems approach of general systems theory which is invented by Bertalanffy (1968), an organization is regarded as an open system in a steady state which interacts and is influenced by the environment. The systems approach is an important theory to be applied in viewing some problems in management fields, so that the analysis based on this approach will be useful to find solutions of the problems. As well as an organization, CSR should be regarded as a comprehensive system instead of merely considered as a partial procedure of business activities. Since business is a rational entity, then CSR should be regarded as a rational program and conducted systematically, rather than only a philanthropic program. Thus, the effectiveness of CSR should be considered as a system and evaluated comprehensively through inputs, process, outputs, and feedback mechanism.

Adopting strategy maps asserted by Kaplan and Norton (2004), this research considers that social responsibility is delivered by a company through a process which includes input, value creating process, and output. Input consists of resources needed to operate the business, such as human capital, technology, and culture (Kaplan and Norton, 2004). Value creating process is the stage in which the company manages the input to deliver the output. The process consists of

environmental assessment, stakeholder management, and issues management (Wood, 1991). The output is goal effectiveness of CSR which can be represented by the attributes of Corporate Social Performance (CSP), such as financial soundness, long term investment value, quality of management, innovativeness, quality of products and services, environmental management systems, community relations, employee relations, and the compliance with companies' responsibilities of economic, legal, ethical, and discretionary as asserted by Carroll (1979).

CSR is a part of business activities, rather than only a philanthropic program. Since business is a rational entity, then CSR should be regarded as a rational program and conducted systematically in managerial procedures in accordance with management functions, i.e. planning, organizing, actuating, and controlling. Implementing CSR cannot be separated from management functions. As a rational entity, a company should run all business activities, including CSR, in systematic ways. Management is a process that includes four functions of planning, organizing, actuating, and controlling to achieve the stated goals by empowering humans and other existing resources (Terry, 1972). Planning is the key point of management, it is about setting the goals and determining the directions to achieve the objectives. Organizing is the function of structuring resources and dividing tasks in the efforts of achieving the goals. Actuating is the function of motivating, mobilizing and synergizing the contributions of resources to achieve the goals. Controlling is the function of measuring performance and evaluating in what extent the organization has achieved the stated goals. Thus, the processes of an effective CSR can be categorized into four sections, i.e. planning, organizing, actuating, and controlling.

## **CONCEPTUAL FRAMEWORK AND PROPOSITIONS**

The proposed model regards CSR as a system which consists of inputs, process, outputs, feedback, and contextual conditions. The contextual conditions moderate the relationships between inputs toward process, process towards outputs, and as well the feedback mechanisms between output towards inputs and between outputs towards process. Thus, the contextual conditions are regarded as the moderating

variables. They generate the interaction effects. Inputs are the independent variables which will influence the process. Process is the mediating variable that theoretically affects the relationship between the dependent and independent variables. Process is divided into four sections based on management functions, i.e. planning, organizing, actuating, and controlling. In

feedback mechanisms, outputs of a certain period will also influence the inputs and process of the next period in return. The initial conceptual framework based on deductive approach from literature review is shown in Figure 1;

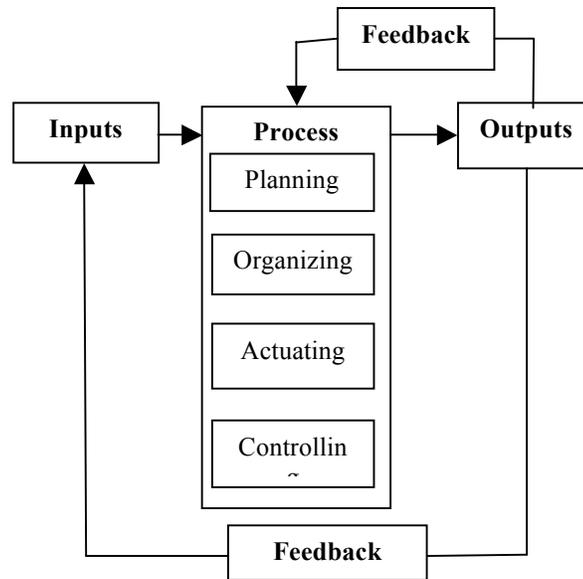


Figure 1 Initial Conceptual Framework based on Deductive Approach

The relationships among inputs, process, and outputs within the CSR effectiveness system can run in the such pattern under moderations of certain situations. The certain situations are represented by the contextual conditions. Thus, contextual conditions of Indonesian business practices are regarded as the moderating variables in this CSR effectiveness model. Based on Indonesian legal regulations, CSR initiative in Indonesian business practices is categorized into four contextual conditions based on business chareacteristics and ownership, i.e. natural-resource-based business, non-natural-resource-based business, state-owned business, and non-state-owned business.

The proposed conceptual framework is further elaborated into five propositions as follow:

*Proposition 1: Inputs will give influence towards process of CSR.*

*Proposition 2: Process will influence the relationship between inputs towards outputs of CSR.*

*Proposition 3: Outputs of a certain period will give influence towards inputs of CSR in the next period as a feedback mechanism.*

*Proposition 4: Outputs of a certain period will give influence towards process of CSR in the next period as a feedback mechanism.*

*Proposition 5: Contextual conditions of Indonesian business practices will moderate the relationships among inputs, process, and outputs of CSR.*

## RESEARCH METHODS AND DATA

This research requires deductive reasoning in the stage of building a model. Deductive reasoning is applied in finding constructs through literature review of previous studies and through content analysis of Indonesian existing legal regulations to understand the social meaning in terms of CSR in the context of Indonesian business practices. The constructs are gathered by conducting case studies within the samples. The gathered constructs are selected to be arranged in

model building. Some steps of multiple case studies are conducted to deliver complete answers for research questions of this study. A set of interview protocol is arranged based on the proposed conceptual framework. In-depth interview is conducted to collect data. The gathered data are then analyzed for building a model.

This study uses a purposive sampling technique. According to contextual matters of the existing regulations regarding CSR in Indonesia, this study takes efforts to build an effective model of CSR to be applied in Indonesia within cross-case studies of different type of business

and different ownership of enterprises. The contextual matters based on existing legal regulations of CSR in Indonesia lead to the reasons of choosing cases for multi-case analysis due to the similarities and differences among the clusters of samples. Thus, the samples taken in this research are Indonesian companies from both natural-resource-based industry and non-natural-resource-based industry and from both state-owned enterprises and non-state-owned enterprises. Based on the determined criteria of sampling, the selected samples of this research are shown in the Table 1;

Table 1 Matrix of Selected Samples

	STATE-OWNED		Indexed		NON-STATE-OWNED		Indexed
<b>NATURAL RESOURCES-BASED</b>	1	PT. Tambang Batubara Bukit Asam (Persero), Tbk.	LQ45 & SRI-KEHATI		1	PT. Bakrie Sumatera Plantations, Tbk	Listed but Non-LQ45 & SRI-KEHATI
	2	PT. Pupuk Kujang (Persero)	Non-listed		2	PT. Kaltim Prima Coal	Non-listed
					3	Pertamina Hulu Energi (PHE) ONWJ	Non-listed
<b>NON-NATURAL RESOURCES-BASED</b>	1	PT. Telekomunikasi Indonesia (Persero), Tbk	LQ45 & SRI-KEHATI		1	PT. Tower Bersama Infrastructure, Tbk.	LQ45
	2	PT. Wijaya Karya (Persero), Tbk.	LQ45 & SRI-KEHATI		2	PT. Bank Danamon Indonesia, Tbk.	SRI-KEHATI
	3	PT. AP II (Persero)	Non-listed		3	PT. Elnusa, Tbk.	Listed but Non-LQ45 & SRI-KEHATI

The eleven selected samples are then categorized into four clusters based on the matrix, i.e. Cluster I - Natural resource-based, state-owned firms, Cluster II - Natural resource-based, non state-owned firms, Cluster III – Non natural resource-based, state-owned firms, dan Cluster IV – Non natural resource-based, non state-owned firms.

**FINDINGS AND DISCUSSION**

To answer Research Questions #1, the findings of this study are categorized into middle-range theory by conducting data analysis which is done through individual case study of the eleven samples and crosss-case analysis of

the four clusters. Middle-range theory is an intermediary lying between minor constructs and general theory which is essential as a systematic effort of developing a unified theory that would explain all observed uniformities within a social system (Merton, 1968). Middle-range theory explains the constructs categorically without any endeavors to build universal laws but it goes beyond the specific contexts of individual cases those are regarded as local theories (Swanson and Chermack, 2013). In this study, the middle-range theory is built by finding the similarities of constructs among the clusters as the results of comparisons between Cluster I and II, Cluster I and III, Cluster II and IV, Cluster III and IV. Below is the summary of middle-range theory;

Table 2 Summary of Middle Range Theory

Constructs	Cluster I	Cluster II	Cluster III	Cluster IV
INPUTS	Compliance with prevailing legal regulations	Compliance with prevailing legal regulations	Compliance with prevailing legal regulations	Compliance with prevailing legal regulations
PLANNING	Social mapping	Social mapping	Social mapping	Social mapping
	Collecting proposals from community	Collecting proposals from community	Collecting proposals from community	Collecting proposals from community
	Work Plan	Work Plan	Work Plan	Work Plan
	Budgeting	Budgeting	Budgeting	Budgeting
ORGANIZING	Establishing a special division to particularly handle CSR	Establishing a special division to particularly handle CSR	Establishing a special division to particularly handle CSR	-
ACTUATING	Community Development (BL)	Community Development	Community Development (BL)	Community Development
CONTROLLING	Monitoring	Monitoring	Monitoring	Monitoring
	Reporting	Reporting	Reporting	Reporting
OUTPUTS	Economical self-reliance of community	Economical self-reliance of community	Economical self-reliance of community	Economical self-reliance of community
FEEDBACK MECHANISM	Evaluation	Evaluation	Evaluation	Evaluation

The results of comparison in Table 2 show the major constructs of CSR effectiveness those are applicable in the four clusters within Indonesian business practices. The major constructs are inputs; process which consists of planning, organizing, actuating, and controlling; outputs; and feedback mechanism. Each construct includes one or more sub-constructs that can be applied in all clusters. The construct of inputs is represented by compliance with prevailing legal regulations. The construct of planning comprises of social mapping, collecting proposal from community, work plan, and budgeting. The different phenomenon is found in organizing function in which not all clusters can apply organizing function through establishing a special division to particularly handle CSR. Cluster IV applies organizing function by regarding CSR as a part of jobs or functions under a relevant division, establishing a

foundation to help handle CSR programs, and running CSR activities through each business line or per project. Thus, it can be seen that organizing function is a specific contextual matter, it depends on the type of business and the ownership of business, so that it can not be generalized, even into a middle-range theory. The construct of actuating function is represented by community development. The construct of controlling function includes activities of monitoring and reporting. The outputs will be reached by CSR is represented by the construct of economical self-reliance of community. Feedback mechanism is conducted through the construct of evaluation.

The Research Question #2 which is stated, “How do the companies conduct their CSR within Indonesian business practices based on Good Corporate Governance?” is answered by proposing an effective model of CSR in alignment with Good Corporate Governance within the Indonesian business practices. The

proposed model regards CSR as a system which consists of inputs, process, outputs, feedback mechanism, and contextual conditions. Inputs are the independent variables which will influence the process. Process is the mediating variable that theoretically affects the relationship between the dependent and independent variables. Process is divided into four sequential steps based on management functions, i.e. planning, organizing, actuating, and controlling. Outputs are the dependent variables which are the expected results of conducting CSR. The contextual conditions moderate the relationships between inputs toward process, process towards outputs, and as well the feedback mechanisms between output towards inputs and between outputs towards process. Thus, the contextual conditions are regarded as the moderating variables. They generate the interaction effects. In feedback mechanisms, outputs of a certain period will also influence the inputs and process of the next period in return.

The relationships among inputs, process, and outputs within the CSR effectiveness system can run in the such pattern under moderations of certain situations. The certain situations are represented by the contextual conditions, i.e. natural-resource-based business, non-natural-resource-based business, state-owned business, and non-state-owned business. The constructs gathered from individual case study are then compared and incorporated among the four clusters based on similarities and differences of type of business and type of ownership. The results of comparison and incorporation of those constructs are formulated to propose the model. Thus, the proposed model is built from Indonesian business contextual conditions, so that it fits to be applied in Indonesian business practices. Type of business, as well as type of ownership, has effects on the relationship between Inputs towards Process. Type of business, as well as type of ownership, has effects on the relationship between Process towards Outputs. Type of business, as well as type of ownership, has effects on the relationship between Outputs towards Process. Type of business, as well as type of ownership, has effects on the relationship between Outputs towards Inputs.

Based on the middle-range theory shown by Table 2, an effective model of CSR for

Indonesian business practices can be proposed as shown by Figure 2;

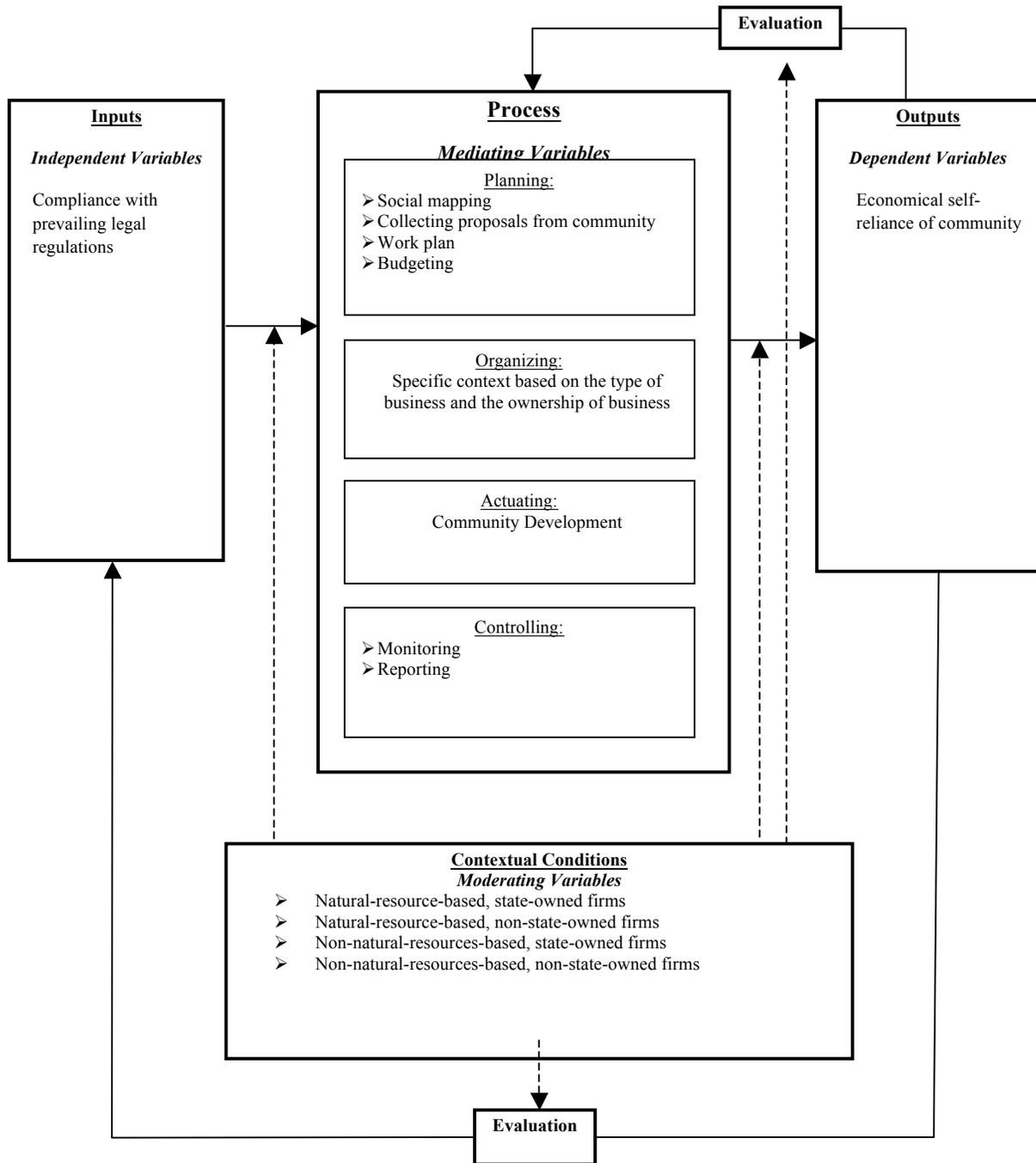


Figure 2 An Effective Model of CSR for Indonesian Business Practices

### CONCLUSIONS AND IMPLICATIONS FOR FURTHER RESEARCH

The constructs that build the proposed model are derived from individual case study and cross-case analysis. The individual case study is conducted on eleven samples which are the companies running business in Indonesia. The cross-case analysis is done by grouping those

eleven companies into four respected clusters. The constructs gathered from individual case study are then compared and incorporated among the four clusters. The results of comparison and incorporation of those constructs are formulated to propose the model. Thus, the proposed model is built from Indonesian business contextual conditions, so that it fits to be applied in Indonesian business practices. Based on the intersections and domains obtained in the middle-range theory and grand theory to answer

the Research Question #1 regarding the constructs, then it can be summarized the relationships among the major constructs, i.e. Inputs, Process, and Outputs, those are moderated by the contextual conditions which comprise of type of business (natural-resources-based or non-natural-resources-based) and type of ownership (state-owned or non-state-owned).

The result of this research might bring implications for further research to prove relationships among the constructs within the proposed model by applying quantitative methods. It is to enhance management science regarding business ethics, good corporate governance, stakeholder theory, sustainable development, and triple bottom line concept. Further research can be done to cover the limitation of this study in terms of limited samples, so that it can conduct more proper comparisons in cross-case analysis. The limitation of sampling matter in this research can be an avenue for future research by expanding the classification of samples, such as the size of organization and the sector of business. One of the limitation of this research is using subjective measurement for CSR performance only from the company's side of view. Further research can also be done to address this matter by applying objective measurements from beneficiaries in quantified data, using some indexes and ratio scales for instance.

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## **INTERACTIVE EFFECT OF INCENTIVE SYSTEM AND LOCUS OF CONTROL ON INDIVIDUAL PERFORMANCE IN A TEAMWORK: A LABORATORY EXPERIMENT**

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### ***ABSTRACT***

*This study investigates the effect of interaction between incentive systems and locus of control (LoC) on individual performance in a teamwork. This paper uses interactional perspective to reconcile opposite lines of arguments between dispositional approach and situational approach regarding determinant of individual performance when working in a team. This perspective states that a particular behavior is more determined by states, i.e. an interaction between situational and personality factors.*

*A laboratory experiment is conducted with one hundred and five accounting postgraduate students divided into teams. After participants' LoC were measured, they were assigned to work groups under one of two types of incentive, i.e. individual and group incentive. Each team member completed a different task in a three-person group. Analysis of covariance (ANCOVA) is used to test the hypothesis. The covariates are age, sex, and grade-point average (GPA).*

*Result suggests that individual performance is the product of person and situation interaction. Separately, incentive system and LoC do not influence team member performance. Consistent with the person-environment fit theory, this research shows a team member will show his/her better performance when there is a match between characteristics of individual and his/her work environment. Individual with internal LoC shows his/her better performance at individual incentive than at group incentive, while external LoC performs better at group incentive than at individual incentive system. This finding contributes in resolving debate between dispositional and situational approach. From managerial point of view, this finding affirms the importance of fit consideration in a workplace, particularly team composition design and its compatibility with the incentive system.*

**Keywords:** *individual performance, incentive system, locus of control, interactional perspective, person-environment fit theory.*

**CORPORATE CULTURES ON THE EFFECTIVENESS OF MANAGEMENT CONTROL SYSTEM FOR STRATEGY IMPLEMENTATION IN NATIONAL NEWS AGENCIES: THE INDONESIAN CASE**

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**ABSTRACT**

*The aim of this research is to analyze the corporate cultures on the management control system for strategy implementation in the national news agencies. Since the tremendous development of digital technology and internet users over the past two decades, news agencies around the globe have strived for their sustainability due to the decrease of their revenues. It even drew UNESCO's attention that in 2001 facilitated an international convention among news agencies discussing that glitch. This circumstances impose the agencies to make adjustment on their business strategies and to manage their organizations more efficiently. The global phenomenon is analyzed based on quantitative and qualitative methods in the case of Indonesia embodied by the Antara News Agency, the only national news agency in the country. Antara's branch offices spreads across 34 provinces and couple of international representatives. The corporate culture in the press organization that is commonly equal and autonomous along with the corporate strategy should induce the effectiveness of management control system. It will be corroborated quantitatively by inquiring low and middle managers to complete questioners. This research reveals that the organization cultures has no effect on the management control system while the corporate strategies turn out the opposite result. The findings can be applied by the management to improve the effectiveness of its management control systems.*

**Keywords:** *Corporate cultures, Efficiency, Management Control Systems, News agency, Strategy*

**INTRODUCTION**

Management control is an important function in the organization, because of the failure of this function can lead to huge financial losses, reputational damage and even destruction of the organization (Merchant & Stede, 2007).

Management Control System (MCS) is defined by Anthony & Govindarajan (2007) as a process for resource managers to ensure the organization obtained and used effectively and efficiently in order to achieve the objective of the organization. Merchant & Stede (2007) focuses on the behavioral aspects in the control of management involves managers to take steps to ensure that employees do the best for the organization.

Furthermore, they stated that the main focus of management control is to answer the question of how the employee's behavior can be influenced as desired.

Various views on the management control system forced the management to choose the best combination of control system (Simmons, 2000). The best option is the control system are considered most effective for organizations, according to (Malina & Selto, 2001) effective management control system is to deliver the organization to achieve its strategic position and which can provide positive motivation to employees. While (Hoque, 2003) argued that effective MCS must be in accordance with the target organization, motivating employees, has a formal and informal control mechanisms and has a target system and the allocation of risk.

This study uses the case study method, defined according to Yin (2003) are: A case study is an empirically inquiry that investigates a contemporary phenomenon within its real-life context, especially when the boundaries between phenomenon and context

are not clearly evident. The definition of these case studies can be interpreted as an empirical analysis that investigates a contemporary phenomenon in a real context occurs, especially when the boundaries between phenomenon and context is not clear.

This study discussed contemporary phenomenon actually experienced by news agencies around the world. UNESCO in 2001 in Amman, Jordan facilitated working session global news agencies, including the National News Agency Antara, discuss issues that threaten the sustainability of the revenue decline in organizations concerned with the development of information technology. The case study method is applied, which is the case in Perum LKBN Antara as the only national news agency in Indonesia as part of the global cases.

Similar problems revealed by Assegauff (2006) that the national news agency is currently in critical condition, in danger of dying as a result of internet use. In order to stay alive he added, news agencies should conduct business transformation, from only as a supplier of news into a provider of information and data for the purposes of decision-making / policy.

The phenomenon of the strengthening of multinational multimedia business and wholesale classic model expressed by Boyd-Barrett (2008) eroding share news agency services, resulting in lower profitability or revenue because of the operational expenditure. Moreover, the reduction of government subsidies make news agencies are not free to respond to external business dynamics.

Based on the description that has been presented, this research will be the theme entitled "The Influence of Organizational Culture and Strategy of the Management Control Systems National News Agency: The Case of Indonesia."

From the description of the background research that has been submitted, some of the problems that arise in the research to be conducted. Specifically, questions were raised by the research formulation of the problem as follows:

- 1) How is the influence of organizational culture on management control system?
- 2) How is the influence of corporate strategy to the management control system?

## **PREVIOUS STUDIES**

Previous studies reveal a phenomenon in the global news agency performed by Ramos (2014) showed the news agency is currently trying to emphasize the core values of the mission in the digital environment. So that the news agency was forced to undergo restructuring management, reorganizing strategies and business models as well as the reduction of employees for efficiency.

In his study (Ramos, 2014) analyzes the importance of corporate culture in the case of the world's major news agencies, namely: Reuters, Agence France Presse (AFP) and Associated Press (AP). (Lemghalef 2010) examined the competitiveness and efficiency of Thomson-Reuters news agency after the merger, empirically proven, the new structure led news agencies to improve profitability by promoting efficiency.

The phenomenon further revealed (Lethovaara, 2011) conducted a study on Finnish news agency, Finnish News Agency (STT) that is facing challenges on its operations in the future, and how change happens and applied. Not only on STT, he also examines some news agencies of Europe, namely: ANP Dutch (Algemeen Nederlands Persbureau), APA Austria (Austria Presse Agentur), DPA Germany (Deutsche Presse Agentur), PA English (The Press Association Limited) and Thomson Reuters. The results show global news agency revenues decreased due to the development of the internet, forcing the agency to optimize the working process.

Research that studies the relationship between MCS and corporate strategy once undertook by Malina and Selto (2001) in the company through the interview survey exploring the effectiveness of the Balance Score Card as a tool of communication strategies and management control. Marginson (2002) also made a similar case study of the nature and extent of the relationship between the MCS and strategies at the lower and middle management.

Relationships between variables in addition to the three variable itself will be addressed in this

study, namely: Cultural Organization (X1), Strategy Organization (X2), Management Control Systems (Y). These variables will be tested in a case study in Perum LKBN Antara, as the only news agency in Indonesia.

According to UNESCO (1951) news agency is a company whose sole purpose, regardless of the form of legal entity, is gathering news and news material, distribute it to a group of companies reporting, complete, not siding with the payment in accordance with the provisions of civil law. A similar sentiment was expressed by Straubhaar & La Rose (2002) that the agency is a news provider that serves as the source of the newspaper contributions. This was confirmed by Boyd-Barrett and Rantanen (2002) is a news agency journalism different information with opinion journalism in newspapers or magazines.

#### Corporate culture

Studies conducted by Ramos (2014) showed the news agency is currently trying to emphasize the core values of the mission in the digital environment. So that the news agency was forced to undergo restructuring management, reorganizing strategies and business models as well as the reduction of employees. In his study that (Ramos, 2014) analyzes the importance of corporate culture in the world's major news agencies, namely: Reuters, Agence France Presse (AFP) and Associated Press (AP).

The corporate culture plays an important role in a period of change news agency. A dynamic corporate culture can be a powerful trigger for innovation and better performance for large companies, especially those organizations that rely on speed and accuracy as news agencies. Organizational culture according to Anthony & Govindarajan (2007) is one of the factors to consider in designing a control system.

(Schein, 2010) defines organization culture as a pattern of basic assumptions shared and absorbed by a group to solve the problems associated with external adaptation and internal integration that has been running well enough to be considered as the truth, therefore taught to new members as the correct way to understand, think and feel these issues. (Robbins, Stephen P. & Coulter, Mary, 2012) also said that the organizational culture as shared values,

principles, traditions and ways of doing things that affect the way members of the organization to act. Moreover (Laudon, Kenneth C. & Laudon, Jane P., 2012) looked at the organizational culture is a unifying force that holds political conflicts and promote mutual understanding, agreement on procedures and common practice. (Hoque, 2003) consider the organizational culture is a key component of the management control system.

In the process of helping to create mutual understanding in the life of the organization, according to (Wagner III, John A. & Hollenbeck, John R., 2005) organizational culture fulfill four basic functions, namely: giving identity to the members of the organization, facilitating collective commitment, and organizational stability memdorong shaping behavior in ways that help members understand their environment.

From the definitions above, the culture of the organization has several dimensions. According to (McShane, Steven L. & Glinow, Mary Ann Von 2010) organizational culture has seven dimensions: Innovation, Stability, Respect for people, Outcome orientation, Attention to detail, Team Orientation, Agressiveness. Meanwhile Robbins & Coulter (2012) also puts forward seven dimensions of organizational culture, consisting of: Attention to Detail, Outcome Orientation, People Orientation, Team Orientation, aggressiveness, Stability, and Innovation and Risk Taking. Dimensions of organizational culture references above two have much in common, so this study will use the following dimensions: Attention to Detail, Innovation, Team Orientation, Outcome Orientation and aggresiveness.

- 1) Attention to Detail (McShane & Glinow, 2010; Robbins & Coulter, 2012). This dimension shows the thoroughness and attention to detail as well as the employees' own accuracy in analyzing.
- 2) Innovation (McShane & Glinow, 2010; Robbins & Coulter, 2012). These dimensions indicate the extent to which employees have the innovative nature and dare to take risks such as looking for opportunities, trying new things and take risks.
- 3) Team Orientation (McShane & Glinow, 2010; Robbins & Coulter, 2012). These dimensions indicate the extent of the work done by the employees organized a team rather than

individuals such as collaboration and oriented to people in the organization.

4) Outcome Orientation (McShane & Glinow, 2010; Robbins & Coulter, 2012). This dimension refers to the action taken, the high expectations of an activity-oriented results of the activities performed.

5) aggressiveness (McShane & Glinow, 2010; Robbins & Coulter, 2012). These dimensions indicate the aggressiveness of the employee to do the job the individual rather than collective and competitive.

#### Corporate strategies

Strategy refers to Atkinson et al (2012) is the setting of choice in the organization about what to do and not least also about what will not be done. (Thompson, 2016) defines the company's strategy is a set of actions taken by managers to beat the competitor companies and profit superior. While the strategy formulation referring to Anthony and Govindarajan (2007) is the process of determining the organization's goals and strategies to achieve those objectives. Wheelan et al. (2015) mentions that the formulation of the strategy is the process of investigation, analysis and decision making that provides criteria to gain a comparative advantage for the company. Strategy in view of Merchant & Van der Stede (2007) describe how the organization should use its resources to achieve its objectives.

Management Control Systems by Anthony & Govindarajan (2007) must comply with the company's strategy. Furthermore, according to the strategy was first prepared through a process of formal and rational, then this strategy dictates the design of management control systems. The relationship between formalization strategy with MCS expressed also by Merchant & Van der Stede (2007) that a spontaneous decision sometimes in direct conflict with the statement formal strategy of the organization, not because MCS her troubled but because the statement strategies formal obsolete and employees decide to take more action good compared to that outlined a formal strategy. Furthermore, they explained formal statement facilitate management strategies to identify alternative management control and to implement them effectively.

Managers must have a sense of what is happening in the environment, in order to

develop interpretations that can be used as a guide in taking action (Choo, 1998). This sensitivity, he said, to help managers anticipate the uncertainty and ambiguity of the strategic issues in order to produce a "clear question and a clear answer" as a condition for decision making. Daft & Weick (1984) divides the three strategic decision making process, i.e. observation, interpretation of environmental changes and responses to such changes. Kim (2001) describes it in Figure 1.

Manager system using formal and personal contacts to observe the environment in order to raise new issues. The next step, managers perceive through interpretative process, and finally the manager acted based on his interpretation. Feedback from actions taken gives the new issue to be observed and interpreted. Horngren et al. (2002) called formal mechanism to collect, organize and communicate information about the activities of the organization as a system of management accounting.

Business unit strategy with regard to how to create and maintain a competitive advantage in their respective industries that have been selected by a company to participate (Anthony & Govindarajan, 2005). It relies on two interrelated aspects include:

- 1) The mission, which is the overall goal of the company
- 2) The competitive advantage, namely how should the business unit to compete.

Dimensions according to strategy formulation (Wheelan, Thomas L. et al, 2015) consists of: Defining the Competitive Advantage, Crafting the Corporate Mission, Objectives and Achievable Specifying Settings Policy Guidelines.

In addition, Merchant & Van der Stede (2007) formal strategic planning process led to the development of a broad organizational strategy, include:

- a) Vision, mission and goals of the organization as a whole as a single entity
- b) An understanding of the organization's current position, its strengths and weaknesses, opportunities and risks.
- c) Agreement on the type of activity or business in an organization that should be (and are not supposed to be) achieved.
- d) The strategy of each major business activity or

organization decided to achieve. In this study, the coverage is expressed by Merchant & Van der Stede (2007) will be used as the dimensions of formalization strategy.

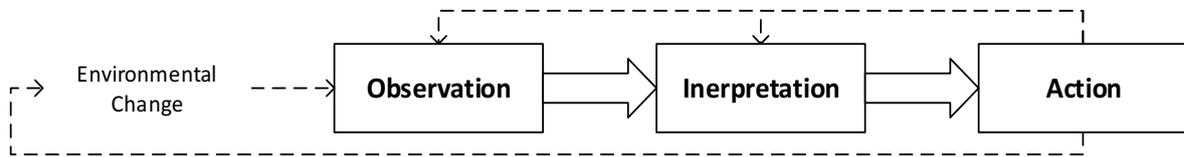


Figure 1. Strategic decision making process (Kim, 2001)

### Management Control System

Management Control System (MCS) is defined by Anthony & Govindarajan (2007) as a process for resource managers to ensure the organization obtained and used effectively and efficiently in order to achieve the objective of the organization. Flamholtz (1983) added as an activity undertaken to influence the behavior of managers and employees in achieving the company's goals.

According to Chapman (1997), only in an environment that is very stable and controllable alone MCS considered irrelevant. Even MCS in view Ahrens and Chapman (2002) were able to provide innovative strategies present in an unstable environment. (Merchant, Kenneth A. & Van der Stede, Wim A., 2007) emphasizes the aspects of behavior in the control of management involves managers to take steps to ensure that employees do the best for the organization.

Furthermore, according to him, the important thing in the MCS is focused on humans are involved because their response is what will determine the success or failure of MCS.

The important role of human importance and behavior in MCS as revealed by Merchant and Van Der Stede above, this study directs the interactive approach control system (interactive control system) in MCS. Interactive control system is a formal system that is used by the top managers of a company to engage him regularly and personally in the decision-making activities of an enterprise subordinate (Simmons, 2000) Simmons (1995), in the development control framework, emphasizing the interactive control

system that is over-represented by the use of force rather than a purely technical system.

A detailed analysis on this case Bisbe et al. (2005) reveals five important indicator for the behavior that shape interactive control system, namely: (1) The use of intensive by senior managers; (2) intensive use by operational managers; (3) the frequency of interaction (dialogue / debate) between the two groups, focusing on strategic uncertainty and (4) the involvement of senior managers that facilitate operational decision making. In its analysis, Bisbe et al. (2005) study is currently more focused on the four dimensions of the first in the interactive control system mentioned above. The fifth dimension requires special attention from the perspective of performance management as organizational capabilities.

Meanwhile, from the standpoint of contingency theory, control system varies according to the specific conditions in which the organization operates (Hoque, 2003). So according to (Otley, 1980) and (Chapman, 1997) there is no universal best design for system management control, but depends on factors that are situational and contextual. (Anthony & Govindarajan, 2007) argues the process of management control in a company dependent or contingent on various external and internal factors. Important factors that influence the design of the control system are: the size of the organization, the environment, technology, interdependence and strategies. Various views on the management control system forced the management to choose the best combination of control system (Simmons, 2000).

The best option is the control system are considered most effective for organizations, according to (Malina & Selto, 2001) includes the following dimensions: First, to achieve a strategic position: (1) Measurement of a comprehensive but easy to understand on important performance variables, linked to a strategy; (2) Measurement of key performance causally linked to the achievement of the organization; (3) Measurement of effective performance. Second, to support positive motivation: (1) Measurement of performance that reflects the controlled action manager; (2) Performance targets are challenging but achievable; (3) Measurement of performance-related remuneration commensurate. According to Anthony & Govindarajan (2007), MCS is the only device manager to implement the company's strategy to be desired.

While (Hoque, 2003) holds MCS must have the following dimensions: (1) Congruence targets, MCS contribute to maintain consistency between the managers have personal targets that are affected by MCS with organizational goals outlined in the strategy; (2) The employee motivation, the desire of employees to achieve certain targets set management; (3) formal and informal control mechanisms, are there any control mechanisms applied in the organization, such as the reward system; (4) Target system and the allocation of risk, whether there is a system of risk allocation of the various divisions in the organization.

Dimensions effectiveness of MCS proposed by Hoque is what will be used in this research think the framework and the following framework:

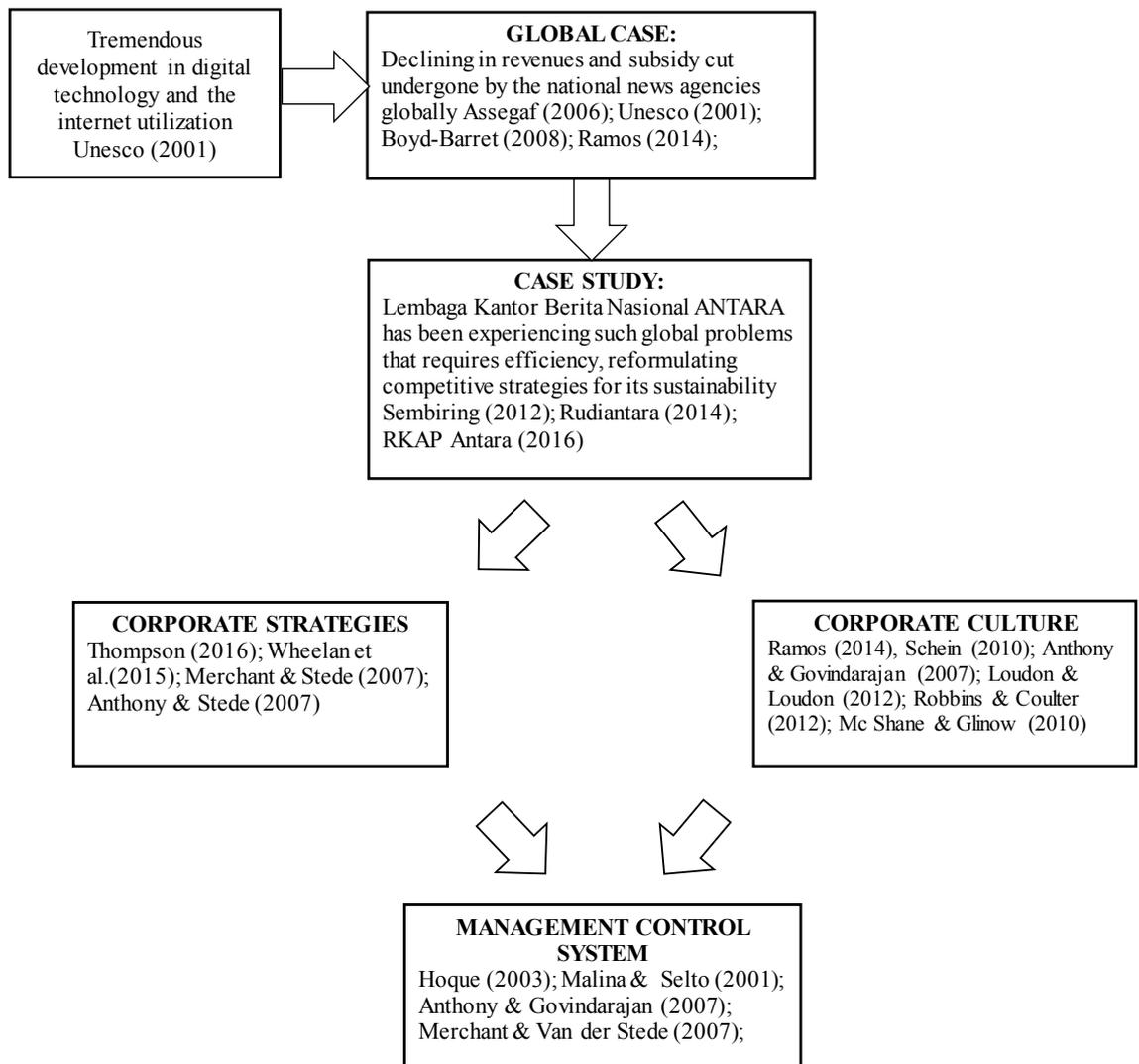


Figure 2. Research Framework

**RESEARCH METHODOLOGY**

The object of this study is Cultural Organization, Corporate Strategy and Management Control Systems. Type of research is applied research (applied research) explorative using quantitative and qualitative methods (mix-method) with a case study on Perum ANTARA, the Indonesian national news agency both at headquarters, overseas offices and regional offices in several provinces.

This study on the relationship between the

MCS and strategies of perspective positivist assuming the reality is more objective than subjective, according Langfield-Smith (2005) conducted with a case study utilizing quantitative and qualitative data.

The case study according to Yin (2003) was conducted to answer the question 'how' and

'why' on a series of recent events. This study examines the global phenomenon that occurs on a news agency linked to the development of digital technology, especially the Internet. These developments resulted in a decrease in earnings, forcing companies to change the strategy and improve efficiency. The global phenomenon is captured in a case study on the only news agency in Indonesia, Antara. This study analyzes the independent and dependent variables. The independent variables in this study is Organizational Culture and Corporate Strategy. While the dependent variable in this study is a Management Control System. In order to clarify the filing of the hypothesis that these variables need to be defined so that these variables can be operationalized. The operationalization defined by Sekaran (2014) as a concept to make it can be measured, is done by looking at the dimensions of behavior, aspect or characteristic shown by the concept.

**FINDING AND DISCUSSIONS**

This research is a case study, the population in this study are employees who hold managerial positions in Perum LKBN Antara both at the center and in the Bureau zone located in 34

provinces. Respondents of managerial level employees in Perum LKBN Antara per September 2016 is as shown in Table 1.

Table 1. Managerial level employees

No.	Managerial Levels	Numbers
1	General Manager	4
2	Manager	14
3	Assistant Manager	18
	Total	36

Table 2. Respondents answer rate

Interval	Categories	
	Number	Percentage
Max. Score	5	100%
Min. Score	1	20%
Levels		
20,00% - 35,99%		Very Poor
36,00% - 51,99%		Poor
52,00% - 67,99%		Fair
68,00% - 83,99%		Good
84,00% - 100%		Excellent

Respondents in this study were employees of Perum LKBN Antara who hold managerial positions in all fields including the local bureau chief. They are Assistant Manager, Manager and General Manager. Selection of managerial level as a respondent, because they have the responsibility to execute the company's strategy to achieve its targets that have been defined through a control system, the management control system.

**Descriptive analysis**

Description responder results can be used to enrich the discussion on each dimension and indicator variables of the study. To facilitate interpretation of the variables being studied, the respondents categorized based on the scores of respondents Sugiyono version (2009)

We found 36 respondents who answered the questionnaire research produces a value for each variable answer research and further referred to the guideline value category answers. Values of respondents in total for each variable refers to Table 2.

Organizational culture as a whole is worth 79.83% belong to the category of 'Good' means having an organizational culture that supports management control system. Meanwhile, Corporate Strategy with a value of 74.65% and management control systems with a value of 73.60% even though the percentage of value under the organizational culture, but both these variables still fit into the category of 'good'. These descriptive result can be seen in Table 3.

Table 3. Respondents' rate

No.	Variables	Rate	Category
1.	Corporate Culture	79,83%	Good
2.	Corporate Strategies	74,65%	Good
3.	Management Control System	73,60%	Good

Nonetheless there are respondents in the company's strategy and management control system that should receive attention from management. For the company's strategy, according to respondents vision and mission of the company has not formulated thoroughly. In addition, the company's goal to be achieved has not been spelled out specifically. Respondent answers for these things belong in the unfavorable category.

As for management control system, respondents believe a lack of compatibility between your personal targets with firm targets outlined in the strategy. In addition they perceive that the measurement of the performance of under-inclusive (comprehensive) and yet effective.

**Statistical analysis**

The entire 30 statement in the questionnaire that represent variables Organizational Culture, Corporate Strategy and Management Control Systems through validity test. Measuring the level of validity by calculating the correlation

between scores item statements with a total score of variables. If the correlation coefficient with the statement item total score  $\geq 0.30$  more items then the statement declared invalid (Barker, 2002).

The test results demonstrate the validity of the index over the validity of each item statement greater than the threshold of 0.30, so that all items are statements of each of the variables assessed valid, worthy of study is used as a measuring tool.

In addition, the researchers also performed to measure reliability Test Reliability measuring instruments used by the coefficient of reliability, Cronbach Alpha values  $> 0.70$ . Reliability test resultsshow that the questionnaire used to measure each variable is declared reliable, because the value of Cronbach Alpha on any of the above variables 0.70.

**Multiple Regression Analysis**

Before performing multiple regression analysis, researchers conducted a test for

normality, multicollinearity and heteroscedasticity test. The results of the tests conducted are eligible to do multiple regression analysis.

### Results of hypothesis testing

#### *The influence of organizational culture on management control systems*

H0: Cultural Organization (X1) has no effect Management Control Systems (Y) → (b1 = 0)

H1: Cultural Organization (X1) has effect to Management Control Systems (Y) → (b1 ≠ 0)

#### *Influence the company's strategy on management control systems*

H0: Corporate Strategy (X1) has no effect to Management Control Systems (Y) → (b1 = 0)

H1: Corporate Strategy (X1) has effect to Management Control Systems (Y) → (b1 ≠ 0)

The criteria of the hypothesis testing is as follows:

- If t-result > t-table, means Ho is rejected while H<sub>1</sub> is accepted.
- If t-result < t-table, means Ho is accepted while H<sub>1</sub> is rejected.

Another way is to compare the research significance values (sig) to the significance rate of 0,05 with criteria as follows:

- If research sig. < 0,05 means Ho is rejected while H<sub>1</sub> is accepted.
- If research sig. > 0,05 means Ho is accepted while H<sub>1</sub> is rejected.

Based on the test, the t-result X1 is 1,112 < t-table at 2,034. Another way by comparing the research significance values 0,274 > 0,05 that concludes Ho is accepted while H<sub>1</sub> is rejected. It indicates that organization culture has no effect on the management control system at Perum LKBN Antara.

For the t-result X2 is 4,160 > t-table at 2,034. Another way by comparing the research significance values 0,000 < 0,05 that concludes Ho is rejected while H<sub>1</sub> is accepted. It indicates that corporate strategies has significant effect on

the management control system at Perum LKBN Antara.

#### *The effect of organization culture to the management control system*

From the survey, the overall Organizational Culture and Management Control Systems in Perum LKBN Antara classified as 'Good'. Although there are indicators of organizational culture which showed 'Fair', namely flexibility to innovate because of the rules of the company. This problem relates to the status of Antara as a state company can not escape from the rule of SOEs since the Government Regulation No. 40 was published in 2007. After 70 years of the organization's culture must be adjusted in line with its status as a government enterprise.

Partially from hypothesis testing, organizational culture does not influence the management control system in Perum LKBN Antara. This is contrary to Anthony & Govindarajan (2007), which explains that the management control system is affected by the strategy, organizational structure, culture and human resource management. However, research conducted by (Savitri, 2011) and (Poerwati, 2002) found that organizational culture does not play a role in determining the means of control and feedback system mechanism. Innovation, team orientation and the orientation of the company's results in the organization's culture is strong enough. But the strength of the dimensions of organizational culture can not be actualized to establish control systems that qualified as no impact on the dependent variable.

These results indicate that management control systems in Perum LKBN Antara has not adapted the development of organizational culture within the company. Whereas (Hoque, 2003) consider the organizational culture is a key component of the management control system.

Hence the management needs to be more sensitive to changes in the organization as revealed by Hoque (2003) control system varies according to the specific conditions in which the organization operates. So according to (Otley, 1980) and (Chapman, 1997) there is no universal best design for system management control, but depends on factors that are situational and contextual.

*The effect of corporate strategies to the management control system*

Referring to the results of a descriptive survey, the overall Corporate Strategy and Management Control Systems in Perum LKBN Antara classified as 'Good'. Although the dimensions of the Vision, Mission and Objectives of companies shows the results of 'Fair'. The poll proves that the manager level and considers the vision, mission and objectives of the company has not yet thoroughly and specifically spelled out. This problem can not be separated from Antara status as a state-owned company since the Government Regulation No. 40 published in 2007. The new organization has not yet been in a decade, plus the national news agency conditions globally depressed, have difficulty in determining the position, direction and purpose.

Partially from hypothesis testing, corporate strategy and significant positive effect on the management control systems in Perum LKBN Antara. This is according to Anthony & Govindarajan (2007), which explains that the management control system must be in accordance with the company's strategy, besides influenced also by the organizational structure, culture and human resource management. With a positive and significant influence, the strong corporate strategy will strengthen the company's management control systems as well. In turn, the manager was very helpful in the decision-making process.

As for management control system, respondents believe a lack of compatibility between personal targets with the target company are described in the company's strategy. In addition they perceive that the measurement of the performance of under-inclusive (comprehensive) and yet effective.

Of respondents average of 65.56% which indicates that the target company congruence in Perum LKBN Antara categorized as 'Fair'. This is due to the employees found no compatibility between personal targets to company goals outlined in the strategy. This is also linked to the

purpose, vision and mission of the company in the corporate strategy that is less clear. In addition, employees assume the measurement of performance has not been thorough and effective. This condition will delay in the achievement of overall corporate objectives.

These results demonstrate the importance of the corporate strategy in determining control management system according to Anthony & Govindarajan (2007) that the MCS is the only device for managers to implement the company's strategy as desired.

## CONCLUSION

Based on research that has been done in Perum LKBN Antara, researchers concluded that:

- a) There is no effect of the organizational culture to the management control system. Cultural organizations are not the factors that make up the company's management control system. Although the descriptive analysis showed its organizational culture quite well.
- b) Corporate strategies has positive and significant impact on the company Management control systems. The better the company's strategy, the better the management control system.

The researchers also propose some suggestions for Perum LKBN Antara as follows:

- a) Evaluate and redesign the management control system that takes into account the organizational culture so that the system's effectiveness can be increased.
- b) Describe the vision, mission and objectives of the company as a whole and specific, so that employees do not lose their orientation in working to achieve corporate goals.
- c) Harmonizing personal targets with the company's target set out in the strategy in order to reach the company's target congruence.

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## **THE EFFECTS OF INTERNAL CORPORATE GOVERNANCE ON PERFORMANCE OF FEDERAL STATUTORY BODIES IN MALAYSIA**

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### ***ABSTRACT***

*Malaysia is undergoing a dramatic transformation to become a high-income developed nation by year 2020. In order to realise this Vision 2020, the government has launched Government Transformation Programme (GTP) which aims to accelerate the performance of public sector agencies through the embodiment of the highest standard of ethical conduct and good governance. Since good governance will results in good performance, GTP has made governance in public sector more important than ever. In spite of this assurance by the government, Malaysia continues to experience challenges including: corruption perception; inefficiency; unfair action and delay in service provision which seem to indicate a lack of internal control. Hence, this research examines the effects of internal corporate governance (CG) on the performance of Malaysian Federal Statutory Bodies (FSB), bodies incorporated by their own incorporation acts and adopt a corporate style management. Content analysis was conducted on 41 samples out of 127 Federal Statutory Bodies (FSB). The results demonstrate that the Board Independence (BIN) Board Diversity (BDV) and Corporate Governance Disclosure (CGD) have significant relationship with performance of Federal Statutory Bodies.*

**Keywords:** *Corporate Governance (CG), Effects of ICG on Performance, Federal Statutory Bodies, Malaysia*

**THE INFLUENCE OF INTERNATIONAL FINANCIAL REPORTING  
STANDARD (IFRS)  
ADOPTION ON EARNINGS MANAGEMENT  
(EMPIRICAL STUDIES ON FOOD AND BEVERAGES COMPANIES  
LISTED IN INDONESIA STOCK EXCHANGE 2010-2013)**

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***ABSTRACT***

*The purpose of the research is to give empirical evidence of the effect of the IFRS adaptation on earning management. The research objects are the food and beverage companies listed in Indonesia Stock Exchange in 2010-2013. The main variables are IFRS and earnings management and other control variables i.e. size, financial leverage, market to book ratios, and equity. The data use multiple regression analysis and different t-test Paired Two Samples analysis. The results are that four controls variables, size and institutional investors have a positive influence on the earnings management. Financial leverage and market to book value indicate negative influence for earnings management. Partially, the IFRS adoption gives negative effects and insignificant for earnings management but simultaneously the IFRS adoption and control variable i.e. size, financial leverage, market-to-book ratios, and equity holdings by institutional investors influence positively and significantly for earnings managements. The result analysis t-test paired two samples test shows no significant differences between the level of earnings management level before and after the IFRS adoption. Based on this research, partially, IFRS adoption has no impact on earnings management.*

***Keywords:*** *IFRS, earnings management, size, financial leverage, market-to-book ratios, and equity.*

## **FRAUDULENT FINANCIAL REPORTING: AN ANALYSIS OF PROSECUTION REPORTS ON MALAYSIAN PUBLIC LISTED COMPANIES**

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### ***ABSTRACT***

*The occurrence of fraudulent financial reporting has become a more crucial discussion as it impacts does not fall into the organization alone but the society as well. Periodic high profile cases of fraudulent financial reporting raise concern about the credibility of the Malaysian financial reporting process and eroded public confidence in capital markets. This study aims to examine cases of fraudulent financial reporting, which falls under Criminal Prosecution by the Securities Commission (SC) Malaysia. The sample is selected from 1997 until 2015 for reasons submitting false information to the Bursa Malaysia. It investigates the methods used in cooking the reports (how), the personal traits and abilities that play a major role on the occurrence (who). This study undertakes a close examination of the published enforcement actions as it is the optimal way to reach a more comprehensive and detailed understanding of the occurrence of fraudulent financial reporting. This study also collects data which provide evidence for the sentence given to the cases. The practical reason for the findings can be used to guide future efforts to combat the problem of fraudulent financial reporting and to provide a better understanding of fraudulent financial reporting cases.*

**Keywords:** *Capability, Methods, Fraudulent Financial Reporting*

## **FINANCIAL MISREPORTING: CLOSING THE GAP FROM BOARDS' PERSPECTIVES**

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### ***ABSTRACT***

*This study investigates the relationship between board attributes and real earnings management among Malaysian listed companies. Malaysian corporate landscape offers an interesting platform for a study on relationship-based capitalism. The sample of this study comprise of 651 Malaysian listed firms from the period of 2010 – 2014. This study offers a contemporary analysis of the relationship between board of directors' quality (composition and diversity) on real earnings management. The findings of the study shows that boardroom with women on board, foreign directors and having directors with international experience are more inclined to engaged in real earnings management. In the wake of recent corporate failures and corporate governance reforms, this study should provide a greater contribution in understanding the relationship between board of directors' attributes and financial reporting quality from the perspective of a multi-racial developing country.*

**Keywords:** *Financial Misreporting, Corporate Governance, Real Earnings Management, Board of Directors, Earnings Quality*

# WHAT HAPPENS AFTER THEY LAUGHS : HOW HUMOROUS ADVERTISEMENT WITH NEED FOR HUMOR AS A MODERATING ROLE EFFECT ON CONSUMER ATTITUDES, WORD OF MOUTH INTENTION, AND PURCHASE INTENTION

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## ABSTRACT

*Even though that more than a fourth of worldwide advertisement has used humor appeal as its advertising strategy, there is also a risk of using humor in advertising. Humor can blur the message and harm the brand. This research aims to narrow this gap by investigating the effect of humorous advertisement with the need for humor as a moderating role in consumer attitudes, consumer intent to purchase, and word of mouth intention. The research was designed to focus on the consumer who classified as young adults (18 to 34 years old) and was not classified as the user of the advertised mobile SIM card brands that they perceived as the funny ones. The researcher conducted a survey with 5-point Likert scale, questionnaire, and purposive sampling as the primary data collection method. The result shows that although the humorous advertisement has significant impact on attitude towards advertisement and word of mouth intention, the humorous advertisement has not significant impact on brand attitude and consumer intent to purchase. Need for humor failed to moderate the relationship between humorous advertisement and attitude toward advertisement in this study. In addition, the researcher concludes that the impact of humorous advertisement was limited only to entertain consumers so encourage their word of mouth intention, not purchase intention.*

**Keywords** : *Attitude toward Advertisement, Attitude toward Brand, Need for Humor, Word of Mouth Intention, Purchase Intention*

## INTRODUCTION

Advertisement is considered to be the most persuasive tools in marketing history. Designing an effective advertisement is not an easy job. A good advertisement should be able to attract attention and bring a good

sense to targeted buyers at the same time. One type of advertisement appeals that's commonly used by advertisers is humor. According to Madden and Weinberger (1984), Weinberger *et al.* (1995), Cafanescu and Tom (2001), Clow and

Baack (2002), Olsson and Larsson (2005), Beard (2005), Wang *et al.* (2014), Lee (2014), Chang and Chang (2014), Ventakesh and Senthilkumar (2015), the use of humor in advertising is about 10-30% of the ads population. Humor had been widely used in commercials because it is an effective tool to attract the consumer attention, enhances likeability of ad and brand, creating emotional bonds with consumer, increasing brand awareness and popularity, enhances comprehension, leads brand recall, and gaining more purchase. Phelps *et al.* (2004), Porter and Golan (2006), Moldovan and Lehman (2009) also added that the more creative (engaging, entertaining, and enjoying) advertising perceived by the consumer, the higher the advertising will be discussed (word of mouth) and going viral.

Even though that more than a fourth of worldwide commercials advertisement has used humor appeal, there is also a risk of using humor in advertising. Humor can blur the message and harm the brand (Beard, 2006:154 and Mehra, 2009:31). People who watch humor advertisement are too focused with the humor so they take little notice of anything else (humor can distract people to targeted message or even the brand). More than that, the use of humor in the advertisement can be ineffective when the product that advertised rally on trust or

technology (Dong-Hun, 2009). Therefore, humor advertisement should be limited in low involvement and low risk product type (Spotts *et al.*, 1997; Djambaska *et al.*, 2016).

While previous research has only been focused on how the effectiveness of humor advertisement in terms of its impact on source credibility, comprehension, persuasion, attention, retention, awareness, recall, brand attitude, ad attitude, and purchase intention. This study proposed to investigate the effect of humor advertisement with the need for humor as a moderating role in consumer attitudes and its impact on consumer intent to purchase and word of mouth intention. The researcher chooses the mobile SIM card (Axis, XL, and As) advertisement as the object of this research due to the reason that the industry has spent over 4 trillion rupiah's on advertising and the consistency of the brand using humor appeal in their advertising campaign.

According to Spotts *et al.* (1997), Dong-Hun (2009), Djambaska *et al.* (2016), the high involvement and high risk product like financial, telecommunications, and electronics should not be allowed to use humor appeal as its advertising strategy. Therefore, the fact that there is a great number of humor advertisements that is arranged by telecommunication companies

need to be researched. This research will cover this gap.

## **LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT**

### **Humor Advertisement**

Marketers often use humor in their advertising strategy. The use of humor appeal in advertising will work more effective in promoting low involvement and low risk product categories (feeling oriented sense) when the humor can enhances the selling message in a meaningful way (Spotts *et al.*, 1997; Schiffman *et al.*, 2007:291; Cline and Kellaris, 2007; Hawkins and Mothersbaugh, 2013:403; Djambaska *et al.*, 2016). Humor need to be relevant with the product/brand so the consumer can relate the marketed message easily. The relevance between humor and message type can be classified in two categories, humor dominant and message dominant. In humor dominant advertisement, the use of humor is superordinate than the message. Meanwhile, in the dominant message advertisement, the use of humor is subordinate than the message. Spotts *et al.* (1997) suggested that advertisers of low involvement and low risk products should reconsider their decision to use humor dominance in their advertisement. For high involvement-high risk products, the humor advertisement should be focused on

message dominance rather than humor dominance.

The use of humor appeals is a popular and considered to be an effective advertisement executional style to attract consumer attention. Many advertisers use humor as its advertising strategy due to the reason that humor can enhance liking of the advertisement, which, in turn affects on positive brand attitude. The more positive consumer attitude towards brand the higher the possibility of purchase intention will be (Weinberger and Gullas, 1992; Schiffman *et al.*, 2007:292; Shimp, 2010:259; Hawkins and Mothersbaugh, 2013:403).

H<sub>1</sub> : Humor advertisement has a positive effect on attitudes towards advertising

### **Need for Humor**

Galloway (2003), Schiffman *et al.* (2007:292), Shimp (2010:260), Piccard and Blanc (2013) has been defined need for humor as the individual needs or tendency to produce, seek out, enjoy, process, engage, and entertain by amusement, wit or nonsense (humorous) stimuli. Need for humor is a moderator of the relation between humor advertisement and attitude toward advertisement. Individuals with a higher need for humor responded humor stimuli more positively than individuals with low need for humor (Cline *et al.*, 2013; Gregory and Crawford, 2011; Piccard

and Blanc, 2013; Hawkins and Mothersbaugh, 2013:403).

H<sub>2</sub> : Humor advertisement that moderated by need for humor has a positive effect on attitudes towards advertisement

### **Attitude toward Advertisement and Brand**

Attitude towards advertisement has been defined as a predisposition (feelings and judgments) toward advertising exposure (Schiffman *et al.*, 2007:241; Sallam and Algammash, 2016). While attitude towards the brand is defined as a consumers overall evaluation toward the brand/product attributes and beliefs (Schiffman *et al.*, 2007:238; Ghorban, 2012). Previous research found that there is positive and significant relationship between attitude towards advertisement and attitude towards brand (Gardner, 1985; Gresham and Shimp, 2013; Mackenzie *et al.*, 1986, Ghorban, 2012; Sallam and Algammash; 2016)

H<sub>3</sub> : Attitude towards advertisement has a positive effect on attitudes towards brand

### **Purchase Intention**

Purchase intention is a plan or like hood to purchase particular brand or product in the future (Schiffman *et al.*, 2007:241). Purchase intention is formed through the

interaction between attitude towards advertisement and attitude toward brand. Attitude toward advertisement influences brand attitude both directly and indirectly. The more positive consumer attitude toward advertisement the higher the possibility of brand/product perceived positively by consumers. Thus, the more positive brand/product perceived by consumers the higher the possibility consumers to purchase brand/product advertised (Gardner, 1985; Gresham and Shimp, 1985; Mackenzie *et al.*, 1986; Ghorban, 2012; Mirabi *et al.*, 2015).

H<sub>4</sub> : Attitude towards advertisement has a positive effect on purchase intention

H<sub>5</sub> : Attitude towards the brand has a positive effect on purchase intention

### **Word of Mouth Intention**

Word of mouth is one of the marketing strategy which an individual who does not have any interest with brand/product willing to share an interesting information about brand/product in a verbal form, including face-to-face, telephone and internet. Mikalef *et al.* (2013) are defined word of mouth intention as the intention to share a relevant and interesting information about product or service through various communication channels. Generally, consumers having more trust to family or friend's opinions than marketing communication because these personal

sources have no reason not to express their true feelings and opinions (Hawkins and Mothersbaugh, 2013:230).

With the extensive growth of technology in recent years, more than a half companies used viral video as their new advertising strategy. Viral (marketing) video is electronic word of mouth advertising in which consumers will spread any information about brand/product to other consumer through technology (social media) channel (Phelps *et al.*, 2004). Huang *et al.*, (2013) are explained that positive attitude toward advertisement play a significant role in affecting viral. Advertising with an unusual content (creative, engaging, entertaining, and enjoying) is considered to be the most viral advertisement content worldwide (King and Tinkham, 1990; Porter and Golan, 2006; Binet and Field, 2009; Moldovan and Lehman; 2009).

H<sub>6</sub> : Attitude towards advertisement has a positive effect on the intention to communicate by word of mouth.

## **RESEARCH METHODOLOGY**

### **Research Design**

The researcher chooses the mobile SIM card TV advertisement (Tukang Ojek by Axis, Awet Muda by Axis, Gratis Hapi-Hapi by As, Gratis 30 Jam by As, Seribu Donat by XL, Seribu Halte by XL) as the

object of this research. The reason why researcher uses those advertised product categories and brand as the object of this research was because those industries has spent over 4 trillion rupiahs on advertising and the consistency of the brand using humor appeal in their advertising campaign.

This research can be classified as conclusive-causal research due to reason that the aim of this research is to investigate the effect of humor advertisement with the need for humor as a moderating role in consumer attitudes and its impact to purchase and word of mouth intention.

Researcher conducted a survey with 5 point Likert scale, questionnaire, and purposive (which also known as judgement) sampling as the primary data collection method. Purposive sampling is type of non-probability sampling in which the researcher selects the sample based on his or her judgement (Fricker, 2008:200). The target respondents of this research are individual who classified as young adults or with the age range from 18 to 34 years old (Blackwell *et al.*, 2007:192) and was not classified as the user of advertised mobile SIM card brands that they perceived as the funny (humor) ones. The researcher argued that the young adult consumers are having their own purchase capability, impulsive, and mature enough to evaluate brand or products. Wolburg and Pokrywczynski

(2001) added that this group of age have a high current amount of spending power.

**Table 1.** Research Variable and Indicator

Variable	Indicator	Reference
Humor (HUM)	The commercial message was fun to watch (HUM1)	Bearden and Netemeyer (1999:297)
	The commercial storyboard was fun to watch (HUM2)	
	The commercial actor was so funny (HUM3)	
	I thought the commercial was very funny and good (HUM4)	
Need For Humor (NHUM)	People expect me to say amusing things (NHUM1)	Picard and Blanc (2013)
	People tell me that i am quick witted (NHUM2)	
	I need to be with people who have a sense of humor (NHUM3)	
	I often read jokes and funny stories (NHUM4)	
	I enjoy being around quick witted people (NHUM5)	
Attitude Toward Ads (AAd)	I thought the commercial was interesting (AAd1)	Chattopadhyay and Nedungadi (1992)
	I thought the commercial was pleasant (AAd2)	
	I like the commercial (AAd3)	
	The commercial was not bad (AAd4)	
Attitude Toward Brand (AB)	I thought the SMS/Telephone tariff of brand X was beneficial (AB1)	Mitchel (1986)
	I thought the social media/BBM tariff of brand X was beneficial (AB2)	
	I believe that the signal of brand X was good (AB3)	
	I thought the internet plans of brand X was beneficial (AB4)	
Purchase Intention (PI)	I want to buy the advertised brand/product in the near future (PI1)	Mullet and Karson (1985)
	I may will buy the advertised brand/product in the near future (PI2)	
	I definitely will buy the advertised brand/product in the near future (PI3)	
	I probably will buy the advertised brand/product in the near future (PI4)	
WOM Intention (WOMI)	I will recommend this funny commercial to my friend (WOMI1)	Cheema and Kaikati (2010) and Mikalef et al (2013)
	I will talk to my friend about this funny commercial (WOMI2)	
	I will click "share" to show my appreciation to this commercial on social media (WOMI3)	
	I will talk to my friend about brand X (WOMI4)	

The researcher uses mixed delivery (computer delivered survey) channel to method, in which questionnaires were delivered through traditional (personal delivered survey) channel and online yield higher response rate at competitive cost. At the beginning, the targeted respondents are exposed by the mobile SIM

card humorous advertisement (Axis, As, XL). Then, they have to answers a close question about what is the most liked (funniest) mobile SIM card exposed advertisement. The targeted respondents should/must answer the specific brand questionnaire that they perceived as the funny ones. For example, respondent “A” feels that Seribu Donuts as the funny ones so “A” should/must answer the XL questionnaire and so on. Totally 126 valid questionnaires from 156 questionnaires recovered. Henseler, Ringle, and Sinkovics (2009), Marcoulides and Saunders (2006), Wiyono (2011:80) argued that these sample size was considered a good starting point in running out path models.

**Research Variables**

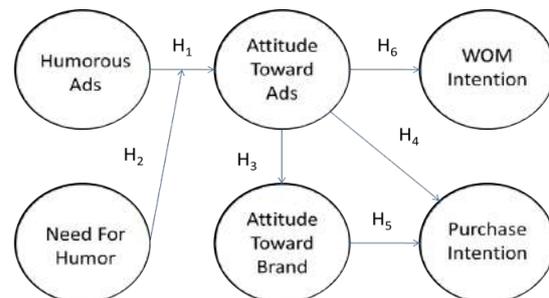
This research consists of four variables which are exogenous (humorous advertisement), exogenous-endogenous (attitude towards advertisement and attitude towards brand), endogenous (purchase intention and word of mouth intention), and moderator (need for humor). All of the indicators in this research can be classified as reflective indicators. The reflective indicator known as the function of latent variables are expected to have high inter correlations with the latent variable (Coltman *et al.*, 2008; Okazaki, 2012:254).

**Research Framework**

The research framework that was proposed by the researcher to investigate the effect of humorous advertisement on consumer attitudes, purchase intention, and word of mouth intention with the need for humor as a moderating role can be briefly described in Figure 1.

The research adopted PLS-SEM analysis to examine the different effects between variables. The researcher use PLS-SEM due to the reason that the research is trying to extend the existing structural theory. PLS is particularly suitable tool to analyze data where the theoretical model is insufficiently grounded and its measures are not robust (Acedo and Jones, 2007; Ritcher *et al.*, 2016). This research adds a need for humor and word of mouth intention variables to predict the effectiveness of humorous advertisement that uncommonly used by other researchers.

**Figure 1. Research Framework**



**Table 2. Reliability Test**

Variable	Cronbach's Alpha	Composite Reliability
HUM	0,777	0,857
NHUM	0,644	0,803
AAd	0,799	0,870

AB	0,807	0,878	WOMI	0,819	0,892
PI	0,940	0,957			

**Table 3.** Convergent and Discriminant Validity Test

	AVE / Communality	HUM	NHUM	AAd	AB	PI	WOMI
HUM 1	0,602	0,845*	0,138	0,540	0,070	0,018	0,294
HUM 2		0,756*	0,163	0,458	0,021	0,141	0,179
HUM 3		0,687*	0,018	0,513	0,035	-0,011	0,225
HUM 4		0,805*	0,077	0,591	0,135	0,058	0,317
NHUM 1	0,491	0,192	0,750*	0,160	0,067	0,133	0,385
NHUM 2		0,033	0,681*	0,114	-0,037	0,036	0,042
NHUM 3		0,029	0,589*	0,062	-0,027	0,051	0,052
NHUM 4		0,012	0,732*	0,104	-0,087	0,146	0,102
NHUM 5		0,097	0,738*	0,190	-0,011	0,028	0,180
AAd 1	0,626	0,580	0,134	0,797*	0,160	0,203	0,284
AAd 2		0,506	0,139	0,722*	0,099	-0,013	0,348
AAd 3		0,562	0,108	0,802*	0,020	0,0003	0,338
AAd 4		0,506	0,249	0,838*	0,061	0,208	0,276
AB 1	0,647	0,120	-0,096	0,158	0,907**	0,375	0,265
AB 2		0,033	0,050	0,096	0,858**	0,376	0,237
AB 3		0,045	0,039	0,076	0,824**	0,314	0,201
AB 4		0,084	-0,028	0,006	0,592**	0,344	0,099
PI 1	0,847	0,020	0,081	0,046	0,450	0,924*	0,161
PI 2		0,054	0,042	0,064	0,274	0,856*	0,165
PI 3		0,054	0,111	0,148	0,476	0,955*	0,248
PI 4		0,110	0,149	0,204	0,376	0,943*	0,224
WOMI 1	0,588	0,344	0,079	0,344	0,200	0,130	0,887**
WOMI 2		0,293	0,128	0,386	0,158	0,109	0,893**
WOMI 3		0,243	0,174	0,284	0,246	0,269	0,772**
WOMI 4		0,032	-0,061	0,104	0,317	0,357	0,415**

**RESEARCH RESULTS**

**Validity and Reliability**

The researcher use convergent validity and discriminant validity to measure the validity of construct. According to Chin (1998), the rule of thumbs to measure validity are AVE/communality score must

be higher than 0.50, the loading factor scores must be higher than 0.70, and the cross loading scores of the reflective construct with its own indicators must be greater than the correlation with other latent variables. The results showed that there are two indicators of need for humor

which is NHUM2 (people tell me that i am quick witted) and NHUM 3 (I need to be with people who have a sense of humor) that must be extracted from the models due to the reason that those indicators are lower than 0.70 and 0.50 for its loading factor and AVE-communality scores.

The rule of thumbs that used by the researcher to measure reliability are Cronbach’s alpha > 0.60 and composite reliability > 0.70. The results showed that value of Cronbach’s alpha and composite reliability are more than 0.60 and 0.70 which means the entire variables are reliable.

**Discussion of Research Findings**

**Table 4.** Demographic Profile

Demographic Profile		Percentage
Gender		100
A	Male	73
B	Female	27
Age (Years Old)		100
A	18 – 21	30
B	22 – 25	46
C	26 – 29	15
D	≥ 30	7
E	Unanswered	2
Most Liked Ads		100
A	Tukang Ojek by Axis	38
B	Seribu Halte by XL	17
C	Gratis 30 Jam by As	14
D	Awet Muda by Axis	13
E	Seribu Donat by XL	12
F	Gratis Hepi-Hepi by As	6
Brand Switching Reason		100

A	Signal issue	46
B	Another brand promo	24
C	Try another brand	23
D	Expiration of promo plans	7

The following demographic profile of respondent (Table 4) shows that 73 percent of the respondents were male, 46% were aged between 22 and 25 years old, and 38% of the respondent feels that Tukang Ojek (Axis) advertisement as most liked exposed advertisement. Signal issue is the main reason for respondent to switch their existing brand (46%). Followed by another brand promotion plan, try another brand, and the expiration of the respondent promo plans reason.

Hypothesis 1 stated that there was a positive and significant effect of humor advertisement on attitudes towards advertisement. The result of hypothesis testing (Table 5) shows that the value of the t-statistics (8.379) was higher than t-tables (1.64) in  $\alpha = 0.05$  which means that hypothesis 1 is accepted. Therefore, this research supports previous studies that humor can enhance liking of the advertisement (Weinberger and Gullas, 1992; Schiffman *et al.*, 2007:292; Shimp, 2010:259; Hawkins and Mothersbaugh, 2013:403). The humorous advertisement can explain about 48% of the positive attitude towards advertisement in this research.

This research also proved that there was a positive and significant relationship between attitude towards brand to purchase intention (that stated in this research as hypothesis 5) and attitude towards advertisement to word of mouth intention (that stated in this research as hypothesis 6). For hypothesis 5, the value of the t-statistics (4.460) was higher than t-tables (1.64) in  $\alpha = 0.05$ . Thus, for hypothesis 6, the value of the t-statistics (5.204) also higher than t-tables (1.64) in  $\alpha = 0.05$ . Therefore, this research supports previous studies about the effect of consumer attitudes to word of mouth intention and purchase intention. The more positive attitude towards advertisement the higher the possibility of the advertisement will stimulate word of mouth intention. Thus, the more positive brand attribute perceived by consumer the higher the encouragement of consumer to have an intention to purchase. In addition, the  $R^2$  value of attitude towards advertisement to word of mouth intention (20%) that is higher than the  $R^2$  value of attitude towards brand to purchase intention (15%) indicated that the effect of humorous advertisement to word of mouth intention is higher than its effect to purchase intention.

HUM	-
NHUM	-
AAd	48.0%
AB	1.20%
PI	15.5%
WOMI	20.2%

**Table 5.**  $R^2$  Value

Variable	$R^2$
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Unlike Galloway (2003), Schiffman *et al* (2007:292), Shimp (2010:260), Piccard and Blanc (2013), Hawkins and Mothersbaugh (2013:403) who stated that individuals with higher need for humor are more reluctant toward humorous appeals, thus, it can adds their positive attitudes towards advertisement, this research concluded the opposite. The researcher found that there is a negative and insignificant relationship between humor advertisements and attitude towards advertisement with the need for humor as a moderating role in this research. The researcher indicated that the decision to use the mobile SIM card as the object of this research are the root causes on why there is different results between this research and the previous ones. The majority of respondent in this research are perceived the mobile SIM card as the high risk and high involvement product (they will change their existing brand only if there are some technical issues like signal problem and the perception that the mobile SIM card is like an identity alternative for each individuals). Therefore, consumer will be more detailed and more critical in

deciding whether they should switch their existing mobile SIM card or not.

This research was failed to prove the proposed hypothesis that there was positive and significant relationship between attitudes towards advertisement to attitudes towards brand (H<sub>3</sub>) and attitudes towards advertisement to purchase intention ((H<sub>4</sub>). The value of the t-statistics (0.940 and 1.181) was lower than t-tables (1.64) in  $\alpha = 0.05$  which means that H<sub>3</sub> and H<sub>4</sub> rejected. The majority of respondent in this research are choose Tukang Ojek advertisement as the funny ones. The researcher classified Tukang Ojek advertisement as the humor dominant. The use of humor dominant appears to be ineffective for high risk product categories due to the reason that a high risk product requires an extensive though (information) and a high level of involvement. Therefore, the use of humor dominant for high risk product will harm the brand because consumers are too focused with the humor so they take little notice to targeted messages. The lower the

brand attributes information that was consumers get from advertisement the lower the consumer attitude towards brand. Thus, the lower the consumer attitude towards brand has implicated in the lower the possibility of purchase intention.

## RESEARCH CONCLUSIONS, IMPLICATIONS, AND LIMITATION

### Conclusions

The purpose of this study is to examine the effect of humorous advertisement with the need for humor as a moderating role to consumer attitude, consumer intent to purchase, and word of mouth intention. The results showed that there is a positive relationship between humorous advertisement, attitude towards advertisement, and word of mouth intention. It means that the use of humor appeals has significantly proved to increase the acceptance and liking of the advertisement, thus, excrete their intent to share stories about brand, product, or campaign.

**Table 6.** Hypothesis Testing

	<b>Beta Coefficient</b>	<b>t-Statistics</b>	<b>t-Table</b>	<b>Decision</b>
HUM -> AAd	0,6711	8,379	1,64	Accepted
HUM*NHUM -> AAd	-0,0097	0,087	1,64	Rejected
AAd -> PI	0,1280	1,181	1,64	Rejected
AAd -> AB	0,1093	0,940	1,64	Rejected

AAd -> WOMI	0,3986	4,460	1,64	Accepted
AB -> PI	0,4328	5,204	1,64	Accepted

This research also proved the positive relationship between attitude towards brand and purchase intention. Although, there is a positive relationship between attitude towards brand and purchase intention, this research was failed to explain the effect of attitude towards advertisement to attitude towards brand. Therefore, the researcher concludes that the impact of humorous advertisement was limited only to entertain consumers so encourage their word of mouth intention, not purchase intention.

Need for humor has failed to moderate the relationship between humorous advertisement and attitude towards advertisement in this research. The failure need for humor to moderate the relationship between humorous advertisement and attitude towards advertisement due to the reason that the majority of respondent in this research perceived mobile SIM card as the high risk product. A high risk product requires an extensive though and a high level of involvement. Therefore, the need for cognitive will be higher than the need for humor at this product category.

### **Implications**

This research has contributed to both theoretical and practical aspects. From theoretical aspects, this research adds the literature about the metrics of advertising effectiveness. The result of this research showed that there is a positive relationship between attitudes toward advertisement and word of mouth intentions which means the more positive consumer attitude toward advertisement, the higher the advertising will be discussed (word of mouth) and going viral. Therefore, researcher suggests the word of mouth as a new indicator in measuring the effectiveness of advertising campaigns (the higher the word of mouth effect, the most effective advertising campaign that was arranged by marketers).

For practical standpoint, the failure of this research to prove that there is a positive relationship between need for humor and attitude towards brand, thus, attitude towards brand and attitude towards advertisement to purchase intentions indicated that the mobile SIM card that used as the object of this research is perceived as high risk product categories. A high risk product requires an extensive though and a high level of involvement. The consumer will be more detailed and

critical in selecting and evaluating information. They need more information about a brand or product before made a purchase decision. Therefore, researcher suggests the design of the advertisement should be arranged to fulfill the consumer cognitive needs. Intentional relatedness message both focused on image and information ads can be used as an alternative in designing humor advertisements. Another recommendation that can be considered in designing humorous advertisements for a high risk product is using humor appeal as a tool (just) to grab consumer attention then directed their attention to marketing campaign that already published in website or social media channel that owned by brand or company. The use of integrated promotion channel both traditional (TV) and modern (website/social media) is based on the assumption that the target market of new mobile SIM card is a new user, those consumers who have aged from 18 to 21 years old. Consumers at that age are classified as a tech savvy person and have an adventure spirit which means that they are still looking best fit options for every brand/product that they consumed. They were usually more reactive toward promotional exposure.

### **Limitations**

The majority of the respondents that classified as young post-college (22-25 years old) might make the findings about purchase intentions and word of mouth intentions less generalizable. Young post-college consumers often see the mobile SIM card as the high involvement product (they will change their mobile SIM card only if there are some technical issues like signal problem). Therefore, the use of humor in the mobile SIM card advertisement to persuade their intent to purchase will be ineffective. Future research should address this issue by taking a sample that more representative.

The result of this research that have small  $R^2$  value indicated that there are other variables outside models that needed to be engaged in explaining purchase intentions and word of mouth intentions. Future research should be done on a broad scale by including need for cognition, need for uniqueness, subjective norm, previous brand evaluation, and other variables in predicting purchase intentions and word of mouth intentions.

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## **INVESTIGATING CONSUMER-BRAND ENGAGEMENT ON SOCIAL MEDIA: AN INDONESIAN CONTEXT**

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### ***ABSTRACT***

*Since social media platforms began allowing organizations or corporations to create profiles and official accounts, organizations and corporations have started adopting those new media platform into their marketing communication vehicle portfolio. In Indonesia, more companies start using social media tools such as Facebook, Twitter, Instagram, and YouTube to provide product information, develop positive image, and interact or engage with their customers. Considering those objectives, it is highly important for companies to understand what types of message content posted on social media that generate positive responses from customers. However, little is known about what kind of brand message contents that encourage customers to get engaged with brands. Through a content analysis of 10,752 brand posts on Facebook, Twitter, Instagram, and YouTube accounts of 10 Indonesian leading brands, this study examines how Indonesian brands have crafted their social media strategy differently in order to develop relationships with consumers. Some important findings suggest that consumer responds differently toward message contents posted by goods and service brands; while entertaining posts work better for consumer goods, informative and educating posts are preferred for service brands. Recommendation are provided to help marketers of Indonesian brands develop their message content strategy in their social media accounts in order to enhance their effectiveness in engaging with customers.*

**Keywords:** *social media, consumer-brand relationships, content analysis, e-marketing*

## **WHEN HARRY MEETS JOHN: TESTING THE EFFICACY OF REASONED ACTION MODEL TO PREDICT CONSUMERS' RESPONSE TOWARD LGBT CAMPAIGN**

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### ***ABSTRACT***

*Cause-related marketing is a marketing strategy that relates business offerings to social causes. Although it benefits companies, customers and stakeholders in a way, it is deemed as having a big risk of boomerang effect for the companies especially when the cause being promoted is not supported by the customers. This research examines the impact of cause-related marketing on the purchase intention by employing extended model of theory of reasoned action. It focuses on Starbucks campaign supporting same sex marriage and LGBTQ (Lesbian, Gay, Bisexual, Transgender, and Queer). In this study, researcher invites other independent variable such as religiosity, perception of cause-related marketing, evaluation towards advertising, interest on social cause, involvement in social cause, and income. Researcher conducted survey to collect data from 170 respondents and performed the analysis by using Smart PLS software for Partial Least Square analysis. The results shows that religiosity significantly affects attitude toward social-cause. In addition perception of cause-related marketing, evaluation toward advertising, interest to social cause, and income positively affects purchase intention. On the contrary, attitude towards behavior and involvement in social cause were found no significant in affecting purchase intention.*

**Keywords:** *Theory of Reasoned Action, Cause-Related Marketing, Religiosity, Attitude towards Behavior, Involvement on Social Cause*

## ELUCIDATING THE RELATION OF LEADERSHIP EMPOWERMENT BEHAVIOR TO SALESPERSON PERFORMANCE

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### ABSTRACT

*A salesperson plays the role of boundary-spanner at the interface between an organization and its customers. Role conflict is inevitable when a salesperson has faced incompatible requests from an organization and its customers as s/he represents the organization to customers and also represents customers to the organization (Ingram et al. 2005). Therefore, empowerment by giving greater authority to make decisions in order to create an atmosphere of autonomy and self-determination (Schneider, Dowling, and Raghuram, 2007) in a salesperson's work responsibility is explored as a manager's effective strategy to increase salesperson performance.*

*This research focuses on the impact of leadership empowerment behavior (LEB) on salesperson performance. This research involves psychological and creativity variables those are psychological empowerment, creative process engagement, adaptability, and affective commitment, to link leadership empowerment behavior and employees performance. Moreover, the authors propose the relation between leadership empowerment behavior and psychological empowerment will be moderated by the presence of employee's need for achievement. The hypotheses are tested using survey data collected from a sample of 149 salespeople in cigarette field. The SEM-PLS was occupied in data analysis.*

*Results showed that the hypotheses are supported, except that of the moderating role of need for achievement on the relationship of leadership empowerment behavior and psychological empowerment. The positive impact of empowering leader to perceived empowerment increase creativity, adaptability, and commitment. Furthermore, this psychological constructs affect salesperson performance. The findings contribute to fill the void in elucidating the relation of empowerment and performance. Study concludes with discussion of the implications of the findings and directions for future research.*

**Keywords:** *empowerment, creativity, commitment, performance, salesperson*

### INTRODUCTION

A salesperson plays the role of boundary-spanner at the interface between an organization and its customers. Role conflict is inevitable when a salesperson has faced incompatible requests from an organization and its customers as s/he represents the organization to customers

and represents customers to the organization (Ingram et al. 2005). Therefore, empowerment by giving greater authority to make decisions in order to create an atmosphere of autonomy and self-determination (Schneider, Dowling, & Raghuram, 2007) in a salesperson's work responsibility is explored as a manager's effective strategy to increase salesperson

performance. Bateson (1985) argued that boundary-spanning employees were better able to satisfy customers, thereby increasing performance, when they had control over their service encounters.

Empowered salespersons will be more flexible and ready adjusting their selling strategy (Scott & Bruce, 1994). Adaptive salespersons in selling strategy when interacting with consumers tend to be more capable to meet the needs and requests of the consumers (Bitner, Booms, & Mohr, 1994; Humphrey & Ashforth, 1994). They are likely to be hard workers and more persistent so that they produce better services to customers (Sujan, Weitz, & Kumar, 1994). Empowerment gives opportunity to a salesperson to develop competence and skill. Consumers will gain highly qualified services from a salesperson having strong belief on self-competence (Hartline & Ferrell, 1996).

Empowerment is an effort to give salespersons wider space to develop their skills. Successful empowerment will result in psychological empowerment as a phase to advance the competence of employees (Conger & Kanungo, 1988) reflected in four dimensions covering up meaning, competence, self-determination, and impact (Spreitzer, 1995). Empowerment is also closely related to creativity (Zhang & Bartol, 2010). An empowered salesperson is actually demanded to be a creative individual. In the context of marketing, salesperson is encountering different consumers. This situation often demands more adaptive and effective solutions in marketing products. Creative and effective solutions come up when someone is conducting creative process engagement. An empowered salesperson will always be enthusiastically formulating more creative and effective solutions in adaptive selling. An empowered salesperson also has a strong affective commitment so that s/he tends to stay in the organization (Kraimer, Seibert, & Liden, 1999).

This research aims to test the relationship between leadership empowerment behavior and salesperson performance by using the variables of psychology and creativity such as psychological empowerment, creative process engagement, adaptability, and affective commitment. In this research, the researcher proposes moderation of need for achievement in leadership empowerment behavior and psychological empowerment relation. Not all

employees will respond in the same way to an empowering leader (Ching, 2012). However, there may be some factors affecting this association. For example, Zhang and Bartol (2010) suggested that empowerment role identity, which is the degree of an individual views whether s/he want to be empowered in the job, moderates the linkage between leadership empowerment behavior and psychological empowerment. Employees with higher role identity will be ready to be empowered and to handle new responsibilities.

## **THEORETICAL BACKGROUND AND HYPOTHESES DEVELOPMENT**

### **Leadership Empowerment Behavior and Psychological Empowerment**

Arnold, Arad, Rhoades, and Drasgow (2000) submitted that leadership empowerment behavior involved the process of implementing conditions that increased employee's feelings of self-efficacy and control (e.g., participative decision making), removing conditions that fostered a sense of powerlessness (e.g., bureaucracy), and allowing them the freedom to be as flexible as circumstances warranted. Leach, Wall, and Jackson (2003) defined leadership empowerment behavior in terms of a practice involving the delegation of responsibility down the hierarchy so as to give employees increased decision-making authority in respect to the execution of their primary work tasks.

Spreitzer (1995) defined psychological empowerment as increasing individual motivation featuring four psychological dimensions. Those are meaning, competence, self-determination, and impact.

Previous researches showed positive relationship between leadership empowerment behavior and psychological empowerment. Ahearne *et al.* (2005) showed that leadership empowerment behavior could improve self-efficacy dimension (competence). Raub and Robert (2010) stated that when a leader respected the employee's contribution, the dimension of meaning was strengthened. The research by Zhang and Bartol (2010) showed the linkage mechanism of leadership empowerment behavior and psychological empowerment. First, an empowering leader tends to enhance the meaningfulness of work by helping an employee understand the importance of his/her contribution to overall organizational

effectiveness. Second, an empowering leader expresses confidence in an employee's competence and prospects for high performance. Third, an empowering leader provides an employee with autonomy and prospects for self-determination by encouraging the individual to decide how to carry out his/her job (Pearce *et al.*, 2003; Sims & Manz, 1996). Lastly, an empowering leader fosters an employee's participation in decision-making (Manz & Sims, 1987). This process potentially gives an employee a feeling of greater control over the immediate work situation and an enhanced sense that his/her own behaviors can make a difference in work results, thus promoting the sense of impact. Based on the explanation, the first hypothesis comes up as follows:

Hypothesis 1: Leadership empowerment behavior has positive effects on psychological empowerment.

#### **Moderation of Need for Achievement in Leadership Empowerment Behavior and Psychological Empowerment Relation**

Need for achievement refers to the strong motivation for accomplishing a task or achieving a goal better than the others or the person's previous achievements (Atkinson, 1964; McClelland, 1961; Hansemark, 2003). People with higher need for achievement tend to set challenging goals for work task and have a stronger need to receive positive feedback from others (Riipinen, 1994). In addition, they are more likely to accept additional responsibility given by managers through leadership empowerment behaviors.

An employee pursuing high achievement in career must have believed the job is very important and worth having. Implementing leadership empowerment behavior may facilitate an employee to pursue the achievement. Having authority delegated from a leader, an employee will feel self-engagement to the organization. The employee moreover believes that s/he has important contribution to the organization, is meaningful, and is competent. Then, the employee pursuing high achievement in career is more likely to engage higher-level job than other employees are. The employee's deep involvement in work closely related to the need for achievement. The higher the need for achievement is, the deeper the self-engagement will be, in that it tightens the relationship between leadership empowerment behavior and

psychological empowerment. Based on the explanation, the second hypothesis is formulated as follows:

Hypothesis 2: Need for achievement positively moderates the effects of leadership empowerment behavior on psychological empowerment.

#### **Psychological Empowerment and Creative Process Engagement**

Creative process engagement is a process to walk through by individuals willingly to seek creative solutions when the situation asks (Amabile, 1983; Reiter-Palmon, & Illies, 2004). Creative process engagement has some phases. The first phase is identifying problems in that it requires individuals to comprehend problems from various views. The second phase is collecting information, which is a process by which individuals are taking and sorting information relevant with the problem. The third is forming ideas and alternatives.

Zhang and Bartol (2010) stated that psychological empowerment had important effects on the motivation of the employee to think creatively. When an employee believes that his/her job is very important and worth striving, s/he will try to understand the problems comprehensively, seek solutions through exploring various kinds of information, and make a number of alternatives by connecting to different sources of information (Gilson & Shalley, 2004; Jabri, 1991). According to Spreitzer (1995), an employee would be more determined and strive to deal with any problems when s/he believed that s/he was competent for the tasks, had strong self-determination, and was capable of producing the expected results. Such an employee, according to Amabile *et al.* (1996) was a risk taker, an explorer of new things, and an ideas tester. Based on the explanation, the third hypothesis is formulated as follows:

Hypothesis 3: Psychological empowerment has positive effects on creative process engagement.

#### **Psychological Empowerment and Adaptability**

Being contextual with the dynamics of the job, a sales person often encounters various consumers with different characteristics. It forces a sales person to adjust the marketing strategy to avoid making consumers disappointed. A psychologically empowered sales person understands that the work s/he is running is

meaningful and gives contribution to the entire performance of the organization (Ahearne *et al.*, 2005). Such a salesperson is also more likely confident with his/her competence in dealing with any professional problems (Behling & McFillen, 1996). Previous researches showed a positive relationship between psychological empowerment and adaptability. The finding said that competence has a positive relationship with salesperson's adaptability (Ahearne *et al.*, 2005; Hartline & Ferrell, 1996).

A sales person will rigidly strive to make adjustment on the selling approach for various consumers of different characteristics when feeling that the work is meaningful. With a belief on the self-competence, a sales person will be able (self-determination) to select which selling strategy accords the current situation to gain positive selling results (impact). Based on the explanation, the fourth hypothesis is formulated as follows:

Hypothesis 4: Psychological empowerment has positive effects on adaptability.

#### **Psychological Empowerment and Affective Commitment**

Affective commitment is a commitment structured by the employee's finding that the job is meaningful and becomes an important part of self-identity (Meyer & Allen, 1991). In his research, Kraimer *et al.* (1999) stated that employee empowerment could boost affective commitment. With strengthening the employee's self-determination and impact dimensions, the affective commitment of the employee highly increases. The psychologically empowered employees with high impact and strong self-determination believes that they are competent and have stronger control in the organization so that they decide to keep staying in the organization because the organization has become a very important part of their personal identities (Kraimer *et al.* 1999). According to Thomas and Velthouse (1990), a high level of meaning can increase commitment, engagement, and concentration of employees in their work. Based on the explanation, the fifth hypothesis is formulated as follows:

Hypothesis 5: Psychological empowerment has positive effects on affective commitment.

#### **Creative Process Engagement and Salesperson Performance**

Salespersons need creativity when engaging consumers. Creative ideas need developing for the sake of encountering certain consumers to give satisfying services. Creative ideas development depends on the personality of the sales persons. The research of Zhang and Bartol (2010) showed a positive relationship between creative process engagement and employee's performance. Zhang and Bartol (2010) said that an employee would experience a problem in the form of having less creative and less effective solution if s/he was less interested in creative ideas development. Nevertheless, the solution would be more effective and creative when an employee was entirely concerned with the existing problems and tried hard to find the best solution through understanding the problem from various views, collecting information, and developing various alternatives. Amabile *et al.* (1996) also supported the statement. Amabile said that an employee showing creativity in would produce useful new ideas to overcome the in-front-of-the-eyes problems and improve performance. Based on the explanation, the sixth hypothesis is formulated as follows:

Hypothesis 6: Creative process engagement has positive effects on salesperson performance.

#### **Adaptability and Salesperson Performance**

A research conducted by Boorum, Goolsby, and Ramsey (1998) stated that salesperson's adaptability has positive relationship with sales performance. The research of Ahearne *et al.* (2005) also stated that salesperson's adaptability had positive relationship with customer satisfaction and employee's performance. An adaptive salesperson in marketing strategy when interacting with consumers is likely able to meet the customers' needs and requests, and thus the quality of his/her services increase (Bitner *et al.*, 1994; Humphrey & Ashforth, 1994; Reid *et al.*, 2002). This service quality is meant as performance. Based on the explanation, the seventh hypothesis is formulated as follows:

Hypothesis 7: Adaptability has positive effects on salesperson performance.

#### **Affective Commitment and Salesperson Performance**

The research of Shore, Barksdale, and Shore (1995) stated that affective commitment was positively correlated with employee's performance. According to Liou (2008), the

success of an organization lay in the commitment and participation of the employees. Strongly committed employees increased retention rate, decreased operation costs, and improved performance and efficiency (Liou, 2008). Meyer and Allen (2004) stated that strongly committed employees were likely to work harder to achieve the organization goals. Employees with high affective commitment stayed in the organization on their own will and were apt to carry out their responsibility well (Meyer & Allen, 1991, 1997). Based on the explanation, the eighth hypothesis is formulated as follows:

Hypothesis 8: Affective commitment has positive effects on salesperson performance.

Figure 1 shows the hypothesized model.

[Insert Figure 1]

## METHODS

### Research Setting and Respondents

Distributing questionnaires directly to respondents is the way to get data. The questionnaires are those already developed by previous researchers, translated into *Bahasa Indonesia*, and confirmed on the contents (back-translation) to get as similar to the original version as possible (Brislin, 1980). This process involves experts in the related fields.

The respondents of this research are cigarettes company employees, and limited to those who have worked for at least one year as sales persons offering and selling products directly to consumers. The selection is due to the need of the research to study the characteristics of the leaders and the job. The sales persons become the choice considering that there are two ways of interactions i.e. interaction with leaders and interaction with consumers in that it enables the researcher to study the researched variables. Those already working for at least a year are considered having adequate knowledge and information for the research.

Data collection was taken by disseminating questionnaires. Before being distributed, the sample questionnaires were sent to experts on behaviors to get examination. In collecting the data, the researcher distributed the questionnaires by visiting wholesalers visited by sales persons. The filled questionnaires were directly returned to the researcher.

There were 215 questionnaires distributed and 174 questionnaires were returned (80.93% response rate). After the examination, 149

questionnaires (69.30%) were worth analyzing. Most respondents (75.84%) were male. Respondents with ages between 21-30 years old were 62.42%, with highest education of High School level were 73.83%, and with working tenure between 1-5 years were 58.39%.

### Measures

All the variables were measured by using Likert scale consisting of five points i.e. 1 = strongly disagree; 2 = disagree; 3 = neutral; 4 = agree; and 5 = strongly agree. The following is the discussion of all the variables used in the research.

*Leadership Empowerment Behavior.* To assess leadership empowerment behavior, this research used the measuring instrument once used in the research by Arnold et al. (2000). The instrument consists of 38 points comprising five dimensions i.e. leading by example, coaching, participative decision-making, information sharing, and showing concern/interacting with team. ( $\alpha = .97$ ; point sample: "My leader supports me to undoubtedly proceed my opinions and give inputs").

*Psychological Empowerment.* The instrument to measure psychological empowerment was the one used by Spreitzer (1995). The instrument consists of 12 points of four dimensions i.e. meaning, competence, self-determination, and impact. ( $\alpha = .89$ ; example item: "This job is important for me").

*Creative Process Engagement.* The creative process engagement was measured with research instrument used by Amabile (1983), Reiter-Palmon and Illies (2004), and Perry-Smith (2006). This 11 instrument consists of 11 items covering up three dimensions i.e. identifying problems, searching and coding information, and generating ideas ( $\alpha = .91$ ; example item: I take information from various sources into consideration to develop new ideas).

*Adaptability.* The adaptability was measured with research instrument used by Spiro and Weitz (1990). The instrument consists of 15 items reflecting the selling competence of the sales persons ( $\alpha = .87$ ; example item: I adapt my selling method from one situation to another).

*Affective Commitment.* The instrument to measure affective commitment was the one used

in a research by Allen and Meyer (1991). The instrument consists of 6 items reflecting what the respondents feel to their organization. (Example item: “I am happy to dedicate my career to this company”).

*Salesperson Performance.* The instrument to measure salesperson performance was the one used in a research by Martin and Bush (2006). It consists of 11 items reflecting the respondents’ behaviors to their work. ( $\alpha = .88$ ; example item: “I make great efforts to increase the profit”).

*Need for Achievement.* The instrument to measure need for achievement was the one used in a research by Steers and Braunstein (1976). The instrument consists of 5 items reflecting strong motivation of the respondents to make achievement in their job. ( $\alpha = .84$ ; example item: “I dare taking risk for the sake of my career progress in my job”).

*Control variables.* This research applied four demography factors as control variables. Control variables are variables that are controlled or made constant, thus the relationship between independent variable and dependent variable will not be influenced by other factors excluded from this research. The control variables are gender, age, last education level, and working tenure.

### Analytical Procedures

This research used Structural Equation Modeling (SEM) with WarpPLS 3.0. to analyze the collected data. SEM was elected, rather than other multivariate analysis methods, for its two main advantages (Hair *et al.*, 2010; Smith & Langfield-Smith, 2004). The advantages of SEM are in the way that SEM can assess complex research models simultaneously, analyze variables that cannot be measured directly (unobserved variables), and calculate measuring errors. SEM-PLS has a two-steps approach. The first step is doing confirmatory factor analysis aimed to evaluate the validity and reliability of every construct or latent variable. The second step is to evaluate the structural model aimed to obtain estimated results of path coefficient and significance level for the sake of conclusion making on the results of the hypothesis assessment. SEM-PLS applies three fit indicators i.e. average path coefficient (APC), average R-squared (ARS), and average variance inflation factor (AVIF) to show the goodness of fit of

research model. The criteria that a model is supported by data are that P-value for APC and ARS must be significant (P-value < 0.05), and the value of AVIF as a multicollinearity indicator must be less than 5 (Sholihin & Ratmono, 2013). Hypothesis assessment was done by observing the value of path coefficient and its significance (P-value).

### RESULTS

The first step in SEM-PLS analysis was assessing the measuring model by doing confirmatory analysis factor. Assessment on validity and reliability were conducted by considering two parameters i.e. validity of construct (convergent and discriminant validities) and reliability (Cronbach’s Alpha and Composite Reliability Coefficient).

Convergent validity value was based on the loading factor value of the indicator. The value was considered valid when having loading factor > 0.70 and P-value < 0.05. When the loading factor was between 0.40 – 0.70 the indicator was worth preserving. The indicator would be removed when able to raise the composite reliability > 0.70 and AVE > 0.50 (Hair *et al.*, 2010 in Sholihin & Ratmono, 2013). Discriminant validity value was obtained by comparing the AVE root of every latent variable to other latent variables in the research. The criterion said that AVE root had to be higher than the correlation among other latent variables (Sholihin & Ratmono, 2013). After the confirmatory analysis, the total number of valid indicators were 79 items of statement.

Reliability test was conducted by observing the values of Cronbach’s Alpha of the variables engaged in the research. The indicator was reliable when having the values of Cronbach’s Alpha > 0.60 (Sekaran & Bougie, 2013) and of composite reliability > 0.70 (Sholihin & Ratmono, 2013). By referring to those two criteria, the indicator used in this research was declared reliable. Table 1 presents the details of reliability testing of each variable.

Table 2 shows the descriptive statistic of the respondents’ responses on the items of the research variables. Descriptive statistic consists of average value, standard of deviation, correlation coefficient inter research variables. In Table 2, the average age of the research respondents is 28.85 years old with average working tenure of 5.71 years. In average, the respondents give high score on psychological

empowerment and need for achievement variables with average score above 4. For other variables, average respondents give medium score with average score 3.

[Insert Table 1]

[Insert Table 2]

The second step of SEM-PLS analysis was conducted with structural model evaluation. This evaluation aimed to obtain estimation for path coefficient and level of significance, which were useful in decision-making for hypothesis assessment. Hypothesis assessment was done by observing the value of path coefficient and its significance (P-value). Positive path coefficient value showed that exogenous variables had positive effects on endogenous variables. Meanwhile, negative path coefficient value showed that exogenous variables had negative effects on endogenous variables.

Figure 2 presents the results of hypothesis assessment in which the effect of exogenous variables on endogenous variables is positive. Leadership empowerment behavior has positive effects on psychological empowerment ( $\beta = 0.382$ ;  $R\text{-squared} = 0.211$ ;  $P\text{-value} < 0.001$ ). Psychological empowerment has positive effects on creative process engagement ( $\beta = 0.410$ ;  $R\text{-squared} = 0.169$ ;  $P\text{-value} < 0.001$ ). Psychological empowerment has positive effects on adaptability ( $\beta = 0.396$ ;  $R\text{-squared} = 0.156$ ;  $P\text{-value} < 0.001$ ). Psychological empowerment has positive effects on affective commitment ( $\beta = 0.455$ ;  $R\text{-squared} = 0.207$ ;  $P\text{-value} < 0.001$ ). Creative process engagement has positive effects on salesperson performance ( $\beta = 0.280$ ;  $R\text{-squared} = 0.461$ ;  $P\text{-value} < 0.001$ ). Adaptability has positive effects on salesperson performance ( $\beta = 0.364$ ;  $R\text{-squared} = 0.461$ ;  $P\text{-value} < 0.001$ ). Affective commitment has positive effects on salesperson performance ( $\beta = 0.257$ ;  $R\text{-squared} = 0.461$ ;  $P\text{-value} = 0.029$ ). The results support hypotheses 1, 3, 4, 5, 6, 7, and 8. However, the assessment of moderating variable in this research does not result in significant relationship ( $\beta = -0.221$ ;  $P\text{-value} = 0.234$ ). Thus, the second hypothesis ( $H_2$ ) is not supported in this research.

[Insert Figure 2]

## DISCUSSION

The research is to assess the effects of leadership empowerment behavior on sales person performance. The relationship between

the two variables is elucidated by involving variables of creativity and psychology such as psychological empowerment, creative process engagement, adaptability, affective commitment, and need for achievement as the moderating variable. The relationship of each variable is configured into eight hypotheses in that all hypotheses except one are supported.

Leadership empowerment behavior has positive effects on psychological empowerment. It is in line with the findings of previous researches (Ahearne *et al.*, 2005; Raub & Robert, 2010; Zhang & Bartol, 2010). Empowering leader fosters employee's psychological motivation. Empowerment encourages employees to be competent and have opportunity for self-actualization in the company. It is in line with the definition of psychological empowerment of Behling and McFillen (1996), in that employees believe they are competent to overcome any obstacles emerging from their work. Psychologically empowered employees experience that their job is meaningful (Ahearne *et al.*, 2005) thus they work harder to deal with any work problems. Giving space that is more lavish and delegating more authority encourages employees to overcome problems with their own ways and thus bring positive performances.

Moderating need for achievement on the relationship between leadership empowerment behavior and psychological empowerment configured in the second hypothesis ( $H_2$ ) is not supported. Need for achievement is one of the aspects in the Theory of Motivation by McClelland (1961) elucidating one's personality and the way to motivate. This motivation is related to someone's activity to work maximally. A person with high need for achievement will be motivated when placed in a challenging job. S/he will seek innovative ways accomplish the job, opportunities to promote, and positive feedback from other on his/her achievements. McClelland (1961) stated that high achievement was related to high performance. Meanwhile, performance is a variable of behavior, thus moderation of need for achievement is considered appropriate when placed at moderation of psychological and behavioral variables. In this research, moderation of need for achievement in leadership empowerment behavior and psychological empowerment relation does not bring any effect due to inappropriateness in locating moderation of need for achievement on the two variables of psychology i.e. leadership empowerment

behavior and psychological empowerment. It is in line with the research by Ching (2012) that also conducted moderation of need for achievement on the two similar variables.

Psychological empowerment drives employees to work harder in dealing with problems. It is configured in the third hypothesis (H<sub>3</sub>) stating that psychological empowerment has positive effects on creative process engagement. Employees feeling that their job is meaningful will spare more time to face problems (Gilson & Shalley, 2004) by identifying them from various views, collecting information from various sources, and with self-confidence formulating creative alternatives and solutions (Reiter-Palmon & Illies, 2004). The research findings by Runco (1986) stated that producing creative ideas needed quite a long time of process. Usually the first ideas were not effective and creative enough, but ideas produced through a quite long time of process were likely to be more creative and useful to solve problems (Runco, 1986).

Employees need creative ideas in their job. Salespersons often meet various consumers of different characteristics. Certain selling situation requires a salesperson to be more adaptive in encountering consumers. This research shows that psychological empowerment has positive effects on adaptability. The hypothesis is supported by the research by Ahearne *et al.* (2005). A psychologically empowered salesperson strive more to apply adaptive selling behavior. With strong self-determination and high competence, a salesperson is more confident managing the strategy of selling that can bring positive impact on performance.

Leader fostering psychological empowerment on the employees are more capable to keep his/her employees closer to the company. Psychological empowerment has positive effects on the affective commitment of the employees. A previous research by Kraimer *et al.* (1999) supports the hypothesis. As already mentioned previously, psychological empowerment fosters employees to understand that the job they have is meaningful and is an important part of their life. Psychological empowerment also motivates employees to believe that they are capable to bring changes and have high control toward the company. Such employees are happily dedicating their careers in the company because company has already

become an important part of their personal identities (Kraimer *et al.*, 1999).

Creative ideas development has positive effects on salesperson performance. Hypothesis (H<sub>6</sub>) says that creative process engagement has positive effects on salesperson performance. Previous researches support the hypothesis (Amabile *et al.*, 1996; Zhang and Bartol, 2010). When an employee totally gives concern on the engaged problems and spare quite enough time to deal with the problems, that employee will produce more effective and creative new ideas to increase performance. Besides for dealing with work problems, creative ideas also contribute to the employee's performance during the process of company decision-making that makes him/her engaged in the process. Creative ideas can also come up in the form of adaptive selling behaviors. Hypothesis (H<sub>7</sub>) states that adaptability has positive effects on salesperson performance. Previous researches support the hypothesis (Ahearne *et al.*, 2005; Boorum *et al.*, 1998). Salesperson able to adapt selling approach is likely to meet what the consumers need, and thus the quality of service increases (Bitner *et al.*, 1994; Humphrey & Ashforth, 1994; Reid *et al.*, 2002). The quality of service is regarded as performance in this research.

Affective commitment has positive effects on salesperson performance. The hypothesis supports the findings of the previous research by (Meyer & Allen, 2004). A success of an organization can be seen from the commitment and participation of the employees (Liou, 2008). The research of Meyer and Allen (2004) stated that employees with high affective commitment were inclined to work harder to accomplish the job in order to reach the goal of the organization. Dedicated employees give much benefit to the company and are potential to create competitiveness. It will increase retention rate, decrease the company cost through employees' efficiency, and improve the performance of the entire company.

#### **IMPLICATIONS, LIMITATIONS AND FUTURE RESEARCH**

Many previous researchers have studied and written on leadership empowerment behavior (Ahearne *et al.*, 2005; de Klerk & Stander, 2014; Zhang & Bartol, 2010). However, among those many literatures, only a few discuss the effects of leadership empowerment behavior on salesperson performance. This research is

specifically intended to contribute to elucidating the relationship between leadership empowerment behavior and salesperson performance. Various variables of creativity and psychology such as psychological empowerment, creative process engagement, adaptability, affective commitment, are engaged to elucidate the relationship between the two main variables. Therefore, this research augments the topic on leadership empowerment behavior and can be a reference for the next researches.

Flexible leadership (decentralization) is one of the company's efforts to engage in tighter market competition. This research proposes one of the leadership forms that appropriate for striving in such a tight market competition. Leadership empowerment behavior is to a certain extent a popular leadership in this globalization era. The results of this research show a positive relationship between leadership empowerment behavior and salesperson performance. Implementing leadership empowerment behavior such as leading by example, participative decision making, coaching, and showing concern/interacting with team is an effort that can improve the performance of the company. Below are some steps for company to implement leadership empowerment behavior:

1. Company appoints a manager with good personality (charismatic) in the eyes of the employees. It is because employees need competence and trustable leader in running the job tasks. Thus, empowerment can be administered through such a leader.
2. Manager empowers employees. This step is done by giving training, fostering, emotional support, information supply, and participative decision-making.
3. Fostering and training. What is meant by fostering in this context is that a manager gives guidance and support for the development of the employees. It can be done by delegating some authority along with fostering and guidebook. Besides, a manager must facilitate employees to upgrade their performances through joining various kinds of training. To boost the employee creativity, a manager shall send employees to join trainings on creativity.
4. Emotional support. In this extent, a manager is required to care of the employee's work problems. Some employees may get stressed when having additional responsibilities.

Surmounting such situation, a manager must hold periodical meeting program to listen to employees' whimper or mutter to comprehend what employees need.

5. Information supply. Concerning the company's information especially on rules, decision, and policies, a manager must sort and select which information is appropriate to distribute to employees. With such an information supply, employees may understand what is going on in the company and build trust between them. Information supply is also important in holding training, and useful in encouraging employees to willingly join training.
6. Participative decision-making. A manager gives opportunity to employees to participate in decision-making related to their work. Participative decision-making is useful for new products development planning of the company. Employees' creative ideas can be channeled out through their engagement in decision-making.

Improper placement of moderation of need for achievement in two psychological variables relation (leadership empowerment behavior and psychological empowerment) is considered unable to disclose the moderation effect of the relationship. It is suggested that the next research situated moderation of need for achievement in the relationship between two variables of different characteristics. For example, moderation of need for achievement in psychological variable and behavior variable relation.

The use of self-report on the questionnaires has resulted in common method variance bias. Respondents were likely to give high score on positive statement, but low score on negative statement. It is expected that the next research will involve company leaders to obtain data on the implementation of leadership empowerment behavior and employees to get objective data on performance, psychological empowerment response, creative process engagement, and adaptability.

Taking the data of 149 cigarette salespersons by using purposive technique has caused limited research generalization. It is expected that the next research will take more samples on salespersons of various business kinds in order to increase the research generalization.

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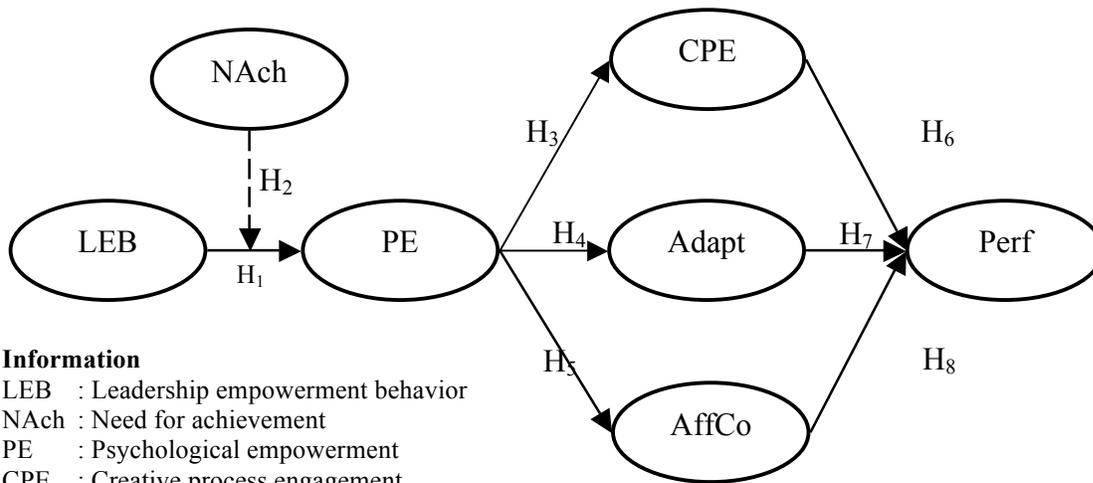
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**Figure 1**  
**Hypothesized Model**



**Information**

- LEB : Leadership empowerment behavior
- NACH : Need for achievement
- PE : Psychological empowerment
- CPE : Creative process engagement
- Adapt : Adaptability
- AffCo : Affective commitment
- Perf : Salesperson performance

**Table 1**  
**Reliability Testing**

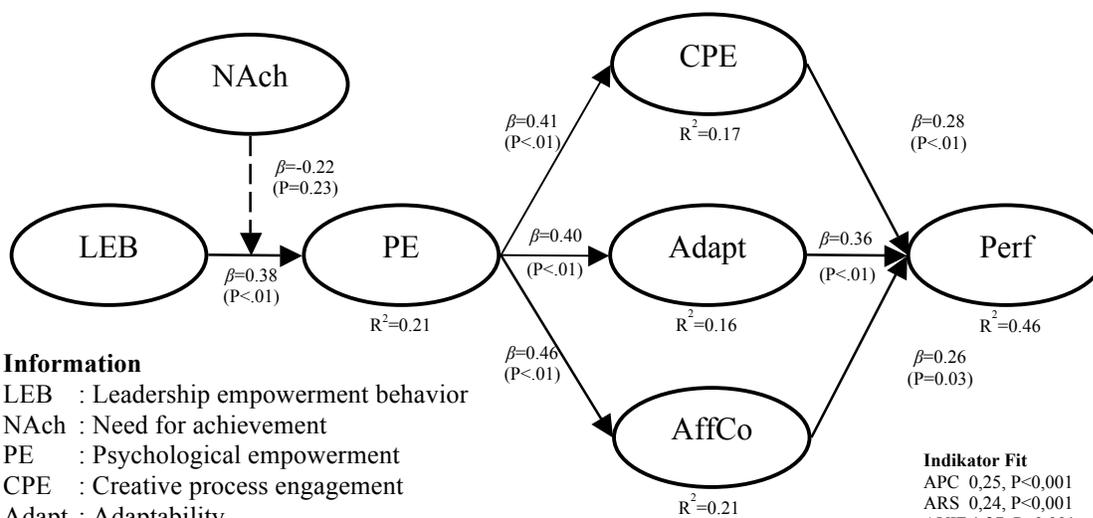
Variable	Cronbach's Alpha	Composite Reliability
Leadership Empowerment Behavior	0,970	0,972
Psychological Empowerment	0,893	0,913
Need for Achievement	0,841	0,888
Creative Process Engagement	0,913	0,929
Adaptability	0,877	0,902
Affective Commitment	0,833	0,878
Salesperson Performance	0,885	0,908

**Table 2**  
**Descriptive Statistics<sup>a</sup>**

Variable	Mean	SD	1	2	3	4	5	6	7	8
Control										
1. Age	28,85	0,51								
2. Job tenure	5,71	0,72	0,47**							
3. Leadership empowerment behavior	3,84	0,52	0,20*	0,16*						
4. Psychological empowerment	4,12	0,39	0,31**	0,21**	0,38**					
5. Need for achievement	4,11	0,44	0,21**	0,22**	0,18*	0,54**				
6. Creative process engagement	3,98	0,41	0,12	-0,05	0,32**	0,41**	0,34**			
7. Adaptability	3,97	0,38	0,31**	0,17*	0,23**	0,38**	0,42**	0,48**		
8. Affective commitment	3,69	0,56	0,23**	0,36**	0,22**	0,43**	0,36**	0,17*	0,18*	
9. Salesperson performance	3,96	0,40	0,16*	0,21**	0,15	0,37**	0,42**	0,46**	0,55**	0,30**

<sup>a</sup>n=149; \*p < 0,05; \*\*p < 0,01

**Figure 2**  
**Structural Equation Modelling with Moderation Results**



**Information**

LEB : Leadership empowerment behavior  
 NACH : Need for achievement  
 PE : Psychological empowerment  
 CPE : Creative process engagement  
 Adapt : Adaptability  
 AffCo : Affective commitment  
 Perf : Salesperson performance

**Indikator Fit**

APC 0,25,  $P < 0,001$   
 ARS 0,24,  $P < 0,001$   
 AVIF 1,27,  $P < 0,001$

## THE EFFECT OF PROJECT MANAGERS' LEADERSHIP STYLES ON PROJECT MANAGEMENT PERFORMANCE (CASE STUDY ON PLTU XYZ 2 X 30 MW)

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### **ABSTRACT**

*PLTU XYZ construction project - with a capacity of 2 X 30 MW - is a part of the accelerated development of a 10000 MW power generation program first phase which is being launched by the Indonesian government. To handle large projects that have high level of complexity requires a leader or a project manager who has expertise in the field of power plant construction, has good leadership skills, and who is expected to be able to overcome the difficulties faced during the process of the project.*

*This research was conducted using a qualitative method to find out the leadership style of the project managers who have led PLTU XYZ project and also to investigate their influence on the project management's team performance. Data were collected by using interviews, which were then analyzed by applying the modified grounded theory.*

*The study discovered that the first project manager has an 'affiliative' leadership style, the second has a 'pacesetting' leadership style while the third has a 'democratic' leadership style. The affiliative leadership style and democratic leadership style brought positive effects to the project management team's performance while the pacesetting leadership style brought negative effects to the project management team's performance. This research also found that the leadership style of the project manager was not the factor that could cause delays in the project.*

**Keywords:** Leadership style, PLTU XYZ 2 x 30 MW project, project management.

### **INTRODUCTION**

To meet the needs of electrical energy in a particular city in the island of Sumatra, PT Perusahaan Listrik Negara (PLN Persero) planed to build, own and operate a steam power plant with a maximum capacity of 2 x 30 MW, which was then known as a PLTU XYZ 2 x 30 MW project. A power plant (PLTU) was chosen to replace a diesel engine, which was considered a waste of fuel and was less efficient to operate

compared with the electricity's selling price by Kwh that is currently set by PLN.

The development of PLTU XYZ 2x30 MW project was one of the accelerated developments of phase one of a 10000 MW power generation program. It was launched by the Indonesian government in 2007 when Indonesia was led by President Susilo Bambang Yudhoyono and Vice President Jusuf Kalla. When the program was implemented, many foreign and Indonesian contractors competed to participate in the

program. Financial support of the program was assisted by the government of China. In the process, almost all of the projects that were part of the accelerated development of phase one of the 10000 MW power generation program were late for completion. There are several power plants that could not be completed on time due to various problems, including land acquisition problems, unfavorable weather conditions during the construction process, the transfer of land location, and other non-technical issues.

To work on the PLTU XYZ 2x30 MW project, PT. PLN (Persero) appointed a partnership between PT. ABC from Indonesia with PT. DEF from China as the prime contractor or 'Engineering Procurement Construction (EPC) Contractor'. PT. ABC acts as the leader of the partnership and has a duty to control the project's process as well as to coordinate with PT. PLN (Persero). Similar to other power plant construction program that were included in the accelerated development of phase one of the 10000 MW power generation program, the construction of PLTU XYZ project was also delayed. At the time of writing in early 2016, the process of the PLTU XYZ project had reached 98.25% and has been delayed for four years.

As with any other project, PLTU XYZ construction project is led by a project manager who is appointed as the head of the project management team. The project manager has a duty to oversee the project implementation so that it will be in line with the project plan. The project manager also has a duty to direct his team members and to communicate with all parties involved in the project implementation. According to Melton & Smith (2009: XIV), the main target to be achieved by a project manager is: *"As a project manager your goal is to deliver the project as planned, taking into account the current environment - both internally within the project and externally within the business "*.

Every project manager has his/her own leadership style that they apply to their team members when running a project. Besides that, the project manager should develop relationships with various stakeholders, including clients, suppliers, team members, corporate management,

and others. Therefore, a suitable leadership style that fit into particular situation is absolutely important. The suitable leadership style is also crucial when the project manager faces the myriad uncertainties that usually happen when leading a project.

The PLTU XYZ construction project faced many non-technical obstacles that caused project delays such as land acquisition problems, lack of road accessibility to the project site, and the weather that was not conducive. To make up for the project delays, PT. ABC intended to improve the performance of project management by appointing a new project manager in order to finish the project soon. Until this study was conducted, PT. ABC had changed the project manager three times, even though there was no valid evidence that the performance of the project management team was one of the causes of project delays since there were too many factors affecting the delay of the project.

Any project should be run by the project manager in accordance with the target time, cost and quality that had been planned previously. Failure to achieve these targets will affect all team members involved in the project management. Based on the discussion above, it can be concluded that the problems that were faced by PT. ABC included:

- There was an indication of dissatisfaction from the management and other departments of PT. ABC towards the performance of the project management team who were in charge of PLTU XYZ Project.
- The changing of the project manager three times showed that the leadership style of the project manager influenced the project management team's performance, considering that each project manager had a different leadership style.
- There might be a relationship between the project management team's performances and the delay of PLTU XYZ Project.

Therefore, the research question of this study is "What is the effect of the leadership style of the first, second, and third project manager on the project management team's performance in PLTU XYZ?" This study aims to identify and

analyse the leadership style of the first, second, and third project manager, to analyse the effect of each project manager's leadership style on the project management team's performance, and to find out whether the project management team's performance was one of the causes of the project delay. The main contributions to this study are:

- As a reference for companies to choose project managers when they have a project which has a high degree of complexity like PLTU XYZ.
- As a reference for companies to reduce the risk of losses when they are working on a project.

This paper is organized into six sections including this introduction, continuing with a literature review. The third section explores the research methodology and the fourth section discusses the data analysis and discussion of the findings. Meanwhile the last section summarizes the implication and recommendation.

## LITERATURE REVIEW

### 1. Project Management

Project management is an activity which combines the technical and human aspects of a project systematically. Project management is used to perform control functions and supervision of all activities within a project so that it can be run successfully and be completed on time. A project is successful if it can be completed on time, meeting the expected quality standards and in accordance with the planned budget.

According to PMBOK Guide (A Guide to the Project Management Body of Knowledge), project management is an application of knowledge, skills, tools, and techniques in an overall project with the aim to meet the requirements of the project. Wysocki (2007), describes that project management as a method or a set of techniques which are applied based on management principles that are used to perform the functions of planning, forecasting, and controlling all work activities to achieve the desired results in a timely manner.

### 2. Project Manager

Every project must have a project manager. The project manager is a person who is in charge to lead the project and the project management team and is responsible for ensuring that the project is completed on time within the budget. This statement is in line with Wysocki's (2007) definition. Besides that according to Walsh (2008:167) "*The wise Project Manager knows that the specification contains errors, ambiguities, and misdirection. Depending on the complexity of the project, the specification will change many times before the project is completed, and probably will increase frequency as the deadline draws closer*". Therefore, it is very crucial for a project manager to have a leadership skill as good as his management skill (Lewis, 2007).

In general, a project manager is selected when a company obtains a project and the project will be implemented soon. According to Kerzner in Wysocky (2007), since the roles and responsibilities of the project manager are so important, so his or her selection should be general management's responsibility. He further explains that a project manager must have the following skills:

- *Background and Experience*: Have a background and experience in the field of project management.
- *Leadership and Strategic Expertise*: A project manager must obtain cooperation and good support from their team members as their leadership ability is a vital ingredient.
- *Technical Expertise*: A project manager does not need to have a high degree of technical expertise but instead, a project manager must have enough technical and technological expertise that is required to produce management decisions.
- *Interpersonal Competence*: The ability to communicate with team members, suppliers, business managers, customers, and other parties.
- *Managerial Ability*: Mastering project management skills such as strategic planning, budget planning, staff planning,

quality management, business process re-engineering, and personal development.

### 3. Leadership

One of the definitions of leadership is expressed by Armstrong (2009: 4), "*Leadership is the process of getting people to do their best to achieve a desired result*". Armstrong also convey the opinions of some experts on leadership, that include:

- Ivancevic et al., (2008): "*Leadership is the process of influencing people to enable the achievement of relevant goals*".
- Goleman (2000): "*A leader's singular job is to get results*".
- House et al (2004): "*Leadership is the ability to motivate, influence and enable individual to contribute to the objectives of organizations of which they are members*".
- Stogdill (1974): "*Leadership is an influencing process aimed at goal achievement*".
- Dixon (1994): "*Leadership is no more than exercising such an influence on others that they tend to act in concert towards the achievement of a goal that they might not have achieved...*".

From the definitions above, it can be concluded that there are some similarities on the general assumptions of leadership that include:

- Leadership involves interaction in a group, and involves more than one person or could involve several people.
- Contain elements that affect a person or a group.
- Has a target to be achieved.

### 4. Leadership style

In doing his/her job, a leader will apply a variety of leadership styles to achieve the desired targets, so it is difficult to determine which leadership style is the best to apply in a particular situation.

Based on the research conducted by Hay McBer Consulting in Goleman (2000), there are six leadership styles which consist of:

- *Coercive*: A leadership style that centralizes all decisions, regulations, measures, and policies on the leader.

Example: the leader closely supervises his/her team members, asks for lots of reports, likes to make his/her own decisions, and motivates the team members by imposing discipline.

- *Authoritative*: A leadership style where the leader makes his/her subordinates achieve the vision of the company.

Example: the leader maximizes the team commitment to achieve the goals and strategies, explains the rules and standards of work, and gives a clear explanation of the vision of the company to motivate the team members.

- *Affiliative*: the leader tries to create a harmonious atmosphere and build an emotional bond with his/her subordinates.

Example: the leader has emotional intimacy with his/her subordinates, communicates positively and always tries to raise the morale of his/her subordinates.

- *Democratic*: A leadership style where the leader gives a high degree of authority to his/her subordinates in doing their jobs. The leader likes to involve others in making decisions, listens to their opinions, and provides directions to solve problems.

Example: the leader builds and encourages the team members to provide ideas and participate in decision-making.

- *Pace-setting*: A leadership style where the leader demands perfection from his/her subordinates, sets high standards and provides examples to subordinates.

Example: the leader expects perfection from his/her subordinates in doing their work, applies high standards, and considers the subordinates have the same abilities as him/her.

- *Coaching*: A leadership style where the leader develops his/her subordinates, because with the advancement of their abilities, they will greatly assist him/her in developing the organization.

Example: the leader builds teams for future purposes, has dialogues with the subordinates, gives flexibility to his/her subordinates, and develops long-term plans and targets.

## RESEARCH METHODOLOGY

### 1. Research Approach

Observation and interviews were conducted to investigate employees' perception of the leadership style of the first, second, and third project manager on the project management team's performance in PLTU XYZ. The ontology of this study is constructivist and it relies upon the understanding that reality is socially constructed. To incorporate multiple realities/views of the employees' perceptions, the constructivist approach is designed, which is in line with Denzin and Lincoln's (1994, p.13-14) statement:

*"The constructivist paradigm assumes a relativist ontology (there are multiple realities), a subjectivist epistemology (knower and subject create understandings), and a naturalistic (in the natural world) set of methodological procedures. Findings are usually presented in terms of the criteria of grounded theory"*.

Consistent with Denzin and Lincoln's statement above, first, the multiple realities are found in different data sources which are comprised of managers, supervisors, and officers.

Secondly, a qualitative methodology is the most suitable approach for this research since the epistemology is interpretive because the knower (the researcher) and the subjects (the

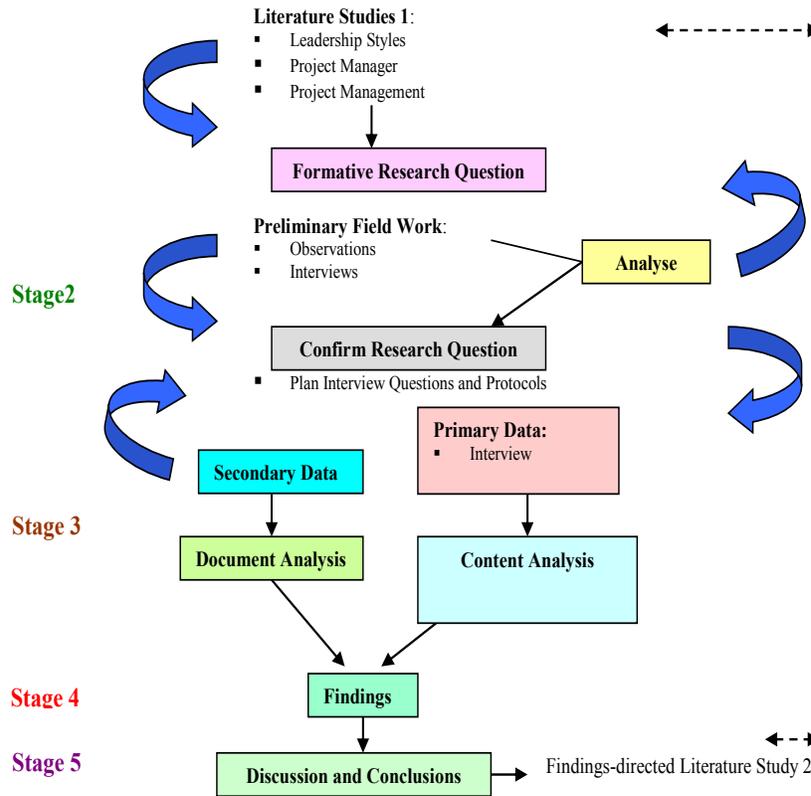
interviewees) create the understandings through the interaction between them.

Thirdly, the findings are presented in terms of the criteria of grounded theory. Glaser and Strauss (1967) state that grounded theory is a process that facilitates the generation of theory from data that is systematically obtained from social research. The grounded theory proposed that the discovery of meaning as constructed by social actors should be carried out by a researcher who does not have any preconceptions about the phenomena. But Whiteley (2004) argues that there are some difficulties when applying it to business settings. Her reason is that usually business research begins with defining a problem or issue. Therefore, she proposes the term 'grounded research' as an alternative to grounded theory. Other qualitative experts called this approach a modified grounded theory. This study applies grounded research/modified grounded theory because it begins with a predetermined issue.

### 2. Research Design

According to Whiteley (2002, p. 9), *"the purpose of the research design is to provide a logical sequence that connects field data to a study's initial research questions and ultimately to its conclusions"*.

The research design of this study can be seen in Figure 1 below.



Source: Modified from Thoha (2006)

Figure 1. Research Design

### 3. Research Method

In doing this research, several stages were conducted:

1. *Literature review*: Collecting the theories that are related to the research from the books, journals, the internet and other sources.
2. *Observation*: Direct observation at the project site to investigate the project management team's performance involved in the project construction.
3. *Data collection*: Data collection was conducted through interviews, and then the data were processed by applying the *coding* process.
4. *Data analysis*: Data analysis was conducted using *content analysis* that reflected *theoretical sensitivity* in developing the *leadership* concepts.

5. *Conclusion and recommendations*: Contains the research results as well as some suggestions/recommendations.

### 4. Data Sampling Technique

There are various sampling techniques that can be used in conducting a research; however, this study applied the purposive sampling method. Purposive sampling is a method of data sampling which selects participants who meet the criteria so that they can provide informations that are required and the results can be used to answer the research questions.

### 5. Data Collection and Analysis Techniques

In this study, the data were collected by using interviews. The purpose of doing the interviews was to obtain relevant information with a fairly high degree of accuracy. Data that were obtained through interviews served as primary data, while the secondary data was obtained through the

existing literature, as well as the company's documents.

Business research usually begins with a defined problem or issue, so this study utilized semi-structured interviews (Whiteley, 2004). According to King (1994), the semi-structured interview is also called a 'structured open-response interview'. This research applied semi-structured interviews as pointed out by May (1997) because it allowed the researcher to ask open-ended specified questions which gave more freedom to the researcher to explore and probe the issues. In addition, as suggested by Patton (1990), it also kept the interaction within boundaries whilst leaving room to probe as recommended by Berg (1989). This is consistent with the principle of the tradition of 'giving voice' to respondents (Charmaz, 2000), where the interviewees had an opportunity to tell their stories based on their personal experiences.

The interviews in this study were conducted with three levels of respondents that included managers (3 people), supervisors (7 people), and officers (3 people). The aim was to investigate the opinions from different levels of respondents in order to minimize the difference of each person's opinion and to know the opinion of the respondents from different levels. This method is conducted for 'triangulation purposes'. According to Mathison in Wahyuni (2012:40), *"Triangulation has raised an important methodological issue in naturalistic and qualitative approaches to evaluation [in order to] control bias and establishing valid propositions*

*because traditional scientific techniques are incompatible with this alternate epistemology."*

The interviews were conducted three times with each respondent in order to get in-depth information on the first, second, and third project managers' leadership style. All interviews were recorded. The purposes of recording the interviews are: first, by studying the tapes of conversations the researcher is able to focus on the 'actual details' of respondent's opinions. Secondly, they can be replayed and transcripts can be improved (Sack, in Silverman, 2000). In this study, 39 interviews were conducted which were then transcribed into 198 pages.

## **DATA ANALYSIS AND DISCUSSION OF FINDINGS**

### **1. Data Analysis**

The transcript data were sorted, coded, and analyzed utilizing content analysis as stated by Patton (1990, p.381): *"Content analysis is the process of identifying, coding, and categorizing the primary patterns in the data. This means analyzing the content of interviews and observations."*

By applying content analysis, various nodes that were developed were based on the respondents' words or terms. These nodes were then grouped to determine sub-categories. Several sub-categories were grouped to develop categories and later on to develop super-categories. The categories that were developed were compared and contrasted in a way that reflect theoretical sensitivity in developing the leadership concepts.

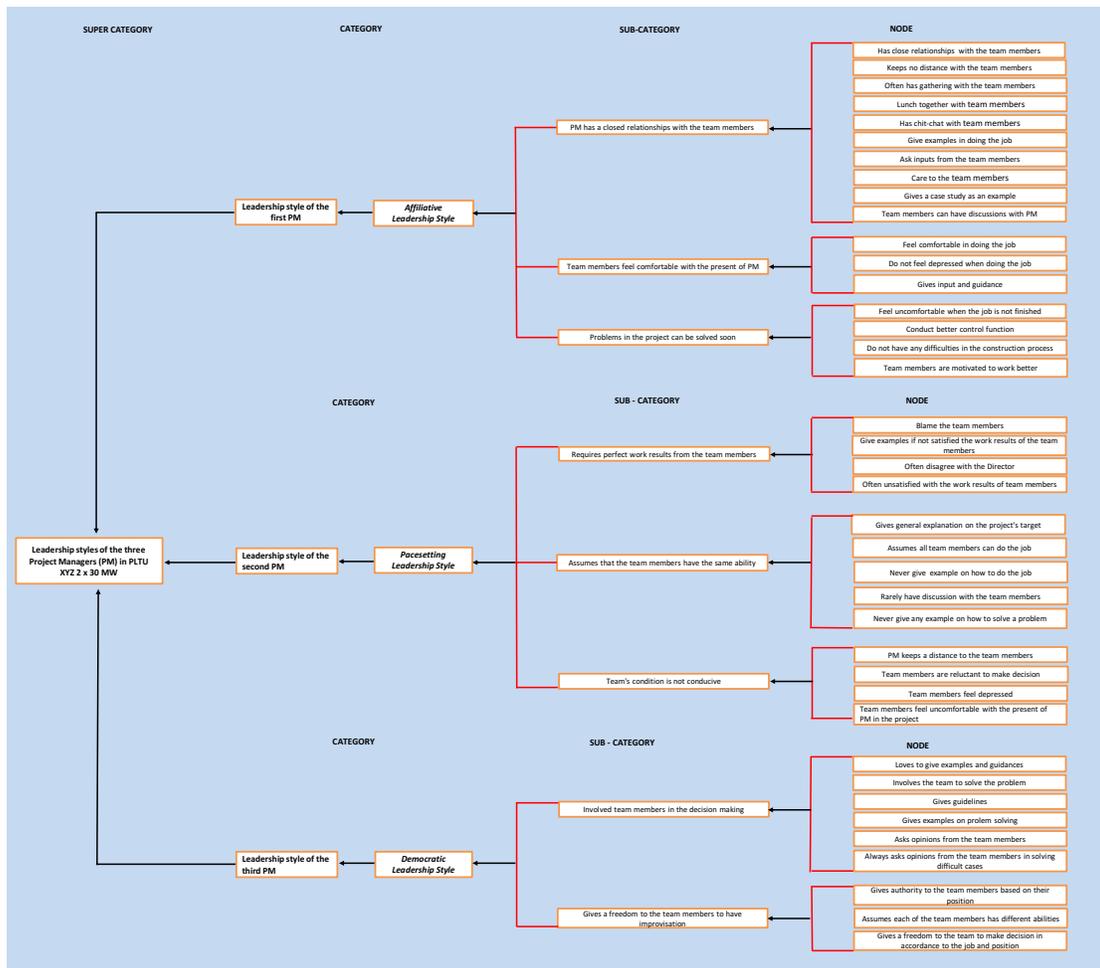


Figure 2. Coding and Categorizing of Project Managers' Leadership Styles in PLTU XYZ

## 2. Discussion Of The Findings

The primary data that were obtained through observations at PLTU XYZ 2 x 30 MW project site, and the interviews in the form of direct interviews either by phone or face to face, were able to be used to determine the leadership style of each project manager while they were leading at PLTU XYZ 2 x 30 MW project, and to identify their influence on the project management team's performance.

### Project Manager's Leadership Style

Figure 2 presents the coding mapping results from the interview transcript data on the leadership style of the first, second, and third project managers. It consists of category, sub-category, and node from each category. It can be seen from the category in Figure 2 that each project manager who led PLTU XYZ 2 x 30 MW

project, had their own leadership style (including affiliative, pace-setting, and democratic leadership styles) when dealing with the project, team members, and other stakeholders.

### **The leadership style of the first project manager: affiliative**

The first project manager who led PLTU XYZ project had an affiliative leadership style. The characteristics of this leadership style are such that the leader tries to create a harmonious atmosphere and build an emotional bond with his subordinates as stated by Garrick from Hay McBer Consulting (2006; p. 7): "*Affiliative Style - Primary Objective: Creating harmony among employees and between the manager and employees*".

This characteristic was consistent with the three sub-categories of the first project manager's leadership style that comprised of project

manager had close relationships with the team members, team members felt comfortable with the presence of the project manager, and problems in the project could be solved quickly. Meanwhile, these three sub-categories were developed from the 17 nodes as can be seen in figure 2. The nodes were taken from the respondents' (managers, supervisors, and officers) words/terms. For example:

- Managers' statements:

*// This project manager always paid attention to the team members and often invited his team members for gatherings outside of working hours. //*

*// Yes, I was considered to have a close relationship with the project manager. //*

*// I felt quite comfortable when the project manager was at the construction site. //*

- Supervisor's statements:

*// The project manager often paid attention to his team members and often invited the team members to have a meal together. //*

*// Yes, our relationship with the project manager was very close. //*

*// I felt quite comfortable when the project manager was at the construction site. //*

- Officer's statements:

*// The project manager often approached and invited his team members to have a meal together. //*

*// Yes, I think that my relationship with the project manager was very close. //*

*// Yes, I felt very comfortable when the project manager was at the construction site. //*

**The leadership style of the second project manager: pacesetting**

The second project manager who handled PLTU XYZ project had a pacesetting leadership style. The characteristic of this leadership style are the leader demands perfection from his/her subordinates, sets high standards, and provides examples to subordinates as confirmed by Garrick from Hay McBer Consulting (2006; p. 7): *"Pacesetting Style - Primary Objective: Accomplishing tasks to high standards of excellence."*

These characteristics are in line with the three sub-categories of the second project manager's

leadership style that included: requiring perfect work results from the team members, assuming that the team members have the same ability, and the team's condition was not conducive. The 13 nodes that can be found in figure 2 were taken from the respondents' (managers, supervisors, and officers) words/terms and were used to develop these sub-categories. For example:

- Managers' statements:

*// This project manager always assumed that his team members could do the job so he did not give a detailed explanation regarding the job. //*

*// The project manager gave an example of the work that is considered to be not suitable with what he wants. //*

*// Usually, this project manager would be upset and give examples of general solutions to the problems. //*

- Supervisors' statements:

*// He always considered that the team members had the same ability/skills as he does; he didn't give any explanations. //*

*// Always gave examples on the job that he considered not suitable with what he likes. //*

*// Sometimes gave examples on how to complete the job. //*

- Officers' statements:

*// The project manager always considered that the team members were able to or definitely could do any job so no detailed explanation were provided. //*

*// He will give an example of the work that he considered to be not suitable with the way the project manager wants or the quality was considered bad by the project manager. //*

*// The project manager would be upset and give instructions on how to complete a job. //*

**The leadership style of the third project manager: democratic**

The third project manager who managed the PLTU XYZ project when this research was conducted had a democratic leadership style. This style of leadership gives high authority to his/her subordinates. This type of leader is very pleased to involve others in decision-making, listen to their opinions, and provide solutions to problems. Garrick from Hay McBer Consulting (2006) refers to this leadership style as a style that has

the primary objective that are building commitment among employees and generating new ideas.

These characteristics are consistent with the two sub-categories of the third project manager's leadership style that included: involving the team members in the decision making and giving freedom to the team members to make improvisations in doing their job. As can be seen in figure 2, these two sub-categories were developed from the nine nodes that were taken from the respondents' (managers, supervisors, and officers) words/terms. For example:

- Managers' statements:

*// Usually for complicated things the project manager would ask the team's opinion. //*

*// The project manager gave high authority according to the duties and position of each team member. //*

*// Yes, he often involved us in problem solving and decision-making. //*

- Supervisors' statements:

*// Yes, he always asked for the team members' opinions. //*

*// I think yes, the project manager gave high authority to team members according to their position. //*

*// Yes, we were often being involved //*

- Officers' statements:

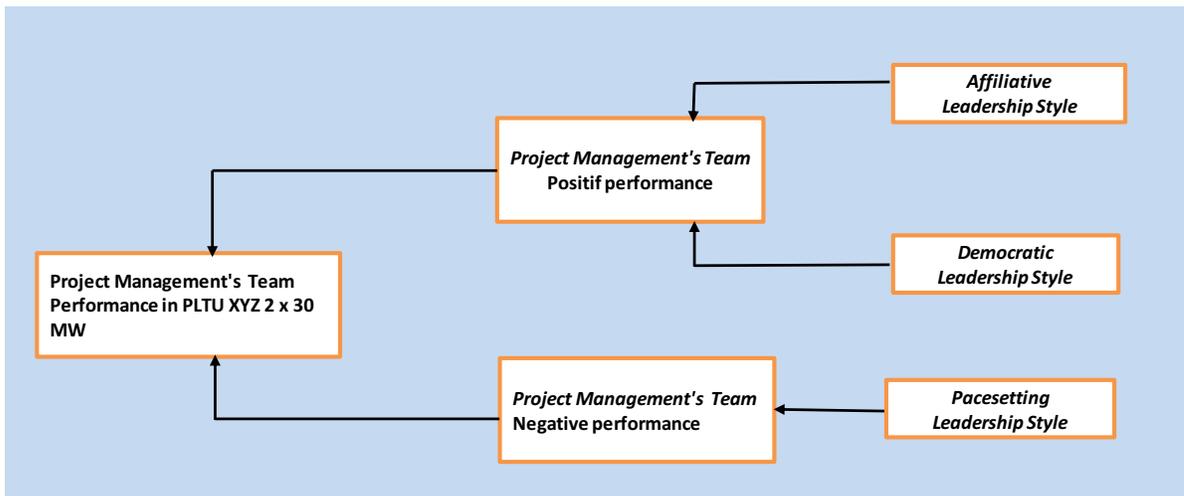
*// The project manager often asked for opinion if the problem faced was complicated and involved various parties/departments for completion. //*

*// The project manager gave high authorities to the team members according to the job and position in the project, team members were allowed to create their own things. //*

*// Yes, always being involved in problem solving and also its solutions. //*

**Project Management Team's Performance**

Figure 3 shows the project manager's leadership style has an influence on the project management's team performance. The influences of the leadership style can be positive or negative that ultimately might simplify or complicate the construction process at PLTU XYZ 2 x 30 MW project site.



**Figure 3.** The Relationships Between the Project Managers' Leadership Style and the Project Management Team's Performance

**The Project Management Team's Performance Under the First Project Manager**

The affiliative leadership style that was applied by the first project manager brought a positive impact on the project management team's performance. This is supported by the evidence that include the team members were motivated to

work better, compelled to perform better functions on planning and control of the project, and felt a comfortable working environment. This was supported by the interview results below:

- Managers' statements:

*// Yes, I felt uncomfortable when I was not able to complete the work on time or our work was not good. //*

*// Yes, I felt happy when the project manager was at the construction site. //*

*// For me, I think with this leadership style, we felt safe and comfortable, thus we will completed our jobs better. //*

*// This project manager dared to argue in rejecting interventions from the Board of Directors. //*

▪ Supervisors' statements:

*// Yes, if we completed our job with low quality then we felt uncomfortable. //*

*// Yes sir, I felt very happy when the project manager was at the construction site. //*

*// Yes, I was worried if the construction process was not fulfilling the project manager's wants. //*

*// The Board of Directors always intervened in the work arrangement at the construction project site, but however, the project manager always strived to reject any forms of intervention. //*

▪ Officers' statements:

*// Yes sir, there was an uncomfortable feeling if the work was not good. //*

*// Yes, I felt comfortable when the project manager was at the construction site. //*

*// I did not feel any pressure but instead felt comfortable. //*

*// The Board of Directors always intervened in the decision making; however the project manager always managed to reject any forms of intervention. //*

### **The Project Management's Team Performance Under the Second Project Manager**

The second project manager applied a pacesetting leadership style that brought negative effects on the project management team's performance, for example working conditions became uncondusive, the team members were scared to make decisions because they were afraid to be blamed by the project manager. Therefore, the team members were not motivated to work better. This can be inferred from the interview results as follows:

▪ Managers' statements:

*// .... I felt upset and wanted to just quickly go back home. //*

*// For me, the working conditions were not conducive, full of pressure, and fear to be wrong, so people would become apathetic in working. //*

▪ Supervisors' statements:

*// No, because usually there is just something to be blamed even though we have already tried to complete the job according to the schedule. //*

*// We often feel under pressure because the boss always thought we made mistakes, but for us actually not. //*

*// Yes, because a lot of our colleagues felt horrified to make decisions due to the fear to be blamed or scolded by the boss. //*

▪ Officers' statements:

*// Not at all, because for being creative, we were scared to be blamed by the project manager if was not according to what he wanted. //*

*// Yes, I felt under pressure because I was scared to make mistakes in doing my work in case i got scolded by the project manager. //*

*// Yes, I was worried ....because if the process was not as the project manager wanted ....he always blamed his own team members. //*

### **The Project Management Team's Performance Under the Third Project Manager**

The third project manager's leadership style, which was democratic, brought positive effects to the project management team's performance; for example, supporting the construction process, creating a comfortable working environment for the team, encouraging the team to work harder or better, and the team members were not hesitant to make decision because they were being given high authority.

▪ Managers' statements:

*// Yes because this project manager was quite detailed when asking about the job status to the extent that we had to do well in control function. //*

*// We did not feel any pressure but instead felt comfortable. //*

*// He was not disturbing the construction process. //*

▪ Supervisors' statements:

*//Yes sir, because project manager was very detailed about the construction progress. //*

*// Yes, I felt very happy when the project manager was at the construction site. //*

*// Not feeling any pressure but instead feeling comfortable. //*

- Officers' statements:

*// Yes, there was an uncomfortable feeling while doing a job with not so good quality. //*

*// Not feeling any pressure but instead feeling comfortable because the project manager would provide direction or solution if we made any mistakes. //*

*// Never felt any difficulties but instead felt peaceful in doing the work. //*

#### **The Delay on PLTU XYZ Project**

The project manager's leadership style was not one of the factors that caused the delay of the project; this can be inferred from the interview results as follows:

*// In my opinion, the delay of the project was not because of the leadership style; there are a lot of other things to be considered such as land tillage, engineering, and the procurement side. //*

*// No, the delay on the project happened because there were a few factors; for example, weather factors, the involvement of the Board of Directors, lack of preparation of the operators, and other factors. //*

*// XYZ project experienced delays because of the weather factors, infrastructure, unreliable electricity network system, the Board of Directors' wrong policies and other factors. There was no relationship between the delayed project and the project manager's leadership styles. //*

## **IMPLICATIONS AND RECOMMENDATIONS**

Based on the findings explained above, this section will discuss the implications of the findings and provide several suggestions or recommendations.

### **Selection of project manager**

The project manager's leadership style has an influence on the project management team's performance, however according to Hay McBer theory each of these leadership styles has

advantages and disadvantages depending on the situation encountered.

In selecting a project manager to handle a project that has a high level of complexity, companies might consider choosing a project manager who has an affiliative or democratic leadership style because these leaders are capable of achieving positive performance in project management. Even though for this particular project the affiliative and democratic leadership styles can bring positive results for the project management team, but it does not mean that leaders who apply other leadership styles are not suitable to lead a project.

The best project manager is the project manager who possess four or more leadership styles as proposed by Hay McBer theory, because each of these leadership styles have its own unique style in facing a particular situation or problem. This is in line with the theory stated by Goleman (2000), "Leaders who have mastered four or more - especially the authoritative, democratic, affiliative, and coaching styles have the very best climate and performance. The most effective leaders are also able to switch flexibly among the leadership styles as needed."

### **Cause of Delays on PLTU XYZ Project**

The PLTU XYZ project has been delayed for four years. The delay was caused by several factors that are consistent with the categories of delays that are proposed by Kraiem dan Diekmann in Ng,et.al., (2004):

- Delays that are eligible for compensation (compensatory delays).

At PLTU XYZ project this delay was caused by the project's owner lateness to acquire the land, access road problem, lack of preparation on the operator side, and by unreliable electricity networks.

- Delays that are not eligible for compensation (non-excusable delays).

At PLTU XYZ project this delay was caused by the intervention of the Board of Directors to the project management team and the application of wrong policies from EPC contractor that were determined by the Board of Directors and influenced the construction process.

- Delays that were not caused by the project's owner or contractor (excusable delays). At PLTU XYZ project this delay happened due to high rainfall and lack of appropriate local infrastructure to support a large capacity project.

To sum up, as can be seen from figure 4, the delay of PLTU XYZ project was not caused by

the leadership style of the project managers, but by the owner of the project, the force majeure circumstances, and by other causes. Therefore, PT. PLN (Persero) provided an extended time of contract - called the Extension of Time - to the consortium of PT. ABC and PT DEF as the main contractor for the construction of the PLTU XYZ project.

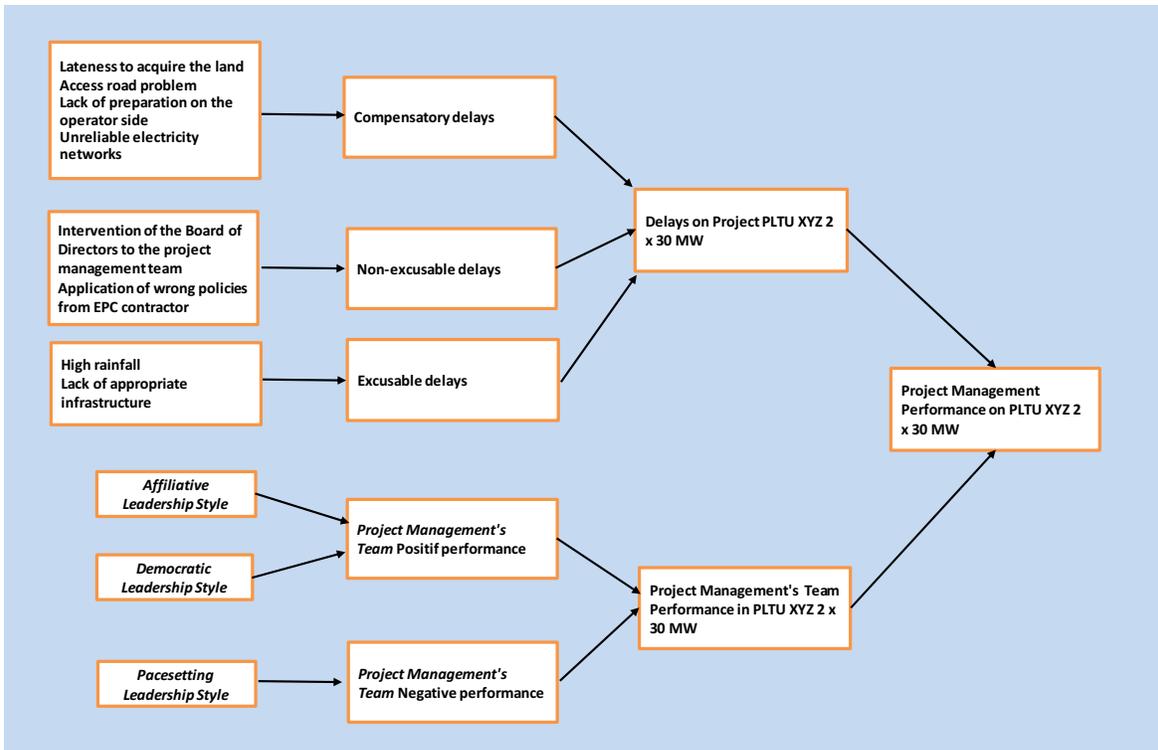


Figure 4. Factors that Influence Project Management Performance on PLTU XYZ 2 x 30 MW

## CONCLUSION

The purposes of this research are to identify and analyse the leadership style of the first, second, and third project managers, to analyse the effect of each project manager's leadership style on the project management's team performance, and to find out whether the project management team's performance is one of the causes of the project delay.

The first project manager applied an affiliative leadership style that had positive impacts on the project management team's performance. Meanwhile the second project manager had a pacesetter leadership style that brought a negative impact on the project management team's performance, and the third project manager had a democratic leadership style that had a positive impact on the project management team's performance.

Based on these findings, it can be seen that the leadership style can bring negative effects as well as positive effects to the project management team's performance. However the delay of the PLTU XYZ project was not caused by the leadership style of project managers.

The best project manager is the project manager who possessed a minimum of four or more leadership styles that are stated by the theory from Hay McBer. However, if a company is having trouble finding project manager candidates who possess several leadership styles, then a leader who has democratic leadership style is relevant to be considered as the project manager to handle projects that have high levels of complexity.

Each leadership style has its own strengths and weaknesses, in the sense that there is no best leadership style that can be applied in all situations. It depends on the situation faced by the project and the strength of the project management's team members. A good project manager must be able to choose the best leadership style according to the problems faced in a particular situation.

Intervention from the company's Board of Directors regarding the project's decision-making sometimes unconsciously played a role in the delay of the project. The project manager must

have the courage to reject the decisions made by the Board of Directors if such decisions would cause problems, so that the project can be run in accordance with the objectives and within the period set.

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**CONSUMER PRODUCT INFORMATION CENTRE:  
ISSUES TO BE CONSIDERED**

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***ABSTRACT***

*There is a traditional rule in a sale contract, that a buyer has the right to know the specifications of the goods. Today, in line with this rule, the concept of 'freedom of information' is created. The combination of the indispensable right of the buyer to know about the subject of the contract and the concept of freedom of information has led to the creation of a new trend among some governments and companies to establish product information centres. Product information management (PIM), which is central to the creation of any product information center, is a process through which manufactured products' data or information are evaluated, identified, stored, managed and distributed in a reasonable and timely way. Through the PIM system, the maintenance of different types of data, product content or any other product information are facilitated and such information are managed in a centralized way. Concepts of consumer welfare, consumer protection and competition between the competitors in the market have considerable role and effect on the creation of such centres. In creating a product information centre, there are many different issues from variety of aspects that ought to be considered from technological issues to legal, political, economic and industrial matters. As such, through a doctrinal type of research, this paper aims to study some aspects relevant to a product information centre from different angles.*

**Keywords:** *Product information centre; product information management; consumer protection; consumer welfare; right to information.*

## THE EFFECT OF LEVEL OF INTRA INDUSTRY COMPETITION AND THE INTENSITY OF ROLE OF GLOBAL INVESTORS TOWARD DEGREE OF CAPITAL MARKET INTEGRATION IN ASEAN

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### ABSTRACT

*By the integration of the ASEAN capital markets, global investors need to diversify among industries in the ASEAN capital markets with the consideration that there is no relevancy regarding to diversify among countries. One way to measure the degree of integration in addition to cointegration techniques are already widely used is the correlation. The use of correlation is done not only to show different degree of integration but also intended to identify the determinant of market integration. The first finding of this study is the different degree of integration at the country and industry levels in the ASEAN which reflects the difference in the benefits of international diversification among industries and countries). The second finding as the important result for this study is the effectiveness of the entropy as a proxy for the level of intra industry competition in Singapore. The implication is global investors need to consider the dynamics of competition among firms within the industry in Singapore as the industry risk for conducting their international diversification strategy. The latest finding is Malaysian bourse still protective so that global investors need to be more active penetration by networking through the local brokerages.*

**Keywords:** *capital market integration, level of intra industry competition, intensity of role of global investors, inter industry diversification, entropy*

### INTRODUCTION

According to Click and Plummer (2005) and Yu, et al. (2010) integration of stock exchanges in ASEAN can be seen from the openness of the exchange to international capital flows and movements together (comovement) between the index with regional and international stock exchange market. The opening exchanges in ASEAN, according to Bekaert and Harvey (1995) was caused by the financial liberalization in the decade of the 1990s. While the comovement occurs, because of increased capital flows from global investors to emerging markets (ASEAN) according Pretorius (2002).

The more open the ASEAN capital markets related financial liberalization makes

the flow of international capital into the region continues to increase. Woonan and Wei (2002), Kuper and Lestano (2007) and Sula and Willett (2009) states in addition to an increase in capital flows will have implications for the further integration of ASEAN capital markets also indicates the behavior of global investors in international diversification. Their behavior according to Richards (2005) is the tendency to give higher weight (overweight) in emerging markets such as ASEAN as part of a global portfolio. Further to the already integrated ASEAN capital markets, the benefits of international diversification will be reduced. This is because diversification will succeed if the pattern of movement of the market return of each stock exchange is

different. Roll (1992) states reduced benefits of international diversification will encourage global investors to change the diversification among countries to diversify across industries. The success of diversification depends on the amount of capital and the level of knowledge of global investors.

International diversification strategy would be successful if any global investors could find, not only where capital markets are not integrated but also look at what factors will create an integrated capital market. These factors include Global Push Factors (GPF) and the Local Pull Factors (LPF). GPF are the driving forces of the degree of openness (openness level) in the capital market-related dynamics of international capital flows. While the LPF is the driving forces of each form of capital market i.e. volatility, liquidity and industry sectors. According to Bekaert and Harvey (1995) and Baele and Inghelbrecht (2009), global investor needs to consider the above factors in order to obtain optimality guarantees the benefits of international diversification because the level of integration varies according to time (can be referred to as time-varying integration).

The trend level of integration varies according to time (time-varying integration) can be viewed as a form of capital market integration dynamics. According to Hong (2005) and Baele and Inghelbrecht (2009), the dynamics of the level of integration can be seen by the pattern of correlations between stock market index returns of each country that has a rising trend ranging from tranquil conditions (calm) to the volatile conditions (crisis). During global financial crisis of 2008, the level of correlation between stock market indices at the ASEAN increased. The increase in the level of correlation results in an increase in the degree of integration that lowers the level of international diversification benefits. If global investors want to maintain the ASEAN capital markets as part of a global portfolio, the diversification strategy across countries need to be converted into inter industry diversification.

Argumentation dynamics of capital market integration can be associated with the study results Errunza, et al. (1992) which divides the integration of the three levels of perfect integration, mild segmentation and perfect segmentation. Under conditions of perfect

integration, barriers to entry for global investors do not exist and vice versa for the perfect segmentation. In the conditions of mild segmentation, the barrier to entry for global investors is not the maximum. Entry barriers in the form of a difference in treatment as quoted by Bae, et al. (2004) and Sun, et al. (2009), a global investor in the China stock market can only buy shares of series B. While shares of series A are only preferred to local investors (that of course is the Chinese's people).

Yu, et al. (2010) found the level of capital market integration in ASEAN tend to vary according to time (time-varying). These conditions encourage global investors to continue to observe the performance of their portfolios. Observation is no longer a partner at the state (country) level but has been in the industry pair level as in the Benson and Green (2005). This is because each country in ASEAN will have a unique structure in addition to industry related differences in the level of openness to foreign capital flows. The uniqueness of the industrial structure of competition is reflected in the characteristics of each industry. In order to ensure the success of inter industry diversification, the global investors need to form a portfolio of industrial partners with a low level of competition. This is based on the findings Carrieri, et al. (2004) that the lack of competition resulted in a lower risk of inter industry diversification. With the growing integration of ASEAN capital markets by making time-varying, global investors need to analyze the dynamics of competition in every industry through a measuring instrument with adequate theoretical basis of the entropy index Ruefli (1990). The use of the entropy index is expected to help ensure the success of diversification but also to note the differences in the level of openness in each ASEAN country.

If the capital markets in the ASEAN have been integrated, the (global) diversification across countries is no longer relevant. The right choice for internationally diversified of global investors is diversified among industries. This is because at the time of the integrated market conditions, the pattern of movement in any stock market return will be the same. Because the pattern of movement in any stock market return as the correlation between the markets return has increased. Based on the classic literature of the

Markowitz investment, when the return correlation in the ASEAN market is increasing, the benefits of international diversification for global investors will be reduced. Benefits of international diversification is generally measured by the Sharpe Ratio as on Ratner and Leal (2005) who has managed to find the phenomenon of integration of the industry level in developed markets.

Reduction in the benefits of international diversification as a result of the capital markets in ASEAN has been integrated is certainly a problem for global investors. This is due to a common pattern of movement in any stock market returns that raise the level of systematic risk of the market respectively. But for global investors will be less efficient if they divert the flow of capital out of ASEAN. This would increase the total cost of investment transactions in addition to the more difficult for global investors get higher returns outside the ASEAN which has been more perfect market.

Therefore, global investors remain focused only on ASEAN capital markets; it's just that they now need to better see the condition of the industry. According Menchero and Morozov (2011), emerging markets such as ASEAN still has the potential for a prospective industry. Industries are considered to have a competitive advantage because it categorized as GICS (Global Industry Classification Standard) which has always been a top priority of global investors. However, due to capital market integration in ASEAN is time-varying and the study of Benson and Green (2005) states that the time-varying level it had reached in the industry makes the global investors need to be constantly up-date portfolio of each pair of industries in the hope of international diversification benefits remain awake.

Thus the main problem of this study is the need for global investors when faced with the situation in the capital markets in ASEAN are increasingly integrated to consider two main factors from diversification across industries namely the level of intra industry competition and the intensity of role of global investors, where previously they also need to analyze the dynamics of the level of integration at the level of related industries. Furthermore from the main problem as stated before, we have three research objectives as follow:

- a) Test whether there are differences in the level of integration at the level of countries and industries to the 5<sup>th</sup> ASEAN equity markets on the basis of the argument time-varying world market integration from Bekaert and Harvey (1995).
- b) Examine the influence of the level of intra industry competition on the degree of integration for the 5<sup>th</sup> ASEAN equity markets with reference to an argument of similarity of industrial structure from Roll (1992), Pretorius (2002), Faff and Mittoo (2003), Dutt and Mihov (2008) and strategic industry risk of Ruefli (1990).
- c) Examine the influence of the intensity of the role of global investors on the level of integration in the 5<sup>th</sup> ASEAN equity markets on the basis of international capital mobility argument from Marston (1995) and Miskhins and Eakins (2000) and the role of global investors from Bekaert and Harvey (2000) and Froot and Ramadorai (2008).

## **HYPOTHESIS DEVELOPMENT**

### **1) The Difference of Capital Market Integration**

Understanding about the different levels of integration in terms of intensity level the role of global investors and industry characteristics, first it is necessary described the condition of the capital market integration of such as: perfect integration, partial segmentation (mild segmentation), partial integration (mild integration) and perfect segmentation. Explanation of any conditions in addition to the capital markets will have implications for large and small difference in the international diversification benefits for global investors. However it also has implications for the difference between high and low integration. If the integration were high, they should focus on industrial diversification.

Forms of integration and segmentation above according to Errunza and Losq (1985) is caused by the existence of two classes of global investors are restricted and unrestricted, and the existence of two classes of securities to be eligible and ineligible. The definition of unrestricted global investors is investors who have no limits to purchase various securities in the capital market of a country. While

restricted global investors are investors with the purchases limits of securities. This limitation arises because of the rule of the local regulator to protect domestic investors. The consequences are that restricted investors can only get eligible securities, while for unrestricted investors can gain eligible and ineligible securities. In perfect segmentation condition, then there are only restricted investors but not able to obtain eligible securities. This is because of the strict rules by regulator. As for the mild segmentation, there will only restricted investors but are still be able to have access to eligible securities for the strict rules of the game back loose. Another case for the mild integration, the number of unrestricted investors will be more dominant than the restricted but because of banged the strict rules then them only able to invest in eligible securities. And when conditions are perfect integration is achieved, then the global investors is able to diversify internationally in eligible and ineligible securities, but consequently the international diversification benefits will be minimum.

The existence of capital market liberalization in emerging markets such as quoted by Bekaert and Harvey (1995) make the entry barriers for global investors will be minimum. This is because the increasingly high regulatory beliefs about the importance of the role of global investors in improving the performance of local exchange such as the strengthening of stock indexes and cooperation of global investors and local brokers. And then there was a condition shift from the perfect and mild segmentations to the mild and perfect integrations.

But Choi and Rajan (1997) found only a condition of mild integration in emerging capital markets as well as to mild segmentation. This indicates that the level of integration is no longer determined by the rules of regulatory limitation for global investors, but rather from a global investors's own motives for investing in a country or postpone it. The motive was based on the attractiveness of each stock are then realized in the form of positive and negative sentiment. The stronger the positive and negative sentiment that happens, the higher the level of integration that occurs. Because the context sentiment, it is usually temporary and it is in harmony with the concept of time-varying integration of

Bekaert and Harvey (1995) that the level of integration can vary according to time. The difference is that global investors should be utilized to maximize the benefits of diversification while still looks to the condition in the level of integration.

After the monetary crisis, the U.S. investment flows become smaller in each ASEAN country and different for the Japanese investment flows. The existence of differences in U.S. and Japanese investment flows will indicate different levels of sentiment in each ASEAN country. According to Eun and Resnick (1994), this fact indicates different levels of participation of global investors which implies a difference in the level of integration of each ASEAN country. Based on this description, we propose a hypothesis:

**First Hypothesis.**

*There is a difference in level of capital market integration among Indonesia (IDX), Malaysia (KLSE), Singapore (SGX), Thailand (SET), and Philippine (PSE).*

**2) The Concept of Capital Market Integration Determinants**

**a) Level of Intra Industry Competition and Degree of Capital Market Integration**

Engwall (1973) and Ruefli (1990) conducted a study on the importance of industry structure for the company in terms of the dynamics of competition in an industry sector. They hold the view that the importance of analysis of competition between firms as measured by the entropy index in addition to knowing the position of superior and inferior inter-company now also be able to predict the position of superior and inferior among companies in the future. This is because technically the entropy index is calculated on the basis of time-series and use the ordinal scale (ranking) for example 1,2,3,4, ... n where for n indicates the number of firms in the industry. Refer to Collins and Ruefli (1992) that is the nature of the dynamics of competition in entropy is derived from the information theory of Shannon in 1948. As we know the information theory is related to disorder, uncertainty and randomness in a system.

Characteristic of the dynamics of competition between firms within the business environment can be brought to the dynamics of competition among the company's stock if the company is also related to listing on the stock

market of a country. The use of entropy index in evaluating the performance ranking of companies listing on stock exchange will attract the attention of global investors because of the assessment ranking for this by using common ratio scale proved disappointing market participants as in the case of Enron and World dotcom and probably the fallen of Lehman Brother in 2008 due to global financial crisis.

When examined in the study of capital market integration, the author's knowledge no one has to use the entropy index Ruefli (1990) as a determinant factor. That has existed so far is proving the integration of capital markets in the context of industrial sectors such as studies Carrieri, et al. (2004), Ratner and Leal (2005) and Antoniou, et al. (2007). They have a view of the context of sectoral integration is sufficient to provide a picture for global investors see the potential in each industry sector is viable or not as part of their portfolio of industrial diversification. However, when examined using the entropy index, the dynamic changes of each company in one industry sector will be more apparent, so too when they need full information about the general picture of the existing industrial sector in the capital market, then the numbers in the sub-component of entropy (lower, diagonal and upper entropy) is expected to be more objective in the assessment of strategic industry risk. Based on the description, the second hypothesis proposed is:

**Second Hypothesis.**

*Level of intra industry competition will influence toward degree of capital market integration in ASEAN countries.*

**b) The Intensity of Role of Global investors and Degree of Capital Market Integration**

Two arguments are used to explain the relationship between the two is the role of global investors and international financial integration through the concept UCIRP. Both of these arguments stem from a grand theory: international capital mobility. According to Sula and Willet (2009), with increasingly free flow of capital from developed country to a developing country as a result of liberalization and free trade, then physical activity, economics and finance of each country as if it had been fused. This happens because the

enactment of a good standard in shape, size and price in each country who declare themselves as members of an economic and trade bloc, so that each country will declare readiness to open with each other and compete freely with each other. A manifestation of international capital mobility is greatest in the history of European economic integration which gave birth to the EEC (European Economic Community). On each member of the EEC (see now the EU) will occur in an efficient capital mobility, because member state have been open with each other and compete freely. As for non-members countries, then capital mobility occurs when common rules which would receive a reduction in restrictions.

At a higher level then the international capital mobility will reach the level of Optimum Currency Area (OCA), such as the formation of the Euro currency in 1999. When the context has led to the standardization of currencies like euro and dollar, the level of integration has led to a discussion of domain Interest Rate Parity (IRP). This is because the flow of capital that occurs because of differences in interest rates. Marston (1995), Bhatt and Virmani (2005) and Solnik and McLeavey (2009) state the interest rate differential may be relevant to CIRP (Covered Interest Rate Parity) and UCIRP (Uncovered Interest Rate Parity). CIRP related to international capital flows are not restricted tend to equate the nominal interest rate if they are tied up in a common currency (single). Seeing the EEC who already have the Euro currency then it should be applied CIRP. However this is not easily realized because the EEC became the European Union has changed and although the Euro (except Pound Sterling) still exist but tend to be less bargaining power Euro against the U.S. dollar. Not easy to apply CIRP create the context of financial integration are discussed with UCIRP. UCIRP associated with unrestricted capital flows tend to equalize nominal interest rates.

An effort to cope with exchange rate risk, and then by taking into account differences in domestic interest rate ( $i_d$ ) and abroad ( $i_f$ ), make global investors are always looking for opportunities to do the CIA (Covered Interest Arbitrage). According to Marston (1995) and Solnik and Mcleavey (2009), the CIA can be done by purchasing foreign securities because

of the condition of the forward discount. The phenomenon of the CIA in lines with the argument that there cointegration between international capital flows and exchange rates in addition to the interest rate even if only for the case of Indonesia. This is because global investors who bring different currency than the local currency on the one hand can be correlated with the movement of local currency and may also be correlated with stock market conditions. Based on a study of Dvorak (2005) and Aggarwal, et al. (2009) in Indonesia, the activity appeared to be particularly dominant global investors as domestic investors. But the unique despite the inferior performance of global investors in the short term, but were superior in the long run. Explanation of differences in the performance of global investors it is a phenomenon of the difference of information between global investors and domestic investors. Domestic investors are perceived to have the advantage of knowledge of local conditions of Indonesia, while foreign (global) investors are considered to have the experience and global network of brokerage as a form of information superiority. In order to become the most dominant, the investor needs to have a combination of local ownership and global capabilities of information brokerage.

Bekaert and Harvey (2000) state there are two roles of global investors in emerging markets. The first role relates to the actions of global investors in influencing the technical aspects of trading in a stock because it could potentially increase the liquidity, efficiency and value of related shares. While the role of the second act of a global investors to better obtain information superiority. But according to Bekaert and Harvey (2000) the role of negative impact if it is so global investors does not get the information advantages, then they will make a withdrawal. In larger-scale withdrawal of funds called the phenomenon of surge or sudden stop of capital flows [Sula and Willet (2009)]. This phenomenon triggers global investor's restrictions such in Malaysia since 1998. The restriction is conduct by increasing level of protection toward domestic investors. It is not only make limit purchase some series stock like as in China and Philippines but also increasing the tight control of capital outflow from Malaysia. Hence starting in 1999 Malaysia imposed this

restriction by excluding its investable index from IFC. Based on previous description, we propose hypothesis as follow:

**Third Hypothesis.**

*The intensity of the role of global investors tend to raise the degree of capital market integration in ASEAN countries.*

**EMPIRICAL MODEL**

In the test the first hypothesis (H1), we used ANOVA test with the F-test simultaneously for both country and industry level with the UCC and the DCC. To prove the Second Hypothesis (H2) and Third Hypothesis (H3), it would require empirical model to estimate the level of capital market integration. This empirical model will include the industry-level correlation  $\rho(R_{ijt}, R_{wt})$  and two factors related determinants. The first determinant of  $\rho(R_{ijt}, R_{wt})$  is the level of intra industry competition with proxy index of entropy ( $E_{ij,t-1}$ ) and three supporting proxy DINDG<sub>ijt</sub> namely,  $PGDP_{ij,t-1}$  and  $LNMCAPS_{ij,t-1}$ . Furthermore, the second determinant is the intensity of the role of global investors with the two main proxy  $NFFF_{jt}$  and  $FOR_{jt}$  and the alternative variable that is deviation IRP with the symbol  $d(Fx)_{jt}$  functioning complement the testing analysis results of the Second and Third hypotheses are whether the integrated capital market condition, is still valid conditions of IRP (Interest Rate Parity). When the condition is integrated then the IRP should be held. Furthermore, empirical models for testing hypotheses two and three state as follows:

$$\rho(R_{ijt}, R_{wt}) = \alpha + \beta E_{ij,t-1} + \gamma DINDG_{ijt} + \theta PGDP_{ij,t-1} + \zeta LNMCAPS_{ij,t-1} + \lambda NFFF_{jt} + \delta FOR_{jt} + \omega d(Fx)_{jt} + \varepsilon_{ijt} \dots (1)$$

$\rho(R_{ijt}, R_{wt})$	Correlation between $R_{ijt}$ (industry return i in country j at period t) and $R_{wt}$ (international indexes (world) return w at period t), where international index is MSCI. To calculate this correlation we used Pearson techniques which downloaded from spreadsheet. To count $R_{ijt}$ we employ database as well as used to entropy index.
$E_{ij,t-1}$	Entropy index from industry i in country j at period t-1 which

	derived from Ruefli (1990) and Collins and Ruefli (1992). Process to calculate $E_{ij,t-1}$ is important to test the H2. $E_{ij,t-1}$ is calculated by adaptation formula of $H(S)_k = [\sum_i (\sum_j p_{i,j,k} \ln p_{i,j,k}) / q \ln q]$ . To calculate $H(S)_k$ we conduct 3 steps: create a database for 10 GICS of 5 countries in ASEAN, to rank the firm in industry by net profit, to make a transition matrix ( $p_{ijk}$ ).
DINDG <sub>ijt</sub>	Global industry dummy (D=1) and regional (D=0). This variable is adapted from study of Faff and Mittoo (2003).
PGDP <sub>ij,t-1</sub>	Proportion of GDP inter industry i in country j at t-1.
LNMCAPS <sub>ij,t-1</sub>	Log natural of market capitalization industry i in country j at t-1.
NFFF <sub>jt</sub>	Net Foreign Fund Flow in country j at period t.
FOR <sub>jt</sub>	Foreign Ownership Restriction is one minus the ratio between MSCI Investable Index and MSCI Global Index in country j at period t [which could be written as follow: $FOR=1-(MSCI-II / MSCI-GI)$ ]. $FOR = 1$ means market is closed for global investors' participation while $FOR = 0$ means that market will open 100%.
d (Fx) <sub>jt</sub>	Deviation of IRP in country j at period t. Formulation with $i_d - i_f$ or $(S_{t+1} - S_t)/S_t$ . Code of Fx is foreign exchange in country j at period t and not an identifier.
$\alpha, \beta$ to $\omega$	Intercept and coefficient
$\epsilon_{ijt}$	error (residual) for model 4.1 i.e. common factors beside $E_{ij,t-1}$ , DINDG <sub>ijt</sub> , PGDP <sub>ij,t-1</sub> , LNMCAPS <sub>ij,t-1</sub> , NFFF <sub>jt</sub> , FOR <sub>jt</sub> and d (Fx) <sub>jt</sub> .

Model (1) will be employed by SUR (Seemingly Unrelated Regression) based on Srivastava and Giles (1987). The eligibility of SUR is the existence of contemporaneous correlation [see Dufour and Khalaff (2002)].

**RESULT AND DISCUSSION**

**a) Hypothesis Testing Differences of Integration Level 5 ASEAN Countries**

As the realization of the first hypothesis testing will be made in three stages namely: **first**, to test differences in the level of capital market integration in the respective ASEAN exchanges with the local exchange rate for  $R_{jt}$ . **Second**, to test differences in the level of capital market integration by each exchange in ASEAN at adjustment  $R_{jt}$  to the exchange rate of USD. This type of correlation used in phase 1 and phase 2 is the UCC (Unconditional Correlation). **Third**, do a comparison test result differences in the level of capital market integration with DCC (Dynamic Conditional Correlation). One of the implications of the analysis of DCC is to check the function of the standardized residuals  $R_{jt}$  and  $R_{wt}$  to be seen how strong the effect of noise on the process for this transaction in any securities companies that indicated high noise during 2006-2009.

Based on table 1, obtained an F-Test 6.28 is greater than F-table for 2.38 and significant at 1% significance level. So based on the testing table 2, **H1** is accepted which means that there are differences in the level of integration in ASEAN stock exchanges.

**Table 1. Comparison Mean and Variance from Unconditional Correlation at Country Level**

Pairs of Unconditional Correlation	Mean	Variance	F-Test (F-table)
$\rho [R(STI),R(MSCI)]$	0.32	0.21	28.64*** (2.38)
$\rho [R(KLCI),R(MSCI)]$	0.18	0.25	
$\rho [R(IHSG),R(MSCI)]$	-0.13	0.25	
$\rho [R(SET),R(MSCI)]$	0.28	0.23	
$\rho [R(PSI),R(MSCI)]$	0.07	0.23	

**Table 2. Comparison Mean and Variance from UCC Adj. USD each Industry Sector**

Industry Sector (GICS Code)	Mean	Variance	F-Test (F-Table)
Oil & Gas (10)	0.41	0.10	1.59** (1.47)
Basic Material (15)	0.56	0.02	
Industrial Goods (20)	0.57	0.04	
Services Goods (25)	0.33	0.11	
Consumer Goods (30)	0.34	0.09	

Health Care (35)	0.41	0.06
Financial Institution (40a)	0.55	0.08
Property-Real Estate (40b)	0.48	0.08
Technology (45)	0.39	0.08
Utilities- Telecom (50)	0.35	0.10

In addition to testing for country level testing is also done for the industry level in Table 2. The purpose of testing to see whether the integration of capital markets is also happening within the industry level. Based on the results of testing, the F-test  $UCC > F\text{-table}$  and significant at a significance level of 5%, then **H1** is received again which means the existence of differences in sectoral capital market integration across the ASEAN stock exchanges. Like the unconditional correlations in local currency, then for adjustment also needs to be drawn for studying the behavior of the unconditional correlation of data in five ASEAN stock exchanges from 2006-2009. Unconditional correlation patterns USD from each ASEAN stock exchanges also have a wavy characteristic length but the upper range limit (positive correlation) and the lower limit (negative correlation) are almost equal.

The difference of negative and positive correlation will be responded by global investors as part of important information for international diversification strategies. Based on table 3, the F-Test  $41.9 > F\text{-table}$  for 2.38 and significant at 1% significance level, thus **H1** is accepted. It means that there are differences in the level of integration in the five ASEAN exchanges when the correlation was adjusted to USD, consistent with Eun and Resnick (1994)..

**Table 3 Comparison Mean and Variance from Unconditional Correlation Adj. USD at Country Level**

**b) Hypothesis Testing Differences of Integration Level 5 ASEAN Countries**

Comparison of UCC and DCC both local and USD currencies in each ASEAN exchanges done by selecting the year 2008. The reason is effect of the global financial crisis of 2007/2008 is relevant to prove the usefulness of the DCC correlation of stock returns in emerging markets and developed

Pairs of Unconditional Correlation	Mean	Variance	F-Test (F-table)
$\rho [R_{(STD)}, R_{(MSCI)}]$	0.31	0.22	41.90*** (2.38)
$\rho [R_{(KLCI)}, R_{(MSCI)}]$	0.10	0.25	
$\rho [R_{(IHSG)}, R_{(MSCI)}]$	-0.25	0.23	
$\rho [R_{(SET)}, R_{(MSCI)}]$	0.29	0.25	
$\rho [R_{(PSD)}, R_{(MSCI)}]$	0.09	0.24	

**Table 4. Comparison Mean and Variance from UCC Adj. USD each Industry Sector**

Industry Sector (GICS Code)	Mean	Variance	F-Test (F-table)
Oil & Gas (10)	0.42	0.09	1.59** (1.47)
Basic Material (15)	0.58	0.03	
Industrial Goods (20)	0.59	0.05	
Services Goods (25)	0.38	0.10	
Consumer Goods (30)	0.39	0.11	
Health Care (35)	0.42	0.07	
Financial Institution (40a)	0.56	0.08	
Property -Real Estate (40b)	0.54	0.06	
Technology (45)	0.41	0.08	
Utilities- Telecom (50)	0.38	0.11	

In addition to testing for country level testing is also done for the industry level in Table 4. The purpose of testing to see whether differences in capital market integration also occurs at the industry level. Based on test results below, the F-test  $UCC > F\text{-table}$  and significant at a significance level of 5%, then **H1** accepted which means that there are differences among industry sectors of capital market integration in ASEAN stock exchanges.

markets increased during the crisis period [Kuper and Lestano (2007) and Baele and Inghelbrect (2009)]. In the crisis period we hope time-varying pattern of correlation which indicates the volatility clustering in the markets. This is because the increasing of comovement of stock market indices with developed market indices such as DJGI and MSCI.

**Table 5. Comparison Mean and Variance from UCC & DCC in 5 ASEAN Stock Market (Sample Period of 2008)**

**Panel A. Local Exchange Rate**

Pairs of Correlations	UCC	DCC	t-test
$\rho$ [R(STI),R(MSCI)]	0.369026	0.346883	-0.354352
$\rho$ [R(KLCI),R(MSCI)]	0.275834	0.492558	2.967885***
$\rho$ [R(IHSG),R(MSCI)]	-0.193196	0.201142	5.669739***
$\rho$ [R(SET),R(MSCI)]	0.179888	0.283354	1.384783
$\rho$ [R(PSI),R(MSCI)]	0.156740	0.402135	3.171695***

**Panel B. Local Exchange Rate**

Pair of Correlations	UCC	DCC	t-test
$\rho$ [R(STI),R(MSCI)]	0.344968	0.458142	2.100281**
$\rho$ [R(KLCI),R(MSCI)]	0.192174	0.202646	0.144727
$\rho$ [R(IHSG),R(MSCI)]	-0.185120	0.191574	5.803634***
$\rho$ [R(SET),R(MSCI)]	0.191461	0.249483	0.795448
$\rho$ [R(PSI),R(MSCI)]	0.054285	0.291478	3.07117***

Based on table 5 panel A and B we find the significant difference in the UCC and DCC in Indonesia and Philippines. Specifically in Indonesia it is finding a negative correlation of UCC and positive form in the DCC and the highest level when testing t-test. It has implications for Indonesia's most integrated than the other 4 countries as the global financial crisis. The next sequence in the integrated condition (t-test UCC and DCC) are the Philippines, Malaysia and Singapore. Surprisingly Thailand as source of monetary crisis of 1997/1998 shows no condition of integration difference. This is because none significantly of difference between UCC and DCC in Thailand which uses LOC and USD.

**c) Hypothesis Testing for Determinants of Capital Market Integration**

Listed in table 6 below many independent variables have significantly effect toward level of capital market integration. It makes a great opportunity to accept the **H2** and **H3**.

When analyzing the validity of SURE model, we get  $\lambda^2$ -test of 39.393 (significant at 1% level). It is greater than  $\lambda^2$ -table so that the assumption of residual contemporaneous correlation of SURE model is very satisfied. Thus we can use this model in hypothesis testing of **H2** and **H3**.

**Table 6. Hypothesis Testing for Determinants of Capital Market Integration**

IND. VARIABLES	ASEAN COUNTRIES (OBSERVATION 2006-2009)				
	PHI	THA	MAL	SIN	INA
INTERCEPT	18.145 (2.03)**	-7.523 (-3.39)***	-50.646 (-2.46)**	11.408 (0.61)	8.194 (2.19)
ENTROPI <sub>(ij,t-1)</sub>	0.044 (0.60)	-2.145 (-2.47)**	0.027 (0.04)	-0.755 (-1.76)*	0.0059 (0.04)
DINDG <sub>(ij,t)</sub>	0.151 (2.48)**	-0.188 (-2.19)**	0.134 (-1.52)	0.088 (1.54)	0.151 (2.35)**
PGDP <sub>(ij,t-1)</sub>	-0.001 (-0.01)	-0.746 (-1.76)*	0.527 (0.93)	-0.991 (-3.25)***	0.0138 (0.07)
LNMCAPS <sub>(ij,t-1)</sub>	-0.0095 (-0.93)	0.048 (1.45)	-0.031 (-0.71)	0.074 (0.64)***	-0.003 (-0.27)
FOR <sub>(j,t)</sub>	-22.812 (-2.04)**	14.138 (3.71)***	81.747 (2.50)**	-25.479 (-0.59)	-11.508 (-2.11)**
NFFF <sub>(j,t)</sub>	0.0035 (0.24)	-0.011 (-1.54)	-0.134 (-1.85)*	0.0035 (0.38)	-0.585 (-2.20)**
DIRP <sub>(j,t)</sub>	19.711 (2.96)***	-14.691 (-1.63)	-15.456 (-1.97)**	19.189 (0.70)	-37.082 (-1.86)*
R <sup>2</sup>	0.33	0.55	0.27	0.44	0.31
$\lambda^2$ -test	39.393*** (Breusch-Pagan test of independence), non iterated SUR				

### **c.1.) Level of Intra Industry Competition**

From testing of **H2** in table 6 it could be looked the significance of entropy as a proxy for the level of intra industry competition. Singapore (SIN) and Thailand (THA) have significant entropy index, but it does not like Indonesia, Malaysia and Philippines. These results suggest **H2** is still accepted and indicate the relationship between the level of integration and the level of intra industry competition. Based on the analysis with lower entropy (*trend of firm as member industry move to the higher rank*) according to Ruefli (1990), the industrial good in Singapore and property & real estate in Thailand can be an option for global investors. This means that the effect of capital market integration condition that occurs in these two industries would not be a barrier for global investors to further enlarge the portfolio formation in both types of industry. This is because both industries have the advantage of being shown with more companies in the industry who have promoted compared with other. Especially global investors in Thailand and Singapore must look the dynamic of competition among firms in both industries in order to maintain the benefit of industrial diversification.

Meanwhile alternative proxies of entropy such as DINDG, PGDP and LNMCAPS give the different results. From the test results table 5.7, DINDG effectively influence the level of integration in the Philippines (PHI), Thailand and Indonesia (INA). It supports **H2** again and consistent with Faff and Mittoo (2003). The implication is global investors can multiply the portfolio formation on the global GICS industry sectors while maintaining the ability to access information on a local brokerage in three countries. For testing with PGDP, we find PGDP effectively influence the level of integration in the Thailand and Singapore. So that **H2** is received again and this result support Carrieri, et al. (2008). It suggests beside dynamic of competition among firms in such industry, global investors should aware about the attractiveness of such industry in both countries respecting to Heckscher Ohlin Theorem.

Finally, LNMCAPS is effectively influence the level of integration only in Singapore. It indicates the acceptance of **H2** and consistent with study of Carrieri, et al. (2008). Thus it suggest Singapore is the best portfolio for global investors since the industry sector has closed to GICS and the dynamic of competition is most referred to entropy of Ruefli (1990).

### **c.2.) Intensity of Role of Global Investors**

Several countries experienced significant FOR except Singapore. But for NFFF only two significant countries, namely Indonesia and Malaysia (MAL). This findings is still accepted **H3**, although findings of NFFF and FOR asserts dominance in the FOR compared NFFF as a determinant of the level of integration. This means that the effect of market capitalization on the intuition does not change the still high protection against domestic investor's regulators. Worries about the negative role of global investors will be destabilize the monetary crisis in 1997/1998 still experience perceived clearly in the minds of the regulator to Thailand and Malaysia, which has a positive and significant FOR.

In contrast to the Philippines and Indonesian stock exchange which has a negative FOR indicates already low level of protection of domestic investors from the local regulator. Regulators aware of the potential global investors as a means to trigger the growth of liquidity traders market indexes because their actions are often the benchmark for local brokerage and local investors in improving the liquidity of the local trade. Increased liquidity in emerging stock markets such as Indonesia will be a positive consideration to other potential global investors to enter. With high liquidity and trade openness is still a big factor as well as coupled with a global network of brokerage

owned by the global investors can optimally utilize both markets. In contrast to Malaysia and Thailand that the level of high protection against then domestic investors to global investors need to establish cooperation with a local brokerage for the effectiveness of penetration in these two markets.

In Philippines and Indonesia we find some mixed result about FOR and NFFF. This argument is simply the flow of international funds will easily flow into countries with low FOR. But what happened to Indonesia and the Philippines turned out to international fund flows are not so large that flowed. In contrast to Singapore with FOR was not significant but the direction of the positive NFFF. This underscores Singapore's still a reference to global investors in the flow of international investment funds. For the Philippines and Indonesia, the low flow of international funds can be caused due to global investors move some funds into capital markets, capital markets outside ASEAN is seen to be more prospective.

As a whole it is indicated the level of industrial countries and the global dominance of push factors is almost equal to the local pull factors is the finding that the Singapore stock exchange with the entropy index is always significant and the stock exchanges of Malaysia is the highest level of protection. That way, the SURE model as formulated in point 1 and estimated in table 6 could bridge the divergent of Global Push Factors (GPF) and Local Pull Factors (LPF) as initiated by Pretorius (2002) and Hong (2005).

## **CONCLUDING REMARKS**

### **Conclusion**

The first finding is the difference in the level of integration of country and industry levels. It can be seen from the differences in unconditional correlations in the fifth ASEAN capital markets and differences in the unconditional correlation of tenth GICS industry. The findings of differences in the level of integration to the country level indicate a difference in the benefits of international diversification can be obtained by global investors. So that the benefits of international diversification are effective then global investors need to see the difference in the level of integration at the industry level of tenth GICS industry. Two findings support the

opinion Carrieri, et. al. (2004) and Ratner and Leal (2005) that global investors can diversify the industries that have a low correlation.

Furthermore, when used dynamic conditional correlation (DCC), the difference in the level of country level integration is also still being discovered. This indicates the validity of the concept of time-varying integration of Bekaert and Harvey (1995) which makes global investors must constantly update its international diversification strategy in the 5<sup>th</sup> ASEAN equity markets due to the dynamics of correlation is often the case.

The second finding is the level of intra industry competition proved to affect the level of capital market integration in Singapore and Thailand. This indicates that global investors in determining the international diversification strategy does need to consider the factor of competition between firms within the industry especially has a tendency every company in the industry to increase ratings. The study by Collins and Ruefli (1992) need more attention by global investors due to higher ratings of each company in the industry means an increase above the target return of their international diversification strategy.

Then with proven entropy index as a proxy for the level of intra industry competition in influencing the level of integration supports the view of previous studies such as Tu (1998), Faff and Mittoo (2003), Carrieri, et al. (2004) and (2008), Dutt and Mihov (2008) that industry characteristic related to global investors to consider international diversification strategy. Specifically this study can be considered to provide the more adequate proxy for the level of intra industry competition in ASEAN. This is because many studies use Herfindahl index which actually is more appropriate to measure industry concentration. Being related to Tu (1998), then the findings supports the validity of the concept of entropy-based pricing, albeit in different forms i.e. not a non-parametric SDF (Stochastic Discount Factors).

The latest findings are that the intensity of the role of global investors was not so effective in raising the level of integration in ASEAN. It can be seen from no significance Net Foreign Fund Flow (NFFF) to the degree of capital market integration in ASEAN. These findings do not support the study of Richard (2005) and Froot and Ramadorai (2008) which state the

integration of capital markets in ASEAN should be influenced by NFFF.

However, if associated with FOR then found a different thing. FOR proven several times significantly affect the degree of capital market integration. These findings support the results of the study FOR from Edison and Warnock (2003) on the persistence of the limits of regulators in several exchanges of the role of global investors. From the results FOR and NFFF, it is found clarity that there are limits to global investors make capital flow will be hampered. This can be justified because the data period in 2008 observation we associated with the global financial crisis the regulators in some markets will be more protective of domestic investors especially Malaysia.

Thus the general purpose of the study that is effectiveness of the of enforceability of capital market integration at the industry level has been reached. It can be seen the significance of differences in the level of integration of the industry level through the first findings of this study. The difference is not only to strengthening the industrial level integration studies from Carrieri, et al. (2004) and Ratner and Leal (2005) which based on the industry level but also makes a major contributing of us to meet the linkages between capital market integration and the level of intra industry competition. Linking the two is when the ASEAN capital markets have integrated the inter industry diversification is more relevant than diversification across countries. In order to get the benefits of international diversification will be optimum, the global investors need to does a redefinition of inter industry diversification with more focus on the prospective industry.

### **Implications**

With the achievement of two of the three objectives of this study that the different levels of integration through the correlation and the influence of intra industry competition level on the level of integration makes validation of SURE model that the author has proposed. SURE estimation model is actually a search of the correlation model of equation from Dutt and Mihov (2008) and Ferreira and Laux (2009) developed theoretical models of argumentation IAPT by Errunza and Losq (1985) and empirical models IAPT by Faff and

Mittoo (2003). The main purpose correlation equation not to seek the relevant determinants of integration but also to determine the optimal correlation.

Corresponding argument of Chaieb and Errunza (2007) then the optimal correlation will show the best benefits of international diversification for global investors. In another form of the condition of the optimal correlation can be approximated by the concept of mild integration by Errunza and Losq (1985) and time-varying integration from Bekaert and Harvey (1995). According to these concepts, global investors need to be more flexible in managing its diversification strategy because there is no extreme condition for integration even though the era of liberalization has taken place two decades and more importantly, every exchange can be set FOR each as a form of indirect investment barriers. The main results of the corresponding author of the optimal correlation is shown by the magnitude of the correlation level both UCC and DCC but rather on the significance of entropy as the relevant local push factors in each market are more effective when global investors are more active role to foster partnerships with local brokerage.

For global investors are inter industry diversification options applying the entry and exit strategy from the Brooks and Negro (2006). Entry strategy carried out by taking the industrial sector with a lower entropy of the best and improves information superiority by networking at local brokerage. Exit strategy is done by rebalancing the portfolio in industry sectors with lower entropy is higher and networking with other local brokerage. For each regulation, the relevance of the entropy index shows that they need to more vigorously promote the industrial sector are listed on stock market in order to meet the ASEAN Stock Market Linkage (ASML) in 2015.

### **Possible Development**

The next study should confirm Conditional Regime Switching (CRS) from Bekaert and Harvey (1995) so that it can play an effective role as a DCC from Engle (2002). This is because the CRS is able to capture the volatility asymmetry effect caused by DCC return data. Just to be able to implement CRS in SUR requires the SUR simulation model. Currently Zellner (inventor of the SUR) is

being tried out by researchers SUR econometric simulation in Japan. The second thing is to link the integration of capital markets and noise traders like Gehrig's study (1993). Along with a growing finance research into the realm of behavioral finance and market microstructure is the role of global investors as value traders and noise traders in the integration of capital markets attract examined more deeply.

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**THE IMPACT OF GOVERNMENT SUBSIDY AND TAX MANAGEMENT OF FINANCIAL DISTRESS STATE OWNED ENTERPRISES : AN EMPIRICAL STUDY OF ENERGY, MINES AND TRANSPORTATION SECTORS IN INDONESIA**

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***ABSTRACT***

*This study aims to understand (1) the effects of government subsidies and (2) the effect of the tax on financial distress management of public sectors of energy, mining and transportation at State-Owned Enterprises. Also This research aims to understand the real variable impact of earnings management activities, accruals earnings management, financial performance and operating as control variables. The method used in this research is multiple regression analysis using SPSS-Amos 23. The sample used in this research is 42 companies is a financial statement for the period 2010-2015 the data from 7 companies of the sector of energy, mining and transportation at State-Owned Enterprises, The results Showed that government subsidies and tax management variable significant negative effect on public sector financial distress of energy, mining and transportation at State-Owned Enterprises. Financial operating performance as a control variable positive and significant impact on financial distress of the public sectors of energy, mining and transportation at State- Owned Enterprises, while the other control variables such as real earnings management activities and accruals earnings management is not significant.*

**Keywords:** *Government Subsidy, Tax Management, and Financial Distress*

**INTRODUCTION**

This research was motivated by the tang phenomenon occurs in the environment State-Owned Enterprises or SOEs that continuously rely on the financial needs of State Budget or the budget increasing from time to time. Even some of the companies that is no longer possible to operate without the help of

government subsidies or have experienced financial distress at the time no longer obtain government funding. Sectors that burdened the state budget in a number of very significant is the energy, mining and transport of which consists of seven companies with the scale relatively large, namely PT Pertamina, PT Perusahaan Listrik country, PT Perusahaan Gas

Negara, PT Bukit Asam, PT Aneka mines, PT Kereta Api Indonesia, and PT Garuda Indonesia. This company has gone public by selling shares and bonds to meet financing the investment, but some of them are still receiving funding operations glittering form of Government Subsidy (GSUB) or subsidies because they suffered losses and is a position of financial distress if it is not helped by the state budget funds as experienced by PT PLN, PT Pertamina and PT Kereta Api Indonesia. Companies that still persist in the achievement of decent profitability is PT PGN and PT Bukit Asama, so that the two companies are able to run the business independently and provide dividends to shareholders. While the company suffered a loss or declining financial condition is PT Garuda Indonesia and PT Aneka Tambang, so the company is in danger of experiencing financial distress, and the price of shares in the capital market has declined. Thus, when viewed from the perspective of financial distress then there are three groups of companies in this sector, ie companies that depend on the state budget subsidies, the company that produces decent profitability, and the company suffered a loss without a state budget subsidies. Financial distress experienced by the company in this sector varies according to the conditions faced by each company. But in general can be assessed by looking at the factors that affect the company distress. Therefore, the study identified several key variables that affect the company's financial distress SOE sector energy, mining and transport, the variable subsidy or Government Subsidy and tax variable management conducted by the company concerned. While moderating variable nature strengthen and weaken that relationship is a real variable earnings management activities, variable accrual earnings management and financial variables operating performance.

Based on these descriptions, the question becomes this research are: (a) whether the Government Subsidy variables significantly influence the financial distress the energy sector, mining and transport in the environment of SOEs? and (b) whether the wisdom of Tax Management of the company to reduce its tax burden, significantly influence the company's financial distress sectors of energy, mining and transport in the environment of SOEs?

Based on research problems mentioned above, it is the purpose of this study is (a) assessing the level of significance of the effect of Government Subsidy or financial condition distress subsidies on energy, mining and transport in the environment of SOEs. (B) analyzing the wisdom of Tax Management and its influence on the company's financial distress of the energy sector, mining and transport in the environment of SOEs.

The study is expected to contribute to: (a) decision-makers to anticipate the possibility of financial distress that are getting worse; (B) provide input for investors to understand the financial distress facing the company; (C) a reference like a practitioner in understanding the company's financial distress SOE sector energy, mining and transportation; and (d) a reference for subsequent research related to financial distress within the SOE.

## **LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT**

### **1. Subsidy and Financial Performance**

Theoretically, viewpoints on subsidy performance may seem contradicting, as in the case of promotion vs. rent-seeking viewpoints. According to the former, subsidies promote R&D and the investment in enterprises which enhance corporate performance in the current period. This view, however, has gained the support of only a few scholars, such as Kong and Li (2009) in Huiming Zhang., Yu Zheng.,

Dequn Zhou and Peifeng Zhu (2015). Instead, more scholars have pointed out that subsidy cannot necessarily be distributed effectively because of rent-seeking behavior. A subsidy may result in slow growth of profits or the reduction of return on asset. Beason, Bergstrom, Balsar and Ucdogruk, and Lu and Huang *et al.* all validated this argument through their empirical analyses of investment subsidy, fiscal subsidy, or food and beverage manufacturing companies]. Moreover, the influence of subsidy on corporate financial performance may also be uncertain and subject to some conditions, such as the period of influence, political relations, and others. Although previous studies on the subsidy issue have been worthwhile and beneficial, several shortcomings are observed:(1) Studies on the relationship between subsidy and corporate financial performance mainly examine agriculture or ordinary manufacturing and pay little attention to the industry of renewable energy. A few studies consider the influence of subsidy modes on corporate financial performance; (2) The classification of subsidy modes is not yet unified. At present, some scholars classify the subsidy modes into direct and indirect, whereas others classify the subsidy modes into tax preference, fiscal subsidy, factor support and preemption, and so on. The difference in classification results in an uncertain research conclusion. Using the abovementioned analysis and the subsidy types acquired by renewable energy firms in China, we classify subsidy modes according to the two standards (*i.e.*, whether they are fiscal direct subsidies or innovative subsidies), in order to explore the relationship of subsidies to corporate financial performance. Based on the results of the above study, the hypothesis proposed in this study is presented below.

Based on previous research, the theory and hypothesis proposed in this study is as stated below.

**H1.** Wisdom Government Subsidy or subsidy from the state budget significantly influence financial distress energy sector, mining and transport of an environmental SOEs.

## **2. Tax Planning And Finance Performance**

Correlative-description design using cross sectional method of analysis was conducted by Desai and Hines (2002), Chen, Chen, Chen and Shevlin (2010) in Ogundajo, Grace Oyeyemi and Onakoya, Adegbemi Babatunde (2016) They established that intensive tax planning is associated with higher firm performance. On the other hand, the study reported that tightening of the tax system is positively associated with higher market performance of firms. The same positive association was reported between tax planning savings and performance for well-governed firms by Desai and Dharmapala (2009). They concluded that corporate governance mediates the tax planning-firm performance relationship. Mahfoudh & Ku Nor Izah (2015) in Ogundajo, Grace Oyeyemi and Onakoya, Adegbemi Babatunde (2016) conducted a library research on Corporate Tax Planning Activities and concluded that there are several approaches to tax planning such as income shifting, modify of characteristics of income, organizational structure and tax-exemption. The study opined that the primary motivations for undertaking tax planning are the expected financial benefits. Rohaya, Nur Syazwani and Nor'Azam (2010) in Ogundajo, Grace Oyeyemi and Onakoya, Adegbemi Babatunde (2016) are of the opinion that larger companies endure higher effective tax rates (ETR) in the examination of Malaysian public companies listed on Bursa Malaysia. This conclusion was established during official assessment system and selfassessment system

tax regimes. The study also concluded that lower ETRs are significantly related to highly leverage companies, greater investment in fixed assets and lower investment in inventory. The results of the investigation by Abdul-Wahab and Holland (2012) in Ogundajo, Grace Oyeyemi and Onakoya, Adegbemi Babatunde (2016) which sought to know the relationship between tax planning savings of firms and their value utilised the regression model was negative. Indeed, relationship between firm value and tax planning activities from the perception that as tax planning activities increase, the tax costs and risks outweighs the benefits.

Studies on tax planning and firm performance cum value have yielded mixed results. Desai and Hines (2002) in Nwaobia Appolos N., Kwarbai Jerry D., and Ogundajo Grace O (2016) provide evidence on firm performance and tax planning behavior of firms. Again, the study investigated the relationship between tightening of tax systems and market value of firms. This study of 850 listed US firms established that intensive tax planning is associated with higher firm performance. On the other hand, the study reported that tightening of the tax system is positively associated with higher market performance of firms. Kawor & Kportorgbi (2014) examined the effect of tax planning on firms market Performance in Ghana' using 22 non-financial companies listed on the Ghana Stock Exchange between 2000 and 2011 in Nwaobia Appolos N., Kwarbai Jerry D., and Ogundajo Grace O (2016). The study found that as tax rates increased, firms intensified tax planning activities. Firm performance and sales growth and firm size are found to be positively associated while firm's age and financial leverage are negatively associated with firms' market performance. Based on the results of the

above study, the hypothesis proposed in this study is presented below.

**H2.** Measures Tax Management management to significantly influence financial distress companies in the sectors of energy, mining and transport in the environment of SOEs.

## **RESEARCH METHODS**

### **Research Design**

This study examines specific to the energy sector, Mining and transport within the State-Owned Enterprises or SOEs with the consideration that this sector is very strategic in social life and national economic development. In terms of subsidizing the electricity sector and fuel oil occupy a very significant role because these two sectors to cost the state budget for subsidy of about Rp 300 trillion per year, so the other sector budgets must be reduced to meet the funding needs of fuel and electricity subsidies. In terms of the development of the manufacturing industry sector is very large role, so the government should give priority to the sectors of energy, mining and transport in the environment of SOEs. The mining sector as a support for the needs of power generation and encourage exports to strengthen the trade surplus and help the state budget deficit. Air and ground transportation is a basic requirement for the smooth mobility of the resources that are needed by the community, so that the state budget to provide financial assistance in the form of subsidies and equity participation for development investment.

Based on the reasons for the selection of the research sector, then selected seven state-owned companies this sector that have been going public either sell shares or to sell bonds in the capital market. State-owned companies this sector which has been selling shares is PT Perusahaan Gas Negara, PT Bukit Asam, PT Aneka Tambang and PT Garuda Indonesia. While this new sector companies selling bonds

is observed PT Pertamina, PT PLN and PT Kereta Api Indonesia. Observations were made during the period 2010 to start the company in 2015 as many as 42 times. In using variable measurement estate activities earnings management is done by using a regression equation calculating the residual or abnormal cash flow operations or ACFO, abnormal production costs or APROD and abnormal discretionary expenses or ADEXP should use the variable revenue change in previous years, so a period of 6 years only use four years of each company are observed. This is what causes the sheer number of samples used in the calculation of the regression by 28 companies-time (7 companies x 4 years = 28 company-years).

### Variabels and Measurement

#### Dependent Variable

##### Financial Distress

Financial distress ( $YFD_{it}$ ) as measured by the value of the Altman Z-score (1983 and its development in 1984) Altman Model 1983 using the basic calculation of the value of Z-score:

$$Z_i = 1.2 + 3.3X_1 + 1.4X_2 + 0.6X_3 + 1.0X_4 + 1.0X_5$$

Where :

$X_1$  = (Current assets - current liabilities) / Total Assets

$X_2$  = Retained earnings / total assets

$X_3$  = Earnings before interest and taxes / Total Assets

$X_4$  = The market value of common stock da preferred / book value of total debt

$X_5$  = Sales / Total Assets

$Z_i$  = Value Z-Score

Model 1984 using the base value calculation Z-score: *Altman* then develop an alternative model to replace the variable  $X_4$  (market value of the preferred stock and common stock / total book value of the debt). The equation obtained is:

$$Z_i = 0,717X_1 + 0,847X_2 + 3,107X_3 + 0,420X_4 + 0,998X_5$$

The cut-off is  $Z < 1.81$ , the company went bankrupt category;  $1.81 < Z\text{-Score} < 2.99$  the company enters a gray area (gray area or zone of ignorance) or areas prone and  $Z > 2.99$  the company is not bankrupt.

#### Independent variable

##### Government Subsidy

Government subsidies ( $X_1GSUB_{it}$ ) are budgeted through the budget as government subsidies or Government Subsidy observation period (2010 - 2015) for each SOE observed.

##### Tax management

Tax management ( $X_2TAM_{it}$ ) is measured by the magnitude of the effective tax burden paid by the company that the achievement of bias is smaller than the average tariff of company tax is generally defined by the government. MALDI, SM, Anwar, Y., Dwi Chrism, EBA (2014) in his study of Examining Corporate Governance and Corporate Tax Management, using variable rate taxes ETR or effective as in the model presented below.

$$ETR_{i,t} = \beta_1 + \beta_2 ETR_{i,t-1} + \beta_3 BOARD + \beta_4 INDEP + \beta_5 COMP + \beta_6 SIZE + \beta_7 ROA + \beta_8 LEV + \beta_9$$

Where: ETR = effective tax rate of i- corporation at t-time (GAAP ETR and ETR Current is used in this research); GAAP ETR = tax expense based on GAAP-based accounting report; Current ETR = current tax expense / pretax income; BOARD = number of boards; Indep = number of independent board (in percentage); COMP = board compensation to total sales; SIZE = control variable (log of total assets); ROA = control variable (net income to total assets); LEV = control variable (debt to equity). Tax management is used by company management to achieve operational financial performance. In the short term, the company to save or reduce the tax burden compared to the actual conditions that increase profitability, but long-term natural may affect the sustainability of the company because the government will

apply a penalty if it turns out the results of a tax audit is apparently act of tax manipulation, even threatened business license suspended even can result in criminal manipulation adverse tax state.

### Control variables

#### Earnings management activities

Earnings management activities ( $X_3RAEM_{it}$ ) measured by using abnormal operating cash flow, the cost of abnormal prouksi and abnormal discretionary expenses. The independent variable real earnings management activities are actions taken by management to influence the financial statements through policies related to corporate activity such as production, sales, accounts receivable, inventory and more. Real variable measurement activities as in Roychowdhury, S (2006) in equation (1) to the equation (5) below, but in this study only using equation (1), (4) and (5) the grounds according to the relevance of research in the energy sector SOEs environment, mining and transport were studied.

Equation (1) Operating cash flow (CFO).

$$CFO_t/A_{t-1} = \alpha_0 + \alpha_1(1/A_{t-1}) + \beta_1(S$$

Equation (2) cost of goods sold (COGS),

$$COGS_t/A_{t-1} = \alpha_0 + \alpha_1(1/A_{t-1}) + \beta_1(S$$

Equation (3) changes in inventory ( $\Delta INV$ ),

$$\Delta INV_t/A_{t-1} = \alpha_0 + \alpha_1(1/A_{t-1}) + \beta_1(\Delta S$$

Equation (4) production (PROD),

$$PROD_t/A_{t-1} = \alpha_0 + \alpha_1(1/A_{t-1}) + \beta_1$$

Equation (5) discretionary expense (DISEXP),

$$DISEXP_t/A_{t-1} = \alpha_0 + \alpha_1(1/A_{t-1}) +$$

Where:  $A_t$ : total assets, end of year  $t$ ; and  $S_t$ : sales period  $t$

Variable measurement procedure in this study begins by using equation (1), Equation (2) and equation (5), and then calculated the residual or abnormal from the third equation (ACFO, APROD, ADEXP) as in the study by Cohen et al. (2008) in Roychowdhury, S (2006) below.

$$AREAL_t = ACFO_t + APROD_t + ADEXP_t$$

Where: AREA: abnormal estate activities; ACFO: abnormal operating cash flow; APROD: abnormal production costs; and ADEXP: abnormal discretionary expense.

#### Accruals earnings management

Measurement of accruals earnings management variables ( $X_4ACEM_t$ ) based on the difference between the interest and earnings before tax, as defined by Kasznik (1999).

The independent variable is the total accruals earnings management actions taken to affect the financial statements or earnings management by using techniques accruals in recording financial transactions. Measurement of total accruals earnings management variable (TEAM) was used formula as in the model proposed by Jones (1991), Dechow (1995) and Kasznik (1999) below.

$$ACCR = NI - CFO$$

Where: ACCR = total accruals; NI = net income before extraordinary items; CFO = cash flow from operating activities.

Kothari, SP, Leone, AJ, Wasley, CE (2002) in his research on Performance Matched Matched Measures. Performance Discretionary Discretionary Accrual Accrual Measures using variable total accruals as used in the model of Jones (1991) that total accruals measured as the difference between net income with operating cash flow. In its findings stated that the total accruals and exhibited significantly positively influenced by variables: Book / Market Sales Growth, E / P Ratio, Size, and Cash Flows.

#### Operation performance

Variable measurement of operation performance ( $X_5FOPT$ ) based on the achievement level of operating profit to total assets used by the company, as in Aba, EK, Badar, MA, Hyden, MA (2014) in his study of *Impact of ISO 9001 certification on financial*

firms operating performance. *International Journal of Quality & Reliability Management*, have used Financial Operation Performance variables as the following formulations.

$$FOP = EBITA / \text{Total assets}$$

Where: FOP = financial operating performance; EBITA = earnings before interest, taxes and amortization; and TA = total assets

**Research Model**

In this study related to causality and using panel data, namely time series and cross section, so that the regression model is the right choice. The basic concept of regression analysis was first introduced by Francis Gultom (1886) and supported by Karl Person and A. Lee (1903), in Guajarati (2016) and Suliyanto (2011). The regression model to test the hypothesis through the tendency of positive or negative relationship and the level of significance of the relationship between the independent variables with the dependent variable. The significance level relationships simultaneously conducted via statistical tests-F while significantly the level of the relationship partially or individually for each independent variable on the dependent variable is done through statistical t-test. Furthermore, to determine how much ability the regression model is able to explain the phenomenon under study is reflected in the amount of adjusted R-squared or the coefficient of determination. And to assure the accuracy of predication model of proficiency level, then performed classical assumption through multicollinearity test, autocorrelation test and test heteroscedasticity. To test the hypothesis proposed in this study, the analysis model used is as the following equation.

$$YFD_{it} = \beta_0 + \beta_1 X_1GSUB_{it} + \beta_2 X_2TAM_{it} + \beta_3 X_3RAEM_{it} + \beta_4 X_4AEM_{it} + \beta_5 X_5FOP_{it} + e_{it} \dots\dots\dots(1)$$

Where :

YFD : financial distress companies sector energy, mining and transport in the environment of SOEs in period t.

X<sub>1</sub>GSUB : Government Subsidy or the state budget subsidies for tariff or the sale price is lower than that treated its economic cost in period t.

X<sub>2</sub>TAM : tax management undertaken to sign a number of the company's tax burden in period t.

X<sub>3</sub>RAEM : real earnings management activities undertaken by the company in an environment of SOEs in period t.

X<sub>4</sub>AEM : accruals earnings management conducted by the management company to affect the financial statements via the system of recording transactions accruals in period t.

X<sub>5</sub>FOP : operating financial performance or the financial performance of the company's operations in an environment of SOEs in period t.

β<sub>0</sub> : constants

β<sub>1</sub> ... β<sub>5</sub> : regression coefficient independent variable

e<sub>it</sub> : error

**RESULTS OF RESEARCH AND DISCUSSION**

**1. Descriptive Statistics and Correlations Matrix**

**Descriptive Statistics**

Descriptive research results as the table below shows that there are variations in the data in each variable is quite high, as reflected in a range between the minimum and maximum figures. This is mainly due to differences in scale State-owned enterprises, or SOEs were observed. Some companies have a high level of revenue while others obtain revenue is relatively low, some companies earn higher profit, and the other is still a loss or is subsidized by the state budget to avoid financial distress. Variations of the observational data shows that

the selection of the sample in this study to get an overview represent the energy sector, mining and transport within the state-owned enterprises, so as to obtain a result of analysis which can be useful for decision-making SOEs, and observations practitioners or researchers of this field. Companies in this sector vary on when the business is large-scale business with mid-level categories such as Bukit Asam, PGN, and Aneka Tambang, while large-scale top level categories such as Pertamina, PLN, Garuda Indonesia and Railways. Companies in

this sector requires investment funds large enough to require funding from the capital market. State-owned companies in the sectors of energy, mining and transport observed is already go public selling stocks and bonds in the capital market both nationally and internationally. PLN, Pertamina and Rail only limited to selling bonds in national and international capital market instrument, while others have sold shares on the Indonesia Stock Exchange.

**Tabel 1. Descriptive Statistics**

	N	Minimum	Maximum	Mean	Std. Deviation
YFDt	28	.40	2.76	1.5265	.72242
X1GSUBt	28	0.00	.51	.1075	.15793
X2TAMt	28	-.27	6.09	.5821	1.31055
X3REAMt	28	-.19	.52	.0002	.17193
X4AEMt	28	-.69	.11	-.1165	.17480
X5FOPt	28	-.42	.32	.0270	.17882

\*\*\* Significant at a level of 1 percent, \*\* Significant at a level of 5 percent, \* Significant at a level of 10 percent, Note: YFDt: financial distress companies in SOEs, X1GSUBt: government subsidies or public service obligation, X2TAMt : tax management undertaken by the company so that the tax burden is lower than the prescribed rate, X3REAMt: management actions to influence the financial performance corresponding objectives to be achieved in a way through the main activities are lower than the rates stipulated, X3REAMt: management actions to influence the its financial performance objectives to be achieved in a way through the principal activity of the company, X4AEMt: action taken to affect the financial statements through the treatment of transaction records accruals, and X5FOPt: the financial performance of the company's operations.

The standard deviation also shows the extent of the deviation of observational data of the average value or mean, and are consistent, as described on the minimum and maximum range. The higher the number of standard deviations, the higher the degree of deviation from the average value or mean, which means observation corporations that time there has been a variation sharp enough so that it can be stated that this study has represented observations on the range is quite wide and can

explain the condition this sector is better for medium-scale enterprise level and the top level in this sector.

**Correlation Matrix**

The correlation between independent variables with the dependent variable as the table correlations below, which varies in the range of 0.226 to 0, 877 consisting of independent variables that have a strong correlation is X1GSUBt = 0,829 and X5FOPt = 0.877 which means that these two variables

have a high level of sensitivity in relation to the company's financial distress energy sector, mining and transportation.

GSUB Government or Public Service Obligation (X1GSUBt) as funding from the state budget subsidy granted to the company sector of electricity, fuel and train because without the funding, the company will experience financial distress. Prices were treated lower than its economic cost, which means the company is not able to finance its operations, not coined liquidity ability to repay debts maturing and difficult to undertake

development or investment. GSUB or the state budget subsidies in the sector of electricity, fuel and train becomes a must if the government does not provide alternative domestic fuel price increase, the increase in basic electricity tariff and railway tariff adjustments. This has become increasingly interesting from this study because of the company's operational or without subsidy has been in the position of financial distress, not only to help with the relatively limited number or a small but significant amounts of around Rp 300 trillion per year.

**Tabel 2. Correlations**

	YFDt	X1GSUBt	X2TAMt	X3REAMt	X4AEMt	X5FOPt
YFDt	1					
p-value						
X1GSUBt	-.829**	1				
p-value	.000					
X2TAMt	-.226	.062	1			
p-value	.124	.376				
X3REAMt	-.294	.417*	-.131	1		
p-value	.064	.014	.253			
X4AEMt	.469**	-.440**	.104	-.653**	1	
p-value	.006	.010	.298	.000		
X5FOPt	.877**	-.711**	-.082	-.296	.660**	1
p-value	.000	.000	.340	.063	.000	

\*\* Correlation is significant at the 0.01 level (1-tailed).

\* Correlation is significant at the 0.05 level (1-tailed).

Financial operating performance (X5FOPt) as variables that describe the company's operating financial performance was very strong correlation with the financial distress of energy sector companies, mining and transport environment of state-owned enterprises. This shows that the operational financial performance has contributed to the sustainability of the company and therefore the shareholders in this ministry of state enterprises applying performance assessment system that must be met by the state, especially on the performance of financial, operational and administrative performance. Among the

performance of the charter, the financial performance has the highest weighting in the calculation of the level of health of SOEs. Financial operation performance is strongly correlated with financial distress which means also that this variable must be a priority in controlling the stability of the financial order not to experience difficulties in operating cash flow, cash flow and investing cash flow financing.

Correlation variable accrual earnings management (X4AEMt) = 0.469, or around 50% which means that the variable is correlated with less financial distress, although it is not too

strong compared to the variable X1GSUBt and X5FOPt. This means that financial distress is also influenced by the actions of management earnings accrual recording transactions, so as to signify the position of financial distress experienced by SOE sector energy, mining and transportation.

Correlation variable tax management (X2TAMt) = 0.226 and real variable earnings management activities (X3REAMt) = 0.294 is relatively small so it can be stated that these two variables are less reflect the ability to explain the change in the dependent variable of financial distress as a result of changes in the independent variables. Tax policy management in reality it is difficult to do because the company different from a private SOEs in terms of tax management, because of financial distress that occurred in SOEs, it will be saved by the finance ministry and do not need to tax management. This is the reason for the low correlation between the dependent variable tax management with financial distress (YFDt).

The correlation between the independent variables as indications of multicollinearity, although it is still early stage, and needs to do a follow-up test of the theory and statistical tests *Variance Inflation Factor* or VIF to confirm a violation of classical regression assumptions. Among the independent variables turns X1GSUBt variables correlated with variables X5FOPt at the level of 0.771 or correlation reaches 77.1%. Theoretically this does not happen correlation for each stand alone or are not related to one another. X1GSUBt as the level of subsidies provided by the state budget to companies related to the life of many pawns of electricity, fuel and train. While X5FOPt as an indicator of financial performance reflects the operational achievement figures correspond core business operating results respectively compared with total assets of company-operated energy sector,

mining and transportation. The statistical indicates VIF each independent variable was obtained in the range between 1.056 to 3.753, or less than 10, so it is stated that in the regression equation there is no multicollinearity. In particular, the VIF level variables and X5FOPt X1GSUBt = 2.530 = 3.753 showed that these two variables there is no indication multicollinearity, so that a strong correlation between the two variables does not happen multicollinearity.

## **2. Hypothesis Testing Results**

Government Subsidy Policy (X1GSUBt) which provides subsidies to state-owned companies experiencing financial distress due to the price level that is applied is lower than the cost economics. X1GSUB variable regression coefficient = - 1.695 with p-val = 0.003, which means that these variables negatively affect the level of financial distress companies energy, mining and transport in the environment of SOEs. This illustrates that the coefficient is Matematik case of X1GSUB variable increment by one unit, it causes a decrease in the level of financial distress or condition into bankruptcy. This is mainly due to the looseness fulfillment subsidy funding will further exacerbate financial distress because of the company's management was just busy doing without thinking about the investment rate of return, and even tends to expand increasingly detrimental, thus diminishing financial distress. And this has resulted in higher dependence on subsidies, and the suit to make any price adjustments because the range between tariffs and the cost of getting away and the amount of subsidies increased from time to time.

Wisdom tax management (X2TAMt) shows the management's action to make efforts to reduce the tax burden. The results showed regression coefficient = -0.074 with p-value = 0.078, which means that which means that an

increase of one unit of this variable will cause a decrease in financial distress variable (YFDt) amounted to 0,074 with a confidence level of 7.8%. This occurs because the act of tax

management that reflects a decreasing tax burden will lead to increased levels of financial distress due to liquidity conditions could be improved or save on payment of the tax burden.

**Tabel 3. The effect of Government subsidy and Tax management on Financial Distress BUMN**  
 (1) Model-1 :  $YFDt = \beta_0 + \beta_1 X1GSUB_t + \beta_2 X2TAM_t + \beta_3 X3REAM_t + \beta_4 X4AEM_t + \beta_5 X5FOP_t + e$   
 (2) Model-2 :  $YFDt = \beta_0 + \beta_1 X1GSUB_t + \beta_2 X2TAM_t + e$

Variables	Prediction	Model-1			Model-2		
		Coefficients	p-value	VIF	Coefficients	p-value	VIF
Constant		1.5779	0.0000 ***		1.9849	0.0000 ***	
X1GSUBt	-	-1.6949	0.0033 ***	2.5298	-3.7417	0.0000 ***	1.0039
X2TAMt	+	-0.0740	0.0784 *	1.0555	-0.0965	0.1128	1.0039
X3REAMt	-	-0.3251	0.4787	2.3043			
X4AEMt	-	-0.8269	0.1414	3.4390			
X5FOPt	-	2.8739	0.0000 ***	3.7527			
Adj- R2		0.865			0.6950		
F - statistic		35.570			31.7586		
Prob F-statistic		0.000			0.0000		
Durbin-Watson		1.369			1.3091		
Total Observations		28			28		

\*\*\* Significant at a level of 1 percent, \*\* Significant at a level of 5 percent, \* Significant at a level of 10 percent, Note: YFDt: financial distress companies in SOEs, X1GSUBt: government subsidies or public service obligation, X2TAMt : tax management undertaken by the company so that the tax burden is lower than the prescribed rate, X3REAMt: management actions to influence the financial performance corresponding objectives to be achieved in a way through the main activities are lower than the rates stipulated, X3REAMt: management actions to influence the its financial performance objectives to be achieved in a way through the principal activity of the company, X4AEMt: action taken to affect the financial statements through the treatment of transaction records accruals, and X5FOPt: the financial performance of the company's operations.

The company's policy is to do management earning income through earnings management activities (X3REAMt) showed coefficient = -0.325 with p-value = 0.479 which means that these variables negatively affect financial distress (YFDt). It shows that the addition of these variables will lead to a decrease in the level of financial distress or heading in the financial conditions are getting worse. This variable has a p-value levels are relatively high or greater than 0.10, or 10%, so it can be stated that this variable does not have significant influence on the dependent variable of financial distress companies energy, mining and transportation.

Earnings management actions by the company through accruals earnings management (X4AEMt) showed coefficient = -0.827 with p-value = 0.141, which means that these variables negatively affect financial distress (YFDt). This indicates that the addition of these variables will lead to a decrease in the level of financial distress or heading in the financial conditions are getting worse. This variable has a p-value levels are relatively high or greater than 0.10, or 10%, so it can be stated that this variable does not have significant influence on the dependent variable of financial distress companies energy, mining and transportation.

Operational financial performance (X5FOPt) showed coefficient = 2.874 with a p-value = 0.000, which means that this variable positively affects financial distress (YFDt). Added one unit X5FOPt variable will cause the increase of the level of financial distress companies, so getting away from financial difficulties because the company is increasing the achievement of the z-score is the basis for determining the level of the financial difficulties the company's energy sector, mining and transportation of natural environment SOEs.

Model-1 by using the control variable, but the result is consistent with the model-2 when only independent variable or without the use of control variables. The consistency of the calculation results are reflected in the negative directional tendencies and X2TAMt X1GSUBt variables. The same result also occurs consistency at the level of significance of the influence of these two variables, ie variables were significant effect on the variable X1GSUBt YFDt, while variable X2TAMt not significant effect on YFDt. This further proves that the more subsidized, then further aggravated the financial distress of the company. The weakening condition of financial distress score mainly because the focus of the company's management more oriented towards achieving the targets set by the shareholders or the government, while the subsidy is no longer a concern as more and more to achieve the target subsidy increase and decrease the score of the index or financial distress of the company.

Variable X2TAMt significant effect on the confidence level is 0.078, which means the variables significantly influence the company's financial distress or YFDt. A significant degree of influence of these variables showed that there had been an effort management company to take action to reduce the tax burden, even

though the government has given tax burden reduction facilities in order to motivate and awareness taxpayers to make the calculations more transactions relaistis.

Level adjusted - R<sup>2</sup> = 0.865 showed regression model used has the ability to explain the phenomenon. This suggests that the change in the dependent variable of financial distress (YFDt) can be explained by changes in the independent variable of about 86.5%.

The F-statistic = 35.570 with Prob = 0.000 indicate that the independent variables simultaneously or collectively have a significant effect on the financial distress (YFDt), but only partially variable X1GSUBt, X2TAMt and X5FOPt that significantly, while the other independent variable is not significant influence on YFDt variable dependent on the company's energy sector, mining and transport in the environment of SOEs.

Test autocorrelation using the Durbin-Watson showed DW-statistic = 1.369, while DW tables at N = 28 and k = 5 is obtained dL and dU = 1.03 = 1.85 so it is stated that the regression model used can not be ensured aotocorrelation or uncertain, because the position of the value of DW-statistic (1.369) is between the value of dL (1.03) and the value of dU (1.85). Otherwise no autocorrelation if DW-statistic is smaller than from dL (1.03), and declared free from autocorrelation if DW-statistic greater than dU (1.85).

Muticollinearity test has been proven in VIF described in the above correlations matrix, ie there is no indication multicollinearity for each independent variable levels of VIF smaller than 10. The calculation results for each variable VIF varies between 1.056 up to 3.753 or less of 10 as required for testing multicollinearity.

Test heteroskedasticity using Glejser method showed that none of the independent variables have significant influence with p-

value varies between 0.365 up to 0.884, which means that in the regression model used is not indicated the existence of heteroskedasticity.

Normality test showed that the data used in the regression model assumptions of normality is in compliance with a significant level greater than 0.05 on a test for normality with the Kolmogorov-Smirnov test, so it is stated that that no violation of normality assumption as in classical assumptions.

### 3. Sensitivity Test

In a sensitivity analysis is intended to show the consistency of the results when using the method of measurement variables to be replaced or changes. In this sensitivity analysis used the same model to model 1 and model-2 but with the dependent variable measurement methods are different, namely on-1 models using Altman model in 1984 while on a model of sensitivity analysis using the model 1993. Model Altman Altman year 1984 using current Z-score calculation basis:

$$Z_i = 0,717X_1 + 0,847X_2 + 3,107X_3 + 0,420X_4 + 0,998X_5$$

While Altman mode 1983 using the basic calculation -score:

$$Z_i = 1.2 + 3,3X_3 + 1,4X_2 + X_1 + + + 0,6X_4 + 1,0X_5$$

Against the independent variable  $X1GSUB_t$ ,  $X2TAM_t$ ,  $X3RAEM_t$ ,  $X4AEM_t$ , and  $X5FOPT$  in this sensitivity analysis using measurement methods previously fixed or unchanged. Regression analysis by measuring the change in

the dependent variable  $YFD_t$  obtained in Table 4 below.

The results of the sensitivity analysis in Table 4 shows that there is consistency in terms of the tendency of negative influence and a positive influence as the model 1 and model 2 Table 3. The significant level variables influence  $X1GSUB_t$  and  $X5FOPT$  results are consistent with Table 3, but the special variable, but the result is different  $X2TAM_t$  ie on-1 models have a significant effect whereas the sensitivity of the model or model-3 does not have significant influence on the financial distress  $YFD_t$ . This proves why Altman model of a modification to the calculation of Z-scores in 1983 and 1984.

When associated with the results of model calculations of the 2nd and 4th models ie without using control variables, the results of model calculations-one consistent result than model-3. And when associated with the condition of the company off is, then the tax management actions undertaken by the company is relatively small due to its status as a state does not provide benefits for state-owned enterprises, and management will take action according to the rules applicable tax and tend to avoid tax management. The financial difficulties will be assisted by the government through additional equity or additional subsidy, so the company is less likely to commit tax management. If this happens then the model-4 sensitivity using the Altman Z-1983 core capital is more relevant than the Z-score in 1984.

**Tabel 4. Sensitivity Analysis**

(1) Model-3 :  $YFD\_SENS_t = \beta_0 + \beta_1 X1GSUB_t + \beta_2 X2TAM_t + \beta_3 X3REAM_t + \beta_4 X4AEM_t + \beta_5 X5FOP_t + e$

(2) Model-4 :  $YFD\_SENS_t = \beta_0 + \beta_1 X1GSUB_t + \beta_2 X2TAM_t + e$

Variables	Prediction	Model-3			Model-4		
		Coefficients	p-value	VIF	Coefficients	p-value	VIF
Constant		1.9208	.000 ***		2.3921	0.0000 ***	
X1GSUBt		-1.6249	.041 ***	2.5298	-4.2230	0.0000 ***	1.0039
X2TAMt		-0.0756	.208	1.0555	-0.0953	0.2306	1.0039
X3REAMt		-0.5359	.423	2.3043			
X4AEMt		-0.7631	.344	3.4390			
X5FOPt		3.3995	.000 ***	3.7527			
Adj - R2		.795			0.6183		
F - statistic		21.901			22.8684		
Prob F-statistic		0.000			0.0000		
Durbin-Watson		1.323			1.2862		
Total Observations		28			28		

\*\*\* Significant at a level of 1 percent, \*\* Significant at a level of 5 percent, \* Significant at a level of 10 percent, Note: YFDt: financial distress companies in SOEs, X1GSUBt: government subsidies or public service obligation, X2TAMt : tax management undertaken by the company so that the tax burden is lower than the prescribed rate, X3REAMt: management actions to influence the financial performance corresponding objectives to be achieved in a way through the main activities are lower than the rates stipulated, X3REAMt: management actions to influence the its financial performance objectives to be achieved in a way through the principal activity of the company, X4AEMt: action taken to affect the financial statements through the treatment of transaction records accruals, and X5FOPt: the financial performance of the company's operations.

#### 4. Discussion of Research Results

The correlation matrix shows that independent variables X1GSUBt, X4EMt and X5FOPt strongly correlated to the dependent variable YFDt which means that these variables have a strong correlation with the financial distress experienced by the company waterwheel sector, mining and transport in the environment of SOEs. In relation to the strong correlation between the independent variables X1GSUBt with X5FOPt indicated the existence of multicollinearity, but in theory the two variables are not correlated with each other, while statistically proven that the amount VIF only varied between 1.056 to 3.735, or less than 10 so stated there are no indications of multicollinearity.

Regression analysis showed variabel X1GSUBt, X2TAMt, and X5FOPt significantly influence financial distress (YFDt) state-owned

enterprises in the energy sector, mining and transportation. While other independent variables not significant effect on the sector's financial distress. SOE policy implications for improving the position of financial distress, should pay attention to the tendency of the influence of the significant variables as mentioned above.

Variable X1GSUBt negatively affect financial distress, kaka implications subsidize permanently every year it will be even worse for the company's financial performance because management is no longer oriented to the achievement of a certain return, but oriented towards the expansion does not see the financial feasibility, further threaten the financial distress of SOEs concerned especially if the subsidies are reduced much less eliminated, then bankruptcy is instantaneous.

Variable X2TAMt negatively affect the financial distress implies that state-owned enterprises that reduced the tax burden, then the position of financial distress are getting better or getting away from a position of financial hardship. The implication is a state of emotion wary of doing tax management for not providing actual benefit but simply reflects a better performance than the actual condition.

Variable X5FOPt positive effect on financial distress which means increased operational financial performance will be better. SOE for decision makers should tighten the financial performance of operations in an effort to nourish the financial condition of the energy sector, mining and transportation.

The regression model that is used to explain the phenomenon under study, test F-statistic is significant but partial only some variables that have a significant effect, namely X1GSUBt, X2TAMt and X5GSUBt, while the other independent variables had no significant effect.

Classic assumption test showed no indication of multicollinearity, autocorrelation can not be ensured, there are no heteroskedasticity and meet the assumptions of normality, so that the regression equation can be used to predict the future of the company if there is a change to the independent variable.

## **CONCLUSIONS**

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Based on the analysis and discussion of the above, then the following can be concluded that the financial distress of the energy sector, mining and transport in the environment SOEs affected negatively and significantly by variable Government Subsidy or the state budget subsidies (X1GSUBt) which means that an increase in the independent variable will cause a decrease the level of financial distress because the company no longer oriented toward the return or profitability, but oriented to the development or investment projects that are not financially feasible.

Tax management actions or efforts to suppress the tax burden (X2TAMt) negatively affect the financial distress the energy sector, mining and transport in the environment of SOEs, so that decision makers should look like this effort because they tend to perform actions that harm the state revenue.

Operational financial performance (X5FOPt) positive influence on the financial distress of state-owned enterprises in the energy, mining and transportation. It becomes imperative for policy makers SOE that this sector should be controlled financial performance of operations in order to become more healthy financial distress or increased, then gradually increase this performance with the development of information systems and technology used.

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## WHAT INTELLECTUAL CAPITAL IN PRIVATE UNIVERSITIES CAN IMPROVE PERFORMANCE AND COMPETITIVENESS ?

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### **ABSTRACT**

*Intellectual Capital (IC) is a news strategy tool in the business world that can increase the performance and competitive power of a company. Is it possible if a high education institution that becomes the base of knowledge asset, Intellectual capital can also increase the performance and competitive power to the private university? For that purpose, this study is made to analyze the influence of IC to the performance and competitive power of th university. IC is an interaction from human capital, relational capital and structural capital. The sample of this research is 38 study programs of bachelor degree in the high education institution in the area of Kopertis III chosen by purposive sampling. The result of this study shows that human capital, relational capital are proven to significantly influence the performance and institution competitive power positively, while structural capital is not yet been able to influence significantly.*

*Keywords : Intellectual Capital, Human Capital, Structural Capital dan Relational Capital*

### **1. Introduction**

Knowledge assets are a strategic resource that plays a role in maintaining a competitive advantage (Bontis, 2001). One of the approach used in the assessment and measurement of knowledge assets are intellectual capital. Intellectual capital is the interaction of human capital, structural capital and relational capital (Bontis, 2001). Human Capital concerning the competence, skills, brainpower, expertise, creativity, problem solving ability, leadership, entrepreneurial and managerial skills possessed by company's human resources

(SDM). Structural Capital is the ability of companies to respond the needs and challenges of the market in the form of technologies, methodologies, and processes. Customer Capital regarding the relationship, feedback, input of goods and services, as well as the experience of the customer. The three types of capital formed three circles interlocking and united by a triangle which eventually became known by the term of Intellectual Capital (IC). IC is an important asset in the business sector today because the IC is a company's resource that plays an important role in improving the performance

and competitiveness of enterprises (Cynthia, 2004).

Private institutions of higher education in Indonesia are not able to compete with the state institutions in terms of new admission, so that in some private institutions the new admissions have decreased continuously. This is one reason that 30 percent of the 374 private higher education institutions in West Java threatened with bankruptcy, even that 90 percent of the 3,214 private institutions in Indonesia is predicted not ready to compete with foreign universities when the implementation of the ASEAN Community by 2015, so have the potential bankrupt. This phenomenon is certainly not wanted by all parties including the government as well as private higher education institutions.

The higher education institutions produce knowledge both technically and through scientific research (Córcoles, 2013), making it an ideal framework for the implementation of the ideas associated with IC (Zhao & Ordonez de Pablos, 2009). IC in the company has been proven by many researchers can improve the performance of the company (Lu et al., 2010; Lu et al, 2014) and is also a strategic tool (Rexhepi, 2013) in order to increase competitiveness (Cynthia, 2004). Is the IC are also able to play a role in improving the performance and competitiveness in higher education institutions, is the focus of this research.

Research related to IC has been widely applied in various countries both in developed countries and in developing countries. IC research in developing countries, among others in Jordan (Sharabati et al, 2010); Serbia (Komnenic and Pokrajčić, 2012; Dženopoljac, 2016); Iran (Mehralian et al, 2012); India (Kamath, 2008; Sriranga and Vijay, 2014); Romania (Morariu, 2014); Malaysia (Ting and Lean, 2009). IC research in developed countries, among others in China (Chu et al, 2011); Greece (Mavridis, 2005); Russia

(Andreeva and Garanina 2016). The object of this study examines more companies (Madinios, et al 2011; Singh et al 2016; Maji and Goswami, 2016) and fewer to higher education institutions. Therefore this research will examine how the effect of IC on the competitiveness and performance of higher education institutions

## **2. Theoretical framework and development of hypotheses**

### **2.1 Intellectual Capital**

Research on IC has been done since the era of the 60s and 70s. But the term intellectual capital became popular when it appeared in the article "Brainpower" in Fortune magazine by Stewart (1991). In 1995 held the first meeting of the Intellectual Capital Management (LCM) where Petrash, Edvisson and Sullivan with eight representatives from different companies to discuss the IC they believe are owned by their respective companies (Andriessen, 2004). These meetings ultimately define IC as knowledge that can be converted into profit (Sullivan, 2000). According to the International Federation of Accountants (IFAC), Intellectual Capital is synonymous with intellectual property, intellectual assets and knowledge assets. The Economist defines IC as "The part of a country's or a firm's capital or an individual's human capital that consists of ideas rather than something more physical. It can often be protected through patents or other intellectual property laws (Klein and Prusak 1994) define IC as intellectual material that has been formalized, and utilized to produce more high-value assets. IC is generally identified as the difference between the market value of the company and the book value of the assets of the company from company's financial capital. It is based on an observation that since the late 1980s, the market value of most businesses and particularly knowledge based businesses, have become larger than the value reported in the financial statements

based on calculations performed by accountants (Roslender & Fincham, 2004).

Furthermore, Edvinsson and Malone (1997) identify the IC as the hidden value of the business. The term of hidden is used for two related things. First IC particularly as intellectual assets or assets of knowledge is not generally seen like other assets, and secondly, such assets are usually not seen in the financial statements. According to Bontis in his journal, entitled "A Review of The Models Used to Measure Intellectual Capital" stated that the Intellectual Capital consists of three main elements, namely: human capital, structural and relational capital.

Human capital is related to expertise, talent and attitude of employees (Choong 2008). Chen et al (2004) stated that the human capital is associated with the knowledge and expertise that exists in the minds of employees, and if the company can not take advantage of these employees, the knowledge and expertise of these employees will be wasted and can not be translated into a value for company. Another factor in human capital is the core of creativity in the company's development in the future. Human capital reflects the company's collective ability to produce the best solution based on the knowledge possessed by the people in the company. Human capital according to Peng et al 2007, Intellectual capital is the set of critical resources used by firms to facilitate productive activities and generate economic rents, will improve performance if the company is able to use the knowledge held by employees (Brinker, 2000).

Wang and Chan (2005) describes that the structural capital has a relationship with the system and the company's structure that can help employees to achieve their full intellectual performance, so that the company's overall performance can be improved. Structural capital is the ability of an organization or company to meet the routine of the company and the structure that supports

employee efforts to produce optimum intellectual performance and overall business performance, for example: systems operations, manufacturing processes, organizational culture, management philosophy and all forms of intellectual property owned by the company. An individual can have a high intellectual level, but if the organization has bad systems and procedures then the intellectual capital can not achieve optimal performance and potential can not be fully utilized.

Relational capital is the company's value in relation to people and organizations that do business with the company (Cabrita & Bontis, 2008; Hormiga et al., 2011; Longo et al., 2009). This capital including relationships with external stakeholders, network with suppliers, distributors, lobby organizations, partners, customer relations and branding (attitudes, preferences, reputation, brand recognition) (Jacobsen et al, 2005; Marr, et al., 2004).

This element is an IC component that provides real value. Relational capital is a harmonious relationship which is owned by the company with its partners, both from suppliers and reliable quality, comes from loyal customers and satisfied with the company's service, and as well as from the company's relationships with governments and with local communities. Relational capital can arise from various parts of the environment outside companies that can add value to the company.

## **2.2 Intellectual Capital and Performance**

Firer and Williams (2003) test to examine the creation of added value through the component of physical capital, human capital and structural capital on profitability, productivity and market valuation. Data were taken from the 75 public companies in South Africa. The results showed that there was no relationship between the Intellectual capital with profitability, except for capital employed

has a positive effect on the market value of the company. Gan and Saleh (2008) examined the intellectual capital and company performance in technology intensive companies listed on Bursa Malaysia by using model Pulic. The results showed that technology intensive enterprise still depends on the efficiency of physical capital. Physical capital efficiency is a significant variable related to profitability, while human capital has a positive influence on the productivity of the company. Intellectual capital in the company is not able to explain its relationship with the market valuation. Chen et al., (2005) conducted study using a model Pulic to the listed public company in Taiwan. The results showed the hypothesis that intellectual capital has a positive influence on the company's financial performance and market valuation, as well as an indicator of financial performance in the future. Under those conditions, the hypothesis is as follows

- H1 Human capital has positive influence on the performance of higher education institutions.
- H2 Structural capital has positive influence on the performance of higher education institutions
- H3 Relational capital has positive influence on the performance of higher education institutions

### 2.3 Intellectual Capital and Competitiveness

IC is a knowledge-related intangible (Lu, 2012) held in an organization. IC a key highlight in the era of knowledge-based economy, in which IC plays an important role in organizational performance (Bollen et al, 2005; Chang et al, 2008; Pulic, 2002; Tan et al., 2007) and that IC may have impact significantly to the educational organizations (Jones et al., 2009; Martínez - Torres, 2006; Ramirez et al., 2007). Under those conditions, the hypothesis is as follows

- H4 Human capital has positive influence on the competitiveness of higher

education institutions

- H5 Structural capital has positive influence on the competitiveness of higher education institutions
- H6 Relational capital has positive influence on the competitiveness of higher education institutions

### 3. Research Methodology

Purposive sampling is a method of determining the sample used in this study due consideration of the location. The samples are 38 courses in higher education institutions in Jakarta area include courses of management, accounting and communications, and law.

Data were analyzed using Partial Least Squared (PLS). This technique is used because the intellectual capital not yet have a strong theoretical concepts and the number of observations below 100 (one hundred). Measurement of indicator variables for HC, SC and RC are as follows:

Table 1  
Measurement of variables

Variables	Indicator
Human Capital (HC)	HC1 Percentage of lecturers— S2
	HC2 Percentage of lecturers— S3
	HC3 Number of lecturers get grants
	HC4 Lecturer's publication
Structural Capital (SC)	SC1 The ratio of faculty per student
	SC2 Study period
	SC3 E learning
	SC4 Electronic library
Relational Capital (RC)	RC1 The research collaboration
	RC2 Cooperation of new admissions.
	RC3 Internship cooperation
	RC4 Other cooperation
Institution Performance	P1 Number of alumni per year
	P2 Graduates Waiting Period
	P3 Income
Competitiveness	C1 Number of student applicant
	C2 Number of New Students
	C3 New Student /Registrant Ratio

The statistics model proposed in this study is formulated in equation

$$\eta_1 = \beta_0 + \beta_1 \xi_1 + \beta_2 \xi_2 + \beta_3 \xi_3 + \zeta_1 \dots \dots \dots (1)$$

$$\eta^2 = \beta_0 + \beta_1\xi_1 + \beta_2\xi_2 + \beta_3\xi_3 + \zeta_2 \dots \dots \dots (2)$$

4. Results and discussion

Descriptive statistic test results are as follows:

Table 2  
Deskriptive Statistic

	N	Minimum	Maximum	Mean	Std. Deviation
HC1	38	.29	.96	.76	.13
HC2	38	.00	19.00	4.18	5.00
HC3	38	.00	0,19	.07	.04
HC4	38	3.00	170.00	22.47	34.66
SC1	38	.01	.04	.02	.01
SC2	38	3.500	5.00	4.02	.26
SC3	38	.00	1.00	.61	.50
SC4	38	.00	1.00	.45	.50
RC1	38	1.00	40.00	8.11	10.36
RC2	38	1.00	40.00	12.61	11,78
RC3	38	2.00	50.00	10,24	11.59
RC4	38	.00	20.00	7.50	7.22
P1	38	80.00	900.00	328.87	229.95
P2	38	1.00	6.00	3.68	1.243
P3	38	8.86	10.32	9.55	0,41
C1	38	170.00	3,000.00	437.74	337.36
C2	38	120.00	1,400.00	437.74	337.36
C3	38	.54	.98	.79	.13

Human capital variable, structural capital and relational capital has a value of correlation between those variables. The correlation between these variables can be seen in Table 3

Table 3  
Correlation

Competitiveness	1.00				
Human Capital	0.80	1.00			
Performance	0.82	0.47	1.00		
Relational Capital	0.60	0.25	0.73	1.00	
Structural Capital	0.43	0.45	0.58	0.50	1.00

To determine whether or not valid indicators are seen from the t value. If the t value above 1.96 then the indicator has met validity. The independent variables namely HC, SC and RC measured formative indicators. The results show the validity of the t value HC1 3.05; HC2 2.698; HC3 0.117;

HC4 5.895. HC3 indicator is not valid because the t value below 1.96 so removed from the model. The results show the validity of indicators SC, SC1 t value of 0.014; SC2 2.947; SC3 1.561 and SC4 9.282. Indicators SC1 and SC4 is not valid because the t value below 1.96. Indicators SC1 and SC4 will be removed from the model. The results demonstrate the validity of indicators RC RC1 t value 5.312; RC2 2.664; RC3 3.417 RC4 0.124. RC4 indicator is not valid because the t value below 1.96. RC4 indicator will be removed from the model. Institutional Performance and Competitiveness variable measured with reflective indicators.

Validity test results of Institutional Performance indicators show the value of P1 to P3 loading factor above 0.60; communality and AVE values above 0.50, the value of cross loading is big enough to measure performance variables Institutions, as well as the value of the root AVE. Based on all of these criteria shows all the performance indicators Institutions is eligible validity. Summary of test results

Table 4  
Validity Test Performance Variable

Validity	Parameter				Explanation
Converget Validitas	Loading Factor				
	P1	0.93	>	0.6	Validity
	P2	0.63	>	0.6	Validity
	P3	0.79	>	0.6	Validity
	AVE	0.63	>	0.5	Validity
Diskrimina nt Validity	Communality				Validity
	Cross Loading				
	P1	0.93	>	0.81	Validity
	P2	0.63	>	0.12	Validity
	P3	0.79	>	0.56	Validity

The test results demonstrate the validity of competitiveness indicators show factor loading values C1, and C2 above 0.60; communality and AVE values above 0.50, the value of cross loading is big enough to measure variables, as well as the value of the root AVE. Indicator

C3 of factor loading value is invalid ie below 0.60 but based on the AVE, communalities, cross loading and will qualify the validity outer AVE model, to the C3 is not included in the model

Table 5  
Validity Test Competitiveness Variable

Validity	Parameter			Explanation
Converget Validitas	Loading Factor			
	C1	0.96	> 0.60	Validity
	C2	0.99	> 0.60	Validity
	C3	0.53	< 0.60	NotValidity
	AVE	0.73	> 0.50	Validity
	Communalitiy	0.73	> 0.50	Validity
Diskriminant Validity	Cross Loading			
	C1	0.96	> 0.77	Validity
	C2	0.99	> 0.78	Validity
	C3	0.53	> 0.33	Not Validity

Reliability test results showed that the value of Cronbach alpha model of performance institution variables at 0.696; for Competitiveness at 0.798. Cronbach alpha value of each of these variables is greater than 0.60, this means that the reliability of the model qualifies. Value of composite reliability showed performance institutions variable at 0.833 and Competitiveness of 0.833, this means also qualifies the reliability model

R-square value of the variable performance of 0, 6426, this means that the magnitude of the variation of the performance is influenced by 64.26% of human capital, structural capital and relational capital. Remaining 35.74% institutional performance variation influenced by other variables outside the research. The R square of competitiveness variable is 0.825, it means that the magnitude of the variation of the competitiveness is influenced by 82.52% of human capital, structural capital and relational capital. Remaining 17.46% of the variation of competitiveness influenced by other variables outside the research.

Hypothesis test results show the value of t statistic for hypothesis 1 equal to 3.29 this value is greater than t table 1.98. This suggests the hypothesis 1 is accepted. This means there is a significant positive effect human capital on the performance of the institution's. This research results in line Kumar and Vijay (2014) and Jardon and Martos (2009).

The hypothesis 2 test shows the t statistic of 2.32. This value is grater than t table 1.98. This suggests the hypothesis 2 is accepted. This means there is a significant positive effect on the performance of the institution's structural capital. The hypothesis 3 test shows the t statistic of 4.66. This value is greater than t table 1.98. This suggests the hypothesis 3 is accepted. This means there is a significant positive effect on the performance of the institution's relational capital.

Table 6  
Hyphoteses Test Result

	Original Sample	Sample Mean	Standard Error	T Statistics
HC ->Performance	0.25	0.25	0.07	3.29**
SC -> Performance	0.19	0.21	0.08	2.32**
RC ->Performance	0.57	0.55	0.12	4.66**
HC ->Competitiveness	0.74	0.79	0.11	6.70**
SC -> Competitiveness	-0.12	-0.09	0.06	1.90
RC ->Competitiveness	0.48	0.47	0.10	4.75**

\*\* significance  $\alpha=0.05$

The hypothesis 4 test shows the t statistic of 6.70. This value is greater than t table 1.98. This suggests the hypothesis 4 is accepted. This means there is a significant positive effect of human capital on the competitiveness of higher education institutions. The hypothesis 5 test shows the t statistic of 1.90. This value is smaller than t table 1.98. This suggests the hypothesis 5 is rejected. This means there is no a positive significant effect of structural capital on the competitiveness of higher education institutions. The hypothesis 6 test shows the t statistic of 4.75. This value is greater than t table 1.98. This suggests the

hypothesis 6 is accepted. This means there is a significant positive effect of relational capital on the competitiveness of higher education institutions.

#### 5. Concluding remarks

The results of the research results show that IC is not just profit organizations such as corporations but in higher education institutions also IC significant positive effect on performance and competitiveness. IC influential show in this study, namely human capital and relational capital, while structural capital is only able to show the influence of significantly to performance. The higher education institutions and locations where repertory knowledge to implement, create and disseminate knowledge. Thus it is clear that the IC is a major asset for the college, and furthermore, that the quality of education directly affects the national competitive advantage. Therefore, the identification and measurement of IC in higher education institutions is essential for understanding the impact of IC on the performance and competitiveness.

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**COMPARING OF ENTREPRENEURIAL INTENTION STUDENT:  
BEFORE AND AFTER TAKING ENTREPRENEURSHIP COURSE**

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***ABSTRACT***

*This paper compares two models which are entrepreneurial intention before and after taking subject. This paper will explore and discuss entrepreneurial intention theory. It is a causality study which uses multiple regressions for data analyzing. The samples of this research are undergraduate students by which sampling method used judgement sampling for 150 respondents. This research contrasts student taking entrepreneurship subject without considering performance of the subject. This paper suggests contribution to board of director, faculty and department to make decision and policy. The study contributes for entrepreneurship curriculum course implications.*

***Keywords:*** *entrepreneurial intention, entrepreneurship subject, student, and proposition*



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