EFFECT OF CORPORATE GOVERNANCE AND ACCRUALS QUALITY TO CORPORATE CASH HOLDINGS: STUDY ON MANUFACTURING COMPANY IN INDONESIAN STOCK EXCHANGE

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ABSTRACT

This study objective was examined the effect of corporate governance and the accruals quality to corporate cash holdings. The research was conducted at a manufacturing company listed on the Indonesian Stock Exchange in 2009 to 2010. The study populations are all of manufacturing companies listed on the Indonesian Stock Exchange. The study samples are 143 companies taken used purposive sampling method. The study hypothesis was tested using multiple linear regressions. The analysis results were shown that: corporate governance positively affects corporate cash holdings; the accruals quality negatively affects corporate cash holdings.

Keywords: Corporate governance, accruals quality, cash holdings, manufacturing company.

JEL Classification: G34, M40

INTRODUCTION

This study objective was examined the effect of corporate governance and the accruals quality to corporate cash holdings of manufacturing companies in Indonesia Stock Exchange 2009-2010. Ginglinger and Saddour (2007) were stated that the determination of corporate cash holdings rate is one of the most important financial decisions of a finance manager. Ferreira and Vilela (2004) were stated that by the end of 2000, most European Union companies had an average of 14.8% of cash and cash equivalents in the total composition of the company's assets. Duchin (2010) was explained that companies in America have experienced a significant increase in cash ratio compared to total company assets. Data from 1990 to 2006 was shown that companies in the US that have business diversification have cash holdings average of 11.9%, while stand-alone companies hold more than 20.9% of the company's assets in cash (Duchin, 2010).

Couderc (2005) was mentioned that corporate cash holdings are related to the company's efforts to minimize the external funding cost. The company has large sums of cash in the hope that the investment may be financed with internal funding sources, if the internal sources are lacking, then used external funding. According to Couderc (2005), managers have an incentive to enlarge the company's free cash flow. This is because cash is the most manageable asset by managers. Managers have cash holdings in order to avoid financial distress in the future, invest when financial constraints increase and reduce costs incurred to acquire external funding and finance projects that suit the managers' interests.

According to Soddour (2006) in the perfect capital markets, holding large sums of cash is irrelevant. This is because companies will easily enter the market as well as easy to obtain funds for their investment financing. However, in reality many studies have shown that many companies consider

cash holdings to be an important thing that needs to be maintained at the optimum level to finance various corporate activities. Ditmar et al. (2003) was explained that the implementation of corporate governance within the company is one of the factors that affect corporate cash holdings. This was related to agency issues and protection of shareholder rights. Ditmar et al. (2003) was mentioned that if the shareholders rights protection is weak then the company will have a tendency to have large cash holdings in order to pay high agency fees. According to Couderc (2005), research on cash holdings was still considered not enough to prove the motivation of the company in holding cash in large amount, so it is necessary to do research about the factors that affect corporate cash holdings.

Teruel et al. (2009) was stated that the accruals quality as a proxy of the financial statements quality is one of the factors that affect corporate cash holdings. Accruals quality negatively affects asymmetry information. If accruals quality is high then asymmetry information will be low. If the asymmetry information is low then the company will more easily obtain access to external funding, the certainty of the company's business risk is more predictable so that the company can had cash holdings in low amount. Dechow and Dichev (2002) explained that accruals quality is an accrual mapping of the realization of corporate cash flows where low levels of matching indicated low accruals quality. The low accruals quality raised both internal and external uncertainties that caused the company to hold cash in larger amount when compared to normal conditions. Mokhtari et al. (2012) was mentioned that the financial report provided an overview of the company's ability to generate current cash flow and future cash flows. If the accruals quality was presented in the financial statements is low then the users of the financial statements cannot measure the risk of the company's business in the future. This caused the company hold large amounts of cash in case of uncertainty in the future.

Chalaki et al. (2012) was conducted a study on the effect of corporate governance to the corporate financial statements quality in Iran on the research period of 2003-2011. Chalaki et al. (2012) was stated that the financial scandal that led to the bankruptcy of the company led to act in the USA of Sarbanes-Oxley act which implicated to the high demands of corporate governance implementation. Klai and Omri (2011) were explained that the implementation of corporate governance within a company was expected to improve the financial statements quality. The measurement model of the financial statements quality was disclosed in the research of Klai and Omri (2011) and Chalaki et al. (2012) was used an accruals quality approach.

The research problem was motivated by the difference of research result and testing of corporate governance model, accruals quality and company cash holdings in previous research. Research that examined the effect of corporate governance on company's cash holdings gives inconsistent results. Research conducted by Kusnaidi (2006), Ammann et al. (2011) found a negative influenced of corporate governance and company's cash holdings. Another study was conducted by Harford et al. (2008) stated that the effect of corporate governance to corporate cash holdings is positive. Other research conducted by Ginglinger and Saddour (2007) was shown that in companies without financial difficulties, there is not effect between corporate governance and company's cash holdings. Valipour et al. (2012) also found no significant effect of corporate governance and company's cash holdings. Previous research that examined the effect of the accruals quality and company's cash holdings also gave inconsistent results. Teruel et al. (2009) found a negative effect of accruals quality to corporate cash holdings. Mokhtari et al. (2012) was indicated that the accruals quality testing with discretionary accruals proxy does not significantly affect to corporate cash holdings while used non-discretionary accruals proven have significant effect to the cash holdings.

1. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

1.1 Literature Review

Mokhtari et al. (2012) was stated that cash holdings are a very important component for each company's balance sheet. There are three theories that try to explain the decision of corporate cash holdings. First, Trade-off Theory (TOT) explained that the motive of having cash holdings is the consideration between the cost and the marginal profit from holding cash. The advantages of having

cash holdings include preventing the occurrence of financial distress in the company, the accuracy of investment policy especially in case of financial difficulties, minimize the cost of issuing new external funding sources as well as prevent liquidation of company assets. The cost of cash holdings is the opportunity cost that arises from the choice to invest in a liquid asset. The second theory is Pecking Order Theory (POT). This theory was explained that to minimize the asymmetry information cost and other financing costs, the company must finance its investment with retained earnings first, issue secured debt, risky debt, and then equity. This theory was explained that a company should not have a cash holdings target but need to maintain a balance between retained earnings and investment needs. The third theory is the theory of Free Cash Flow (FCF) revealed by Jensen (1986). This theory was explained that managers have an incentive to form cash and increase the assets value in the management control in order to gain freedom in carrying out investments. Cash holdings was reduced the pressure to the managers to make the best investments according to shareholder needs (Ferreira and Vilela, 2004).

Tsai (2012) was stated that the main idea of corporate governance is ensuring accountability and assuring individuals within the organization follow mechanisms that attempt to eliminate unfair practices within the company system. Tsai (2012) explained that corporate governance is closely related to the transparency aspects. The effectiveness of the corporate governance implementation in a company can be evaluated through the quality of the company's financial statements.

Ditmar et al. (2003) was described one process that is closely related to the agency theory is corporate governance. Klai and Omri (2011) were described the occurrence of major financial scandals in early 2000 as the Enron, Parmalat, and Worldcom cases open the eyes of many parties about the fragility of the protection system of shareholders' rights. Chalaki et al. (2012) was stated the emergence of act in the USA of Sarbanes-Oxley act raises various rules on the protection of shareholder's interests. According to Chalaki et al. (2012), corporate governance is a set of regulatory processes that emerge so that shareholder rights as a company owner remain well protected.

Valipour et al. (2012) was conducted research on the effect of corporate governance to corporate cash holdings in Iranian companies. The research results were indicated that institutional ownership and board independent as a corporate governance mechanism in Iran has not significant effect on corporate cash holdings policy. Denis and Silbilkov (2010) were conducted research on financial difficulties, investments and the value of company cash holdings. The research result was found that companies experiencing financial difficulties will hold cash in small amounts due to a small amount of cash flow. Duchin (2010) was conducted research on corporate cash holdings in relation to the diversification of the company's divisions. This study revealed that companies with diversified divisions have lower cash holdings than firms that do not have diversification divisions. Duchin (2010) also mentioned that there is a relationship between financial difficulties with respect to corporate governance and its relation to investment opportunities, when related to the company diversification and cash holdings.

Soltani and Ravanmehr (2011) was conducted research on corporate governance in relation to company cash holdings and corporate value. The research result was indicated that independent commissioners as a component of corporate governance strongly affect the company value. Cash holdings have a negative effect on value. Companies that have too large cash holdings responded negatively by a market that considers large cash holdings as less productive assets. The research result also shown that company with low long-term debt has higher corporate value. The research results of Toledo and Bocatto (2013) stated that investors' assessment to corporate cash holdings was influenced by corporate governance system in the company.

Klai and Omri (2012) were stated that improvement of financial statements quality is one of the demands after the occurrence of various financial scandals in early 2000. Qualified financial statements were expected provide more appropriate accounting information and useful for business decisions of financial statements users. Verdi (2006) was stated that the financial statements quality can be seen from the quality of the company's accruals. The company financial statements quality can improve the efficiency of company investment through efforts to reduce asymmetry

information. Financial reports quality will reduce asymmetry information between firms and investors, reduce the adverse selection costs and lower corporate financing costs. In addition, financial reports quality will reduce asymmetry information between investors and managers, reduce agency conflict, lower supervisory costs of managers and improve project selection.

Doyle et al. (2007) was stated that the company's accruals quality can be low for two reasons; first, management deliberately reports biased accruals due to earnings management measures; second, accidental mistakes in accrual judgments caused by difficulty in recording or difficulty in predicting future events or simply due to weak controls that cause errors in data reporting.

Dechow and Dichev (2002) were stated that the accruals quality is not only limited to opportunistic corporate managers, but also because it is difficult to determined, such as companies with special characters. Accruals quality was attributed to the company's cash flow. In general, the accruals quality will be low for companies with certain characters such as companies with high losses, fluctuating cash flows and sales, low total assets and longer company operational activities.

1.2 Hypotheses Development

Tsai (2012) was stated that corporate governance is a mechanism related to the existence of agency problems in the company. Borhanuddin and Ching (2011) were explained that the internal and external mechanisms of corporate governance were created with the intention of individuals in the company to keep working in line with the goals of the company owner. Harford et al. (2008) was stated that corporate governance is one of the factors that affect corporate cash holdings policy. A study by Harford et al. (2008) in companies in the United States found a positive effect between corporate governance and corporate cash holdings. Corporate governance in this study was measured by corporate governance index. Firms with weak corporate governance structures have smaller cash reserves compared to firms with strong corporate governance structures. Harford et al. (2008) was explained that the research results are contradicted to the previous research with a sample of inter-state enterprises, which found a negative relationship between corporate governance and cash holdings.

Tsai (2012) was conducted research on corporate governance and cash holdings in companies affiliated to the Taiwan Stock Exchange in the period of 2005-2009. In theoretical explanation, this research was explained that transparency and information disclosure are important aspects of corporate governance mechanism. Good corporate governance can limit the occurrence of high agency costs so that companies can hold cash in small amounts. Chen (2008) conducts research on the effect of corporate governance on company's cash holdings by considering investment opportunities and company types in the categories of new economic form and old economic form. The research results were indicated that corporate governance mechanisms are able to reduce agency issues related to companies' cash holdings in the company type of old economic form. In new economic form company types, the influence of corporate governance on cash holdings is positive, as companies are more focused on the potential losses of investment cancellation, rather than the agency problem of cash flow.

Kusnaidi (2006) was conducted a study on corporate governance and cash holdings mechanisms of companies listed on the Malaysian and Singapore Stock Exchanges. This study was used 445 sample companies in the period of 1999-2000. The study results were indicated that internal corporate governance mechanisms in the form of director board characteristics and concentration ownership are important factor affecting cash holdings. The study results were indicated that companies with weak corporate governance will make the company to hold cash in larger quantities compared to the strong corporate governance company. The effect of corporate governance and cash holdings is negative.

Research on the effect of corporate governance on cash holdings gives inconclusive results. Kusnaidi (2006) found a negative effect of corporate governance and cash holdings. Harford et al. (2008) found a positive influence of corporate governance and cash holdings. Valipour et al. (2012) was stated that corporate governance is not a dominant factor that affects corporate cash holdings policy but corporate cash holdings are more dominantly affected by the company characteristics.

In this study, researchers were positioned the research hypothesis on the research results of Harford et al. (2008), researchers were suspected that in the sample companies in Indonesia, the effect of corporate governance and cash holdings is positive. This is because Indonesia's capital market was included in the category of emerging markets where there may be high levels of asymmetry information. According to Ozkan and Ozkan (2004) high levels of asymmetry information will make expensive external financing costs so companies have to hold large amounts of cash. Ditmar et al. (2003) conducts inter-state research related to the effect of corporate governance and cash holdings. Ditmar et al. (2003) was categorized Indonesia as a country with a low level of shareholders' rights protection. According to Ditmar et al. (2003) in a country with weak shareholder protection, the company has a tendency to hold large amounts of cash due to the company's desire to obtain an easy funding source.

Based on the above statements, the hypothesis of this study was formulated as follows.

H1: Corporate governance positively affects corporate cash holdings.

Gray et al. (2008) was mentioned that some studies have tried to link the financial statements quality and accruals quality to the information risk. The information risk is a risk that cannot be diversification. Information risk was raised asymmetry information that causes investors have more information compared to other investors. Profit provided a representation of potential future cash flows. Higher accruals quality better describes the better relationship between profit and cash flow that impact on the low information risk so that capital cost down. Teruel et al. (2009) stated that good accruals quality decreases the level of asymmetry information so that agency costs can be reduced which affects the company can hold cash in small amounts.

Verdi (2006) discussed the agency theory in terms of asymmetry information by linking the financial statements quality and asymmetry information. This study was argued that the financial statements quality can improve the efficiency of investment in the company through two ways: 1) the financial statements quality reducing the level of asymmetry information between firms and investors as well as lower the cost of issuing new capital, 2) the financial statements quality reducing the level of asymmetry information between managers so that reduce supervisory costs to managers and improve project selection.

Accruals quality according to Dechow and Dichev (2002) related to the ability to calculate the company's cash flow. Accruals quality is useful for forecasting the future cash flows of the company used to determine the business risks of a company. Mokhtari et al. (2012) stated that poor accruals quality causes the greater business risk to the investors due to high uncertainty aspect in the future. This causes when companies have poor accruals quality then the company seeks to have a large cash holdings to overcome these uncertainties. Teruel et al. (2009) found that company with poor accruals quality would have larger cash holdings when compared to the company with good accruals quality. Accruals quality contains information about expected cash flow informed to shareholders. Good accruals quality will impact on reporting earnings that more represent future cash flow so that the amount of cash holdings in the balance sheet can be reduced. Companies with good accruals quality will reduce their cash amount in order to minimize the amount of current assets that are not productive in the company's balance sheet (Teruel et al., 2009).

Based on the above description, the study hypothesis was formulated as follows.

H2: Accruals quality negatively affects corporate cash holdings.

2. RESEARCH METHODS

The study populations are all of manufacturing companies listed on the Indonesia Stock Exchange. This study was used secondary data from the financial statements of manufacturing companies in 2009-2010. The data analyzing was used multiple linear regression. The first independent variable is corporate governance. Corporate governance was measured using the corporate governance index referring to Sunhilde and Hajnalka (2009), Bekiris and Doukakis (2011), Bhuiyan et al. (2013), and Strydom et al. (2009). The corporate governance index comprises the following components: statements related corporate governance (3 items), information related ownership structure (4

items), investor relations (7 items), financial transparency (4 items), information related company commissioner (13 items), stakeholder role in corporate governance (6 items), remuneration (6 items), and audit (8 items). On the calculation of corporate governance index there are 50 items statement. A score of 1 is given when the statement in the index is met and value 0 otherwise. The index measures good corporate governance practices in the company. The corporate governance index (ICG) denoted by the following formula:

$$ICG = \frac{Company\ CG\ index\ score}{CG\ index\ total}$$

The second independent variable is the accruals quality. Accruals quality was measured by accruals-cash flow approach refers to McNichols (2002). Accruals quality was calculated by the following formula.

$WCA = \alpha + \beta1\ CFO_{t-1} + \beta2\ CFO_t + \beta3\ CFO_{t+1} + \beta4\ \Delta REV + \beta5\ PPE + e$

Where:

WCA = Working Current Accrual
= Δ current assets − Δ current debt − Δ cash and cash equivalents,
CFO_{t-1} = Operating cash flow year t-1,
CFO_t = Operating cash flow year t
CFO_{t+1} = Operating cash flow year t+1
ΔREV = Revenue changes
PPE = Company fixed assets

Dependent variable is cash holdings. According to Teruel et al. (2009), cash holdings are the financial ratios that compare the amount of the company's cash with the amount of the company's assets out of cash. Cash holdings are denoted by the following formula.

$$Cash\ holdings = \frac{Cash + cash\ equivalent}{TOtal\ asset - cash}$$

This research was used leverage and company size as control variable. Leverage and company size were predicted to be factors that affect corporate cash holdings. Leverage was measured by total debt divided by total company assets while company size was measured by the total natural log of company assets.

2.3 Hypothesis Testing
The regression equation was used as follows.

$CASH_{t+1} = \alpha + \beta1\ ICG_t + \beta2\ AQ_t + \beta3\ LEV_t + \beta4\ LNSIZE_t + e$

Where:

$CASH_{t+1}$ = Cash holdings year t + 1,
ICG_t = Index corporate governance year t,
AQ_t = Accruals quality year t,
LEV_t = Leverage year t,
$LNSIZE_t$ = Natural log of company size year t,
$\beta1 - \beta4$ = Regression coefficient,
e = Error.

3. ANALYSIS AND DISCUSSION
3.1 Data Collection Results
The following table presents the results of the study sample selection.

Table 1 Sampling Results	
Sample criteria	Amount
Manufacturing companies listed on the Indonesia Stock Exchange	137
A manufacturing company that publishes annual reports in 2009-2010	98
Number of observations during 2009-2010	196
Data not qualified (outlier)	53
Number of samples	143

Source: The data collection results

From the table above known that the number of samples in 2009 to 2010 as many as 196 companies. The researcher tested outlier with the aim of obtaining data with normal distribution. Outlier test results shown there are 53 outlier data that must be excluded from the analysis. The samples number as many as 143 companies in the period of 2009-2010.

3.2 Descriptive Statistics
The following table was shown the results of descriptive statistical test and correlation test of each research variable.

Table 2. Descriptive Statistics					
Variables	N	Minimum	Maximum	Average	Standard Deviation
ICG	143	0.40	0.88	0.67	0.10
AQ	143	-0.07	1.46	0.66	0.21
LEV	143	0.07	0.95	0.48	0.19
LNSIZE	143	24.97	32.36	27.90	1.47
CASH	143	0.00	0.61	0.10	0.12

Source: Data processing results

The table above was shown that corporate governance index variables have a minimum value of 0.40 with a maximum value of 0.88. The average value of corporate governance index is 0.67 with a standard deviation of 0.10. The accruals quality variable has a minimum value of -0.07 with a maximum value of 1.46. The average value of the company's accruals quality is 0.66 with a standard deviation of 0.21. The leverage variable has a minimum value of 0.07 with a maximum value of 0.95. The average leverage value is 0.48 with the standard deviation of 0.19. The firm size variable has a minimum value of 24.97 with a maximum value of 32.36. The average value of firm size is 27.90 with standard deviation of 1.47. The cash holding variable has a minimum value of 0.00 with a maximum value of 0.61. The average value of cash holding is 0.10 with a standard deviation of 0.12. The data used in this study has passed the classical assumption test that includes test of data normality, test of autocorrelation, test of multicollinearity and test of heteroskedasticity.

3.3 Hypothesis Testing
The hypothesis testing was used multiple linear regressions. The test results from each hypothesis are as follows.

Table 3. Research Hypothesis Test

Equation: $CASH_{t+1} = \alpha + \beta_1\ ICG_t + \beta_2\ AQ_t + \beta_3\ LEV_t + \beta_4\ LNSIZE_t + e$		
Description	Coefficient	The p value
Constants	-0.108	0.530
ICG	0.234	0.023
AQ	-0.102	0.019
LEV	-0.259	0.000
LNSIZE	0.009	0.195
F-Value	7,862	0.000
Adjusted R Square	0.263	

Source: Data processing results

From the table above was known that the coefficient of determination was shown the R square value of 0.263. This means that the 26.3% variation changes in the variable of company's cash holdings can be explained by corporate governance, the quality of the company's accruals, leverage and firm size. The remaining 73.3% is affected by other factors outside the research model. The result of F test was shown F value equal to 7,862 with p value of 0.001, so it can be concluded that the regression model has fit with the data used.

Hypothesis 1 objective was examined the effect of corporate governance on company's cash holdings. Regression test results were shown that regression coefficient amounted to 0.234 with p value of 0.023. Regression test gives a significant result, so it can be concluded that corporate governance has a positive effect on corporate cash holdings. Hypothesis 1 is supported. The results of this study support the research results of Harford et al. (2008) stated that the effect of corporate governance on cash holdings is positive. The study results also support the opinion that the Indonesian capital market is included in the category of emerging markets where there may be high levels of asymmetry information that impact on expensive external costing costs. This causes the company to hold a large amount of cash as an easier source of funding. This result is in line with the research of Ditmar et al. (2003) explained that the company holds large amounts of cash to finance various agency issues in the company.

Hypothesis 2 objective was examined the effect of accruals quality on company's cash holdings. Regression test results were showed regression coefficient of -0.102 with p value of 0.019. Regression test gives a significant result, so it can be concluded that accruals quality negatively affects corporate cash holdings. Hypothesis 2 is supported. The results of this study support the research results of Teruel et al. (2009). The study results were indicated that the accruals quality negatively affects the company's cash holding. This was indicated that good accruals quality can lower corporate cash holdings. The study results are support the opinion of Teruel et al. (2009) which stated that good accruals quality can decrease the level of asymmetry information so that agency costs can be suppressed which impact on companies can hold cash in smaller amounts. Good accruals quality will impact on earnings reporting that more represent future cash flow so that the amount of cash holdings in the balance sheet can be reduced. The study results also support the opinion of Verdi (2006) which stated that the financial statements quality can reduce the asymmetry information that impact on the cost of issuing new equity is cheaper and the agency costing are smaller.

Testing on leverage control variables provide significant results. Leverage negatively affects corporate cash holdings, the greater the leverage then the smaller company's cash holdings. The study results were indicated that leverage is a substitute on the company's cash. Firms that are able to obtain easy funding accumulation will hold a larger amount of cash. Testing on control variables of company size give insignificant results, company size does not affect company's cash holdings.

4. CONCLUSION

This study objective was examined the effect of corporate governance and the accruals quality to corporate cash holdings in manufacturing companies listed on the Indonesia Stock Exchange in 2009 to 2010. Based on the analysis and discussion in the previous section, the researcher concludes

that corporate governance has a positive effect on company cash holdings. The study results was supported the results of research Harford et al. (2008) that found a positive effect of corporate governance on corporate cash holdings. Accruals quality has negatively affects to corporate cash holdings. The study results support the study results of Teruel et al. (2009) which found a negative effect of the accruals quality to corporate cash holdings.

This research has several weaknesses, such as adoption of corporate governance index from Sunhilde and Hajnalka (2009), Bekiris and Doukakis (2011), there are index points that contain multipoint in one index so it is quite difficult in the calculation of corporate governance index. This study period is relatively short because it only done in 2009-2010. This research is only conducted on the type of manufacturing company so it cannot be used as a basis to generalize for all types of industries in the Indonesia Stock Exchange.

Further research was suggested to improve the corporate governance index measurement model used in this study. Further research was suggested to re-examine this research model used other proxies of corporate governance such as corporate governance mechanisms (managerial ownership, institutional ownership, board size, and independent commissioner). Subsequent research was suggested to consider the condition of companies that allegedly affect the companies' cash holdings such as financial distress and accounting conservatism.

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