

INDEPENDENT COMMISSIONER'S EXISTENCE AND EXPERTISE INFLUENCES ON INDONESIAN RURAL BANK'S CREDIT PERFORMANCE

INDEPENDENT COMMISSIONER'S EXISTENCE AND EXPERTISE INFLUENCES ON INDONESIAN RURAL BANK'S CREDIT PERFORMANCE

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Abstract

Although the BPR's growth rate is very good, most BPRs of 1,184 (68%) are with limited core capital (CC) of less than IDR 6 billions. One of the main problems with BPRs with core capital below IDR 6 billions is that the credit performances of those Indonesian Rural Banks tend to deteriorate. In the other hand, according to OJK in POJK No.4/POJK.03/2015, the existence of independent commissioner is only compulsory for BPRs with core capital IDR 50 billionss and above.

This research is concentrated to the empirically analyze of the worsening cause of the lack of governance, especially the effects of the existence of independent commissioner and independent commissioner's expertise on the credit performance of BPRs with core capital below IDR 50 billions. Using purposive sampling, the sample data are taken from BPRs in Central Java Province and Yogyakarta Special Region Province. The secondary data related to these research variables are processed and analyzed by cross-sectional linear regression using SPSS statistic software with a significance level of 5%. This research result shows that independent commissioners' existence and independent commissioner's expertise have positive significant effects on the credit performance of BPRs with core capital below IDR 50 billions.

Keywords: *Credit Performance, Expertise, Internal Governance, Independent Commissioner, and Rural Bank*

1. BACKGROUND

In order to develop micro, small and medium enterprises (MSMEs) in Indonesia, Indonesian Rural Banks (Bank Perkreditan Rakyat/BPR) are encouraged to increase their role and contribution (Armanto, 2016). To achieved it, the government through Bank Indonesia (BI) has also encouraged the banking industry in Indonesia by way of appointment of BPRs as executing agents or channeling agents from commercial banks to specifically extend credit to MSMEs (Bank Indonesia, 2004). Moreover, The Decree of the Minister of Finance No.1064/KMK.00/1988 on the Establishment and Enterprises of BPRs states that the duty of BPR is directed to support the growth and modernization of rural economy as well as to reduce the practices of debt bonds. Bank Indonesia also has issued Peraturan Bank Indonesia (PBI) no. 14/22/PBI/2012 requiring every commercial bank to distributed credit or UMKM financing in 2018 at least 20% of the total credit or financing discharged. With the issuance of that PBI, for BPRs, it is a challenge, opportunity, and potential to be as the partners of commercial banks in that mentioned linkage program.

According to Data from Direktorat Penelitian dan Pengaturan BPR Departemen Penelitian dan Pengaturan Perbankan of OJK in 2016, the total number of Conventional BPRs in Indonesia as of June 2016 is 1,634. The growth rate of BPR's assets in the period 2011 to 2015 increased 16%. In terms of loan disbursement, as of June 2016, BPR credit disbursement reached IDR 79 billions

The widespread of the services, accompanied by an increase in the volume of BPR business, caused the greater risk of BPR (OJK, 2016). Although the BPR's growth rate was very good, most BPRs of 1,184 (68%) are BPRs with limited core capital (MI) less than IDR 6 billions, even 16 BPRs have a core capital of less than IDR 3 billions.

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The main problem with BPRs with core capital below IDR 6 billions is about the financial performance of banks that tend to deteriorate. Referring to the data from Bureau of Research and Conventional BPR Statistics (BI, 2016), especially for BPRs' credit performance, it showed the worse evidence until June 2016 as the NPL of June 2016 is 6.20 compared with 2012 (4.75), 2013 (4.45), 2014 (4.76) and 2015 (5.40).

From the investigation, that worsening was caused by the lack of capital, the lack of management, the lack of governance, and the lack of IT system (OJK, 2017). Relating to that, this research is concentrated to empirically analyze to the worsening cause by the lack of governance, especially the existence of independent commissioner. According to OJK in POJK No.4/POJK.03/2015, the existence of independent commissioner is only compulsory for BPRs with core capital of IDR 50 billions or above. In fact, contradictive with that, the worsening of financial performance precisely happened mostly in BPRs with limited core capital (CC) of even less than IDR 6 billions.

The focus is related to the effect of the existence of independent commissioners of BPR and the appropriateness of BPR's independent commissioner education only on the performance of BPR loans on the grounds:

1. According to Law No. 10 of 1998 concerning banking, the main function of banks in general is to raised funds from the public and redistribute funds to the public (mainly in the form of credit).
2. Appointment of Rural Banks as executing agents or channel agents from commercial banks to specifically provide loans to MSMEs (Bank Indonesia, 2004).
3. The Minister of Finance Decree No.1064 / KMK.00 / 1988 concerning the Establishment and Business of Rural Banks states that the duties of BPR are directed at supporting the growth and modernization of the rural economy and to reduce the practices of moneylenders.
4. Credit performance (as the main fund distribution product) of BPRs until June 2016 shows deteriorating evidence.

Indeed, some BPRs with core capital of IDR 50 billions or bellow have their independent commissioners. In the other hand, results from the prior researches of the influence of independent commissioner on financial performance of companies were not consistent. Novia & Lukviarman (2006) gave no-positive result or even negative. In contrast with them, Nisasmara & Musdholifa (2016), Manzaneque et al. (2016), and Nurim et al., (2016) found positive results. Even in other studies (Agrawal & Knoeber, 1996; Yermack, 1996; Klein 1998; Bhagat and Black, 2002; and Drakos & Bekiris, 2010) found that there was no significant relationship between the existence of independent commissioners and company performance.

Governance research related to the influence of independent commissioners on the financial performance of companies including in the banking sector, the results of which are still contradictive because so far these studies have been based on agency theory. Whereas in agency theory, the emphasis is on contractual relations and conflicts between the owner of the company as principal and the company's manager as an agent (Jensen & Meckling, 1976).

Especially for research on governance in banking, it should be more appropriate to use the basis of stakeholder theory (Freeman, 1984) because the main source of funding of banks is obtained from the customers' deposit not from the owner. Although the main funding sources of banks are more obtained from deposit customers, customers as one of the main stakeholders in the banking sector are actually possible to be the object of fraudulent actions carried out by management and/or bank owners.

Relating to those phenomena and gaps, the objectives of this research are to give new scientific evidences with new data by the examining the influences of independent commissioner's existence and independent commissioner's appropriate education on the credit performance of BPRs with core capital below IDR 50 billions. So, this research questions are:

INDEPENDENT COMMISSIONER'S EXISTENCE AND EXPERTISE INFLUENCES ON INDONESIAN RURAL BANK'S CREDIT PERFORMANCE

1. Is the existence of BPR's independent commissioner as one of the mechanisms especially the supervision of BPR governance effectiveness affecting the credit performance of BPR?
2. Is the BPR's independent commissioner's expertise as the independent supervisor of the effectiveness of BPR governance affecting the credit performance of BPR?

While, the differences of this research compared to previous studies are:

1. The sample of this study uses BPRs in Indonesia whose data has not been widely used by previous researchers.
2. This study uses Stakeholder Theories as its grand theory even though it is related to corporate governance problems that typically use Agency Theory (focusing on contractual relationships between owners and management)
3. This study considers the appropriateness of independent commissioner education that may influence the credit performance of rural banks, which so far in previous studies only considered the level of education. In this study the author has a different view from the previous author that in the management, supervision, and / or decision making of any business, the suitability of education from managers, supervisors, or key decision makers is needed in this case is formal education in the business field. For this reason, the authors also built their own method of measuring the appropriateness of independent commissioner education.
4. In this study, the control variable in the form of the age of BPR is used and based on the consideration that the financial performance of a BPR may also be indirectly affected by the operational experience of the BPR, which in accordance with time will affect the effectiveness of the implementation of BPR operational policies.

This research contributes as the proposal to OJK to revise or add governance rules as stipulated in Regulation of the Financial Services Authority number 4/POJK.03/2015 which is mainly related to the compulsory of the existence of independent commissioner as a mechanism for internal governance of BPRs with core capital of less than IDR 50 billions. That mechanism is very important for supervision of the effective implementation of BPR's governance. This research can also give education to public observers of governance that for the effective implementation of internal governance mechanism conducted by the board of commissioners needs independent supervision conducted by the independent commissioners and their existence must be supported by their eligibility in terms of their education appropriateness.

2. THEORETICAL FRAMEWORK AND HYPOTHESIS DEVELOPMENT

The formulation of financial performance of banking is usually done by using Return on Assets (ROA), Return on Equity (ROE), Operating Expense compared to Operating Income Ratio (OEOI), Non-Performing Loans (NPL) and other financial ratio analysis (Cochran & Wood, 1984 and Wu & Shen, 2013). In connection with the various measures of banking financial performance, the authors use measurement of credit performance of banking in accordance with the characteristics of BPR (micro finance) which is based on the ratio of credit performance of Non-Performing Loans (NPL); related to BPR credit risk because the loans provided usually have small guarantees (Armendariz & Morduch, 2005).

On the basis of the results of previous studies, the first hypothesis of this study are:

H1 = The existence of independent commissioners of BPR has a positive significant effect on the credit performance of BPR

In previous studies (Agrawal & Knoeber, 1996; Yermack, 1996; Klein 1998; Bhagat & Black, 2002; and Drakos & Bekiris, 2010) found that there was no significant relationship between the presence of independent commissioner and firm performance.

According to the Basyith (2016), some companies choose commissioners on the basis of good relations or friendship, so its existence does not cause a positive and significant impact on the performance or value of the company. This is in the context of companies in Indonesia also supported by Novia & Lukviarman (2006) that there is a positive indication of increased corporate compliance in Indonesia in terms of improving board governance structures, but allegedly increased compliance is due to the company's obligation to comply with regulations and avoid sanctions. The success of the mechanism for implementing the governance of the board of commissioners in relation to its duties ensures that good governance is carried out by the BPR board, it is necessary to have appropriate judgment in the assessment. In some studies in the context of behavioral accounting has revealed the important role of knowledge on the accuracy of judgment, such as Bonner & Lewis (1990), Earley (2001), and Nurim & Harjanto (2015). Knowledge enhances cognitive appropriateness of the judgmentist with his assignments, so judgment is more accurate. It is also supported by Hirst et al. (1999) and Borthick et al. (2006) which states that the performance and accuracy of judgment is influenced by appropriate knowledge and is obtained formally at the appropriate level as well. In terms of the board of commissioners' co-ordination as a mechanism for internal governance, it is important to note the background of experience and expertise possessed by the board of commissioners, the composition and the right combination will have a positive impact on the company's performance through optimizing the strategic role of the board of commissioners (Lukviarman, 2016). Thus, commissioner knowledge will have a positive effect on the company's financial performance. OJK (2016) also states that BPRs also experienced problems in the lack of human resources expertise of BPR including independent commissioner's expertise.

Therefore, the author attempts to consider the independent commissioner's expertise element that may affect the credit performance of the BPR, so the second hypothesis of the study is:

H2 = The appropriateness of independent commissioner of BPR's education has a positive significant effect on the credit performance of BPR

However, considering the financial performance of a BPR may also be influenced by the BPR's operational experience in accordance with the passage of time (Coad & Teruel, 2007), then in this study, the authors include the element of BPR's Age as a reflection of the operational experience of the BPR as a control variable. The selection of BPR's Age as a reflection of BPR operational experience in this study is in accordance with research has been done by Mersland & Strom (2009) in measuring the effect of a governance mechanism on the financial performance of microfinance institutions.

3. RESEARCH METHOD

The secondary data related to these research variables that have been collected are processed and analyzed by cross-sectional linear regression using SPSS statistic software with a significance level of 5%. The criteria used for this research are:

1. If the significance value of t-count is greater than $\alpha = 5\%$, meaning that the independent variable does not significantly influence the dependent variable.
2. If the significance value of t-count is smaller than $\alpha = 5\%$, meaning that the independent variable has a significant influence on the dependent variable.

3.1. The Research Data and Sample

According to the objectives, the steps in this study are:

1. Collect secondary data in the form of annual financial statements and information related to this research in 2016 from selected BPR samples in Central Java Province and Yogyakarta Special Region Province taken from BI website (www.bi.go.id) and / or OJK website (www.ojk.go.id) and the corresponding BPR website.

INDEPENDENT COMMISSIONER'S EXISTENCE AND EXPERTISE INFLUENCES ON INDONESIAN RURAL BANK'S CREDIT PERFORMANCE

2. The collected secondary data will be processed and analyzed by means of cross-sectional regression using statistic software and the results will also be described in depth.

The sample data are taken using a purposive sampling method of the BPR population in Central Java Province and Yogyakarta Special Region Province. Determination of the sample using purposive sampling method is done in order to obtain the sample that meets the criteria with special specifications in accordance with the problems that occur. The criteria are:

1. BPRs with a core capital of less than IDR 50 billions
2. The BPR is still in operation until the end of June of 2016
3. The BPR publishes its annual financial statements and / or other information in June of 2016 on the website of Bank Indonesia (BI) and the Financial Services Authority (OJK)
4. The BPR published the information related to the data which is needed in this research on the respective BPR website.

3.2 The Definition of Research Variables and Model

Based on the previous studies and the development of research hypotheses, the authors derived dependent variables, independent variables, and control variables from this study. The dependent variable of this research is credit performance which is more specifically reflected by BPR's Non-Performing Loans (NPLs).

The independent variable of hypothesis 1 of this study is the existence of independent commissioners of BPR. That variable is indicated by the value 0 if there is no independent commissioner in the respective BPR, the value of 1 if there is 1 independent commissioner in the respective BPR, and the value 2 if there are 2 independent commissioners in the respective BPR.

The dependent variable of this hypothesis 2 research is credit performance same as the hypothesis 1 as BPR's Non-Performing Loans (NPLs). The independent variable of hypothesis 2 of this study is the appropriateness of independent commissioner of BPR's education. That independent variable is indicated by 1 if the commissioner of the respective BPR has education level under S1; 2 if the commissioner in the respective BPR has a minimum education level of S1 from non-economic or business majors; and 3 if the commissioner in the respective BPR has a minimum education level of S1 from majoring in economics or business.

The authors include the element of the Age of BPR as a reflection of the operational experience of the BPR as a control variable. The control variable of the age of the BPR is indicated by the number of years since the BPR is established.

Based on the research variables that have been determined, then the secondary data related to these research variables that have been collected are processed and analyzed by cross-sectional regression using SPSS statistic software with a significance level of 5%. Data processing and analysis will be done in accordance with the model for hypothesis 1 as follows:

$$\text{NPL_BPR} = \alpha + \beta_1 \text{N_Ind_Com_BPR}_{it} + \beta_2 \text{E_Ind_Com_BPR}_{it} + \beta_3 \text{Age_BPR}_{it} + \epsilon$$

Note:

1. Dependent Variables; NPL_BPR = Non-Performing Loans of BPR
2. Independent Variable 1; N_Ind_Com_BPR = The existence of BPR's independent commissioner
3. Independent Variable 2; E_Ind_Com_BPR = The Appropriateness of Education of BPR's independent commissioner
4. Control Variables; Age_BPR = BPR's Age

4. RESEARCH RESULTS

In this study, to test the research hypotheses, from the BPR population in Central Java Province and Yogyakarta Special Region Province, a total of 59 BPR samples were tested. The samples meet the purposive sampling criteria mentioned in the research method.

4.1. The Descriptive Statistics

Descriptive statistical data for hypothesis 1 and 2 testing, the minimum number of Independent Commissioners is 0, maximum 3, with mean and standard deviations 1.36 and 0.826. Whereas for testing hypothesis 2, the minimum score for Educational Appropriateness of BPR's Independent Commissioners is 0, a maximum of 8, with a mean and standard deviation of 3.00 and 2.244. For Non-Performing Loans, the minimum amount is 0 and the maximum amount is 17 with an average of 4.50 and a standard deviation of 3.191.

The latter for Age, minimum age is 0.496 years and the maximum is 64.959 years with an average of 2.107 years and standard deviation of 16.345. Descriptive statistics are contained in table 1 as follows:

Table 1 The Descriptive Statistics

Variables	Min	Max	Mean	Std. Deviation
N_Ind_Com_BPR	0	3	1.36	0.826
E_Ind_Com_BPR	0	8	3.00	2.244
NPL_BPR	0	17	4.50	3.191
Age_BPR	0.496	64.959	26.107	16.345

Note:

1. N_Ind_Com_BPR = Number of Independent Commissioner of BPR
2. E_Ind_Com_BPR = Appropriateness of Expertise of Independent Commissioner of BPR
3. NPL_BPR = Non-Performing Loans of BPR
4. Age_BPR = BPR's Age

4.2 Test Results for Hypotheses 1 and 2

The results of hypothesis 1 and 2 testing of the research are shown in table 2 below:

Table 2 The Regression Result of Hypothesis 1

	Coefficient of Regression	Sig
(Constant)	6.631	0.000
N_Ind_Com_BPR	-1.460*	0.006
E_Ind_Com_BPR	-0.563*	0.005
Age_BPR	-0.006	0.824
Adjusted R Square	0.121	

Note:

1. Dependent Variable: NPL_BPR (Non-Performing Loans of BPR)
2. * = significant at 5%

The adjusted R square coefficient is 12.3%. This means that the independent variables of BPR controlled by the age of BPR affect the NPL of rural banks by 12.3%. It also implies that other variables not included in this research model affect the NPL of BPR around 87.9%. The classic assumption of the regression model has also been

INDEPENDENT COMMISSIONER'S EXISTENCE AND EXPERTISE INFLUENCES ON INDONESIAN RURAL BANK'S CREDIT PERFORMANCE

tested. The results of the classic assumption test show that the data is normally distributed, there are no problems with multicollinearity and heterocedasticity.

4.3 Discussion of the results

From the testing results of *H1 = The existence of independent commissioners of BPR has positive significant effect on the credit performance of BPR*; show that the H1 is accepted. From the linear regression, as shown by the table the significant level of 0.006 or it is < 0.05 with coefficient of regression of -1.460 . It means that the Number of Independent Commissioner of BPR has negative impact on Non-Performing Loans of BPR (positive for credit performance). Every additional Number of Independent Commissioner will effect to the lower in Non-Performing Loans by 1.460. This result supports the previous research of Nisasmara and Musdholifa (2016), Manzaneque et al. (2016), and Nurim et al. (2016).

From the testing results of *H2 = The appropriateness of independent commissioner of BPR's education has a positive significant effect on the credit performance of BPR*; show that the H2 is accepted. From the linear regression, as shown by the table the significant level of 0.005 or it is < 0.05 with coefficient of regression of -0.563 . It means that the Appropriateness of Expertise of Independent Commissioner of BPR has negative impact on Non-Performing Loans of BPR (positive for credit performance). Every additional level of The Appropriateness of Expertise of Independent Commissioner will effect to the lower in Non-Performing Loans by 0.563. This result supports the previous research of Bonner and Walker (1994), Earley (2001 and 2003), Nurim and Harjanto (2015), Hirst et al. (1999), Borthick et al. (2006), and Lukviarman (2016).

Regression testing results of BPR Age as a control variable show no significant effect on Non Performing Loans with a significant level of 0.824. These results contradict previous studies conducted by Mersland and Strom (2009) about the positive influence of firm age in testing the influence of governance mechanisms on the financial performance of microfinance institutions.

5. CONCLUSION, IMPLICATIONS, LIMITATIONS, AND SUGGESTION

5.1 Conclusion

From the results of testing H1; this shows that H1 is accepted. From the linear regression results, the number of Independent BPR Commissioners has a negative impact on BPR Non Performing Loans (positive for credit performance). Any additional number of Independent Commissioners will affect the lower number of Troubled Loans. These results support previous studies from Nisasmara & Musdholifa (2016), Manzaneque et al. (2016), and Nurim et al., (2016).

While from the results of testing H2; indicates that H2 is received. From the results of the linear regression, the suitability of BPR Independent Commissioner Education has a negative impact on the Non Performing Loan of BPR (positive for credit performance). Each additional level of suitability of Independent Commissioner Education will have an impact on lower problem loans. These results support previous studies of Bonner & Walker (1994), Earley (2001), Nurim & Harjanto (2015), Hirst et al. (1999), Borthick et al. (2006), and Lukviarman (2016).

Regression testing results of Age BPR as a control variable show no significant effect on Non Performing Loans. These results contradict previous studies conducted by Mersland & Strom (2009) about the positive influence of firm age in testing the influence of governance mechanisms on the financial performance of microfinance institutions.

Based on the those test of hypothesis 1 and hypothesis 2 results, the authors conclude that the existence of independent BPR commissioners and the appropriateness of independent commissioner BPR's education have a significant positive effect on the performance of BPR loans. This is indicated by the regression results that any increase in the number of independent BPR commissioners or the level of appropriateness of

independent commissioner BPR's education has resulted in a significantly lower Non Performing Loan (BPR) performance of BPR.

5.2 Research Implications

The results of this study which state that: a) the existence of independent BPR commissioners has a positive and significant effect on the credit performance of BPR; and b) the appropriateness of independent commissioner of BPR's education has a positive effect on BPR's credit performance, the results of this study are expected to provide awareness that to guarantee good credit performance in this case a low NPL ratio, any BPR with any core capital should have an independent commissioner. Thus, this research is also expected to contribute as a suggestion to OJK to revise the governance rules at POJK number 4 / POJK.03 / 2015 regarding the existence of independent BPR commissioners with core capital of less than IDR 50 billions to support the implementation of more effective internal governance mechanisms.

The results of this study also provide education as well as new evidence to academics and observers and researchers on governance issues that to ensure the effective implementation of internal governance mechanisms carried out by the board of commissioners needs independent supervision by independent commissioners. However, the existence of independent commissioners who have function to ensure the effective implementation of internal governance mechanisms must be supported by their feasibility in terms of their education.

5.3 Research Limitations

This study focused on empirical analysis of prevention of deteriorating BPR credit performance as a result of poor governance implementation, particularly related to the effect of the existence of independent BPR commissioners and the suitability of independent BPR commissioner education on the performance of BPR loans with core capital under IDR 50 billions. This research only focused on the effect of the existence of independent BPR commissioners and the suitability of the education of independent BPR commissioners because in fact in principle BPRs are required to implement good governance as stipulated in POJK No.4 / POJK.03 / 2015. However, even though in principle BPRs are required to implementing good governance, in fact the implementation is still less effective in most BPRs. This resulted in the performance of BPR credit until June 2016 showing deteriorating evidence. Meanwhile, independent commissioners have a function, one of which is to ensure the implementation of effective governance.

This research also only focused on BPRs with core capital bellow IDR 50 billions. The focus on BPRs with core capital under IDR 50 billions is due to OJK in POJK No.4 / POJK.03 / 2015, the existence of independent commissioners is only mandatory for BPRs with the core capital of IDR 50 billions and above. This contradicts the situation in the field which shows that the deterioration in financial performance mostly occurs in rural banks with core capital (CC) limited to even less than IDR 6 billions.

5.4 Suggestions

In this study, the authors included just one component of the BPR's internal governance mechanism, namely independent commissioners of BPR becoming independent variables. Although in this study it is proven that the existence of independent commissioners of BPR and the suitability of independent commissioner's education of BPR have a significantly positive effect on BPR credit performance, it is possible that BPR credit performance is also influenced by other BPR internal governance mechanisms or even influenced by BPR external governance mechanisms. Therefore, in subsequent studies the authors suggest considering the involvement of other BPR's internal governance mechanisms or even the external governance mechanisms of BPR that might affect the credit performance of BPR.

INDEPENDENT COMMISSIONER'S EXISTENCE AND EXPERTISE INFLUENCES ON INDONESIAN RURAL BANK'S CREDIT PERFORMANCE

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