

THE EXISTENCE AND ROLE OF INDEPENDENT BOARD MEMBERS AND THEIR IMPACT ON THE BOARD'S EFFECTIVENESS AND FIRM'S VALUE: THE CASE OF THE EMERGING MARKET

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Abstract

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The implementation of good corporate governance (GCG) within a firm dictates its organizational behavior driven down by the board functionality effectiveness, among which the existence and role of an independent board member are taken into account. This study examines the effect of the existence and role of independent board members in Indonesia listed firm on the board's functionality effectiveness, and subsequently, its impact on the value of the firm. Since Indonesia adopts a two-board system instead of a one-board system, the independent board member is known as an independent commissioner (IC) who sits on the company board of commissioners (BOC) which is equivalent to the company board of directors (BOD) in the one-board system. It is found through regression analysis that when an IC holds a powerful leadership position, it enhances the BOC's functionality effectiveness. Likewise, if the IC has the position as the chair of BOC's sub-committee in the company. The regression analysis was conducted in two periods, before the establishment of the Financial Services Authority (FSA) and after.

Keywords: Board of Commissioners, Independent Commissioners, Listed Firms, Market-to-Book Ratio, Value Creation

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1. INTRODUCTION

Since the financial crises of 1998 and 2008, the importance and the necessity of integrating good corporate governance (GCG) principles within the firms' conduct and activities have become more pronounced. Many studies (Berglöf & Claessens, 2004; Hughes, 2019; Suhadak, Kurniaty, Handayani,

& Rahayu, 2019) have elaborated on the consequences that can happen to a firm when it lacks an effective and appropriate GCG structure and mechanism. For example, those consequences include the expropriation of minority shareholders and the classic case of conflict of interest among the firm's stakeholders and shareholders. In fact, both the 1998 and 2008 financial crises are the product

of poor GCG implementation and integration, such as ineffective risk management, excessive leverage, and moral hazard (Best, 2010; Buckley, Avgouleas, & Arner, 2018).

In order to prevent such crises from occurring once again, many regulatory reforms that have taken place are made to impose and enforce the mandatory implementation of GCG principles — transparency, accountability, responsibility, independence, and fairness — within the firms' activities and conducts. Such reforms also occur within Asian countries, which enhance the firm's corporate governance effectiveness through judicial and regulatory enforcement (Organisation for Economic Co-operation and Development [OECD], 2011). The established regulatory reforms impose every firm to uphold the GCG principles and, at the same time, ensure such principles are realized through appropriate board structure and mechanism (Andreou, Karasamani, Louca, & Ehrlich, 2017; Hillman & Dalziel, 2003). It is intended to give the firm the capability and capacity to create value without expensing certain parties (e.g., the minority shareholders).

Following the global efforts, emerging markets including Indonesia are also expected to implement GCG by improving their board functionality effectiveness. Accordingly, the Government of Indonesia had issued mandatory appointments of independent commissioners (IC) within the board structure of all firms listed on the Indonesia Stock Exchange (IDX). They are expected to help the firm uphold the principles of GCG within its business practice and, simultaneously, prevent any conflict of interest. Upon the underlying corporate law, all the Indonesian corporations must implement a two-tier board system. It means that there are two separate board entities, namely: 1) the board of commissioners (BOC) and 2) the board of directors (BOD). The BOC consists of commissioners (equivalent to non-executive directors in the one-tier board system). In contrast, the BOD comprises executive directors (equal to executive directors and C-level in the one-tier board system). Subsequently, the governance practices within a firm are driven by the BOC's behavior in the matter of its functionality.

The existence and role of an IC in a two-tier board system are equivalent to an independent non-executive director in one tier-board. An IC is not affiliated with any other board member — both BOD and BOC, nor with the controlling shareholder. Further, they are not either a representation of any professional services provider or vendor to the company.

The purpose of non-executive directors within the firm is to create accountability at the top management level (Roberts, McNulty, & Stiles, 2005). Creating accountability refers to the non-executive directors' conduct that critically and objectively challenges, assesses, and questions the executive director's actions and decisions — such behavior is made to see whether the executive director's decisions and actions align with the firm's best interest. When done effectively, there are at least three contributions that the non-executive director is expected to deliver to the firm: 1) supervising and managing the firm's risk-taking behavior to ensure they act more responsibly (Mollah, Liljebloom, & Mobarek, 2021); 2) enhancing the firm's monitoring mechanism effectiveness (Young, 2000); and

3) ensuring the firm's board remains independent and have a proper checks-and-balances mechanism within its activities (Oehmichen, Schult, & Wolff, 2014).

Given that the existence and role of the non-executive director are crucial in upholding the GCG principles within the firm, the Indonesian Financial Services Authority (FSA) enforces the appointment of an independent non-executive director which best suits Indonesian corporation law. Hence, it should be an independent board member within the company's BOC. The enforcement started in 2011 through the Indonesian Capital Market Supervisory Agency and Financial Institution (*Badan Pengawas Pasar Modal dan Lembaga Keuangan* or "BAPEPAM-LK"). The FSA was then replaced upon its official establishment in 2013.

The FSA is an Indonesian government agency that regulates and supervises the financial services sector. It is an autonomous agency designed to be free from interference and has the functions, duties, and powers to regulate, supervise, and investigate. The FSA was established to replace the Indonesian Capital Market Supervisory Agency and Financial Institution in regulating and supervising the capital market and financial institutions. Moreover, the FSA also replaces the role of Bank Indonesia — the central bank of Indonesia — in supervising the banks. Hence, FSA in its final state is to regulate and supervise the banks, the non-banking financial institutions, and the capital market. On the other side of the coin, the FSA is responsible for protecting the consumers of the Indonesian banking and financial services, capital markets, and the non-banking financial industry.

Concerning this context, some previous studies have been made to understand the impact of an IC on the companies' compliance performance, especially in enhancing the firm's risk disclosure, reducing the likelihood and possibility of fraudulent financial reporting to occur, and improving the firm's financial reporting performance (Gati, Nasih, Agustia, & Harymawan, 2020; Sudarman, Aniqotunnafiah, & Masruri, 2019; Zulfikar, Lukviarman, Suhardjanto, & Agustiningsih, 2017). However, although there are merits of the study above, none of them have been made from the perspective of organizational behaviour dynamics at the board level, especially from the angle of the company board's functionality. As a result, there is a lack of understanding on how the existence and role of IC affect the BOC's functionality effectiveness, and subsequently, increase the GCC practices in the corporation. Since those understanding is very important for the practicing board members to learn and get insights, the corporation in improving their BOC structure and composition, the academicians in deepening their knowledge, and the authorities in evaluating their directives, the urgency of such study prevails.

Therefore, this study aims to examine the effect of the IC's role and existence on the BOC's functionality effectiveness and analyze the influence of the BOC's functionality effectiveness on the firm's market value. This study will further examine whether there is an implication due to the establishment of FSA and therefore, the observation period is divided before the FSA establishment and after. In a way, this study responds to the call of Oehmichen et al. (2014) concerning whether the formal or informal institutions that build or support a specific

corporate governance system affect the firm's board monitoring and advising responsibilities.

The findings from this study, thereof, should provide the government institutions — especially the FSA of Indonesia — and the listed firms with greater understanding and insights on which aspect of the independent commissionerhip can be further enhanced to improve the BOC's functionality effectiveness, and ultimately leverage the GCG better practices across listed firms in the country.

The remainder of this paper is structured as follows. Section 2 reviews the relevant literature. Section 3 presents the research methodology used in the study. Section 4 reveals the results and Section 5 concludes the paper.

2. LITERATURE REVIEW

The literature review will discuss the relationship and the connection between the agency, shareholders, and stakeholders theories as to the grand theories of corporate governance, followed by the description of how those theories are practiced through the two-board system in Indonesia.

The agency theory states that the firm with legal fiction has an essential role in directing various individuals' targets to operate in the state of equilibrium (Jensen & Meckling, 1976). The respective view is based on separating the firm's ownership and management. In this regard, the firm's shareholders act as its principles. They delegate their responsibilities and powers to the agents — such as directors and managers — to run the firm and achieve its objectives. Thus, the concept of the principals and the agents is critical to the agency theory, and it is assumed that the interest between the two is consistent and clear (Daily, Dalton, & Cannella, 2003).

Besides the agency theory, the shareholder and stakeholder theories also become the pillars in establishing an effective corporate governance mechanism that considers the effect of the firm's management on its shareholders. Additionally, it is also considered the firm's approach to serving its shareholders. As the name suggests, the shareholder theory is oriented on the management's idea of maximizing the shareholder's return and obtaining profits (Smith, 2003). Meanwhile, the stakeholder theory is oriented on the basis of the actions and interactions of the firm with regard to its internal and external stakeholders (Parmar et al., 2010).

Based on these two theories, the firm's interests must be balanced with its stakeholders' and shareholders' interests. On the same token, it must also be accompanied by a decision-making process that considers the effect of those decisions on all parties involved in achieving its objectives. Finally, all things considered, such a decision-making process, must be accompanied by a proper and effective monitoring mechanism to ensure the firm's activities, conducts, and practices follow the principles of GCG (Chahine & Safieddine, 2008; Walsh & Seward, 1990).

However, many challenges prevent firms from implementing an effective GCG mechanism within their activities under the agency, shareholder, and stakeholder theories. For instance, given that the firm's wealth is not directly linked to the agent's wealth, the respective agent may prioritize their

self-interest instead of the firm. Consequently, the agent's interest may not be aligned with the firm by default. Aguilera and Jackson (2003) state that the agency theory overlooks the diversity among the stakeholders, which may trigger a conflict of interest between the firm's principals and agents. If the discrepancy among the principals and the stakeholders is not addressed appropriately, it can make the firm deviate from its intended target and its interest. In another perspective, suppose the firm overly prioritizes its shareholders. In that case, it can hinder its ability to implement effective GCG mechanisms — it is a given that for a firm to have effective GCG mechanisms within its practices, they are required to establish a proper checks-and-balances mechanism that treats all stakeholders fairly. Without an appropriate and effective monitoring mechanism within the firm, it can expose the management to the exploitation of potential misuse, create an unfair treatment of certain stakeholders, and reduce the capital that can be used to boost the firm's growth (Kumala & Siregar, 2021; Tse, 2011).

Following this situation, the regulators of Indonesia imposed mandatory appointments of IC within the firm's corporate boards listed in the IDX. Since the corporate board's structure in Indonesia applies the two-tier board system, the appointment of ICs is automatically placed within the firm's BOC.

The BOD is responsible for the firm's management, whereas the BOC focuses on supervising and advising the BOD in running the firm. Within the Indonesian listed firms, every listed company must at least have one director within the BOD and one commissioner within the BOC. The directors and commissioners are appointed in the annual general meeting of shareholders. In relation to the agency theory, the shareholders (as principals) entrust the BOD to manage the firm in fulfilling its objectives and entrust the BOC (as the firm's overseer) to supervise and advise the BOD in the decision-making process and ensure the GCG principles are optimally implemented within the firm. However, there are three challenges in terms of the board's oversight effectiveness, namely: 1) maintaining independence from the management, 2) information asymmetry, and 3) operational issues (Block & Gerstner, 2016). Hence, by design and purpose, the mandatory appointment of IC is meant to cope with the existing governance issues within the Indonesian corporate environment.

Referring to the study of Freeman and Reed (1983), it is implied that the value of the firm's governance is dependent on its executive's capability and capacity in producing and taking appropriate actions in addressing (internal and external) issues. It is also emphasized that the firm's governance mechanism must effectively manage its stakeholders and reduce the likelihood of conflict of interest occurring among them — failing to do so would harm the firm's directions and objectives. Considering those perspectives, by design and purposes, the functions and roles of IC are enhancing BOC to effectively oversee and manage the interest of all stakeholders and the firm's conduct.

Theoretically speaking, the IC's roles are aligned with the perspectives of Freeman and Reed (1983) on the matter of handling various stakeholders'

interests and the idea of corporate governance. In this regard, rigorous criteria of IC are introduced and assured accordingly in addressing the independence challenge. In this regard, IC comes from the outside of the firm and must not be affiliated with the BOD, the BOC, and the shareholders. Implicitly, this regulation imposed the Indonesian listed firms to maintain independence within the firm's board structure. Furthermore, they are expected to play a balancing role to assure the firm is run and managed according to the GCG principles. The ICs within the board are to ensure the interest between the stakeholders, the shareholders, and whether the firm is reasonably aligned.

Apart from the independency challenge, another two challenges (i.e., information asymmetry and operational issue) are addressed by imposing listed companies to have at least two BOC's committees which should be led and chaired by the IC. As such, the IC must hold the position of chairman within the respective committee; through which, the information asymmetry should be addressed via BOC's committee audit and the operational issues within the firm should be addressed via BOC's oversight risk committee.

The appointment of an IC (and the creation of the BOC's sub-committee) is bound to affect the firm's organizational behavior. The idea of organizational behavior concentrates on how the individuals and the groups function within a firm (Sharpe, 2012). It focuses on the interactions, behavior, and characteristics of the groups (e.g., BOD and BOC) and the individuals (e.g., executive and non-executive directors). This implies that the executive and non-executive directors have to operate in harmony (Forbes & Milliken, 1999; Pye & Pettigrew, 2005). Concerning the IC's role and the BOC's functionality as the firm's overseer and BOD advisor, they can help the firm shape and imbue GCG principles within its activities and provide the BOD with suggestions and advice that can accelerate the firm's progress in achieving its objectives. But to be truly effective, it is required for both the BOC and the BOD to have meaningful discussions and engagement in various aspects of the firm (Bankewitz, 2018).

By putting the agency, shareholder, and stakeholder theories and their relation to the two-tier board system into one basket, the implementation of GCG should be based on the balanced interest between the shareholders, the stakeholders, and the firm. The value creation from the GCG implementation should focus on such balanced interests whereby the functionality of the BOC is even more effective through an IC.

Two research questions are addressed in this study, which are:

RQ1: With the existence and the role of IC within the firm, does it affect the effectiveness of the BOC's functionality? Subsequent to this question, Would it be the result is different before and after the establishment of FSA?

RQ2: Does the BOC (with the inclusion of IC) increase the firm's value? Subsequent to this question, Would the result be different before and after the establishment of FSA?

Following the mentioned research questions above, it leads to the following hypothesis:

H1: The IC's role and existence within the BOC increase its functionality effectiveness for both the period before and after FSA establishment.

H2: The BOC's functionality effectiveness increases the firm's value through the existence and the role of IC for both the period before and after the FSA establishment.

3. RESEARCH METHODOLOGY

3.1. Research design

To address the questions above, the data was collected through questionnaire, and then used in a regression analysis to uncover the effect of IC on the BOC's functionality effectiveness, and to discover the influence of BOC's functionality effectiveness on the firm's value creation. The detail of the data and methodology applied in this study are explained in the next sub-sections.

Besides data from questionnaire, interviews with practitioners are also conducted with some IC, non-IC, members of executive board of directors, and even the representatives of FSA and independent observers in Indonesia. The purpose of the interview is to find out some possible explanations for the result of regression.

3.2. Data

Two datasets are used in this study. The first dataset is about IC's role and existence within the Indonesian listed firms with additional information concerning the IC's practice and dynamics within the BOC. The second dataset is related to the BOC's effectiveness and the firm's market-to-book ratio (MBR).

The data concerning the IC's existence and role within the BOC and the firms' MBR are obtained from the public reports published by the IDX. Conversely, the information regarding the IC's practice and dynamics and the BOC's functionality are acquired through a questionnaire answered by the respondent of the respective listed firms. The respondents who participate in this study either hold the position of the firm's corporate secretary or its top executive. In total, there are 42 respondents from various Indonesian business sectors. Table 1 presents the exact number of respondents based on their business sector category.

Table 1. The total number of respondents under their respective business sector

Sector	Number of respondents
Agriculture	5
Mining	4
Basic industry and chemicals	4
Miscellaneous industry	6
Consumer goods industry	5
Property, real estate and building construction	3
Infrastructures, utilities and transportation	4
Finance	6
Trade, services and investment	5
Total	42

In capturing the changes in the effectiveness of the BOC's functionality, the questionnaire follows the ten indicators defined by the Indonesian Institute of Directors and Commissioners (also known as *Lembaqa Komisaris dan Direktur Indonesia* or "LKDI" in Indonesian). It is interesting to note that the LKDI slightly adjusted the board's eight key functions defined by the OECD (2004, pp. 24-25) to become the ten indicators of the BOC's effectiveness (presented in the Appendix).

3.3. Research method and variables

3.3.1. Methodology

In capturing the changes in the BOC's functionality effectiveness and the firm's MBR due to the IC's existence and role before and after the FSA establishment (i.e., 2007-2013 and 2013-2018, respectively), the regression equations (1) and (2) are applied in the analysis. For clarification, the FSA was legally established in 2011; however, the FSA itself started operating in 2013. Therefore, the phrase "before the FSA establishment" refers to the period when the FSA is not fully operated (i.e., 2013).

$$FBOC = \alpha_0 + \alpha_1 PROIC + \alpha_2 ICPC + \alpha_3 ICC + \alpha_4 BNB + \alpha_5 SNP + \varepsilon \quad (1)$$

$$\Delta MBR = \beta_0 + \beta_1 FBOC + \beta_2 BNB + \beta_3 SNP + \varepsilon \quad (2)$$

In equation (1), the BOC's functionality (*FBOC*) acts as a dependent variable in the regression analysis. The Likert scale is used in the questionnaire ranging from 1 to 5. For the period before the FSA establishment (2007-2013), the value of 1 indicates that the BOC's effectiveness is at the level of "very poor". In contrast, the value of 5 indicates the BOC's effectiveness is "very good". Meanwhile, for the period after the FSA is fully operated (2013-2018), the value of 1 indicates that the BOC's effectiveness has "decreased significantly". In contrast, the value of 5 shows that the BOC's effectiveness has "increased significantly".

While this study recognizes the two phases of the period (i.e., before and after the FSA establishment), the given questionnaire also captures the respondents' view in terms of the full-time horizon of the study (i.e., 2007-2018) concerning the firm's *FBOC*. Thus, another Likert scale is used. The value of 1 indicates that the changes in the BOC's functionality effectiveness from 2007 to 2018 are "much worse", whereas the value of 5 indicates the overall changes in the BOC's functionality effectiveness are "much better".

As for equation (2), the firms' market value (ΔMBR) changes are used as a dependent variable. This equation is applied to capture the effect of the BOC's functionality on the firm's market value. The MBR reflects the investors' willingness to accept the firm's valuation within the market. Moreover, changes in MBR also reflect the investors' appetite and confidence in the firm. Hence, the firm's MBR changes are used as a proxy for shareholder value creation. Following this study objective, the ΔMBR of each firm is measured and compared according to the three specified timeframes, namely: 1) before the FSA establishment (2007-2013), 2) thereafter

(2013-2018), and 3) the overall changes of the firm's MBR within the full-time horizon of the two periods (2007-2018).

3.3.2. Variables

Referring to equation (1) above, there are five independent variables used in the analysis:

- 1) *PROIC* = the proportion of ICs in the BOC;
- 2) *ICPC* = whether the IC holds a leadership role as president commissioner;
- 3) *ICCC* = whether the IC holds the chairman's position in the other board-appointed committee besides the audit committee;
- 4) *BNB* = whether the organization of the respondent is a bank or not;
- 5) *SNP* = whether the organization of the respondent is a state-owned enterprise or a private firm.

The five independent variables above are selected due to the following reasons:

- *PROIC* is used to understand whether the proportion of IC in BOC has a positive impact due to a more collective power within the board. However, since there is already a by-law that requires the proportion of IC should be a minimum of 30%. Consequently, the degree of freedom has in effect only for the proportion higher than 30%.

- *ICPC* is used to investigate whether the position of IC as the leader of BOC (i.e., as the president commissioner) has a positive impact due to holding an official leadership role within the board. If the answer to the questionnaire is "yes", then the value of this variable is "1", otherwise is "0".

- *ICCC* is used to investigate whether the position of IC in the board-appointed committee, besides the audit committee, has a positive impact due to holding such an official leadership role within the respective committee. The *ICCC* variable excludes the audit committee because it is already mandatory (the chairperson of the audit committee must be the IC) through the IDX's listing requirements, hence there is no freedom of choice. If the answer to the questionnaire is "yes", then the value of this variable is "1", otherwise is "0".

- *BNB* is used to recognize and consider the different intensity levels of GCG implementation in the bank versus in the non-bank. In this case, the banks are required to comply with much more GCG-related requirements due to their industry-specific and interconnectedness with the international correspondence and its national counterparts. Therefore, if the answer to the questionnaire is "non-bank", then the value of this variable is "1", otherwise is "0".

- *SNP* is used to distinguish the difference between a state-owned enterprise (SOE) and a private enterprise. In this regard, SOE has two additional characteristics which do not apply to their private counterparts, namely: 1) they have multiple authorities as regulators, and 2) they have public service obligations. Consequently, besides complying with the FSA's regulations, SOE must also comply with the regulations from the Indonesian Ministry of State-Owned Enterprises, Ministry of Finance, and the Technical Ministry under which the respective SOE is supervised. Therefore, if the answer to the questionnaire is "private", then the value of this variable is "1", otherwise is "0".

Whereas, in reference to the equation (2), there are three independent variables used in the analysis:

1) *FBOC* = BOC's functionality effectiveness. It is used to understand whether the BOC functionality effectiveness impacts the organization's market value creation. The value comes from the results of equation (2), where *FBOC* is the dependent variable.

2) *BNB* = whether the respondent's organization is a bank or not. It is used to recognize the different intensity levels of GCG implementation in the bank versus in the non-bank, and to understand whether this difference is considered or not by the market. If the answer to the questionnaire is "non-bank", then the value of this variable is "1", otherwise is "0".

3) *SNP* = whether the organization of the respondent is SOE or private. It is used to recognize the difference between a SOE that must comply with

multiple regulations besides FSA's whilst private companies comply with only FSA's regulation and understand whether this difference is considered by the market. If the answer to the questionnaire is "private", then the value of this variable is "1", otherwise is "0".

4. RESULTS

4.1. Changes in the independent commissioners' impact on the BOC's effectiveness

As shown in Table 2 below, the independent variables have different influence levels on the effectiveness of BOC functionality in each specified period.

Table 2. Regression results of the BOC's functionality

Independent variable	Unstandardized coefficients		Sig	Collinearity statistics	
	β	Std. Error		Tolerance	VIF
Panel A: Full-time horizon (2007-2018)					
(Constant)	3.211	0.444	0*		
<i>PROIC</i>	0.157	0.435	0.72	0.967	1.034
<i>ICCC</i>	0.823	0.366	0.031*	0.892	1.121
<i>ICPC</i>	0.228	0.114	0.053	0.95	1.052
<i>SNP</i>	-0.256	0.12	0.039*	0.68	1.47
<i>BNB</i>	-0.452	0.151	0.005*	0.688	1.453
Panel B: Pre-FSA establishment (2007-2013)					
(Constant)	3.683	0.305	0*		
<i>PROIC</i>	0.715	0.556	0.207	0.956	1.046
<i>ICPC</i>	0.171	0.202	0.403	0.94	1.063
<i>SNP</i>	-0.074	0.181	0.683	0.733	1.364
<i>BNB</i>	-0.32	0.229	0.17	0.736	1.359
Panel C: Post-FSA establishment (2013-2018)					
(Constant)	4.335	0.348	0*		
<i>PROIC</i>	-0.537	0.431	0.221	0.944	1.06
<i>ICCC</i>	0.196	0.197	0.325	0.872	1.147
<i>ICPC</i>	0.197	0.086	0.029*	0.891	1.122
<i>SNP</i>	-0.321	0.128	0.017*	0.669	1.494
<i>BNB</i>	-0.729	0.163	0*	0.665	1.504

Note: * represents a 5% significance level. The dependent variable used in the regression analysis is *FBOC*. The total number of respondents used for the regression analysis is 42 respondents. The reliability of the independent variables results is considered acceptable, as the tolerance value is not less than 0.1 and the variance influence factor (VIF) does not exceed the value of 10 (Hair, Black, Babin, & Anderson, 2013).

The results presented in Table 2 indicate that the IC's role and existence within the Indonesian listed firms have had different effects before and after the FSA establishment concerning the BOC's effectiveness.

The regression results for the period before the FSA establishment are as follows:

- Independent variable *PROIC* ($\beta = 0.715$; p -value = 0.207) positively increases the BOC's functionality. Even though the effect is not statistically significant, it indicates that the more considerable proportion of ICs in the BOC might give more courage. Furthermore, it gives more room for the voice of the ICs within the BOC discussion. Hence, it gave more weight consideration to the BOC's decision-making process.

- Independent variable *ICPC* ($\beta = 0.171$; p -value = 0.403) positively increases the BOC's functionality. Even though the effect is not statistically significant, it indicates that the position of the IC as the president commissioner gave more credibility to the IC when they shared input, feedback, or thoughts in the BOC meeting.

- Independent variable *ICCC* is excluded from the regression analysis because its value is constant throughout all 42 respondents. It means that all

the respondents have no other appointed board committee except the audit committee that IC should hold.

- Independent variable *BNB* ($\beta = -0.32$; p -value = 0.17) shows a negative relationship with the *FBOC*. Although it is not statistically significant, it indicates that the existence and role of IC have less effect on the non-banking entities as opposed to the banking entities. It is well understood that the non-banking entities have much less pressure on GCG practices and implementation. Therefore, it might be the case that non-banking entities have not optimally accommodated the ICs' duties and tasks in supervising the firm's conduct and behavior.

- Independent variable *SNP* ($\beta = -0.074$; p -value = 0.683) shows a negative relationship with the *FBOC*. Although it is not statistically significant, it indicates that the existence and role of IC have less effect on the non-SOE entities as opposed to the SOE entities. It is understood as the SOE has more regulations to comply with and therefore the effect of ICs is much bigger than the BOC functionality.

With regards to the regression results for the period after the FSA establishment, it is explained as follows:

- Independent variable *PROIC* ($\beta = -0.537$; $p\text{-value} = 0.221$) showed a negative relationship. Although it is not statistically significant, it indicates that a higher proportion of ICs within the BOC is not seen as a factor that increases the BOC's functionality. The result implied that a more significant proportion of ICs beyond the requirements will be counterproductive, reducing the BOC's functionality effectiveness.

- Independent variable *ICPC* ($\beta = 0.197$; $p\text{-value} = 0.029$) showed a positive relationship with BOC functionality and is statistically significant. Nevertheless, as the president commissioner of BOC, the IC has a strategic role and weight to determine the agenda of BOC meetings and balance the interests among BOC members and assure GCG practices are upheld.

- Independent variable *ICCC* ($\beta = 0.196$; $p\text{-value} = 0.325$) has a positive influence on the BOC's functionality. Although it is not statistically significant, it indicates that the more IC appointed as the head of the BOC sub-committee — apart from the audit committee — helps increase the BOC's functionality to a certain degree.

- Independent variable *BNB* ($\beta = -0.729$; $p\text{-value} = 0.000$) shows a negative relationship with the *FBOC* and is statistically significant. It means there is a positive relationship between the existence and role of IC to the BOC functionality in the bank, or at least more positive than the non-bank entities.

- Independent variable *SNP* ($\beta = -0.321$; $p\text{-value} = 0.017$) shows a negative relationship with the *FBOC* and is statistically significant. It means there is a positive relationship between the existence and role of IC to the BOC functionality in the SOE, or at least more positive than the private companies.

Lastly, concerning the regression result for the overall period (2007–2018), it is found that:

- Independent variable *PROIC* ($\beta = 0.157$; $p\text{-value} = 0.72$) showed a positive relationship, although it is not statistically significant.

- Independent variable *ICPC* ($\beta = 0.228$; $p\text{-value} = 0.053$) showed a positive relationship, although it is not statistically significant.

- Independent variable *ICCC* ($\beta = 0.823$; $p\text{-value} = 0.031$) positively influenced the *FBOC* and is statistically significant.

- Independent variable *BNB* ($\beta = -0.452$; $p\text{-value} = 0.005$) showed a negative relationship and is statistically significant.

- Independent variable *SNP* ($\beta = -0.256$; $p\text{-value} = 0.039$) showed a negative relationship and is statistically significant.

4.2. The impact of the FBOC on the firm's value creation

As shown in Table 3, the regression result indicates that all of the independent variables *FBOC*, *SNP*, and *BNP* have a positive relationship with the firm's value (ΔMBR) but are statistically not significant. In the case of the independent variable *FBOC*, the result indicates that the level of influence of the BOC within the firm is not strong enough to generate growth in the firm's value (ΔMBR). Whereas for the independent variables *BNB* and *SNP*, the result suggests that the firm's nature (whether a bank or non-bank, and whether SOE or a private firm) has some degree of influence on the firm's market value.

Table 3. Regression results of ΔMBR

Independent variable	Unstandardized coefficients		Sig	Collinearity statistics	
	β	Std. Error		Tolerance	VIF
Panel A: Full-time horizon (2007–2018)					
(Constant)	-45.714	34.409	0.192		
<i>FBOC</i>	10.299	8.074	0.21	0.592	1.688
<i>SNP</i>	6.267	6.495	0.341	0.705	1.419
<i>BNB</i>	6.223	9.245	0.505	0.561	1.784
Panel B: Pre-FSA establishment (2007–2013)					
(Constant)	-7.306	13.742	0.598		
<i>FBOC</i>	1.398	3.301	0.674	0.918	1.089
<i>SNP</i>	2.792	3.746	0.461	0.741	1.35
<i>BNB</i>	0.932	4.88	0.849	0.704	1.421
Panel C: Post-FSA establishment (2013–2018)					
(Constant)	-23.96	16.32	0.15		
<i>FBOC</i>	5.262	3.658	0.158	0.417	2.398
<i>SNP</i>	3.333	3.205	0.305	0.646	1.547
<i>BNB</i>	4.12	4.787	0.395	0.467	2.141

Note: * represent a 5% significance level. The dependent variable for the regression equations for each of the timeframe is ΔMBR . The total number of respondents used for the regression analysis is 42 respondents. The reliability of the independent variables results is considered acceptable, as the tolerance value is not less than 0.1 and the variance influence factor (VIF) does not exceed the value of 10 (Hair et al., 2013).

4.3. The respondents' change of perception concerning the BOC's effectiveness

Whilst the regression result of equation (2) shows a positive indication but is not statistically significant,

further investigation is made to understand the respondents' perception concerning the BOC's effectiveness in listed firms under three different situations as shown in Table 4.

Table 4. BOC's effectiveness score

Sector	Average FBOC		
	2007-2013	2013-2018	2007-2018
Agriculture	4	3	3
Mining	4	3	4
Basic industry and chemicals	4	3	4
Miscellaneous industry	4	3	3
Consumer goods industry	4	3	3
Property, real estate and building construction	3	3	3
Infrastructures, utilities and transportation	4	3	3
Finance	4	4	4
Trade, services and investment	4	3	3
Average	4	3	3

Note: The value of the average FBOC for the period before and after establishment and the full-time horizon of this study are using a round number. The indicators used to measure the effectiveness of the functionality of the BOC are presented in Appendix. The total number of respondents in this research is 42. Three Likert scales are applied in measuring the respondent's perception of the BOC's effectiveness with regards to the IC's role and existence, ranging from 1 to 5. For the period before FSA establishment (2007-2013), the score of 1 represents "very poor", whereas the score of 5 represents "very good". For the period after the FSA establishment (2013-2018), the score of 1 means "decreases significantly", whereas the score of 5 represents "increases significantly". Lastly, for the changes in the BOC's effectiveness in the full-time horizon (2007-2018), the score of 1 represents "much worse", whereas the score of 5 represents "much better".

Following the BOC's effectiveness score presented in Table 4, there are three uncovered situations:

The first situation is under the period before the FSA establishment (2007-2013) indicates that the BOC's effectiveness is considered effective as FBOC aggregate average score is 4 or "good", except for Property, Real estate, and Building construction, which score is only 3 which means "indifferent". This perception is in line with the hypothesis as there was a strong perception and expectation that the existence and role of IC would positively affect the FBOC. Exception existed in the Property, Real Estate, and Building construction as at that time, the practice of having IC in those industries was still low, and if any, the appointment was not really coming from real independent parties but still coming from "as if" independent parties, for example, former auditor, vendor, and consultant. Apparently, the market reacts by giving a score of 3 or "indifferent" in this case.

The second situation is under the period after the FSA (2013-2018) indicates that BOC's effectiveness is perceived not to have any change, except for finance, with a score of 4 meaning "increasing". These phenomena are understood as after FSA, most listed companies did not have experience of the further push to implement GCG except finance — especially banking which has more international push to implement GCG further as a part of sustainable and green banking practices. Likewise, the new regulations in the early establishment of the FSA are predominantly in the banking sector as it was the priority agenda of the FSA. This is in line with the global drive to stimulate sustainable finance and sustainable development goals, which encourage the bank to implement GCG and ESG (environmental, social, and corporate governance) to support those initiatives. Apparently, the market reacts positively to this particular industry whilst remain not seeing much difference in practices in other industries after the FSA establishment.

The third situation is under full period (2007-2018), which indicates that there had been no changes as a score of FBOC is 3, except for three industries that have been perceived as getting better as their FBOC score is 4, namely Mining, Basic industry and chemicals, and Finance. The market is not seeing much of FBOC as it was a hidden factor in

practices and already feel comfortable before FSA establishment and respond indifferently since then as FSA assure the maintenance of regulation to keep them on hand. Whereas the industries Mining and Basic industry and chemicals are perceived as getting better as the general sentiment, there are new regulations on this particular industry that enforce the players to implement many things regarding sustainability and environmental protection. Although it took slowly effect, these phenomena are captured and responded to by the market that there is perceiving getting better.

5. CONCLUSION

The grand theories of corporate governance are adopted in the two-board system in Indonesia, whereby it recognizes BOC as the oversight organ and BOD as the executive organ that fulfills its duties for the best interest of the firm. However, such structure and format alone would not be enough to ensure the GCG principles are functioning well. It requires, somehow, strong independence within the BOC with explicit leadership roles for those who are supposed to assure and uphold such independence. These phenomena are shown through this study that the existence and roles of IC would positively affect the board functionality effectiveness if they hold the role of president commissioner and the head of BOC's sub-committee.

The phenomena could become a consideration to the organization to ensure that independent board members within our company board should be equipped with official leadership roles and consequently need the training and competency as a leader with sufficient leadership competency-based. The implications are then to determine leadership criteria in appointing independent board members to ensure they would effectively lead the BOC and its BOC's sub-committee effectively, therefore able to apply GCG principles to the functionality of BOC. Although the FBOC is not directly affluent the firm's market value, it could still be hoped and expected that the company is run based on GCG principles, then balance the interest of stakeholders, including shareholders, for the firm's best interest.

Therefore, the regulation to impose mandatory appointment of ICs should remain and even further

echoed. Whilst the composition of 30% is already considered optimal, it might be supported with consideration that IC should hold the role of PC to echo strong leadership at BOC and, therefore, could be expected for the *FBOC* to be more effective in upholding GCG principles more effectively.

One thing to note is the regression result of *FBOC* and the perception are coming along but are not identical. Whereas the regression about *FBOC* shows a positive indication and gets more statistically significant from the period before and after FSA establishment, the perception as far as per period is not automatically the same. This is a message to the authority to make it more explicit as the market does not automatically just consider the existence and role of the IC to the *FBOC* per se but is influenced by other factors such as the international sphere of banking and now insurance, natural environment, and climate change responsibility.

Therefore, these externally amplifying factors need to be well understood and charted by FSA to also take into consideration and at the same time

encourage corporations, if not mandatory, to give the leadership of BOC to IC to make them more powerful in exercising GCG principles. Hopefully, this is not just for finance and natural-resources-related industries but for all industries. Therefore, we could expect the *FBOC* effectiveness to be seen and perceived in line with the regression result of the existence and role of ICs. On the other hand, let the ICs increase the leadership competency to effectively lead the BOC in upholding GCG principles at the utmost and the BOC's committee performance.

Since the study has adopted the same periodical effect between the two equations, there is a lack of considering the lead time effect of *FBOC* on the market value. Based on some inputs and expectations, a further study is recommended to see whether there is a lead time effect in at least one cycle of BOC effectiveness (e.g., 3-5 years after the *FBOC* takes place). Therefore, it is recommended that the equation of *FBOC* and the increase of MBR (ΔMBR) consider the different time-periodic $t + 3$ up to $t + 5$. This is to see the effect.

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APPENDIX. THE TEN INDICATORS OF THE BOC'S EFFECTIVENESS DEFINED BY THE LKDI

No.	Indicators	Dimensions
1.	The roles of the board of commissioners (BOC) in selecting, monitoring, and replacing the president director or director(s)	<ul style="list-style-type: none"> a. The shareholders request a recommendation from the BOC in selecting or appointing a new director(s); b. The shareholders request a recommendation from the BOC in replacing the existing director(s); c. The BOC is monitoring the board of directors' performance in running the company.
2.	Ensuring the conduct by the board of directors (BOD) is appropriate to the formulation of long-term strategies	<ul style="list-style-type: none"> a. The BOC is challenging and reviewing the firm's long-term strategies prepared by the BOD; b. The BOC gives an in-depth input to BOD in terms of the company's long-term strategies.
3.	Ensuring the risk management implementation and an internal control system within the firm	<ul style="list-style-type: none"> a. The BOC assures the implementation of risk management by the BOD, and the BOC regularly conducts its implementation; b. The BOC assures the BOD places the internal control system, and the BOD regularly conducts its implementation.
4.	Monitoring and evaluating the firm's business operation to prevent poor results	<ul style="list-style-type: none"> a. The BOC is monitoring the company's business operations regularly; b. The BOC pursues the BOD assessment on the process of business operations, discerning poor operating performance.
5.	Actively oversee the potential conflict of interests within the company and ensuring the integrity of the company's financial reporting	<ul style="list-style-type: none"> a. The BOC assures the BOD to comply with the capital market protocol resolution if there is a potential conflict of interest at the BOD; b. The BOC assures themselves to comply with the capital market protocol resolution if there is a potential conflict of interest at BOC; c. The BOC has regular meetings with the internal auditors concerning the financial reporting control objective and process; d. The BOC has regular meetings with the external auditors concerning the financial reporting control objective and process; e. The BOC assures the BOD to follow up on the internal auditors' findings, especially regarding the weaknesses against the integrity of the company's financial reporting process; f. The BOC assures the BOD to follow up on the external auditors' findings, especially concerning the weaknesses against the integrity of the company's financial reporting process.
6.	Maintaining and ensuring the competency and the independence of the BOC	<ul style="list-style-type: none"> a. The BOC assures the company to have a board charter for the BOC; b. The BOC assures themselves to adhere to the BOC charter and conduct an assessment or review of their implementation; c. The BOC ensures themselves to be qualified based on the requirement stated in the BOC charter.
7.	Ensuring the competency and the independence of the BOD and making sure they clearly understand their role	<ul style="list-style-type: none"> a. The BOC assures that the BOD has a charter; b. The BOC ensures that BOD adheres to its BOD's charter and conducts a regular assessment of its compliance; c. The BOC ensures that the BOD to be qualified based on the requirement stated in the BOD charter.
8.	Critically review the director's compensations	<ul style="list-style-type: none"> a. BOC conducts regular formal review or evaluation of executive compensation, especially for the BOD; b. The BOC is requested by the shareholders to give their review or recommendation of BOD's remuneration and to be approved in the general meeting of shareholders.
9.	Critically review commissioners compensations	<ul style="list-style-type: none"> a. The BOC conducts regular formal review or evaluation of the BOC compensation; b. The BOC is requested by the shareholders to give their review or recommendation of BOC's remuneration and to be approved in the general meeting of shareholders.
10.	Implementing the practice of good corporate governance transparently with adequate public disclosure of relevant information	<ul style="list-style-type: none"> a. The BOC conducts regular reviews or assessments of good corporate governance implementation; b. The BOC assures that all required public disclosure of relevant information is carried as per capital market protocols and standards and measures.

Source: Alijoyo (2013).