Sensitivity of Employee Stock Option Offering: Study of Corporate Governance Structure in Indonesia

Nur Fadjrih Asyik

Abstract—This paper investigates the impact of corporate governance structure on the effect of executive stock option plans offering proxied with proportion of stock options to market reaction in Indonesia. The results showed that the corporate governance structure consisting of independent commissioners composition, audit committee existence and structure of managerial ownership motivate employees to take up their rights to employee stock options and the market responded positively to the stock option program. Employee stock option plans are competitive enough to attract and to retain high quality managers, to link bonuses to performance, and to be able to develop performance-oriented climate within the company by giving rewards to whom perform very well. This paper contributes to that stream of accounting research by identifying factors of good corporate governance. Efforts at the development of good corporate governance are aimed to promote optimization of resource allocation or use of the company’s resources in order to growth awake.

Keywords—Audit Committee, Executive Stock Option Plans, Independent Commissioner, Managerial Ownership Structure

I. INTRODUCTION

Employee stock option program, known as the Employee Stock Option Plans (ESOP) is one of the company's long-term policy that involves psychology of employee in the form of equity-based compensation program [24]. ESOP aims to increase the sense of belonging of the company which will be reflected by the increase of earnings contained in the report submitted by the company's accounting.

Several empirical studies show that the stock price movement as the reaction of investors to the company’s reported accounting information. By reporting the information of the ESOP, it is expected that the market will respond positively and an abnormal return can be achieved [25]. Market reaction to the announcement of the ESOP was expected to be fit and positive, and the research conducted by [8] found a positive and significant abnormal return after the announcement.

In addition, the implementation of Corporate Governance is very important in the management structure of the business and the modern economy is sustained by capital markets and money markets [11] because it can increase public confidence in the company [15], and increase efficiency, in the sense of an attempt to reduce transaction costs [17]. The goal is to increase the efficiency of the company, minimizing the cost of the company's performance, enhancing the value of the company. There are some elements to consider - an important element in corporate governance, including the composition of an independent commissioner, the existence of an audit committee, and managerial ownership structure [21]. The sensitivity of employee stock option offering to stock price is the change in the stock price for a 1% change in the stock option value.

Based on the background described above, then the problem in this study can be formulated as follows: (1) Does the implementation of employee stock options (the proportion of stock options) affect the market reaction?, (2) Does the structure of the corporate governance (the composition of an independent commissioner) has an impact on the effect of implementation of employee stock options (the proportion of stock options) to the market reaction?, (3) Does the structure of the corporate governance (the existence of audit committee) has an impact on the effect of implementation of employee stock options (the proportion of stock options) to market reaction?, and (4) Does the structure of corporate governance (managerial ownership structure) has an impact on the effect of implementation of employee stock options (the proportion of stock options) the market reaction?

The purposes of the current study are as follows: (1) to examine the effect of the implementation of employee stock options (the proportion of stock options) to the market reaction, (2) to examine the impact of corporate governance structure (the composition of an independent commissioner) on the effect of the application of employee stock options (the proportion of stock options) to the reaction of the market, (3) to examine the impact of corporate governance structure (the existence of audit committee) on the effect of the implementation of employee stock options (the proportion of stock options) to the market reaction, and (4) to examine the impact of corporate governance structures (managerial ownership structure) on the effect of the implementation of employee stock options (the proportion of stock options) to the market reaction.
II. THEORETICAL FRAMEWORK AND HYPOTHESIS

A. Theoretical Framework

Executive Stock Option Plan (ESOP)

ESOP is an incentive program in order to appreciate the long-term performance of the company which is an effective step to narrow and to reduce the agency and agency cost problems through the alignment of interest, the executives with the shareholders [2]. The ownership of shares by employees of the company (insiders) is to give the impression as a financial investment. The Ownership will provide a great feeling of satisfaction and commitment to the company's control [3]. ESOP is expected to improve the performance of agents, who will be reflected in the earnings information that is often called the accounting earnings. Expectations are not excessive because the theoretical equity-based compensation indirectly will consider existence of labor, so that in the long run, companies will employees who are generally qualified and holds proprietary concepts in carrying out the duties of the company. [14] state that compensation contracts motivate corporate executives, so that the executive compensation program should be competitive enough to attract and to retain high quality managers, and to link bonuses to performance, and to be able to develop performance-oriented climate within the company by giving rewards to well performance assessment.

In October 1995, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 123 which recommends companies to recognize the fair value of stock compensation as the amount of dollars compensation in the financial statements and using option pricing model for calculating the value of stock options [10]. On 4 September 1998, the Indonesian Institute of Accountants (IAI) issued Statement of Financial Accounting Standards and through the Statement of Financial Accounting Standards (PSAK) No. 53, stock options offered to employees as compensation for services of employees are measured and recognized at fair value of stock options are concerned [12].

Corporate Governance (CG) Structure

The principle referred to by many institutions CG is the principle of fairness, transparency, accountability, and responsibility consists of aspects: protection of the rights of shareholders, equitable treatment of all shareholders, role of stakeholders in CG, openness and transparency, and the role board of directors in the company.

One of the basic principles of accountability that emphasizes the importance of creating an effective monitoring system based on the division of powers between directors and shareholders [1] which includes monitoring, evaluation, and control of the management to ensure that management acts in the interests of shareholders and other interested parties. Accountability carried out in the presence of: (1) the composition of an independent commissioner, (2) an audit committee, and (3) the managerial ownership structure.

The Composition of an Independent Commissioner.

According to CG framework, commissioners tasked to ensure the implementation of corporate strategy, to oversee management in managing the company, and to require effective accountability [22]. Accountability function is intended to protect the owners of capital and other stakeholders. This function may not work as they should if there is dominance of power in decision-making by the commissioner or the management. [22] cites criteria of independent commissioner is not a member of management, not shareholders, or who have a relationship with majority shareholder of the company, in the last three years as the executive was not employed by the company or another companies in a single business group nor employed in his capacity as commissioner after no longer occupy such a position, not a professional advisor to the company or any other company within the group companies.

The Audit Committee. The audit committee is a committee formed to assist in the duties and responsibilities of the board in overseeing the company's activities. The Securities Exchange Commission (SEC) issued Accounting Series Release (ASR) No. 19 in 1940 recommending that companies in the stock market to assign a specific committee in charge of the appointment of the external auditors and supervisory contractual relationship between the company and the external auditors. The establishment of an audit committee is expected to support the implementation of the review of the company's internal controls and creates financial reporting more objective.

The Managerial ownership Structure. [19] explains that the successful implementation of corporate governance cannot be separated from the managerial ownership structure of the company. Ownership structure is reflected through both stocks and debt instruments that may be explored through such structures possible forms of agency problems that will occur.

B. Hypothesis

As part of good corporate governance, companies who are offering stock options are expected to allocate some of their shares to employees, including directors, in order to boost employee’s performance and further to enhance the sense of belonging to the company in order to improve the company’s performance. Therefore, the operational hypotheses which are the alternative hypotheses are as follow:

H1: Implementation of employee stock options (the proportion of stock options) affects the market reaction

H2: The corporate governance structure (the composition of an independent commissioner) has an impact on the influence of the implementation of employee stock options (the proportion of stock options) to market reaction

H3: The corporate governance structure (the existence of audit committee) has an impact on the influence of the implementation of employee stock options (the proportion of stock options) to market reaction
H4: The corporate governance structure (managerial ownership structure) has an impact on the influence of the implementation of employee stock options (the proportion of stock options) to market reaction.

III. RESEARCH METHOD

A. Population and Sampel

The population includes companies which are listed on The Indonesia Stock Exchange (ISE). The standard regarding of that stock-based compensation (executive stock options) became effective in 1998, and some companies have implemented executive stock option plans started in 1999. The sample selection is determined by purposive sampling in order to obtain a representative sample in accordance with the specified criteria. The criteria used for selecting the sample is as follows: (1) Companies have listed in ISE before December 31, 2009 since that would be observed in this study is to offer stock options beginning in 2009 until 2011, (2) Issuers that already includes the financial statements on December 31st, 2009 until 2011. Election periods are based on the grounds that the statement on December 31st  is the reports that have been audited, so that those statements can be more reliable. In addition, the period is most companies have offered stock option program, and (3) Issuers adopt and maintenance of executive stock option program in 2009 until 2011. The final sample of this study is as many as 22 samples of the company. The numbers of observations were 66 observational studies.

B. Variable and Operational Definition

Cumulative Abnormal Return/CAR (Dependent Variable)

Dependent variable in this study is market reaction. Cumulative Abnormal Return stocks which are used as the dependent variables are which have the value determined by testing the relationship of the financial ratio saham digunakan sebagai variabel dependen yang nilainya ditentukan untuk menguji kekuatan hubungan rasio keuangan. The stock return is the changing the stock price within the observation period or systematically can be formulated as follow: Return saham adalah perubahan harga saham selama periode pengamatan atau secara sistematis dapat dirumuskan sebagai berikut ini.

\[ SR_t = (P_t - P_{t+1})/P_{t+1} \] (1)

According to the above equation, \( SR_t \) is the stock return, \( P_t \) is the stock price today, and \( P_{t+1} \) is the stock price of the previous day. The share price is the price at the closing price for the period of observation. Statistical analysis was used to estimate the mean abnormal return is adjusted return are defined in the following equation:

\[ AR_{i,t} = R_{i,t} - R_t \] (2)

\[ R_t = \frac{1}{100} \sum_{t=-105}^{t=-6} R_{i,t} \] (3)

in the above equation, \( AR_{i,t} \) is the abnormal return of firm \( i \) in period \( t \), \( R_{i,t} \) is the daily stock return of firm \( i \) in period \( t \), \( R_t \) is the simple average of daily stock return for estimation period (-244, -6). Cumulative Abnormal Return (CAR) on the announcement date is defined as follows:

\[ CAR_{i,(t_{1},t_{2})} = \sum_{t=t_{1}}^{t_{2}} AR_{i,t} \] (4)

in the above equation, \( CAR_{i,(t_{1},t_{2})} \) is cumulative abnormal return of firm \( i \) in period \( t \), \( AR_{i,t} \) is defined in equation (2), \( (t_{1}, t_{2}) \) is the length of the interval (cumulation period).

Proportion of Stock Option (Variabel Independent)

Independent variable in this study is the adoption of executive stock option plans (ESOP). The variable uses of measurement the proportion of executive stock options like [2], the proportion of employee stock options is the number of stock options granted to executive during the event window deflated with managerial ownership.

Some of the previous studies using the structure of CG as a proxy for the application CG [5]. CG structure is the managerial ownership structure, the composition of an independent commissioner, and the existence of the audit committee.

The Composition of an Independent Commissioner (Moderating Variable)

The composition of an independent commissioner referred to in this study is the proportion of independent commissioners with the total membership of the board of commissioners. The study using the proportion of independent commissioners as proxy variables such as the composition of the board of commissioners [7].

The Existence of the Audit Committee (Moderating Variable)

Some of the previous studies were using the existence of the audit committee as a proxy for CG structure. The existence of an audit committee is expected to improve the quality of financial reporting, it is in accordance with the duties and responsibilities of the audit committee are governed by the Indonesia Stock Exchange. These variables are classified into two categories, namely the presence and absence of an audit committee [9]. This variable uses nominal scale categories, "1" for companies that have an audit committee, and "0" otherwise.

Managerial Ownership Structure (Moderating Variable)

There are several proxy for ownership structures used in empirical research: the magnitude of external holdings which are not/do not have a relationship with the management [18], the proportion between the number of shares held by the family ownership by the number of shares held by outsiders [20], ownership concentration; proportion of individual ownership among institutional investors, and foreign ownership. This study used a proxy for the percentage of...
managerial ownership.

IV. ANALYSIS AND DISCUSSION

A. Test about Influence ESOP Offering (Proportion of Stock Option) to Market Reaction

The results of the analysis in Table 1 (Model 1) shows that the coefficient $\beta_1$ (the proportion of stock options) have a positive value of 0.015 with a $p$-value of 0.004 thus statistically significant at the 1% level, thus concluded that the study is successfully rejected $H_{01}$. In addition, individual moderating variable coefficient $\beta_2$, $\beta_3$, and $\beta_4$ (independent commissioner, audit committee, and ownership structure) have positive values of 0.126, 0.028, and 0.430 with a $p$-value of 0.050, 0.014, and 0.000 thus statistically significant at the 5% and 1% level.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coeff</th>
<th>t-value</th>
<th>p-value</th>
</tr>
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<tbody>
<tr>
<td>Intercept</td>
<td>-0.012</td>
<td>-0.862</td>
<td>0.392</td>
</tr>
<tr>
<td>SO</td>
<td>0.015</td>
<td>2.964</td>
<td>0.004 ***</td>
</tr>
<tr>
<td>IC</td>
<td>0.126</td>
<td>1.997</td>
<td>0.050 **</td>
</tr>
<tr>
<td>AC</td>
<td>0.028</td>
<td>2.536</td>
<td>0.014 **</td>
</tr>
<tr>
<td>MO</td>
<td>0.430</td>
<td>6.800</td>
<td>0.000 ***</td>
</tr>
</tbody>
</table>

Model 2

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coeff</th>
<th>t-value</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
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<td>-0.946</td>
<td>0.348</td>
</tr>
<tr>
<td>SO</td>
<td>0.069</td>
<td>2.065</td>
<td>0.043 **</td>
</tr>
<tr>
<td>IC</td>
<td>0.181</td>
<td>3.222</td>
<td>0.002 ***</td>
</tr>
<tr>
<td>AC</td>
<td>0.018</td>
<td>1.923</td>
<td>0.059 *</td>
</tr>
<tr>
<td>MO</td>
<td>0.399</td>
<td>7.440</td>
<td>0.000 ***</td>
</tr>
<tr>
<td>SO*IC</td>
<td>0.022</td>
<td>2.272</td>
<td>0.027 **</td>
</tr>
<tr>
<td>SO*AC</td>
<td>0.020</td>
<td>3.714</td>
<td>0.000 ***</td>
</tr>
<tr>
<td>SO*MO</td>
<td>0.016</td>
<td>2.397</td>
<td>0.020 **</td>
</tr>
</tbody>
</table>

R2 (Adjusted) 0.747 (0.716)
F 24.462 ***

Description:
SO = Stock Option, IC = Independent Commissioner, AC = Audit Committee, MO = Managerial Ownership Structure

*** Statistically significant at the 0.01 level
** Statistically significant at the 0.05 level
* Statistically significant at the 0.10 level

This proves that implementation of stock options will result in management will be motivated to work harder and this fact will increase the performance of the company. Employee stock option also makes the employee as part of the company and consequently will share knowledge and related information technology companies with all stakeholders in the company. The results are consistent with [16] document that the employee exercise patterns are positively related to stock prices. This suggests that years of high employee exercises are indicative of good firm performance.

B. Test about the Impact Corporate Governance Structure (The Composition of an Independent Commissioner) on the Influence of Implementation of Stock Option (the Proportion of Stock Options) to Market Reaction

The results of the analysis in Table 1 (Model 2) shows that the coefficient $\beta_4$ have positive value of 0.022 with a $p$-value of 0.027 thus statistically significant at the 5% level, thus concluded that the study is successfully rejected $H_{02}$. The data suggest that as many as 9 samples or 13.6% sample has a higher proportion of independent commissioners 0%-29%, while 57 samples or 86.4% above the proportion of independent commissioners or equal to 30%. It can be concluded that the majority of the sample had an independent commissioner greater than or equal to 30%, which means the majority of the samples already have independent commissioners above the minimum of the prescribed rules that at least 30% of the total membership of the commissioner. The results of this study support [19].

C. Test about the Impact Corporate Governance Structure (The Existence of the Audit Committee) on the Influence of Implementation of Stock Option (the Proportion of Stock Options) to Market Reaction

The results of the analysis in Table 1 (Model 2) shows that the coefficient $\beta_6$ have positive value of 0.020 with a $p$-value of 0.000 thus statistically significant at the 1% level, thus concluded that the study is successfully rejected $H_{03}$. The results are consistent with previous studies by [1] and [4] which found that the results of an independent audit committee of the company increased marker reaction. The results also proved the existence of committees enhance the credibility and perception of quality of earnings. Increased credibility and perceptions of earnings quality and then improve the market reaction of firms ([6], [23], and [2]).

D. Test about the Impact Corporate Governance Structure (Managerial Ownership Structure) on the Influence of Implementation of Stock Option (the Proportion of Stock Options) to Market Reaction

The results of the analysis in Table 1 (Model 2) shows that the coefficient $\beta_7$ have positive value of 0.016 with a $p$-value of 0.020 thus statistically significant at the 5% level, thus concluded that the study is successfully rejected $H_{04}$. The research sample taken in this study is a company that has the managerial stock ownership. With an average suggests that at least some managers as well as owners of the company. The existence of managerial ownership is expected to produce a more robust governance because they also act as an investor. The results support the Suranta and Puspa (2003) which states that a substantial shareholding in terms of the economy have an incentive to monitor. Manager of the company's stock holdings would be seen to align the potential divergence of interests between shareholders outside the agency assumed management so that problems would disappear if a manager is as well as an owner [13].
V. CONCLUSION AND SUGGESTIONS

A. Conclusion

The belief that managers and directors can be compensated in stock and stock options in order to create high-powered incentives for them to maximize share value follows naturally from the approach of using the economists' model of human behavior to analyze corporate governance. The corporate governance structure including the composition of an independent commissioner, the existence of an audit committee, and managerial ownership structure can increase the efficiency of the company, increasing the return on capital, minimizing the cost of the company's performance, and enhance the value of the company. Finally, implementation of employee stock options which are supported by good corporate governance will lead to a positive response by the market.

B. Suggestion

The Examination of the perception is taking longer time to get sample research which is many and in order to give a better result. Despitefully, subsequent research not only considers corporate governance principles of accountability, but also it may consider other principles are fairness, responsibility, and transparency.

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Effect of Service Quality Dimensions on Adoption of Internet Banking—An Empirical investigation of Customer’s Perspectives in Kerala

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Abstract—The purpose of this research is to examine the interrelationship between the IB service quality dimensions and adoption of IB by customers in Kerala. Using a structured questionnaire, primary data were collected from 240 IB users from both public sector banks and private sector banks, identified randomly from various parts of Kerala. It is quite evident that adoption of IB by customers is a function of various service quality dimensions and extent of adoption is determined by the level satisfaction on various elements. Multiple regression was used to study the interrelationship between dependent variable (Adoption i.e., Years of IB use) and independent variables (web security, reliability, responsiveness, fulfilment, efficiency and privacy). The findings indicate that the strongest predictor based on Beta values is website security followed by privacy and responsiveness. The banks should take appropriate strategies and tactics to empower and delight customer force to popularise and penetrate IB services since it is cheap, convenient and easily accessible. Findings of the study may assist banks immensely in addressing the user problems and understanding their perceptions influencing adoption decision.

Keywords—e-services, Internet Banking, IB adoption, Service quality dimensions, web security.

I. INTRODUCTION

The marvellous kinds of innovation in technology and hard line blend of it with information technology made a paradigm shift in the banking industry. Technology itself created its world in the globe of human beings. Internet banking is a service that allows consumers to perform a wide range of financial and non-financial services through a bank’s website. With the rapid diffusion of the Internet, web-based banking has fast become an alternative channel to provide banking services and products.

Internet banking is a kind of system that enables financial institutions, customers, individuals or businesses, to access accounts, transact business, or obtain information on financial products and services through the Internet. Online banking (or Internet banking) allows customers to conduct financial transactions on a secure website operated by their retail or virtual bank, credit union.

Online banking is the practice of making bank transactions, both informational and transactional, via, internet. Thanks to technology, and the Internet in particular, one can no longer have to leave the house. One can shop online, communicate online and even do banking online. Online banking allows us to make deposits, withdrawals and pay bills all with the click of a mouse.

Internet banking is defined as “the provision of retail and small value banking products and services through electronic channels. Such products and services can include deposit-taking, lending, account management, the provision of financial advice, electronic bill payment, and the provision of other electronic payment products and services such as electronic money”[1].

According to Khalfan, et al.,[2] reasons for e-banking infrastructure investment include the promise of transaction cost reduction by limiting overheads associated with bank staff and bank branch costs and to provide better services to customers who increasingly desire 24 hour banking. Indeed, Almogbil [3] note that a common reason for bank adoption of e-banking is to maintain the bank’s competitive position and image.

II. STATEMENT OF THE PROBLEM

Changes in banks’ external environment, including globalization and deregulation, have made the banking sector highly competitive. Banks find it hard to compete on price, and need to look at other ways to retain customers. As customers become more sophisticated, it becomes imperative for banks to consider the use of technology to respond to their continuously changing requirements. But current scenario in India shows that pace at which technology in Internet banking proceeds doesn’t march with the customers’ usage rate.

Modern banking is high-tech, electronic and tech-savvy. Banking institutions are adopting most modern technology to deliver high value added and customised services at the doorstep of the customers round the clock. Though there is deliberate attempt from banks to propagate and penetrate internet banking, it is seen that only a fraction of customers are using IB services. There are diverse hidden risks inherent in IB which de motivates a prospective customer to use it. Existing literature reveals that studies conducted on the topic are scanty. Hence there is a dire need to conduct a study of this kind which is expected to be a pioneering on in the field. The proposed study intends to analyze customer