Unika SOEGIJAPRANATA

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[jak] Submission Acknowledgement

1 message

Dr. Dra. Juniarti, M.Si., Ak. <jak-acc@petra.ac.id> Fri, Feb 28, 2020 at 3:49 PM
To: sansaloni Butar Butar <sansaloni@unika.ac.id>

Dear Mr/Mrs sansaloni Butar Butar:

Thank you for submitting the manuscript, "The effects of Corporate Governance, Audit Quality, and Conservatism on Loan Collateral Requirements" to Jurnal Akuntansi dan Keuangan. With the online journal management system that we are using, you will be able to track its progress through the editorial process by logging in to the journal web site:

Manuscript URL:
http://jurnalakuntansi.petra.ac.id/index.php/aku/author/submission/22595
Username: sansaloni_butar

If you have any questions, please contact me. Thank you for considering this journal as a venue for your work.

Dr. Dra. Juniarti, M.Si., Ak.
Jurnal Akuntansi dan Keuangan

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Jurnal Akuntansi dan Keuangan

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Sansaloni Butar Butar <sansaloni@unika.ac.id>

[jak] Editor Decision

Dr. Juniarti, M.Si., Ak., CA. . <yunie@petra.ac.id> Wed, Mar 18, 2020 at 3:45 PM
To: sansaloni Butar Butar <sansaloni@unika.ac.id>

Dear Mr. Sansaloni Butar Butar:

We have reached a decision regarding your submission to Jurnal Akuntansi dan Keuangan, "The effects of Corporate Governance, Audit Quality, and Conservatism on Loan Collateral Requirements".

Our decision is to:
Please revise the article according to Reviewer 's review result below, (reviewer file attachment has already been attached in your JAK account in this article) and please return the file after revision before 25 of March 2020 (1 week). Please do the marking toward each and every changes in the article. We would like also to inform you that from Reviewer A comment, it is written that some grammatical errors persist. If your article has been accepted by the editor of JAK, then the author needs to complete two kinds of payment which is Proofread Payment and Article Processing Charge which later be informed.

Dr. Juniarti, M.Si., Ak., CA. .
Accounting Department, Petra Christian University
yunie@petra.ac.id

Reviewer A:

Originality: Does the paper contain new and significant information adequate to justify publication?:
The manuscript is good and has its originality

Relationship to Literature: Does the paper demonstrate an adequate understanding of the relevant literature in the field and cite an appropriate range of literature sources? Is any significant work ignored?: :
The literature is adequte

Methodology: Is the paper's argument built on an appropriate base of theory, concepts, or other ideas? Has the research or equivalent intellectual work on which the paper is based been well designed? Are the methods employed appropriate?:
The methodology is acceptable

Results: Are results presented clearly and analysed appropriately? Do the conclusions adequately tie together the other elements of the paper?:
this part need special attention. please refer to the attached file

Implications for research, practice and/or society: Does the paper identify clearly any implications for research, practice and/or society? Does the paper bridge the gap between theory and practice? How can the research be used in practice (economic and commercial impact), in teaching, to influence public policy, in research (contributing to the body of knowledge)? What is the impact upon society (influencing public attitudes, affecting quality of life)? Are these implications consistent with the findings and conclusions of the paper?: :
The implication is sound

Quality of Communication: Does the paper clearly express its case, measured against the technical language of the field and the expected knowledge of the journal's readership? Has attention been paid to the clarity of expression and readability, such as sentence structure, jargon use, acronyms, etc.
:

Some grammatical errors persist

COMMENTS TO THE AUTHOR(S):
Need some works on the logic for running the t-test for dummy variable and for the use of assumption of t-test

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Reviewer B:

Originality: Does the paper contain new and significant information adequate to justify publication?:
Yes, acceptable

Relationship to Literature: Does the paper demonstrate an adequate understanding of the relevant literature in the field and cite an appropriate range of literature sources? Is any significant work ignored?: :
Yes, enough and acceptable

Methodology: Is the paper's argument built on an appropriate base of theory, concepts, or other ideas? Has the research or equivalent intellectual work on which the paper is based been well designed? Are the methods employed appropriate?:
yes, enough

Results: Are results presented clearly and analysed appropriately? Do the conclusions adequately tie together the other elements of the paper?:
yes, acceptable

Implications for research, practice and/or society: Does the paper identify clearly any implications for research, practice and/or society? Does the paper bridge the gap between theory and practice? How can the research be used in practice (economic and commercial impact), in teaching, to influence public policy, in research (contributing to the body of knowledge)? What is the impact upon society (influencing public attitudes, affecting quality of life)? Are these implications consistent with the findings and conclusions of the paper?: :
yes, enough

Quality of Communication: Does the paper clearly express its case, measured against the technical language of the field and the expected knowledge of the journal's readership? Has attention been paid to the clarity of expression and readability, such as sentence structure, jargon use, acronyms, etc.
:
need to revise for descriptive statistic and for the preparation of result

COMMENTS TO THE AUTHOR(S):
see comments and notes on reviewed paper

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Author Revision Reminder

1 message

Redaksi Jurnal Akuntansi dan Keuangan <jak-acc@petra.ac.id> Mon, Mar 23, 2020 at 12:54 PM
To: Sansaloni Butar Butar <sansaloni@unika.ac.id>

Dear Mr. Sansaloni Butar Butar

Regarding your article that have been submitted, “The effects of Corporate Governance, Audit Quality, and Conservatism on Loan Collateral Requirements” for Jurnal Akuntansi dan Keuangan (JAK). We would like to remind you that we hope to have this revision finished by 25 of March 2020 as the latest, and would be pleased to receive it as soon as you are able to prepare it. Revise the article by referring to the ms. word attachment named "Revisi Admin 1803202" (the file can be found on the previous email 18 of March 2020, if not in Inbox, maybe in spam). Please refer to reviewer results below and mark it to which part in the article that has been revised. Please log in to jurnalakuntansi.petra.ac.id, to upload the result from author revision.

Dr. Juniarti, M.Si., Ak., CA
Editor in Chief

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Unika SOEGIJAPRANATA

Sansaloni Butar Butar <sansaloni@unika.ac.id>

The effects of Corporate Governance, Audit Quality, and Conservatism on Loan Collateral Requirements

1 message

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sansaloni Butar Butar <sansaloni@unika.ac.id> Mon, Mar 23, 2020 at 9:44 PM
To: "Editor in Chief, JAK" <jak-acc@petra.ac.id>, "Dr. Juniarti, M.Si., Ak., CA. ." <yunie@petra.ac.id>

Yth. Editor JAK

Saya mengirim/upload kembali artikel yang telah direvisi sesuai dengan saran reviewer (admin). Bagian yang direvisi diberi highlight warna kuning.

Salam,
Sansaloni Butar Butar

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The effects of Corporate Governance, Audit Quality, and Conservatism on Loan Collateral Requirements

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ABSTRACT

In competitive credit markets, borrowers and lenders have equal information on default risks. Under these circumstances, loan collateral are less important in credit decision-making. But in emerging credit market, like Indonesia, borrowers and lenders do not possess equal information on firms' future prospect, making use of collateral in mitigating default risk have become common practice. Despite strong theoretical support for the use of collateral to protect lenders from default risk, excessive protection may have a negative effect on the debt markets. However, some Indonesian firms are not required to provide collateral for bank debts. This study examines the effect of Board of Commissioners independence, governance committees, audit quality, and conservatism on the likelihood of using loan collateral. Using slovin formula, as much as 785 firm listed in Indonesia Stock Exchange were collected during sample period of 2012-2015. Logistic regression analysis suggest that firms with higher Board of Commissioners independence, having separate governance committee, hire Big 4 auditors, apply conservative accounting policies are less likely to provide loan collateral.

Keywords: Collateral, conservatism, Board of Commissioners independence, audit quality, Governance committees.

INTRODUCTION

Bank loans have become major sources of funding for businesses in Indonesia and their contribution to national economic growth are very significant. The Governor of Bank Indonesia once said that bank lending had grown by 12.7% during September 2018 and the largest increase was in the investment loan segments [1]. A research in 2015 conducted by The Financial Services Authority (OJK) found that the allocation of bank lending in the agriculture, hunting and forestry sectors had positive effects on regional economic growth in most regions of Indonesia, except Maluku and Papua [38].

Bank loans help firms accelerating growth and expanding various business activities. A recent study conducted in African countries shows that firms with no credit constraints had exhibited faster growth relative to those with credit constraints [16]. Firms may also use bank loans to execute business plans and to make sure that all claims are paid as scheduled. In return for providing investment credits, banks earn interest revenue. In fact, interest revenue has become a major source of income, enabling them to grow and offer a wide variety of services. However, banks must carefully assess credit worthiness and grant credits based on prudent business decisions. Banks must have comprehensive knowledge of borrowers' track records and their abilities to pay bank loans as stated in debt contracts. Default risks are always there and can hardly eliminate completely.

The Financial Services Authority of Indonesia released a regulation Number 42/POJK.03/2017 that requires loan agreements to be specified in written contracts [38]. In addition to interest terms, due dates and some other information, collateral requirements should be stated explicitly. Loan collateral is a buffer against default risk arising from moral hazard [25]. Arguably, the collateral serves as a controlling mechanism to prevent unexpected problems arising from the information asymmetry between internal and external parties. Borrowers with lower default risk tend to choose mild terms of contracts which impose lower collateral. On the other hand, lenders consider collateral as a safety net because default risks can never be eliminated completely.

A popular view to support the use collateral is to prevent friction between lenders and borrowers. These frictions arise because of moral hazard problems [25]. Specifically, collateral is a signal that helps mitigate information asymmetry between borrowers and lenders [12]. The fact that lenders have rights to confiscate assets pledged as collateral pressurize borrowers to obey contract agreements. Moral hazard factors are relatively more dominant than information asymmetry when considering the amount of collateral to provide [18]. The use of collateral is central on loan contracts because it helps overcome agency conflicts arising from information asymmetry and incentive problems [25].

However, an analytic study show that in markets where asymmetric information exist, collateral may cause negative incentive [31]. Collateral induce borrower to gamble for resurrection with the project output. In fact, the use of collateral is higher for borrowers with lower credit quality [23] and the likelihood to pledge assets as collateral is lower in countries with higher uncertainty avoidance and corporate ethical behavior [34]. Overall, these prior studies suggest that collateral requirements depend on credit markets development and firms'characteristics.

Unsecured loan can be agreed as long as lenders believe that the borrowers' ability to pay loan interest and its principal are very high [34]. The use of collateral varies widely among countries ranging from 23% in Brazil to 100% in Guinea and Sudan. Types of loan contracts might differ between countries, especially in developing countries where credit markets are not as competitive as developed markets.

As a developing country, loan contracts with no collateral requirements can also be observed in Indonesia. The following are some examples of bank loans with no collateral requirements found in annual reports. PT Astagraphia Tbk received a loan of Rp 100 billion from PT Bank OCBC NISP Tbk with no collateral requirement in 2013. This can be observed in the firm's annual report. No collateral loan was also received by PT Unilever Indonesia Tbk from Deutsche Bank AG, PT Bank Mizuho Indonesia, JP Morgan Chase, and The Hongkong and Shanghai Banking Corporation Ltd. in 2014 with a total loan of Rp 1250 billion. In addition to the two companies, unsecured loan was also granted by Standard Chartered Bank to PT United Tractors Tbk with a total loan of Rp 82.8 billion in 2015.

Prior studies linking corporate governance with credit quality show that good corporate governance reduces the probability of financial distress and credit risk [17], [18]. Corporate governance lowers the amount of collateral [18]. However, Prior studies on the association between amount of collateral and corporate governance find inconsistent results [26]. Therefore, the role of corporate governance in reducing default risk is not conclusive and more studies are required to deepen our understanding.

Other studies focus on the association between audit quality and collateral [40], [43]. These studies presumed that the quality of financial reports are largely affected by audit quality. One study suggests that lenders pay considerable interest in the firm's financial statements when assessing credit worthiness [10]. Other studies find that observed effects of financial information on loans contracts arising from reduced credit risks [27] and the use of collateral is negatively related to audit quality [40]. Using auditor industry expertise as a proxy for audit quality, one study finds that firms hiring industry-specialist auditors receive lower interest rate and less likely to use loan collateral [43].

In addition to the auditor's attributes, the quality of financial statements is also influenced by the accounting policies underlying the preparation of financial statements. Firms with more conservative accounting applications exhibit less moral hazard problems and accelerates covenant violations [4]. A study by [11] shows that conditional conservatism decreases earnings persistence. Another study finds that application of conservative accounting increases contract efficiency of contract-based accounting numbers for limiting the ability of managers to exploit the firm's resources [3]. As a reward for applying more conservative accounting, lenders may be willing to reduce the amount of collateral or require firms to provide no collateral at all.

This study attempts to identify the determinant of no-collateral bank loans. Unlike previous studies that have focused on the extent to which collateral are used on loan contracts, the present study mainly focus on why banks impose no collateral on loan contracts. In addition, this study propose a new variable that has not been examined in prior studies. The new variable is Governance Committee. Although imposing no-collateral on bank loans contracts are not very common, investigating determinants of no-collateral loans is crucial especially in less competitive credit markets as Indonesia. More specifically, this study examines the effect of corporate governance, audit quality, and conservatism on loan contracts. Board of Commissioners independence and the existence of the Governance committee are used as a proxy for corporate governance. Note that this study is limited to bank loans. Unlike other kind of loans, information on bank loans are accessible from annual reports of public companies. Four variables are prediced to be associated with no-collateral bank loans, namely Board of Commissioners, Governance Committee, audit quality, and conservatism. A logistic regression model with four control variables are employed to test hypotheses.

The rest of paper is organized as follows: Section 2 discusses relevant literature and hypothesis development. Section 3 describes sample selection procedure. Section 4 reports results and discussion. Section 5 presents conclusion and suggestion for future research.

Corporate Governance and Board of Commissioners.

Agency theory describes the pattern of relationships among parties with various interests on firm. They describe the relationship as a contract requiring managers to act in the best interests of shareholders. Unfortunately, managers'interests are often in disagreement with shareholders' leading to conflict of interests. Agency conflict may reduce the expected value of cash flows and increase the probability of financial distress [2]. Increased financial distress will in turn increase credit risks and amount of collateral. Therefore, firms need to create a monitoring mechanism that help promoting the alignment of interests between managers and shareholders. In modern corporations, monitoring mechanism advocated by agency theory is more popularly called corporate governance.

Corporate governance generally refers to policies that govern processes and structures in companies aiming to uphold transparency, accountability, responsibility, independence and fairness. Specifically, Corporate governance is a set of processes that directs managers to act for the best interest of shareholders and helps build investor confidence in the capital market [36]. In sum, corporate governance is related to the systems and procedures governing all firm's activities which help protect shareholders from dysfunctional behavior of managers. Corporate governance and investor protection have generally improved following asian financial crises during the late 1990s [22].

As a part of corporate governance organs, Board of Directors are responsible for urging managers to follow sound managerial practices. A report for the finance ministries of countries included in the G20 group released by the Organization for Economic Co-operation and Development (OECD) in 2015 states that an effective Board of Directors requires firms to hire members with adequate expertise in monitoring functions and ability to exercise the function independently [33]. Board of Directors must be able to act independently and freely from psychological constraints when giving criticism, suggestions or recommendations for managers. The report also requires the existence of independent external auditors to give reasonable assurance that the financial statements have been free from material misstatements. Audited financial reports provide greater assurance that financial statement faithfully reflect the firm's underlying economics [13].

One corporate governance organ that has been largely established by Indonesian public companies is Board of Commissioners. Regulation in Indonesia require public companies to form two distinct Boards, namely Board of Directors and Board of Commissioners. Board of Commissioners main duties are to monitor managers and to make sure that managers have followed all rules and procedures. Board of directors are mainly responsible for managing and running the company. Compared to corporate governance practices of anglo-saxon countries, Board of Commissioner is essentially a synonym for board of directors which is commonly used in United States. Therefore, the two terms are used interchangeably in the rest of the paper.

A growing concern over managers' abuse of power accentuate the importance role of board of commissioners as a balancing party between shareholders and managers. As representative of shareholders, Board of commissioners ensure that managerial activities are directed toward shareholders' interests and these are reflected in firms' financial reports. Therefore, monitoring financial reporting processes becomes a central function of Board of Commissioners to mitigate agency problem [9], [15], [37], [41].

Collateral

Loan collateral has been widely used to overcome information and incentive problems [25]. Collateral prevents unexpected situation arising from moral hazard and adverse selection [2]. Setting aside some assets as a back up for future losses has become common practice in loan contract agreements. The contracts usually contain information about interest rates, maturity, amount of debt and other information.

Despite strong theoretical support for the use of collateral to protect lenders from default risk, excessive protection may have a negative effect on the debt markets.

Theoretical analysis of [28] show that in countries where excessive protection against default risks prevail, debt markets have been smaller than those of loose protection. In a competitive banking industry, banks usually provide additional service to help borrowers in selecting profitable projects. In contrast, unduly use of collateral causes banks to overlook projects feasibility assessments. Moreover, [28] suggest that relaxing the use of collateral in a loan contract increases economic efficiency and lower the likelihood of bankruptcy. In addition, small and medium enterprises have regularly complained about banks' too much reliance on collateral.

Recently, studies on determinants of loan collateral have been largely conducted in China and emerging economies [2], [12], [29], [37], [40]. A survey on young companies in China show that the market value of collateral exceeded 80% of loans [1]. Third parties guarantee on important asset can also be used as substitute for collateral in Thailand [29]. Taken together, unique business practices in developing countries, including Indonesia, provide better research setting to investigate the determinants of collateral due to higher information asymmetry and increasing use of collateral on bank loans relative to developed countries [1], [29].

Independent Board of Commissioners and Collateral

A variety of factors contribute to the failure of Board of Directors to prevent managers from intervening financial reporting processes, ranging board duality [37] to the lack of independence [41]. However, higher competence does not a guarantee of good monitoring function if Board of Directors cannot express their opinions and criticism freely against managers' action which are not consistent with firm' objectives. Thus, it is very important to hire people from outside who have no direct or indirect relationship with managers and firms because they are more courageous in expressing their opinions openly when meetings with firm's directors. This is especially true in relation with financial reporting process. A study of [33] report that higher proportion of independent directors are associated with lower earnings management. Moreover, a study of [35] provide additional evidence of negative relationship between earnings management and independent Boards.

The results cited above collectively suggest that weak oversight encourages managers to expropriate firm's resource by choosing accounting policies that can obscure a firm's poor performance from outside observations. Financial statements no longer reflect true economic condition and potentially mislead users. As a result, probability of financial distress and default risks increase. Note once again that the term 'board of directors' and 'board of commissioners' are used interchangeably in this study.

A study of [35] examine the effect of corporate governance on collateral requirements using firms listed on the Shanghai and Shenzhen capital markets of China. They argue that independent directors are expected to perform effective monitoring function relative to inside directors because bad monitoring performance may ruin their reputation in market for directors. In effect, independent directors reduce the ability of managers to opportunistically hiding bad financial results and thus reducing financial distress and credit risk. They find higher proportion of independent directors is associated with lower default risks. The finding suggests that effective Board of Directors increases investor confidence in financial reports. Such confidence reduces the use of collateral in bank loan contracts.

Based on preceding discussions and prior empirical findings, the association between collateral and proportion of independent commissioners is stated in the following hypothesis:

H_1. Firms with more independent Board of Commissioners are less likely to use collateral in loan contracts.

Governance Committee and Collateral

Corporate governance system provides guidance for every individual in the company to perform functions and responsibilities consistently and in harmony with the company's goals. A good corporate governance system protect companies from adverse events and situation that might effect firm's long-term objective because it help mitigate agency conflicts. These agency conflicts may reduce expected value of cash flow and increase the propensity of financial distress [2]. When financial distress increases, credit risks will also increase and creditors demand higher collateral [12].

As one element of good corporate governance, Board of Commissioners are formed to protect long-term interests of shareholders. But as business activities are becoming increasingly complex, monitoring function of Board of Commissioners are also getting complex. In this complex situation, some companies have formed separate corporate governance committee to help the Board of Commissioners in maintaining governance policies implementation throughout company. Examples of firms listed on the Indonesia Stock Exchange that have formed a separate Governance Committee including PT United Tractor Tbk., PT Indofarma Tbk., And PT Indika Energy Tbk.

Annual reports of firms that disclose information on Governance Committee show that the Committee was under supervision of Board of Commissioners with main tasks of guiding and maintaining the application of good governance practices in all aspects of company. However, corporate governance system and procedures may differ among companies. No formal model is suitable to all kinds of firms because each firm has different business model. Tasks and authorities given to the governance committee are firm-specific. In medium-scale companies, Governance Committees are responsible for evaluating and providing input for Board of Commissioners to improve corporate governance practices, assess internal control system adequacy, and implement risk management system. In larger companies, the task of assessing internal control adequacy lie in the Audit Committee and risk management is part of Risk Management Committee tasks.

Establishing separate governance committees is indicative of a firm's desire and strong determination to pursue the best business practices. An effective corporate governance committees enhances firm's ability to anticipate uncertainties and fundamental changes which threaten frim's competitiveness in the future. Firms having corporate governance committees show strong commitment of prudent business practices and constant efforts to maintain financial stability. Thus, firms with effective governance committee are less likely to experience bank loan default making lender to relax collateral requirements. The association between corporate governance committee and collateral is stated in the following hypothesis

H_2. Firms with governance committee are less likely to use collateral in loan contracts.

Audit Quality and Collateral

Audited financial information add user's confidence on the outcome of their economic decisions. However, reliable financial statements vary across firms. Beside firm's innate characteristics, audit quality also contribute to reliable financial statements [13]. Audit quality commonly refers to the ability of auditors to detect and report material misstatements resulting from violations of generally accepted accounting principles. But according to [13], however, audit quality is not limited to detecting material misstatements but also giving assurance that financial statements reflect true economic realities.

Moreover, [13] states that auditor characteristics are associated with increased audit quality. Auditors of Big Four accounting firms are expected to provide higher audit quality relative to non-Big Four auditors because the urge to maintain their reputation forcing them to provide high-quality audit services. An empirical study comparing the magnitude of abnormal accruals between firms audited by Big Six auditors and non-Big Six auditors shows that firms with Big Six auditors report lower abnormal accruals [13]. The result suggests that financial statements audited by Big Six auditors are of higher quality. Another researcher focuses on the relation between quality of financial statements and debt contracts and find that lower quality of financial statements affects debt contracts agreements [27]. In additon, a study of [20] show that reduced credit risks are associated with higher financial reports quality.

The preceding discussion suggest that high qualified auditors are more likely to improve the reliability of financial statements then auditors with lower quality. In turn, higher financial statements quality improve credit granting decisions resulting in lower default risks. If default risk decreases, then collateral requirements will also decrease. The association between audit quality and collateral requirements is stated in the following hypothesis:

H_3: Firms with higher audit quality are less likely to use collateral in loan contracts.

Conservatism and Collateral

Accounting conservatism is one of basic concepts underlying financial statements that many believe reduce agency problem, arising from asymmetry information [4]. Conceptually, there are two types of conservatism: conditional conservatism and unconditional conservatism. However, most studies on conservatism have focused on conditional conservatism [7], [10]. Conditional conservatism generally refers to the timely recognition of events or transactions that result in lower earnings or assets and delay recognition of those resulting in higher earning or assets. Lower earnings or assets are results of higher degree of verification for recognizing good news relative to bad news [30].

Chen et al. (2013) argue that there are two advantages of applying conservative accounting [12]. First, accounting conservatism accelerates violations of debt contracts making transfer of control from borrowers to lenders faster. Second, understatement of net assets allows lenders to determine the lower limit of collateral. This is quite important since assets pledged as collateral determine the remaining debt default that can be covered through collateral [5]. Conservatism is essential in credit assessment because it gives lenders early warning of default risks [42]. Lenders reward timely loss recognition when net asset values become more reliable. Riskier borrower display larger increases in conservatism when lending requirements are tightened [24].

The preceding discussion suggests that firms applying conservative accounting are less likely to have financial difficulty and loan default. It follows that the more conservative borrowers' accounting systems that deals with losses, the lower the probability of using loan collateral. Based on this argument, the relationship between conservatism and collateral is hypothesized as follows:

H_4: Firms with more conservative accounting are less likely to use collateral in loan contracts.

RESEARCH METHOD

The test of hypotheses are conducted by estimating the following logistic regression model:

$$COLET_{it} = \beta_0 + \beta_1 INDP_{it} + \beta_2 GOVCOM_{it} + \beta_3 AUDIT_{it} + \beta_4 CONCER_{it} + \beta_5 SIZE_{it} + \beta_6 ROA_{it} + \beta_7 LEV_{it} + \beta_8 AGE_{it} + e_{it}.$$

Where,

COLET =Collateral is a dummy variable equal to 1 if a loan contract requires collateral 0 otherwise.
INDP =Board of Commissioners independence is a proportion of outside commissioners sitting in board of commissioners.
GOVCOM = Governance committee is a dummy variable equal to 1 if a firm has a separate governance committee and otherwise.
AUDIT =A dummy variable equal to 1 if a firm affiliate with Big Four and 0 otherwise
CONCER=Conservatism proxied by market to book value ratio.
SIZE =Firm size is measured by log of total assets.
ROA =Return on asset is the ratio of net income to total assets.
Lev =Leverage is the ratio of total liabilities to total assets
AGE= age of firm is natural logarithm of age of the company.

Test of hypotheses are carried out using logistic regression. The four hypotheses are supported if $\beta1$, $\beta2$, $\beta3$, and $\beta4$ are negatives and statistically significant.

Measures of Variables.

Loan Collateral

Two measures of collateral are commonly used in literature,. The first one is the proportion of collateral loans to total loan outstanding [12], [40]. and the second is to use indicator variable to separate bank loans into loans with no collateral and with collateral [23]. A firm's annual report is observed manually to determine the use of loan collateral. Due to difficulty to track the amount of collateral in financial statement, this study uses indicator variables coded 1 if bank loans require collateral and 0 otherwise.

Independent Board of Commissioners

Based on Bapepam-LK, an independent commissioner refers to outside commissioners who have no business interests directly or indirectly with company. Consistent with prior studies, a measure of independent Board of commissioners is the proportion of outside commissioners divided by total commissioners [33], [35], [41].

Governance Committee

Only few companies listed in Indonesia Stock Exchange in the period of 2012-2015 establish Governance Committee. Note that this committee is responsible to Board of commissioners. This study uses an indicator variable to assess the effect of Governance Committees on collateral. Firms with Governance Committee is set to 1 and 0 otherwise. Information on Governance Committee is obtained from firm's annual report.

Audit Quality

Most prior studies used auditor size as a proxy for audit quality. It is argued that large accounting firms have stronger incentives and competencies to provide hide audit quality [13]. Following prior studies, this study uses an indicator variable equal to 1 if firms hired Big Four affiliated accounting firms and 0 otherwise. Auditors from Big Four accounting firms are expected to have higher audit skills than non-Big Four because they are vulnerable target in misleading financial reports lawsuits and thus motivated to provide high quality of audit.

Conservatism

Currently, several measures of conservatism have been introduced in the accounting literature. Each method has its strengths and weaknesses. In this study, I use market to book value ratio (MTB) as a proxy for conservatism. Despite its simplicity, the measure has a strong theoretical basis which is derived from theoretical study of [14]. The model posits that conservative use of accounting suppresses book value of equity and causes book value to be biased downward. Thus, higher MTB reflect higher application of conservative accounting in financial reporting. MTB is the most popular proxy for conservatism among researchers [39]. Market To Book value (MTB) ratio is calculated as follows:

$$\text{MTB} = \frac{Market\ Value\ of\ Equity}{Book\ Value\ of\ Equity}$$

Where, market value of equity (market capitalization) is defined as stock price multiplied by outstanding shares and book value of equity is total assets less total liabilities.

Control Variables

Four control variables are included in the regression model to control for differences in firm characteristics. They are leverage (Liabilities / Total Assets), firm size (log of total assets), profitability (net income /total asset), and firm age ((natural logarithm of firm's age). Prior results suggests that these control variables are associated with collateral [2], [12], [23].

Data and Sample Selection

Firms samples are selected from Indonesia Stock Exchange from 2012-2015 using Slovin formula (n = N / 1 + Ne2). With margin error of 5% and 1.930 firms (N) registered in the period of four years, a minimum samples to be collected are 331 firm-year samples. But to increase generalization, a number of firms are added so that the proportion is up to 40% of all listed companies during the sample periods. If annual report of a company does not provide necessary information to measure variables, the process of random selection is repeated to replace firms with missing data. Sample period of 2012-2015 is chosen because during these years a number of firms were not required to provide collateral in loan contracts. After whole process, as much as 785 companies were selected and used in test of hypotheses.

Descriptive Statistics

As described in previous section, Slovin formula generated 785 firm-year observations for the test of hypotheses. Descriptive statistics for each variable are presented in table 1.

Table 1. Descriptive Statistics.

Variables	Mean	Median	Minimum	P75	Maximum
OLET	0,9	1	0	1	1
INDP	0,42	0,38	0,2	0,5	1

GOVCOM	0,09	0	0	0	1
AUDIT	0,42	0	0	1	1
CONCER	1,75	1,23	-10,83	2,32	13,56
SIZE	28,87	28,8	23	30,16	34
ROA	4,89	3,76	-54,62	8,14	87,27
LEV	0,58	0,52	0,03	0,69	7,69
AGE	34,22	33	6	43	132

Mean for Collateral (COLET) is 0.9, suggesting that 10% of the sample firms do not use loan collateral. And the proportion of outside members in Board of Commissioners (INDP) is 42%, satisfying minimum requirement of 33%. Mean for Governance Committee (GOVCOM) is 9%, suggesting that 91% of the sample firms do not have separate Governance Committee. Meanwhile, only 42% of accounting firms have an affiliation with Big 4 accounting firms (AUDIT). Conservatism (CONCER) has a mean of 1.75, indicating that market value of equity is higher than the book value. It suggests that, on average, the sample-firms use more conservative accounting policies. The minimum and maximum values of the four control variables suggests considerable differences in firms' characteristics.

A more complete picture of loan collateral in relation with firm's characteristics is displayed in table 2. Sample-firms are split into two categories, firms having collateral requirements in their bank loan contracts (COLET = 1) and firms with no collateral requirements (COLET = 0). The statistics suggest that the collateral requirements group has lower Board of Commissioners independence, less governance committees, hired fewer Big 4 accounting firms, less conservative, and tend to have younger age than no-collateral group. However, profitability and leverage ratio are similar between these two groups. Overall, these statistics provide preliminary evidence to support H_1, H_2, H_3 and H_4.

Table 2. Collateral Versus Non-Collateral Requirements

	COLET=1	COLET=0	Mean	*P-VALUE*
Variables	Mean	Mean	Diff.	*(t-test)*
INDP	0,41	0,49	-0,08	0,000
GOVCOM	0,07	0,29	-0,22	0,000
AUDIT	0,37	0,87	-0,50	0,000
CONCER	1,68	2,38	-0,70	0,027
SIZE	28,68	30,63	-1,95	0,000
ROA	4,78	5,97	-1,19	0,463
LEV	0,57	0,63	-0,06	0,314
AGE	33,51	40,81	-7,30	0,000

For signaling purposes, firms establish a governance committee to show their strong commitment on sound business practices. Unlike the Audit Committee, no capital market regulations in Indonesia that requires public companies to form governance committees separately from Board of Commissioners. But some firms decided to form the committee. As reported in table 2, only 9% of the firm-samples establish governance committee. The characteristic of firms that belong to these different groups are reported on table 3.

Table 3. Governance Committee Partition.

	GOVCOM= 1	GOVCOM= 0	Mean	*P-Value*
Variables	Mean	Mean	Diff.	*(t-test)*
COLET	0,69	0,92	-0,23	0,000
INDP	0,44	0,41	0,03	0,033
AUDIT	0,67	0,40	0,27	0,000
CONCER	1,8	1,74	0,06	0,789
SIZE	30,76	28,68	2,08	0,000
ROA	3,79	5,00	-1,21	0,321
LEV	0,64	0,57	0,07	0,304
AGE	40,92	33,55	7,37	0,002

Table 3 shows that on average firms with governance committee have fewer collateral loans, larger outside commissioners, hired more Big Four auditors, more conservative financial reporting, larger firm size and longer firm age than those with no governance committee. But level of conservatism, firm size and age between these two group are not statistically different

Correlation Coefficients

Table 4 presents the correlation coefficients between variables of interest. All variables, except leverage, are negatively associated with collateral. As predicted, audit quality and collateral are negatively associated with a correlation coefficient of -0.299. Independence of the Board of Commissioners and collateral are negatively associated with a correlation coefficient of -0.207 and consistent with prediction. The correlation between governance committee and collateral has a negative value of -0.222 and consistent with prediction as well. As predicted, conservatism and collateral are negatively associated with a correlation coefficient of -0.105. Overall, the results presented in table 4 provide preliminary evidence in favor of supporting H_1, H_2, H_3, and H_4.

Table 4. Correlation Coefficients.

	COLET	AUDIT	SIZE	ROA	AGE	INDP	LEV	GOV	CON
COLET	1								
AUDIT	-0,299**	1							
SIZE	-0,307**	0,530**	1						
ROA	-0,036**	0,124**	0,022	1					
AGE	-0,131	0,100**	0,229**	0,045	1				
INDP	-0,207**	0,073*	0,250**	-0,098**	0,079*	1			
LEV	-0.036	0,005	-0,059	-0,092**	0,062	0,180**	1		

GOVCOM	-0,222**	0,157**	0,318**	-0,035	0,128**	0,076*	0,037	1	
CONCER	-0,105**	0,07*	0,108**	0,181	0,021	0,084*	-0,089*	0,010	1

RESULTS AND DISCUSSION

Since collateral is a binary variable, test of hypotheses is carried out using logistic regression analysis. Table 5 reports the test results which is separated into two models, with and without control variables. Estimation of the two models shows that all hypotheses are supported at 5% and better. Four control variables, except firm size, have no significant effect on collateral. Adding four control variables do not alter the results. The results of the two model are qualitatively similar. Thus, all hypothesized variables in H1, H2, H3, and H4, are supported.

Hypothesis One

Hypothesis One that predicts a negative association between collateral and the proportion of independent commissioners is statistically supported at less than 1%. The findings suggest that firms with more independent commissioners are less likely to use loan collateral. Agency theory suggests that firms should establish monitoring mechanisms to minimize the negative effects of asymmetry information. In this perspective, independent commissioners are representative of the shareholders placed in the company to carry out the oversight function and mitigate opportunistic behavior of managers. The main task is to ensure that allocation of firm’s resource are in line with sound business practices and making sure that managers put their effort in the best interest of shareholders. An effective Board of commissioners increase creditors confidence that the firm has been well managed and allocation of resources has been directed to projects with positive net present value. In turn, good business management together with good corporate governance are expected to improve the company's financial performance and ultimately reduce default risk. Lower default risk increases the probability of granting credit without collateral requirements.

Table 5. Logistic regression results.

		Without Control			With Control		
Variables	*Exp. Sign*	Coefficients	SE	*P-value*	Coefficients	SE	*P-value.*
INDP	-	-4,526	1,012	0,000	-3,72	1,086	0,000
AUDIT	-	-2,286	0,358	0,000	-1,93	0,399	0,000
CONCER	-	-0,109	0,059	0,032	-0,116	0,065	0,037
GOVCOM	-	-1,243	0,326	0,000	-0,914	0,353	0,005
SIZE	-	-	-	-	-0,188	0,093	0,021
ROA	-	-	-	-	0,005	0,016	0,374
LEV	+	-	-	-	-0,033	0,513	0,475
AGE	-	-	-	-	-0,007	0,007	0,188

In addition, an effective Board of Commissioners is more likely to increase creditor's confidence in financial statements. Transparent financial reports statements that show the actual condition of the company are very important for creditors in assessing credit worthiness. Credit analysis that is not based on correct information increases the likelihood of default risk. If the creditor considers that the financial statements are not trustworthy so that the default risk increases, the creditor will be compelled to set guarantees for banks loans. The result suggests that creditors perceived that financial reports of firms having more independent Board of Commissioners are reliable and useful in prediction of default risks. The evidence is consistent with [2] who used samples from Chinese capital market. They show that independent directors reduce a firm's use of collateral.

Hypothesis Two

Hypothesis Two that predicts the existence of governance committee lower the probability of collateral imposed on bank loans are significantly supported at less than 1%. The findings suggests that firms with a governance committee is less likely to provide collateral for bank loans. Firms deliberately establish a separate governance committee give positive signals to lenders that these firms are committed to sound business practices and to uphold good corporate governance. Having a separate governance committee enable firms to focus on detecting potential risks and take preventive actions to avoid unnecessary situation that brings harm to future prospects. The existence of a governance committee increases creditor trust in the firm's ability to anticipate and overcome unpredicted changes of business environments. In short, lenders positively perceive the firm's ability to fulfill debt contracts. This is the first solid evidence of positive association between governance committee and collateral.

Note that forming a separate governance committee is not a common practice in public companies. The descriptive statistics described before show that only 9% of public companies in Indonesia voluntarily form a governance committee. This small percentage reflects that the majority of public companies in Indonesia have not given serious attention on the benefit of the committee to drive company performance. These companies seem to be quite satisfied with the existing governance system that has been established in accordance with regulation. They only try to meet the minimum requirements set by capital market regulators and are not willing to incur additional costs to form a committee that is responsible for the consistent implementation of corporate governance policies in every aspect of organization. Most public companies have not yet realized that creditors pay much consideration on the consistency of corporate governance implementation when assessing credit worthiness. Based on the findings of this study, it is recommended that public companies form a governance committee because it gives signal to creditors about sound business practices that companies has implemented. It follows that sound business practices will reduce default risk.

Hypothesis Three

Hypothesis Three that predicts firms hiring Big Four auditors is less likely to use collateral in bank loan contracts. Big accounting firms are expected to provide higher audit service leading to higher accounting reports quality. Higher accounting reports quality lower default risk and the use of collateral. Consistent with the prediction, the results show that audit quality and collateral are negatively associated at less than 1% level of significance. The findings suggest that Big Four auditors add to the credibility of financial reports. Lenders perceive the Big Four's audited financial statements are more transparent and reliable in assessing the firm's ability and thus reduce agency costs. In return, banks do not impose collateral requirements of their bank loans.

Agency theory suggests that asymmetry information results in conflict of interests between managers and shareholders. There should be minotoring mechanisms to protect shareholders from manager dysfunctional behavior. External audit is regarded as one of the monitoring mechanisms to increase transparency of financial statements and reduce credit risk. Audited financial statements help creditors make credit decisions effectively. Ratio analysis that has relied upon figures presented in financial statements will be more useful in assessing the ability of companies to pay bank loans if the ratio reflect the company's ability to generate cash in the future and pay its debt. If the creditor believes that these figures reflect the firm's real financial condition, then the requirement to provide collateral on bank loans may not be necessary at all.

The result is consistent with [40] using firms listed in Chinese capital market are used to test the association between audit quality and collateral. In the study, audit quality and the use of collateral are found to be negatively associated. He interpreted the evidence as creditors regard collateral and higher audit quality as alternative means of reducing credit risk.

Hypothesis Four

Hypothesis Four that predicts firms applying more conservative accounting tend not to use loan collateral. The analysis support the hypothesis at 5% level of significance. The findings reported on table 5 suggest that lenders put more trust on financial statements under conservative accounting policies. Conservative financial statements play an important role in fulfilling debt contracts between lenders and borrowers. In the creditor perspective, borrowers implementing more conservative financial reports have a lower chance of violating debt contracts than non-conservative financial reporting [42]. As widely discussed in literature, application of conservative accounting result in reduced earnings. The argument is that conservative accounting recognizes potential losses (costs) faster than revenues (assets). A slower recognition of revenues suppresses earnings and worsen leverage ratios which is commonly used to assess a firm's ability to its debt. The fact that companies keep applying more conservative accounting policies are interpreted by lenders as positive signal of a firm's commitment to prudent business management. As a result, lenders are more willing to provide lenient loan contracts through absent of collateral. While using different proxy, result of [12] show similar findings. They measure collateral as a percentage of collateral to total bank loans and provide evidence of application of conservative accounting reduces bank collateral.

CONCLUSION

Problems of moral hazard intensify friction between lenders and borrowers, causing agency costs to increase. To minimize such costs, lenders impose collateral in debt contracts. Prior analytical and empirical studies support the use of collateral to reduce default risks. On the other hand, opposing views argue that in a competitive credit market where lenders and borrowers possesses equal assessment of creditworthiness, collateral are no longer needed. At worse, collateral requirements create noncompetitive credit markets. Thus, research on determinants of no-collateral requirements of bank loans in emerging credit markets as Indonesia banking industry is still an interesting topic. I examine the firms' characteristics that influence lenders to relax loan collateral. Four factors are expected to effect loan requirements: Board of Commissioners independence, governance committees, audit quality, and accounting conservatism. Logistic regression analysis confirm the association of these four variables with the use of collateral.

Firms with higher proportion of independent commissioners are less likely to provide loan collateral. The findings indicate that creditors perceive firms having more independent commissioners have the ability to pay their debts and these firms are not required to bank loan collateral. The main task of the Board of Commissioners is to monitor managers and to ensure that all firm's resources are used efficiently. Board of Commissioners will encourage managers to carry out their responsibilities properly and report financial results transparently. Transparent financial statements allow creditors to conduct credit analysis appropriately and assess credit worthiness properly. Granting bank loans without adequate information increases the risk of default. When creditor believe that financial statements are not prepared on the basis of sound standards, default risk is increasing. In anticipation of higher default risk, creditors require firms provide collateral.

Firms with a separate governance committee are less likely to provide loan collateral. Establishing a separate governance committee is not a common practice in public companies. Only 9% of public companies in Indonesia voluntarily form a governance committee. It seems that the majority of public companies in Indonesia decline the benefits of a governance committee in the company. These companies only maintain corporate governance system that meet the minimum requirements set by the capital market regulatory body and are not willing to form a governance committee because additional costs has to be incurred. Most public companies fail to realize that creditors would consider the consistency in implementation of corporate governance as important when assessing creditworthiness. Based on the findings of this study, public companies in Indonesia should form a governance committee because it can reduce default risk.

Firms with higher audit quality are less likely to impose loan collateral. Conflicts of interest between managers and shareholders triggered by asymmetry information can be minimized by an external audit. The audited financial statements add credibility to the financial statements, making it easier for creditors to make proper credit decisions. Ratio analysis that relies on figures presented in financial statements will be more useful in assessing the ability of companies to pay bank loans when these ratios reflect the ability of companies to pay their debts. If creditors believe that these figures reflect the real financial condition of the company, then the requirement to provide collateral for bank loans may not be necessary at all.

Firms applying more conservative accounting policies are less likely to provide loan collateral. Borrowers who apply conservative financial statements have a smaller chance of breaking debt contracts than those who implement non-conservative financial reporting. Firms with conservative accounting policies tends to report lower net income than non-conservative firms. This is quite understandable because conservative accounting policies recognize potential losses (costs) faster than income (assets). If revenue is recognized slower than expenses, debt ratios tend to be higher. Note that that debt ratios are commonly used in assessing default risk. However, firms may deliberately chose a more conservative accounting policy as a signal to creditors that the company had persistent earnings. As a consequence, lenders are willing to provide loan contracts with no collateral.

Limitation and Suggestions

This study measures collateral as a dummy variable. One disadvantage of discrete measure is unable to capture subtle differences in the firm's characteristic. Future research in Indonesia should consider to use continuous measure to provide deeper insight into the use of collateral in debt contracts. One alternative continuous measure is amount of collateral. In addition, subsequent research also needs to consider alternative measures for audit quality and conservatism to get robust and more generalized results. Alternative audit quality measures include audit fees, going-concern opinions, earnings management, and financial restatements. Alternative measures for conservatism include asymmetric timeliness measure [6], asymmetric cash flow to accruals measure [3], and negative accruals measure [19].

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[jak] Editor Decision

Dr. Juniarti, M.Si., Ak., CA. . <yunie@petra.ac.id> Wed, Apr 1, 2020 at 1:17 PM
To: sansaloni Butar Butar <sansaloni@unika.ac.id>

Dr. Sansaloni Butar Butar:

We have reached a decision regarding your submission to Jurnal Akuntansi dan Keuangan, "The effects of Corporate Governance, Audit Quality, and Conservatism on Loan Collateral Requirements".

Our decision is to:
We have found that you havent revised based on Reviewer B's review result. File review can be found by logging to your account and the review from Reviewer B is presented below. Please revise by attachment in this email Revisi Admin 30032020, we will wait this revision finished until next week on 8th of April 2020.

Dr. Juniarti, M.Si., Ak., CA. .
Accounting Department, Petra Christian University
yunie@petra.ac.id

Reviewer B:

Originality: Does the paper contain new and significant information adequate to justify publication?:
Yes, acceptable

Relationship to Literature: Does the paper demonstrate an adequate understanding of the relevant literature in the field and cite an appropriate range of literature sources? Is any significant work ignored?: :
Yes, enough and acceptable

Methodology: Is the paper's argument built on an appropriate base of theory, concepts, or other ideas? Has the research or equivalent intellectual work on which the paper is based been well designed? Are the methods employed appropriate?:
yes, enough

Results: Are results presented clearly and analysed appropriately? Do the conclusions adequately tie together the other elements of the paper?:
yes, acceptable

Implications for research, practice and/or society: Does the paper identify clearly any implications for research, practice and/or society? Does the paper bridge the gap between theory and practice? How can the research be used in practice (economic and commercial impact), in teaching, to influence public policy, in research (contributing to the body of knowledge)? What is the impact upon society (influencing public attitudes, affecting quality of life)? Are these implications consistent with the findings and conclusions of the paper?: :
yes, enough

Quality of Communication: Does the paper clearly express its case, measured against the technical language of the field and the expected knowledge of the journal's readership? Has attention been paid to the clarity of expression and readability, such as sentence structure, jargon use, acronyms, etc.
:
need to revise for descriptive statistic and for the preparation of result

COMMENTS TO THE AUTHOR(S):

see comments and notes on reviewed paper

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The effects of Corporate Governance, Audit Quality, and Conservatism on Loan Collateral Requirements

sansaloni Butar Butar <sansaloni@unika.ac.id> Sun, Apr 5, 2020 at 2:41 PM
To: "Editor in Chief, JAK" <jak-acc@petra.ac.id>, "Dr. Juniarti, M.Si., Ak., CA. ." <yunie@petra.ac.id>

I have revised my manuscript as suggested by reviewer B. But the following reviewer suggestions seems to be questionable and thus no revision made.

1. Reviewer B: Must be separated between dummy variables and continuous variables. For the dummy variable it is not possible to calculate the mean, but rather the frequency or proportion. Separate the table into Panel A for dummy variables and Panel B for continuous variables.

My argument: Statistically, the mean for any dummy variable points to a group frequency that has been coded 1. In this study, coded 1 firms refers to the collateral required firms. Therefore, the mean for COLET of 0.9, suggests that 90% of the sample firms are required to provide loan collateral. In act, I could easily add panel B for the dummy variable as suggested by reviewer B. But I need to show the fact that mean for any dummy variabel that is coded 1 is exactly the same as frequency. I have known this fact for long time.

2. Reviewer B: It is recommended to display the t-test. Besides that, the p-value is replaced by a star (* for ten percent level, ** for five percent level, and *** for 1 percent level).

My response: The recommendation of Reviewer B to present t values in table 5 had assumed that the multiple regression was performed in the test of hypotheses. In fact, as I had stated repeatedly in my manuscript, the test of hypothesis was performed by using logistic regression which is totally different statistics from multiple regression. Logistic regression does not recognize t values and SPSS output for logistic regression produce p-value (sig) to determine whether hypothesis is rejected or accepted.

Regard,
Sansaloni Butar Butar

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The Effects of Corporate Governance, Audit Quality, and Conservatism on Loan Collateral Requirements

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ABSTRACT

In competitive credit markets, borrowers and lenders have equal information on default risks. Under these circumstances, loan collateral are less important in credit decision-making. But in emerging credit market, like Indonesia, borrowers and lenders do not possess equal information on firms' future prospect, making use of collateral in mitigating default risk have become common practice. Despite strong theoretical support for the use of collateral to protect lenders from default risk, excessive protection may have a negative effect on the debt markets. However, some Indonesian firms are not required to provide collateral for bank debts. This study examines the effect of Board of Commissioners independence, governance committees, audit quality, and conservatism on the likelihood of using loan collateral. Using slovin formula, as much as 785 firm listed in Indonesia Stock Exchange were collected during sample period of 2012-2015. Logistic regression analysis suggest that firms with higher Board of Commissioners independence, having separate governance committee, hire Big 4 auditors, apply conservative accounting policies are less likely to provide loan collateral.

Keywords: Collateral, conservatism, Board of Commissioners independence, audit quality, Governance committees.

INTRODUCTION

Bank loans have become major sources of funding for businesses in Indonesia and their contribution to national economic growth are very significant. The Governor of Bank Indonesia once said that bank lending had grown by 12.7% during September 2018 and the largest increase was in the investment loan segments [1]. A research in 2015 conducted by The Financial Services Authority (OJK) found that the allocation of bank lending in the agriculture, labor and forestry sectors had positive effects on regional economic growth in most regions of Indonesia, except Maluku and Papua [38].

Bank loans help firms accelerating growth and expanding various business activities. A recent study conducted in African countries shows that firms with no credit constraints had exhibited faster growth relative to those with credit constraints [16]. Firms may also use bank loans to execute business plans and to make sure that all claims are paid as scheduled. In return for providing investment credits, banks earn interest revenue. In fact, interest revenue has become a major source of income, enabling them to grow and offer a wide variety of services. However, banks must carefully assess credit worthiness and grant credits based on prudent business decisions. Banks must have comprehensive knowledge of borrowers' track records and their abilities to pay off bank loans as stated in debt contracts. Default risks are always there and cannot be eliminated completely.

The Financial Services Authority of Indonesia released a regulation Number 42/POJK.03/2017 that requires loan agreements to be specified in written contracts [38]. In addition to interest terms, due dates and some other information, collateral requirements should be stated explicitly. Loan collateral is a buffer against default risk arising from moral hazard [25]. Arguably, the collateral serves as a controlling mechanism to prevent unexpected problems arising from the information asymmetry between internal and external parties. Borrowers with lower default risk tend to choose mild terms of contracts which impose lower collateral. On the other hand, lenders consider collateral as a safety net because default risks can never be eliminated completely.

A popular view to support the use of collateral is to prevent friction between lenders and borrowers. These frictions arise because of moral hazard problems [25]. Specifically, collateral is a signal that helps mitigate information asymmetry between borrowers and lenders [12]. The fact that lenders have rights to confiscate assets pledged as collateral pressurize borrowers to obey contract agreements. Moral hazard factors are relatively more dominant than information asymmetry when considering the amount of collateral to provide [18]. The use of collateral is central on loan contracts because it helps overcome agency conflicts arising from information asymmetry and incentive problems [25].

However, an analytic study show that in markets where asymmetric information exist, collateral may cause negative incentive [31]. Collateral induce borrower to gamble for resurrection with the project output. In fact, the use of collateral is higher for borrowers with lower credit quality [23] and the likelihood to pledge assets as collateral is lower in countries with higher uncertainty avoidance and corporate ethical behavior [34]. Overall, these prior studies suggest that collateral requirements depend on credit markets development and firms'characteristics.

Unsecured loan can be agreed as long as lenders believe that the borrowers' ability to pay loan interest and its principal are very high [34]. The use of collateral varies widely among countries ranging from 23% in Brazil to 100% in Guinea and Sudan. Types of loan contracts might differ between countries, especially in developing countries where credit markets are not as competitive as developed markets.

As a developing country, loan contracts with no collateral requirements can also be observed in Indonesia. The following are some examples of bank loans with no collateral requirements found in annual reports. PT Astagraphia Tbk received a loan of Rp 100 billion from PT Bank OCBC NISP Tbk with no collateral requirement in 2013. This can be observed in the firm's annual report. No collateral loan was also received by PT Unilever Indonesia Tbk from Deutsche Bank AG, PT Bank Mizuho Indonesia, JP Morgan Chase, and The Hongkong and Shanghai Banking Corporation Ltd. in 2014 with a total loan of Rp 1250 billion. In addition to the two companies, unsecured loan was also granted by Standard Chartered Bank to PT United Tractors Tbk with a total loan of Rp 82.8 billion in 2015.

Prior studies linking corporate governance with credit quality show that good corporate governance reduces the probability of financial distress and credit risk [17], [18]. Corporate governance lowers the amount of collateral [18]. However, Prior studies on the association between amount of collateral and corporate governance find inconsistent results [26]. Therefore, the role of corporate governance in reducing default risk is not conclusive and more studies are required to deepen our understanding.

Other studies focus on the association between audit quality and collateral [40], [43]. These studies presumed that the quality of financial reports are largely affected by audit quality. One study suggests that lenders pay considerable interest in the firm's financial statements when assessing credit worthiness [10]. Other studies find that observed effects of financial information on loans contracts arising from reduced credit risks [27] and the use of collateral is negatively related to audit quality [40]. Using auditor industry expertise as a proxy for audit quality, one study finds that firms hiring industry-specialist auditors receive lower interest rate and less likely to use loan collateral [43].

In addition to the auditor's attributes, the quality of financial statements is also influenced by the accounting policies underlying the preparation of financial statements. Firms with more conservative accounting applications exhibit less moral hazard problems and accelerates covenant violations [4]. A study by [11] shows that conditional conservatism decreases earnings persistence. Another study finds that application of conservative accounting increases contract efficiency of contract-based accounting numbers for limiting the ability of managers to exploit the firm's resources [3]. As a reward for applying more conservative accounting, lenders may be willing to reduce the amount of collateral or require firms to provide no collateral at all.

This study attempts to identify the determinant of no-collateral bank loans. Unlike previous studies that have focused on the extent to which collateral are used on loan contracts, the present study mainly focuses on why banks impose no collateral on loan contracts. In addition, this study proposes a new variable that has not been examined in prior studies. The new variable is Governance Committee. Although imposing no-collateral on bank loans contracts are not very common, investigating determinants of no-collateral loans is crucial especially in less competitive credit markets as Indonesia. More specifically, this study examines the effect of corporate governance, audit quality, and conservatism on loan contracts. Board of Commissioners independence and the existence of the Governance committee are used as a proxy for corporate governance. Note that this study is limited to bank loans. Unlike other kind of loans, information on bank loans are accessible from annual reports of public companies. Four variables are prediced to be associated with no-collateral bank loans, namely Board of Commissioners, Governance Committee, audit quality, and conservatism. A logistic regression model with four control variables are employed to test hypotheses.

The rest of paper is organized as follows: Section 2 discusses relevant literature and hypothesis development. Section 3 describes sample selection procedure. Section 4 reports results and discussion. Section 5 presents conclusion and suggestion for future research.

Corporate Governance and Board of Commissioners.

Agency theory has been also applied to describes the agency conflict between creditors and managers in modern corporation [2]. The agency conflict may reduce the expected value of cash flows and increase the probability of financial distress [2]. Increased financial distress will in turn increase credit risks and amount of collateral. Therefore, firms need to create a monitoring mechanism that help promoting the alignment of interests between managers and shareholders. In modern corporations, monitoring mechanism advocated by agency theory is more popularly called corporate governance.

Corporate governance generally refers to policies that govern processes and structures in companies aiming to uphold transparency, accountability, responsibility, independence and fairness. Specifically, Corporate governance is a set of processes that directs managers to act for the best interest of shareholders and helps build investor confidence in the capital market [36]. In sum, corporate governance is related to the systems and procedures governing all firm's activities which help protect shareholders from dysfunctional behavior of managers. Corporate governance and investor protection have generally improved following asian financial crises during the late 1990s [22].

As a part of corporate governance organs, Board of Directors are responsible for urging managers to follow sound managerial practices. A report for the finance ministries of countries included in the G20 group released by the Organization for Economic Co-operation and Development (OECD) in 2015 states that an effective Board of Directors requires firms to hire members with adequate expertise in monitoring functions and ability to exercise the function independently [33]. Board of Directors must be able to act independently and freely from psychological constraints when giving criticism, suggestions or recommendations for managers. The report also requires the existence of independent external auditors to give reasonable assurance that the financial statements have been free from material misstatements. Audited financial reports provide greater assurance that financial statement faithfully reflect the firm's underlying economics [13].

One corporate governance organ that has been largely established by Indonesian public companies is Board of Commissioners. Regulation in Indonesia require public companies to form two distinct Boards, namely Board of Directors and Board of Commissioners. Board of Commissioners main duties are to monitor directors and to make sure that directors have followed all rules and procedures. Board of directors are mainly responsible for managing and running the company. Compared to corporate governance practices of anglo-saxon countries, Board of Commissioner is essentially a synonym for board of directors which is commonly used in United States. Therefore, the two terms are used interchangeably in the rest of the paper.

A growing concern over managers' abuse of power accentuate the importance role of board of commissioners as a balancing party between shareholders and managers. As representatives of shareholders, Board of commissioners ensure that managerial activities are directed toward shareholders' interests and these are reflected in firms' financial reports. Therefore, monitoring financial reporting processes becomes a central function of Board of Commissioners to mitigate agency problem [9], [15], [37], [41].

Collateral

The loan collateral has been widely used to overcome information and incentive problems [25]. Collateral prevents unexpected situation arising from moral hazard and adverse selection [2]. Setting aside some assets as a back up for future losses has become common practice in loan contract agreements. The contracts usually contain information about interest rates, maturity, amount of debt and other information.

Despite a strong theoretical support for the use of collateral to protect lenders from default risk, excessive protection may have a negative effect on the debt markets. Theoretical analysis of [28] show that in countries where excessive protection against default risks prevail, debt markets have been smaller than those of loose protection. In a competitive banking industry, banks usually provide additional service to help borrowers in selecting profitable projects. In contrast, unduly use of collateral causes banks to overlook projects feasibility assessments. Moreover, [28] suggest that relaxing the use of collateral in a loan contract increases economic efficiency and lower the likelihood of bankruptcy. In addition, small and medium enterprises have regularly complained about banks' too much reliance on collateral.

Recently, studies on determinants of loan collateral have been largely conducted in China and emerging economies [2], [12], [29], [37], [40]. A survey on young companies in China show that the market value of collateral exceeded 80% of loans [1]. Third parties guarantee on important asset can also be used as substitute for collateral in Thailand [29]. Taken together, unique business practices in developing countries, including Indonesia, provide better research setting to investigate the determinants of collateral due to higher information asymmetry and increasing use of collateral on bank loans relative to developed countries [1], [29].

Independent Board of Commissioners and Collateral

A variety of factors contribute to the failure of Board of Directors to prevent managers from intervening financial reporting processes, ranging board duality [37] to the lack of independence [41]. However, higher competence does not a guarantee of good monitoring function if Board of Directors cannot express their opinions and criticism freely against managers' action which are not consistent with firm' objectives. Thus, it is very important to hire people from outside who have no direct or indirect relationship with managers and firms because they are more courageous in expressing their opinions openly when meetings with firm's directors. This is especially true in relation with financial reporting process. A study of [33] report that higher proportion of independent directors are associated with lower earnings management. Moreover, a study of [35] provide additional evidence of negative relationship between earnings management and independent Board.

The results cited above collectively suggest that weak oversight encourages managers to expropriate firm's resource by choosing accounting policies that can obscure a firm's poor performance from outside observations. Financial statements no longer reflect true economic condition and potentially mislead users. As a result, probability of financial distress and default risks increase. Note once again that the term 'board of directors' and 'board of commissioners' are used interchangeably in this study.

A study of [35] examines the effect of corporate governance on collateral requirements using firms listed on the Shanghai and Shenzhen capital markets of China. They argue that independent directors are expected to perform effective monitoring function relative to inside directors because bad monitoring performance may ruin their reputation in market for directors. In effect, independent directors reduce the ability of managers to opportunistically hiding bad financial results and thus reducing financial distress and credit risk. They find higher proportion of independent directors is associated with lower default risks. The finding suggests that effective Board of Directors increases investor confidence in financial reports. Such confidence reduces the use of collateral in bank loan contracts.

Based on preceding discussions and prior empirical findings, the association between collateral and proportion of independent commissioners is stated in the following hypothesis:

H_1. Firms with more independent Board of Commissioners are less likely to use collateral in loan contracts.

Governance Committee and Collateral

Corporate governance system provides guidance for every individual in the company to perform functions and responsibilities consistently and in harmony with the company's goals. A good corporate governance system protect companies from adverse events and situation that might effect firm's long-term objective because it help mitigate agency conflicts. These agency conflicts may reduce expected value of cash flow and increase the propensity of financial distress [2]. When financial distress increases, credit risks will also increase and creditors demand higher collateral [12].

As one element of good corporate governance, Board of Commissioners are formed to protect long-term interests of shareholders. But as business activities are becoming increasingly complex, monitoring function of Board of Commissioners are also getting complex. In this complex situation, some companies have formed a separate corporate governance committee to help the Board of Commissioners maintaining and enforcing governance policies throughout company. Examples of firms listed on the Indonesia Stock Exchange that have formed a separate Governance Committee including PT United Tractor Tbk., PT Indofarma Tbk., And PT Indika Energy Tbk.

Annual reports of those firms disclosing that Governance Committee is under the supervision of Board of Commissioners with main tasks of guiding and maintaining the application of good governance practices in all aspects of company. However, corporate governance systems and procedures may differ among companies. No formal model is suitable to all types of firms. Each firms has its unique business model. Tasks and authorities given to the governance committee are firm-specifics. In medium-scale companies, Governance Committees are responsible for evaluating and providing input for Board of Commissioners to improve corporate governance practices, assess internal control system adequacy, and implement risk management system. In larger companies, the task of assessing internal control adequacy lie in the Audit Committee and risk management is part of Risk Management Committee tasks.

Establishing a separate governance committee is indicative of the firm's desire and strong determination to pursue the best business practices. An effective corporate governance committee enhances firm's ability to anticipate uncertainties and fundamental changes that have threaten firm's competitiveness in the future. Firms having corporate governance committees are expected show strong commitment of prudent business practices and constant efforts to maintain financial stability. Creditors might perceive these firms as reliable and trustworthy firms with the adequate capabilities to meet financial obligations. In addition, applying prudent business practices prevent firms from unexpected consequences of changing business environments, leading to lower business risks. Thus, firms with effective governance committee are less likely to experience bank loan default making lender to relax collateral requirements. The association between corporate governance committee and collateral is stated in the following hypothesis

H_2. Firms having governance committees are less likely to use collateral in loan contracts.

Audit Quality and Collateral

Audited financial information add user's confidence on the outcome of their economic decisions. However, reliable financial statements vary across firms. Beside firm's innate characteristics, audit quality also contribute to reliable financial statements [13]. Audit quality commonly refers to the ability of auditors to detect and report material misstatements resulting from violations of generally accepted accounting principles. But according to [13], however, audit quality is not limited to detecting material misstatements but also giving assurance that financial statements reflect true economic realities.

Moreover, [13] state that auditor characteristics are associated with increased audit quality. Auditors of Big Four accounting firms are expected to provide higher audit quality relative to non-Big Four auditors because the urge to maintain their reputation forcing them to provide high-quality audit services. An empirical study comparing the magnitude of abnormal accruals between firms audited by Big Six auditors and non-Big Six auditors shows that firms with Big Six auditors report lower abnormal accruals [13]. The result suggests that financial statements audited by Big Six auditors are of higher quality. Another researcher focuses on the relation between quality of financial statements and debt contracts and find that lower quality of financial statements affects debt contracts agreements [27]. In additon, a study of [20] shows that reduced credit risks are associated with higher financial reports quality.

The preceding discussion suggest that high qualified auditors are more likely to improve the reliability of financial statements then auditors with lower quality. In turn, higher financial statements quality improve credit granting decisions, resulting in lower default risks. If default risk decreases, then collateral requirements will also decrease. The association between audit quality and collateral requirements is stated in the following hypothesis:

H_3: Firms with higher audit qualities are less likely to use collateral in loan contracts.

Conservatism and Collateral

Accounting conservatism is one of basic concepts underlying financial statements which may reduce agency problems, arising from asymmetry information [4]. Conceptually, there are two types of conservatism: conditional and unconditional conservatisms. However, most empirical studies on conservatism have focused on conditional conservatism [7], [10]. Conditional conservatism generally refers to the timely recognition of events or transactions which result in lower earnings or assets. These resulting effects of accounting conservatism are caused by applying higher degree of verification for recognizing good news relative to bad news [30].

According to [12], there are two advantages of applying conservative accounting. First, accounting conservatism accelerates violations of debt contracts making transfer of control from borrowers to lenders faster. Second, understatement of net assets allows lenders to determine the lower limit of collateral. This is quite important since assets pledged as collateral determine the remaining debt default that can be covered through collateral [5]. Conservatism is essential in credit assessment because it gives lenders early warning of default risks [42]. Lenders reward timely loss recognition when net asset values become more reliable. Riskier borrower display larger increases in conservatism when lending requirements are tightened [24].

The preceding discussion suggests that firms applying conservative accounting are less likely to have financial difficulty and loan default. It follows that the more conservative borrowers' accounting systems that deals with losses, the lower the probability of using loan collateral. Based on this argument, the relationship between conservatism and collateral is hypothesized as follows:

H_4: Firms applying more conservative accounting are less likely to use collateral in loan contracts.

RESEARCH METHOD

The test of hypotheses are conducted by estimating the following logistic regression model:

$$COLET_{it} = \beta_0 + \beta_1 INDP_{it} + \beta_2 GOVCOM_{it} + \beta_3 AUDIT_{it} + \beta_4 CONCER_{it} + \beta_5 SIZE_{it} + \beta_6 ROA_{it} + \beta_7 LEV_{it} + \beta_8 AGE_{it} + e_{it}.$$

Where,

COLET =Collateral is a dummy variable equal to 1 if a loan contract requires collateral 0 otherwise.
INDP =Board of Commissioners independence is a proportion of outside commissioners sitting in board of commissioners.
GOVCOM = Governance committee is a dummy variable equal to 1 if a firm has a separate governance committee and otherwise.
AUDIT =A dummy variable equal to 1 if a firm affiliate with Big Four and 0 otherwise
CONCER=Conservatism proxied by market to book value ratio.
SIZE =Firm size is measured by log of total assets.
ROA =Return on asset is the ratio of net income to total assets.
Lev =Leverage is the ratio of total liabilities to total assets
AGE= age is the number of years that a firm has been established expressed in natural logarithm.

Test of hypotheses are carried out using logistic regression. The four hypotheses are supported if $\beta 1$, $\beta 2$, $\beta 3$, and $\beta 4$ are negatives and statistically significant.

Measures of Variables.

Loan Collateral

Two measures of collateral are commonly used in literature,. The first one is the proportion of collateral loans to total loan outstanding [12], [40]. and the second is to use indicator variable to separate bank loans into loans with no collateral and with collateral [23]. A firm's annual report is observed manually to determine the use of loan collateral. Due to difficulty to track the amount of collateral in financial statement, this study uses indicator variables coded 1 if bank loans require collateral and 0 otherwise.

Independent Board of Commissioners

Based on regulations issued by OJK, an independent commissioner refers to outside commissioners who have no business interests directly or indirectly with company. Consistent with prior studies, a measure of independent Board of commissioners is the proportion of outside commissioners divided by total commissioners [33], [35], [41].

Governance Committee

Only few companies listed in Indonesia Stock Exchange in the period of 2012-2015 have established Governance Committee. Note that this committee is responsible to Board of commissioners. This study uses an indicator variable to assess the effect of Governance Committees on collateral. Firms with Governance Committee is set to 1 and 0 otherwise. Information on Governance Committee is obtained from firm's annual report.

Audit Quality

Most prior studies used auditor size as a proxy for audit quality. These studies argue that the large accounting firms have stronger incentives and competencies to provide higher audit quality [13]. Following prior studies, this study uses an indicator variable equalling 1 if firms hire Big Four affiliated accounting firms and 0 otherwise. Auditors from Big Four accounting firms are expected to have higher audit skills than non-Big Four because they are vulnerable target in misleading financial reports lawsuits and thus are motivated to provide high quality of audit.

Conservatism

Currently, several measures of conservatism have been introduced in the accounting literature. Each method has its strengths and weaknesses. In this study, I use market to book value ratio (MTB) as a proxy for conservatism. Despite its simplicity, the measure has a strong theoretical basis which is derived from theoretical study of [14]. The model posits that conservative use of accounting suppresses book value of equity, causing book value to be biased downward. Thus, higher MTB reflect higher application of conservative accounting in financial reporting. MTB is the most popular proxy for conservatism among researchers [39]. Market To Book value (MTB) ratio is calculated as follows:

$$\text{MTB} = \frac{Market\ Value\ of\ Equity}{Book\ Value\ of\ Equity}$$

Where, market value of equity (market capitalization) is defined as stock price multiplied by outstanding shares and book value of equity is total assets less total liabilities.

Control Variables

Four control variables are included in the regression model to control for differences in firm characteristics. These are leverage (Total Liabilities / Total Assets), firm size (log of total assets), profitability (net income /total asset), and firm age ((natural logarithm of firm's age). Prior results suggests that these control variables are associated with collateral [2], [12], [23].

Data and Sample Selection

Firms samples are selected from Indonesia Stock Exchange from 2012-2015 using Slovin formula (n = N / 1 + Ne2). Applying margin error of 5% and 1.930 firm years (N) during the study periods, a minimum sample to be collected is 331 firm-years. But to increase generalization, a number of firm years are added so that the proportion is approaching 40% of all listed companies during the sample periods. If annual report of a company does not provide necessary information to measure variables, the process of random selection is repeated to replace firms with missing data. Sample period of 2012-2015 is chosen because during these years a number of firms were not required to provide collateral in loan contracts. After the whole processes, as much as 785 firm years were selected and used in the test of hypotheses.

Descriptive Statistics

As described in previous section, Slovin formula generated 785 firm-year observations for the test of hypotheses. Descriptive statistics for each variable are presented in table 1.

Note that Collateral (COLET) is a dummy variable. Statistically, the mean for any dummy variable points to a group frequency that was coded 1. In this study, a group that had been coded 1 refer to the collateral required firms. Therefore, the mean for COLET of 0.9, suggests that 90% of the sample firms are required to provide loan collateral.

Table 1. Descriptive Statistics.

Variables	Mean	Median	Minimum	P75	Maximum
COLET	0,9	1	0	1	1
INDP	0,42	0,38	0,2	0,5	1
GOVCOM	0,09	0	0	0	1
AUDIT	0,42	0	0	1	1
CONCER	1,75	1,23	-10,83	2,32	13,56
SIZE	28,87	28,8	23	30,16	34
ROA	4,89	3,76	-54,62	8,14	87,27
LEV	0,58	0,52	0,03	0,69	7,69
AGE	34,22	33	6	43	132

The proportion of outside members in Board of Commissioners (INDP) is 42%, satisfying minimum requirement of 33%. Mean for Governance Committee (GOVCOM) is 9%, suggesting that 91% of the sample firms have no a separate Governance Committee. Meanwhile, only 42% of accounting firms have an affiliation with Big 4 accounting firms (AUDIT). Conservatism (CONCER) has a mean of 1.75, indicating that market value of equity is higher than the book value. It suggests that, on average, the sample-firms use more conservative accounting policies. The minimum and maximum values of the four control variables suggests considerable differences in firms' characteristics.

A more complete picture of loan collateral in relation with firm's characteristics is displayed in table 2. Sample-firms are split into two categories, firms having collateral requirements in their bank loan contracts (COLET = 1) and firms with no collateral requirements (COLET = 0). Nonparametric Kolmogorov-Smirnov (KS) test of differences are performed to see if the two groups characteristics differs. This statistic does not require normal distribution. The statistics suggest that the collateral requirements group has lower Board of Commissioners independence, less governance committees, hire fewer Big 4 accounting firms, less conservative, lower leverage and tend to have younger age than no-collateral group. However, profitability ratio is similar between these two groups. Overall, these statistics provide preliminary evidence of supporting H_1, H_2, H_3 and H_4.

Table 2. Collateral Versus Non-Collateral Requirements

	COLET=1 (N=710)	COLET=0 (N=75)	Mean	*Asymp. Sig.*
Variables	Mean	Mean	Diff.	*(K-S npar)*
INDP	0,41	0,49	-0,08	0,000
GOVCOM	0,07	0,29	-0,22	0,003
AUDIT	0,37	0,87	-0,50	0,000
CONCER	1,68	2,38	-0,70	0,001
SIZE	28,68	30,63	-1,95	0,000
ROA	4,78	5,97	-1,19	0,210
LEV	0,57	0,63	-0,06	0,000

AGE	33,51	40,81	-7,30	0,002

For signaling purposes, firms establish a separate governance committee to show their strong commitment on sound business practices. Unlike Audit Committee, no capital market regulations in Indonesia requires public companies to establish governance committee which is separately from Board of Commissioners. But some firms decided to form a governance committee. As reported in table 2, only 9% of the firm-samples establish governance committee. The characteristic of firms with or with no governance committees are reported on table 3. Nonparametric Kolmogorov-Smirnov (KS) test of differences are performed to see if the two groups characteristics differs.

Table 3. Governance Committee Partition.

	GOVCOM= 1	GOVCOM= 0	Mean	*Asymp. Sig.*
Variables	Mean	Mean	Diff.	*(K-S npar)*
COLET	0,69	0,92	-0,23	0,002
INDP	0,44	0,41	0,03	0,023
AUDIT	0,67	0,40	0,27	0,000
CONCER	1,8	1,74	0,06	0,121
SIZE	30,76	28,68	2,08	0,000
ROA	3,79	5,00	-1,21	0,579
LEV	0,64	0,57	0,07	0,005
AGE	40,92	33,55	7,37	0,002

Table 3 shows that on average firms with governance committees have fewer collateral requirements, larger outside commissioners, hire more Big Four auditors, larger firm size, higher leverage, and longer firm age than those with no governance committee. However, the level of conservatism, and profitability ratios are similar between the two groups.

Correlation Coefficients

Table 4 presents the correlation coefficients among variables of interest. All variables, except leverage, are negatively associated with collateral. As predicted, audit quality and collateral are negatively associated with a correlation coefficient of -0.299. Board of Commissioners independence and collateral are negatively associated with a correlation coefficient of -0.207 and consistent with prediction. The correlation between governance committee and collateral has a negative value of -0.222 and consistent with prediction as well. As predicted, conservatism and collateral are negatively associated with a correlation coefficient of -0.105. Overall, the results presented in table 4 provide preliminary evidence in favor of supporting H_1, H_2, H_3, and H_4.

RESULTS AND DISCUSSION

Since collateral is a binary variable, test of hypotheses is carried out using logistic regression analysis. Table 5 reports the test results which is separated into two models, with and without control variables. The estimation of the two models shows that all hypotheses are supported at 5% and better. Four control variables, except firm size, have no significant effect on collateral. Adding four control variables into the model does not alter the results. The results are qualitatively similar. Thus, all hypothesized variables in H1, H2, H3, and H4, are supported.

Table 4. Correlation Coefficients.

	COLET	AUDIT	SIZE	ROA	AGE	INDP	LEV	GOV	CON
COLET									
AUDIT	-0,299**								
SIZE	-0,307**	0,530**							
ROA	-0,036**	0,124**	0,022						
AGE	-0,131	0,100**	0,229**	0,045					
INDP	-0,207**	0,073*	0,250**	-0,098**	0,079*				
LEV	-0.036	0,005	-0,059	-0,092**	0,062	0,180**			
GOVCOM	-0,222**	0,157**	0,318**	-0,035	0,128**	0,076*	0,037		
CONCER	-0,105**	0,07*	0,108**	0,181	0,021	0,084*	-0,089*	0,010	

Hypothesis One that predicts a negative association between collateral and the proportion of independent commissioners is statistically supported at less than 1%. The findings suggest that firms with more independent commissioners are less likely to use loan collateral. Agency theory suggests that firms should establish monitoring mechanisms to minimize the negative effects of asymmetry information. In this perspective, independent commissioners are representative of the shareholders placed in the company to carry out the oversight function and mitigate opportunistic behavior of managers. The main task is to ensure that allocation of firm's resource are in line with sound business practices and making sure that managers put their effort in the best interest of shareholders. An effective Board of

Table 5. Logistic regression results.

		Without Control			With Control		
Variables	*Exp. Sign*	Coefficients	SE	*P-value*	Coefficients	SE	*P-value.*
INDP	-	-4,526	1,012	0,000	-3,72	1,086	0,000
AUDIT	-	-2,286	0,358	0,000	-1,93	0,399	0,000
CONCER	-	-0,109	0,059	0,032	-0,116	0,065	0,037
GOVCOM	-	-1,243	0,326	0,000	-0,914	0,353	0,005
SIZE	-	-	-	-	-0,188	0,093	0,021
ROA	-	-	-	-	0,005	0,016	0,374
LEV	+	-	-	-	-0,033	0,513	0,475
AGE	-	-	-	-	-0,007	0,007	0,188

commissioners increase creditors confidence that the firm has been well managed and allocation of resources has been directed to projects with positive net present value. In turn, good business management together with good corporate governance are expected to improve the company's financial performance and ultimately reduce default risk. Lower default risk increases the probability of granting credit without collateral requirements.

In addition, an effective Board of Commissioners is more likely to increase creditor's confidence in financial statements. Transparent financial reports statements that show the actual condition of the company are very important for creditors in assessing credit worthiness. Credit analysis that is not based on correct information increases the likelihood of default risk. If the creditor considers that the financial statements are not trustworthy so that the default risk increases, the creditor will be compelled to set guarantees for banks loans. The result suggests that creditors perceived that financial reports of firms having more independent Board of Commissioners are reliable and useful in prediction of default risks. The evidence is consistent with [2] who used samples from Chinese capital market. They show that independent directors reduce a firm's use of collateral.

Hypothesis Two that predicts the existence of governance committee lower the probability of collateral imposed on bank loans are significantly supported at less than 1%. The findings suggests that firms with a governance committee is less likely to provide collateral for bank loans. Firms deliberately establish a separate governance committee give positive signals to lenders that these firms are committed to sound business practices and to uphold good corporate governance. Having a separate governance committee enable firms to focus on detecting potential risks and take preventive actions to avoid unnecessary situation that brings harm to future prospects. The existence of a governance committee increases creditor trust in the firm's ability to anticipate and overcome unpredicted changes of business environments. In short, lenders positively perceive the firm's ability to fulfill debt contracts. This is the first solid evidence of positive association between governance committee and collateral.

Note that forming a separate governance committee is not a common practice in public companies. The descriptive statistics described before show that only 9% of public companies in Indonesia voluntarily form a governance committee. This small percentage reflects that the majority of public companies in Indonesia have not given serious attention on the benefit of the committee to drive company performance. These companies seem to be quite satisfied with the existing governance system that has been established in accordance with regulation. They only try to meet the minimum requirements set by capital market regulators and are not willing to incur additional costs to form a committee that is responsible for the consistent implementation of corporate governance policies in every aspect of organization. Most public companies have not yet realized that creditors pay much consideration on the consistency of corporate governance implementation when assessing credit worthiness. Based on the findings of this study, it is recommended that public companies form a governance committee because it gives signal to creditors about sound business practices that companies has implemented. It follows that sound business practices will reduce default risk.

Hypothesis Three that predicts firms hiring Big Four auditors is less likely to use collateral in bank loan contracts. Big accounting firms are expected to provide higher audit service leading to higher accounting reports quality. Higher accounting reports quality lower default risk and the use of collateral. Consistent with the prediction, the results show that audit quality and collateral are negatively associated at less than 1% level of significance. The findings suggest that Big Four auditors add to the credibility of financial reports. Lenders perceive the Big Four's audited financial statements are more transparent and reliable in assessing the firm's ability and thus reduce agency costs. In return, banks do not impose collateral requirements of their bank loans.

Agency theory suggests that asymmetry information results in conflict of interests between managers and shareholders. There should be minotoring mechanisms to protect shareholders from manager dysfunctional behavior. External audit is regarded as one of the monitoring mechanisms to increase transparency of financial statements and reduce credit risk. Audited financial statements help creditors make credit decisions effectively. Ratio analysis that has relied upon figures presented in financial statements will be more useful in assessing the ability of companies to pay bank loans if the ratio reflect the company's ability to generate cash in the future and pay its debt. If the creditor believes that these figures reflect the firm's real financial condition, then the requirement to provide collateral on bank loans may not be necessary at all.

The result is consistent with [40] using firms listed in Chinese capital market are used to test the association between audit quality and collateral. In the study, audit quality and the use of collateral are found to be negatively associated. He interpreted the evidence as creditors regard collateral and higher audit quality as alternative means of reducing credit risk.

Hypothesis Four that predicts firms applying more conservative accounting tend not to use loan collateral. The analysis support the hypothesis at 5% level of significance. The findings reported on table 5 suggest that lenders put more trust on financial statements under conservative accounting policies. Conservative financial statements play an important role in fulfilling debt contracts between lenders and borrowers. In the creditor perspective, borrowers implementing more conservative financial reports have a lower chance of violating debt contracts than non-conservative financial reporting [42]. As widely discussed in literature, application of conservative accounting result in reduced earnings. The argument is that conservative accounting recognizes potential losses (costs) faster than revenues (assets). A slower recognition of revenues suppresses earnings and worsen leverage ratios which is commonly used to assess a firm's ability to its debt. The fact that companies keep applying more conservative accounting policies are interpreted by lenders as positive signal of a firm's commitment to prudent business management. As a result, lenders are more willing to provide lenient loan contracts through absent of collateral. While using different proxy, result of [12] show similar findings. They measure collateral as a percentage of collateral to total bank loans and provide evidence of application of conservative accounting reduces bank collateral.

CONCLUSION

Problems of moral hazard intensify friction between lenders and borrowers, causing agency costs to increase. To minimize such costs, lenders impose collateral in debt contracts. Prior analytical and empirical studies support the use of collateral to reduce default risks. On the other hand, opposing views argue that in a competitive credit market where lenders and borrowers possesses equal assessment of creditworthiness, collateral are no longer needed. At worse, collateral requirements create noncompetitive credit markets. Thus, research on determinants of no-collateral requirements of bank loans in emerging credit markets as Indonesia banking industry is still an interesting topic. I examine the firms' characteristics that influence lenders to relax loan collateral. Four factors are expected to effect loan requirements: Board of Commissioners independence, governance committees, audit quality, and accounting conservatism. Logistic regression analysis confirm the association of these four variables with the use of collateral.

Firms with higher proportion of independent commissioners are less likely to provide loan collateral. The findings indicate that creditors perceive firms having more independent commissioners have the ability to pay their debts and these firms are not required to bank loan collateral. The main task of the Board of Commissioners is to monitor managers and to ensure that all firm's resources are used efficiently. Board of Commissioners will encourage managers to carry out their responsibilities properly and report financial results transparently. Transparent financial statements allow creditors to conduct credit analysis appropriately and assess credit worthiness properly. Granting bank loans without adequate information increases the risk of default. When creditor believe that financial statements are not prepared on the basis of sound standards, default risk is increasing. In anticipation of higher default risk, creditors require firms provide collateral.

Firms with a separate governance committee are less likely to provide loan collateral. Establishing a separate governance committee is not a common practice in public companies. Only 9% of public companies in Indonesia voluntarily form a governance committee. It seems that the majority of public companies in Indonesia decline the benefits of a governance committee in the company. These companies only maintain corporate governance system that meet the minimum requirements set by the capital market regulatory body and are not willing to form a governance committee because additional costs has to be incurred. Most public companies fail to realize that creditors would consider the consistency in implementation of corporate governance as important when assessing creditworthiness. Based on the findings of this study, public companies in Indonesia should form a governance committee because it can reduce default risk.

Firms with higher audit quality are less likely to impose loan collateral. Conflicts of interest between managers and shareholders triggered by asymmetry information can be minimized by an external audit. The audited financial statements add credibility to the financial statements, making it easier for creditors to make proper credit decisions. Ratio analysis that relies on figures presented in financial statements will be more useful in assessing the ability of companies to pay bank loans when these ratios reflect the ability of companies to pay their debts. If creditors believe that these figures reflect the real financial condition of the company, then the requirement to provide collateral for bank loans may not be necessary at all.

Firms applying more conservative accounting policies are less likely to provide loan collateral. Borrowers who apply conservative financial statements have a smaller chance of breaking debt contracts than those who implement non-conservative financial reporting. Firms with conservative accounting policies tends to report lower net income than non-conservative firms. This is quite understandable because conservative accounting policies recognize potential losses (costs) faster than income (assets). If revenue is recognized slower than expenses, debt ratios tend to be higher. Note that that debt ratios are commonly used in assessing default risk. However, firms may deliberately chose a more conservative accounting policy as a signal to creditors that the company had persistent earnings. As a consequence, lenders are willing to provide loan contracts with no collateral.

Limitation and Suggestions

This study measures collateral as a dummy variable. One disadvantage of discrete measure is unable to capture subtle differences in the firm's characteristic. Future research in Indonesia should consider to use continuous measure to provide deeper insight into the use of collateral in debt contracts. One alternative continuous measure is amount of collateral. In addition, subsequent research also needs to consider alternative measures for audit quality and conservatism to get robust and more generalized results. Alternative audit quality measures include audit fees, going-concern opinions, earnings management, and financial restatements. Alternative measures for conservatism include asymmetric timeliness measure [6], asymmetric cash flow to accruals measure [3], and negative accruals measure [19].

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[jak] Editor Decision

2 messages

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To: sansaloni Butar Butar <sansaloni@unika.ac.id>

Sansaloni Butar Butar:

We have reached a decision regarding your submission to Jurnal Akuntansi dan Keuangan, "The effects of Corporate Governance, Audit Quality, and Conservatism on Loan Collateral Requirements".

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