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# The impact of expatriates directors on the Indonesian company's performance

**I M Ronyastra**

Department of Industrial Engineering, University of Surabaya, Raya Kalirungkut, Surabaya 60293, Indonesia

E-mail: ronyastra@staff.ubaya.ac.id

**Abstract.** This research examined the impact of employing expatriates as board of directors (BOD) to the financial performance of Indonesian companies. Using samples from Kompas 100 index in Indonesian Stock Exchange, the research performed analyses on three performance indicators i.e. Return on Asset (ROA), Return on Equity (ROE), and Tobin's Q. Binary variable of whether a company employing expatriate and the proportion of expatriate in the BOD were used as the proxy for the independent variable. The research did not find enough evidence to support the hypothesis that employing expatriate in the BOD would make the financial performance different.

**Keywords:** Expatriate; Financial Performance; Kompas 100; Organization Design

## 1. Introduction

As a logical consequence of a free trade era, the competition among countries is getting more complex as the market for products and services expands. Labor selection plays important part in the companies' effort to improve their competitiveness. Furthermore, the companies can seek for candidates both domestic and international which create an expansion in the labor market [1]. Indonesia, which is currently sitting on 16<sup>th</sup> World's GDP ranking, is exposed to the risk in becoming the destination country for labor force. This condition can be a threat for local labors force whose numbers is predicted to surge as a result of demographic bonus in the next 5 years [2].

This research is interested in examining the impact of employing expatriates on the corporate financial performance which reflected in the accounting performance and market performance. The focus is on expatriates with executive level position i.e. board of director (BOD) because they have the greatest authority to plan and direct the companies' strategic decisions. The relationship between board of director and corporate performance has attracted the interest of many researchers to examine it from many angles. Lindorff and Johnson analyzed the CEO's business education level and firm performance [3], while the CEO's working experience was previously examined by Elsaid, Wang and Davidson [4]. Some other researchers conducted the research using data from Indonesian companies. As done by Darmadi who found out the negative relationship between gender of the top management and the firm performance in Indonesia [5] and by Lindrianasari & Hartono who revealed that decreasing performance could encourage a CEO's turnover [6].



There is an observable increasing trend of hiring expatriates as directors in Indonesian companies from only 10% in 2011 to 13% in 2014. The researcher would like to gather empirical evidence on the outcome of this decision towards the financial performance of the companies.

The remainder of this paper includes literature review and hypothesis on the second section, followed by research methodology on the third section. The data processing and result are discussed in section 4 and closed by some concluding remarks in section 5.

## 2. Literature review and hypotheses

### 2.1. Board of Directors (BOD) and Corporate Performance

As the leader in the management team, BOD has the highest responsibility in making strategic decisions which has the purpose to grow the company. On the external point of view, BOD must also be able to acquire investors' trust so that they feel safe to invest in the company. Some researchers tried to figure out factors that can predict the success of an executive in performing his tasks to improve corporate financial performance. As the findings in [3], there seems to be not enough evidence to create a relationship between CEO's business education and the performance for the Australian companies. Veprauskaite & Adams are interested in CEO power which was proxied by several variables including tenure, ownership, remunerations and bonus pay [7]. They found out that CEO power is negatively related to financial performance. While Liu & Jiraporn found out that CEO with higher power can cause bond holders to demand higher yield for it will be more difficult to monitor the executives [8].

Another angle was used by Nourayi & Daroca when treating CEO's compensations as the dependent variable which then led to the conclusion that CEO compensations are significantly explained by the company's size and market-based return [9]. Sun, Wei & Huang found out firm efficiency in terms of revenue and cost are positively associated with the CEO compensations [10]. Personal traits of the CEO also attract interest from researchers as Takeda, et al. tried to explore the stereotyping based on CEO's hair color in the Fortune 500 companies [11]. Pillemer, Graham & Burke examined the relationship among CEO's facial appearance, gender-linked traits and the financial performance [12]. While the gender angle was also taken by Chandani, Mehta & Chandrasekaran [13] and Darmadi [5].

### 2.2. Measuring the financial performance

Sun, Wei, & Huang in [10] measured the financial performance based on revenue efficiency and cost efficiency which were estimated through data envelopment analysis method. Chandani, Mehta & Chandrasekaran [13] measured bank performance using CAMEL Model that combined capital adequacy, asset quality, management efficiency, profit, and liquidity. The popular metrics to measure the corporate financial performance are Return on Asset (ROA) and Return on Equity (ROE) which can be obtained from the financial statement. ROA, the capability of the corporate to generate profit from the entire asset they have, is also commonly used as the accounting based performance measurement. Corporate assets usually come from debt financing and paid in capital. ROE is used to measure the profit generation capability from the amount of capital paid by the corporate owners.

From time to time, a publicly listed company is being valued by investors in the secondary market. Their valuations are reflected in the fluctuating corporate stock price in the stock exchange. To include this valuation to the corporate performance, Darmadi [5] and Veprauskaite & Adams [7] used Tobin's Q that can be considered as the market based financial performance.

### 2.3. Hypotheses

As the objective of this research was to find the impact of expatriate executives to the companies' performance, a performance comparison between a corporate that employs Indonesian directors only and the corporate that employs at least 1 expatriate as a director must be done. The researcher guesses that there will not be any difference between the two groups. Hence:

$H_0$ : there is a difference in financial performance between the two groups of companies

$H_1$ : there is no difference in financial performance between the two groups of companies.

The research also wanted to find the impact of hiring expatriates as directors toward the corporate performance, so we would also find the relationship between numbers of directors hired and the financial performance:

H<sub>2</sub>: there is a positive relationship between proportion of expatriates on the BOD and financial performance.

### 3. Data and research methodology

#### 3.1. Sample data

This research used sample data from companies listed in Indonesian Stock Exchange (IDX), but the sample was limited to those companies belongs to the Kompas 100 index. The Kompas 100 index consisted of 100 chosen companies based on market capitalization, stock liquidity and fundamental condition. The research observed data were obtained from annual reports during the financial year 2012 until 2014. The index member was updated twice a year. The main source of data for this research was the official IDX website.

#### 3.2. Variables

- **Dependent Variables:** to measure the company financial performance, this research used three dependent variables. Return on Assets (ROA) and Return on Equity (ROE) were used as proxy for the accounting based financial performance. Data for ROA were collected from corporate's annual financial statements which was calculated as ratio of net income to the total assets book value. While ROE measured the ratio of net income to the total equity of the companies. Tobin's Q was used as proxy for the market based financial performance. Tobin's Q was measured using the formula in Darmadi [5] which subtracting book value of equity from the total assets and adding market value of equity to find the market value of the companies and then divided by the total book value of assets. Darmadi [5], also suggest that the Tobin's Q should be included in the regression model using its natural logarithm form.
- **Independent Variables:** the hypothesis suggested that the independent variables was the presence of expatriates in the BOD. This research used two proxies for the independent variables. The first proxy was a binary variable that defined the presence of expatriates in the BOD, 1 if there was any expatriate and 0 if there was not. The second proxy was the proportion of the expatriates in the BOD which was the ratio of numbers of expatriate directors to the total count of the BOD members.
- **Control Variables:** this research used two control variables namely the companies size and the company board size. The companies size was estimated using data from total assets as the proxy while board size was stated in number of BOD members. In the regression model, the control variables were also presented in its natural logarithm form.

#### 3.3. Methodology

- Two sample T-test was used to test the hypothesis of different mean between two groups of companies. The T-test was conducted for all three dependent variables using the binary variable as the separator between samples.
- To learn about the relationship of the expatriates BOD and financial performance, this research used the following regression model:

$$FP = \beta_0 + \beta_1 RExpat + \beta_2 LNAssets + \beta_3 LNBSize + \varepsilon \quad (1)$$

$$FP = \beta_0 + \beta_1 PExpat + \beta_2 LNAssets + \beta_3 LNBSize + \varepsilon \quad (2)$$

Where FP was the financial performance, as measured by ROA, ROE, and Tobin's Q, RExpat was the proportion of expatriates in the BOD, PExpat was the binary variables stating the presence of Expat in the BOD, LNAssets was the natural logarithm form of the total assets and LNBSize was the natural logarithm form of the board size.

## 4. Results and discussion

### 4.1. Descriptive statistics

The descriptive statistics are presented in table 1. The average total assets for the sample is near 43 trillion rupiah which is significantly higher compared those reported on Darmadi [5] at 6.9 trillion rupiah. This data indicates that the Kompas 100 index members are bigger in terms of average asset size than the rest of the IDX members.

**Table 1.** Descriptive statistics.

<i>Variables</i>	<b>Mean</b>	<b>Median</b>	<b>SD</b>	<b>Min</b>	<b>Max</b>
<i>ROA</i>	7%	5%	8%	-12%	42%
<i>ROE</i>	17%	13%	47%	-170%	799%
<i>Tobins Q</i>	2.159	1.514	2.079	0.528	17.935
<i>Total Asset (IDR Bio)</i>	42,744	11,754	111,899		855,040
<i>Board Size</i>	5.89	6.00	2.21	174	13.00
<i>Presence of Expat</i>	0.376	0.000	0.485	1.00	1.000
<i>Proportion of Expat</i>	11%	0%	18%	0%	100%

**Table 2.** Correlation results.

<i>Variables</i>	<i>ROA</i>	<i>ROE</i>	<i>LN Tobins Q</i>	<i>R Expat</i>	<i>LN Total Asset</i>	<i>LN Board Size</i>
<b>ROA</b>	1.00					
<b>ROE</b>	0.53	1.00				
<b>LN Tobins Q</b>	0.68	0.37	1.00			
<b>R Expat</b>	0.07	0.09	0.11	1.00		
<b>LN Total Asset</b>	-0.13	-0.06	-0.36	0.01	1.00	
<b>LN Board Size</b>	0.07	0.04	-0.07	0.14	0.60	1.00

### 4.2. Correlation results

The correlation coefficients for all variables are presented in Table 2. It can be seen that there are positive correlations between the RExpat and the financial performance although the coefficients are very small. Positive correlation also found in LN Total Assets (natural logarithm of total asset) and LN Board Size (natural logarithm of board size), 0.60, indicating that the numbers of BOD members are bigger in the larger companies.

### 4.3. Two sample T-test results

The F-test result suggests that, at alpha of 0.05, both ROA and ROE have equal variance, but not the LN Tobin's Q. Thus, T-test for ROA and ROE are conducted under the equal variance assumption while LN Tobin's Q under the unequal variance assumption. The detail of the test results are summarized in Table 3. The T-test for ROA revealed that the t Stat is -0.81, which indicates that there is no mean difference between the two sets of companies and we can then reject the null hypothesis of difference in performances' mean. The same conclusion can be inferred for the other financial performance indicators based on the results summary in Table 3.

### 4.4. Regression results

This research employs a multivariate regression analysis to test the hypothesis H<sub>2</sub>. Table 4 and Table 5 summarize the regression of financial result on the proportion and on the presence of expatriates in BOD. It is observed that the P-value for both proportion and presence of expat are not significant and

must be removed from the regression model since they do not explain the changes in the response. The R-square suggest that the explanatory variables can explain more variations on Tobin's Q than ROA and ROE. These data provide slight hint that the proportion of expatriates on the BOD has lower impact on the accounting based performances than the impact on the market based performances. The relationship between the variables are seen positive and imply that expatriate directors helped the company to gain trust from the capital market and make the market value of the companies' assets higher. It is an interesting finding that although the mean for the financial results from two sets of samples are not different, the presence and proportion of expatriates on the BOD are positively correlated to the market based financial performance.

**Table 3.** F-test and T-test results summary.

<i>P</i> Expat	ROA		ROE		LN Tobin's Q	
	No	Yes	No	Yes	No	Yes
<b>Mean</b>	0.0670	0.0741	0.1489	0.2001	0.5290	0.5512
<b>Variance</b>	0.0047	0.0078	0.0244	0.5599	0.3453	0.4240
<b>Observations</b>	209	126	209	126	209	126
<b>Df</b>	208	125	208	125	208	125
<b>F</b>	0.6041		0.0436		0.8143	
<b>P(F&lt;=f) one-tail</b>	0.0007		0.0000		0.0960	
<b>F Critical one-tail</b>	0.7718		0.7718		0.7718	
<b>Variance?</b>	<b>Equal</b>		<b>Equal</b>		<b>Unequal</b>	
<b>Pooled Variance</b>	0.0059		0.2254			
<b>Hyp. Mean Difference</b>	0		0		0	
<b>Df</b>	333		333		243	
<b>t Stat</b>	-0.8148		-0.9556		-0.3131	
<b>P(T&lt;=t) two-tail</b>	0.4158		0.3400		0.7544	
<b>t Critical two-tail</b>	1.9671		1.9671		1.9698	

**Table 4.** Regression of financial performance on proportion of expatriates in BOD.

Independent Variables	ROA			ROE			Tobins' Q		
	Coef.	S.E	P.Val	Coef.	S.E	P.Val	Coef.	S.E	P.Val
<b>Intercept</b>	0.389	0.089	0.000	1.076	0.562	0.056	5.867	0.664	0.000
<b>R Expat</b>	0.018	0.023	0.429	0.200	0.144	0.165	0.271	0.169	0.110
<b>LN Total Asset</b>	-0.013	0.003	0.000	-0.038	0.021	0.072	-0.197	0.025	0.000
<b>LN Board Size</b>	0.041	0.013	0.001	0.122	0.079	0.122	0.327	0.093	0.001
<b>R Square</b>	0.05241			0.01877			0.01750		
<b>Observation</b>	335			335			335		
<b>Significance F</b>	0.00047			0.09873			0.00000		

**Table 5.** Regression of financial performance on presence of expatriates in BOD.

Independent Variables	ROA			ROE			Tobins' Q		
	Coef.	S.E	P.Val	Coef.	S.E	P.Val	Coef.	S.E	P.Val
<b>Intercept</b>	0.395	0.089	0.000	1.138	0.561	0.043	5.959	0.663	0.000
<b>P Expat</b>	0.003	0.009	0.431	0.040	0.055	0.468	0.026	0.065	0.689
<b>LN Total Asset</b>	-0.013	0.003	0.000	-0.040	0.021	0.057	-0.200	0.025	0.000

<b>LN Board Size</b>	0.041	0.013	0.001	0.128	0.080	0.109	0.344	0.094	0.000
<b>R Square</b>		0.05106			0.01459			0.16905	
<b>Observation</b>		335			335			335	
<b>Significance F</b>		0.00059			0.18141			0.00000	

These results also suggest that the same conclusion as the result from Darmadi [5] in 2010 regarding the size of the BOD members which has positive association with market based financial performance. The more directors in the BOD seems to be believed can create a more focused work management and wider perspective during the strategic decision making process.

## 5. Conclusion and further research

Hiring expatriates as board of directors of Indonesian companies did not have observable impact on the accounting-based financial performance, but it may have positive impact on the market-based financial performance. The expatriates are able to gain investors' positive image which is translated into higher valuation of the companies' assets. However, they failed to make a difference in the companies' performance which should have been the main reason of hiring them. It is debatable that the companies' performance is influenced by many factors. Thus, it requires further examination on how the expatriates can contribute more to improve the performance. The research can also be extended to find out the other explanation on the increase in number of expatriates hired as directors.

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