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CEO Power, Corporate Governance, Auditors' Reputation, and its Effects on Corporate Islamic Bonds Rating

[1]Gusni [2]Darwis Agustriyana [3]Didi Tarmidi, [4]D.J. Anderson Butar Butar

Abstract---*Islamic bonds or commonly known as "sukuk" is one of the capital market instruments that is come up as one of the important components in the global Islamic financial system and has become an innovative investment instrument for recent years. The purpose of this paper is to investigate the effect of CEO power, corporate governance, auditors reputation and firm characteristic as control variables (productivity, leverage, and firm size) to the corporate Islamic bonds rating listed in Indonesia stock exchange for the period of 2013-2017. This research uses ordinal logit regression model to find out variables that has powerful effect to the corporate Islamic bonds rating which samples were taken from 11 firms that issued Islamic bonds by using purposive sampling technique. The research finding was denoted that CEO power, board size, and leverage have no effect on the Islamic bond's rating. This result was explained that CEO power is measured by CEO tenure, board size and leverage do not determine the better of corporate Islamic bonds rating. Meanwhile, auditors reputation, board commissioner, productivity and firm size have positive effect on the corporate Islamic bonds rating.*

Keywords---*Islamic bonds rating, CEO power, Corporate governance, Auditors reputation*

I. INTRODUCTION

Islamic bonds exist as an investment alternative in capital market. Islamic bonds comply with sharia principles that make it be attractive instrument investment for the Islamic financial institutions and sharia managed funds that cannot invest in the conventional securities which using interest payments. Besides that, it's also can used by giant firms and sovereign entities as an alternative source of financing (Alam, Hassan, and Haque, 2013).

Islamic bond in Indonesia started at 2002, published by Indosat firm, then followed by several other companies. The type of Islamic bonds traded consist of corporate Islamic bonds (corporate sukuk) and country Islamic bond (country sukuk). Over the past five years, corporate Islamic bonds has witnessed rapid growth approximately 108.41%, even though the corporate Islamic bonds market share is still low compared to conventional corporate bonds (Financial Service Authority Website). Corporate Islamic bonds growth as an alternative to the conventional bonds has drive the importance of Islamic bonds rating (Elhaj, Muhamed, and Ramli, 2017). Islamic bonds are slightly different from conventional bonds because they are not debt securities but evidence of joint ownership

[1] Department of Management, Widyatama University, Bandung, Indonesia.
gusni.tanjung@widyatama.ac.id
[2] Department of Management, Widyatama University, Bandung, Indonesia.
[3] Department of Management, Widyatama University, Bandung, Indonesia.
[4] Department of Management, Widyatama University, Bandung, Indonesia.

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towards an asset/project. Even so, Islamic bonds still have risks, especially the default risk. In order to reduce investment risk, investors can use bond rating in determining bond quality and risk. The higher of bond rating will indicate level of investing security. Conversely, the lower of bond rating level will push the higher of investment risk (Saudi, 2018). There are three licensed bond rating agency in Indonesia, namely Indonesian Rating Agency (Pefindo), Fitch Rating Indonesia and Indonesia Credit Rating Agency/ICRA (TICMI, 2016).

Corporate Islamic bonds rating influence by several factors like CEO power, corporate governance, auditor's reputation, productivity, leverage and firm size (Bhojraj & Sengupta, 2003; Kisgen, 2006; Weber, 2006; Liu & Jiraporn, 2010; Purwaningsih, 2013; Kuang & Qin, 2013; Zhang & Khurana, 2015; Altwijry, 2015; Elhaj et. al., 2017; Homsi, et. al., 2017). Liu & Jiraporn (2010) said CEOs can affect companies if they have influence over important decisions. The dominance of CEOs in the firm can lead to lower bond ratings because strong CEO power allows the CEO to act in a manner that only benefits themselves (Adams, et al., 2005). CEO power by using CEO tenure will increase bond's rating, because they have longer-tenure and experience (Zhang & Khurana, 2015). Strong CEO power can reduce bond costs that can increase bond ratings (Pathan, 2009).

Corporate governance can affect corporate Islamic bond rating indirectly through reduction information risk by encouraging the firms to disclose information in a timely manner. Sengupta (1998) proof that corporate governance has positive association with bond rating. Bhojraj and Sengupta (2003) explain the relationship between bond rating and corporate governance and said that effective corporate governance can affect bond ratings. Elhaj et. al. (2017) documented that corporate governance (board size) has positive effect to the Islamic bonds rating. Auditor reputation plays an important role in determining whether the report prepared by the manager is in accordance with the contract provisions, including agreed accounting principles to add credibility of the report and reduce the information risk that could disserve investors (Cha, Hwang, & Yeo, 2016). A number of research mention that auditors reputation has effect to the bond rating (Widowati, et. al., 2013; Pranoto, et.al., 2017). Different research result said that auditors reputation does not affect bonds rating (Pandutama, 2012; Erdawati and Rambe, 2018). The objective of this paper is to explain the effect of CEO power (CEO tenure), corporate governance (board size and board commissioner), auditors reputation and firms characteristic (productivity, leverage and firm size) on corporate Islamic bonds rating by following the theoretical and previous empirical research that can contribute to the corporate Islamic bonds literature that can improve our understanding about determining factors of corporate bonds rating in Indonesia

This studyis conducted different from other papers. This research uses corporate Islamic bonds listed In Indonesia which is still rarely investigated. Using this firm inspired by research of Liu & Jiraporn (2010) that use conventional bond ratings in their research and only focus to the effect of CEO power to the bond ratings and yields. Their research does not using corporate governance and auditors reputation as determinants of corporate Islamic bonds rating. Corporate governance practice still new in Indonesia, which is why important to analyze related to its function to protect the investors from any information manipulation by the insiders companies. Auditors reputation is also still slightly discussed in Indonesia related to the corporate Islamic bonds rating.

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II. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

II.I.CEO power and corporate Islamic bonds rating

CEO is a person who represents top management in the companies. The CEO is responsible for maintaining or increasing the company's rating. CEO Power has a close relationship with the length of the CEO's tenure (Liu & Jiraporn, 2010). CEO tenure is involve two dimensions of the firm's managerial experience, first, general experience as senior executives and second, special experience with rating agencies. CEOs who have a longer tenured tend to have better communication skills with rating agencies, so they are able to achieve the desired ranking results, but lead to lower ranking quality, due to that ratings are less accurate, less timely, and more volatile (Listokin dan Taibleson, 2010; Becker dan Milbourn, 2011; Zhang & Khurana, 2015). CEO power is tends to retain fading information. Powerful CEOs are difficult to monitor by bondholders, so they request higher returns for the bond. That is why bondholders are interested about CEO power (Liu & Jiraporn, 2010). A study show that CEO able to use their power to fulfill their self interest in the firms (Albuquerque and Miao, 2013).

CEOs power is tend do not compromise with other executive opinions and variability in company performance increases along with the high influence of the CEO due to decision making is more likely to be taken by more dominant CEOs (Adams et al., 2005). Research conduct by Liu & Jiraporn (2010) show that CEO power has a negative effect to the bond rating. Meanwhile, Zhang & Khurana (2015) documented that the bond rating was inaccurate, imprecise and unstable for the company with the length of the CEO's tenure.

CEO power in the firms is can lead to a dominance power that can generate a negative effect on the rating of corporate bonds refer to the above explanation and theory, thus the first hypothesis in this study are:

H_1: CEO power has a negative effect on the corporate Islamic bonds rating

II.II. Corporate Governance and Corporate Islamic Bonds Rating

Corporate bonds rating is related to corporate governance that cover mechanism, process and correlation in organization structure. Any company makes corporate governance as one of the important pillars in the company's business activities. Firms with good corporate governance will reduce not only agency conflicts but also conflict between bondholders and shareholders by increasing incentives for decision makers, that will reduce the occurrence of errors which can push increasing of firm value and finally will degrade investors risk (Aman & Nguyen, 2013; Elhaj, Muhamed, and Ramli, 2017). Good corporate governance is associate with higher corporate bonds rating, because has important role for investors in credit market. Corporate governance able to reduce asymmetry information that can lead moral hazard problem when manager is used their power to pursue their self interest. If firms managers hunt their self interest, it's can push increase in agency risk faced by external stakeholders and decline firms future expected cash flows. This condition will push default risk for bondholders and make corporate bonds rating decline (Skaife, Collins & LaFond, 2006). Ouni & Omri (2010); Alali et al. (2012), mention that there are positive effect of good corporate governance to the corporate bonds rating. Finally, evidence shows that corporate governance systems are useful to protect the interests of bondholders by reducing the possibility of various unconscious problems that can adversely affect the company's bonds rating. Two of important corporate governance is the role of board of directors and board of commissioner.

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II.III. Board Of Directors And Corporate Islamic Bonds Rating

Board size shows how many directors sitting on the board. Board plays an important role in the firms to do control over manager representing shareholders interest. According to agency theory, limiting the number of boards to a certain level is believed to improve the firm's financial performance because the large number of boards can lead poor communication and difficulties in decision making. This condition is not relevance right now due to there are change in business condition, strategy and technology that drive firms to have more board of directors (Aldamen et al., 2012; Elhaj, Muhamed, and Ramli, 2017). The large number of board will play an important role in monitoring and controlling managers actions to improve firms performance that can bring companies to increase firms bonds rating. Large number of board also believed to mitigate agency conflict and reduce default risk for debt holders. A number of research show that board size has positive effect to the credit rating (Aman and Nguyen, 2013). Its mean that the large number of board will increase firms bond rating. Shaheen and Javid (2014), examine the determinants of credit rating in Pakistan and found that the board size had an effect on the firms credit rating. Different research result show by Altwijry (2015), mention that board size has negative effect to the corporate bonds rating. Refer to the above illustrations and theories, the second hypothesis can be formulated as follows:

H_2: Board size has a positive effect on the corporate Islamic bonds rating

II. IV. Board Of Commissioners Size And Corporate Islamic Bonds Rating

The National Governance Policy Committee (2006) defines the board of commissioners as the internal control mechanism that is collectively responsible for supervising and advising the board of directors and ensuring that the company implements good corporate governance. Jiraporn and Ning (2011) state that board of commissioners is an important corporate governance mechanism. The success of implementing corporate governance is largely determined by the quality of supervision carried out by the board of commissioners which can reduce the default risk and will increase the corporate bonds rating (Ross and Crossan, 2012). Based on the above explanation, this study third hypothesis as below:

H_3: Board of Commissioners size has a positive effect on corporate Islamic bonds rating

II. V. Auditors Reputation And Corporate Islamic Bonds Rating

The company's financial performance will be assessed based on financial reports issued by the company. Registered companies are always asked to submit their financial reports to the public. In the way to produce accurate and reliable financial statements, companies are asked to use reputable public accounting services, so that financial statements deliver are credible and reliable. Mostly, reputable public accounting services indicated by affiliated accounting services with a large accounting services that applies universally or known as the Big Four. Butar-Butar (2014) said that the signal about the quality of financial statements can be reflected in the accounting firm used by the company. Reputable auditors are believed to provide audit quality results, so that it is unlikely that the company will experience defaults risk that can increase the rating agency trust on the quality of the company, finally will increase the corporate bonds rating. The role of external auditors gives an opinion regarding the fairness of financial statements in making decisions. The higher of auditor's reputation, then the higher of firms certainty level, so that it is less likely that the company will fail. Research result conduct by Vina, 2017, show that auditor's reputation has a

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positive effect to the corporate bonds rating. Contrary research result mention by Pranoto et.al. (2017), found that auditor's reputation has a negative effect on corporate bond rating. Refer to the above explanation and theories, the fourth hypothesis can be formulated as follows:

H_4: Auditor's reputation has a positive effect on corporate Islamic bonds rating

II. VI. Firm Characteristic And Corporate Islamic Bonds Rating

Firm characteristics play an important role, because it can have a direct impact on the company's ability assessment by rating agency. Firm characteristic use in this study pervade productivity, leverage and firm size. Firm productivity measure how effectively the company is uses the resources owned by the firm. Firm with high productivity show the ability of the firm to generate the higher profits is compared to companies with low productivity levels. It will be effect to the firm credit rating. Research conduct by Winanti et. al. (2017) show that productivity has a positive effect to the corporate bond rating. Different result found by Pranoto et. al. (2017) mention that productivity has a negative effect to the Islamic bond rating.

Firm leverage indicate how much the firm uses debt to meet the company's funding needs. Firms high debt compared to the company equity is shows the higher default risk that will be faced by companies and will impact on the firm bond rating (Elhaj, Muhamed, and Ramli, 2017; Hussain et al., 2019). A number of research show that leverage has a negative effect to the bond rating (Barclay et al., 2006; Ashbaugh-Skaife et. al. 2006; Kisgen, 2006). Meanwhile, Purwasingsih (2013) mention that leverage has no effect to the Islamic bonds rating.

Firm size is one of the accounting variables that affects the firm Islamic bonds rating. Firm size represents company capability to maximize firm profitability and firm performance. The larger firm size will push the companies to have more capabilities, source of fund, economics of scale and product diversified (Khan, 2012). The large firm size shows the amount of total assets owned by the company, so it is less likely that the company will experience financial distress and bankruptcy. A number of research show that firm size has a positive effect to the Islamic bonds rating (Kilapong and Setiawati, 2012; Bradley and Chen, 2011; Aman and Nguyen, 2013).

III. **RESEARCH METHOD**

This research is applied research with quantitative approach. The data uses in this study was gather from the official website of Indonesia Stock Exchange (www.idx.co.id) and financial services authority (ww.ojk.go.id). The data was secondary data in the form of documents on financial statements, company annual report, statistic report, and etc. This research used firms that issued Islamic bonds for the period of 2013 -2017 which sample were taken from11 firms by using purposive sampling technique. Researcher also takes information which has already existed, like articles, journals, text books, and etc for additional information. The data used in this research is the combination of time series data and cross section data, which is known as pooling data/panel data.

This study analyze the effect of CEO power, corporate governance, auditors reputation on Islamic bonds rating. The variables are uses in this research consist Islamic bonds rating as dependent variable and CEO power, corporate governance, auditors reputation, also control variables as independent variables. All the variables used in this research and measurements are shown in table 1.

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In the way to test the hypothesis proposed in this research used ordinal regression model because of different categories of credit rating. Ordinal logit regression is the development of logistic regression for any dichotomous dependent variable allowing for more than two ordered response categories. This technique recommended whenever the dependent variable has multiple values that can be ranked from low to high like bonds rating. Empirical tests come from general models that represent CEO power, corporate governance, auditors reputation and firm characteristic:

IBR = f (CEO power, corporate governance, auditors reputation and firm characteristic).

Tabel 1:*Research variables and measurement*

Research Variables	Symbol	Measurement
Dependent Variable		
Islamic bonds rating	IBR	Ordinal rating score (AAA=7, AA=6, A=5, BBB=4, BB=3, B=2, C & D=1)
Independent Variables		
CEO power	CEO	CEO tenure
Corporate Governance		
Board size	BS	Number of board of directors
Board commissioners	BC	Number of board of directors
Auditors reputation	AR	Dummy variable equal to 1 if audit by the Big Four public accounting services, 0 otherwise
Firm characteristic		
Productivity	PRO	Net sales divided by total assets
Leverage	LEV	Total debt divided by total equity
Firm size	SIZE	Natural log of total assets

IV. RESULT AND DISCUSSION

IV. I. Descriptive Statistic

Summary of descriptive statistics of variables are explain in table II. The mean value of CEO power is 1.18. The average value of corporate governance is 1.65 same for both of variable used in this study and auditors reputation is 0.49. Firm characteristics have the average value for productivity is0.57, leverage is 1.84 and firm size is 30.53. The mean value of Islamic bonds rating by using ordinal data is 5.20. This results indicate that the average of sample Islamic bonds rating used in this research is passably and have investment grade rating.

Table 2:*Descriptive statistic of Islamic bonds rating*

Variables	Mean	Std. Deviation	Minimum	Maximum
IBR	5.2	1.61	1	7
CEO	1.18	0.84	0	2.71
BS	1.65	0.47	0.69	2.56
BC	1.65	0.37	0.69	2.3
AR	0.49	0.5	0	1
PRO	0.57	0.58	0.06	3.34
LEV	1.84	7.31	-44.97	25.01
SIZE	30.53	1.65	27.7	34.83

Source: Financial statement, annual report, statistic idx, ojk.go.id, data processed

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Ordinal logit regression result

The results of this study as shown in table III, show that CEO power as measured by CEO tenure has no effect on the corporate Islamic bond rating. The research result is not in line with study result by Liu & Jiraporn (2010) which states that CEO power has an effect on bond ratings. This condition is shows that the longer working period of the CEO does not have an effect on the increase or decrease on the Islamic bonds rating. The longer tenure of CEO's that can allowed the CEO to have better communication skills with rating agencies as mention by Listokin dan Taibleson, 2010; Becker dan Milbourn, 2011; Zhang & Khurana, 2015 was not proven to bring Islamic bonds rating as desire.

Tabel 3:*Ordinal logit regression result*

Variables	Wald	Sig.
CEO Tenure	0.36	0.55
Board Director Size	0.41	0.521
Board Commissioner size	6.77	0.009*
Productivity	3.37	0.066*
Leverage	0	0.966
Firm Size	4.04	0.045**
Auditor Reputation	2.98	0.084*

*Significant at $p < 0.10$, ** Significant at $p < 0.05$

Source: Financial statement, annual report, statistic idx, ojk.go.id, data processed

Corporate governance variables measured by the board size is show that board size does not affect the change in corporate Islamic bonds rating. Monitoring and controlling managers actions by board are still not effective to improve firms bonds rating. The role of board to mitigate agency conflict and reduce default risk for debt holders was not proven. Thus, the manager's oversight mechanism is not appropriate for managing corporate debt in order to maintain a reputation for credit worthiness in front of the rating agency. The number of boards are seems to be adjusted with the needs of the company for firms that issued Islamic bonds. This research results not in line with research conduct by Aman and Nguyen (2013); Shaheen and Javid (2014) that said board size has a positive effect to the credit rating. Meanwhile, corporate governance measured by board commissioners size has positive effect to the Islamic bonds rating. The ability of board commissioners in supervision of the firms is allowed companies to reduce the default risk and increase the corporate bonds rating. This research result imply that a large number of board commissioners will make Islamic bonds rating higher.

Auditors reputation is believed to provide quality and reliable financial statement audit results that can increase corporate Islamic bonds rating. Research result show that audits reputation positively affect the Islamic corporate bond rating, it's mean more reputable public accounting services is used by the firm, higher corporate Islamic bonds rating. Reputable auditors will provide certainty about the firm condition towards bondholders. Generally, reputable public accounting services or known as big four is used by large firm with better financial performance which can

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provide certainty to bondholders. This research result in line with research conduct by Vina (2017), show that auditor's reputation has a positive effect to the corporate bonds rating.

Firm characteristics as control variables consist of productivity, leverage and firm size show that productivity and firm size have a positive effect to the corporate Islamic bonds rating, meanwhile, leverage does not effect to the corporate Islamic bonds rating. Firm productivity level is elucidate how effective the company in using resources to increase firm sales. The higher of firm productivity level, then greater of company's ability to generate profits. This condition will increase the rating agency trusted to the companies that can improve corporate Islamic bonds rating. This study result in line with research conduct by Winanti et. al. (2017) mentioned that productivity has a positive effect to the corporate bond rating.

Leverage used by the firm to fulfill company financial needs. High level of debt in the company capital structure without better debt management will bring companies face financial distress that can decrease firm bond rating. Research result show that leverage does not affect corporate Islamic bonds rating, meaning larger or low debt rate in the firm do not lead to higher or lower corporate Islamic bonds rating. Firm who issued Islamic bonds in Indonesia believed by rating agency is used debt according to company requirements with better debt management, so it doesn't affect corporate Islamic bonds rating. This research result in line with Barclay et al. (2006); Ashbaugh-Skaife et. al. (2006); Kisgen (2006). Firm size show the company capability to increase firm profitability and firm performance. Positive relationship between firm size and corporate Islamic bonds rating show that bigger firms will have higher corporate bonds rating. The larger firm size then the less likely the company is experiencing financial problems that can increase corporate Islamic bonds rating. Finally, larger firm size will enjoy firm superior rating.

V. CONCLUSION

This study investigates whether CEO power, corporate governance and auditors reputation matters in influencing change of corporate Islamic bonds rating. We measure CEO power by using CEO tenure. Study result show that CEO power does not affect corporate Islamic bonds rating. This result highlight that longer tenure of CEO's with better communication skills unable to influence rating agency to get desired rating. Corporate governance measure by board size and board commissioners size point that only board commissioners affect on corporate Islamic bonds rating. Large number of board can't improve firm bonds rating. The role of board in increase firm bond rating through their role in monitoring and controlling managers still limited. Meanwhile, the role of board commissioners in the firm already effective in increase firm bonds rating. Auditors reputation also has positive effect on corporate Islamic bonds rating. The role of reputable auditors able to increase rating agency and bondholders credence. Reputable auditors able to provide certainty about firm performance.

Firm characteristics as control variables give different results. Productivity and firm size have a positive effect on corporate Islamic bonds rating, and leverage has no effect. Firm with high and large size will enjoy their superior rating and get credibility from bondholders.

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This study still have several limitations which may affect the research results. First, limitation of research sample used that is only 11 listed firms who issued corporate Islamic bonds for the period of 2013 – 2017 that fulfill the criteria. Thus, the researcher suggests that the future research will use a wider research sample and a longer period of time, so the number of observation is bigger and more accurate. Second, limitation of independent variables is used in this research. Thus, the researcher suggests that the future research will add more independent variables by collaborating with more theories and previous research.

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