Corporate Governance and Firm Value: The Case of Non-Financial Company in Indonesia

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Abstract. This study aims to assess how various aspects of corporate governance specifically, foreign ownership, CEO duality, the presence of independent commissioners, and the size of the board of commissioners influence market performance or firm value. The research relies on secondary data from the IDX website, with a sample comprising 535 non-financial companies from 2009 to 2019, selected using purposive sampling. The analysis was conducted through a stepwise regression method. Findings reveal that foreign ownership does not significantly impact firm value, and the independent board of commissioners also shows no significant effect. However, CEO duality and the size of the board of commissioners are found to negatively impact firm value, while the presence of independent commissioners exerts a positive influence. Among the corporate governance mechanisms analyzed, independent commissioners are shown to positively affect firm value.

Keywords: Corporate Governance, Non-Financial Company, Indonesia

1 Introduction

The Over the past few years, Indonesia has shown a positive trend in its economic growth. As a result, it contributed to a steady increase in business establishments. According to recent statistics from the Central Statistics Agency (BPS), approximately 3.98 million new businesses were founded over the past decade. Data from the 2019 economic census revealed a 17.51% rise in business entities since 2006, underscoring the intensifying competitive landscape across various industries. Currently many companies are growing and starting to develop which of course can lead to increasingly fierce competition. The more intense business competition, a company must determine a strategy and make efforts to be able to compete in an industry. Therefore, a company has an obligation to determine the direction of managing its assets so that it can provide maximum results for the company. In this process, the company certainly needs a lot of capital. A company can be said to have good performance if the company has an optimal proportion of capital structure [25]. All of these goals can be realized if the company has good performance.

Measurement of company performance in this study uses a market-based approach, Tobin's q. Market ratios can be used to see the development of company value based on the

IRCEB 2023, September 26, Malang, Indonesia
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DOI 10.4108/eai.26-9-2023.2350686

company's book value. The higher the value of the market ratio, the better the prospects for the company in the future. Tobin's q represents the ratio of a company’s market value to its total asset value. Favorable market conditions can drive up stock prices, while less favorable conditions may have the opposite effect. Market conditions are considered to have enormous potential in influencing the high and low values of Tobin's q [26]. Companies must have appropriate and strategic steps to achieve company goals. An essential aspect of achieving corporate objectives involves focusing on governance practices and funding policies.

The presence of Corporate Governance can assist companies in directing and controlling. Corporate Governance is very important to reduce bankruptcy risk and can increase the company's market value [23];[29]. [24] stated that foreign ownership is one of the determining factors for the successful implementation of good corporate governance. This is because foreign parties are very concerned about agency problems, where conflicts that occur between managers and shareholders can hinder the company in carrying out company goals. But when the relationship between shareholders and managers can be controlled through foreign ownership, the company's performance will be better. Foreign ownership will oversee the manager by including members who are considered to be responsible for managing the company optimally.

Agency theory posits that agents may act in self-interest, potentially prioritizing personal gains over shareholder value. From this perspective, CEO duality—where one individual holds both CEO and chairperson roles—can lead to excessive power concentration, dilute board oversight, and contribute to managerial entrenchment, all of which may negatively impact firm performance [2];[15]. This power consolidation is often criticized as weakening corporate governance [14]. Conversely, stewardship theory suggests that CEO duality can benefit the firm by creating cohesive leadership, projecting stability, and inspiring confidence in management [9]. According to this view, combining the roles may reduce the costs associated with role separation and improve firm performance [6].

Independent Commissioners act as an essential governance mechanism, providing oversight of company directors' policies and offering strategic guidance. The board size of Independent Commissioners can influence company performance: larger boards may face challenges in coordination and decision-making, while smaller boards often operate more efficiently. Additionally, Independent Commissioners contribute to improving the quality of financial reporting, thereby enhancing corporate value. For instance, research by [19] found a positive impact of independent commissioners on company value. In contrast, [7], examining Food and Beverage companies from 2015 to 2018, reported no significant link between independent commissioners and company value.

The board of commissioners, as a key corporate governance mechanism, is responsible for ensuring that directors perform their duties in alignment with shareholder directives established during general meetings [14]. Effective oversight by the board can guide directors to work more effectively and efficiently, thereby enhancing company value [3]. [18] demonstrated a significant positive relationship among the board of commissioners and company value. However, research by [27] indicated that an increase in board size could negatively impacted company value.

Apart from paying attention to the implementation of corporate governance, this study also considers other company characteristics such as tangibility and company age. With the support

of these factors, it is hoped that the results of the research will be more accurate and can be a reference for investors in choosing the right company to invest in.

2 Literature Review

2.1 Agency Theory

Agency theory describes the relationship between principals (shareholders) and agents (managers) as a contractual arrangement. This relationship arises when a principal hires an agent to provide certain services and grants decision-making authority to them. Managers may act opportunistically, sometimes prioritizing personal interests over the goal of maximizing shareholder wealth. These differing interests can lead to agency conflicts, particularly between shareholders and managers. Additionally, conflicts may emerge between shareholders and creditors, as well as between majority and minority shareholders.

Implementing good corporate governance can help reduce agency conflicts that frequently arise in the pursuit of maximizing corporate value. According to agency theory, a company must have good governance to reduce the possibility of conflicts of interest between agents and principals. Good governance structures can reduce information asymmetry [12]. The existence of good corporate governance is able to become a necessity that can bridge between investors and company management [22]. The aim of improving corporate governance is to reduce agency conflicts, so that company competitiveness and company value can increase. In addition, it also provides added value for all parties who have an interest in it continuously in the long term. Corporate governance strengthens the supervisory function, thereby lowering the risk of managerial misconduct [11]. Additionally, effective governance enhances company efficiency by establishing a robust framework for direction, control, and oversight [5];[30].

3 Methodology

3.1 Population and Samples

The population of this study included all companies listed on the Indonesia Stock Exchange (IDX) from 2009 to 2019. The sample focused on non-financial companies listed on the IDX, selected through purposive sampling, resulting in a total of 554 companies.

3.1 Variable Measurement

Table 1. Variable Measurement

Variable	Description	Measurement
Tobin's q (TOB)	This metric assesses the ratio between a publicly listed company's market value and the total of its assets.	$\frac{MVE + Total\ Liability}{Total\ Asset}$
Foreign Ownership (FOR)	Measure the percentage of the shares owned by foreign of the total listed shares	$\frac{Shares\ Owned\ by\ Foreign}{\text{Listed Shares}}$
CEO Duality (CD)	A company's Board Chairman who simultaneously serves as Chief Executive Officer.	**Dummy variable, given value 1 if a company's Board Chairman who simultaneously serves as Chief Executive Officer, and 0 otherwise**
Independent Commissioners (IC)	Calculates the percentage of independent board members relative to the total members on the board of commissioners.	**Independent commissioners / ∑ board of commissioners**
Board Size of Commissioners (BSIZE)	Measure a total board of commissioner	**∑ board of commissioners**
Asset Tangibility (TANG)	Calculate the asset structure by dividing the company's total fixed assets by the company's total assets.	$\frac{Fixed\ Asset}{Total\ Asset}$
Firm Age (LNAGE)	Calculate the age of the company since the year the company was listed on the capital market until the research period was conducted.	**Ln (IPO year – Research year)**

Source: data processed (2023)

3.2 Model

This study aimed to examine the impact of corporate governance on company performance, with Tobin's q serving as the performance metric. Stepwise regression was employed to test the proposed hypotheses, using the following equation model:

$$TOB = \alpha + \beta_1 FOR_{i,t} + \beta_5 TANG_{i,t} + \beta_6 LNAGE_{i,t} + \varepsilon \quad (1)$$

$$TOB = \alpha + \beta_2 CD_{i,t} + \beta_5 TANG_{i,t} + \beta_6 LNAGE_{i,t} + \varepsilon \quad (2)$$

$$TOB = \alpha + \beta_3 IC_{i,t} + \beta_5 TANG_{i,t} + \beta_6 LNAGE_{i,t} + \varepsilon \quad (3)$$

$$TOB = \alpha + \beta_4 BSIZE_{i,t} + \beta_5 TANG_{i,t} + \beta_6 LNAGE_{i,t} + \varepsilon \quad (4)$$

$$TOB = \alpha + \beta_1 FOR_{i,t} + \beta_2 CD_{i,t} + \beta_3 IC_{i,t} + \beta_4 BSIZE_{i,t} + \beta_5 TANG_{i,t} + \beta_6 LNAGE_{i,t} + \varepsilon \quad (5)$$

4 Results and Discussion

Table 2. Hypothesis Testing Results

VARIABLES	(1) TOB	(2) TOB	(3) TOB	(4) TOB	(5) TOB
FOR	0.421				0.416
	(0.395)				(0.404)
CD		-0.258***			-0.222***
		(0.084)			(0.071)
IC			0.788**		0.772**
			(0.339)		(0.351)
BSIZE				-0.057*	-0.059*
				(0.031)	(0.033)
TANG	-0.507**	-0.476**	-0.477**	-0.489**	-0.490**
	(0.213)	(0.199)	(0.197)	(0.200)	(0.209)
LNAGE	-0.427***	-0.376***	-0.371***	-0.347***	-0.382***
	(0.089)	(0.072)	(0.071)	(0.066)	(0.076)
Constant	3.171***	3.142***	2.765***	3.224***	3.018***
	(0.346)	(0.329)	(0.257)	(0.373)	(0.318)
Observations	3,769	3,769	3,800	3,800	3,769
R-squared	0.006	0.006	0.006	0.006	0.009
N	554	554	554	554	554

Source: Processed data (2023). *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

4.1 Effect of Foreign Ownership on Firm Value

Regression analysis results using the OLS method indicate that foreign ownership does not have a significant impact on company performance, as measured by Tobin's q. This shows that foreign ownership is not able to influence management decisions nor does its role as company supervisor go well because it has delegated the oversight function to the board of commissioners [8]. Even though foreign parties as majority shareholders have control and supervision over management, however, they do not do so strictly even though they have the ability to influence every management decision.

4.1 Effect of CEO Duality on Firm Value

CEO duality negatively affect company performance. According to agency theory, which underscores the importance of board oversight, it is essential for boards to maintain

independence from management to mitigate risks of managerial entrenchment and self-serving actions [12]. When board independence is compromised—such as in cases of CEO duality—the board's capacity to oversee management may be weakened, potentially leading to adverse performance outcomes [10];[13]. [2] suggest that CEO duality may reduce board oversight while increasing executive power. Additionally, CEO duality, where one person serves both as CEO and board chair, remains a contentious topic in strategic leadership due to its frequent association with declines in company performance and value.

4.2 Effect of Independent Commissioners on Firm Value

Independent commissioners have a favorable impact on company performance. Serving both as an oversight mechanism and a source of guidance for company managers, the board of commissioners plays a vital role in upholding corporate governance [4]. Independent commissioners, being external to the company, help balance decision-making within the board [17]. Through their supervisory role, independent commissioners shape important decisions that enhance reporting quality and overall company performance, thereby increasing company value. These results are consistent with [19], who also found that Good Corporate Governance (GCG), represented by an independent board of commissioners, positively affects company value. However, this contrasts with the findings of [7].

4.3 Effect of Board Size of Commissioners on Firm Value

The board of commissioners appears to negatively affect firm value, suggesting that an increase in board size might actually reduce company value. While the board of commissioners is intended to serve as an internal Good Corporate Governance (GCG) mechanism to ensure strategic alignment and oversee management, the observed negative effect indicates that a larger board may impair effective management oversight, leading to lower-quality decisions. This can affect investor confidence and, in turn, decrease firm value. [28] supports this view, noting a negative link between board size and company value due to weaker decision-making processes. [27] argue that the board's effectiveness in oversight is more dependent on its strategic and supervisory role than on its size, underscoring these responsibilities as the foundation of corporate governance.

4.4 Effect of Tangibility on Firm Value

The test results indicate that tangible assets have a negative and significant impact on company performance. A higher tangible asset ratio reflects an increase in the company's fixed assets. As tangible assets grow, maintenance costs rise, and these assets also experience depreciation, leading to reduced asset value over time. Additionally, excessive ownership of tangible assets can raise tax obligations. Together, these costs reduce company profits and, consequently, its value. These findings align with those of [21] but differ from the results of [1].

4.5 Effect of Firm Age on Firm Value

The findings indicate that company age has a significant negative impact on firm value, aligning with studies [20]. Hariyanto and Juniarti [31] suggest that older companies may be perceived as inflexible, slow to adapt, and lacking in innovation, which can reduce organizational profitability. Similarly, Loderer and Waelchli [32] found that older firms tend

to have lower profit margins, higher costs, outdated assets, and slower growth rates, factors that discourage investor interest and lead to a decline in company value.

5 Conclusion

The This study examines the impact of corporate governance on company performance. The findings reveal that CEO duality and the board size of commissioners negatively affect company performance, while independent commissioners have a positive effect. Foreign ownership, however, does not significantly impact performance. These findings suggest that independent commissioners serve as the most effective monitoring mechanism, with their role in decision-making contributing significantly to the quality of reporting and overall company performance.

The study, however, is limited by a short timeframe and constrained analytical tools, suggesting that future research could enhance robustness by incorporating longer timeframes, additional variables, and comparisons across industry sectors, as well as various measures of firm performance like return on assets or return on equity.

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