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Global Journal of Business and Social Science Review

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Foreword

Global Journal for Business & Social Science Review (GJBSSR) is a refereed international quarterly journal having an advisory panel from world's leading universities and business schools. the journal welcomes articles in all areas of Management and Business. Both theoretical and applied manuscripts are considered for the journal. The journal employs double blind and peer reviewed process. The primary goal of GJBSSR is to provide opportunities for Academicians and Corporate leaders from various business related fields in a global realm to publish their paper in one source.

In order to bring quality to the published work in GJBSSR, we have established an internationally renowned large Editorial Board, consisting of excellent scholars and well-qualified subject specialists. This is to ensure that the research published is filtered through double-blind peer review process thus bringing accuracy, clarity and quality to the work published.

This issue contains 45 articles. The authors of these articles come from different countries, namely, Britain, Australia, Indonesia, Malaysia, Bangladesh. The articles cover a wide range of topics, from Accounting, Finance, Banking, Marketing, Economics, Management, Law, Education, Political Science, Communication & Culture, Psychology and Society.

I sincerely hope that this journal will contribute to furthering business and social sciences research by exploring alternative methods, frameworks and issues, and delegates' career development in particular.

Furthermore, the GJBSSR is getting more international each year, which is and indicator that is getting worldwide known and recongnized. Scholars from all over the world contributed to the issue of the journal. Special thanks are to all the reviewers, the member of international editorial board and editorial staff.

I hope that you will enjoy reading the papers.

Best regards,

Editor In Chief

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The Effect of Corporate Governance on Firm Performance: Empirical Evidence from Indonesia

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ABSTRACT

Objective – The main purpose of this research is to examine the effect of corporate governance on firm performance. The corporate governance characteristics was represented by the board structure (board of commissioner, board of director and independent commissioner) and ownership structure (institutional ownership, managerial ownership and public ownership), while the proxy of firm performance is return on equity.

Methodology/Technique – This research used data from Indonesian Stock Exchange (IDX) period 2004-2014 with purposive sampling method and panel data regression analysis as data analysis method.

Findings – The empirical result indicate that board of director, independent commissioner, institutional ownership and public ownership in a company has significant effect on firm performance, otherwise the board of commissioner and managerial ownership has no significant effect on firm performance. Overall, all of the independent variables (board and ownership structure) have significant effect on firm performance.

Novelty – The use of long research period during 2000 to 2014 allows to see the consistency of the application of corporate governance in Indonesia since 2001. Confirmed that Corporate Governance (Board and Ownership Structure) have significant effect on firm performance in Indonesia.

Type of Paper: Empirical

Keywords: Board Structure; Corporate Governance; Firm Performance; Panel Data Analysis; Return on Equity; Ownership Structure

1. Introduction

Corporate Governance became familiar topic and received much more attention in the emerging market economies. Since 2001, when Enron Xerox, WorldCom gets involved in

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accounting scandals, the credibility of corporate financial reports started to under suspicion. Consequently, a corporate governance mechanism has been a crucial issue discussed again.

A research study in Indonesia, Hamzah and Suparjan (2009), find that the good corporate governance will increase the value of the firm. Corporate governance help direct the corporate system to be more focused, to increase corporate value and shareholder wealth.

The Indonesian Stock Exchange has made an effort to realize good corporate governance, in 20 July 2001 by implementing the regulations of Securities Registration about the Establishment of an Independent Commissioner, these regulations required all companies listed in Indonesian Stock Exchanges to establish an audit committee, independent board and company secretary. In the Private sector, there is also initiated to help disseminate corporate governance in Indonesia, such as forming some institutions, there are Forum for Corporate Governance in Indonesia (FCGI), Corporate Leadership Development in Indonesia (CLDI), Indonesian Institute for Corporate Directorship (IICD) and Indonesian Institute for Corporate Governance (IICG). Each institution has a different activity, but have the same goal of helping the government to socialize the application of corporate governance in Indonesia.

Many characteristics of corporate governance had been identified by Heenetigala & Armstrong (2011) and Zangina et al.,(2009). Zangina et al., (2009) find that board size, leverage and income volatility are significantly determined the firm value (share price), nevertheless inside ownership has no significant influence on firm value (share price). Heenetigala & Armstrong (2011), find positive relationship between governance practices (separate leadership, board composition, board committee) with the firm performance (based on return on equity, return on asset and Tobin's Q). Such a relationship along with this its effect shows that firms have implemented corporate governance strategy, has a higher profitability and share price performances.

Most of the works in the literature have evolved against the backdrop of developing economies, while there is very little known (empirically) about such issues in emerging market economies, like in Indonesia. Besides, there was inconsistency of the results from several prior studies about the influence of corporate governance characteristics and firm performance. Gap phenomenon occurs when there was inconsistencies direction of the relationship among the research variables, in which some researchers stated positively related corporate governance characteristics to firm performance, while some other researchers expressed negatively relationships. Those two reasons are exactly inspired the researcher to examine the effect of corporate governance on firm performance in Indonesia, during the period 2000 to 2014. The reason for choosing the period of 2000 to 2014 is during the period the economic situation in Indonesia has gradually improved after the monetary crisis in 1998.

The results of this study are expected to give a new contribution to the firms, investors, governance and the researchers. The First is to provide evidence about the effects of corporate governance on firm performance in Indonesian firms at the time 2000 - 2014. The Second is for the firms those are listed on the Indonesia Stock Exchange, the result of this research can be used to better manage corporate governance in order to achieve the higher firm performance. For investors the research results can be used to assist investment decision. For the government, they can be trigger to make a good corporate government regulation. Finally, for the scientific research will open new horizons in research and issues of financial management, especially about the issue of corporate governance and firm performance.

2. Literature Review

According to Cadbury Committee, Corporate Governance is a set of rules that define the relationship between shareholders, managers, creditors, the government, employees and internal and external stakeholders in respect of their rights and responsibilities. Since the early work of Berle and Means (1932), corporate governance has focused upon the principal-agent problems arising from the dispersed ownership in the modern corporation. They viewed corporate governance as a mechanism where a board of directors is an essential monitoring device to minimize the problems brought about by the principal-agent relationship. In this context, agents are the managers, principals are the owners and the board of directors act as

the monitoring mechanism. The separation of ownership from management can lead to managers of firms taking action that may not maximize shareholder wealth, but could benefit them and not the owners. Hence a monitoring mechanism is required to protect shareholder interests (Jensen & Meckling 1976).

2.1 Corporate Governance in Indonesia

In Indonesia, several institutions propose a definition of corporate governance, one of the institutions is FCGI (Forum for Corporate Governance in Indonesia). Corporate Governance can be defined as a set of rules that govern the relationship between shareholders, directors (managers), creditors, government, employees and all of the internal and external others that relating to their rights and obligations or in the other words, as a system regulating and controlling the firms (FCGI, 2002). Corporate governance problems arise due to separation between ownership and control of the company (agency theory). Asian Development Bank (ADB) explained that:

> The issue of corporate governance arises because of the separation of ownership from control in modern corporations. When salaried managers run companies on behalf of dispersed shareholders, they may not act in shareholders and managers, but also between controlling and minority shareholders, between shareholders and creditors and between controlling shareholders and other stakeholders; including suppliers and workers. A sound corporate governance system should provide effective protection for shareholders and creditors such that they do not deny the return on their investment (Zhuang, 1999).

Some consequences are, first, the owners can be divided into two groups, namely controlling and minority shareholders, it may cause misalignment of interests. In Indonesia, it is very often the case, which the controlling shareholders become the main actors in the control of management and therefore the decision was not appropriate because it may harm the interests of minority shareholders. Second, good corporate governance system should provide effective protection for shareholders and creditors. The protection can be done through an internal mechanism (internal monitoring and control) and external mechanism. The external system of corporate governance consists of, first, the regulations that clarify between shareholders, managers, creditors, government and other stakeholders (legislation defining the rights and obligations), and the second, a wide variety of mechanisms, either directly or indirectly, in term of enforcing regulations.

To ensure the achievement of Good Corporate Governance, firms should pay more attention to several principles: transparency, accountability, responsibility, independence, and fairness. The implementation of Good Corporate Governance can be found in the corporate governance characteristics such as board structure (board of commissioner, board of director and independent commissioner) and ownership structure (institutional ownership, managerial ownership and public ownership). Therefore, we hypothesized:

Corporate governance characteristics that represented by board structure (board of commissioner, board of director and independent commissioner) and ownership structure (institutional ownership, managerial ownership and public ownership) has a significant effect on firm performance.

3. Data and Methodology

3.1 Data

The data used in this study is secondary data in the form of annual financial report of the company listed in the Indonesian Stock Exchange during the period of 2000 to 2014. This research takes only the primary and secondary sectors based on JASICA (Jakarta Stock Industrial Classification) Index, and excludes both financial and services companies due to the implication of their regulation. Used purposive sampling technique, based on following criteria:

1. Listed as an Emiten in Indonesian Stock Exchange during 2000 – 2014 (never had a delisting)
2. Issue financial statements yearly
3. The information about board structure (board of commissioner, board of director and independent commissioner), ownership structure (institutional ownership, managerial ownership and public ownership) and firm performance should be mentioned in the financial statements

3.2 Develop the Model

Data used in this study can be categorized as a panel (pooled) data, because used the combination of time series data (15 year period, 2000 – 2014) and cross section data (all primary and secondary firms listed in the Indonesian Stock Exchange). Thus, regression model using panel data referred as a Panel Data Regression Model. According to Gujarati, 2004, there are three estimations of panel data regression model: pooled OLS regression model, fixed effect model and random effect model. Statistical test should perform to be assigned the appropriate model. After obtaining the appropriate panel data regression model, the next step is to do a classical assumption test, such as autocorrelation, multicolinearity and heterocedasticity test.

The panel data regression analysis used to explain the relationship between corporate governance characteristics and firm performance, with the basic model:

$$FP_{i,t} = \alpha + \beta_1 \textit{Board of Commisioner}_{i,t} + \beta_2 \textit{Board of Director}_{i,t} + \beta_3 \textit{Independent Commisioner}_{i,t} + \beta_4 \textit{Institutional Ownership}_{i,t} + \beta_5 \textit{Managerial Ownership}_{i,t} + \beta_6 \textit{Public Ownership}_{i,t} + \varepsilon_{i,t}. \quad (1)$$

Where:

$FP_{i,t}$ = firm performance of firm *i* at time *t*

$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5, \beta_6$ = coefficient regression of each regressor firm *i* at time *t*.

$\varepsilon_{i,t}$ = error term of firm *i* at time *t*

Firm Performance is the dependent variable which is a proxy of profitability, measured by:

$$Return\ on\ Equity = \frac{Net\ Income}{} \quad (2)$$

Corporate governance represented by board structure and ownership structure, each of the variables measured by:

a. Board of Commissioner = ∑ Number of commissioners (3)
b. Board of Director = ∑ Number of active members of the board directors (4)
c. Independent commissioner = ∑ Number of independent commissioners (5)
d. Institutional ownership = % of shares owned by institutions (6)
e. Managerial ownership = % of shares owned by managers (7)
f. Public ownership = % of shares owned by the public (8)

Some prior studies, declared that large board of director and board of commissioner has diverse opinion and consensus is difficult to reach, then the efficiency being lower (Lipton ND Lorsch, 1992), but the other study reverse, the larger board implies members with diverse background and viewpoints, which is helpful for the quality of decisions therefore positively significant with the firm performance (Bacon, 1973; Zahra & Pearce, 1989; Kiehl & Nicholson, 2003). The independent commissioner must be independent, because according to the Agency Theory, when a chairman acting ad decision maker and supervisor at the same time, the function of the board to minimize the agency cost could be weaken tremendously, in the end corporate performance goes down (Jensen and Meckling, 1976). Besides, ownership structure has a negative significant effect on firm performance, Berle and Means (1932), stated that ownership dispersion may contribute to agency problems between managers and shareholders or shareholders and debtors, then it will cause the lower firm performance.

4. Results and Discussion

This study uses balance panel data with 50 firms as samples, which are classified as primary and secondary industry and listed in the Indonesian Stock Exchange during the period 2000 – 2014.

We use the fixed effect model in panel data regression analysis. This study passes the classical assumption test, there is no autocorrelation, multicollinearity and heteroscedasticity.

Table 1. Descriptive statistics

	ROE	BC	BD	IC	IO	MO	PO
Mean	0.2719	4.6520	4.9533	1.5613	0.6877	0.0342	0.2594
Maximum	31.4500	16.000	12.000	7.0000	0.9960	0.6720	0.9774
Minimum	-44.4152	0.0000	2.0000	0.0000	0.0000	0.0000	-3.7600
Std. Dev.	2.5033	2.1344	1.9103	1.1051	0.2104	0.0537	0.1859
Observations	750	750	750	750	750	750	750

Table 1. shows that from 750 observations, we obtain the average return on equity 27.19%, means that the owner gets return 27.19% from their investments in companies. The average value of board structure: board of commissioner, board of director and independent commissioner are 4.65, 4.95 and 1.56. During the period 2000 – 2014, the average number of commissioners and directors owned by the company is around 4 – 5 persons, and the average of the proportion of the independent commissioners owned by the company is 1-2 persons. Meanwhile the average value of ownership structure: institutional ownership, managerial ownership and public ownership are 68.77%, 3.42% and 25.94%, means that based on the three kinds of ownership structure, the institutional ownership dominated with the highest average value 68.77%.

4.1 Regression Results

We will test the effect direction and the significance between independent variables (board and ownership structure) and dependent variables (firm performance).

Table 2. Regression Results

Dependent Variable: ROE
Method: Panel Least Squares (Cross-section weights)
Sample: 2000 2014
Periods Included: 15
Cross-sections included: 50
Total panel (balanced) observations: 750

Variable	Coefficient	Std. Error	t-Statistic	Prob.	R^2
C	0.3039	0.1149	2.6460	0.0083	0.7792
BC	0.0016	0.0074	0.2164	0.8287	
BD	-0.0135	0.0065	-2.0942	0.0366*	**Adjust R2**
IC	0.0770	0.0152	5.0849	0.0000*	0.7048
IO	0.1136	0.1107	-1.0255	0.0355*	
MO	-0.4850	0.2544	-1.9069	0.0569	
PO	0.4291	0.1275	-3.3672	0.0008*	
F Statistics	10.4646				
Prob (F-Stat)	0.0000				

Based on the regression results table, there are four variables that have a significant effect to firm performance: board of director, independent commissioner, institutional ownership and public ownership. While in overall, corporate governance characteristics (board and ownership structure) have a significant effect to firm performance (probability value of F-statistics = 0.0000 below $\alpha = 0.005$).

Adj-R2 showed 70.48%, means that 70.48% firm performance can be explained by the board and ownership structure (board of commissioners, board of director, independent commissioner, institutional ownership, managerial ownership and public ownership), while the rest 29.52% is explained by the other variables.

The main objective of this study is to examine the effect of corporate governance characteristics on firm performance. Corporate governance characteristics are represented by board structure (board of commissioners, board of director and independent commissioner) and ownership structure (institutional ownership, managerial ownership and public ownership).

Board of director has a negative significant effect on firm performance, means that the increase in board size member will have significant effect to decrease firm performance, this research study shows that the increase of board director seen as something does not benefit to the firm performance, contrast with independent commissioner. An increase in independent commissioner has positive significant effect to firm performance, because the existence of an independent commissioner is expected to help monitor the actions of directors to act in the interest of the company. They believed that independent commissioner is a member of a board of commissioner who are not affiliated with the board of directors, other commission members and controlling shareholders, as well as free of the business relationship or other relationship which could affect its ability to act independently or act solely in the interests of the company.

There are two variables from ownership structure that has a positive significant effect to firm performance, shows that the domination of the ownership by some large institutions proven to force company, they provide best efforts to get a positive contribution to firm performance. Although the public ownership have a small percentage in the ownership structure but also have a significant effect to contribute to increase firm performance.

5. Conclusion and Limitations

Based on panel data regression test, there are four variables of corporate governance characteristics that have significant effect on firm performance during the period 2000-2014, those are board of director, independent commissioner, institutional ownership and public ownership, while the board of commissioner and managerial ownership have no significant effect. Therefore the firm has to pay attention more to the board of director, independent commissioner, institutional ownership and public ownership (firm need to consider properly the decision related to increase or decrease the board size of director or the decision to change the percentage of institutional and public ownership, because every decision will give impact to firm performance). The limitations of this research are:

1. Use of Indonesian company listed in the Indonesian Stock Exchange, thus it can enrich the result analysis for various types of Industry.
2. Consider to use control variable to see the impact of corporate governance characteristics to firm performance.
3. Indonesian Stock Exchange (IDX) was implementing good corporate governance in 20th of July 2001. Therefore, we need to consider to make research comparison between the periods before and after the implementation of Good Corporate Governance in Indonesia, it could help us to get a clear picture about the implementation of Corporate Governance in Indonesia.

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