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Does the Quality of Good Corporate Governance Provide Economic Value for Investors? Evidence from Indonesia

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Abstract—This study aims to examine the impact of Good Corporate Governance (GCG) on corporate value by using financial performance proxied by Return on Assets (ROA) and Return on Equity (ROE) as intervening variables. The samples used in this study were Non-financial companies participating in the Corporate Governance Perception Index (CGPI) listed on the Stock Exchange during the period 2012 to 2016. The sampling technique used in this study was purposive sampling technique.The tests that will be carried out are Analysis of Multiple Linear Regression and Hypothesis Test (partial and simultaneous test) using the Eviews program. The test results show that the variable Good Corporate Governance (GCG) has a significant positive effect on Return on Assets (ROA), the Return on Assets (ROA) variable has a significant positive effect on influencing the value of the company. ROA variables are proven to interfere with the influence of Good Corporate Governance (GCG) on company value. While the ROE variable is not proven to mediate the influence of GCG on the value of the company. The direct influence of Good Corporate Governance on company value is also not empirically proven. GCG variables have no effect on ROE. Likewise the ROE variable does not have an influence on the value of the company.

Index Terms—Good Corporate Governance, Firm Value, ROA, ROE

I. INTRODUCTION

Good Corporate Governance (GCG) is a system that regulates and controls companies that create added value for all stakeholders, Kaihatu (2006). The benefits of implementing GCG in a company are to reduce agency costs arising from abuse of authority, increase the value of company shares, protect the rights and interests of shareholders, and improve the efficiency and effectiveness of the board or top management and company management, while improving relationship quality between top management and senior management of the company, Taufik (2006) in Sutojo and Aldridge (2009).

Company value is the company's selling value or added value for shareholders. The value of the company will be reflected in its stock market prices, Andri and Hanung (2007). Tobin’s Q is a more rigorous measure of how effectively management uses economic resources in its power. Financial performance is one of the ways in which management fulfills its obligations to funders and its objectives have been set by the company, (Khumairoh, Sambharakreshna, &Kompyurini, 2014). Thus financial performance has an important meaning in the company because it helps in making decisions for both the company's internal and external parties. Accordingto (Wibowo, Yokhebed, &Tampubolon, 2016) stated that the financial performance (performing measurement) of a company can be seen from its profit.

The research questions in this study are as follows:

1. Does the quality of Good Corporate Governance affect profitability?
2. Does the quality of Good Corporate Governance affect Return on Equity?
3. Does Return on Assets (ROA) affect Tobin’s Q?
4. Does Return on Assets (ROA) affect Tobin’s Q?
5. Does the quality of Good Corporate Governance affect Tobin’s Q directly?
6. Does the quality of Good Corporate Governance affect Tobin’s Q through ROA as an intervening variable?
7. Doesthe quality of Good Corporate Governance affect Tobin’s Q through ROE as an intervening variable?

II. THEORETICAL FRAMEWORK AND HYPOTHESES

A. Theoretical Framework

Good Corporate Governance and Return on Assets have a role in improving company performance. The efficiency of the company will increase and reduce the cost of capital to produce high corporate profits. Investors will tend to avoid companies that have a bad GCG predicate that results in company performance. If corporate governance can run well it will affect the company's performance, have a higher market valuation and increase profits that can be seen through the ROA ratio. A good predicate or quality of Corporate governance has a positive effect on Return on Assets.

One indicator to measure financial performance is Return on Equity which is a comparison of net income after tax on capital invested by the capital owner. Therefore, managers have a responsibility to obtain higher profits than the capital invested by investors. In its implementation, a GCG mechanism is needed to avoid agency conflicts. This is supported by the existence of agency theory where this theory is used as an intermediary between managers and capital owners. Good Corporate Governance quality influences Return on Equity supported by research from Ratih, Sukimah (2011).

According to Ken Zuraedah (2010) research, it shows that ROA and CSR cost allocation affect the value of the company measured using Tobin’s Q. According to Rahayu

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(2010), the company's financial performance and work performance are contained in the company's financial statements. This is one of the ways that management fulfills its obligations to funders. Companies that have good financial performance will carry out good operational activities, so that the company is expected to obtain high profits and then pay high dividends to investors. This shows the relationship between Return on assets Against Tobins Q which is the main goal of the company Ratih, Sukimah (2011). This is supported by the research of Ken Zuraedah (2010) danRahayu (2010) danMulyani(2014).

Good Financial performancereflects the quality of the company, so it will generate interest in interest by investors to invest. ROE and Tobins Q have a direct relationship. This is supported by Ayu (2016) and Lismasari (2016) research. Previous research also shows that Return on Equity (ROE) has an effect on TobinsQ which is based on the argument that profits derived from equity affect the value of the company that is proxied by TobinsQ. If the company's financial performance is good, investors will attract interest in investing. Companies with high profitability will get more or enough funds, so that the company's prospects will increase which can attract investors to increase stock demand. This is in accordance with the signaling theory. Increasing demand for shares will cause the value of the company to increase(Martikarini, 2014).

The quality of implementing Good Corporate Governance brings great benefits to the company, because companies that implement GCG well will have good operational performance as well. Mc. Kinsey and Co (2002) show that investors tend to avoid companies with a bad predicate in corporate governance, because there is still a conflict of interest within the company, which worries investors. In applying the principles of good corporate governance, a strong structure is needed and able to act as a role model and driving force so that the implementation of GCG can run optimally. In addition, the purpose of implementing GCG is to improve company performance over time. Theoretically, companies that implement GCG can certainly be able to increase company value. Through the implementation of GCG, it is able to reduce the risks that may be carried out by those who have authority in making decisions that benefit themselves, and generally corporate governance can increase investor confidence in the company, (Gwenda, 2013) in (Newell and Wilson, 2002). The research conducted by Sayidah (2007), shows that GCG Quality has an effect on Tobins Q directly.

Return on Assets(ROA) is used to measure the effectiveness of a company's overall operations. Companies that implement GCG will find it easier to get funding with lower capital costs, making it easier for companies to obtain loan capital. This is because investors believe companies that implement GCG will be able to prosper stakeholders. FCGI (2006) explains that GCG, makes it easier to obtain capital, lower cost of capital, so it can increase efficiency which will affect financial performance and business performance which is indicated by the company's stock price and the value of the company increases. According to research conducted by Ratih (2011) which states that the quality of GCG affects ROA.

Return on Equity shows the extent to which the company manages its own capital effectively, measures the level of profits from investments that have been made by the owners of their own capital or often called the company's profitability. Companies that implement GCG will have good quality company management so they are able to know the factors that can increase ROE which will make it easier for companies through financial creditors to further increase company profits through return on equity or company capital. So that later it can provide good dividends to shareholders and can be a consideration for investors to invest their capital into the company. In addition, it will have an impact on stock prices and the value of the company will also increase.

B. Hypotheses

Some of the hypotheses proposed in this study are as follows:

H1: The quality of Good Corporate Governance (GCG) has a significant positive effect on Return On Assets (ROA).

H2: Quality of Good Corporate Governance (GCG) has a significant positive effect on Return On Equity (ROE).

H3: Return on Assets (ROA) has a Significantly Positive Impact on Tobin's Q.

H4: Return on Equity (ROE) has a positive effect on Tobin's Q.

H5: The quality of Good Corporate Governance (GCG) has a significant positive effect on Tobin's Q directly.

H6: The quality of Good Corporate Governance (GCG) has a significant effect on Tobin's Q through ROA as an intervening variable.

H7: The quality of Good Corporate Governance (GCG) has a significant effect on Tobin's Q through ROE as an intervening variable.

III. METHODOLOGY

Data and Resources

The data used in this study is secondary data obtained from the Indonesia Stock Exchange (IDX). The sample that will be used in this study are companies that participate in the Corporate Governance Perception Index (CGPI). The sampling technique used in this study was purposive sampling method with the following criteria:

Companies listed on the Indonesia Stock Exchange (IDX) for the period 2012 - 2016.

The company studied has implemented GCG and has followed the Corporate Governance Perception Index (CGPI) ranking in a row during the period 2012-2016.

Companies that publish complete financial statements in the rupiah during the 2012-2016 period.

Research Model

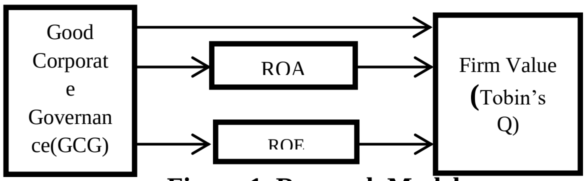

Figure 1. Research Model

Model Formulation

SPSS software will be used to: (1) test descriptive statistics, (2) eliminate outlier data. While the EVIEWS software will be used to carry out classical assumption tests and research hypothesis tests. Hypothesis 1 through hypothesis 5 in this study will be tested using multiple linear regression. To test hypotheses 6 and 7 is done by looking at the results of the hypothesis 1 to 5 regression tests. In this study, all data that will be used uses a scale ratio. The relationship between variables can be described by the following equation:

ROA = $\alpha + \beta 1$ GCG + e.......................................(1)

ROE = $\alpha + \beta 1$ GCG + e.................................... (2)

Tobin's Q = $\alpha + \beta 1$ GCG + $\beta 2$ ROA + $\beta 3$ROE + e.(3)

Information:

α = constant

β = Slope or Regression Coefficient (value of increase or decrease)

Tobin's Q = Company Value

ROA = Return on Asset (Financial Performance Proxy)

ROE = Return on Equity ((Financial Performance Proxy)

e = Error

IV. RESULT

Results of Multiple Linear Regression equations one, two and three are shown in the following Tables 1, 2 and 3:

Table 1.
Results of Multiple Linear Regression Equation 1

Variable	Coefficient	t- Statistic	Prob
C	-0,141272	-2,346159	0,0260
GCG	0,314131	3,499288	0,0015

Table 2.
Results of Multiple Linear Regression Equation 2

Variabel	Coefficient	t-Statistic	Prob
C	-0,106441	-0,534696	0,5969
GCG	0,308327	1,281956	0,2100

Table 3.
Results of Multiple Linear Regression Equation 3

Variabel	Coefficient	t-Statistic	Prob
C	1,094861	0,981326	0,3351
ROA	7,700226	2,487754	0,0193
ROE	0,506690	0,233976	0,8168
GCG	-0,217863	-0,158387	0,8753

Summary of Hypotheses Testing Results

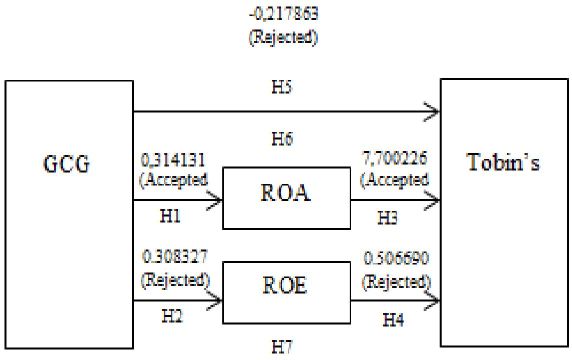

Figure 2. Summary of Hypotheses Testing Result

V. DISCUSSION

Investors will tend to choose companies that have a good GCG predicate because this will affect the company's performance. Good Corporate Governance can increase the efficiency of the company so that the profits obtained by the company will increase as well. A good predicate or quality of Corporate governance has a positive effect on Return on Assets. This result is supported by the results of the study of Premuroso&Bhattacharaya (2008) and Sakai &Asaoka (2003) which states that GCG has a positive and significant effect on ROA.

The second hypothesis in this study shows insignificant results, so the hypothesis is rejected. This is possible due to the data in this study which shows that the average Return on Equity (ROE) received by investors from 2012 - 2016 shows a declining trend. The net profit received by the company may increase, but the increase in Return on Assets (ROA) does not necessarily affect the amount of profit received by investors. The profits obtained by the company are not necessarily used to pay dividends to investors but the company has a decision to use profits for investment or be used as retained earnings which can be used as the company's capital in the next period. Companies that have benefits from equity do not affect the value of the company that is proxied by Tobins Q.

Good Financial performance will cause the company to carry out its operational activities well too, so that the company is expected to obtain a high level of profit. Through this high level of profit, the company is expected to pay high dividends to investors. The results of this study are supported by the research of Zuraedah (2010) and Rahayu (2010) and Luh (2014) who have successfully proven Return on Assets (ROA) to have a significant positive effect on firm value.

Return on Equity (ROE) is not proven to have an effect on company value. This can be caused because it starts with the average ROE in 2012-2016 which shows a declining trend. The decrease in ROE is caused by the number of companies that lose or decrease the amount of profit while the amount of their own capital increases, resulting in a low ROE value. Low ROE indicates that the company is unable to make a profit for shareholders. The results of this study support previous research conducted by Tetelepta (2011) which states that ROE does not affect the value of the company.

The result of this study are supported by research conducted by Sumarno (2010) which shows that GCG does not affect the value of the company. Good corporate governance is a system that regulates and controls the performance of the company, so as to increase the value of the company. GCG measured using CGPI issued by IICG is a measurement to see whether companies in Indonesia have implemented GCG properly. It is possible to implement GCG practices in companies, but the implementation has not been applied evenly by companies in accordance with GCG principles or it can be said that GCG practices implemented by companies are only mere formality (Sumamo, 2010).

Based on table 4, it shows that ROA is able to be intervening or mediate between GCG and Tobins Q. Variables are called to be intervening variables if the indirect correlation coefficient value is greater than the direct and significant relationship coefficient value. ROA is able to mediate or be intervening from the influence of GCG on Tobins Q. These results indicate that high levels of GCG with appropriate use will make the company better productivity assets in generating net profits. Then, an increase in assets will make the company more attractive to investors. This result is in accordance with research from Kartika & Ferry (2012)

Based ontable 4, it can be seen that ROE is unable to mediate or be intervening from the effect of GCG on Tobin’s Q. This result is due to GCG not proven to significantly affect ROE. And the effect of Return on Equity (ROE) on Tobin’s Q is also not proven to increase company value. It is possible for other variables to be more appropriate to be mediators between the variables of Good Corporate Governance on Return on Equity, as well as the Return on Assets variable which has proven to be significant in mediating the effect of GCG on Tobin’s.

Tabel 4. Indirect Effect of GCG to Firm Value

Effect between variable	Causal Effect		Tobin’s	
	Direct Effect	Indirect Effect ThroughROA	Direct Effect	Indirect Effect
GCG – TOBIN’S	-0,217863	(0,314131) X(7,700226)= 2,41887969	Insignificant	Sig
Effect between variable	Causal Effect		Tobin’s	
	Direct Effect	Indirect Effect ThroughROE	Direct Effect	Indirect Effect
GCG – TOBIN’S	-0,217863	(0,308327) X(0,506690)= 0,15622621	Insignificant	Insignificant
GCG - ROA	0,314131	-	Sig	-
ROA – TOBIN’S	7,700226	-	Sig	-
GCG – ROE	0,308327	-	Insignificant	-
ROE – TOBIN’S	0,506690	-	Insignificant	-

VI. CONCLUSION AND IMPLICATION

This study examines the importance of the quality of GoodCorporateGovernance in increasing the value of the company, so that investors can use this variable as a consideration in making investment decisions. In testing the model, the researcher uses the ROA and ROE variables as intervening variables, so that it can be known whether Good Corporate Governance can increase company value directly or through intervening variables. Data used are companies that participate in the Corporate Governance Perception Index (CGPI) during the period 2012-2016.

The regression finding showed that Good CorporateGovernance does not directly influence the value of the company. ROE variable is proven to be able to significantly mediate the influence of Good Corporate Governance and Tobins Q. Meanwhile, the ROE variable is also not proven to mediate the effect of Good Corporate Governance on firm value. Based on the results of this test, it can be concluded that Good Corporate Governance can make the company more efficient so that the company's profitability increases. Increasing ROA can increase firm value.

Futhermore, the result showed that Good corporate governance has no effect on ROE. In addition, ROE also does not prove to significantly affect firm value (Tobin’s Q).

The implication of this study can be explained by three point as follows:

1. This research can be used by academics as an additional reference and enrich the findings according to the topic of this research.
2. Prospective investors can consider the factors that prove significant in increasing the value of the company, so as to maximize the return that will be obtained.
3. Companies can make consideration of variables that have proven influence can increase company profits so as to increase the value of the company in this study. Companies should be able to apply the principles of Good Corporate Governance so that they can increase company profits and ultimately increase company value.

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