

## **The Influence of Good Corporate Governance and Financial Performance on Firm Value**

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### **ABSTRACT**

Good Corporate Governance is a system that regulates the roles of the board of commissioners, the board of directors, shareholders, and other stakeholders. Every company is expected to implement Good Corporate Governance to support financial performance, which can also increase the company's value. However, some companies experienced performance issues and even losses, especially during the COVID-19 pandemic. In such a pandemic phenomenon, an alternative global financial system is needed, one of which is Islamic finance, which was also discussed during the global financial crisis of 2008-2009. This study aims to analyze the influence of good corporate governance, including variables such as the board of directors, institutional ownership, managerial ownership, audit committee, and audit quality, as well as financial performance measured by cash flow return on assets (CFROA) on firm value, and to compare the results between conventional and sharia banking. The type of this research is quantitative research with the research population being conventional and sharia banking listed on the Indonesia Stock Exchange for the period 2019 to 2023, with sampling using the purposive sampling technique. The data used are documentary data in the form of financial statements and annual reports. The analysis method used is multiple linear regression analysis, and hypothesis testing is conducted using the F statistical test (Simultaneously) and the t statistical test (partially) with the Eviews 12 software.

**Keywords: Good Corporate Governance, Financial Performance, Stock Return, Sharia Finance.**

## **INTRODUCTION**

A company has a long-term goal of maximizing the company's value. The higher the company's value, the greater the prosperity of the shareholders will increase. According to Aries (2011), the value of a company is the result of management's work from several dimensions, including net cash flow from investment decisions, growth, and the company's cost of capital. For investors, the value of a company is an important concept because it is an indicator of how the market assesses the company as a whole. The value of a company is often associated with investors' views on the level of success of a company, which is influenced by the stock price, so if the stock price is high, the value of the company can also be high. According to Fatimah et al (2017), the value of a company is fundamental for a company because optimizing the value of a company is equivalent to optimizing the company's main objectives. This will attract investors to invest in value above the company's asset value.

At the end of 2019, the world was shocked by the emergence of a new outbreak called COVID-19 (Corona Virus Disease 2019), which is known to attack the human respiratory system. The outbreak originated in the city of Wuhan, China, and the local government officially reported its existence to the World Health Organization (WHO) in December 2019. ([www.who.int](http://www.who.int)). The WHO officially declared the COVID-19 outbreak a global pandemic due to its rapid spread to almost every country in the world, with over 700 million cases and around 6 million deaths recorded by March 2023. In response to the COVID-19 pandemic, many countries implemented lockdowns to prevent the spread of the virus and stabilize the situation in their nations. The Indonesian government itself established the Large-Scale Social Restrictions (PSBB) policy by issuing Government Regulation of the Republic of Indonesia Number 21 of 2020 concerning Large-Scale Social Restrictions in the Context of Accelerating the Handling of Corona Virus Disease 19 (COVID-19), also through regulations from each district/city mayor. The policy was implemented as a form of protection for public health. The restrictions imposed by the government include at least the closure of schools and workplaces (work from home), restrictions on religious activities, and restrictions on activities in public places or facilities, including tourist attractions.

The COVID-19 pandemic has had negative implications for Indonesia's social life and economy. With the implementation of PSBB, most industries and offices are prohibited from operating for a considerable period, resulting in economic losses. (Hadiwardoyo, 2020). Data from the Central Statistics Agency (BPS) shows that Indonesia's economic growth in 2020 experienced a contraction of 2.07 percent. The unstable movement of Indonesia's economy led to deflation or a drastic decline in Indonesia's economy in 2020. A company with good governance is certainly expected to maintain its value during disasters such as the COVID-19 pandemic. Good corporate governance is considered capable of providing greater benefits to

investors. The results of a survey by the global management consulting firm McKinsey show that many global investors are willing to pay a premium price of up to 40% for shares of issuers with good corporate governance. The performance of shares from issuers with good corporate governance will be much higher than that of issuers with poor corporate governance practices. (Sanny, 2018).

The development of Good Corporate Governance (GCG) among domestic issuers is considered to be not yet optimal. Some time ago, the Lippo Group, including LPKR (PT Lippo Karawaci Tbk) and LPCK (PT Lippo Cikarang Tbk), was accused of not implementing GCG properly, as they secretly transferred ownership of Meikarta. (Kontan, November 2018). The major case is evidence that the company did not apply the GCG principle of transparency, which requires the company to be open in providing material and relevant information about the concerned company. Next, Putri (2016) researched the topic of Corporate Governance and company performance measured by Cash Flow Return on Asset (CFROA). The research findings indicate that the board of directors, independent commissioners, and institutional ownership have a significant positive impact on financial performance, while the audit committee has a significant negative impact on financial performance. CFROA shows the company's asset ability to generate operating profit and focuses more on measuring the company's current performance. (Cornett et al., 2006 dalam Sekaredi (2011). Unlike Putri (2016), Marjono and Ningsih (2016) state that the audit committee has a positive and significant effect on CFROA, while the board of commissioners, independent commissioners, board of directors, and Institutional ownership factors do not have a significant impact on CFROA.

Besides the COVID-19 pandemic, there are several factors causing the global economic crisis. One of them is accounting fraud, such as the Enron scandal and the collapse of Arthur Andersen in 2001, which led to the emergence of the Sarbanes-Oxley Act, a federal law standard in the United States. However, a few years later, as we know, the global financial crisis occurred in 2008-2009. A number of empirical studies have been conducted with the crisis as the subject, and some research discusses Islamic finance as an alternative financial strategy. Jawadi et al. (2014) investigated the performance of Shariah-compliant stocks and found that they were less significantly impacted by the 2008-2009 global financial crisis compared to conventional markets. According to Ho et al. (2014), the Sharia stock index has outperformed conventional investments since the subprime crisis began and during periods of instability. Islamic finance is a financial system based on Sharia principles or Islamic law. The basic principle of Islam in finance prohibits all business activities related to alcohol, gambling, prostitution, tobacco, weapons, and consumer products containing pigs or pork. (Al-Khazali et al., 2014). Islamic law also prohibits conventional financial services because they involve interest (*riba*) in every transaction. On the

other hand, there are Islamic banks with a profit-sharing and loss-sharing system with investors. (profit sharing). Furthermore, Islamic finance prohibits businesses with speculation and excessive risk and regulates investment restrictions for assets that comply with Islamic law.

Based on the explanation above, it can be concluded that what distinguishes this research from previous studies is the ratio used to measure financial performance. In this study, financial performance is measured using Cash Flow Return on Asset (CFROA), whereas in previous studies, financial performance was measured using Return on Asset (ROA) and Return on Equity (ROE). In this study, the researcher also included all elements of GCG to see their impact on the company's value.

Based on the phenomenon and the differences in research results from several researchers that have been explained previously, the purpose of this study is to determine whether there is an influence of Good Corporate Governance (GCG) and financial performance on the value of companies in the banking sector in Indonesia.

## LITERATURE REVIEW

### Agency Theory

Mallin (2016:16) mentions that the theories related to the development of corporate governance are agency theory and stakeholder theory. Fahmi (2014:65) explains that agency theory is a condition that occurs in a company where the management, referred to as the agent, and the capital owner, referred to as the principal, establish a cooperation contract known as the "nexus of contract." This cooperation contract contains agreements that stipulate that the company's management must work maximally to provide maximum satisfaction, such as high profits, to the capital owner.

### Stakeholder Theory

The stakeholder theory states that a company is not an entity that operates solely for its own benefit, but must provide benefits to stakeholders. Thus, the existence of a company is greatly influenced by the support provided by stakeholders to the company (Ghozali dan Chariri, 2007). Mallin (2016:20) explains that shareholders and stakeholders can support different corporate governance structures and also monitoring mechanisms. With an emphasis on shareholder value, the board, which consists of executive and non-executive directors, is elected by the shareholders.

### Good Corporate Governance

The term corporate governance was first introduced by the Cadbury Committee in 1992. The definition of corporate governance according to the Cadbury Committee:

“A set of rules that define the relationship between shareholders, managers, creditors, the government, employees, and internal and external stakeholders in respect to their rights and responsibilities.”

The Forum For Corporate Governance In Indonesia (FCGI) in Effendi (2016:3) explains:

“Corporate governance is a set of regulations that govern the relationship between shareholders, company managers, creditors, the government, employees, and other internal and external stakeholders concerning their rights and obligations, or in other words, a system that controls the company.”

Good Corporate Governance is a system that regulates the roles of the board of commissioners, the board of directors, shareholders, and other stakeholders. (Agoes, 2006:101). Blair (1996) in Fahmi (2014:63) provides a broader and more comprehensive definition of corporate governance, which is a holistic unit encompassing legal regulations, culture, and institutions so that public companies can operate, determine who controls, how control is exercised, and how risks and revenues from their activities are allocated. According to Indonesia Constitution Law Number 40 of 2007 concerning Limited Companies, the number of members of the board of commissioners consists of more than one member who form a council, and the actions taken by each member of the board of commissioners must be based on the decisions of the board of commissioners.

### **Sharia Finance**

In Indonesia, the Financial Services Authority (OJK) regulates the sharia capital market, which is part of the sharia financial industry. Meanwhile, the application of Islamic principles in the Indonesian Capital Market is regulated by Dewan Syariah Nasional Majelis Ulama (DSN-MUI). This council issues Islamic regulations, called fatwas, which govern investment activities in the Indonesian sharia capital market (<http://www.idx.co.id>). The Financial Services Authority (OJK) plays a role in converting Islamic principles in the Indonesian capital market into OJK regulations to make them more binding and legally certain.

All sharia-compliant stocks listed on the Indonesian sharia capital market must be included in the Sharia Securities List (DES) published by the OJK every May and November. This is done to ensure that all companies adhere to Islamic principles. There are several main criteria for selecting sharia-compliant stocks ([www.idx.co.id](http://www.idx.co.id); Ho et al., 2014):

1. The company does not engage in activities that are not in accordance with Islam:
  - a. Production of pork and alcohol for human consumption.
  - b. *Riba*-based financial services (conventional interest-based financial contracts)

- c. Advertisements or media containing elements of pornography.
  - d. Buying and selling risks that involve elements of uncertainty or speculation (gharar) and/or gambling (maisir), including conventional insurance.
2. The company meets the financial ratio standards:
- a. total interest-based liabilities compared to total assets must not exceed 45%.
  - b. The total interest income and other non-Islamic income compared to total income and other income must not exceed 10%.

### **Definition of Financial Performance**

According to Basri (2005:16), Financial performance is something produced by a company within a certain period, referring to the established standards. The measurement of financial performance activities is designed to estimate how the activities perform and the final results achieved. Moerdiyanto (2010) revealed that financial performance is the result of a series of business processes which involve the sacrifice of various resources, including human resources and the company's finances. If the company's performance improves, it can be seen from the company's vigorous activities aimed at generating maximum profit. The profit or earnings generated will certainly vary depending on the size of the company operating.

According to Zarkasyi (2008:48), financial performance is something produced by an organization within a certain period, referring to the established standards. The performance of a company should be a measurable result that reflects the empirical condition of a company based on various agreed-upon metrics.

### **Cash Flow Return on Asset (CFROA)**

Cash Flow Return on Asset (CFROA) is one of the performance measurements of a company that shows the ability of the company's assets to generate operating profit. CFROA focuses more on measuring the company's current performance and is not tied to stocks. (Cornett et al., 2006 on Sekaredi, 2011). Hardikasari (2011) explains that CFROA is calculated from earnings before interest and taxes plus depreciation and divided by total assets.

### **Firm Value**

The value of a firm is determined by its market value. When stock prices rise, the welfare of the shareholders also increases. To achieve this. A shareholder must choose a competent individual to run their company. (Kusumawati dan Setiawan, 2019). Meanwhile, according to (Rudangga and Sudiarta,

2016), the value of a company is the state achieved as a result of the company's activities over several years. This value serves as an indicator of public trust in the company since its inception.

According to Brigham and Houston (in Rachmat et al., 2019), the importance of company value lies in its connection to shareholder wealth. The increasing value of the company and its stock price will enhance the welfare of the shareholders. This is one of the company's goals to achieve the highest possible value for the company.

In measuring the value of a company, investors can use the Price-to-Book Value (PBV) ratio. This ratio serves to assess the market price of outstanding shares compared to the book value of the shares. A high PBV ratio indicates that the stock is expensive (overvalued), while a low PBV ratio suggests that the stock is cheap (undervalued). (Rahmahsari, 2019).

From the explanation above, it can be concluded that the value of a company is a value determined by its stock price. With the growth of the company's value, the shareholders' welfare will follow as the stock price rises. The value of this company is created from the results of its activities and the public's trust in the company over the years. To measure the value of a company, investors can use the Price-to-Book Value (PBV) ratio in evaluating the company. The formula for PBV is as follows.

The use of the Price to Book Value Ratio as an indicator of a company's value is based on the fact that many investors use this ratio to determine whether a stock is still worth buying or not. According to Murhadi (2009), there are several reasons why investors use PBV in investment analysis. The book value is relatively stable. For investors who are less confident in cash flow estimates, the book value is a simple way to compare. The relatively standard accounting practices among companies allow the PBV to be compared and ultimately provide a signal of whether the company's value is under or overvalued.

## **RESEARCH METHOD**

This research utilizes a quantitative approach to analyze the effects of independent variables, including financial performance and various components of Corporate Governance, such as the Number of Board of Directors, Institutional Ownership, Audit Committee, and Audit Quality. The population for this study comprises banking companies listed on the main board of the Indonesia Stock Exchange (IDX) during the period from 2019 to 2023, totaling 30 companies. The sampling method is purposive sampling with the following criteria:

1. Conventional and Sharia bank companies listed on the IDX main board in 2023;
2. Conventional and Sharia bank companies that have the required financial data;
3. Conventional and Sharia Banks that have not incurred losses for 5 years.

based on the predetermined criteria, the following sample were obtained:

| No | Ticker | Compnaies Name                                   |
|----|--------|--------------------------------------------------|
| 1  | BACA   | PT Bank Capital Indonesia Tbk                    |
| 2  | BBCA   | PT Bank Central Asia Tbk                         |
| 3  | BBNI   | PT Bank Negara Indonesia (Persero) Tbk           |
| 4  | BBRI   | PT Bank Rakyat Indonesia (Persero) Tbk           |
| 5  | BBTN   | PT Bank Tabungan Negara (Persero) Tbk            |
| 6  | BDMN   | PT Bank Danamon Indonesia Tbk                    |
| 7  | BINA   | PT Bank Ina Perdana Tbk                          |
| 8  | BJBR   | PT Bank Pembangunan Daerah Jawa Barat dan Banten |
| 9  | BJTM   | PT Bank Pembangunan Daerah Jawa Timur Tbk        |
| 10 | BMRI   | PT Bank Mandiri (Persero) Tbk                    |
| 11 | BNGA   | PT Bank Cimb Niaga Tbk                           |
| 12 | BNII   | PT Bank Maybank Indonesia Tbk                    |
| 13 | BRIS   | PT Bank Syariah Indonesia Tbk                    |
| 14 | BSIM   | PT Bank Sinarmas Tbk                             |
| 15 | BTPN   | PT Bank BTPN Tbk                                 |
| 16 | BTPS   | PT Bank BTPN Syariah Tbk                         |
| 17 | MAYA   | PT Bank Mayapada Internasional Tbk               |
| 18 | MEGA   | PT Bank Mega Tbk                                 |
| 19 | NISP   | PT Bank OCBC NISP Tbk                            |
| 20 | PNBN   | PT Bank Pan Indonesia Tbk                        |
| 21 | SDRA   | PT Bank Woori Saudara Indonesia 1906 Tbk         |

The analysis for this research is conducted using Eviews 12 as the primary analytical tool. The data analysis techniques employed include classic assumption tests specifically multicollinearity test, heteroscedasticity test, and autocorrelation test along with regression analysis and coefficient evaluation. Furthermore, hypothesis testing is performed through the coefficient of determination, f-test and t-test. These methodologies ensure a robust examination of the data, allowing for a comprehensive understanding of the underlying relationships within the study.

## RESULT AND DISCUSSION

### Classic Assumption Test Result

#### Heteroscedasticity Test

The objective of the heteroscedasticity test is to assess whether there are variations in the residual variances across different observations within the regression model. The heteroscedasticity test can be conducted using the Glejser statistical test by examining the significance value. If the significance value is greater than 0.05, it indicates that there is no heteroscedasticity. Conversely, if the significance value

is less than 0.05, it suggests the presence of heteroscedasticity issues. Based on the Glejser test results, it was found that all independent variables have significance values greater than 0.05, indicating no evidence of heteroskedasticity.

### **Multicollinearity Test**

The multicollinearity test is used to determine the presence of relationships among independent variables. If a correlation exists among the independent variables, it indicates a potential multicollinearity issue. The multicollinearity test can also be assessed through the correlation values among independent variables. The criteria for drawing conclusions from the multicollinearity test indicate that if the correlation value between any pair of independent variables is greater than 0.8, multicollinearity is present. Conversely, if the correlation value is less than 0.8, multicollinearity is not present. Based on the correlation test using EViews, it can be concluded that none of the independent variables show signs of multicollinearity, as all correlation values between the variables are below 0.8.

### **Autocorrelation Test**

The Durbin-Watson test is a statistical procedure employed to identify autocorrelation in the residuals of a regression analysis. It evaluates the independence of residuals, specifically targeting first-order autocorrelation. The resulting statistic ranges from 0 to 4, with a value near 2 suggesting no autocorrelation, values below 2 indicating positive autocorrelation, and values above 2 signifying negative autocorrelation. This test is essential for verifying the validity of regression outcomes by examining potential violations of the independence assumption. Based on the EViews results, a Durbin-Watson statistic of 2.091067 was obtained which suggests the absence of significant autocorrelation in the residuals of the regression model. Given the observed statistic, the results support the validity of the regression analysis, reinforcing the reliability of the model's estimates and the inferences drawn from the data.

### **Panel Data Regression Model**

Regression analysis is a statistical procedure used to systematically estimate the average relationship between independent and dependent variables. The regression model utilized in this study is a panel data regression model employing a Fixed Effects approach. Based on the analysis conducted with EViews, the following equation was obtained:

$$Y = 0.129757 + 0.142822*X1 - 0.823903*X2 - 0.015411*X3 + 0.435120*X4 + 36.81004*X5$$

### **Coefficient of Determination**

The coefficient of determination indicates the extent to which the independent variables explain the variation in the dependent variable within a regression model. The test results reveal that the Adjusted R-Squared value is 0.918778, meaning that all independent variables collectively account for 91.877% of the influence on stock prices.

### **T-Test Result**

The t-statistic test is a statistical method used to assess the individual impact of an independent variable on the variation in a dependent variable. The criteria for evaluating a t-test indicate that if the significance value of the variable is below 0.05, it can be concluded that the independent variable has a significant partial effect on the dependent variable and vice versa. Based on the Eviews results, it was found that the Number of Board of Directors, Audit Quality, and Firm Financial Performance have a significant partial effect on stock prices. In contrast, Institutional Ownership and the Number of Audit Committee members do not significantly affect stock prices.

A well-sized board of directors can positively impact firm value by enhancing decision-making and resource allocation. Each director contributes unique perspectives and expertise, leading to more informed strategic choices. This diversity facilitates effective handling of complex issues and aligns company strategies with shareholder interests, ultimately improving performance. Additionally, a properly structured board ensures accountability and oversight, which are crucial for maintaining investor confidence. A collective responsibility in preparing comprehensive accountability reports reassures shareholders that their interests are prioritized. Furthermore, avoiding the pitfalls of having too many members prevents confusion and misunderstandings, allowing for more efficient operations. Thus, maintaining an optimal number of directors is essential for maximizing company performance and enhancing firm value (Mishra & Kapil, 2017; Zarkasyi, 2008; Carolina, Vernnita, & Christiawan, 2020).

The t-test results indicating that institutional ownership does not significantly affect firm value can be attributed to several factors. While good corporate governance (GCG) aims to align shareholder and management interests, institutional investors often prioritize short-term returns or adopt passive strategies, limiting their active oversight. The effectiveness of institutional ownership also varies by industry, and some firms may not fully leverage these investors' expertise. Additionally, conflicting interests among institutional investors may dilute potential benefits (Doğan, 2020; Rafsanjani et al, 2008). Thus, while institutional ownership can enhance corporate governance, its effect on firm value may not be significant.

The finding that the number of audit committee members does not significantly affect firm value can be attributed to several key factors. While audit committees are crucial for corporate governance, a larger committee does not necessarily enhance effectiveness. In fact, it may introduce inefficiencies such as communication challenges and diluted accountability. The impact of an audit committee is more closely tied to the quality and expertise of its members rather than their quantity. Research indicates that an increase in audit committee size does not correlate with improved firm performance (Kipkoech, 2016). Thus, while audit committees are essential, their numerical size may not directly influence firm value. Firm value is significantly influenced by audit quality, as high-quality audits ensure accurate financial reporting and enhance investor confidence. When a company is audited by a reputable firm, it benefits from improved financial transparency and reliability, which can lead to better performance. Larger audit firms are typically more diligent due to the greater reputational risks they face if they fail to meet accepted standards. Consequently, high audit quality fosters trust among stakeholders, ultimately contributing to an increase in firm value. This highlights the critical role of audit quality in maintaining investor confidence and promoting positive business outcomes.

Financial performance positively affects firm value for several reasons. Based on Sanusi et al (2022) research, higher profitability often leads to increased dividend payments to investors, enhancing shareholder satisfaction and attracting more investment. Additionally, profitable companies tend to have better capital structures, reducing their cost of capital and allowing for more efficient resource allocation for growth. Firms with strong profitability are also viewed as having greater growth potential, making them more appealing to investors. This combination of higher dividends, improved capital efficiency, and growth opportunities increases demand for the company's shares, ultimately boosting its market value. Thus, profitability is a key indicator of a firm's financial health and future potential, significantly influencing its overall value.

### **F-Test Result**

The F test was conducted to determine whether there is a simultaneous effect of all independent variables on the dependent variable. Based on the test results, the F-Statistic probability value of 0.000 indicates that the overall model effectively explains the variation in firm value based on the included independent variables. In the context of the partial tests, while specific variables such as institutional ownership and the number of audit committee members did not show significant effects on firm value, the significant F-test suggests that other variables, particularly the size of the board of directors, audit quality, and financial performance, collectively contribute to explaining changes in firm value.

The positive impact of a well-sized board of directors highlights its importance in enhancing decision-making and resource allocation, which directly influences firm value. The role of audit quality further reinforces the model's robustness, as high-quality audits build investor confidence and lead to better financial performance. While certain variables may not individually exhibit significant effects, the F-test confirms that when considered together, these variables provide valuable insights into how corporate governance and financial metrics relate to firm value. This underscores the importance of evaluating both individual and collective impacts of these factors in understanding their overall influence on firm performance.

### CONCLUSION

This study aims to examine the impact of corporate governance (GCG) components and financial performance on firm value, both simultaneously and partially. The sample used in this research consists of Islamic and conventional banking companies listed on the main board of the Indonesia Stock Exchange for the period 2019-2023. Based on the predetermined sample criteria, a total of 21 companies were selected. The variables employed in this study include firm value (Price to Book Value) as the dependent variable, and the Board of Directors, Institutional Ownership, Audit Committee, Audit Quality, and Financial Performance as independent variables. Based on the research findings and discussions presented, several conclusions can be drawn as follows:

1. The Board of Directors has a positive and significant impact on firm value. This indicates that the size of the board of directors can be a consideration for investors when selecting stocks, thereby potentially increasing firm value.
2. Institutional ownership has a negative and insignificant effect on firm value. This means that institutional ownership does not serve as a consideration for investors when choosing stocks.
3. The Audit Committee has a negative and insignificant impact on firm value. This suggests that the audit committee does not influence investors' stock selection.
4. The Board of Directors has a positive and significant impact on firm value. This reinforces that the size of the board of directors is a relevant factor for investors in stock selection, which can enhance firm value.
5. Financial performance has a positive and significant effect on firm value. This indicates that financial performance is an important consideration for investors when choosing stocks, contributing to increased firm value.

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