DETERMINANT OF CORPORATE GOVERNANCE AND FIRM VALUE

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Abstract

Good Corporate Governance is essential to increase the confidence of investors. Corporate Governance can provide effective protection for stockholders and facilitate effective monitoring. The empirical study intends to investigate determinant Good Corporate Governance and the effect of implementation corporate governance toword firm value in banking sector. Corporate Governance practical is measured by composite index Good Corporate Governance. Samples of this study are banking companies listed in Indonesia Stock Exchange during 2008 - 2012. This research data from annual reports obtained from the Indonesian Stock Exchange website, the Indonesian Banking Directory and Indonesian Capital Market Directory (ICMD). The analytical method used is multiple linear regression .

This research gives some evidences that determinants of implementation quality of Corporate Governance are size and ownership concentration. Good Corporate Governance showed significant and positive relationship to firm value. The test result of indirect influence of ownership concentration, growth to firm value with intervening variables (GCG) is not significant

A. INTRODUCTION

Good Corporate Governance (GCG) has been widely recognized in the community. Generally, good corporate governance is a system as well as a structure to manage the firm with the goal of increasing shareholder value as well as accommodating the various parties concerned with the firm *(stakeholders)* such as creditors, suppliers, business associations, consumers, workers, government and the community. Thus the concept was quickly accepted by the public and even the performance of a firm's stock is now determined by the extension of GCG implementation (Shindhunata and Cynthia, 2005). In order to create conditions that support the implementation of good corporate governance, according to Ervin and Eko (2007), one of the government's responsibilities and also the relevant authorities is publishing legislation that allows the GCG implementation effectively. To improve the quality of management and good operational, BI published Bank Indonesia Circular Letter No. 9/12/DPNP date May 30th, 2007, which describes five principles of good corporate governance in more detail. These principles are: *openness (transparency), accountability, liability (responsibility), independency,* and *fairness.* The principles of GCG implementation are embodied in the implementation of both tasks and responsibilities of the Commissioners Board and Directors Board; the assignment implementation done by committees as well as work units running the internal control; the compliance implementation, the internal and the external auditor; the implementation of risk management, including the internal control system; provision of funds related to parties and large exposures; a strategic plan of the bank; and transparency of financial and non-financial conditions. Each Bank is required to make an assessment (self assessment) on the GCG implementation and report compiled on a regular basis, which will later be assessed by the BI (Indonesian Banking Booklet, 2012).

The implementation of *Good Corporate Governance* is necessarily compulsory to meet the trust of both public and the international community as an essential condition for the industrial worlds aiming to achieve the stakeholder value (Etty, 2009). The concept of *corporate governance* emerges as an attempt to cope with self-profit based behavior management by creating mechanisms and control tools to enable a profit sharing system, balanced wealth for stakeholders, and to create firm's efficiencies (Shindhunata and Cynthia, 2005). The *good corporate governance* is expected to maintain the firm's sustainability and provides benefits for all *stakeholder* (Yusriati et. al., 2010).

Several studies that have been done successfully figure out the determinants of corporate governance implementation. Klaver and Love (2003), find the determinants of the *corporate governance implementation* which is elaborated as: firm's characteristics with *fixed assets* proxies, growth opportunities, and the *legal system.* Durnev and Kim (2003) have successfully found that a firm with high investment opportunities, high needs of financial and external funding, and concentrated ownership style provides a better *corporate governance.* Under the *corporate governance* measurability at the enterprise level, many studies find a positive relationship between *corporate governance* with the value or performance of the firm (Black et al., 2003; Klapper and Love, 2002; Siddharta and Cynthia, 2005). Based on previous empirical findings, researchers are interested in studying the determinants of *corporate governance* implementation and its effect on the value of the firm at the bank *listed* on the Stock Exchange. Specifically in more details, it can be formulated into research problems as follows:

1. Do the growth opportunity, the size of the bank, and ownership concentration affect the quality of bank's *governance corporate* implementation?
2. Do the growth of the bank, the quality of *corporate governance* implementation, and ownership concentration affect the value of the firm?

B. REVIEW OF RELATED LITERATURES

Good Corporate Governance according to *Forum Corporate Governance in Indonesia* (FCGI) is defined as a set of rules that govern the relationship between shareholders, management or manager of the firm, creditors, government, employees and shareholders leadership of internal and external, other rights, and obligations or in other words, a system that regulates and controls the firm. The purpose *of corporate governance* is to create additional value for all interested parties *(stakeholders).*

In general, there are five basic principles *of good corporate governance;* the first principle is *transparency* (information disclosure). It is generally defined as information disclosure in the decision-making process and in disclosing material information and relevant about the firm. The second one is *accountability* (accountability) which is defined as a clarity of function, structure, and accountability system that creates an effective management in a firm. The third principle is *accountability* (responsibility) which is defined as the presence of conformity or compliance in firm's management towards fair corporate principles as well as applicable laws and regulations. The fourth principle is *independency* which is defined as a situation where the firm is managed professionally without any conflict of interest and influence/pressure from any party that does not comply with the legislation. The last principle is *fairness* (equality and fairness) which is defined as a form of treatment which is fair and equitable in meeting the rights of *stakeholders* that emerges under the agreement and applicable laws and regulations.

Relationships between Variables

The Firm Growth and the Quality of Corporate Governance

Companies with high investment opportunities will increasingly require external funding for expansion; therefore, they will strive to improve the quality of *corporate governance* to facilitate the acquisition of external funding and to lower the capital cost (Klapper and Love, 2003).

Managers in companies with high firm growth, will have the opportunity to make greater discretion in the project selection compared to those in companies with less investment opportunity. Thus, the companies with high investment opportunity will require a better quality of *corporate governance*. Based on the elaborated description above, the first hypothesis is formulated as follows:

H1: Firm Growth has a positive influence on the quality of *corporate governance.*

The Firm Size and the Quality of *Corporate Governance*

According Klapper and Love (2003), large companies are more likely to have more agency problems and hence require more stringent *governance* mechanism. Furthermore, Durnev and Kim (2003) describe that the firm size has a positive effect on the implementation of *corporate governance* due to their tendency to attract bigger attention which leads into higher encouragement to implement a better corporate governance. Because of this elaboration, the second hypothesis is formulated as follows:

H2: The size of the banks has a positive influence on the quality of *corporate governance.*

The Ownership Concentration and the Quality of *Corporate Governance*

Deni (2006) states that there are increasing rights to the cash flows from the largest shareholder that bring a positive impact. By having a good *corporate governance*, market will appreciate the firm and increase the firm's value which may lead into a positive impact on the share value. Consequently, the shareholders will have an incentive to improve the quality of *corporate governance* in the firm. Based on the description above, the third hypothesis is formulated as follows:

H3: The ownership concentration has a positive effect on the quality of *corporate governance.*

The *Corporate Governance* and the Firm Value

In the perspective of agency theory, selfish agents will tend to allocate *resources* that do not increase the value of the firm. The agency issues would indicate that the value of the firm will increase if the firm owner can control the behavior management in order not to waste *resources* companies. *Corporate governance* is the system that regulates and controls the firm which is expected to provide and enhance the value of firm through shareholders. Thus, the implementation of *Good Corporate Governance* is believed to increase the value of the firm (Hamonangan and Mas'ud, 2006). Through the implementation of *Good Corporate Governanance*, the firm is also expected to easily gain less financial funds leading into the increased *corporate value* (Tri, 2010). Related to explained description, the fourth is therefore formulated as follows:

H4: The implementation of GCG has a positive effect on the value of the firm.

The Growth Opportunity and the Firm Value

The investment decision is very important since the achievement of firm's objectives will only be generated through corporate investment activities. Companies with large investment opportunity indicate a bright future prospects and therefore will have a positive impact on the value of the firm (Ludwina and Ratna, 2012). Moreover, the investment decision also affects on the stock value of the firm (Ludwina, Ratna, 2011). Related to the elaborated information, the fifth hypothesis is formulated as follows:

H5: The growth opportunity has a positive effect on the value of the firm.

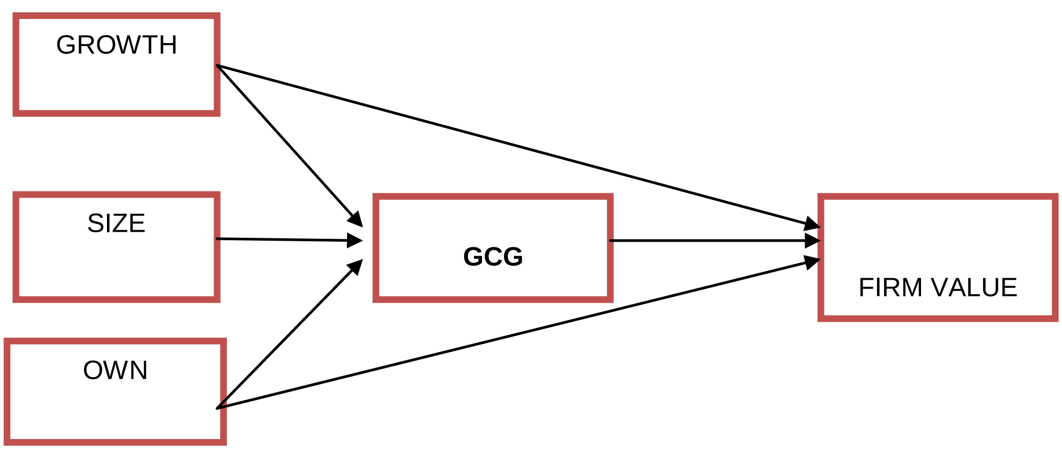
The Ownership Concentration and the Firm Value

The ownership concentration describes how and who is in control of the whole or large part of the firm ownership as well as the business activities (Abdullah and Bily, 2011). According to (Mohamed, 2009) the controlling shareholders are able to intensely monitor the firm and decrease the opportunity of managers to make self-profitable decisions. It reduces the agency conflicts and aligns the management interest and shareholders interests, which leads into the improved performance. The higher ownership concentration of the firm, the higher value of the firm will be.

Through the concentrated ownership, the manager supervision will be tighter. In addition, the high levels of ownership concentration will reduce the interest diversity of the shareholders and consequently increase the possibility of cooperative establishment between the managers and shareholders to increase the firm's value (Filla and Endang, 2010). Thus, the ownership concentration has a positive effect on the value of the firm. Based on the description above, the last hypothesis is formulated as follows:

H6: The ownership concentration has a positive effect on the value of the firm.

Research Model



Research Method

Population used in this research were all banks listed in the Indonesia Stock Exchange. While firms taken as sample were selected based on the following specific critera:

1. Any bank had issued the report of Good Corporate Governance for the period of 2008-2012
2. Any firm had issued its financial reports for the observation period of 2008-2012

Data sources used there were annual reports, firms' webs observed and ICMD (Indonesian Capital Market Directory).

Operational definition of each variable in this research are as follows:

1. Firm Growth. Growth Opportunities are measured by assets growth.

2. Ownership Concentration. Ownership Concentration means a proportion of shares owned by largest shareholders (at least 5% of total shares outstanding). It is measured by comparing total shares owned by the largest stakeholders to total shares outstanding (Sanda et al., 2005).

3. Firm Size. The size is measured using natural logarithm of total sales.

4. Tobin's Q (Klapper and Love, 2002)

   Tobin's Q = (MVE + DEBT)/TA

5. Corporate Governance
   The measurement of GCG is based on the self-assessment of bank GCG implementation report. Its maximum score is 5. The lower the index of GDG, the better its implementation. So that, GCG in this research was measured by 5-scale index of GCG. (Tjondro, Wilopo, 2011).

ANALYSIS

The period of this research was 5 years started from 2008 to 2012. The sample of firms were as follows:

Table 1
Research Sample

Annotation	Year				
	2008	2009	2010	2011	2012
Banks listed and had issued their financial reports	28	28	31	31	33
Incomplete data	(13)	(13)	(6)	(7)	(7)
Firms with completed data	15	15	25	24	24
Total	102				

Recent research was using *time-series cross-section* with a total data of 102.

Classic Assumption Test

a. Normality Test

Normality test was performed using Kolmogorov-Smirnov (K-S) (Ghozali, 2007). Both of equations had a significance level of more than 5% which meant that the residual data was distributed normally.

b. Multicollinearity Test

Of both equation 1 and equation 2, there was no independent variable having a tolerance value of less than 0.10. This means that there was no correlation among independent variables which had scores of more than 95%. The result of calculation of Variance Inflation Factor value also indicates similar condition that there was no independent variable having a score of more then 10. Thus, it can be concluded that there was no multicollinearity among independent variables in regression model.

c. Heteroskidastity Test

Using Glejser Test, there was no heteroskidastity for equations 1 and 2. It was shown from the significance of the propability that was more than 5% of the level of confidence. It can be concluded that the regression model didn't contain any heteroskidastity.

d. Autocorrelation Test

Autocorrelation Test uses Durbin-Watson Test (DW test) (Ghozali, 2007).

The DW value of equation 1 was 2.230, while for equation 2 was 1.789. These values were compared to table values using a significance value of 5%, with a number of sample of 102 and a number of independent variable of 3 (k=3). The Durbin table became higher than the upper limit (du) and less than 4-du. Thus, it can be concluded that there was neither positive autocorrelation nor negative one.

3. Hypothesis Test

Equation 1

Table 2
Analysis Result
Equation 1 (dependent variable: GCG)

Model	B	t	sig
(constant)	-3.642	-4.217	0.000

KK	0.439	1.695	0.093
SIZE	0.226	8.620	0.000
GROWTH	0.345	1.173	0.244
F = 26,714 R square =0,450 Sig= 0,000			

According to the table, shown that: the Growth has a significant effect on Good Corporate Governance; the Size has a significant-positive effect on Good Corporate Governance; while the Ownership Concentration has significant-positive effect on Good Corporate Governance, with a significance level of 10%.

Equation 2

Table 3
Analysis Result
Equation 2 (dependent variable: TOBINS Q)

Model	B	T	sig
(constant)	0.988	8.700	0.000
KK	-0.075	-0.927	0.356
GROWTH	-0.012	-0.121	0.904
GCG	0.054	2.063	0.042
F = 1,997 R square =0,058 Sig= 0.119			

According to the Table, both the Growth and the Ownership Concentration have no significant effect on the Tobin's Q, while Good Corporate Governance has a significant-positive effect on the Tobin's Q

c. Discussion

Firm Growth and the quality of Corporate Governance

Firm growth measured by the asset growth have no significant affect on Good Corporate Governance. This is not in accordance with Klapper and Love (2003) who stated that firms which had great opportunities to invest need more external funds to expand, therefor, those firms would make efforts to increase the quality of corporate governance in practice to obtain external funds and reduce capital costs.

This research result shows that the Growth which was significantly affecting Good Corporate Governance was probably caused by the sales growth which was increasing internal funds. That's what made the firm did not need any external fund and did not make any effort to increase the quality of corporate governance in practice.

Firm Size and the Quality of Corporate Governance

According to this research result, it is shown that the Size of a firm has positive effect of the implementation of its corporate governance. The greater the Size of firm , the better the implementation of its good corporate governance. This is in accordance with Klapper and Love (2003) and Durney and Kim (2003) who argued that the Size had a positive effect on the implementation of corporate governance since a firm was usually tending to attract great attention which encouraged it to implement a better corporate governance.

Ownership Concentration and the Quality of Corporate Governance

The research result shows that the Ownership Concentration has positive effect on Good Corporate Governance index. The higher the Ownership Concentration the better the implementation of Good Corporate Governance.

The success of the implementation of corporate governance is not separated from the structure of firm's ownership. A concentrated ownership gives incentives to the largest stockholders to be actively participating in the firm which in turn will increase the quality of Good Corporate Governance (Shindhunata dan Cynthia, 2005)

Corporate Governance and Firm Value

Corporate governance is a system managing and controlling a firm and expected to give and increase the firm value to the stockholders. Therefor, the implementation of Good Corporate Governance is believed to be able to increase the firm value (Hamonangan and Mas'ud, 2006). Through this implementation of Good Corporate Governance, it is also expected that the firm will be easily raising cheaper financing funds which can increase its corporate value. (Tri, 2010)

The results of this research are in accordance with Siddharta and Cynthia (2005) who stated that the practice of GCG is leading to the increase of firm value, since firm which implements GCG in a good manner gives a signal that its management shall act in a good manner too.

Growth Opportunity and Firm Value

Investment Opportunity has no significant effect on bank performance. this is not in accordance with Ludwina and Ratna (2012) who stated that a firm with a great opportunity of investment indicated that such firm had a good future prospect. This can affect positively on the firm.

The insignificant effect of investment growth on bank performace measured by the market performance is probably caused by that the investement growth has a long-term impact. So, the effect can not be observed directly in a short-term period.

Ownership Concentration and Firm Value

Ownership concentration images how and who is controlling the overall or mayority of the ownership as well as the overall or majority of firm's business activities (Abdullah dan Bily, 2011). The research result show that the ownership concentration has no effect on bank performance, measured by its market performance.

This result is not in accordance with Mohamed (2009) who stated that controlling shareholders could control more intensively to limit frauds by managers who make decisions to benefit theirselves. This could reduce agency conflicts and harmonize managements' and stockholders' interests. The higher the Ownership Concentration, the higher the Tobin's Q. When the ownership is scattered, the controlling pressure on the managers becomes lower. This can lead the manager to act for their own sake.

The insignificant effect of the Ownership Concentration on the firm value is probably caused by that the ownership concentration is not just a matter of whether the ownership is concentrated or not, but it is about the extent to which that ownership is dispersed.

Undirect effects of GROWTH and Owner Concentration on Firm Value with GCG as Variable Intervening

According to the analysis results above, since the effect of GROWTH on GCG and the effect of Ownership Concentration on GCG are insignificant, GCG is not a variable intervening.

CONCLUSIONS AND RECOMMENDATIONS

The results of the research which examined the effect of bank characteristics on Good Corporate Governance and the implications on the firm value are as follows:

1. The bank Growth has no significant effect on the implementation of Good Corporate Governance.
2. The Firm Size has a positive effect ont the index of Good Corporate Governance, or the greater the Firm Size, the better the implementation of its Good Corporate Governance.
3. Ownership Concentration has a positive effect on the index of Good Corporate Governance, or, the higher the Ownership Concentration, the better implementation of Good Corporate Governance.
4. Firm growth has no significant effect on the bank performance assessed base on the market performance (Tobin's Q).
5. Ownership Concentration has no significant effect on the bank performance assessed base on the market performance (Tobin's Q).

6. Good Corporate Governance has a positive effect on the index of Good Corporate Governance, or, the higher the index of Good Corporate Governance, (the better the implementation of Good Corporate Governance), the higher the bank's performance assessed by the market value (Tobin's Q).
7. The test result of indirect influence of ownership concentration, growth to firm value with intervening variables (GCG) is not significant

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