Examining the Causality of Six Measurements of Good Corporate Governance on Value of Firm: An Empirical Evidence From Firms of Jakarta Islamic Index

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ABSTRACT: The objective of this study is to ascertain the effects of GCG, measured by board of director size, board meeting frequency, independent commissioner proportion, audit committee size, and managerial ownership, on firm value utilizing firm size and leverage as control variables. All companies listed in the Jakarta Islamic Index during 2017 to 2021 are the population of this study. Total sample of 18 companies were used using the purposive sampling for analysis. Data from the study were examined using panel data regression analysis. Based on the testing, firm value was positively impacted by the board meetings frequency, number of director board, and percentage of independent commissioners. The audit committee and managerial ownership, in contrast, have no impact on firm value. Firm size, a control variable, has a detrimental impact on firm value. Leverage, however, has no influence on firm value. As the implication, the firms should enhance the standard of good corporate governance and abide by applicable laws in order to boost investor and public confidence and firm value.

KEYWORDS: firm value, good corporate governance, leverage, size of firm

I. INTRODUCTION

Companies are able to continue to improve their performance as a result of increasingly fierce globalization competition. Firm value is one indicator of increasing company performance. According to Pernamasari & Mu'minin (2019), companies are able to achieve the welfare of their shareholders or owners by enhancing value of the company as seen in the stock price.

The Islamic capital market is a sector that is currently in demand by investors. Since the introduction of the Jakarta Islamic Index (JII) as the first Islamic stock index in Indonesia on July 3, 2000, the Islamic capital market has experienced increased competition. JII includes 30 Islamic stocks with the highest liquidity during two sample periods, namely in May and November.
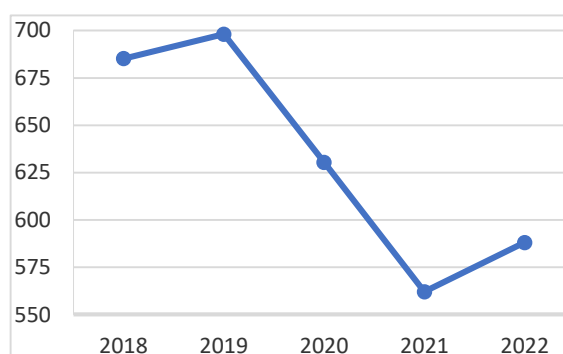

Figure 1. Jakarta Islamic Index during 2018 – 2022
Source: Market Update – Indonesia Syariah Capital Market 2022

In figure 1, JII has fluctuated over the past 5 years. Firm value is related to changes in the stock index. Investor interest in investing can be influenced by unstable stock prices, which have an effect on firm value. When stock prices rise, firm value can maximize shareholder wealth (Yusmaniarti et al., 2020).

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According to Muryati & Suardikha (2014), one of the strategies of shareholders or company owners to increase company value is to delegate responsibility for managing the company to management. Based on agency theory, different goals between shareholders as principle of company and the management as the agent could lead to agency problems in an effort to increase its value of firm. The need for GCG (good corporate governances) was rooted in the emergence of different goals between agents and principals. La Porta et al. (2000) stated that GCG is basically a group of mechanisms by which a shareholder protects himself from takeover by majority shareholders or management.

Research of CG Watch in 2020 by the Asian Corporate Governance Association (ACGA) is presented in Table 1. Based on the findings of this research, Indonesian corporate governance (CG) ranks lowest among the Philippines, China, Korea, Thailand, and India. The slow implementation of GCG in Indonesia shows a lack of awareness of the need to make GCG a fundamental value and practice in corporate management (Yusmaniarti et al., 2020).

Table 1. Market Rankings and CG Score

No.	Country	Total Score (%)	No.	Country	Total Score (%)
1	Australia	74.7	7	India	58.2
2	Hong Kong	63.5	8	Thailand	56.6
3	Singapore	63.2	9	Korea	52.9
4	Taiwan	62.2	10	China	43
5	Malaysia	59.5	11	Philippines	39
6	Japan	59.3	12	Indonesia	33.6

Source: Asian Corporate Governance Association (2020)

To monitor policies or actions that have been decided, GCG implementation requires internal and external monitoring mechanisms. The GCG mechanism has a control function that can bring together the interests of owner and management. Mechanisms for the director board, board meetings frequency, independent commissioner proportion, audit committee, and managerial ownership are the main topics of this discussion.

To measure GCG, Rosdani et al. (2021) applied three types, namely director board, independent commissioner proportion, and audit committee size. They stated that number of director board members and number of audit committee have a positive impact on the firm value, while independent commissioner proportion has no impact on the value of firm. In contrast, Ningtyas et al. (2014) stated that number of director board member has no impact on value of firm, while independent commissioner proportion and number of audit committee have a negative impact on firm value.

There are still inconsistencies in the conclusion of prior researches. Thus, we test influence of GCG on firm value by adding control variables, namely firm size & leverage. Leverage has shown as a measurement for the risk of a company and firm size is an indicator of its financial strength.

The inclusion of board meeting frequency variable in this research is a development from prior researches. The independent variable of board meeting frequency has been used by Arora & Sharma (2016) for companies in India and by Rahadi & Octavera (2020) for Indonesian Stock Exchange companies. There is no research that examines the influence of board meetings frequency on firm value, especially for companies that are included in JII. Based on the phenomena, research gaps, and theories previously described, we are interested in carrying out further research regarding the impact of GCG on value of firm. This research aims to test the effect of GCG using six measurements on value of firm listed at JII during 2017-2021.

II. LITERATURE REVIEW

Agency Theory. Agency relationship is an agreement between an agent and a principal to carry out a task given by the principal (Jensen & Meckling, 1976). Agency relationships can create problems when there is distinguish in interest between the agent and the principal. Jensen & Meckling (1976) explain that company owners can set appropriate incentives for agents and avoid deviant agent behaviour by issuing a budget for supervision.

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Firm Value. The value of a firm has an important term from investor's point of view because it is used as a parameter in the stock market in pricing overall of the firm (Fauzia, 2016; Amin et al., 2019; Shafira et al., 2022). It could be described using James Tobin's explanation of Tobin's Q. It has shown as a parameter for the value of a firm and could measure the performance of a company, particularly to regard as an indicator for company's performance in asset management (Kurniasih et al., 2012; Suzan & Utari, 2022).

Good Corporate Governance (GCG). GCG is a policy applied by a firm which has the purposes to increase the value of the firm and allocate to all stakeholders in the company, namely creditors, suppliers, trade coalitions, customers, employees, government, and the general public (Kusmayadi et al., 2016).

Firm Size. The scale known as "firm size" can be used to classify company size in several ways, such as the market value of its shares and total assets (Novari & Lestari, 2016; Rasyid et al., 2019). It could be assessed by observing the number of asset owned and used for operations.

Leverage. The definition of leverage, based on Nahdi et al. (2013) and Triayuni et al. (2023), is the ratio to determine how much the company is able to fulfil its obligations, both long term and short term. Leverage also functions in assessing how much a company is capitalized on by debt.
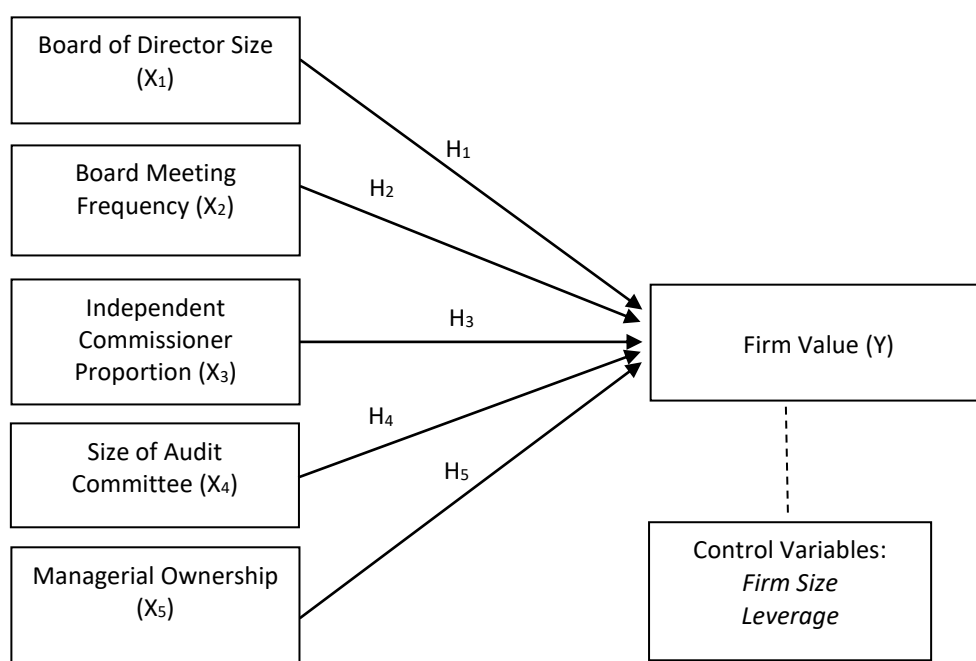

Figure 2. Research Model

III. RESEARCH METHOD

This study was classified in the type of a quantitative and associative research which aims to examine the impact of the association between two variables or more. The research data compilation methodology was carried out through literature and documentation studies. This study uses annual company reports as secondary data. Companies included in JII in 2017-2021 are the study population. As a sampling method, the purposive sampling was utilized and 18 sample companies were obtained.

Table 2. Research Variables

Variable	Measurement
Tobin's Q (TOBINSQ)	MVE (*Market Value Equity*) + *Debt*/Total Asset
Board of Director Size (DIR)	Number of board of director in the company
Board Meeting Frequency (RDEW)	Number of meeting held in a year by board of director and commissioner
Independent Commissioner Proportion (IND)	(Number of independent commissioner/Number of commissioner) x 100%

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Variable	Measurement
Audit Committee Size (AUD)	Number of audit committees in the company
Managerial Ownership (KM)	(Total share hold by management/Total outstanding share) x 100%
Firm Size (SIZE)	Logarithm natural (Ln) total asset
Leverage (LEV)	Total Debt/Total Asset

The variables analyzed by panel regression in this study are presented in Table 2. Panel data regression had been used in prior studies such as Dwiputri & Najmudin (2021) and Muharam et al. (2021). This study uses the following equation model:

$$TOBINSQ_{it} = \beta_0 + \beta_1 DIR_{it} + \beta_2 RDEW_{it} + \beta_3 IND_{it} + \beta_4 AUD_{it} + \beta_5 KM_{it} + \beta_6 SIZE_{it} + \beta_7 LEV_{it} + \varepsilon$$

Where: TOBINSQ = Tobin's Q; β_0 = Constant; β_{1-7} = Regression Coefficients; DIR = Board of Director Size; RDEW = Board Meeting Frequency; IND = Independent Commissioner Proportion; AUD = Size of Audit Committees; KM = Ownership by Management; SIZE = Total Asset of a Firm; LEV = Total Debt/Total Asset; ε = Residual.

IV. RESULTS AND DISCUSSION

Descriptive Statistics. Based on the outlier test, it was found that the four company data were outliers. These four data were removed from the sample data used in the study to produce 86 observations. According to Table 3, the value of Tobin's Q variable (TOBINSQ) informs the average value of 2.502 and a standard deviation of 3.705. It has a minimum value of 0.770, while the maximum value is 23.285. Board of directors size (DIR) has an average of 6.744 and a standard deviation of 1.763. In addition, the minimum value is 4, while the maximum value is 11.

The board meeting frequency variable (RDEW) appears an average value of 7.453 and a standard deviation of 3.830. The minimum value for the frequency of board meetings is 3 times, meanwhile the maximum value is 15 times. The variable of independent commissioner proportion (IND) appears an average value of 0.401 and its standard deviation of 0.129. In addition, the value of minimum is 0.200, meanwhile the maximum is 0.833.

Table 3. Values of Descriptive Statistics

Variables	Obs.	Average	Std.dev.	Minim.	Maxim.
TOBINS-Q	86	2.502	3.705	0.77	23.285
DIR	86	6.744	1.763	4	11
RDEW	86	7.453	3.830	3	15
IND	86	0.401	0.129	0.2	0.833
AUD	86	3.488	0.891	1	7
KM	86	0.049	0.169	0	0.732
SIZE	86	31.623	0.728	30.441	33.255
LEV	86	0.393	0.205	0.019	0.773

The average value for size of audit committee variable (AUD) is 3.488 with a standard deviation of 0.891. It has a minimum value of 1, meanwhile the maximum value of audit committee size is 7. The average value for managerial ownership variable (KM) is 0.049 with a standard deviation of 0.169. The values of minimum and maximum for managerial ownership respectively are 0 and 0.732. The size of firm variable (SIZE) appears an average value of 31.623 and a standard deviation of 0.728. The values of minimum and maximum respectively are 30.441 and 33.255. In addition, the leverage control variable (LEV) appears an average value of 0.393 with a standard deviation of 0.205. The values of minimum and maximum for this variable appear 0.019 and 0.773.

Based on the Shapiro-Wilk test, a probability value of 0.836 was obtained which was more than 0.05. Therefore, the research data was declared normally distributed. The results of the Variance Inflation Factor (VIF) appear less than 10 respectively in every independent variables. It means the multicollinearity was not found for this regression model. Through the Glejser test, it

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was found that the probability value of each independent variable was > 0.05. It can be stated that there is no indication of heteroscedasticity. In addition, based on the Run test, the Run test probability value is 0.66 > 0.05. Therefore, it can be said the autocorrelation was not found in this model.

Analysis of Panel Data Regression. The testing with panel data regression applies two models due to the use of two control variables in the analysis, i.e. size of firm and leverage variables. The two models are a comparison between the model before using the control variable and after using the control variable. The two models are model 1 for the Fixed Effect Model regression without a control variable and model 2 for the Fixed Effect Model regression which includes a control variable.

Table 4. Output of Panel Data Regression Test

TOBINSQ	Coefficient	Prob.	Coefficient	Prob.
	Model 1		**Model 2**	
Constant	-0.335	0.69	19.011	0
DIR	0.028	0.503	0.078	0.019
RDEW	0.055	0.148	0.064	0.027
IND	1.050	0.062	1.230	0.005
AUD	-0.014	0.844	0.004	0.940
KM	-2.366	0.852	-0.200	0.983
SIZE			-0.623	0.000
LEV			-0.719	0.190

Table 4 informs that the constant value is 19.011 which is interpreted if the board of director size, the board meeting frequency, the independent commissioner proportion, the size of audit committees, and managerial ownership along with the control variables of firm size and leverage equal to a value of 0, then the Tobin's Q variable will increase by 19.011. For board of director size (DIR), the value of the coefficient appears 0.078, which means that this independent variable has an influence positively on Tobin's Q. The coefficient of frequency of board meeting (RDEW) appears 0.064, which means this independent variable has an influence positively on Tobin's Q. Furthermore, the coefficient of independent commissioner proportion (IND) appears a value of 1.230, which means that this independent variable has an influence positively on Tobin's Q.

The coefficient for audit committee size (AUD) appears 0.004, which shows that the size of the audit committee had an influence positively on Tobin's Q. The managerial ownership coefficient (KM) appears -0.200, which means that managerial ownership had a negative impact on Tobin's Q. Furthermore, the coefficient for variable of firm size (SIZE) had a value of -0.623 which shows that this independent variable has an influence negatively on Tobin's Q. In addition, the coefficient for leverage (LEV) had a value of -0.719 which means this control variable has an influence negatively on Tobin's Q.

Coefficient of determination (Adjusted R^2). The result of test for adjusted R squared using the fixed effect model shows a value of 0.305 or 30.5%. According to this value, all main independent and control variables could explain of 30.5% on Tobin's Q. In addition, according to the F test, a probability value shows 0.000. It was less than 0.05 which means regression model is fit.

Table 4 model 2 reports that the probability value for board of director (DIR) appears 0.019 which was lower than 0.05 as a level of confident. In addition, the sign of the coefficient shows positive which means that the hypothesis of board size having a negative influence on Tobin's Q (H_1) is rejected. Furthermore, the probability value of board meeting frequency (RDEW) appears 0.027 which was lower than 0.05. The direction of the coefficient shows positive sign which means the hypothesis that board meeting frequency had a positive influence on Tobin's Q (H_2) is accepted.

The probability value of the independent commissioner proportion (IND) appears 0.005. The direction of the coefficient shows positive sign so that the decision that the hypothesis of independent commissioner proportion had a positive impact on Tobin's Q (H_3) is accepted. Furthermore, the probability value of audit committee size (AUD) is 0.940 and the direction of the coefficient is positive. Thus, it can be stated that the hypothesis consisting of size of audit committee had a positive influence on Tobin's Q (H_4) is rejected. Furthermore, the probability value of managerial ownership (KM) appears 0.983 and the direction of the coefficient is negative. This shows that the hypothesis consisting of managerial ownership had a positive impact (H_5) is rejected.

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Table 4 also provides information that the probability value of firm size (SIZE) was 0.000 and had a negative coefficient direction. This means that size of firm had a negative influence on Tobin's Q. In addition, the probability value of leverage (LEV) is 0.190 and the direction of the coefficient is negative. This means that leverage had no influence on Tobin's Q.

V. DISCUSSION

The analysis proves that the size of the board of director had an influence positively on firm value. This finding suggests that the larger the size of board of director often has an advantage in terms of greater human resources whose role is to address information asymmetry through greater supervisory control (Barako et al., 2006). This finding was not in line with theory of agency by Jensen & Meckling (1976) in which this theory explains that the larger the board of directors tends to be difficult to coordinate and have communication problems that lead to increased agency costs and monitor the company inappropriately (Kholeif, 2008). The evidence of this study was in line with Arora & Sharma (2016), Kao et al., (2019), Ciftci et al., (2019), Puni & Anlesinya (2020).

Statistical test proves that the board meeting frequency had an influence positively on firm value. When the boards of commissioner and director come and gather frequently in joint meeting, the board of commissioners has more opportunities to discuss company-related issues and monitor management more effectively. Thus, the board can carry out its work in a more coordinated manner and in accordance with the principal's objectives (Lipton & Lorsch, 1992). This finding provides empirical support for agency theory which proves that when boards of commissioners and directors meet more frequently, their ability to effectively monitor, advise, research, and create a condition of discipline increases. It would improve the performance of the board so as to achieve the principal's goal, which is to maximize principal wealth (Eluyela et al., 2018). This finding is in line with Ntim & Osei (2011), Arora & Sharma (2016), Eluyela et al., (2018), Puni & Anlesinya (2020).

Statistical analysis documents that independent commissioner proportion had an influence positively on value of firm. Good supervision from an independent commissioner is able to minimize fraudulent acts by agents in financial reporting. When the company's financial reports are of high quality, investors can be more confident in making investments which usually leads to higher stock prices and an increase in company value (Dewi & Nugrahanti, 2014). This evidence was in accordance to agency theory which assumes that when company management has individual interests and the independent commissioner works according to monitoring mechanism effectively in protecting the principals, restraining agent self-interested behaviour, and moderating conflicts between principal and agent (Shan, 2013). As a result, more independent commissioners are able to carry out their oversight role effectively, which can result in lower agency costs and increased firm value (Fama & Jensen, 1983; Jensen & Meckling, 1976). This evidence was in line with Malik & Makhdoom (2016), Handriani & Robiyanto (2018), Permatasari & Mu'minin (2019), and Kao et al. (2019).

The analysis reports that audit committee size had no impact on value of firm. This can happen because most of the size of audit committees in each firm tend to be the same where each company tends to have the audit committee size of 3-4 members. Number of audit committees which tends to have the same results in investors not paying too much attention to the number of company audit committees. Therefore, it does not have affect investors' decisions in investing and does not effect on value of firm. This finding was irrelevant to agency theory which explains that if a company has an audit committee, then the function in control systems and relationships between the principal and independent commissioner could work well in line with the objectives of the company. In addition, more effective audit committee control will optimize firm value (Rosdani et al., 2021). This finding supports the conclusions from Darko et al. (2016), Pratiwi et al. (2017), Yusmaniarti et al. (2020).

The finding in this paper reveals that the ownership of management had no impact on value of the firm. It is because the managements in the company do not yet have a number of share investment significantly. Thus, lower ownership of management could not solve the problem and become the solution to reduce the agency conflict in companies so that had no influence on value of firm (Prastuti & Budiasih, 2015). This finding contradicts agency theory which states that managerial ownership of company shares can align conflicting interests between agents and principals. Managerial ownership provides an opportunity for agents who are also principals to rise value of firm because an increase in value of firm means an increase in their income as a principal (Pamungkas & Muflih, 2020). This finding supports the conclusions of Prastuti & Budiasih (2015) and Estiasih et al., (2019).

This study proves that size of firm as a control variable has a negative effect on value of firm. Larger company tends to be more diversified and had larger boards and are subject to higher agency costs (Jensen & Meckling, 1976; Choi et al., 2007; Fama & French 1992). Furthermore, Driffield et al., (2007) explained that too large a company size has an impact on top management's minimal control over the effectiveness of operational activities and strategies, thereby reducing the value of firm. The finding of this paper was similar to agency theory assuming that large companies have agency costs that tend to be higher than small

companies so that size of firm had an influence negatively on value of firm. This finding supports the conclusions from Pillai & Al-Malkawi (2018), Kao et al. (2019), and Ciftci et al. (2019) who state that firm value will decrease as firm size grows.

Statistical analysis reveals that leverage as a control variable had no effect on value of firm. It is because changes in leverage may not affect stock prices on the market so that there is no change in company value (Primarkus et al., 2019). That is, investors do not focus too much on the level of debt (leverage) that exists in a company, but tend to pay attention to how effective the company is in using debt. In addition, in terms of asset financing, a number of companies prefer to use share capital and retained earnings rather than debt. This finding differs from theory of agency which assumes that optimal debt involvement is able to optimize firm value by encouraging agents to align interests with principals which will minimize agency costs. Agency theory shows that leverage does not necessarily make a company worse off. Conversely, leverage can help prioritize the principal's interests. This evidence was similar to findings of Arora & Sharma (2016), Primarkus et al., (2019) who concluded that leverage had no impact on value of firm.

VI. CONCLUSION

The following conclusions are formulated from the findings on this paper: (1) the board of director size had a positive influence on value of firm; (2) the frequency of board meeting had a positive influence on value of firm; (3) the proportion of independent commissioner had a positive influence on value of firm; (4) the size of audit committees had no influence on value of firm; and (5) the share ownership by management had no influence on value of firm.

As the implications, companies should enhance the quality of implementation for the GCG mechanism to increase public and investor confidence. It would lead to achieve higher value in firm. In addition, companies should consider the board meeting frequency, the board of director size, and the independent commissioner proportion because these factors have been shown to positively affect firm value. Furthermore, companies should comply with regulations governing GCG with the aim of protecting stakeholders. When investors want to make an investment, they should consider the condition of the firm value, the quality of GCG implementation, and firm size to minimize investment risk in the company.

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