Implementation of the Corporate Governance and Index Value of Manufacturing Companies in Stock Exchanges

(Case Study in Indonesia)

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Abstract: Previous research related to the implementation of GCG was mostly related to operational performance, for example, ROI and ROE. However, there is no research on GCG implementation that is related to corporate value and earnings quality as moderating objects. Corporate value is a measure of market performance that is very important because high corporate value describes the market value of a company that is more valuable than the company's noted value. Therefore, this study wants to develop GCG implementation that associated with a corporate value, which is practically influenced by stock and asset prices also how the influence of corporate governance implementation on corporate value and earnings quality as moderating variables. Thus, in general, this study aims to determine the practice of corporate governance with the implementation of the CG Index. This study aims to examine the effect of implementing the CG Index on Corporate Value, specifically.

Keywords: Corporate Governance; Corporate Value; CG Index; Stock Value

JEL Classification: G34

1. Introduction

Good corporate governance (GCG) is a system that regulates and controls the companies that create additional value for all stakeholders (Dewi, Suhadak & Handayani, 2017). This concept emphasises two things, namely the importance of the shareholders right to obtain information correctly and promptly as well as the obligation of companies to conduct accurate, timely and transparent disclosure of all information on company performance, ownership, and stakeholders. There are five main components needed in the concept of GCG, namely Commitment to CG, Structure and Function of the Directors Board, Environment and Processes Control, Transparency and Disclosure, and also the Rights of Minority Shareholders (Demirag, 1998). The five components are necessary because the application of GCG principles is consistently proven to improve the quality of financial statements

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and also be an obstacle to fraudulent activities which results in undescribed financial statements of the company's fundamental values. From the various results of previous studies, it shows that the implementation of corporate governance in Indonesia is deficient still. This condition happens mainly because companies in Indonesia do not yet have a corporate culture as the core of Corporate Governance. This understanding opens the horizon that companies in Indonesia have not implemented governance properly and effectively.

In Indonesia, issues related to corporate governance reinforced after the financial crisis that occurred in Asia in mid-1997 (Husnan, 2001; Lukviarman, 2016). In its development, this issue has become increasingly popular after multilateral financial institutions such as the World Bank and Asian Development Bank (ADB) revealed that the financial crisis that hit Asia, among others, was caused by the weak implementation of corporate governance. Indonesia is claimed to be the country that suffered the most and the slowest rise from the impact of the crisis (ADB, 2000). The ADB report (2000) shows the phenomena that occur in Indonesia, among others, the absence of professional company management because the concentration of ownership allows the occurrence of affiliation between the owner, supervisor and manager of the company, and the non-functioning of the Board of Commissioners. According to Zarkasyi (2008), the results of the 1998 Booz-Allen and Hamilton survey showed that the effectiveness of corporate governance in Indonesia was the lowest in East Asia (2.88) compared to Thailand (4.89), Malaysia (7.72), Singapore (8.93), and Japan (9.17). In 2014, a survey conducted by Credit Lyonnais Securities Asia (CLSA) regarding the evaluation of the implementation of corporate governance in Asia Pacific countries showed Indonesia’s position at number 10 with a score of 39 (using the CG Watch Market Score) from 11 Asia Pacific countries (Abdullah, Percy & Stewart, 2015; Lukviarman, 2016).

Previous research related to the implementation of GCG was mostly related to operational performance, for example, ROI and ROE. However, there is no research on GCG implementation that is related to corporate value and earnings quality as moderating objects. Corporate value is a measure of market performance that is very important because high corporate value describes the market value of a company that is more valuable than the company’s noted value. Therefore, this study wants to develop GCG implementation that associated with a corporate value, which is practically influenced by stock and asset prices also how the influence of corporate governance implementation on corporate value and earnings quality as moderating variables. Thus, in general, this study aims to determine the practice of corporate governance with the implementation of the CG Index. This study aims to examine the effect of implementing the CG Index on Corporate Value, specifically.

Background

The implementation of GCG serves as an increase in competitiveness among companies and ultimately increases competitiveness with foreign countries. GCG implementation can certainly improve company performance and ultimately increase corporate value. The company aims to maximise the welfare of shareholders by maximising corporate value. Company value is the market value of a company's stock that reflects the owner's wealth. The higher the stock price signifies, the higher the owner's wealth. Investors will choose to invest in companies with maximum company value because they can provide maximum shareholder prosperity — the maximum company value achieved if the company can operate by achieving targeted profits. The targeted profit will obtain if the company can implement GCG. In the long run, the company's goal is to maximise corporate value. The higher corporate value describes, the more prosperous the owner. Corporate value, which forms through indicators of stock market value, is strongly influenced by investment opportunities. Investment expenditures provide a positive signal about the company's growth in the future, thus increasing stock prices as an indicator of corporate value (Arniati, 2008). One measurement of corporate value is Price to Book Value (PBV), which is a comparison of the market price of a stock with its Book Value (BV). PBV shows how far the company can create corporate value. Companies that run well generally have PBV above 1, which shows market value is higher than the value of the book. With a high PBV ratio shows high stock prices. In addition to PBV, the indicator used to measure corporate value is Tobins' Q ratio.

1.1. Corporate Governance

Corporate Governance is a system designed to direct the management of the company professionally based on the principles of transparency, accountability, responsibility, independence, fairness, and equality (Effendi, 2016). Corporate governance is a concept that approachable by various kinds of theories, one of which is agency theory. Corporate governance is expected to function as a tool to provide confidence to investors that they will receive returns on funds that invested. Corporate governance is related to how investors are confident that the manager will provide benefits for his investment. Investors believe that managers will not embezzle or invest in unprofitable projects, and are related to how investors control managers (Larcker, Richardson & Tuna, 2007). Corporate governance practices in each company reflect the mindset of top management and the value system adopted by the company for a long time. In most companies, corporate governance did not develop through natural business processes but forced to adopt due to legal compliance requirements from certain countries or follow certain industry standards (Nisa & Warsi, 2008). Each company establishes corporate governance code based on the condition of the company. At present, the company's operations are not limited to one country but have crossed various countries. In such conditions, there is a need for governance standards that can be universally accepted by each company operating in various countries.

1.2. Corporate Value

Corporate value is an investor's perception that often associated with stock prices. High stock prices increase corporate value. Corporate value commonly indicated by a high PBV will make the market believe in the company's prospects going forward. There are several ratios used in measuring corporate value, among others, by using Tobin's Q ratio which is the market value of a company by comparing the market value of a company listed on the financial market with the value of replacing company assets (Lindenberg & Ross, 1981). If the market value merely reflects the assets recorded in a company, then Tobin's Q will be equal to 1. If Tobin's Q is greater than 1, the market value is higher than the value of the listed company assets. The words indicate that the stock overvalued. If Tobin's Q is less than 1, the market value is smaller than the value of the company's recorded assets. The indicates that the stock is undervalued. The Q-ratio is a more accurate measure of how effectively management uses economic resources in its power. Research conducted by Lindenberg and Ross (1981) shows how the Tobin-q ratio applies to each company. They found that some companies could maintain a Tobin-q ratio higher than one would attract new resource and competition flows until the q-ratio approached one.

2. Hypothesis Development

In the perspective of agency theory, agents who are risk-averse and tend to be selfish will allocate resources from investments that do not increase the value of a more profitable investment company. Agency problems will indicate that the value of the company will increase if the owner of the company can control the behaviour of management so as not to waste company resources, both in the form of investments that are not feasible or in the form of shirking. Corporate Governance is a system that regulates and controls companies that are expected to provide and increase the value of the company to shareholders. Thus, the application of GCG is believed to increase company value (Herawaty, 2008) According to Nasution and Setiawan (2007), corporate governance is a concept that is proposed to improve company performance through supervision or to monopolise management performance and establishing management accountability to stakeholders based on the regulatory framework. The concept of corporate governance is proposed to achieve more transparent corporate management for all users of financial statements. Because of increasing company value, management often takes opportunistic actions by conducting earnings management. The corporate governance mechanism will limit the actions of opportunistic earnings management because of the control mechanisms within the company.

Some public companies that have participated in corporate governance perception index (CGPI) have benefited from the application of good corporate governance (GCG), including the application of GCG to maximise company value through increasing orientation on the principles of openness, accountability, responsibility, independence and fairness in carrying out business activities. The fundamental thing falls from the implementation of GCG is the commitment of the leadership and all members of the company to adapt GCG principles in their business activities (Ramadhani, Andreas & Desmiyawati, 2015). The existence of corporate governance ratings in the form of CGPI, investors can expect that companies that rank highest will be better corporate governance than companies that rank below. CGPI ranking obtained by the company can attract the interests of stakeholders so that the value of the company will increase. The higher CGPI score indicates that the company is increasingly trusted by interested parties (stakeholders) That makes the company able to increase high profitability and can attract investors to invest in expanding their business Amman, David and Markus (2011) find a strong and positive relationship between corporate governance and the value of the company an. The results of the study indicate that better corporate governance practices are reflected in statistics and economics significantly in higher market values.

The results of previous studies show mixed results, but there is a tendency that corporate governance practices in public companies are positively related to firm value. The implementation of corporate governance indicates by the score of applying CG index which has a positive effect on firm value. According to the World Bank Group (2014), the CG index consists of a commitment to CG, structure and functioning of the board of directors, control environment and processes, transparency and disclosure, and rights of minority shareholders. Based on the above arguments, the research hypothesis formulates as follows:

H1: Commitment to CG has a positive effect on corporate value;

H2: Structure and functioning of the Board of Directors has a positive effect on corporate value;

H3: Control environment and processes have a positive effect on corporate value;

H4: Transparency and disclosure have a positive effect on corporate value;

H5: Rights of minority shareholders have a positive effect on corporate value;

H6: Profit Quality reinforces the positive influence of commitment to CG on corporate value;

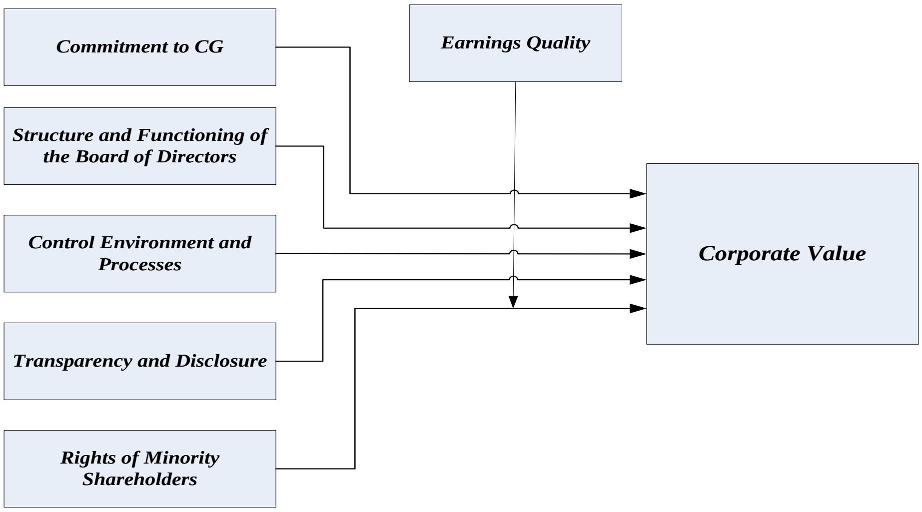
H7: Profit quality reinforces the positive influence of structure and functioning of the Board of Directors on corporate value;

H8: Profit quality strengthens the positive influence of control environment and processes on corporate value;

H9: Profit quality reinforces the positive influence of transparency and disclosure on corporate value;

H10: Profit quality strengthens the positive influence of rights of minority shareholders on corporate value.

3. Research Concept



4. Research Method

The sample of this research is manufacturing companies listing in the Indonesian capital market from 2012 to 2016. The results of a preliminary survey on the Indonesia Stock Exchange (IDX) obtained data on manufacturing companies listing up to 2016 as many as 138 companies. Based on sample selection, obtained 115 companies that fulfil the data. Observations were made over 5 years so that the number was 575 cases. This study uses secondary data, namely company data published on the Indonesia Stock Exchange, consisting of:

a. Company annual report (annual report) consisting of reports of the Board of Commissioners and Directors and Financial Reports: (statement of financial position (balance sheet), income statement and cash flow statement, and notes to financial statements);

b. Corporate governance components include a commitment to CG, structure and functioning of the board of directors, control environment and processes, transparency and disclosure, and rights of minority shareholders.

Research variables group into independent variables, dependent variables, and moderating variables. The independent variable is the CG consumption index which consists of a commitment to CG, structure and functioning of the board of directors, control environment and processes, transparency and disclosure, rights of minority shareholders. Measurement of variables using CG disclosure scores reported by companies in the annual report. The dependent variable is Corporate Value, which is the value of the company measured by the value/ratio of Tobin-Q (Q ratio) with the formula:

Q Ratio = ME + (ME + PS + Debt)/TA

Notes

ME = Value of stock price
PE = Value of preferred stock
Debt = Total Debt - Current assets + inventory

Moderating variables are earnings quality, which is the quality of corporate earnings as measured by the lateral discretion value developed by Kothari, Leone, & Wasley (2005) using proxy performance-adjusted discretionary accruals. In particular, researchers estimate the accrual discretion values as follows:

$$\mathbf{TAccr_{i;t} = \alpha_0 + \alpha_1(1/Assets_{i,t-1}) + \alpha_2\Delta Rev_{i;t} + \alpha_3 PPE_{i;t} + \alpha_4 ROA_{i;t} + \varepsilon_{i;t}}$$

Notes

Residuals from the regression model are discretionary accruals. The researcher used the absolute value of discretionary accruals (DisAccr) multiplied by -1 as the proxy for earnings quality.

5. Analysis Method

The analysis method uses two stages, using Regression Analysis (RA) and using the Moderating Regression Analysis (MRA) with moderating variables. The statistical model presents below.

CorpValue	=	$\alpha + \beta_1 KomitCG + \beta_2 StrFuncBoD + \beta_3 ConEnvProces + \beta_4 TransDisclos + \beta_5\ RightsMinor + \varepsilon$ …………………………………..	(1)
CorpValue	=	$\alpha + \beta_1 KomitCG + \beta_2 StrFuncBoD + \beta_3 ConEnvProces + \beta_4 TransDisclos + \beta_5\ RightsMinor + \beta_6 EarnQual + \varepsilon$ …………………………………………….	(2)
CorpValue	=	$\alpha + \beta_1 KomitCG + \beta_2 StrFuncBoD + \beta_3 ConEnvProces + \beta_4 TransDisclos + \beta_5\ RightsMinor + \beta_6 EarnQual +$	(3)

β_7KomitCG *EarnQual + β_8 StrFuncBoD *EarnsQual + β_9ConEnvProces *EarnQual + β_{10} TransDisclos *EarnQual + β_{11} RightsMinor *EarnQual ε ………………………………………………

Notes

α	:	*Constant*
β	:	*Regression Coeffisien*
CorpValue	:	*Corporate Value*
KomitCG	:	Commitment to Corporate Governance
StrFuncBoD	:	Structure and Function of the Board (Board of Commissioners)
ConEnvProces	:	Environmental and Process Control
TransDisclos	:	Transparency and Disclosure
RightsMinor	:	Rights of Minority Shareholders
EarnQual		Earning Quality
KomitCG *EarnQual	:	Interaction Commitment to CG with Earning Quality
StrFuncBoD	:	Interaction Structure and Function of the DK with Earning Quality
ConEnvProces	:	Interaction of Environmental Control and Process with Earning Quality
TransDisclos *EarnQual	:	Interaction of Transparency and Disclosure with Earning Quality
RightsMinor *EarnQual	:	Interaction of the Rights of Minority Shareholders with Earning Quality
ε	:	Error term

6. Findings and Discussion

Corporate governance (CG) implementation on the commitment aspect of CG which has seven items with an average score of 6.24, the highest score of 7 and the lowest score of 0, the highest score of 7 is 59.4%. These results illustrate that most manufacturing companies have implemented seven items (out of 7 items) in the aspect of commitment to CG including ownership of CG charter, implementing CG rules, codes of ethics and CG policies, expressing compliance with CG, and having the official responsible for implementing CG.

CG implementation in the structure and function aspects of the Board of Commissioners (DK) which has 13 items with an average score of 7.71, the highest score of 12 and the lowest score of 0, the highest score of 10 is 31.7%. This result illustrates that most manufacturing companies have implemented 10 items (out of 12 items) on the structure and function aspects of the DK, including the structure and structure of the DK, having independent commissioners, having committees tasked with assisting DK, DK's role in directors, having diversity of expertise, and conducting DK meetings periodically.

Implementation of environmental control aspects and processes that have 16 items with an average score of 9.26, the highest score of 16 and the lowest score of 0, the highest score of 10 is 46.5%. These results illustrate that most manufacturing companies have implemented ten items (out of 16 items) environmental control aspects and processes including adequate internal controls, having an Audit Committee, having risk restrictions and risk management systems, having internal audit functions, having compliance programs, and has internal and external audits.

Implementation of transparency and disclosure aspects that have six items with an average score of 4.64, the highest score of 6 and the lowest score of 0, the highest score of 5 is 69.3%. These results illustrate that most manufacturing companies have implemented 5 items (out of 6 items) aspects of transparency and disclosure, among others in the form of presenting financial statements according to accounting standards (general SAK), disclosing principal transactions, transactions with related parties, off-balance-sheet activities, and other material events, the DK/Audit Committee reviews the critical elements of the financial statements, has a material (financial and non-financial) written information disclosure policy, is timely and equally available to all stakeholders.

Implementation of aspects of the rights of minority shareholders who have five items with an average score of 4.64, the highest score of 5 and the lowest score of 0, the highest score of 1 is 49.5%. This result illustrates that most manufacturing companies have implemented 1 item (out of 5 items) aspects of the rights of minority shareholders, among others in the form of preparations and calls for annual and extraordinary GMS that allow the participation of all shareholders (sufficient notice, agenda and supporting material. All of that includes propose agenda items; participation in person or through a proxy; right to ask questions; dissemination of results of meetings).

Table 1. Description of Research Variables

	Commitment to CG	*Structure and functioning of the BoD*	*Control the environment and processes*	*Transparency and disclosure*	*Rights of minority shareholders*	*Corporate Value*	*Earnings Quality*
Mean	6.24	9.71	9.26	4.64	1.34	1.68	0.34
Median	7.00	10.00	10.00	5.00	1.00	0.94	0.04
Mode	7.00	10.00	10.00	5.00	1.00	-2.39	-0.55
Std. Deviation	1.25	2.05	2.08	1.18	1.16	2.50	3.99
Minimum	0.00	0.00	0.00	0.00	0.00	-2.39	-0.88
Maximum	7.00	12.00	16.00	6.00	5.00	18.40	56.82

7. Conclusion

The results of the analysis and testing of hypotheses presented in the Table show that the commitment to CG (commitment to CG) and the protection of the rights of minority shareholders have a positive effect on corporate value. The results of interaction testing indicate that earnings quality strengthens the positive influence of the CG index, structure and function of the Board of Directors, and protection of minority rights (shareholders' rights) on corporate value (corporate value). While earnings quality strengthens the negative influence of CG index, commitment to CG (commitment to CG), transparency and disclosure to corporate value (corporate value). Thus it can be concluded that commitment to CG (commitment to CG) and transparency and disclosure (transparency and disclosure) have a positive effect on corporate value. However, after being moderated by earnings quality earnings, showing that the protection of the rights of minority shareholders (rights of minority shareholders consistently has a positive effect on corporate value), the commitment to CG (commitment to CG) hurts company value). The results of hypothesis testing summarised as follows:

Hipotesis	**:**	**Statement**	**Decision**
H_1	:	Commitment to CG has a positive effect on corporate value	Proven
H_2	:	The structure and functioning of the Board of Directors has a positive effect on corporate value	Not proven
H_3	:	Environment and processes control have a positive effect on corporate value	Not proven
H_4	:	Transparency and disclosure have a positive effect on corporate value	Not proven
H_5	:	Rights of minority shareholders have a positive effect on corporate value	Proven
H_6	:	Profit Quality reinforces the positive influence of commitment to CG on corporate value	Evidenced by the opposite results
H_7	:	Profit Quality reinforces the positive influence of structure and functioning of the Board of Directors on corporate value	Not proven
H_8	:	Profit quality strengthens the positive influence of control environment and processes on corporate value	Not proven

H_9	:	Profit quality reinforces the positive influence of transparency and disclosure on corporate value	Evidenced by the opposite results
H_{10}	:	Profit quality strengthens the positive influence of rights of minority shareholders on corporate value	Proven

Table 2. Results of Regression Analysis and Hypothesis Testing

Model	Unstandardized Coefficients		Standardised Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.312	.716		.435	.663
Commitment to CG	.267	.124	.134	2.147	**.032****
Structure and functioning of the BoD	-.123	.085	-.101	-1.443	.150
Control environment and processes	.004	.082	.003	.049	.961
Transparency and disclosure	.109	.115	.052	.945	.345
Rights of minority shareholders	.212	.109	.098	1.942	**.053***
Earnings Quality	2.138	2.729	3.419	.784	.434
ContEnviron*EarnQual	-.316	.193	-5.160	-1.641	.102
TranspDisc*EarnQual	-.365	.198	-2.807	-1.837	**.067***
Right*EarnQual	2.835	.934	4.535	3.035	**.003****
R	0.233				
R Square	0.054				
Adjusted R Square	0.037				
F	3.145				
Sig.	0.001***				

a. Significancy Level ***1%. **5%. *10%
b. Dependent Variable: Corporate Value
c. Predictors: (Constant), Right1_EarnQual1, Transparancy & Disclusure 1, Right & Shareholders 1, Commitent 1, Control & Enviroment 1, Structure & DK 1, TranspDisc1_EarnQual1, ContEnviron1_EarnQual1, EarnrQual1

Table 3. Results of Regression Analysis and Hypothesis Testing (Extention)

Excluded Variables						
Model		Beta In	t	Sig.	Partial Correlation	Collinearity Statistics
						Tolerance
1	*Komit*EarnQual*	-16.801[b]	-1.975	**.049****	-.089	2.625E-5
	*StrukDK*EarnQual*	22.413[b]	3.227	**.001*****	.144	3.887E-5

a. Significancy Level ***1%. **5%. *10%
b. Dependent Variable: Corporate Value
c. Predictors: (Constant), Right1_EarnQual1, Transparancy & Disclusure 1, Right & Shareholders 1, Commitent 1, Control & Enviroment 1, Structure & DK 1, TranspDisc1_EarnQual1, ContEnviron1_EarnQual1, EarnrQual1

8. Conclusion

The results of the study show that commitment to CG and protection of shareholders' rights have a positive effect on company value. The results of interaction testing indicate that the quality of earnings reinforces the positive influence of the CG index:

the structure and function of the DK and the protection of the rights of minority shareholders to the value of the company. While earnings quality reinforces the negative influence of CG index: commitment to CG, transparency and disclosure of company value. The results concluded that commitment to CG and the protection of the rights of minority shareholders had a positive effect on the value of the company. However, after being moderated by earnings quality, it shows that the protection of the rights of minority shareholders is consistently positive for firm value, whereas commitment to CG hurts their value.

The results of the study contribute to corporate governance practices and the assessment of corporate governance in manufacturing companies in the Indonesia Stock Exchange. The implementation of corporate governance, especially the aspect of commitment to CG and protection of the rights of shareholders, can increase the value of the company. This aspect is undoubtedly considered important by stakeholders, especially investors, that the company runs the principles of good corporate governance. However, aspects of the protection of shareholders' rights are still limited to the points of preparation and annual and extraordinary GMS calls that allow the participation of all shareholders (sufficient notice, supporting agenda and material; propose agenda items; participation privately or through a proxy; the right to ask questions, dissemination of meeting results, agenda, participation in person or through a proxy, the right to ask questions, dissemination of results of meetings.

This research has limitations in accessing data related to the implementation of qualitative corporate governance. The explanations revealed in the company's annual report are partially incomplete, making it difficult to give conclusions and scoring. Researchers use the interpretation of disclosure of the implementation of CG based on the subject matter of the researcher. Also, this study uses scoring disclosure of corporate governance aspects with a score of 1 (revealing) and a score of 0 (not revealing). This kind of disclosure scoring certainly has limitations in the value of implementation only to the information disclosed in the annual report.

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