

The Effect of Corporate Governance and Firm Performance on Stock Price: An Empirical Study on Indonesia Stock Exchange

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Received: 29th December 2016/ **Revised:** 1st November 2017/ **Accepted:** 12th Desember 2017

How to Cite: Mulyono, Suprpto, A. T., & Prihandoko, D. (2018). The Effect of Corporate Governance and Firm Performance on Stock Price: An Empirical Study on Indonesia Stock Exchange. *Binus Business Review*, 9(1), 79-85. <https://doi.org/10.21512/bbr.v9i1.1916>

ABSTRACT

This research aimed to determine the effect of corporate governance and firm performance on stock prices. It was shown by Corporate Governance Perception Index (CGPI), Return on Assets (ROA), Total Asset Turnover (TATO), and firm size (SIZE) in the Indonesia Stock Exchange (IDX). Data sample used in this research was company listed on IDX during 2009-2012 and participated in CGPI of that period. Financial statement data and stock prices could be obtained from the IDX website and CGPI data were from the Indonesian Institute for Corporate Governance. Hypothesis test used in this research was a multiple linear regression analysis. As a result, the application of corporate governance and ROA give positive but insignificant effect on stock prices. Meanwhile, TATO and SIZE have a positive and significant effect on stock prices. Both variables of corporate governance and firm performance influence stock prices significantly.

Keywords: Indonesia Stock Exchange, corporate governance, firm performance, Return on Asset (ROA), Total Asset Turnover (TATO), firm size, stock price

INTRODUCTION

Indonesian capital market has developed quite rapidly compared with previous years. The development of capital market can be seen from the increasing number of issuers listed on the Indonesia Stock Exchange. There were 287 companies listed in the year of 2000, and it rose to 506 companies in 2014 (Indonesia Stock Exchange, 2014). The public company has become imperative to provide access information to stakeholders. The information is reflected in the activities of the company in delivering good information disclosure to the stock exchange or directly to the public (Forum for Corporate Governance in Indonesia, 2002).

In the modern economy, the management of the company is separated from the owners. It is in line with agency theory by Ross (1973). It emphasizes the importance of handing over the management of the

company from the owner to professional workers who have a better understanding of running the business. Discretionary managers in maximizing corporate performance can lead to a process of maximizing the interests of management itself. Meanwhile, the owner should take the responsibility. Ross *et al.* (2009) suggested that if this situation left unsupervised, managers tended to maximize the number of resources under their control. Therefore, it needs certainty that management will do its best for the company. The certainty can be provided through a system of corporate governance.

The discussion on corporate governance becomes more prominent. It is shown by the development of rules and policies applied to the international level like the guiding principles of corporate governance on Organization for Economic Cooperation and Development (OECD, 2004). The application of corporate governance in Indonesia is also growing. It

is mainly due to encouragement from the government to companies. In Indonesia, the companies implement good corporate governance. It is issued by the Minister of State-Owned Companies regulation No. PER-01/MBU/2011 on good corporate governance implementation within state-owned companies. The government seeks to implement corporate governance of State-Owned Companies in accordance with the applicable regulations. In 1999, the government established the National Committee on Governance (NCG). Then, NCG published the guide of Indonesia's good corporate governance (National Committee on Governance, 2006). The application of good corporate governance also gets the attention from the public. It can be seen through the establishment of various institutions that play an active role in the development of corporate governance in Indonesia. It includes the Forum for Corporate Governance in Indonesia (FCGI) and the Indonesian Institute for Corporate Governance (IICG).

The applied corporate governance can be driven from two sides. There is the consciousness of the individual business to run a business practice that promotes survival of the company, interests of stakeholders, and ways to avoid creating a profit in a bad way. On the other hand, the impetus of the regulations requires companies to adhere to the current laws. Both approaches have strengths and weaknesses. However, it should complement each other to create a healthy business environment (National Committee on Governance, 2006).

Corporate governance can define as the set of regulations. It governs the relationship between shareholders, the company managers, the creditors, government, employees, and another internal and external party that holds interest relating to the right and obligation or a system that rules and control the companies (Forum for Corporate Governance in Indonesia, 2002). Solomon and Solomon (2013) defined corporate governance as balanced surveillance systems for both internal and external to the company. It ensured the company to carry out its accountability to all stakeholders and act in a socially responsible way in all company activities. Therefore, corporate governance was intended to achieve broader objectives. There were stakeholder objectives rather than shareholders.

National Committee on Governance (2006) suggested the application of the principles in good corporate governance. It included transparency, accountability, responsibility, independence, and fairness. Similarly, according to Minister of State-Owned Companies regulation No. PER-01/MBU/2011 on good corporate governance implementation within state-owned companies, the principles of good corporate governance include transparency, accountability, responsibility, independence, and fairness.

Suri (2014) said companies that implemented good corporate governance would improve the welfare and long-term viability of the company. A company

that performed well with an efficient internal practice had a positive impact on private development sector. Good corporate governance could build healthy organizations and institutions, and lead to sustainable economic growth. Moreover, Reuter Staff (2014) stated that companies implemented good corporate governance and focused on environmental and social issues would cause the performance of share price became higher.

Various researchers support the need for companies to implement optimal corporate governance. Coombes and Watson (2000) concluded that investments in Asia and Latin America were considered more secure and protected if companies implemented good corporate governance and considered the interests of shareholders. Furthermore, Drobetz *et al.* (2004) conducted an empirical study on companies in Germany. They showed that companies with good corporate governance were able to increase its market to book ratio. It meant the increase in company's market capitalization. Meanwhile, Walker (2013) argued that application of the corporate governance positively influenced stock prices. The disclosure of the implementation aspects of corporate governance could be a way for companies to communicate its accountability to stakeholders. With the implementation of corporate governance and good performance, it would produce a positive response from investors to the stock price of the company.

Agency theory argues that in the modern enterprise where ownership is widely held, actions of the management company may deviate from the required target to maximize shareholder profits (Ross, 1973). Jensen and Meckling (1976) described that the agency relationship as a contract meant one or more parties as the owner of the company (the principal) and involved another party (the agent) to perform some of the activities on their behalf of the principal. It might involve delegating some decision-making authority to the agents. The discretionary managers in maximizing corporate performance management can lead to a process of maximizing the interests of management itself. However, the burden is held by the owner of the company. Therefore, in the interests of the management, the company needs certainty that it will act in the best interest (Ross *et al.*, 2009).

Hill and Jones (1992) suggested basis agency theory by using the assumption that the interest of principal and agent were different. According to them, the principle may restrict the different interests by establishing right incentives for the agents, and generate monitoring costs. It is designed to limit opportunistic action by the agent. Related to incentives, Williamson (1985) described that the interests of shareholders (principles) would be kept if the management (agent) had the same interests with shareholders through incentive compensation plans which were designed appropriately.

Moreover, stakeholder theory has the perspective that company needs to consider the interests of the public. Then, it can encourage companies to produce

valuable policies for society (Solomon & Solomon, 2013). A company tries to generate profits for their owners. If they do not, the company activities will be disrupted, or the company cannot survive. Besides profits, companies also need to create values for various parties associated with the company. In accordance with that perspective, it can be seen that the various activities of companies and interests of stakeholders must be considered.

Companies have the complex relationships with many people in the community. Management and shareholders are not the only parties that have an interest in the company's decision. The other parties such as employees, customers, suppliers, and even the government can also have an interest in the company. Ross *et al.* (2009) argued that in general, stakeholder was a party or creditor that could potentially have a claim on the company's cash flow. Furthermore, IICG (2013) provided an understanding of stakeholders as a group or individual who will be directly affected by decision and strategy applied by the company. They can also be as the parties who bear some risk of having an investment in companies or as a result of the company's activities.

Furthermore, company performance is an evaluation of all efforts to achieve company's business objectives (Yildiz and Caracas, 2012). Venkatraman and Ramanujam (1986) divided company performance into three domains. Those were the financial performance, financial and operational performance, and organizational effectiveness. The financial performance had become dominant model in empirical research strategies. In this research, the measurements of company performance used are Return on Assets (ROA), Total Asset Turnover (TATO), and firm size (SIZE).

ROA is a measure of profitability ratios. It measures the company's ability to generate profits by using the total assets of the company. ROA is calculated using the following formula:

$$ROA = Profit (loss) / Total Assets \quad (1)$$

TATO is a measure of operating ratio. TATO shows the overall efficiency level of corporate assets usage in generating sales. TATO is calculated using the following formula:

$$TATO = Sales / Total assets \quad (2)$$

Moreover, SIZE measurements are obtained from a market capitalization. It is shares outstanding quantity multiplied by the stock price. Market capitalization is used as a proxy for public opinion on the net worth of the company. Market capitalization is calculated using the following formula:

$$Market\ capitalization = shares\ outstanding\ quantity\ x\ share\ price \quad (3)$$

Bauer *et al.* (2008) conducted research about the influence of corporate governance on corporate performance in Japanese public companies in a period of 1999-2004. They found that the performance of companies implementing corporate governance significantly outperformed by 15% per year compared to a company that failed to apply corporate governance. They also found that corporate governance was related to financial disclosure, shareholder rights, and remuneration that affected the performance of stock price.

Al-Haddad *et al.* (2011) examined the relationship of corporate governance and performance indicators in the industrial sector companies listed on Amman Stock Exchange in Jordan between years of 2000-2007. The results showed a positive relationship between profitability as measured by Earnings Per Share (EPS), ROA, and corporate governance. It also had a positive relationship between liquidity, dividend per share, SIZE, and corporate governance.

Balasubramanian *et al.* (2010) researched corporate governance practice in India public companies. They gave a detailed picture of the practice of public companies in India. They also identified the areas where corporate governance practices were relatively strong or weak. They found the positive relationship between corporate governance in a company that was more profitable with strong growth opportunities.

Then, Uwuigbe (2013) wanted to determine the relationship between corporate governance and stock prices. They studied corporate governance mechanism by the structure of ownership and audit committee, as well as the share price at Nigerian Stock Exchange. The research used regression analysis and correlation. Empirical findings showed that ownership structure had a negative correlation with stock prices. Meanwhile, the audit committee positively related to the stock price.

Pratiwi and Suryanawa (2014) aimed to examine the effect of good corporate governance and Corporate Social Responsibility (CSR) implementation in stock return of companies listed in Indonesia Stock Exchange 2010-2012. They used multiple linear regression analysis as a method of a hypothesis test. The results showed good corporate governance had no significant effect. However, CSR had a significant effect on stock returns.

Iqbal (2015) examined the association between the risk that was adjusted to the performance of stocks measured by Sharpe Ratio and company performance measured by indicators of profitability, liquidity, leverage and size (market capitalization). The companies were listed on Karachi Stock Exchange during 1996-2007. The empirical findings showed profitability particularly ROA and SIZE had a positive and significant impact on the company financial success. Meanwhile, leverage influenced stock performance.

Based on explanation presented, this research seeks to answer how the influence of corporate

governance application, ROA, TATO, and SIZE is to the company's SP. Specifically, the objective of this research is to examine the role of corporate governance and firm performance application on stock prices on the Indonesia Stock Exchange. Then, this research also analyzes the effect of corporate governance, ROA, total asset turnover, and SIZE to the company's SP.

The benefits and contribution of this research for academic institutions is to understand the role of corporate governance and firm performance on stock prices in Indonesian Stock Exchange. This research contributes to the empirical studies and or issuers by providing a reference for measuring the implementation of corporate governance and firm performance and its impact on the stock price. Thus, the issuers can raise their stock price and contribute to the Indonesia Stock Exchange in improving the implementation of corporate governance and firm performance. If this research is applied, it will have an impact in increasing the performance of the company listed on the Indonesia Stock Exchange.

METHODS

Data sample used in this research have several criteria. First, the company is listed on Indonesia Stock Exchange during 2009-2012. Second, the company participates in CGPI of the period 2009-2012. Third, financial statement data and stock prices can be obtained from the website of the Indonesian Stock Exchange (www.idx.co.id). For CGPI, the data are obtained from the Indonesian Institute for corporate governance.

The independent variable of this research consists of Corporate Governance Perception Index (CGPI), ROA, TATO, and SIZE. Meanwhile, the dependent variable is stock price (SP). Then, CGPI is the corporate governance rating published by the Indonesian Institute for corporate governance. ROA is the measurement used by the company to demonstrate the ability to utilize its assets to generate profits.

Then, TATO is the measure to indicate the overall efficiency level of corporate assets used in generate sales. SIZE is the measurement used as a proxy for net worth companies. It is obtained from market capitalization which is shares quantity multiplied by the stock price. SP is the year-end closing stock price in the period of 2009-2012.

Hypothesis test used in this research is multiple linear regression analysis. This research consists of four independent variables (CGPI, ROA, TATO, and SIZE) and a dependent variable (SP). It uses the following equation:

$$SP_t = \alpha_0 + \alpha_1 CGPI_t + \alpha_2 ROA_t + \alpha_3 TATO_t + \alpha_4 SIZE_t + et \quad (4)$$

Where,

SP : Stock Price

CGPI : Corporate Governance Perception Index

TATO : Total Asset Turn Over

ROA : Return on Asset

SIZE : Firm size

α_0 : Constant

$\alpha_1, \alpha_2, \alpha_3, \alpha_4$: Coefficient of each variable

et : Error term

The research testing model has to meet the classical assumption of normality test, heteroscedasticity, autocorrelation, and multicollinearity. According to Sekaran and Bougie (2013), the hypothesis is a logically expected relationship between two or more variables. Those are expressed in a statement that can be tested. The relationship is estimated based on associations network set out in theoretical framework formulated for research. Thus the hypotheses proposed in this research are as follows:

- H₁: There is a significant effect of corporate governance on stock prices
- H₂: There is a significant effect of return on assets on stock prices
- H₃: There is a significant effect of total asset turnover on stock prices
- H₄: There is a significant effect of firm size on stock prices

RESULTS AND DISCUSSIONS

The companies are participating in the CGPI years of 2009, 2010, 2011, and 2012. There are 62 companies. It is in accordance with the criteria of the research that are only 13 companies. The overall of the selection process is presented in Table 1.

Table 1 Sample Selection

Process	
Selection Criteria	Total
The number of companies participating in CGPI 2009, 2010, 2011, 2012	62
Less: Company is not listed on the Indonesia Stock Exchange from 2009 to 2012	(26)
Less: Company does not participate in the CGPI from 2009 to 2012	(23)
Total Sample	13

CGPI is organized by IICG. In the process of researching and ranking, each company of participant CGPI should follow four phases. Those are self-assessment, documents, papers, and observations. Research results and CGPI ranking are by perception index scores and good corporate governance implementation in the company. The ranking CGPI

is based on a value obtained by each company. It is in accordance with the range of scores for each category level of trust, such as high trust category (85,00-100,00), trust (70,00-84,99), and adequate trust (55,00-69.99). Then, the research results and ratings are published by IICG and SWA Magazine (IICG, 2013).

The profile of variable data used in this research is shown in Table 2. The sample of CGPI has the average value relatively high. It is about 82,31. It is classified as 'trust'. The average value of ROA, TATO, and SIZE are 7,43, 0,59, and 45652,27. The quantity of data (N) of each variable is 52.

Table 2 Descriptive Statistics

	N	Minimum	Maximum	Mean
SP	52	50	26350	5638,00
CGPI	52	67,40	98,04	82,3106
ROA	52	-34,68	33,80	7,4306
TATO	52	0,08	1,59	0,5887
SIZE	52	51,00	190512,00	45652,26
Valid N (listwise)	52			

Before testing the hypothesis, the data needs to be tested whether it meets classical assumption or not. With a confidence level of 5%, the research model meets the test for normality, autocorrelation, heteroscedasticity, and multicollinearity.

The diagram normal P plot shows the data spreading around the diagonal line. It follows the direction of the diagonal line. It means that research models meet the normality assumption. Diagram normal P Plot is presented in Figure 1

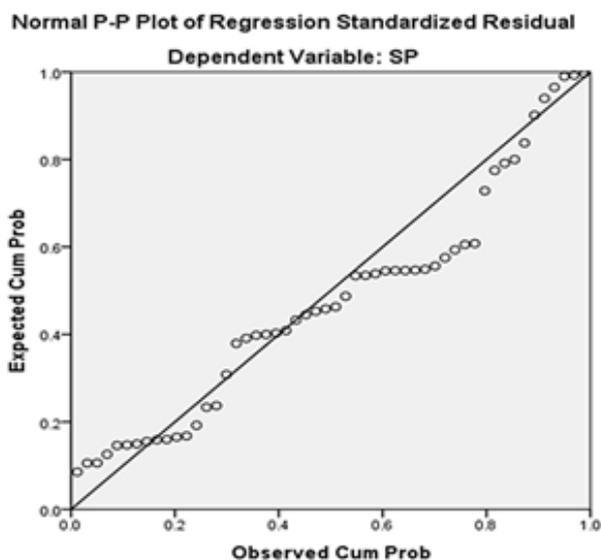


Figure 1 Normal P Plot

The scatter plot diagram shows there is no particular pattern in the chart. Thus, it can be concluded that there is no problem of heteroscedasticity. Diagram scatter plot is presented in Figure 2.

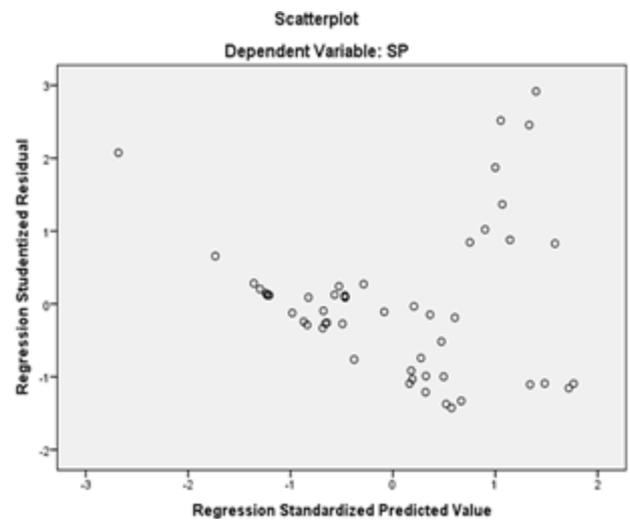


Figure 2 Scatter Plot

On Durbin Watson autocorrelation test, the value is 2,224. Then, it is $dU < DW < 4 - dU$. It can be implied that there is no problem of autocorrelation. Result for Durbin Watson autocorrelation test is presented in Table 3.

Table 3 Autocorrelation Test

Model	Durbin-Watson
1	2,224

a. Predictors: (Constant), SIZE, TATO, ROA, CGPI
b. Dependent Variable: SP

At multicollinearity test, it uses VIF value. All VIF value data are for independent variables which are below 10, and the value tolerance is above 0,1. It means that all variables are free from multicollinearity. Result for multicollinearity test is in Table 4.

Table 4 Multicollinearity Test

Model	Collinearity Statistics	
	Tolerance	VIF
(Constant)		
CGPI	0,360	2,776
ROA	0,446	2,242
TATO	0,469	2,133
SIZE	0,480	2,085

The research model has the R-value of 0,721. It indicates a fairly strong relationship of SP with all independent variables. Meanwhile, the R-square is 0,519. It means that 51,9% of SP changes can be explained by the CGPI, ROA, TATO, and SIZE.

Tabel 5 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0,721a	0,519	0,479	4971,717

The F test is presented in Table 6, value of F significance is 0,000 lower than 0,05. It shows that all independent variables in the research (CGPI, ROA, TATO, SIZE) affect the dependent variables (SP) jointly.

Table 6 F Test and Significance

Model	F	Significance
Regression	12,699	0,000b

In CGPI, the coefficient value is 137,85 and sig. is 0,365. For ROA, the coefficient is 191,38 and significance is 0,064. Meanwhile, for TATO, the coefficient is 5335,92 and significance is 0,019. Then, the value of SIZE coefficient is 0,037 and significance is 0,049. All independent variables (CGPI, ROA, TATO, and SIZE) affect positively on SP as the dependent variable.

Table 7 Constant, Coefficients, T Test, and Significance

Model	Unstandardized Coefficients		T	Significance
	B	Std. Error		
1 Constant	-11977,42	12151,73	-0,99	0,33
CGPI	137,85	150,86	0,91	0,37
ROA	191,38	100,71	1,90	0,06
TATO	5335,92	2204,95	2,42	0,02
SIZE	0,034	0,020	2,020	0,05

Based on the results of the test data, the hypothesis testing is done. Since CGPI significance value, 0,365 is greater than 0,05, H₁ is rejected. Thus, there is no significant effect of CGPI on SP. Then, significant value in ROA is 0,064. It is greater than 0,05. Then, H₂ is rejected. There is no significant effect of ROA on SP.

Then, The significance value of TATO is 0,019. It is less than 0,05. Thus, H₃ is accepted. There is a significant effect of TATO on SP. Last, significance value in SIZE is 0,049. It is less than 0,05. Thus, H₄ is accepted. There is a significant effect of SIZE on SP.

CONCLUSIONS

The results show that the application of corporate governance and firm performance positively affects stock price, corporate governance and return on asset. Those do not significantly affect the stock price. However, total asset turn over and firm size significantly influence stock price.

The application of corporate governance in companies listed on the Indonesia Stock Exchange should be improved. It is reflected from the companies participating in the Corporate Governance Perception Index. In 2012, There were only 42 from 459 companies. Companies need to be aware that the application of corporate governance can be a positive influence on the company's shares which are traded on the stock exchange.

Firm performance has a positive effect on stock prices. It demonstrates the interest of investors to invest in shares issued by companies that have a good performance. Therefore, the company needs to maintain firm performance so that its shares remain attractive to investors.

Research on corporate governance and firm performance on the Indonesia Stock Exchange is performed in stocks. However, there is not much done in bonds. Therefore, for further research, the dependent variable may use bond price or Yield to Maturity (YTM).

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