

Corporate Governance and Company Value: A Manufacturing Industry Case Study

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Abstract

The purpose of this research is to look into the impact of corporate governance in the Indonesia Stock Exchange's Manufacturing Industry. Panel data from 73 Manufacturing Industry companies on the Indonesia Stock Exchange from 2014 to 2018 with a total of 365 observations of data whose research results were analyzed using panel data regression analysis with the Random Effect Model approach. Institutional ownership has a positive effect on Tobin's q and market book value, according to the study's findings. Tobin's q and market book value are negatively affected by foreign ownership. Meetings of the Board of Commissioners and the Audit Committee have a negative impact on stock price returns. Meetings of the board of directors, audit committee, and board of commissioners were found to have no impact on the value of the company. On the basis of these findings, it can be concluded that the results of testing the independent variables on the dependent are inconclusive and should be questioned further.

Keywords: *good corporate governance, stock return, tobin's q, market book value*

Introduction

Corporate governance has a significant impact on a company's competitiveness. Companies that implement sustainable corporate governance can have an impact on the company's value. Corporate governance is aided by the digitalization era, which encourages the strengthening and adaptability of corporate management in the short and long term. The company's value is a reflection of the company's current state as well as investors' perceptions of the company's value and prospects in the present and future. Value is also an important indicator for all parties when it comes to the company's future prospects and viability. According to Keown, Scott, Martin, and Petty (2001), company value is the stock market price that reflects a business's net worth.

As a result of lax legal, auditing, and accounting regulations, poor banking system, and a lack of concern from the board of directors for minority shareholders, corporate governance became an issue in the 1990s. In 1998, during a prolonged crisis in Indonesia, the issue of corporate governance came to light. Aside from the financial crisis, companies failed due to poor management, disregard for regulations, and corruption, collusion, and nepotism. In 1998, the Jakarta Stock Exchange proposed improving listing regulations to include an independent

commissioner and audit committee. Depuis then, corporate governance has become a focus for governments, businesses, investors, and researchers alike.

Corporate governance is the process of ensuring that managers and other insiders act in ways that protect the interests of stakeholders (Velnampy, 2013). Corporate governance practices have evolved as a means of resolving agency conflicts that arise when there is a separation between owners and managers as parties in charge of the company (Lozano et al., 2016). Furthermore, corporate governance can affect the company's value in two ways. First, good corporate governance can lead to an increase in stock prices because investors anticipate the company's cash flow will be lower and the majority of profits earned will be distributed in the form of dividends.(Jensen & Meckling, 1976); Second, as a result of monitoring costs and audit fees, good corporate governance can reduce the firm's return on equity (Shleifer & Vishny, 1997).

Corporate governance implementation in Indonesia is still being studied and researched. Whereas in recent years, cases of corporate governance violations have continued to occur and harm various related parties. Violations of corporate governance are a problem not only in state-owned enterprises, but also in private enterprises in Indonesia. Whereas professionalism and a good track record, particularly integrity, should be important considerations in the company's board of directors placement. This requires more attention in order to reduce conflicts of interest and governance violations, which have a negative impact on stakeholder trust and the long-term viability of the company in question.

The relationship between corporate governance has received a great deal of attention both in Indonesia and abroad. However, research results are still inconclusive and have research gaps, such as research results. (Al-Khouri, 2005; Buallay, Hamdan, & Zureigat, 2017; Ngatemin, Maksun, Erlina, & Sirojuzilam, 2018; Oktari, Melas & Zarefar, 2018; Thanatawee, 2014) where the measurement variables of internal and external corporate governance mechanisms were used, a different relationship on the company's value was obtained.

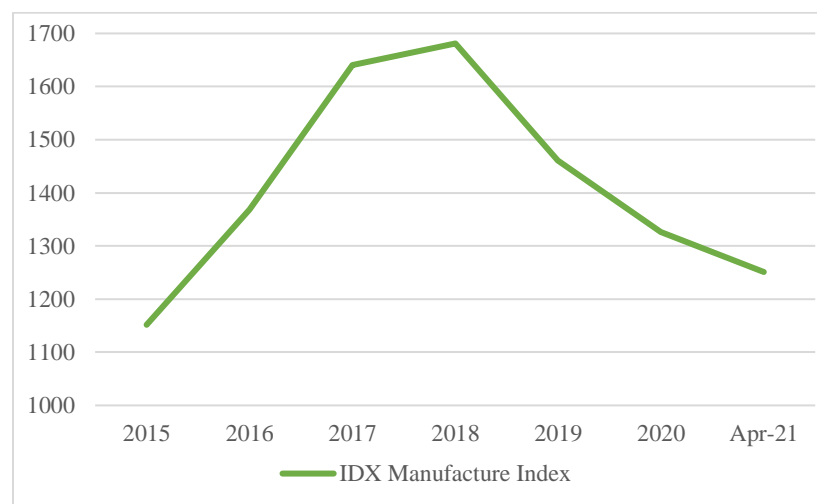


Figure 1. Yearly Movement of Manufacturing Sector in Indonesia Stock Exchange

This research will look into corporate governance in the manufacturing industry. Based on Figure 1, manufacturing is one of the primary sectors that contribute to economic growth. Indonesia's manufacturing industry has grown steadily over the last five years and peaked in 2016-2018. However, one thing that is concerning is that following 2018, the movement of

manufacturing stock prices has been downward. The Decline in the manufacturing sector's contribution to Indonesia's GDP over the last decade, even claiming that the country has entered an era of deindustrialization.

The manufacturing industry's low competitiveness and the perception that inefficiency is to blame for the industry's suboptimal performance in Indonesia. Based on empirical evidence (Fauzia, 2010; Hardiyanto, 2010; Rahman, 2010), the industrial sector in Indonesia has historically lagged behind other countries in the Asia Pacific region in terms of technology contribution to growth. Significant issues affecting the manufacturing industry in Indonesia, for example, there is a problem of inefficiency in the operation and management of the industry, as well as the occurrence of inequality, which results in inefficiency and lowers the company's value (Malini, 2021; Silalahi, 2014).

This research examines the effect of good corporate governance on the performance of industrial companies, which in turn affects the company's value on the stock exchange floor. This research will inform the policies that will be implemented to advance the manufacturing industry in Indonesia, benefiting both businesses and investors, as well as economic growth.

Literature Review

The company's value is an integral part of its establishment. Every aspect of management, decision-making, performance, and company prospects is reflected in the company's value, which is assessed from both the internal and external perspectives. To increase the value of the business, owners and managers must share a common goal and be capable of making sound financial decisions and implementing sound corporate governance. The ownership structure plays a role in the development of corporate governance and managerial control. (AlQadasi & Abidin, 2018).

Generally speaking, corporate governance refers to an organization's management structure and procedures that are based on the principle of accountability and that have the potential to increase the value of the company in the long run. (Velnampy, 2013) because a strong governance system results in improved procedures and oversight of activities. company. Additionally, the ownership structure of the business can be a factor in determining the degree of control exercised by internal parties and external parties such as investors. (Lemmon & Lins, 2003). The following is a description of the test of the influence between variables and the development of research hypotheses:

Institutional Ownership on Firm Value

Institutional ownership is the proportion of company shares owned by non-individual institutions or institutions (Hery, 2017). Institutional ownership plays an important role in management supervision because, in addition to holding a disproportionately large proportion of the company's stock, institutional investors are typically comprised of a number of different institutions, allowing for a more optimal level of control or supervision to be provided. Because the proportion of institutional ownership is higher, the supervision is more stringent. This helps to reduce instances of management actions that are detrimental to the company. Investors are also more confident in the company, which will have an impact on the company's value by increasing the value of the company's stock.

In a study conducted by (Mak & Kusnadi, 2005; Wei et al., 2005), institutional ownership was found to affect firm value. However, different results were found by (Al-Khouri, 2005; Mishra & Kapil, 2017; Ngatemin et al., 2018; Thanatawee, 2014), where institutional ownership was found to have a positive effect on firm value. Based on the description above, the first hypothesis developed is as follows:

H₁ : Institutional ownership affects the value of the company

Foreign Ownership on Firm Value

Individuals or institutions from other countries may hold shares in the company, which is known as foreign ownership. In order to achieve abnormal returns or higher returns than their home countries, foreign investors typically invest in companies located outside of their home countries. As a result, institutional investors are more selective in the investments they make. When a company is owned by a foreign entity, the control and supervision of management and company performance will inevitably become more stringent. As a result, foreign investors will demand strong performance and will send out positive signals to encourage other investors to join in. Furthermore, foreign investors are extremely concerned about the importance of corporate governance and environmental sustainability, which will encourage other investors to join in.

In a study conducted by Thanatawee, (2014), foreign ownership was found to have a negative effect on firm value. Different results were found in studies (Ferris & Park, 2005; Wei et al., 2005), where foreign ownership was found to increase firm value. Based on the description above, the second hypothesis is developed as follows:

H₂ : Foreign ownership affects the value of the company

Board of Directors on Firm Value

The Board of Directors is the management group in charge of overseeing and being accountable for the operation of the company in accordance with the company's objectives. A disproportionately large number of directors on the board of directors can have an impact on the inefficiency of the decision-making process, which in turn can have an impact on the declining performance of the company, resulting in a decrease in the value of the company. A common cause of this is a decreased ability of the board of directors to control management as a result of the large size of the organization, which has an impact on communication problems. (Yermack, 1996).

In a study conducted (Kota & Tomar, 2010; Kumar & Singh, 2013; Mak & Kusnadi, 2005) board size was found to have a negative effect on firm value. Positive results were found in research (Buallay et al., 2017; Lidyah et al., 2019), in addition (Adawi & Rwegasira, 2013; Bhat et al., 2018) revealed that the size of the company's board does not affect firm value. Based on the description above, the third hypothesis developed is as follows:

H₃ : The size of the board of directors affects the value of the company

Board of Commissioners on Company Value

The board of commissioners is the body in charge of overseeing and advising the board of directors on all matters pertaining to the corporation. The Board of Commissioners is tasked with ensuring that the company's strategy is implemented, supervising management's performance in managing the company, and requiring the implementation of accountability measures in the company. (Lidyah et al., 2019). The large size of the board of commissioners will have an impact on the more effective control over the board of directors and management of the company and keep the company running according to its objectives.

The results of research conducted by (Gosal et al., 2018; Oktari et al., 2018) found that there was no relationship between the size of the board of commissioners and firm value. However, (Lidyah et al., 2019; Siallagan & Machfoedz, 2006) found that the size of the board of commissioners has a positive impact on firm value. Based on the description above, the fourth hypothesis is developed as follows:

H₄ : The size of the board of commissioners affects the value of the company

Audit Committee on Company Value

All members of the audit committee are third-party independent contractors who have no affiliation with the company they serve on. The audit committee is one of the parties that has an important role to play in the governance of a company's affairs. In addition, because the audit committee serves as a link between the company's management and the board of commissioners as well as other external parties, its size has an impact on the effectiveness and efficiency of management supervision in the company.

The results of research studies conducted (Obradovich & Gill, 2013; Rouf, 2011; Tornyeva & Wereko, 2012) found a positive relationship between audit committee size and firm value. Based on the description above, the fifth hypothesis is developed as follows:

H₅ : The size of the audit committee affects the value of the company

Board of Commissioners Meeting on Company Value

The number of meetings held by the board of commissioners in a given year is used to calculate the number of meetings held by the board of commissioners in the following year. The number of board meetings will increase the burden on the company, but the board of commissioners will have more time to set strategy and monitor management activities as a result of the increased number of meetings.

In addition, increasing the number of board of commissioners meetings can improve the effectiveness of supervision and decision-making, allowing the board of commissioners to provide input more quickly on problems that arise within the organization. The important key for the board of commissioners in carrying out supervision and effectiveness of management is the number of meetings they have held (Jensen, 1993). The results of research conducted by (Ntim & Osei, 2011) found a positive impact on the frequency of board of commissioners' meetings on firm value. Based on the description above, the sixth hypothesis was developed as follows:

H₆ : The frequency of the board of commissioners meeting affects firm value

Audit Committee Meeting on Company Value

It is critical to increase the number of audit committee meetings held in order to improve the effectiveness of the company's management oversight. Audit committee meetings held on a regular basis can improve the effectiveness of supervision in making decisions related to the company's internal control system, thereby improving management discipline. Audit committees that hold more meetings have more time to oversee the financial reporting process, identify management risks, and monitor internal controls, all of which contribute to the increase in the value of the company.

The result of studies conducted (Al-matari et al., 2012; Beasley et al., 2000). It was discovered that increasing the frequency of audit committee meetings had a positive impact on the value of the company. The following is the seventh hypothesis that has been developed in light of the foregoing description:

H₇ : The frequency of audit committee meetings affects firm value

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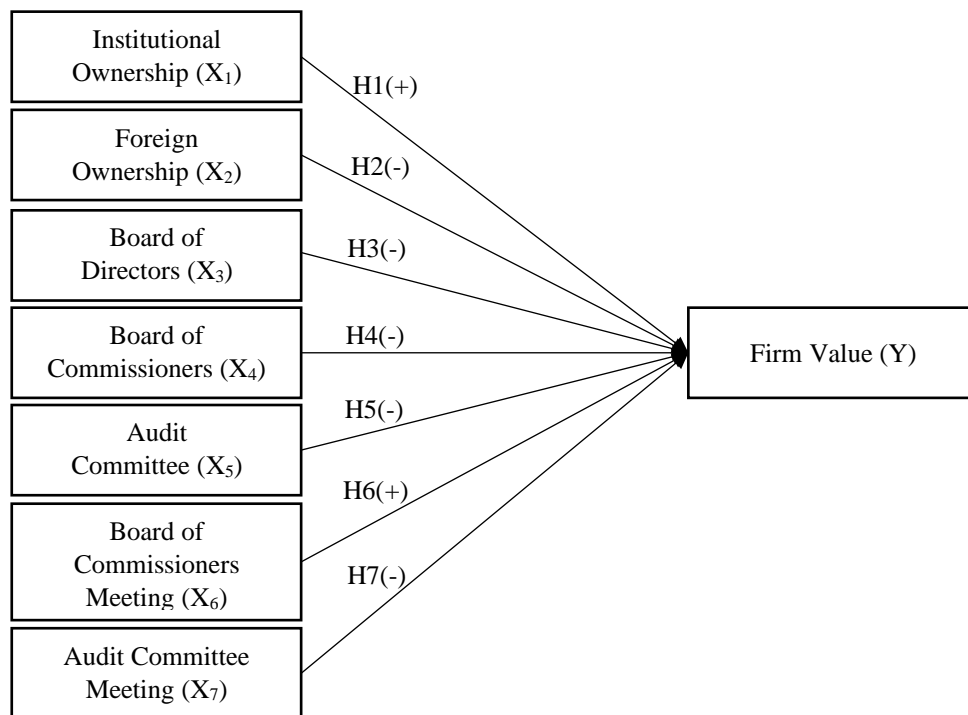


Figure 2. Research Framework

Research Method

This research is quantitative against manufacturing companies in the Indonesia Stock Exchange period 2014 to 2018. The research population is 183 companies. Determination of the sample is done by using a purposive sampling technique, to obtain 73 sample companies. The data analysis technique used in this research is panel data regression analysis. According to Basuki and Prawoto (2016), in determining the estimation of the panel data regression model, it can be done through three approaches, namely the common effect model, fixed-effect model, and random effect model. In addition, to determine the most appropriate model should be tested chow, test Hausman and test Lagrange multiplier.

Table 1. Variable Measurement

Variable	Measurement
Dependent Variable	
Stock Return (SR)	Market price growth rate
Tobin's Q (TQ)	Market capitalization + current debt - current assets + long term debt per total assets
Market Book Value (MBV)	Share market price per share book value
Independent Variable	
Institutional Ownership (IO)	Percentage of institutional ownership per number of shares outstanding
Foreign Ownership (FO)	Percentage of foreign ownership per number of shares outstanding
Board of Directors (BD)	Number of the board of directors
Board of Commissioners (BC)	Number of commissioners
Audit Committee (AC)	Number of the audit committee

Frequency of Board Meetings (FBM)	Frequency/number of board of commissioners meetings
Frequency of Audit Committee Meetings (ACM)	Frequency/number of audit committee meetings
Control Variable	
Company Size (Size)	Natural logarithm of total assets
Profitability (ROE)	Net profit per own capital

The following research model developed in this study:

$$SR_{it} = \alpha + \beta_1 IO_t + \beta_2 FO_t + \beta_3 BD_t + \beta_4 BC_t + \beta_5 AC_t + \beta_6 FBM_t + \beta_7 ACM_t + \varepsilon_t \dots (1)$$

$$TQ_{it} = \alpha + \beta_1 IO_t + \beta_2 FO_t + \beta_3 BD_t + \beta_4 BC_t + \beta_5 AC_t + \beta_6 FBM_t + \beta_7 ACM_t + \varepsilon_t \dots (2)$$

$$MBV_{it} = \alpha + \beta_1 IO_t + \beta_2 FO_t + \beta_3 BD_t + \beta_4 BC_t + \beta_5 AC_t + \beta_6 FBM_t + \beta_7 ACM_t + \varepsilon_t (3)$$

Result and Discussion

According to Table 1, the value of the average return of shares, which amounts to 35.36 percent, demonstrates that the average market movement relative worth is positive on an annualized basis. Tobin's q has an average value of 2.94 on the scale. Conversely, the average market book value is -31.37, indicating that the average company is in the negative. A 72 percent average value of institutional ownership indicates that institutions constitute the vast majority of company shareholders, and foreign ownership of companies accounts for 49 percent of the average value of institutional ownership. The average size of the board of directors, commissioners, and audit committee is approximately 5 to 3 people, and the average frequency of board of commissioners and audit committee meetings is 6 times per year. Finally, based on the standard deviation, the majority of the variables are stable and reliable in their performance over time.

Table 2. Descriptive Statistics

Variable	Mean	Median	Max	Min	Std. Dev.
SR	35.36	-1.90	4400	-99	288.86
TQ	2.94	0.65	120.57	-0.35	10.29
MBV	-31.37	1.11	1949.72	-16490.56	871.99
IO	0.72	0.82	0.99	0.01	0.27
FO	0.49	0.53	0.99	0.00	0.30
BD	5.27	5	18	2	2.71
BC	4.36	3	13	2	2.01
AC	3.11	3	5	2	0.40
FBM	6.27	6	24	1	3.85
ACM	6.33	4	38	2	4.88

Table 2 shows the results of the model's feasibility testing. The results of the Chow, Hausman, and Lagrange Multiplier tests are used to determine the best research model between common effects, fixed effects, and random effects. According to the test results, the best research model for all research models is random effect.

H₁ predicts the influence of institutional ownership on firm value. The test results show institutional ownership has a positive and significant impact on the value of the company as measured by Tobin's q and market book value so that H₁ is accepted. These results explain

that the internal mechanism of corporate governance in terms of ownership structure as measured by institutional ownership can provide supervisory control, signals, and a positive impact on firm value such as research results (Al-Khouri, 2005; Mishra & Kapil, 2017; Ngatemin et al., 2018; Thanatawee, 2014). In addition, the existence of institutional ownership in the company's share ownership structure can also minimize agency problems that may occur and work as an outside monitor of management actions (Al-Khouri 2005). The results of this study show that institutional ownership has no effect on stock price returns, but it does have an effect on Tobin's q and market book value, as demonstrated by the tests. When it comes to institutional ownership, the majority of institutions prioritize long-term investment while still ensuring that stock prices remain stable. Institutional investors are more likely to evaluate the value of a company in terms of its long-term potential.

Tabel 3. Panel Regression Analysis

Variable	Model 1	Model 2	Model 3
C	1.72 (0.88)	-5.70 (0.68)	-57.66 (0.00)
IO	0.26 (0.72)	4.85* (0.00)	0.45* (0.01)
FO	-0.82 (0.27)	-4.49* (0.01)	-0.93* (0.00)
BD	-0.17 (0.27)	-0.02 (0.94)	-0.01 (0.89)
BC	-0.31* (0.02)	0.33 (0.26)	0.00 (0.96)
AC	-0.31 (0.54)	1.40 (0.20)	-0.04 (0.70)
FBM	0.04 (0.38)	-0.13 (0.23)	0.01 (0.45)
ACM	-0.11 (0.08)	-0.07 (0.55)	-0.02 (0.26)
Size	1.04* (0.03)	0.10 (0.84)	0.33* (0.00)
ROE	-0.27 (0.37)	1.91* (0.01)	-0.02 (0.75)
R-squared	0.06	0.06	0.13
Adjusted R-squared	0.04	0.04	0.11
F-statistic	2.60	2.70	5.88
Chow Test	2266.13*	10.50*	4383.89*
Hausman Test	10.877	10.37	2.52
LM Test	679.68*	288.82*	718.27*

Note: *) 5 percent

H₂ predicts the effect of foreign ownership on the value of the company. H₂ is accepted as a result of the test results, which show that foreign ownership has a negative and statistically significant impact on firm value as measured by Tobin's q and market book value. These findings provide an explanation for why companies with foreign investors have lower firm values on average. These findings are consistent with those obtained through Thanatawee's

research.. Thanatawee, (2014) explains that in Thailand companies with foreign investors have low firm value, where the level of control exerted is relatively low, is not active in monitoring managers, and may even take over company resources at the expense of minority shareholders. When it comes to exercising control over a company's management, foreign investors tend to pay more attention to the dividends that will be paid out than they do to the company's financial performance. Foreign investors also have a proclivity to hold onto their company's stock for an extended period of time.

H₃ and H₅ predict the effect of the size of the board of directors and the size of the audit committee on firm value. In the model studied, the size of the board of directors and the size of the audit committee were found to not affect firm value, so that H₃ dan H₅ was rejected. This result is in line with (Adawi & Rwegasira, 2013; Bhat et al., 2018) where changes in the size of the board of directors do not affect firm value. This demonstrates that increasing the number and size of the board of directors and audit committee will not solve the agency problem in the company and will have no impact on the value of the company. A disproportionately large board of directors and audit committee has been shown to have a negative impact on the value of a company. Due to the fact that the supervision provided is still ineffective and inefficient, it will become a burden for the company if the size or number of employees grows significantly. In Indonesia, the selection and appointment of boards of directors, both in state-owned and privately held corporations, is less professional than in other countries. Several legal cases and violations of corporate governance involving the company's board of directors demonstrate this point. It is supported by research findings that are not statistically significant, and it demonstrates that investors do not take the company's leadership structure, particularly the directors and audit committee, into consideration when making investment decisions.

H₄ predicts the influence of the size of the board of commissioners on the value of the company. In the model studied, the size of the board of commissioners was found to have a negative effect on firm value as measured in stock returns so that H₄ was accepted. The size of the board of commissioners that is too large causes the decision-making process to run slower. This result is not in line with the results of research (Lidyah et al., 2019; Siallagan & Machfoedz, 2006) According to the findings, the size of the board of commissioners has a positive impact on the value of the company. The negative relationship found between the size of the board of commissioners and the value of the company in this study demonstrates the ineffectiveness of the board of commissioners' size in controlling and supervising the management of the company, which is the board of commissioners' responsibility. When the results of control and company performance have a negative impact on the value of the company's stock return, this can also be interpreted as a negative signal.

H₆ predicts the influence of the frequency of board meetings on corporate value. In the model examined, the frequency of board meetings found no effect on the value of the company so that H₆ was rejected. The results of this study are not in line with the results of research (Jensen, 1993 dan Ntim & Osei, 2011). This means that when it comes to investing in a company's stock, investors in Indonesia do not pay too much attention to the board of commissioners meeting. Furthermore, board of commissioner's meetings are typically held in closed session and are not broadcast to the general public. The number of meetings held as well as the context in which they were held can only be found in the annual report published after the year has ended.

H₇ predicts the effect of the frequency of audit committee meetings on firm value. In the model studied, the frequency of audit committee meetings was found to have a negative effect on firm value as measured in stock returns so that H₇ was accepted. The results of this study are not in line with the results found (Al-matari et al., 2012; Beasley et al., 2000) when the frequency of audit committee meetings is increased, it has a positive impact on the value

of the company. This meeting's primary goal is to improve the efficiency with which management is supervised. When the frequency of meetings is excessive, however, it can send a negative signal to investors, indicating that the company is experiencing difficulties and that periodic meetings are required far too frequently.

Models 1, 2, and 3 each account for 4% of the influence of corporate governance variables on stock returns and Tobin's q, and 11% of company value as measured by market book value. Finally, the F value is statistically significant, indicating that the model is worthwhile of further investigation.

Conclusions and Recommendations

Some conclusions about the independent variables can be drawn based on the discussant. Tobin's q and market book value both show that the percentage of institutional ownership has a positive effect on firm value. Second, as measured by Tobin's q and market book value, the percentage of foreign ownership has a negative impact on firm value. Third, whether measured by stock returns, Tobin's q, or market book value, the size of the board of directors, the size of the audit committee, and the frequency of board of commissioners' meetings have no effect on firm value. Fourth, the number of audit committee meetings and the size of the board of commissioners have a negative impact on stock returns.

According to the findings of the study, the board of directors should be considered when deciding on an investment because the board and management will be able to implement sustainable corporate governance if they have the necessary competence, capability, and commitment. Because this study was limited to manufacturing companies and focused on corporate governance variables, more research is needed to extend the study period and obtain consistency of influence over time. Further research is being done in other industries, as well as comparative tests on corporate governance in developing and Asian countries.

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