The Effect of Corporate Governance and Financial Health on The Value of Companies Registered in Indonesia Stock Exchange

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ABSTRACT

The main goal to be achieved by a company is to increase its value. Having high company value, the owners will gain higher prosperity. Company value is a particular condition achieved by a company reflected in the stock market price. Strategies to increase it are important. This study aims to determine the effect of corporate governance (X_1) on company value (Y) and to determine conditions of financial health (X_2) on company value (Y). This research is an associative type of hypothesis testing. Companies used in this study are those listed in the Indonesia Stock Exchange during the 2014-2017 period. The sample selections use purposive sampling with the criteria that the companies are CGPI participants and not engaged in finances with 29 companies as the samples. The analysis technique used is multiple regression. The results of the study show that: 1) good corporate governance does not affect the company value. 2) The condition of financial health has a positive effect on company value. The limitation in this study is the lack of research samples, because there are very few companies that participate in the CGPI ranking program. The results of this study are expected to be used as a reference for future researches, besides that research related to corporate governance should use measurements or other indicators to obtain different results.

Keywords: Company Value, Financial Health, Good Corporate Governance, Stock Exchange, Stock Market

INTRODUCTION

In today's globalization era, companies are demanded to be increasingly able to compete in dominating the market. Free trade urges companies not only to compete in the domestic market but also in the international market. Economic activities know no frontiers, not only trade and finance but also from production to marketing. Dealing with this phenomenon, the company must shake things, through good corporate management. Company's management is an effort made by the owner and management to attain company's goals. Management is authorized by the owner to manage the company's operational activities. Those operational activities are to attain company goals as desired by the owners (Rachman et al, 2015).

Corporate governance is a concept proposed to amend company performance through the management performance supervision or monitoring and to ascertain management accountability to shareholders as well. Hence, the application of corporate governance concept is supposed to stir company performance, indivisible with financial

performance. Problematic financial performance will disrupt the firmness, which in some distant future, can lead to bankruptcy (Ananto et al, 2017).

The company value must be retained and preserved, since it is a condition achieved with struggles, and portrays public trust. It can be measured by the stock price in the market; it is a reflection of the public's assessment of the company's performance (Syafitri et al, 2018). The implementation of consistent and reputable corporate governance enables companies to better the financial performance quality. The performance interrelates with the management's ability to carry off company finance, resulting sustainable living and maximum return provision to the shareholders. This is remarkably all-important. Due to poor financial management, financial distress to pay off obligations, lead some businesses' bankruptcy (Haryetti, 2010). Every company is compulsory to maintain its financial health implying its healthy economic performance.

Measurement of the company's financial performance uses financial ratios. Financial ratios display changes in the company's financial condition as well as its potentials in managing its welfare to grow its value (Tjandrakirana & Monika, 2014). It must acquire high company value, reflected by the company's stock price, to lay hands on investors' capital (Kebon & Suryanawa, 2017). Their stock price influences investor decisions. It can be also an indicator of the company management success. If the company's share price increases, investors and other potential investors valuate that it is in a healthy condition and manage its business with success. On the contrary, if it declines, they valuate that the company is in troublesome conditions (Sukmawati & Adiputra, 2014).

Impairment of a company value occurs as a result of economic difficulties and poor financial management. The implementation of good corporate governance and financial management would alter the company value. Therefore, research on the corporate governance application and financial health, as well as its effect to corporate value is necessary.

Literature and Theory Review

Agency Theory
In large companies, the owners do not bring off all the functions necessary to manage the company. This is due to their limited knowledge and time. The *principal* will appoint a professional agent to better manage the company. In this case the principal is the owners or the shareholders delegating their responsibility for decision-making to the agent, while the agent is the manager receiving the delegation. The company's goal is to maximize the owners' wealth, however, in reality, agency problems occur when implementing the goal. This occurs because the managers make decisions to produce their own wealth. That is due to the difference in managers' prosperity smaller than that of the owners. As company managers, they have more extensive information about conditions for the future prospects.

To be in line with the owner's goals, Jensen & Meckling (1976) argues that the owners guarantee that managements make optimal decisions, and provide adequate incentives, such as bonuses, stock options, cars, good offices, which amount depends on how close the decisions taken meet the owners' inclination. In addition, monitoring, such as auditing the company's financial statements periodically and the appointment of the board of commissioners could be possible to do (Sudana, 2015: 13). These imply an effort to reduce agency conflicts, however, incurring agency costs.

Good Corporate Governance (GCG)

Corporate governance arises as a result of a separation between the owners and the managers leading agency problems to appear. Its definition according to IICG (2014) stating that Good Corporate Governance is a structure, system and process to provide added value to a company sustainable in some distant future. Sutedi (2011: 1) argues that the context of corporate governance is a process and structure used by corporate organs (shareholders, commissioners / supervisory boards and directors) to increase the success and accountability of the company. In the future, this could objectify shareholder value while taking the interests of other shareholders into account, based on the prevailing laws and regulations.

Those several definitions conclude that corporate governance is a process and system regulating, managing and overseeing business control processes to enhance the added value of a company. In this discussion, two emphasized matters are, first, the importance of shareholders right to obtain aright timely information; secondly, the company's obligation to accurately, and transparently make timely disclosures of all company performance information (Sutedi, 2011: 2). Five GCG principles, according to the KNKG, comprise: 1) Transparency, 2) Accountability, 3) Responsibility, 4) Independence, 5) Fairness and Equality.

Financial Health

One to measure a company's management achievements in attaining its goals is its good performance (Nuriwan, 2018). Financial performance implies the achievement of a company in carrying out its operations, in which, the company management effectiveness is observable in functioning all company's elements (Hidayat & Topowijono, 2018). Financial performance is remarkably life-or-death, since many companies experience bankruptcy initiated with financial distress in paying off their obligations. This comes about in any companies and indicates bankruptcy. Hence, companies' management experiencing these conditions shall immediately adopt provisions to overwhelm and avoid the occurrence. On the contrary, financial health is a condition signalling company's stable financial performance.

The company's health or financial condition is of interest to all parties concerned, both the owner and management, in implementing good management and in compliance with applicable regulations. The company's financial health could be considered as the financial performance stated in the company's financial statements. The investors can possibly utilize the financial performance as a basis for making decisions. The high profit level and the achievement of the company's target are the justifications for investors to invest. The higher the company's profit is, the higher the return rate will be. Higher return rates suggest the investors' encouragement to invest greater more than before. This will lead the company's stock price rise (Hidayat & Topowijono, 2018).

Company Value

Company value is the investor's perception of a company, frequently associated with stock prices. Higher stock prices create higher company value (Kholis, et al., 2018). Whereas Haryati & Ayem (2014) suggest that company value is the price to pay by prospective investors in case the company is sold. This value is a market value, since it provides maximum prosperity to shareholders if the stock price rises. The higher the stock price rise, the higher the prosperity of the shareholders wil be (Mahpudin &

Suparno, 2016). The definitions above lead us to conclusion that the company value is a certain condition been achieved by a company indicated in the stock market price.

The main goal to achieve by a company is to increase its value, the higher it is, the higher the owner wealth will be. The owners demand high company value, since it displays the prosperity of the shareholders. The shares market price represents the shareholders and companies' wealth, in addition, it is a reflection of investment decisions, financing and asset management (Sarafina & Saifi, 2017). Investor's perception prior to capital investment is determined by the company value, for the reason that it indicates the company's performance and stock price. Thus, companies must obtain high company value to get capital from the investors. Company value is an important conception for the investors because it indicates how the market values the company (Kebon & Suryanawa, 2017).

Managers and investors are concerned in the market value, since the fact shows the net worth shown on the balance sheet bears no relation with the market value. That is mostly because company's welfare, such as good management, good reputation, and future bright prospects, is imperceptible on the balance sheet (Sukamulja, 2004).

Hypothesis Development

The Effect of Corporate Governance on Company value
Corporate governance affects the company value. It is said to be able to raise the company value. By its existence, the company is expected to have good performance; eventually it provides benefits to shareholders and company owners (Amanti, 2012). Implementation of corporate governance is demanded to supervise managements in maximizing corporate value. Jensen & Meckling (1976) argues that the owners guarantee the managements make optimal decisions, and provide adequate incentives, such as bonuses, stock options, cars, good offices, which amount depends on how close the decisions taken meet the owners' inclination.

Several previous studies, Setiawan & Christiawan (2017), Tambunan, et al (2017), Apriada & Suardhika (2016), Le & Thi (2016), Qaesari & Ahmadi (2016), and Kusumaningrum & Raharjo (2013), regarding corporate governance with company value contend that the GCG mechanism variable shapes the company value. In addition, it is different from the research of Prastuti & Budiasih (2015), Syafitri, et al (2018), Utama & Rohman (2013), and Nurfaza, et al (2017) proffering that corporate governance mechanisms have no effect on the company value. Corporate governance is able to foreclose/trim the occurrence of agency conflicts within the company. This will result in the investors' positive perception. The implementation implies that the company has been efficiently managed to meet the shareholders wishes. Investors' positive perception leads the investors to positively react on the company's shares, thus rising company's stock price (Randy & Juniarti, 2013).

H_1 Corporate governance positively affects company value

The Effect of Financial Health on Company value
Company value indicates the company's performance. The owners demand high company value, since it displays the prosperity of the shareholders. The shares market price represents the shareholders and companies' wealth, in addition, it is a reflection of investment decisions, financing and asset management (Sarafina & Saifi, 2017).

Thus, companies must obtain high company value to get capital from the investors. Company value is an important conception for the investors because it indicates how the market values the company (Kebon & Suryanawa, 2017). Basically, investors expect high returns on the capital they spend, by all means, in the event that the company holds a healthy financial performance.

The main goal to achieve by a company is to increase its value, the higher it is, the higher the owner wealth will be. The company needs a management able to handle the company's finances well. Financial management is exceptionally crucial, as many companies experience bankruptcy initiated with poor financial management, resulting in financial distress.

In the event that management is unable to conduct the company's finances well, investors will scarcely believe that the company is able to provide good stock return. They shy away to invest and the investors already having shares in the company will sell them when the stock price is decreasing. Research conducted by Hidayat and Topowijono (2018) demonstrates that a company with either good financial performance or a healthy financial condition will lead high company value.

H₂ Financial health positively affect on company value

Research Gap
The Main & Rohman (2013) study was conducted in 2007-2011, indicating it is outdated. It differs from this study. Furthermore, the difference with Shahwan's (2015) & Tamarani (2015) research is the measurement of corporate governance, which Shahwan (2015) & Tamarani (2015) uses *Corporate Governance Index* (CGI) while this study uses *Corporate Governance Perception Index* (CGPI).

This study differs with the research of Irama (2018) and Sukmawati, et al (2017) on the measurement of financial health conditions using Altman Z-*Score*, prior to modification that can only be utilized in merely manufacturing companies. This study applies modified Z-*Score* highly possible to use at service companies.

RESEARCH METHOD

The population in this study is the companies listed on the Indonesia Stock Exchange. The reason for the selection is their accessible financial statements. Thus, the population used in this study is companies listed on the Indonesia Stock Exchange. The research limits sample period on 2014-2017 to indicate current conditions.

The sample selection is attempted using the *purposive sampling* method, sampling based on certain considerations and criteria (Hermawan & Yusran, 2017: 104). The sample selection criteria are CGPI participating companies from 2014 to 2017 and engaging in non-financial sector. Below is the variables measurement in this study:

* Corporate Governance = CGPI ranking score from IICG
* Financial Health = **6.56X_1+ 3.26X_2+ 6.72X_3+ 1.05X_4**
Notes:
X_1 = Working Capital / Total Assets
X_2 = Retained Earnings / Total Assets
X_3 = Earnings Before Interest and Taxes/Total Assets
X_4 = Market Value of Equity / Total Debt
Company Value $Q = \dfrac{MVE+D}{TA}$
Notes:
Q = Company Value
MVE = *Market Value of Equity*
D = Book Value of total debt
TA = Total Assets

Testing was conducted by multiple linear regression. Regression analysis, in addition to knowing the strength of the relationship between variables, indicates the direction of the relationship between the dependent and the independent variable. The following is multiple linier regression.

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + e$$

Notes:
Y = Company Value
α= Constant
β_1-β_2= Regression Coefficient
X_1= Corporate Governance Scores obtained from *Indonesian Institute of Corporate Governance*
X_2= Financial Health
e= Standard *Error*

Analysis Results

Descriptive Analysis Results
Table 4.1 presents the descriptive statistics results of each variable.

	Maximum	Minimum	Mean	Std. Deviation
Corporate Governance (X1)	91.20	69.72	82,6445	6,12436
Financial Health (X2)	64.8526366	-34,6625489	3.409940281	14,2990018748
Company Value (Y)	2.7672902	0.6451852	1,656991523	0.6368263200

Source: SPSS 23 Output

The results suggest that corporate governance has the highest value of 91.20 and the lowest value of 69.72. The data deduces that corporate governance weightlessly fluctuated. Average corporate governance of 29 sample companies (*mean*) in this study is 82.6445 with a standard deviation of 6.12436 indicating that the mean value is greater than the standard deviation; pointing that the data is sufficiently reputable.

The results contend the financial health variable has the highest value of 64.8526366 and the lowest value of -34.6625489. The data shows that financial health excessively fluctuated. Average financial health of 29 sample companies (*mean*) in this study is 3.409940281 with a standard deviation of 14.2990018748 indicating that the mean value is smaller than the standard deviation. Thus, it signals that the data is not reputable. That is due to the standard deviation is a very high deviation reflection.

The results show the value of those 29 companies had the highest value of 2.7672902 and the lowest value of 0.6451852. The data deduces that corporate governance weightlessly fluctuated. Average corporate governance of the 29 sample companies (*mean*) in this study is 82.6445 with a standard deviation of 6.12436 indicating that the mean value is greater than the standard deviation. It indicates that the data is sufficiently reputable. That is because the standard deviation is a reflection of a very high deviation. The spread of data shows normal results and have no cause on bias.

Classical Assumption

Normality Test

One-Sample Kolmogorov-Smirnov Test

		Unstandardized Residual
N		29
Normal Parameters[a, b]	Mean	,0000000
	Std. Deviation	,62383399
Most Extreme Differences	Absolute	,116
	Positive	,116
	Negative	-,092
Statistical Test		,116
Asymp. Sig. (2-tailed)		,200[CD]

Source: SPSS 23 Output

From the table above, the significance value at 0.200 (> 0.05) allows data to be normally distributed.

Autocorrelation Test

Model Summary [b]

Models	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	0,201[a]	0.040	0,133	0,6473831314	1,902

Source: SPSS 23 Output

From this table the Durbin-Watson value is 1.902 greater than the dU limit of 1.2699 and less than (4-dU) = 2.7301. It can be concluded that no autocorrelation occurred.

Multicollinearity Test

Coefficientsa

Models		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	CGPI	0.974	1,027
	FHEALTH	0.974	1,027

Source: SPSS 23 Output

The multicollinearity test results in table 4.7 above show:
1. The VIF value for corporate governance variables is 1,027 <10 and the *Tolerance* value is to 0.974> 0.10. It concludes that there is no multicollinearity.>
2. VIF value for financial health variables is 1,027 <10 and *Tolerance* values is 0.974> 0.10. It is concluded that there is no multicollinearity.

Heteroscedasticity Test
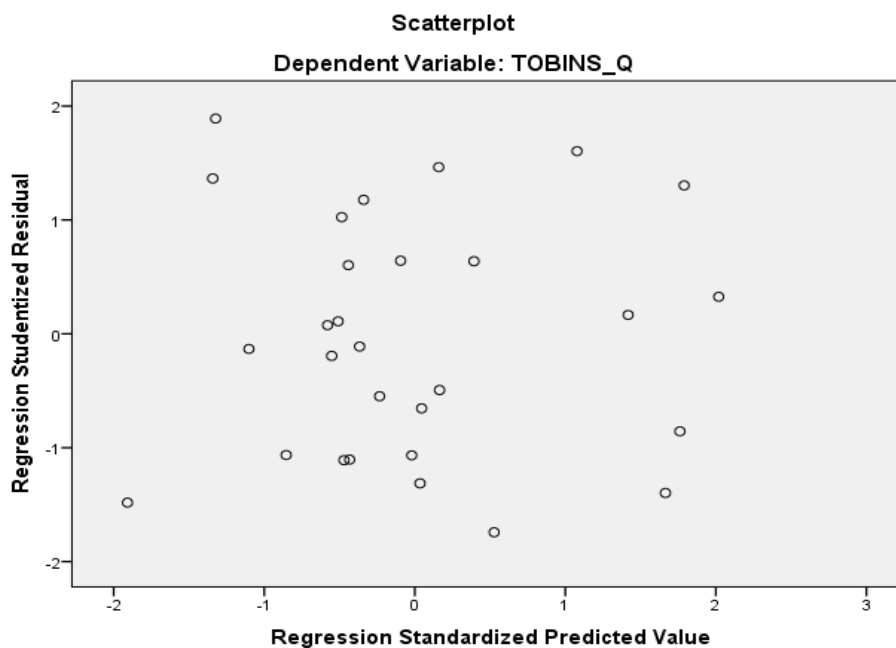
Source: SPSS 23 Output

From the scatterplot graph above, it appears that the points randomly spread above and below 0 on the Y axis. It can be concluded that there is no heteroscedasticity in the regression model.

Multiple Linear Regression Analysis

Determination Coefficient Test Results

Model Summary [b]

Models	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0,201[a]	0.040	0,133	0,6473831314

Source: *Appendix 4.1*

Based on the table above, the value of R^2 shows the number 0.146x100% = 14.6%. This indicates that the contribution of the independent variable of corporate governance and financial health to the dependent variable of corporate value is 13.3%, while 86.7% is influenced by other factors outside the model.

Test Results

ANOVA[a]

Models	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	0.459	2	0,229	0.547	0.585[b]
Residual	10,897	26	0.419		
Total	11,355	28			

Source: *Appendix 4.2*

Based on the table above, it is observable that the F value of 0.547 with a significant value of 0.585 is greater (>) than 0.05. This shows that the independent variable of corporate governance and financial health does not affect the independent variable, the company value.

T Test Results

Coefficientsa

Models	Unstandardized Coefficients		Standardized coefficients		
	B	Std. Error	Beta	t	Sig.
1 (Constant)	3,364	1,673		2,011	0.055
CGPI	-0,021	0.020	-0.200	-1.027	0.314
FHEALTH	0.003	0.009	0.071	0.362	0.039

Source: *Appendix 4.3*

In the table above contends that the independent variable of corporate governance has a significance level of 0.314 which is greater (>) than the significance level of 0.05 with a coefficient of -1.027 indicating that corporate governance has no effect on the company value. Hence, the first hypothesis is rejected. Then, financial health has a

significance level of 0.039 <0.05 with a coefficient of 0.362 indicating that it positively affects company value; the second hypothesis is accepted.

$$Value = 3.364 - 1.027X_1 + 0.362 X_2 + e$$

RESULTS AND DISCUSSION

The Effect of Corporate Governance on Company Value
Based on the results of hypothesis testing, the research obtains results by 0.314 greater (>) than the significance value of 0.05 with a negative coefficient (-1.027) indicating that corporate governance has no effect on company value. These indicate that the application of either good or bad corporate governance will not affect the company value. These results are not in accordance with the hypothesis proposed that the application of good corporate governance will positively affect the value of the company. Thus, the first hypothesis is rejected. The example illustrating that CGPI has no effect on company value is PT. Aneka Tambang with high CGPI score of 88.81, but low company value of 0.8843491724; in addition, PT. Bakrie & Brothers with a CGPI score of 74.00 has a high enough corporate value of 2.767290152.

This is due to governance practices slightly implemented by the company (Tamarani, 2015 & Shahwan, 2015). The company's low awareness in implementing corporate governance not due to the need, but rather the compliance with existing rules (Iswara, 2014). Therefore, the investors pay less attention to the CGPI rating score when investing in companies. This implies corporate governance in this study does not affect the company value. In addition, the dearth of interest and consistency of companies participating in the CGPI ranking elicits the unclear influence of CGPI on financial performance (Puniayasa & Triayati, 2016). As of 635 companies listed on the Indonesia Stock Exchange (BEI) participating in the CGPI rating program from 2014 to 2017, merely 55 companies joined the program. This comes to consideration due to participant inadequacy. Investors will be more convinced in the existing corporate governance mechanism in the company itself, since it better reflects the management and indicates the performance such as governance mechanisms comprising the number of audit committees, boards of commissioners and institutional ownership. Whereas corporate governance using the CGPI rating score focuses more on the completeness of documents relating to corporate governance.

The results of this study do not support agency theory which stating that the existence of a corporate governance mechanism, based on the principles of good corporate governance, is supposed to reduce agency conflict within the company. Agency theory arises due to agency problems occurring between managers and company owners. That is due to the difference in manager's prosperity, smaller than the owner's, thus, the manager makes the decision to produce his/her own wealth. Therefore, companies demand to implement good governance to be in line with the owner's objectives to provide adequate incentives and monitoring (Sutedi, 2011).

Corporate governance can be taken as a process and system regulating, managing and overseeing the process of controlling businesses to gain the added value of a company. This is inevitable to maintain good relations between managers and company owners enabling relevant vision and mission in running the company. Therefore, a step enabling the company avoid agency problems and manage its operational activities is implementing governance based on some principles such as:

transparency, accountability, responsibility, independence and fairness/equality. This study supports the research of Shahwan (2015), Tamarani (2015), and Utama & Rohman (2013), stating that corporate governance has no effect on corporate value. Utama & Rohman (2013) states that the CGPI announcement is not the information able to utilize for the investors to determine a company's stock value. In addition, according to Shahwan (2015) and Tamarani (2015), the practice of corporate governance has been implemented, however its implementation is still not fully enforced.

The Effect of Financial Health on Company Value

Based on the hypothesis testing results, it shows 0.039 more than (>) a significance value of 0.05 with a positive coefficient (0.362) suggesting that financial health positively affects company value. These results indicate that a company with a healthy or stable financial environment considerably affects its value. These are consistent with the proposed hypothesis stating that financial health positively affects company value; the first hypothesis is accepted. These results are due to financial health as measured by Altman Z-*Score* indicates that the higher the value of Z-*Score* is, the higher the value the company has, conversely, if Z-*Score* is low, the company value declination will go after. This is due to the fact that most of the companies sampled have high Altman Z- values Score, or arguably away from financial distress. Thus, the financial health in this study positively affects the company value. These results are proven by PT. Bukit Asam with Altman Z-Score with 6.801656 and high corporate value of 2.35908553. This example is on a par with PT. Telekomunikasi Indonesia with Z-Score of 6,1045 with corporate value of 2.646001557. Furthermore, PT. Garuda Indonesia with pretty low Z-Score of -2,84847 and low company value of 0.903168.

Investors are more interested in companies with sound finance since the investors require that the company will provide good return. This will rise the company value. To keep its value, company management must acquire the knowledge to better manage the company's finances. The ability to predict the financial health of a company is needful to slenderize the risk of bankruptcy (Khamidah & Afandi, 2012). This provides details about the failure possibility, securing the interests of investors from possible losses. Financial management is exceptionally crucial, as many companies experience bankruptcy initiated with poor financial management, resulting in financial distress.

On the contrary, financial health is a condition signalling company's stable financial performance. Carolina, et al (2017) state that financial distress can be predicted based on either the company inability or the funds unavailability to pay overdue obligations. Therefore, the company's management must promptly take the steps to conquer and prevent financial distress early on. The results of this study support agency theory stating that the existence of a corporate governance mechanism, based on the principles of good corporate governance, is supposed to reduce agency conflict within the company. Better financial health will rise the company value. However, company's poor financial performance will show the way of financial distress and eventually undermine investors trust to invest.

This study supports the research of Irama (2018) and Sukmawati, et al (2017) showing a significant positive effect. According to Sukmawati, et al (2017) the financial ratios of the Altman model that are commonly used to assess the bankruptcy level, additionally reflect the company's performance vicariously. The better financial ratios of the Altman Z- model score the healthier the company.

CONCLUSIONS

The study is conducted to determine the effect of corporate governance and financial distress on the company value in CGPI participating companies listed on the Indonesia Stock Exchange in 2014-2017. The researcher uses 29 companies as samples. Based on the analysis results it concludes that corporate governance does not affect the company value. This is due to the fact that governance practices are indeed implemented but their execution has not yet been fully enforced by the company. The companies' low awareness in implementing corporate governance is not due to the need, but rather the compliance with existing rules (Iswara, 2014). Furthermore, there is a positive influence of financial health on company value. This is due to the fact that most of the companies sampled have high Altman Z-Score, or arguably away from financial distress. Thus, the financial health in this study positively affects the company value.

This work suffers from a number of limitations - notably related to small number of companies used as samples as a consequence of the minor participants in the CGPI ranking program. This study has shortcomings and limitations. The researcher seeks advices for further research. Corporate governance, and financial health variables are of the essence in influencing company value, although solely the financial health variables have an effect on it. To that end, the results of this study are reasonable to be operable as a reference for further researchers. The measurement of corporate governance should use alternative measurements or indicators in addition to the CGPI rating score to obtain divergent results.

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