

## Conference Paper

# The Impact of the Implementation of Corporate Governance on the Financial Performance of Non-finance Companies Registered in the Indonesian Stock Exchange

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## Abstract

This research aimed to observe the impact of corporate governance measured with the ranking of CGPI done by *the Indonesian Institute for Corporate Governance (IICG)* on the financial performance of companies measured using ROA, ROE, DER, DAR, and CR. The analysis method used was the linear regression method. The research sample was non-finance companies listed in the Indonesian Stock Exchange and registered as a member of CGPI during the period of 2012–2014. The results of this research showed that corporate governance has a positive correlation with ROA, DER, CR, and a negative correlation with the variables of ROE and DAR. Research has proved that the better management conducted by the company did not mean the dividends shared with the stockholders were larger.

**Keywords:** corporate governance, finance performance, ROA, ROE

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## 1. Introduction

The implementation of GCG in Indonesia is very late compared to other countries – considering that the presence of GCG concepts in Indonesia is still relatively new. The concept of GCG in Indonesia was first introduced by the Indonesian government and *International Monetary Fund (IMF)* for economy recovery in the post-crisis era (Khairandy and Malik, 2007). In addition, as stated by Rokhmawati (2015), the Indonesian government has attempted to encourage awareness of how important good corporate governance is. One of the attempts was through the establishment of the Komite Nasional Kebijakan Governance (KNKG) or National Committee of Governance Policy in November 2004. However, this guidance was not mandatory and had no legally binding provisions. Basically, company management is highly needed by companies.

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The implementation of corporate governance has an impact on a company's performance, either in financial or in non-financial aspects. The performance of a non-financial company here is the financial performance viewed not based on the scale of number in the set of value of money; for instance, the attendance of employees, service satisfaction, product quality and so on. One of the ways that can be used to measure the non-financial performance of a company is by means of questionnaires distributed to the customers to measure the level of customers' satisfaction about the product and service of the company.

Contrary to the non-financial performance, what is meant by the financial performance is the performance assessed based on the size of number in a set of value of money; for instance, the profit achievement, and cash availability. In measuring the financial performance of a company, we can use the ratio of finance, such as the ratio of probability used to measure the ability of a company in having a profit, the ratio of liquidity used to measure the ability of the company in fulfilling its short-term obligations, the ratio of activity used to determine the extent to which the average level of asset at the level of certain activities. As stated by Inam and Mukhtar (2014), the company management could maintain the balance of bank management to protect the rights of shareholders in order to build a positive relationship between the company management and protection for the investors.

## 2. Literature Review

### 2.1. Corporate governance

In accordance with the *Forum Corporate Governance on Indonesia* (FCGI), corporate governance refers to a set of rules regulating the relationship between the shareholders, company management, creditor, government, employees, and other internal and external stakeholders related to their rights and obligations or, in other words, a system controlling the company.

Effendi (2016) stated that the implementation of the principles of good company management are related to two aspects, which are correlated to each other; those are *hardware* and *software*.

## 2.2. Corporate governance index performance

As stated by Effendi (2016), the *Corporate Governance Perception Index* (CGPI) is a grading of the implementation of GCG in companies in Indonesia through research designed to encourage a company to improve the quality of its implementation of the concept of corporate governance (CG) through continual refinement through evaluation and measuring rod.

The grading of the *Corporate Governance Perception Index* (CGPI) is held by the *Indonesian Institute Corporate Governance* (IICG) in collaboration with the SWA Magazine. The assessment of CGPI comprises four phases: self-assessment, document assessment, paper assessment and observation.

## 2.3. Financial performance

### 2.3.1. Liquidity ratio

A ratio shows a relationship between company cash as well as other current assets and current liability. The liquidity ratio is used to measure the ability of a company to fulfil its financial obligations or short-term liability.

### 2.3.2. Leverage ratio

It is the ratio measuring how much funds from loans are used by the company. The leverage ratio can be measured using the Debt Ratio and Total Debt to Equity Ratio.

### 2.3.3. Probability ratio

It is the ratio showing the ability of the company to gain profit from the use of its capital. The higher the profitability ratio, the higher the profit will be.

## 2.4. Previous research

The research of Ahmed and Hamdan (2015) showed that the average value for ROA indicated a poor managerial performance in gaining profit from the company assets. This was supported by Garini (2014), who stated that there was no positive impact of

corporate governance and ROA using the Board of Commissioner and Board of Directors as the independent variables. Similarly, Zabrie et al. (2016) stated that corporate governance had a significantly negative relationship with ROA using the parameter of Board as the control variable. It is different from the research by Agustin (2016), who proved that there was an impact of GCG on the financial performance of a company, measured using ROA, ROE, and EPS. The result of this research is supported by Dedu and Chitan (2013), who also revealed a relationship between GCG toward ROA and ROE. This is similar to Zabrie et al. (2016), who stated that corporate governance has a significantly positive relationship toward ROA using the parameter of Board as its control variable.

In the research of Zabrie et al. (2016) corporate governance was found to have no relationship with ROE. Contrarily, the research by Ahmed and Hamdan (2015) proved that the variable of SBoard, IndepB and PManager had a positive impact on the company performance. This was due to the majority of businesses of Bahrain being owned by families. Another research that gave a similar statement was that by Gupta et al. (2014), whose results showed a significant positive impact on ROA and ROE and the sample used was a company located in India.

## 2.5. Hypothesis development

### 2.5.1. The effect of corporate governance on liquidity ratios

The implementation of good corporate governance will have a positive influence on the financial performance of a company. The existence of a good financial performance means that the company can then meet its short-term financial obligations; for example, payment of trade payable, debts, etc. According to Inam and Mukhtar (2014), liquidity is positively correlated with corporate governance, as good governance can provide guidance to increase the bank's current assets to meet its short-term liabilities.

**H1:** Corporate governance has a positive impact on liquidity ratio

### 2.5.2. The effect of corporate governance on leverage ratios

The implementation of good corporate governance will have a positive influence on the financial performance of a company, measured using the leverage ratio because the smaller percentage of the ratio results will be better for the company because it

shows the lower use of funds from debt. The lower use of debt will reduce the interest payments to the debtors.

**H<sub>2</sub>:** Corporate governance has a positive impact on leverage ratio

### 2.5.3. The effect of corporate governance on profitability ratios

ROE is a formula used to measure how much profit the owner owns the rights (Harjito and Martono, 2014). In the study of Zabrie et al. (2016) they argued that corporate governance has no relationship with ROE.

**H<sub>3</sub>:** Corporate governance has a positive impact on probability ratio

## 3. Method

### 3.1. Definition of variable operational

#### 3.1.1. Corporate governance

*Corporate governance* can be measured using the grading done by the *Indonesian Institute of Corporate Governance* (IICG) with swa magazine. The grading by the IICG was in the form of the *Corporate Governance Perception Index* (CGPI).

#### 3.1.2. Probability ratio

probability is measured using *return on assets* (roa); this ratio is used to measure the level of company level and if its value is higher, then the company will be better. Roe is used to measure the operational performance of a company in managing the capital provided to result in profits for the company.

$$\text{Return on Assets} = \left( \frac{\text{Net Margin} \times 100\%}{\text{Total Asset}} \right)$$

$$\text{Return on Equity} = \left( \frac{\text{Net Margin} \times 100\%}{\text{Total Equity}} \right)$$

#### 3.1.3. Leverage ratio

Leverage ratio is measured using the *debt ratio* and *total debt to equity*. The debt ratio can be used to measure how much capital is coming from the loan; meanwhile, the

*total debt to equity* is used to compare how much of the total loan is owned by the company with its own financial capital.

$$\text{Total Debt to Total} = \left( \frac{\text{Total Debt} \times 100\%}{\text{Assets Ratio Total Asset}} \right)$$

$$\text{Total Debt to Equity} = \left( \frac{\text{Total Loan} \times 100\%}{\text{Own Capital}} \right)$$

### 3.1.4. Liquidity ratio

The liquidity ratio is measured using the *Current Ratio*, which is used to give information about the extent to which the company assets are able to cover its current liability.

$$\text{Current Ratio} = \left( \frac{\text{Current Asset} \times 100\%}{\text{Current Liability}} \right)$$

## 3.2. Data analysis method

### 3.2.1. Descriptive analysis

As stated by Ghozali (2006), descriptive statistics can give a description of data, as seen from the average values, deviation standards, variant, maximum, minimum, sum, range, kurtosis, and skewness.

### 3.2.2. Simple linear regression analysis

As stated by Ghozali (2006), regression analysis, in addition to measuring the power of the correlation between two variables or more, also shows the direction of the relationship between the dependent variable and independent variable.

## 4. Results

### 4.1. Description analysis

Based on Table 1, it can be said that the variable of ROA had the average value of 1.9257 with the minimum value of -34.38 and the maximum value of 17.43. The level of deviation standard value was 17.35008. It can be stated that on average the non-financial companies listed in CGPI can result in profit from the asset by 1.9257 with a deviation of ROA by 17.35008 from its average values.

TABLE 1: Descriptive statistics.

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	7	-34.38	17.43	1.9257	17.35008
ROE	7	-7.78	45.30	17.3100	17.19633
DER	7	-2.83	1.76	0.4371	1.52867
DAR	7	0.35	1.15	0.5600	0.28525
CR	7	0.13	3.29	1.5443	1.15532
CG	7	70.38	90.27	82.8886	6.75506
Valid N (listwise)	7				

The ROE could be stated that on average, the non-financial companies listed in CGPI can have the profits from the investments made by the shareholders of 17.3100 with the ROE deviation of 17.19633 from its average values.

The DER could be stated that the average non-financial companies listed in CGPI had a debt ratio toward the equity of the company at 0.4371 with a deviation of DER by 1.52867 from its average values.

The DAR variable of non-financial companies had the average value of 0.5600 with the minimum value of 0.35 and maximum value of 1.15. The level of the deviation standard value was 0.28525. It can be stated that the average of non-financial companies listed in CGPI had a debt ratio toward the company asset of 0.5600 with a deviation of DAR by 0.28525 from its average values.

The CR variable of non-financial companies had the average value of 1.5443 with the minimum value of 0.13 and maximum value of 3.29. The level of deviation of CR was 1.15532. It can thus be stated that the average non-financial companies listed in CGPI had a ratio of current asset to current liability at 1.5443 with a deviation of 1.15532 from its average values.

The CG variable of non-financial companies had the average value of 82.8886 with the minimum value of 70.38 and maximum value of 90.27. The deviation value of CG was 6.75506. This can be stated that on average non-financial companies listed in CGPI can be seen with a score above 80 in a scale of 1–100 with a deviation value of 6.75506 of its average value.

#### 4.2. Simple linear regression analysis

Table 2 shows a significance value of 0.038, indicating that  $H_1$  is accepted; that is, corporate governance has a significant positive impact on ROA with a significance value of 0.038 at the level of significance of  $\alpha = 5\%$ . This research proved that the

TABLE 2: Simple Linear Regression Analysis of ROA, ROE, DER, DAR, CR toward CG.

Coefficients <sup>a</sup>						
Dependent Variable: ROA, ROE, DAR, DER, CR						
Model		Unstandardized Coefficient		Standardized	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-164.337	59.636		-2.756	0.040
	CG	2.006	0.717	0.781	2.796	0.038
2	(Constant)	131.927	79.456		1.660	0.158
	CG	-1.383	0.956	-0.543	-1.447	0.208
3	(Constant)	-14.364	5.168		-2.779	0.039
	CG	0.179	0.062	0.789	2.872	0.035
4	(Constant)	3.035	1.110		2.734	0.041
	CG	-0.030	0.013	-0.707	-2.236	0.076
6	(Constant)	-1.096	6.247		-0.175	0.868
	CG	0.032	0.075	0.186	0.424	0.689

better the management of a company, the higher the level of profitability obtained. The ROE value shows a significance value of 0.208, meaning that the decision of H<sub>1</sub> was not accepted; corporate governance has no positive impact on ROE, with a significance value of 0.208 at the level of significance of  $\alpha = 5\%$ . The DER value shows the significance value of 0.035, meaning that H<sub>1</sub> was accepted, which means that corporate governance has a significant positive impact on DER with a significance value of 0.035 at the significance level of  $\alpha = 5\%$ . The DAR value shows the significance value of 0.076, meaning H<sub>1</sub> was not accepted; corporate governance has no positive impact on DAR, with a significance value of 0.076 at the significance level of  $\alpha = 5\%$ . The CR value shows that the significance value was 0.689, meaning that H<sub>1</sub> was not accepted; corporate governance has no significant positive impact on CR, with a significance value of 0.689 at the significance level of  $\alpha = 5\%$ .

## 5. Discussion

### 5.1. Corporate governance has a positive impact on ROA

The test of the hypothesis in this research resulted in the significance value of 0.038, meaning that the decision of H<sub>1</sub> was accepted, in which corporate governance has a positive impact on ROA with a significance value of 0.038 at the significance level of  $\alpha = 5\%$ . This research proved that the better the management of a company, the higher the level of profitability obtained.

## 5.2. Corporate governance has a positive impact on ROE

The test of the hypothesis in this research resulted in the significance value of 0.208, meaning that the decision of  $H_1$  was not accepted, in which corporate governance has no impact on ROE with a significance value of 0.208 at the significance level of  $\alpha = 5\%$ . Better implementation of company management does not guarantee a high ROE if the amount of financial capital is higher than the amount of profit after the tax of a company. The probability of the amount of capital itself could be higher than the amount of profit after the tax as the dividend was not shared with the investors, increasing the value of profit maintained in the capital.

## 5.3. Corporate governance has a positive impact on DER

The test of the hypothesis in this research had the significance value of 0.035, meaning that the decision of  $H_1$  was accepted, in which corporate governance has a significant positive impact on DER with a significance value of 0.035 at the level of significance of  $\alpha = 5\%$ .

## 5.4. Corporate governance has a positive impact on DAR

The test of the hypothesis in this research had a significance value of 0.076, meaning that the decision of  $H_1$  was not accepted, in which corporate governance has no impact on DAR with a significance value of 0.076 at the significance level of  $\alpha = 5\%$ . Better implementation of company management is not guaranteed to result in a low DAR if the amount of debt is higher than the amount of assets of a company. This occurred in this research where the probability of obligation debt was accepted in advance, in the example of a larger company, compared to the total asset.

## 5.5. Corporate governance has a positive impact on CR

The test of the hypothesis in this research had a significance value of 0.689, meaning that the decision of  $H_1$  is not accepted, in which corporate governance has no impact on CR, with a significance value of 0.689 at the level of significance of  $\alpha = 5\%$ . Better implementation of company management is not guaranteed to result in higher CR if the amount of current liability is higher than the amount of current assets of a company. This occurred in the research where the probability of the amount of income accepted

in advance was higher. One of the research samples was Garuda Indonesia company; thus, if the customers buy their tickets before the departure, it will be recorded as the income being accepted in advance by the company.

## 6. Conclusion

Based on the results of the research, some conclusions are drawn as follows:

1. The result of the test on the simple regression on ROA showed a positive and significant relationship. This proved that the better the management applied by a company, the higher the level of ROA owned by the company.
2. The result of the test on the simple regression on ROE showed a negative but insignificant relationship. Better implementation of company management does not result in a higher ROE if the amount of capital is higher than the amount of profit after the tax of a company. The possibility of the amount of capital being higher than the amount of capital after tax as the dividend was not shared with the investors; thus the value of profit in capital increased.
3. The result of the test on the simple regression toward DER showed a significant and positive relationship. This research showed that the better the management applied by a company, the lower the level of debt and the higher the capital value owned by the company.
4. The result of the test on the simple regression toward DAR showed a negative and insignificant relationship. This research proved that better management applied by a company is not guaranteed to result in a higher level of assets owned. This might occur as the amount of obligation debt and income accepted in advance could be higher than the amount of assets of the company.
5. The result of the test on simple regression on CR showed a positive but insignificant relationship. This research showed that better management applied by a company does not mean that the amount of current liability of the company is lower. It is possible that the amount of income accepted in advance is higher, as found in Garuda Indonesia Company, which recorded the purchase of passenger tickets before departure as income accepted in advance.

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