

# Ownership Structure, Good Corporate Governance, and Firm Performance in the Indonesian Capital Market

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**ABSTRACT:** This research examines the effect of ownership structure and good corporate governance on firm performance. The research variables used were foreign ownership, institutional ownership, government ownership, size of the board of commissioners, and size of non-financial sector companies on the Indonesia Stock Exchange throughout 2013-2017. This study deployed a quantitative approach through multiple linear regression analysis, with a total sample of 1,650 observations.

The research findings were foreign ownership, government ownership; board commissioner size had a significant positive effect on firm performance while institutional ownership and firm size had a significant negative effect on firm performance.

*Keywords: Ownership structure, Good corporate governance, Firm performance*

## 1. INTRODUCTION

The ownership structure and corporate governance will have an impact on firm performance. The firm's ownership structure may consist of foreign, institutional, and government ownership. Corporate governance is the art of leading and controlling the company by balancing the desires of shareholders. Corporate governance can be associated with agency theory - a contractual relationship whereby the principal makes an agreement with the agent to act following the interests of the shareholders (Jensen and Meckling, 1976). Good ownership structure and corporate governance are essential factors in today's complex environment. Yussof and Alhaji (2012) stated that good governance practices are the actions of the board of directors to ensure the interests of investors are not threatened.

Studies conducted by Aurori et al. (2014), Ghazali (2010), and Mollah et al., (2012), provide conflicting evidence. Aurori et al. (2014) and Ghazali (2010) revealed that foreign ownership has a significant positive effect on firm performance, signifying that foreign investors have better technology and knowledge than domestic investors. However, Mollah et al. (2012) found the opposite, whereby foreign

ownership has no significant effect.

Another finding of Aurori et al. (2014) showed that institutional ownership has a significant positive effect on firm performance because institutional investors act as active monitors of the firm to maximize shareholder welfare. This finding is in contrast to Mollah et al., (2012) that proposed institutional ownership has no significant effect.

Aurori et al., (2014) and Mollah et al., (2012) proved that government ownership has no effect on firm performance, while Ghazali (2010) uttered that the government could effectively monitor companies through their ownership in the company. Furthermore, Aurori et al., (2014) and Mollah et al., (2012) discovered the size of the board of commissioners has no significant effect, while Ghazali (2010) found the opposite result whereby the more the number of board of commissioners, the better the firm performance. For firm size, all Aurori et al., (2014), Ghazali (2010), and Mollah et al., (2012) showed that firm size is insignificant, meaning that large firm size does not affect firm performance.

**2. RESEARCH METHODS**

This research is categorized as a basic research type to explore, describe, and predict natural and social phenomena as well as quantitative research because it involves quantitative data in the data processing. Based on its objectives, this research is causal, because it examines the effect of foreign ownership, institutional ownership, government ownership, size of the board of commissioners, and firm size on firm performance on the Indonesia Stock Exchange throughout 2013-2017.

Operationally, firm performance is an indicator of firm performance measured from market aspects through Tobin's Q.

Tobin's  $Q_{it}$  = total market value of firm<sub>it</sub>/ total equity value<sub>it</sub>..... (1)

Foreign ownership is the ownership or control of companies owned by foreign ownership in a business or individual entity (Bai *et al.* 2004).

Foreign ownership<sub>it</sub> = the percentage of foreign ownership<sub>it</sub>.....(2)

Institutional ownership is the ownership or control of companies owned by institutions (Zheka 2005).

Institutional ownership<sub>it</sub> = the percentage of institutional ownership<sub>it</sub>.....(3)

Government ownership is the ownership or control of a company whose majority of share is owned by the government (Ghazali, 2010).

Government ownership<sub>it</sub> = the percentage of government ownership<sub>it</sub> ... .. (4)

Size of the board of commissioners is the number of board of commissioners in the organizational structure.

Size of the board of commissioners<sub>it</sub> = the number of the board of commissioners<sub>it</sub> ..... (5)

According to Ferry and Jones (2001), firm size reflects the size of the firm shown by total assets.

$Size_{it} = Ln_{it}(\text{Total Asset})$  ..... (6)

This study used panel data that is a combination of time series, cross-sections, and secondary data, namely historical data from the Indonesia Stock Exchange website ([www.idx.co.id](http://www.idx.co.id)) in the form of the company's annual financial statements. The ratio level of measurement reflects the accurate value of the research object.

The population of this study was all non-financial sector companies listed on the Indonesia Stock Exchange throughout 2013-2017 with the following criteria: (1) listed on the Indonesia Stock Exchange for five years, (2) published financial statements that have been audited for five years, and (3) all variable data available. (4) Has a positive equity value in the annual financial statements.

The data processing method used was multiple linear regression. The dependent variable was Tobin's Q, while the independent variables were foreign ownership, institutional ownership, government ownership, size of the board of commissioners, and firm size.

$$Tobin's Q = \alpha + \beta_1 FO_{1it} + \beta_2 IO_{2it} + \beta_3 GO_{3it} + \beta_4 B Size_{4it} + \beta_5 Size_{5it} + e$$

Note:

- $FO_{it}$  : percentage of foreign share ownership in period t
- $IO_{it}$  : percentage of share ownership by the institution in period t
- $GO_{it}$  : percentage of share ownership by the government in period t
- $B Size_{it}$  : number of the board of commissioners in period t
- $Size_{it}$  : firm size in period t
- $\alpha$  : constant coefficient
- $\beta$  : regression coefficient
- $e$  : error

**3. RESULTS AND DISCUSSION**

As described previously there are 4 criteria used, and the number of samples that meet the criteria is 330 companies.. This amount comes from the screening of 555 companies listed on the stock exchange.

After conducting the Chow test and Hausman test, it is known that the best model is the fixed effect model. This study has heteroscedasticity symptoms so that it uses the fixed-effect model of the White cross-section (weight) method. The regression test results

can be seen in the following table.

Table 1. Regression Test Results (BEI-Tobins,')

Variable	Coefficient	t- statistics	Prob.	Hypoth esis
C	32.5458	34.2307	0.0000***	
FO	0.3897	2.3664	0.0181**	+
IO	-0.3196	-1.7652	0.0778*	+
GO	2.1563	2.0008	0.0456**	+
BSize	0.0397	5.7284	0.0000***	+
Size	-1.0605	-30.2055	0.0000***	+
R-squared			0.9023	
Adjusted R-squared			0.8775	
F-Statistic			36.3601	
Prob(F-Statistic)			0.0000	
Durbin-Watson Stat.			1.8903	

Note: \* Sig. at 10%; \*\* Sig. at 5%; \*\*\*Sig. at 1%

$$\text{Tobins}'Q = 32.54584 + 0.389698 \text{ FO} - 0.319551 \text{ IO} + 2.156340 \text{ GO} + 0.039658 \text{ B Size} - 1.060471 \text{ Size}$$

### 3.1 The Effect of Foreign Ownership (FO) on Tobins' Q

Table 1. shows that foreign ownership has a significant positive effect on Tobins'Q of 0.389698 at a significance level of 5%. This result is supported by Biekpe and Abor (2007) that said firms controlled by foreign investors could improve firm performance. Foreign investors have more sophisticated management skills and control systems, as well as specialized knowledge to reduce agency conflicts. This is supported by the experience of foreign investors in managing established international scale company.

Hasketl et al., (2007) proved that an increase in a firm performance whose ownership is by foreign investors occurs due to foreign investors know sophisticated technology so that they can transfer technology. It is supported by Djankov and Hoekman (2012) that technology transfer will result in higher productivity.

### 3.2 The Effect of Institutional Ownership (IO) on Tobins' Q

Table 1. shows that institutional ownership has a significant negative effect on Tobins'Q of 0.319551 at a significance level of 10%. According to David and Kochar (1996), institutional investors act as "passive monitors", so they do not intervene in management.

Meanwhile, according to Elyasiani and Jia (2010), institutional investors working with company management exploit minority shareholders. They also ignore the act of fraud to obtain benefits upon the actions they carried out. This increases the conflict of interest, which results in worsening firm performance.

### 3.3 The Effect of Institutional Ownership (IO) on Tobins' Q

Table 1 shows that institutional ownership has a significant negative effect on Tobins'Q of 0.319551 at a significance level of 10%. According to David and Kochar (1996), institutional investors act as "passive monitors", so they do not intervene in management. Meanwhile, according to Elyasiani and Jia (2010), institutional investors working with company management exploit minority shareholders. They also ignore the act of fraud to obtain benefits upon the actions they carried out. This increases the conflict of interest, which results in worsening firm performance.

This result is supported by Shleifer and Vishny (1997), who proved that majority shareholders, namely institutional shareholders, play a dual role. On the one hand, they can utilize their power to take personal advantage by taking over minority share ownership. The higher the concentration of ownership by institutions, the lower the efficiency of corporate governance because institutional shareholders have personal goals that can harm minority shareholders. The unfavorable thing that can be done is in the form of a company takeover or acquisition, resulting in a conflict of interest between the institutional shareholders and other stakeholders.

### 3.4 The Effect of Government Ownership (GO) on Tobins' Q

Table 1. shows that government ownership has a positive effect of 2.156340 on Tobins'Q at a significance level of 5%. This result is supported by Mejbel (2015) that scrutinized government-controlled companies are considered as companies operating in monopoly markets or markets with special regulations. Regulations made often have alignments that benefit the company, so they can be intervened to improve firm performance. In addition, Aljifri and Moustafa's research (2007) explained that in carrying

out their operations, companies owned by the government, receive strong support with high flexibility.

### 3.5 *The Effect of Size of the Board of Commissioners on Tobins' Q*

Table 1. shows that the result of size of the board of commissioners on Tobins'Q is 0.039658 at a significance level of 1%, which means that size of the board of commissioners has a significant positive effect on Tobins'Q.

Researches by Dalton & Dalton, (2005); Pearce and Zahra, (1992) in Kumar and Singh (2013), explained that an increasing number of boards of commissioners could increase the monitoring capacity of a company and could increase the company's ability to build broader external relations. Management requires input from a large board of commissioners.

Meanwhile, according to Erickson et al., (2005), the large size of the board of commissioners has the potential to cause many new problems and increase complexity in the decision-making process. As such, the greater the board of commissioner number involves, the longer the results of the decision, even though the board of commissioners is acting on behalf of the shareholders and as the main decision-maker. Therefore, complexity in decision making decreases the effectiveness of decision results.

### 3.6 *The Effect of Firm Size on Tobins' Q*

Table 1. shows that firm size has a significant negative effect on Tobins'Q on non-financial sector companies listed on the Stock Exchange throughout 2013-2017. Claessens *et al.* (2006) study said bigger firm size triggers higher monitoring and agency costs. If the firm size is larger, external supervision is needed so that monitoring and agency costs increase, which results in a decrease in firm performance. This argument is in line with Jensen and Meckling (1976), who stated agency costs increase as the firm size grows. Sun et al. (2002) supported that the larger the firm size, the lower the level of efficiency because companies face much bureaucracy, so they have more significant agency problems.

## 4. CONCLUSION

This study found ownership structure and corporate governance affect firm performance, which signifies that all foreign ownership, institutional ownership, government ownership, size of the board of commissioners, and firm size had a significant effect on Tobins' Q.

For the hypothesis test, it was found that foreign ownership, government ownership, and size of the board of commissioners had a significant positive effect on Tobins'Q while institutional ownership and firm size had a significant negative effect on Tobins' Q.

The values of  $R^2$  and adjusted –  $R^2$  are 0.9023 and 0.8775, so it can be concluded that Tobins' Q can be well explained by foreign ownership, institutional ownership, government ownership, and size of the board of commissioners as well as firm size control variable.

### 4.1 *Recommendation for Investors*

As a reference to consider the factors that contribute to Tobins'Q determinants, namely Foreign Ownership, Institutional Ownership, Government Ownership, Size of the Board of Commissioners, and Firm Size in influencing the performance of non-financial companies listed on the Indonesia Stock Exchange throughout 2013-2017.

### 4.2 *For Companies*

As a reference to determine the direction of firm policy that can improve firm performance in the future.

### 4.3 *For Future Researchers*

As a reference regarding the effect of ownership structure on firm performance in subsequent studies. This research has a limitation, namely observation of all non-financial companies listed on the Indonesia Stock Exchange throughout 2013-2017. For further research, it is advisable to use more sample coverage in order to obtain more accurate results by using the latest data.

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