

# The Impact of Corporate Governance Mechanism on Company Value of Those Listed on the Jakarta Islamic Index (JII): The Involvement of Financial Performance Moderating Role

Satrio Aji Pamungkas<sup>1</sup>, Muhammad Muflih<sup>2\*</sup>

<sup>1</sup>*Postgraduate Department, Master of Applied Islamic Finance and Banking, Politeknik Negeri Bandung, Bandung, Indonesia*

<sup>2</sup>*Postgraduate Department, Master of Applied Islamic Finance and Banking, Politeknik Negeri Bandung, Bandung, Indonesia*

*\*Corresponding author. Email: m.muflih@polban.ac.id*

## ABSTRACT

This study aims to identify the impact of Corporate Governance mechanism (proxied by independent commissioner, managerial ownership, and institutional ownership) on Company Value (proxied by Tobin's Q), and how Financial Performance (proxied by Return on Asset, ROA) moderates the relationship. This study employed 67 samples of go public companies listed on the Jakarta Islamic Index (JII) from 2014 to 2018. The samples were chosen by purposes sampling technique. Path analysis using PLS-SEM (Partial Least Square Structural Equation Modelling) with the 6.0 version of WarpPls was used as a statistical analysis of data. The results show that independent commissioner (KomIn) has a significant negative impact on company value (Tobin's Q), managerial ownership (KepMan) has an insignificant negative impact on Tobin's Q, and institutional ownership (KepIn) has a significant positive impact on Tobin's Q. Financial performance (ROA) positively moderates (strengthens) the significant impact of independent commissioner on Tobin's Q, negatively moderates (weakens) the significant impact of managerial ownership on Tobin's Q, and also negatively moderates (weakens) the significant impact of institutional ownership on Tobin's Q.

**Keywords:** *Corporate Governance Mechanism, Financial Performance, and Corporate Value*

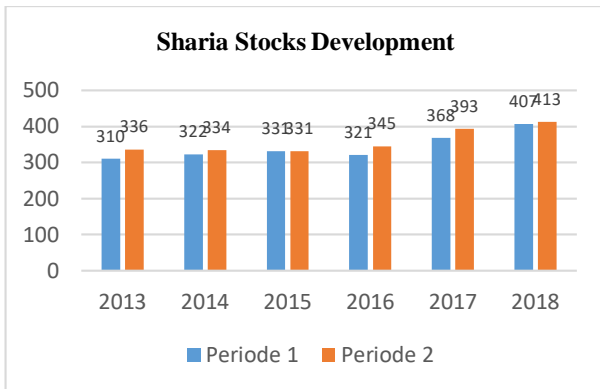
## 1. INTRODUCTION

In recent years, the Islamic capital market has grown rapidly in the global world [1]. The growth is marked by a significant new phenomenon; its global increase by 15-20% per year in the last five years [2]. Despite the increase, however, the stocks in the global Islamic capital market still experience the trend of lower value than the conventional ones. If it continues, it will reduce investors' interest to put their investment in the Islamic capital market [4] since investors will be more likely to invest in companies with high values [5].

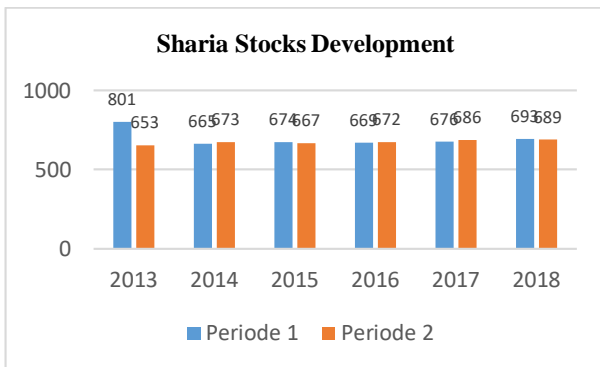
The importance of maximizing company value in the Islamic capital market urges scholars to conduct studies on factors to increase the values of Islamic go public companies. Those factors include the mechanism of Corporate Governance (CG) and Financial Performance [6]. Following the recommendation of Suhadak, et al. [7],

this current study examines the impact of CG on Company Value and how Financial Performance moderates the relationship between these two. This examination, which involves those independent and moderating variables, is hoped to be able to build a positive trend in the Islamic capital market and bring better company value.

This research was conducted in Indonesia because (1) the Islamic capital market has existed in Indonesia for more than two decades; however, the number of companies listed on the Indonesian Islamic capital market is lesser than in Malaysia. The following graphs show the fact.

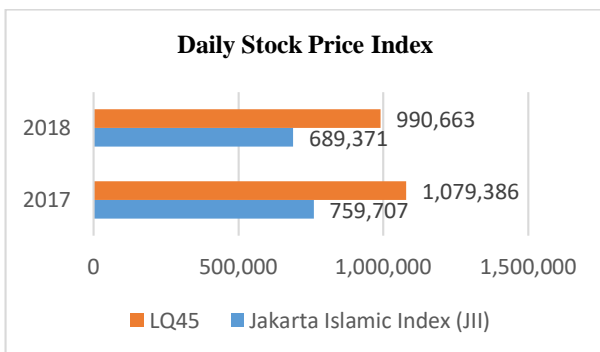


Source: ojk.go.id (data processed by the researchers)  
**Figure 1** The Number of Indonesian Islamic Stocks



Source: sc.com.my (data processed by the researchers)  
**Figure 2** The Number of Malaysian Islamic Stocks

2) Until now, the Islamic capital market still gets difficulty in competing with the conventional one. It can be seen from the daily stock price index of these two capital markets that are presented in the following chart.



Source: idx.co.id (data processed by the researchers)  
**Figure 3** JII & LQ45 Daily Stock Price Comparison

To solve the above problems, it is important to possess a deep understanding of increasing the values of Islamic go public companies. Thus, this research chooses the mechanism of CG and Financial Performance as two

factors to improve the Islamic company value in the future.

Therefore, this study aims to identify and analyze (1) the direct impact of Corporate Governance on Company Value and (2) the ability of Financial Performance on moderating the relationship between Corporate Governance and Company Value.

## 2. LITERATURE REVIEW

### 2.1 Company Value

According to Ilmi et al. [8], company value is a market value of company stocks reflected in the stock price. The higher the stock price, the better the company value. This research used Tobin's Q ratio to measure the value of companies observed. The theory of Tobin's Q explains that higher ratio (>1), the bigger company prospect to grow [12]. It occurs because greater market value may lead to higher interest of investors to own the company's shares [13].

The formula of Tobin's Q is as follow:

$$Tobin's\ Q = \frac{(MVE + D)}{TA}$$

Q is the company value, MVE is the market value of equity (the result of year-end closing stock price multiplied by the number of stocks at the end of the year), D is the book value of total debt, and TA is total assets.

### 2.2 Corporate Governance

According to Jensen and Meckling [14], agency problem occurs because managers put more priority on their personal interest; meanwhile, shareholders do not approve such interest since it costs more on the company and reduces company's profit. It will affect the stock price and decrease company value. Therefore, Corporate Governance mechanism proposed by Jensen and Meckling [14] aims to create a balance between management, stakeholders, and shareholders interests. The mechanism involves independent commissioner, managerial ownership, and institutional ownership.

#### 2.2.1 The Impact of Independent Commissioner on Tobin's Q

The practice of Corporate Governance requires an independent commissioner in a company [15].

Independent commissioner is an independent structure of a company which does not come from the management. It is responsible for conducting general or specific supervision according to articles of association, give advice, and supervise the directors in running the company operation [16]. The independent commissioner is hoped to provide better supervision to management in order to minimize the tendency of directors' moral hazard for their personal interest which will affect the company's profits and values [17] – [18]. Thus, the hypothesis to be proposed is:

H1: Independent commissioner has a positive impact on Tobin's Q.

2.2.2 The Impact of Managerial Ownership on Tobin's Q

The agency theory proposed by Jensen and Meckling [14] claims that the separation between company ownership and management can arise conflict caused by contradicting interests between them. The different interests make the management fraudulent to the detriment of shareholders [19].

According to Jensen and Meckling [14], the managerial ownership of company's stocks can align the conflicting interests between management and shareholders. Managerial ownership gives a chance to the manager, who is also the shareholder, to increase company value, because the increase in company value means the increase in his income as the shareholder [18], [20], [21]. Thus, the hypothesis to be proposed is:

H2: Managerial ownership has a positive impact on Tobin's Q.

2.2.3 The Impact of Institutional Ownership on Tobin's Q

According to Faizal [22], the greater the shares owned by the institution, the more it will act as a deterrent against waste by management which can harm the shareholders. Institutional ownership can monitor the management to work more effectively in order to improve company value [23]. Minimalizing the costs for managers' personal interests can increase company profit. Increase profits show that the company has a good prospect which, then, attracts investors to invest in that company [24]. It will increase the stock price as well as the company value [24]. Thus, the hypothesis to be proposed is:

H3: Institutional ownership has a positive impact on Tobin's Q.

**2.3 Financial Performance**

2.3.1 Financial Performance (ROA) in Moderating the Impacts of Independent Commissioner, Managerial Ownership, and Institutional Ownership on Tobin's Q

The profitability ratio used to measure the financial performance was Return on Asset (ROA) since it can show the extent to which the investment can give the expected returns. Besides, it can also be used to evaluate the adequate compensation received by the management based on the assets under their control [27], [28].

Financial performance on go public companies is one of the most important factors for potential investors to determine their stock investment in the companies [29]. The higher the profits, the bigger the return received by the investors, and the more the company value will increase [26]. Thus, the hypothesis to be proposed is:

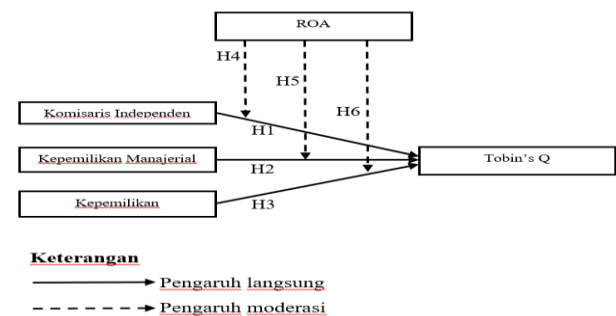
H4: ROA positively moderates the impact of independent commissioner on company value.

H5: ROA positively moderates the impact of managerial ownership on company value.

H6: ROA positively moderates the impact of institutional ownership on company value.

**2.4 Research Model**

The following is the research model that has been carried out.



**Figure 4** The Format of Research Model  
Source: Researchers' personal document

**3. RESEARCH METHOD**

This research employed a quantitative method since the data were numerical. The quantitative method emphasizes on the process of research to give objective results and general explanation to a phenomenon of the population observed [32].

Sixty-seven (67) go public companies listed on the Jakarta Islamic Index (JII) from 2014 to 2018 were used as population (idx.co.id).

The purposive sampling method was conducted in order to get more representative results, answer the research questions, and avoid bias in the findings [33]. Twenty-one (21) of the companies were chosen as the samples. Those companies had met the criteria, which were:

1. the companies listed as having Sharia shares in JII from 2014-2018;
2. publish the annual report of 2014-2018;
3. listed for four consecutive years (including two screenings in a year) in JII in 2014-2018;
4. publish the data and information needed in this study.

Data statistical analysis technique used in this study was the path analysis by applying the PLS\_SEM (Partial Least Square Structural Equation Modelling) method with the 6.0 version of WarpPLS software. The technique aimed to test the proposed hypotheses regarding examining the direct impact of CG on company value and the moderating role of financial performance toward the relationship between those two.

## 4. RESULTS AND DISCUSSION

### 4.1 Model Fit

There were 10 suitability indicators used to measure whether the model hypothesized fit the data [34]. Based on the test of model fit, eight of ten indicators were considered fit, while two others, SCR and RSCR, were not. However, those data and models can still be used in the research [35].

### 4.2 Hypotheses Testing

WarpPLS 6.0 testing obtained the results of model fit and the impact of each variable on the research hypotheses. The results are presented below:

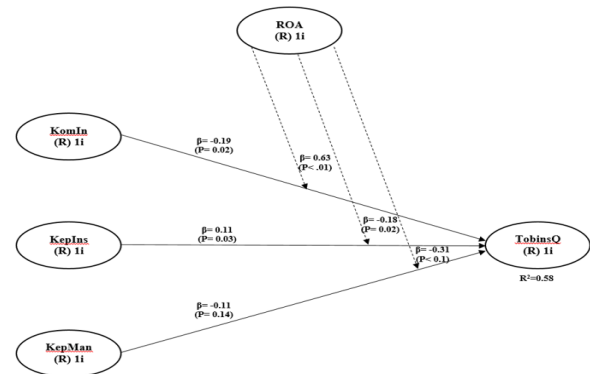


Figure 5 Research Model Results

Source: Researchers' data processing results

The results of hypotheses testing are presented in the following tables:

Table 1 Path Coefficients

	KomIn	KepIns	KepMan	ROA*KomIn	ROA*Kepins	ROA*KepMan
TobinsQ	-0,187	0,109	-0,105	0,635	-0,185	-0,312
	-	+	-	+	-	-

Sumber: Hasil olah data penulis

Table 2 P-Values

	KomIn	KepIns	KepMan	ROA*KomIn	ROA*Kepins	ROA*KepMan
TobinsQ	0,023	0,027	0,135	<0,001	0,025	<0,001
	Sig	N.Sig	N.Sig	V.Sig	Sig	V.Sig

Sumber: Hasil olah data penulis

### 4.3 Discussion of Hypotheses Testing Results

#### 4.3.1 Independent Commissioner Has a Positive Impact on Company Value

Path analysis result with a significance of 0,05 shows that the path coefficients and p-values of the impact of independent commissioner on company value are -0,187 and 0,023, respectively. It means that H1 is rejected or Independent Commissioner (KomIn) has a negative impact on Tobin's Q. This finding is in line with the results of related research conducted by [36]-[41].

According to Boediono [42], this significant negative impact occurs because the addition to independent commissioner members is only to fulfil the formal requirements; thus, it will not improve the performance of the director board. The argument is also confirmed by Carniasih [43] who claims that the establishment of independent commissioner is no more than just a requirement and is not intended to implement the GCG practice in a go public company. The dominance of company founders and major shareholders restricts the independent commissioner to conduct its full supervisory

role, which then only worsens the company performance and decrease the company value [36].

#### 4.3.2 Managerial Ownership Has a Positive Impact on Company Value

Path analysis result with a significance of 0,05 shows that the path coefficients and p-values of the impact of managerial ownership on company value are -0,105 and 0,135, respectively. It means that H2 is rejected or Managerial Ownership (KepMan) has a negative impact on Tobin's Q. This finding is in line with the results of related research conducted by [44]-[47].

The management of companies listed on the Indonesia Stock Exchange (IDX) is still considered ineffective since the system of family-dominated ownership causes a non-clear separation between the owner and the management, the management tends to side one owner only [48]. Whereas, in running a company, a manager should always pay attention to all owners [49]. However, in reality, this manager put his interest first, which then leads to company loss and gives negative effects [50], [51].

#### 4.3.3 Institutional Ownership Has a Positive Impact on Company Value

Path analysis result with a significance of 0,05 shows that the path coefficients and p-values of the impact of institutional ownership on company value are 0,109 and 0,027, respectively. It means that H3 is accepted or Institutional Ownership (KepIn) has a significant positive impact on Tobin's Q. This finding is in line with the results of related research conducted by [7], [23], [52]-[55].

This significant positive impact occurs due to a crucial role of institutional ownership in minimizing the agency problems between managers and shareholders [14]. Institutional investors also get involved in strategic decision making. They hardly believe in fraudulent acts of manipulation so the opportunistic tendency of managers can be prevented [56].

#### 4.3.3 ROA Positively Moderates the Impacts of Independent Commissioner, Managerial Ownership, and Institutional Ownership on Tobin's Q

Path analysis result with a significance of 0,05 shows that the path coefficients and p-values of ROA's role in moderating the impact of independent commissioner on company value are 0,635 and <0,001, respectively. It

means that H4 is accepted or ROA positively moderates the impact of independent commissioner on Tobin's Q. This finding is in line with the results of related research conducted by [7], [37], [45], [57], [58] [7], [37], [45], [57], [58].

Several theories which suggest that financial performance gives impact on company value conduct an empirical evaluation on asymmetry theories which claim that some parties closer to a company do not get the same information about the company prospect and risks [7]. Directors board, including the independent commissioners, usually has better information than the investors [38]. Thus, the independent commissioner will advise the managers regarding the prospects to be pursued and risks to be avoided in order to generate profits and increase dividend as well as market price as a market response [7], [59].

The analysis result of ROA in moderating two ownership structures, managerial and institutional, through path analysis with a significance of 0,05 show path coefficients and p-values of -0,312, <0,001, and -0,185, 0,025 respectively. It means H5 and H6 are rejected since both moderate negatively. These findings are in line with the results of related research conducted by [12], [37], [45], [55], [60]-[63] [12], [37], [45], [60], [61].

The separate function of managers and shareholders becomes the basis of the agency theory proposed by Jensen and Meckling [14]. When both managers and shareholders have a conflict of interest (because the managers' action is sometimes not approved by the shareholders), agency costs will be incurred to minimize the conflict using the total supervision costs conducted by the commissioner board [64]. At the same time, managerial ownership is not capable of maintaining the balance between management and shareholder interests [7]; thus, the profits earned will be misused by the managers [55]. It will affect the dividend and the company market price.

## **4.3 Limitation and Recommendation**

### 4.3.1 Research Limitations

Some limitations are found regarding this research, which are:

1. the research only investigated the Islamic companies in Indonesia; thus, it cannot reflect the condition of Islamic company as a whole;
2. the population of the research was only those Islamic companies listed on the Jakarta Islamic Index (JII);
3. the data were only taken for five years, 2014-2018;
4. only two exogenous variables were used to discover the impact occurred on an endogenous variable.

### 4.3.2 Recommendation

Based on the findings and limitations, further researchers are expected to:

1. expand the scope of research objects to companies in other Muslim countries, such as Malaysia, Brunei, Pakistan, Saudi Arabia, and others, to get more significant value of Tobin's Q and to generally depict the condition of Islamic go public companies;
2. expand the population of the research (if it is still conducted in Indonesia), on the Indonesia Sharia Stock Index (ISSI) or the Jakarta Islamic Index 70 (JII70), for instance;
3. extend the length of data collection (longer than five years);
4. add more exogenous variables such as Corporate Social Responsibility (CSR).

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