



Does Corporate Governance Affect Market Performance as Well as Fundamental Performance? Evidence from Indonesian Manufacturing Sectors

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Abstract. This research aims to determine corporate governance's impact on the firm's financial performance (ROE and Tobin's Q) in the manufacturing sector listed on the Indonesia Stock Exchange during 2016–2020. This research applied a quantitative approach with a sample of 615 observations from 123 manufacturing sector companies listed on the Indonesia Stock Exchange during 2016–2020. The collected data were then processed using multiple linear analysis models using the Eviews 10 program. The results show that the size of the board of commissioners and nomination and remuneration committee significantly affect the company's financial performance based on ROE. In contrast, independent commissioners have no significant impact, and the size of the audit committee has a significant negative effect on the company's financial performance based on ROE. While for the dependent variable Tobin's Q, the size of board of commissioners, independent commissioners, and nomination and remuneration does not significantly affect the company's financial performance, but the size of the audit committee has a significant and negative effect on the company performance based on Tobin's Q.

Keywords: Board of Commissioners · Independent Commissioners · Audit Committee Size · Nomination and Remuneration Committee

1 Introduction

Financial performance is the central focus in predicting economic value or economic benefits. Corporate governance can be defined as a mechanism to provide direction for making managerial decisions and help improve company performance [1]. On the other hand, management theory (stewardship theory) understands that company performance is calculated through trust between executives and shareholders. Management theory is seen as a theory that contradicts agency theory [2]. Management theory is seen as a theory that contradicts agency theory [3] and is considered a 'substitution' of agency theory [4]. Shareholders often demand a company have a good corporate governance mechanism to avoid contradicting goals among executives and shareholders [5]. Ria Murhadi

[6] said that good corporate governance could assure returns to investors by minimizing the related investment risks and contributing to company performance. The size of the board of commissioners is the number of commissioners in the company, which includes inside and outside directors [7]. Waheed & Malik [8] stated that theoretically, the size of the board of commissioners had a role in protecting the interests of shareholders in the company. The company's board of commissioners also has a right to advise, monitor, and hold managers accountable [9]. H1: The size of the board of commissioners positively affects the firm's financial performance. Independent commissioners are the number of independent commissioners on the company's board. Puni & Anlesinya [10] argued that independent commissioners are also known as non-executive commissioners who are considered experts and contribute to organizational success using their expert experience and knowledge and having an impact on corporate governance. H2: Independent commissioners positively affect the firm's financial performance.

The audit committee is a sub-committee established by the board of commissioners. The role of the audit committee is majorly to review the integrity of financial statements, maintain the quality of financial performance announcements [11], and protect investors [10]. H3: The size of the audit committee positively affects the firm's financial performance. According to Puni & Anlesinya [10], the nomination committee, or what is known as the appointment committee, has the responsibility of recruiting and choosing new director candidates for the board members. Agyemang & Castellini [12] revealed that the task of the remuneration committee is to ensure that the organization's compensation system is not structured to provide unilateral benefits to management at the cost of shareholders and other key stakeholders in the company. H4: The nomination and remuneration committee positively affect the firm's financial performance.

2 Research Method

This present study is classified as basic research to develop existing research. The objects used in this research were all manufacturing companies that meet the following requirements: (1) Listed on the Indonesia Stock Exchange (IDX) during 2016–2020, (2) Issued financial reports ending on December 31 every year from 2016–2020, and (3) had the variable data required in the financial statements are available and complete. The independent variable of the size of board of commissioners was calculated by the total of boards of commissioners in the company. Independent commissioners were calculated by dividing the number of independent commissioners by the number of commissioners in the company. The size of the audit committee was calculated by the number of audit committees in the company. The nomination and remuneration committee was calculated using a dummy variable, if the company has a nomination and remuneration committee = 1, if the company does not have a nomination committee and remuneration = 0. The firm size control variable was calculated through the natural logarithm of the company's total assets. Leverage was calculated by net income divided by debt. Meanwhile, firm age was calculated by year n minus the year the company was founded. The dependent variable of this research is the company's performance as calculated by ROE, and Tobin's Q. ROE is calculated by dividing net income by total equity. Tobin's Q is calculated by adding market size to total assets minus total equity then dividing by total assets. The research model used in this research is as follows:

Firm Performance = $\alpha + \beta_1$. Board of Commissioner Size_{*i*}, $t + \beta_2$. Independent Commissioner_{*i*}, $t + \beta_3$. Audit Committee Size_{*i*}, $t + \beta_4$. Firm Size_{*i*}, $t + \beta_5$. Firm Leverage_{*i*}, $t + \beta_6$. Firm Age_{*i*}, $t + e$.

3 Results and Discussion

After testing and following the assumptions, the following outcomes are gained. Table 1 indicates the results of the distribution of manufacturing company data. The multicollinearity test performed on every model shows that no variables run into multicollinearity.

It can be seen in the table of multicollinearity test results below from all the independent variables used that there is no high correlation value (less than -0.8 or more than 0.8). It indicates there is no multicollinearity problem (Tables 2 and 3).

The Chow test was conducted to determine whether the research uses the common effect or fixed-effect method. The chow test was carried out on two models: in model 1,

Table 1. Descriptive Statistics.

Variables	Mean	Maximum	Minimum	N
ROE	0.069501	4.761876	-4.112528	615
Tobin's Q	1.971951	35.40000	0.080000	615
UDK	4.213008	12.00000	2.000000	615
KI	0.414007	1.000000	0.200000	615
UKA	3.034146	5.000000	0.000000	615
NRC	0.375610	1.000000	0.000000	615
SIZE	28.89432	36.83149	20.29667	615
LVG	0.165211	5.237470	-2.337691	615
AGE	3.681811	4.672829	0.693147	615

Table 2. The Results of the Multicollinearity Test.

Var	UDK	KI	UKA	NRC	SIZE	LVG	AGE
UDK	1.00000	-0.0545	0.1850	0.33865	0.21103	-0.0175	0.16220
KI	-0.0545	1.00000	0.08343	0.04445	0.09215	0.07920	0.05394
UKA	0.18500	0.08343	1.00000	0.17498	-0.0204	0.01936	-0.0687
NRC	0.33865	0.04445	0.17498	1.00000	0.15644	0.13580	0.01136
SIZE	0.21103	0.09215	-0.0204	0.15644	1.00000	-0.0332	0.08117
LVG	-0.0175	0.07920	0.01936	0.13580	-0.0332	1.00000	0.19536
AGE	0.16220	0.05394	-0.0687	0.01136	0.08117	0.19536	1.00000

Table 3. The Results of The Chow Test

Model 1 (ROE)			
Effects Test	Statistic	d.f.	Prob.
Cross-section F	2.052057	(122,485)	0.0000
Cross-section Chi-square	255.962373	122	0.0000
Model 2 (Tobin's Q)			
Effects Test	Statistic	d.f.	Prob.
Cross-section F	15.392238	(122,485)	0.0000
Cross-section Chi-square	973.837855	122	0.0000

the dependent variable was ROE, and in model 2, the dependent variable was Tobin's Q. The results of the chow test on model 1 and model 2 show a chi-square cross-section probability result of 0.0000 which means < 0.05 , so H1 is accepted (fixed effects method).

Hausman test was conducted to determine whether the research uses a random effect model or a fixed-effect model. Table 4 shows the probability values of the random cross-section of model 1 and model 2 are 0.0000, and 0.0003, which means < 0.05 , so with a 95% confidence level, H1 (fixed effect) is accepted. After performing the Chow and Hausman tests for panel data, the best model is provided in Table 5. In Table 5, *means sig. α by 10%, **means sig. α by 5%, and ***means sig. at 1%.

The size of the board of commissioners has no influence on the firm's performance on Tobin's Q from a market performance or investor perspective. Murhadi [6] said that in the corporate system in Indonesia, the board of commissioners performs the function of supervisor and adviser to the board of directors. The size of board of commissioners positively and significantly affects the company performance based on ROE as a fundamental performance from an internal firm perspective. Kiel & Nicholson [13] revealed that increasing the size of the board of commissioners will provide positive benefits for the company in the form of a diversity of ideas, skills, and essential resources. Independent commissioners show insignificant results on company performance based on

Table 4. The Results of the Hausman Test

Model 1 (ROE)			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	32.021793	7	0.0000
Model 2 (Tobin's Q)			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	27.439530	7	0.0003

Table 5. Regression Test Results of Models 1 and 2

Variable	Model 1 (ROE)		Model 2 (Tobin's Q)	
	Coefficient	Prob.	Coefficient	Prob.
C	1.295656	0.0000	13.53771	0.0000
UDK	0.011857	0.0002**	0.008769	0.2053
KI	0.072708	0.1520	-0.083679	0.5077
UKA	-0.007246	0.0017**	-0.190941	0.0025**
NRC	0.055490	0.0001**	-0.043079	0.6637
SIZE	0.037549	0.0021**	-0.135575	0.0018**
LVG	0.341053	0.0000**	-0.116944	0.0002**
AGE	-0.664450	0.0000**	-1.910982	0.0000**
Adj. R-sq	0.882145		0.932946	
R-squared	0.906906		0.947034	

ROE (fundamental performance) and Tobin's Q (market performance). Bhatt & Bhattacharya [14] stated that this could occur due to independent commissioners who may not be truly independent because of family control or influence from the company's CEO. The size of the audit committee negatively and significantly affects the company's performance based on ROE (fundamental performance) and Tobin's Q (market performance). Suaryana [15] posited that the implementation of the audit committee tends to be ineffective, so an enhancement in the audit committee was needed. Moreover, lots of companies still need to get a remuneration committee.

4 Conclusion

Therefore, the size of the board of commissioners, the audit committee size, the existence of the nomination and remuneration committee, firm size, leverage, and firm age have various effects on company performance based on ROE as a firm's fundamental performance. Meanwhile, independent commissioners have no influence on company performance based on ROE. The board of commissioners' size, independent commissioners, and the existence of nomination and remuneration committees variables have no effect on company market performance based on Tobin's Q. Meanwhile, audit committee size, firm size, leverage, and firm age have a negative effect on company performance based on Tobin's Q.

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