
ANALYSIS EFFECT OF CORPORATE GOVERNANCE ON FINANCIAL PERFORMANCE WITH VARIABLE CONTROL FIRM SIZE

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Abstract: *This study is aimed to examine the effect of corporate governance on financial performance with variable control firm size. Corporate governance is measured using board of commissioners, proportion of outside commissioners, board of directors, institutional ownership, managerial ownership, and audit committee. Financial performance is measured using tobins q. This study used variable control which is firm size where as measured used log natural assets. This study used sample were as public listed companies in Indonesian Stock Exchange (IDX) in period 2011-2015. Thus, this sampling method used purposive sampling technique. The result of this study showed that board of commissioners, board of directors, institutional ownership, managerial ownership, audit committee not influence to financial performance. This study is showed proportion of outside commissioners influence to financial performance. The purpose study determine where is to add more independent variable. In addition, financial performance is measured used EVA (Economic Value Added) and expanding the corporate companies. More over the result in this study is have implications to each hypothesis.*

Key Words: corporate governance; financial performance.

1. INTRODUCTION

Companies go public will have greater funds obtained from the sale of shares to the public so that companies that go public in need of a good corporate governance management. Good corporate management will produce good company performance also and can earn profit. Profit information from a company is viewed from the company's financial statements, so the financial statements of a company should be reported and presented accurately. Companies that generate high profits will be the first view by investors, because it is judged that the performance in a company is good. Profits of an enterprise can be managed for sustainability of the company's operations.

Corporate governance is a key in improving economic efficiency, which includes a series of relationships between the company's management, board of directors, shareholders and others. Corporate governance is needed to steer the company in order to achieve its objectives, one of which is to prevent fraud in the company.

According to Cornett et al. (2006) many of cases concerning the manipulation of financial statement data such as Enron, Merck, World Com, and the majority of other companies in the United States. Research on the influence of corporate governance on corporate performance has been done by previous researchers both abroad and in Indonesia. Several studies on the influence of corporate governance showed different results. This is because each variable indicator to measure corporate governance and financial performance is different. The study was based on research Sharma (2016) who did the study "Corporate Governance and Firm Performance in Developing Countries: Evidence from India" research results suggest that the relationship between corporate governance and firm performance is not very strong in India. The difference between this study with previous research is the study

conducted in Indonesia by firm size as a control variable. The study uses financial statements of manufacturing companies listed on the Indonesia Stock Exchange. The goal is to generalize the results of previous research. Different sample hence result obtained from this research will be different from previous research.

2. THEORITICAL REVIEW AND HYPOTHESIS DEVELOPMENT

2.1 Agency Theory

Basis for corporate governance is agency theory. This theory explain that agency relations arise when one or more people hire others to provide a service and then delegate decision-making authority to the agent (Jensen & Meckling, 1976). The agency problem occurs because of the different purposes between the owner of the capital and the manager (agent). Agency Theory is the basic concept of corporate governance and is expected to serve as a tool to provide assurance to investors that they would receive a return on the funds they have invested, as well as reassure investors that the manager would benefit them.

2.2 Signalling Theory

Signal theory suggests how companies should signal the users of financial statements. Signals may be promotions or other information that states that the company is better than other companies (Sari & Zuhrohtun, 2006).

2.3 Stakeholders Theory

This theory to explain the company relationships with stakeholders are stakeholders. According to Freeman (1994) stakeholde r include "employees, investors, customers and the community". This theory states that all stakeholders have a right to be provided information on how the activities of the organization affects stakeholders (eg through sponsorship, the initiative of security, etc.) even when stakeholders choose not to use such information and even when stakeholders can not directly play a role

Constructive in organizational survival (Watts & Zimmerman, 1986).

2.4 Theory of Legitimacy

The theory of legitimacy states that a company can survive if the society in which the company is located feels that the company has operated on a value system commensurate with the system owned by the surrounding community. Legitimacy is a strategic factor for companies to develop the company.

2.5 Development of Hypothesis

2.5.1 The Influence of Board of Commissioners on Financial Performance

This commissioner role is expected to minimize agency issues arising between the board of directors and shareholders. Ruvinsky (2005) says that the board size is just the right amount so that the commissioners can work effectively and carry out corporate governance with accountable to shareholders. Previous researcher (Sinaga, 2014) found a positive and significant influence between the size of the board of commissioners and the financial performance of the company. Based on the explanation, the hypothesis in this study are :

H1: The board size of commissioners influence to financial performance

2.5.2 The Influence of Proportion of outside commissioners to Financial Performance

According Haniffa & Cooke (2002) if proportion of outside commissioners greater or dominant it can provide power to the board of directors to pressure management to improve the quality of corporate disclosure. The proportion of independent board that can induce the commissioners to act objectively and are able to protect seluruh stakeholders of the company. Based on the explanation, the hypothesis in this study are:

H2: The proportion of outside commissioners influence to financial performance

2.5.3 The Influence of Board Size to Financial Performance

According Sinaga (2014) the proportion of the board (both board of directors and board of commissioners) plays a role in the company's performance and can minimize the possibility of problems in the company's agency. This means that the greater the net profit earned by the company, the better the company's performance. Previous research Sheikh et al. (2011) found a positive influence between the size of the board of directors and the company's financial performance. Based on the above explanation, the hypothesis of this study are:

H3: The board size influence to financial performance

2.5.4 The Influence of Institutional Ownership on Financial Performance

Institutional ownership is ownership by the government, financial institutions, institutional legal entities, foreign institutions, trust funds and other institutions at the end of the year. Ramdhayani (2015) said that supervision by institutional investors depends heavily on the amount of investments made. The greater the ownership of financial institutions the greater the power of voice and encouragement of these financial instructions to oversee management and consequently will give a greater boost to optimize the value of the company so that the performance of the company will increase. According Arifani (2013) Institutional ownership is regarded as a controller for the company to create a good performance and increasing. Based on the above explanation, the hypothesis of this study are:

H4: The Institutional ownership influence to financial performance

2.5.5 The influence of Managerial Ownership on Financial Performance

According to Jensen & Meckling (1976) the greater ownership of shares by management less management tendency to optimize the use of resources while reducing agency costs due to differences

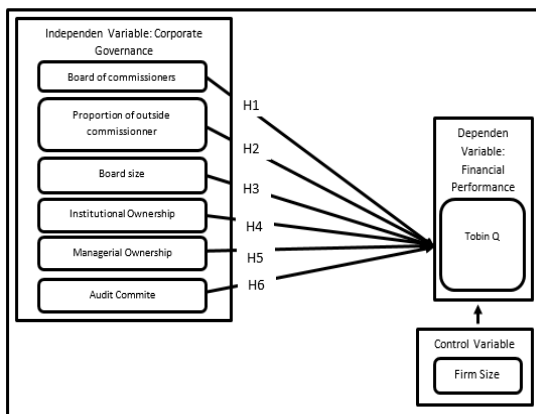
of interest. According to Sweeney et al. (1996) large shareholders will be more expected to monitor manager behavior to reduce the scope of managers involved in earnings management. Company ownership of shares by managers tends to do strategy to improve their long-term financial performance. The hypothesis is: H5: managerial ownership influence to financial performance

2.5.6 The influence size audit committee to Financial Performance

According to Sam'ani (2008), the audit committee has an important and strategic role in maintaining the credibility of the process of preparing financial statements as well as maintaining an adequate system of corporate supervision as well as good corporate governance. With the passage of audit committee functions effectively, the control of the company, the better. The hypothesis is: H6: The Size of audit committee influence to financial performance

2.6 Framework

Based on the description above, the frame of thought of this study as follows:



Source: Data process privat analysis

Figure 1. Framework

3. RESEARCH METHODS

3.1 Data dan sample

The data used in this research is secondary data from the annual financial statements listed in the Indonesia Stock Exchange (BEI) in 2011-2015. This study used a sample of manufacturing sector

companies listed on the Indonesia Stock Exchange 2011-2015. Sample selection is done by using purposive sampling method.

3.2 Research variable and measurements

3.2.1 Dependent variable

The dependent variable used in this research is the company's financial performance. In this study, the company's financial performance is measured by using Tobin's q. Formula Tobin's Q is:

$$\text{Tobin's Q} = \frac{\text{MVE} + \text{DEBT}}{\text{TA}}$$

Source: Mukhtaruddin et al., (2014)

Remarks:

MVE: (closing price x number of shares outstanding)

DEBT: Total debt of the company

TA: Total company assets

3.2.2 Independent variable

Independent variables used in this study is a measure of corporate governance in the board size, the proportion of independent board, the size of the board of directors, institutional ownership, managerial ownership, and the audit committee.

a. The size of the board of commissioners

The size of the board of commissioners is calculated using the following formula:

$$\text{Board of commissioners} = \sum \text{number of commissioners}$$

Source: Mukhtaruddin et al., (2014)

b. Proportion of independent board of commissioners

The proportion of independent board of commissioners is calculated using the following formula:

$$\text{Proportion of outside commissioners} = \frac{\sum \text{number of outside commissioners}}{\sum \text{number of commissioner}}$$

Source: Mukhtaruddin et al., (2014)

c. Board Size

The size of the board of directors is calculated using the following formula:

$$\text{Board size} = \sum \text{number of board size}$$

Source: Mukhtaruddin et al., (2014)

d. Institutional ownership

Institutional ownership is calculated using the following formula:

$$\text{Institutional ownershi} = \frac{\sum \text{institutional share}}{\sum \text{number of market share}}$$

Source: Mukhtaruddin et al., (2014)

e. Managerial ownership

Managerial ownership calculated using the following formula:

$$\text{Kepemilikan manajerial} = \frac{\sum \text{managerial share}}{\sum \text{number of market share}}$$

Source: Mukhtaruddin et al., (2014)

f. Audit Committee

The audit committee is calculated using the following formula:

$$\text{Audit Committee} = \sum \text{number of audit committee}$$

Source: Mukhtaruddin et al., (2014)

3.2.3 Control variable

This study have a control variable to control for independent variables and dependent variables are not influenced by other factors. The control variables in this study is the firm size. Firm size formula is as follows:

$$\text{Firm Size} = \text{Log natural of total assets}$$

Source: Mukhtaruddin et al., (2014)

3.3 Data Processing Techniques

Data was process of tabulating with Microsoft Excel 2016 and processing data using SPSS version 17.

3.4 Data Analysis Techniques

Data analysis technique used in this research is multiple linear regression analysis with SPSS version 17 program. The following is the multiple linear regression equation used in this study

3.5 Descriptive statistic

Descriptive statistic analysis provides general information about the data to be tested in the study. Descriptive statistics were used to describe the sample data profiles that include the mean, median, maximum, minimum, and standard deviation.

3.6 Hypothesis Testing

The following is the multiple linear regression equation used in this study:

$$\begin{aligned} KK &= \alpha + \beta_1 DK + \beta_2 SIZE + \epsilon & (H1) \\ KK &= \alpha + \beta_1 DKI + \beta_2 SIZE + \epsilon & (H2) \\ KK &= \alpha + \beta_1 DD + \beta_2 SIZE + \epsilon & (H3) \\ KK &= \alpha + \beta_1 KI + \beta_2 SIZE + \epsilon & (H4) \\ KK &= \alpha + \beta_1 KM + \beta_2 SIZE + \epsilon & (H5) \\ KK &= \alpha + \beta_1 KA + \beta_2 SIZE + \epsilon & (H6) \end{aligned}$$

Source: Mukhtaruddin et al., (2014)

Remarks:

KK = Financial performance measured by tobin q

DK = The size of the board of commissioners

DKI = Proportion of independent board of commissioners

DD = Size of the board of directors

KI = Institutional ownership

KM = Managerial ownership

KA = Audit Committee

SIZE = Firm size

α = Konstanta β = Koefisien regresi ϵ = Error term

4 RESULT AND DISCUSSION

4.1 Characteristics of Sample

Selection process in determining the criteria that have been determined can be seen in table 1 as follows:

Table 1. Selection Sample

Criteria Sample	Frekuensi
Public listen companies in Indonesian Stock Exchange (IDX)	665
in period 2011-2015	
Sample not complete criteria sample	525
Ending Sample	
	140

Source: Data process privat analysis

Based on these criteria, having accumulated from years 2011- 2015, the number of companies that qualify as samples in the study were as many as 140 companies.

4.2 Analysis Descriptive Statistics

Descriptive statistics were used to describe the sample data profiles that include the mean, median, maximum, minimum, and standard deviation. Descriptive statistics can be seen in table 2 as follows:

Table 2. Descriptive statistical analysis

	N	Minimum	Maximum	Mean	Std. Deviation
X1	140	2	12	3,99	2,223
X2	140	0,17	0,50	0,3662	0,06947
X3	140	2	13	4,57	2,414
X4	140	0,22	1,54	0,6877	0,20235
X5	140	0,00	0,32	0,0537	0,07683
X6	140	2	5	3,04	0,396
Size	140	9,79	14,39	11,9759	0,78751
Tobins (Y)	140	0,12	101,67	2,6446	11,75002
Valid N (listwise)	140				

Source: Analysis data with program SPSS 17.0

Based on table 2 above can be seen that the number of samples used in this study as many as 140 samples of data taken from the annual financial statements of manufacturing companies listed on the Indonesia Stock Exchange in 2011-2015.

The size of the board of commissioners has an average of 3.99 or as many as 4 people, at least 2 people, at most 12 people, and the standard deviation of 2,223 shows a relatively smaller average data deviation. Not the amount of data deviation, indicating that the variable size data of the board of commissioners is said to be quite good.

The proportion of independent board of commissioners has an average of 0.3662, a minimum value of 0.17, a maximum value of 0.50, and a standard deviation of 0.06947 indicating relatively smaller data deviations, since the value is less than the average value. Not the amount of data deviation, indicating that the variable data of the proportion of independent board of commissioners is said to be quite good.

The size of the board of directors has an average of 4.57 or 5 people, at least 2

people, at most 13 people, and the standard deviation of 2,414 shows relatively smaller data deviations, because the value is less than the average. Not the amount of data deviation, indicating that the variable size data of the board of directors is said to be good enough, meaning that the average company has directors who are able to manage the running of the company's operations.

Institutional ownership has an average of 0.6877, a minimum value of 0.22, a maximum value of 1.54, and a standard deviation of 0.20235 denotes relatively smaller data deviations, because the value is less than the average value. Not the amount of data deviation, indicating that the variable data of institutional ownership is said to be quite good, meaning that the average shareholding in the company is held by the institution.

Managerial ownership has an average of 0.0537, a minimum value of 0.00, a maximum value of 0.32, and a standard deviation of 0.07683 indicates the distribution of managerial ownership variables is not good, that is, the low level of managerial ownership or management in the company.

The audit committee has an average of 3.04 or 3 people, at least 2 people, at most 5 people, and the standard deviation of 0.396 shows relatively smaller data deviations, because the value is less than the average. Not the amount of data deviation, indicating that the audit committee variable data is said to be quite good.

Firm size has an average 11.9759, the minimum value of 9.79, the maximum value of 14.39, and a standard deviation of 0.78751 show deviations of data that is relatively smaller, because the value is smaller than the average value. Not the amount of deviation of the data, indicate that firm size variable data is said to be quite good.

Tobins have an average 2.6446, the minimum value of 0.12, the maximum

value of 101.67, and a standard deviation of 11.75002 show the distribution of variable data is less good Tobins.

4.3 Hypothesis Testing Result

Based on the test results hipotesis has been done then the summary results of hypothesis testing can be seen in Table 3 as follows:

Table 3. Test Results

	Hypothesis	Sig.	Kesimpulan
H1	The board size of commissioners influence to financial performance	0,685	Not Support
H2	The proportion of outside commissioners influence to financial performance	0,036	Support
H3	The board size influence to financial performance	0,755	Not Support
H4	The Institutional ownership influence to financial performance	0,109	Not Support
H5	The managerial ownership influence to financial performance	0,297	Not Support
H6	The Size of audit committee influence to financial performance	0,142	Not Support

Source : Dat process privat analysis

4.3.1 Influence board size to financial performance

Based on the results of statistical tests, H1 indicates that the board size does not affect the company's financial performance. This indicates that the first hypothesis (**H1**) is **not supported**. The negative effect of the size of the board of commissioners is due to the lack of coordination among commissioners. This research is in line with research conducted by Nasution and Setiawan (2007), which finds that the difficulty of coordination among members of the board of commissioners can hamper the oversight process that should be the responsibility of the board of commissioners, so that the dissemination of information is not disagreeable. This is supported by the argument that the more the number of boards of commissioners the financial performance is decreasing. This is because the more the size of the board of

commissioners the higher costs incurred and can reduce the financial performance of the company. The emergence of agency problems that agency costs are also incurred. This study rejects the theory of agency where the application of corporate governance in this study did not suppress or lower the agency costs but increase the cost.

4.3.2 The Influence of proportion of outside commissioners on financial performance

Based on the results of statistical tests, H2 showed that the proportion of independent board affect the company's financial performance. The value of significance shows smaller than 0.05 that is 0,036, meaning that variation of variable of independent board of commissioner by partial have significant influence to performance, coefficient direction from variable of independent board of commissioner show negative direction. This indicates that the second hypothesis (**H2**) is **accepted or supported**.

The results of this study differ from research conducted by Lorsch (1989), Mizruchi (1983), Zara & Pearce (1989), Baysinger, Kosnik and Turk (1991), Goodstein et al., (1997), Kusumawati & RJ (2005) . Sylvia & Sidhartha (2005) states that the appointment of independent board by the company may be just for regulatory compliance alone but is not intended to drive corporate governance in the company. According to Kusumawati & Riyanto (2005) the existence of independent commissioners within the company tends to appear just a formality to meet the existing regulations.

This study supports research conducted by Sembiring (2005) which states that the presence of independent board of commissioners in the composition of the board of commissioners can reduce financial reporting fraud so as to increase the value of the company. Fama and Jensen (1983) in Sam'ani (2008) argue that independent commissioners can act as mediators in disputes between internal

managers and oversee management policies and provide advice to the management of independent commissioners is the best position to carry out monitoring functions in order to create a company that good corporate governance. The greater the number of independent commissioners then the decision made by the board of commissioners prioritizes the interests of the company, thus affecting the performance of the company.

4.3.3 The effect of the board size on the financial performance

Based on statistical test results, H3 shows that the size of the board of directors has no effect on the financial performance of the company. This shows that the third hypothesis (**H3**) are not supported. The results support the research conducted by Sharma (2016) who found that the size of the board of directors negatively affect the performance of the company. This is supported by the argument that the more the number of boards of directors the financial performance is declining. This is because the more the board of directors the higher the costs incurred and can reduce the financial performance of the company. This study rejects the theory of agency where the application of corporate governance in this study did not suppress or lower the agency costs but increase the cost.

The results of this study contradict Pfeffer & Salancik (1978) which explains that the greater the need for an increasingly effective external relationship, the need for a larger number of boards will be higher. In addition, the spearhead of the effectiveness and efficiency of the company depends on the management of the company's management mechanism which is the task of the board of directors. Good or bad performance will depend on the ability of the company's board of directors as a better resource.

4.3.4 The Influence of Institutional Ownership to Financial Performance

Based on the results of statistical tests, H4 show that institutional ownership does not affect the company's financial performance. This suggests that the fourth hypothesis (**H4**) is not supported. Judging from the pattern of the relationship, then the effect is negative. That is, the higher level of stock ownership by the institution, the lower the company's financial performance. This is because institutional ownership of shares is temporary owners and focuses on short-term profits, if short-term earnings changes are not perceived to be profitable by shareholder they will liquidate their shares and that will affect the value of the stock as a whole. On this basis to avoid liquidation of investor managers will take profit management actions that ultimately can also degrade the performance of the company.

The results support the research conducted by Jensen and Meckling (1976), Warfield et al., (1995), Dhaliwal et al., (1982), and Midiastuti & Mas'ud (2003), as well as Sujono et al. (2007) found that institutional ownership negatively affects firm value.

4.3.5 The influence of managerial ownership on financial performance

Based on the results of statistical tests, H5 showed that managerial ownership does not affect the company's financial performance. This indicates that the fifth hypothesis (**H5**) are not supported. The results of this study support the results of research conducted by Siallagan and Machfoedz (2006) who found that managerial ownership negatively affect the value of the company. High managerial ownership allows for increased opportunities for management to commit frauds. Sinaga (2015) found that managerial ownership negatively affected no significant effect on financial performance.

The results of this test does not support Rosyada's (2012) study which concludes that managerial ownership affects financial performance. This research rejects agency theory where, according to agency approach, ownership structure is a mechanism to reduce conflict of interest between manager and shareholder by enlarging share ownership by management can increase proportion of shares owned by manager so that will decrease tendency of manager to excessive action.

Managerial share ownership can be done as a form of compensation for management to improve the company's financial performance. In general, the amount of compensation received by the management depends on the size of the company's assets (Puspitasari & Ermawati, 2010). To obtain such compensation, the management will do its utmost to effectively manage the company's assets.

4.3.6 The Influence of the size audit committee to Financial Performance

Based on the results of statistical tests, H6 showed that the size of the audit committee does not affect the company's financial performance. This suggests that the sixth hypothesis **(H6) are not supported.** The existence of audit committees in corporate governance less active part, this is due to the supervision and advice given audit committee is still lacking. This is supported by the argument that the more the number of audit committees the financial performance is decreasing. This is because the higher the size of the audit committee the higher the costs incurred and can degrade the company's financial performance. This study rejects the theory of agency where the application of corporate governance in this study did not suppress or lower the agency costs but increase the cost.

The results of this study contradict the research conducted by Arifani (2013) which states audit committees have a positive effect on financial performance.

The more the audit committee composition the financial performance will be well monitored so that performance will increase. The audit committee is placed as a supervisory mechanism between management and external parties, so the audit committee is considered to improve the performance of the company through such supervision. The result of this study nnot support to agency theory.

5 CONCLUSIONM, LIMITATION, IMPLICATION, AND SUGGESTION

5.1 Conclusion

This study examined the influence of corporate governance on financial performance of the control variables firm size. The sample in this study is a manufacturing company listed on the Indonesia Stock Exchange in 2011-2015. The following conclusions can be drawn from this research:

- a. Based on the results of data processing variable size board of commissioners has no effect on the financial performance of the company. This is supported by the argument that the more the number of boards of commissioners the financial performance is decreasing. This is because the more the size of the board of commissioners the higher costs incurred and can reduce the financial performance of the company.
- b. Based on the result of data processing, the proportion of independent board of commissioners influences the financial performance of the company. This is supported by the argument that the presence of independent board of commissioners in the composition of the board of commissioners can reduce financial reporting fraud.
- c. Based on the results of data processing variable size board of directors does not affect the financial performance of the company. This is

supported by the argument that the more the number of boards of directors the financial performance is declining. This is because the more the board of directors the higher the costs incurred and can reduce the financial performance of the company.

- d. Based on data processing on institutional ownership variables do not affect the financial performance of the company. This suggests that firms need not pay much attention to institutional ownership.
- e. Based on data processing on managerial ownership variable does not affect the financial performance of the company. This shows that the small share ownership of managers gives effect to the decrease of company's financial performance. This means that increased shareholder ownership will degrade the company's performance.
- f. Based on the results of data processing variable audit committee size does not affect the financial performance of the company. This is supported by the argument that the more the number of audit committees the financial performance is decreasing. This is due to the increasing number of audit committees issued higher and can lower the company's financial performance

5.2 Limitation

Limitations in this study is that this study only uses a sample manufacturing companies listed on the Indonesia Stock Exchange (BEI) that can not be generalized in other types of industries. The study period is only 5 years ie 2011-2015 thus less able to describe the influence of corporate governance on the company's overall financial performance. Corporate governance variables measured only by board size, the proportion of independent board, the size of the board of

directors, institutional ownership, possession managerial, and the audit committee. The company's financial performance in this study is only proxied with Tobin's Q.

5.3 Implication

In line with the process of improving the company's financial performance will usually arise a conflict of interest between managers and shareholders who called the agency conflict, it needs a set of rules to resolve the conflict, namely corporate governance or corporate governance is a set of rules that govern the relationship between shareholders, managers, creditors, employees, government, and other stakeholders should be balanced between the rights and obligations.

Corporate governance is good is expected to boost the company's performance is also good. Application of corporate governance also has the benefit of encouraging companies to be more transparency kepada pemegang stocks, helping the supervisory board and company management in decision making. The results of this study are expected to add a reference to research on mainstreaming corporate governance on financial performance.

5.4 Suggestion

The purpose study determine where is to add more independent variable. In addition financial performance is measured used EVA (Economic Value Added) and expanding the corporate companies. More over the result in this study is have implications to each hypothesis.

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