

# Corporate Government Index And Factors Diterminant Study on Manufacture Industries in Indonesia Stock Exchange

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## Corporate Government Index And Factors Diterminant Study on Manufacture Industries in Indonesia Stock Exchange

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### ABSTRACT

The purpose of this study was to examine the factors that affect good corporate governance (GCG) as measured by the GCG index. While the factors that are thought to influence the implementation of GCG are profitability as measured by return on equity (ROE), leverage as measured by debt-to-equity ratio, independent audit committee, and firm size as measured by log natural total assets. The population of this study are manufacturing companies listed on the Indonesia Stock Exchange (IDX), with a sample of 39 companies taken by purposive sampling technique. The data observation period is four years (2017 – 20220) with annual data taken from the website of each sample company. To test the hypothesis, multiple regression analysis tools were used with a significance level of 5%. The results showed that profitability, leverage, and independent audit committee had no effect on the implementation of GCG. Firm size has a significant and positive effect on GCG.

Keyword: GCG, profitability, leverage, independent audit committee, firm size

### Introduction

In carrying out business activities, of course, many parties are involved so that the business can run smoothly and according to plan. In order for these parties to have a good relationship, the company needs to work with existing regulations, and not take deviant actions within the company. Therefore, we need a management / governance (Good corporate governance) in every company to be able to win the competition. According to the (Cadbury, 1992) good corporate governance is the principle that directs and controls the company to achieve a balance between the strength and authority of the company in providing accountability to shareholders and stakeholders in general. This is intended to regulate the authority of directors, managers, shareholders, and other parties related to the development of the company in a certain environment. Good corporate governance is included to regulate these relationships and prevent significant mistakes in the company's strategy and to ensure that mistakes that occur can be corrected immediately (Ridho et al., 2014).

Disclosure of good corporate governance is done by protecting the stakeholders associated with the incident, and most importantly to restore public trust. Disclosure and information regarding the implementation of corporate governance are as important as financial information published by a company (Natalia, 2012). The government through kep-

10/M.EKUIN/08/1999 established an institution, namely the National Committee on Corporate Governance Policy (KNKCG) which was later changed to the National Committee on Governance Policy (KNKG) in 2004 based on the Decree of the coordinating minister for Economic Affairs No: KEP-49 /M. EKON/11/2004. This committee is tasked with formulating and compiling national policy recommendations on CG, including the Code for Good corporate governance.

Research on the impact of the implementation of corporate governance on the financial performance of companies in developing countries has not been widely carried out. (Black & dkk, 2003) found that the influence of corporate governance practices on firm value will be stronger in developing countries than in developed countries. This is due to the variety of good corporate governance practices in developing countries compared to developed countries. (Durnev & Kim, 2003) provide evidence that corporate governance practices are more varied in countries with weaker legal environments. Klapper and Love (2002) found evidence that better corporate governance has a high relationship with operating performance and market valuation. Family companies have a prominent difference with other companies in terms of their characteristics. The most notable difference between these two types of companies is the difference in ownership structure and the composition of the board of directors and commissioners. Family firms tend to be more concentrated and there is no diversity of ownership. Therefore, control is obtained through the CEO, directors and commissioners.

Company profitability which is a measure used to assess the extent to which the company can generate profits. According to Pamungkas & Muid (2012) large profitability can attract investors to invest in the company. With the increasing number of investors, the responsibility of management to continuously improve performance will be even greater. The results of the study by Tjandra & Suryathi (2017) stated that the test results empirically proved that profitability had a positive effect on the implementation of GCG.

According to Kasmir, Financial Statement Analysis (2017) the leverage ratio is the ratio used to measure the extent to which the company's assets are financed with debt. This means that the amount of debt used by the company to finance its business activities when compared to using its own capital. Jensen & Meckling (1976) revealed that because companies with high levels of leverage lead to higher monitoring costs, companies try to reduce these costs by disclosing more extensive information to meet creditors' needs. The results of leverage affect the extent of corporate governance disclosure. The greater the company's debt, the more company information that will be disclosed, including in corporate governance. Muhammad & et al (2009) state that companies with high levels of leverage have a higher obligation to disclose information, especially financial information in order to convince the company's long-term creditors that the company has sufficient resources to finance the company's business activities.

Company size is the ability of the company and the diversity and amount of production capabilities or the quantity and variety of services that the company can offer

simultaneously to its customers Sritharan (2015). According to Pamungkas & Muid (2012) company size is the value of the size of a company as measured by the company's total assets. With a large company size, the company's name is unconsciously in the public spotlight, so management feels the need to always apply the concept of GCG in daily company activities (Pamungkas & Muid, 2012). When a company is led by a CEO who is a family member, it is believed that it can minimize or even eliminate agency problems between the principal and the agent. The family who occupies the CEO position will try their best for the welfare of the shareholders, where the shareholders are members of their own family. CEOs who come from families can make it easier for families to control the company to suit their wishes and interests.

In the Decree of the Chairman of BAPEPAM Number KEP-29/PM/2004, Regulation Number IX.1.5 regarding the Establishment of the Audit Committee, each Issuer or Public Company is obliged to have an Audit Committee and audit committee work guidelines (audit committee charter). According to Tugiman (2014) the audit committee is a group of people chosen by a larger group to do certain jobs or to perform special tasks or a number of members of the board of commissioners of the client company who are responsible for assisting the auditor in maintaining his independence from management. According to Pamudji & Trihartati (2010) the audit committee is one of the components of GCG that plays an important role in the financial reporting system, namely by supervising the participation of management and independent auditors in the financial reporting process. The existence of an audit committee is an important tool in the implementation of good corporate governance. A good audit committee performance can add value to the principal who wants to align interests with the agent (company manager) as the company's business executive. (Natalia & Zulaikha, 2012). Research of Natalia & Zulaikha (2012) shows that there is a significant positive influence on GC disclosure in the annual report.

The purpose of this study was to examine the effect of profitability, leverage, firm size and audit committee independence on the implementation of good corporate governance. In this study, the company used is a manufacturing company listed on the Indonesia Stock Exchange (IDX), manufacturing companies have different characters from service and trading companies. The most important character of a manufacturing company is in production activities. The management of manufacturing companies is very broad so that it takes a lot of natural and human resources, and deals with many stakeholders making good corporate governance management very necessary for the survival of the company. So the authors feel the need to do research on the broad application of corporate governance in manufacturing companies.

#### Theoretical review and hypothesis development

##### Profitability

According to Sartono (2010) the definition of profitability ratios is the company's ability to earn profits in relation to sales, total assets, and own capital. Meanwhile, according to (Fahmi, 2013) is the profitability ratio, which is to show the company's success in generating profits. According to Hartono (2013) Profitability is one of the variables that

affect the firm value of several variables tested. According to Manoppo & Arief (2016) company profitability is a picture that measures how well the company can generate profits from operational processes that have been implemented to ensure the company's survival in the future. Sukarya & Baskara (2019) Stating the profitability of a company can be measured by looking at the return on equity (ROE) value. Return on equity shows the level of return on investment for shareholders. Profitability is one of several factors that prospective investors consider before making a decision to invest in a company. In previous studies, it is often explained that companies with higher profitability tend to disclose more information related to their companies. This is done as a form of attracting attention and convincing investors to invest. With the increasing number of investors obtained, the greater the responsibility of the company's management to continue to grow. One of the efforts to increase management accountability to shareholders is to implement good corporate governance.

#### Leverage

According to Wiagustini (2014) Leverage is a ratio used to measure a company's funding originating from debt. Leverage also means a company's ability to pay off financial obligations owned by banks in the short term and in the long term (Suwardika & Mustanda, 2017). According to Kartikasari & Merianti (2016) wrote that in a broad sense, the leverage ratio is used to measure the company's ability to pay all its obligations, both short-term and long-term, especially when it is dissolved (liquidation). Companies can use leverage to obtain capital to get bigger profits (Suwardika & Mustanda, 2017). For investors, a high leverage value is a signal that the company has a risk of not being able to pay their debts, so there is a possibility that creditors will take over the company (Fahira & et al, 2020). This ratio can be calculated from the division of total debt and equity.

#### Firm Size

Brigham & Houston (2014) say that firm size is the average annual total assets in recent years. In this case, the sales value is greater than the variable cost and fixes cost, so the total income before tax will be obtained. Conversely, if sales are less than variable costs and fixed costs, the company will experience a loss. Companies that have been successful will continue to strive to maintain their success, not infrequently the company will be passed down to the next generation in the family. To pass on this success to the next generation, corporate governance needs to become part of the family business culture so that there will be clear policies for selecting the right family members to take over (Gatamah, 2008). According to Meiryani & et al (2020) Company size is a big factor that determines profitability. The higher the size of the company will be closely related to the funding decisions that will be applied by the company in order to optimize the value of the company (Suwardika & Mustanda, 2017). The size of the company can be seen from the total assets of the company which are included in the company's annual financial statements

#### Independent Audit Committee

The Independent Audit Committee or Independence Audit Committee according to Bruce C & et al (2012) is a public sector organization board-level committee made up of at least a majority of independent members with responsibility to provide oversight of management practices in key governance areas". In Financial Authority Circular Letter No.16/SEOJK.05/2014 Regarding Committees on the Board of Commissioners of Insurance Companies, Sharia Insurance Companies, Reinsurance Companies, and Sharia Reinsurance Companies, it is explained that the audit committee is a committee formed and is responsible to the Board of Commissioners to assist The Board of Commissioners in monitoring and ensuring the effectiveness of the internal control system and the implementation of the duties of internal auditors and independent/external auditors. The audit committee can function effectively to control financial statements (Amin, 2012). The audit committee will provide encouragement for company management to carry out sound business management through its supervisory role (Chrisdianto, 2013). Suayana (2005) stated that the audit committee is tasked with assisting the board of commissioners to monitor the financial reporting process by management to increase the credibility of the financial statements.

#### Effect of profitability on GCG

In research Ahmad & Sulistiani (2014) it is explained that companies with greater profitability than others tend to disclose more information to support the continuity of the company's position. It is used to provide wider disclosure of information to provide assurance to investors. The results of the study Ahmad & Sulistiani (2014) which state that profitability has a significant effect on the extent of corporate governance disclosure. In addition, research conducted by Tjandra & Suryathi (2017) also obtained similar results where profitability has a positive effect on the implementation of GCG.

H1: Profitability has a positive effect on GCG.

#### Effect of leverage on GCG

The high debt ratio of the company will result in the principal putting pressure on the management as an agent to improve the company's performance so that the debt ratio will decrease. Pressure from the principals will force management to apply the concept of GCG better. Tjandra & Suryathi (2017) argue that a high level of leverage ratio management tends to be under pressure from the lenders so that it is necessary to implement good corporate governance. This is supported by the results of research by Ahmad & Sulistiani (2014) with the results that there is an influence of leverage on the extent of corporate governance disclosure. Similar results were also obtained Tjandra & Suryathi (2017) where leverage has a positive effect on the implementation of GCG.

H2: Leverage has a positive effect on GCG.

#### The influence of company size on GCG

Tjandra & Suryathi (2017) Larger companies usually have a wider stakeholder role. This causes each company policy will have an impact on the public so that management must manage the company well. With a large company size, the company's name is unconsciously in the public spotlight, so management feels the need to always apply the concept of GCG in the company's daily activities. Awareness of the need for the implementation of GCG resulted in the company obtaining a high GCG assessment. Research of Tjandra & Suryathi (2017) empirically proven that company size has a positive effect on the implementation of GCG. Meitha & Tuzahro (2009) shows that there is a significant effect of firm size on the quality of corporate governance (CGPI). Research conducted by Akinsokeji, Ogunleye, & O. Akindele (2020) shows that company size has a positive and significant effect on improving the company's board structure. Similar results were also found by Waweru (2014) where it was found that company size is the main factor affecting the quality of corporate governance implementation in Saharan Africa.

H3: Firm size has a positive effect on GCG

The influence of the audit committee on GCG

The audit committee is basically able to encourage company management to carry out various developments related to efforts to fulfill the principles of good corporate governance (Chrisdianto, 2013). Natalia & Zulaikha (2012) found the results that there is a significant influence on the disclosure of corporate governance.

H4: The audit committee has a positive influence on GCG

## RESEARCH METHODS

### Population and sample

This study takes a population of manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the period 2017 to 2020. The sampling in this study uses the purposive sampling method, where there are 39 manufacturing companies that meet the criteria determined by the researcher. The data used in this study is secondary data taken from the annual financial statements of manufacturing companies which are published annually from 2017 to 2020. The sources of data in this research are the websites of each company and [www.idx.co.id](http://www.idx.co.id).

### Variables and measurements

The dependent variable used in this study is good corporate governance as measured by the GCG index. The independent variables consist of profitability as measured by return on equity (ROE), leverage, company size, and an independent audit committee (IAC).

Table 1: Variable measurement

Variable	Notation	Measurement
<i>Good Corporate Governance</i>	GCG	Total items disclosed/Total items that should have been disclosed
<i>Profitability</i>	ROE	Earning afetr tax/Total equity
<i>Leverage</i>	LEV	Total debt/Total equity

Firm size	SIZE	Ln Total Assets
Independent audit committee	IAC	Number of Independent Audit Committees/Number of Audit Committees

#### Data analysis

To test the hypothesis in this study, the researcher used multiple regression analysis with a significance level of 5%. Here's the regression equation:

$$GCG = \alpha + \beta_1ROE + \beta_2LEV + \beta_3IAC + \beta_4SIZE + \varepsilon$$

Dimana:

GCG = good corporate index

ROE = return on equity

LEV = leverage

IAC = independent audit committee

SIZE = firm size

$\alpha$  = constant

$\beta_{1,2,3,4}$  = Slope

$\varepsilon$  = error

## RESULTS AND DISCUSSION

### Descriptive statistics

Descriptive statistical analysis was used to determine the maximum, minimum, mean and standard deviation of each variable.

Table 2: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
SIZE	142	13,12	20,29	15,6929	1,49084
ROE	142	-1,45	1,91	0,1459	0,37921
LEV	142	0,00	8,46	1,2664	1,3369
IAC	142	2,00	4,00	2,993	0,25255
GCG	142	0,36	1,00	0,9049	0,10101
Valid N (listwise)	142				

Source: Data processed

Manufacturing companies in Indonesia have an average GCG implementation score of 0.90 or 90% during the 2017-2021 period. The maximum value of GCG produced by family companies in Indonesia is 1.00 or 100%, while the lowest GCG provided by family companies is 0.36 or 36%. The company's profitability has an average value of 0.14 or 14% during the 2017-2021 period. The maximum ROE value is 191% and the minimum value is -145%. The leverage variable shows an average value of 126%, a maximum value of 8.26% and a minimum value of 0.00%. Company size is measured on the SIZE variable which has an average value of 15.69 during the 2017-2020 period. The maximum value of the company size is 20.29 and the minimum value is 13.12. The number of independent audit committee members who have no affiliation with the company is explained in the IAC variable with an average score of 2.99, a maximum value of 4, and a minimum value of 2.



### Hypothesis test results

After the data was processed using the SPSS version 20.0 program using multiple regression analysis tools, the t-test results were obtained as follows:

Table 3: Result of Hypotheses test

Model	Unstandardized Coefficients		Standardized Coefficients	t	sig
	B	std error	Beta		
Constant	0,536	0,166		3,223	0,002
ROE	0,020	0,022	0,074	0,893	0,374
LEV	-0,08	0,007	-0,107	1,147	0,253
IAC	0,019	0,047	0,524	0,524	0,601
SIZE	0,020	0,007	0,302	3,139	0,002

a. Dependent variable: GCG

### Profitability and good corporate governance

The significance value of 0.374 where this value is greater than 5% indicates that the company's profitability has no effect on the implementation of good corporate governance. This means that H<sub>1</sub> which states that profitability has a positive effect on the implementation of GCG is not accepted.

Based on the results of testing the data above, there are results that the amount of profitability does not affect the implementation of GCG in manufacturing companies in Indonesia listed on the IDX in the 2017-2020 period. These results are similar to previous research conducted by (Pamungkas & Muid, 2012) which showed that the company's profitability had a positive but not significant effect on GCG. The results were similar to the results found by (Putranto & Raharja, 2013) which examined the factors that influence extensive GCG disclosure in banking annual reports and research from (Alimia & Retrinasari, 2007). (Yenney, 2012) also found results where the results of profitability did not affect the company's GCG disclosures. Where these results are also similar to the results of Johan and Lekok (2006). According to (Denny I. P & Prof. Dr. H. Sugeng Wahyudi, 2010) Under these conditions, profitability can be viewed as the manager's performance of a company. Losses experienced by a company can provide a bad view for investors. The low profitability indicates that the company's performance is not effective so that managers feel reluctant to disclose their financial statements in excess because of concerns that they will lose their investors. High profitability indicates the success of a company in generating profits or profits. If a company with a high level of profitability makes wider disclosures, then competing companies can more easily find out the strategies carried out by the company so that it can weaken the company's position in competition.

### Leverage and good corporate governance

The significance value of 0.253 where this value is greater than 5% indicates that the company's leverage has no effect on the implementation of good corporate governance. This means that H<sub>2</sub> which states that company size affects the implementation of GCG is not accepted.

Based on the results of testing the data above, there are results showing that there is no influence between leverage on the implementation of GCG in manufacturing companies in Indonesia. These results are in line with the results of research conducted by Pamungkas &

Muid (2012), Natalia & Zulaikha (2012) and Denny et.al (2010) which obtained results where leverage has no effect on GC disclosures in the annual report. This is because companies with a high level of leverage have a high level of risk as well. Therefore, they will reduce the level of CG disclosure (Natalia & Zulaikha, 2012). Meitha & Tuzahro (2009) found the companies that have a high level of debt in their capital structure will tend to be subject to stricter supervision by creditors which is usually stated in the debt contracts made. Thus, companies are less concerned with the quality of corporate governance because there is already supervision from external parties. This explanation is known as a substitution story.

#### Firm size and good corporate governance

SIZE regression coefficient value of 0.020 this value can be interpreted that there is a change of 1 unit, then the IPCG decreases by 0.020 percent assuming other variables are fixed. With a significance level of 5%, the SIZE variable has a significance value of 0.002. The significance value of 0.002 which is smaller than 5% indicates that the size of the company has a significant effect on the implementation of good corporate governance. This means that H<sub>3</sub> which states that company size affects the implementation of good corporate governance is accepted.

Based on the results of the test data above, it can be concluded that company size has an influence on the implementation of GCG in manufacturing companies in Indonesia. These results are in line with research conducted by Pamungkas & Muid (2012) which shows the results that partially the size of the company affects the extent of corporate governance disclosure. Natalia & Zulaikha (2012) argues that this is because decisions regarding the extent of disclosure and what disclosure items will be disclosed by the company are based more on management's strategic considerations, not because of the greater the total assets owned by the company.

#### Independent audit committee and good corporate governance

The significance value of 0.601 where this value is greater than 5% indicates that the company's independent audit committee has no effect on the implementation of good corporate governance. This means that H<sub>4</sub> which states that the independent audit committee has an effect on the implementation of good corporate governance is not accepted.

Based on the results of testing the data above, it shows that there is no influence of an independent audit committee on the implementation of GCG. These results are in line with Rompas (2014) which shows the results that there is no influence between independent audit committees on the implementation of GCG. This may happen because it already exists in POJK No. 55/POJK.04/2015 explains that the audit committee consists of at least 3 (three members who come from independent commissioners and parties outside the issuer or public company) and are chaired by an independent commissioner. In the research data for this independent audit committee variable, companies with The independent audit committee is generally made up of parties outside the issuer who have absolutely no affiliation with the company.

#### CONCLUSIONS AND RECOMMENDATIONS

The partial test results found that profitability had no significant effect on the implementation of GCG. This means that the size of profitability has not been able to increase the implementation of GCG in manufacturing companies. The partial test results found that leverage had no significant effect on the implementation of GCG. This means that the size of the leverage has not been able to increase the implementation of GCG in

manufacturing companies. The results of the partial test found that the size of the company had a significant effect on the implementation of GCG. This means that the size of the company can increase the implementation of GCG in manufacturing companies. The partial test results found that the independent audit committee had no significant effect on the implementation of GCG. This means that the size of the independent audit committee has not been able to improve the implementation of GCG in manufacturing companies. The results of simultaneous testing of profitability, leverage, firm size, and independent audit committee variables have a significant effect on the implementation of GCG.

Suggestions that can be put forward for this research are in connection with all data test results that do not affect the dependent variable on the independent variable, then further research can add more samples and variables to increase the significance of the study.

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