The Effect of Corporate Governance Mechanism on Financial Performance in Indonesia

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Abstract

This study aims to analyze the effect of size of the board of commissioners, size of the board of directors, independent board of commissioners and institutional ownership on the determination of financial performance. This study uses secondary data collected from company annual reports and Bloomberg financial data. The data used in the form of financial statements of manufacturing companies from 2015-2018. From 167 manufacturing companies, with purposive sampling technique, so that the total sample was 235 observation. The data of this study were further analyzed using multiple linear regression analysis. Based on the results of hypothesis testing through the t test proves that the variable size of the board of directors and independent board of directors has a significant positive effect on financial performance. However, the board size variable is not significantly negative effect on financial performance and institutional ownership does not have a significant positive effect on financial performance.

Keywords: *financial performance; corporate governance mechanism; institutional ownership.*

1. Introduction

Financial performance determines the measures used as a benchmark for the company's success in generating profits. The higher the company's performance, the higher the company's performance in the eyes of investors. Optimal corporate financial performance is influenced by several factors. One of them is caused by the application of the principles of Good Corporate Governance (Andriana & Panggabean, 2017). Efforts to improve the company's financial performance are needed in an effective, efficient and economical Good Corporate Governance mechanism. Financial performance will be in a good condition if the company's activities are carried out continuously. As such, effective regulation and control mechanisms in company operations are needed as well as the ability to identify different stakeholders (Feliciana, 2017).

The importance of good corporate governance mechanism is recognized after various scandals and regulators of large companies in the world tighten regulations (Kandukuri, Memdani, & Raja Babu, 2015). Efforts to reduce conflict or agency problems require oversight mechanisms for managing company activities. Good corporate governance is a management of the company that includes the relationship between company management, the board, shareholders and other stakeholders (OCDE, 2016). Good corporate governance is used as a guide that provides guidelines and principles so that managers can take appropriate steps to harmonize the interests of managers and shareholders. Therefore, reducing agency conflict can increase the welfare and prosperity of shareholders (Hersugondo, Pertiwi, & Udin, 2019). Good corporate governance emerges from the interests of companies to ensure principals/investors that the funds invested are used appropriately and efficiently (Mahrani & Soewarno, 2018).

The mechanism used to create good corporate governance consists of internal and external mechanisms (Ujunwa, 2012). Internal corporate governance is divided into two groups, namely internal governance managers and internal owner-owners (Veno, 2015). Internal mechanisms consist of owners and internal stakeholders as managers of the company such as the board of commissioners, the board of directors, institutional ownership, managerial ownership and company size (Abobakr & Elgiziry, 2015). While external mechanisms include parties outside the company that have interests such as debt users from the company's leverage. The mechanism encourages company management, which may lead to a tendency to gain personal profit, rule-based decision making to achieve goals.

The board of commissioners is an organ in the company that plays an important role, especially in the implementation of corporate governance (Pamungkas, Ghozali, & Achmad, 2018). The board of commissioners has the duty to ensure the strategic implementation of the company, supervise the management of the company's operations, and ensure the implementation of accountability properly (Das, 2017). This shows that the board of commissioners is the core of the implementation of good corporate governance. Through the monitoring function of the implementation of good corporate governance at the discretion of the Board of Directors, it can minimize agency conflict between the Board of Directors and shareholders (Mutmainah, 2012). Independent Commissioner is a commissioner who does not have a relationship with shareholders either controlling shareholders or majority shareholders. The independent commissioner has the task to ensure that the supervisory activities carried out by the board of commissioners are carried out effectively and in accordance with applicable laws and regulations.

In addition to the internal mechanism of good corporate governance, there are also external mechanisms sourced from outside the company. One external mechanism is the structure of institutional ownership (Pamungkas, Ghozali, & Achmad,

2018). Institutional stock ownership comes from financial institutions such as legal entities, insurance institutions, trust funds, and government institutions. According to (KNKG, 2006) the Board of Directors is a corporate organ that has the duties and responsibilities to manage the company. In this case, the Board of Directors has the authority to set policies and implement them. The Board of Directors holds control in the company because it plays the role of being responsible for all policies the company will take.

The implementation of good corporate governance mechanism can create a system to direct, control, and supervise all resources owned by the company effectively and efficiently. Table 1 summarizes the research gap in research on financial performance. Based on various studies conducted previously according to table 1, there are differences in results or gaps in the relationship between the size of the board of commissioners, the size of the board of directors, the proportion of independent board of commissioners, institutional ownership. So, the purpose of this study was to analyze the effect of the size of the board of commissioners, the size of the board of directors on the frequency of independent boards of commissioners and institutional ownership on financial performance.

Relationship Between Variables		Result	Author
Dependent	Independent		
Financial Performance	Size of the Board of Commissioners	Significant Positive	Risnanditya (2018), Gray dan Nowland (2018), Aisyah (2017)
		Significant negative	Haji dan Mubaraq (2015), Kao et. al (2018)
		No effect	Yuniarti (2018), Zahra, et.al (2016), Veno (2015)
	Size of the Board of Directors	Significant Positive	Fernandez, et.al (2014), Veno (2015), Rahmawati dan Handayani (2017), Sihotang (2017)
		No effect	Widyati (2015), Mayangsari dan Andayani (2015)
	Independent Board of Commissioners	Significant Positive	Zahra, et.al (2016), Faatihah, et.al (2016), James dan Joseph (2015)
		Significant negative	Yin dan Gao (2011)
		No effect	Yuniarti (2014), Aisyah (2017) Rahmawati dan Handayani (2017), Yuniarti (2018), Risnanditya (2018)
	Institutional Ownership	Significant Positive	Widyati (2013), Aisyah (2017), Khan dan Nouman (2017), Kao et. al (2018)
		Significant negative	Zouri dan Taktak (2014), Haji dan Mubaraq (2015), Yuniarti (2018)
		No effect	Rahmawati dan Handayani (2017), Rashid (2018), Arora dan Sharma (2016)

Table 1. Previous Research Gap Research

1. Literature

The management of the company gives rise to the separation of ownership and control and responsibility among stakeholders which causes agency problems (Jensen & Meckling, 1976). Agency theory explains the relationship between aspects of human behavior consisting of owners of capital (principal) with managers (agents) who have their respective interests. One party maximizes personal interests by ignoring the principal's interests of the goals made by the company to maximize the interests of shareholders. Therefore, to overcome the agent's actions, a control is needed. Agency theory is closely related to the implementation of corporate governance, this makes corporate governance as an alternative to reducing agency costs incurred by the principal. Through corporate governance gives confidence that investors receive returns on funds that have been invested.

Performance illustrates the achievements that have been generated by the company over the implementation of operational activities so it is known whether good or bad the company's financial condition. The company's performance shows the level of effectiveness and efficiency of the company managing management in achieving the goals set (Isgiyarta, Nugroho, Ratmono, Helmina, & Pamungkas, 2019). There are measures used as benchmarks in measuring financial performance. A measure often used is a ratio that compares two financial data. Financial ratio analysis compares two things: the ratio of the past, present and future in the same company. It also can make comparisons between one company with other similar companies.

Financial performance assessment is a determinant for a company's success in managing its resources, the assessment is carried out using financial ratio analysis contained in the financial statements as the basis for its calculation (Goldwin & Christiawan, 2017). Ratios used to measure a company's financial performance include profitability ratios, liquidity ratios, solvency ratios and activity ratios.

2.1. Size of the Board of Commissioners on Financial Performance

Based on agency theory explained that between the owner and the manager has different interests. This difference in interests can lead to conflict between the two parties. The board of commissioners has the duty to supervise and provide input to the board of directors in carrying out their duties in the company (Anggilia, Puspita, & Rinaldo, 2015). The board of commissioners is part of the company that does not have direct authority with the company. As such, the board of commissioners has an important role as an intermediary between the differences in principal interests in the company. The number of the board of commissioners influences the company's performance. The greater the number of boards of commissioners, the worse the company's performance. This is due to the large number of board of commissioners causing the performance of the board of commissioners themselves to be disrupted, as communication becomes ineffective and coordination of tasks becomes more difficult (Ahmed Haji & Mubaraq, 2015; Dewi, Susanti, Magdalena, Zulvia, & Fernos, 2018; Lloréns & Pedro, 2019).

Different research conducted by Bansal & Sharma, (2016); Supriatna & M. Kusuma, (2009) showed that the size of the board of commissioners had a positive influence on financial performance. That is because the large number of boards of commissioners can provide much better input to directors in relation to their duties in corporate policy making. Differences in the results of these studies will require further research to prove the effect of the size of the board of commissioners on financial performance.

H1: The size of the Board of Commissioners has a positive relationship on financial performance

2.2. Size of the Board of Directors on Financial Performance

Based on the agency theory of Jensen & Meckling, (1976), there is a separation between control and management, the separation in management and ownership functions is carried out by different parties. Shareholders whose job is to carry out control and supervision over the separation of management and management. The board of directors has a function as a supervisor for the duties of managers in the company. Therefore, the board of directors is a corporate organ that has an important role. The supervisory function performed by the board of directors can minimize agency conflicts and opportunistic actions that may be carried out by shareholders or managers. Based on the provisions of Law No.1 of 1995 concerning limited liability companies, each company must have at least two boards of commissioners. Thus, the number of boards of di-

rectors in a company will affect the agency costs and financial performance. Based on agency theory, the more the number of boards of directors, the more advice on company policies and resources will be expected so that decisions taken can be more optimal than if the number of boards of directors is small (Hidayah & Rahmawati, 2019; Veno, 2015).

H2: Board of Directors size has a positive effect on financial performance

2.3. Independent Commissioners on Financial Performance

Based on agency theory the emergence of asymmetric information is caused by opportunistic actions on the part of management. The existence of an independent board of commissioners aims to monitor and control these opportunistic actions (Jensen & Meckling, 1976). The independent board of commissioners as a party that is not affiliated with the board of directors, commissioners or shareholders is expected to be an intermediary from conflicts between stakeholders. Therefore, the existence of an independent board of commissioners causes the management of the company to be more effective so that the company's performance increases (Suhardjanto, Aprilyana, & Setiany, 2018; Tulung & Ramdani, 2018).

H3: Independent Commissioners have a positive influence on Financial Performance

2.4. Institutional Ownership of Financial Performance

Agency problems arise due to information asymmetry between the principal and the agent. One form of information asymmetry is moral hazard, managers prioritizing their own interests at the expense of shareholders. The existence of moral hazard can be a barrier to management. The high number of institutional ownership influences the company's performance monitoring system which is more effective (Chabachib, Yudha, Hersugondo, Pamungkas, & Udin, 2019; Pamungkas, Ghozali, Achmad, Khaddafi, & Hidayah, 2018). This can reduce the possibility of managers and shareholders taking actions that prioritize the interests of each party. The involvement of institutions in these companies increases financial performance for the better. This shows the existence of a positive relationship between the ownership of institutions to financial performance. The results of these studies are consistent with the results of research conducted by Jensen & Meckling, (1976) However, research that states that the involvement of institutions in companies has the opposite effect on financial performance (Hidayah & Rahmawati, 2019; Sari & Patrisia, 2019).

H4: Institutional Ownership has a positive influence on Financial Performance

Based on the description above, it can provide an overview related to the theoretical thinking of the research to be tested, shown in Figure 1.

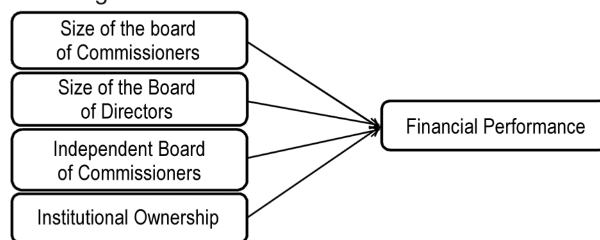

Figure 1. Theoretical framework

3. Research Method

3.1. Sample and Data Collection

The population in this study is manufacturing companies listed on the Indonesia Stock Exchange in 2015-2018. Manufacturing companies were chosen as objects in this study because the manufacturing sector has a potential role in the development of the Indonesian economy and the manufacturing sector has an attraction for investors to invest. The data used in this study are secondary data. which comes from the Annual report and the financial statements of manufacturing companies in 2015-2018. Annual reports and financial reports are obtained from Bloomberg, Faculty of Economics and Business, Diponegoro University and the website www.idx.co.id. The following are the sampling criteria using the purposive sampling method:

No.	Information	Total
1.	Publicly listed manufacturing companies listed on the Indonesia Stock Exchange	167
2.	Manufacturing companies that do not publish financial reports and annual reports in a row during 2015-2018	(39)
3.	Manufacturing companies that do not have complete data for measurements	(31)
4.	Companies that qualify as a sample	97
5.	Number of observation points during 2015-2018	388
6.	Data Outlier	(153)
	Total observational data for 2015-2018	235

Table 2. Research Samples

Table 3. Variable Operational Definitions

Source: Various Research Journals

Variable	Definition	Measurement
Financial Performance	The company's financial ratios related to profit potential measure the strength of the company to produce profits or profits at the level of income, assets and also share capital	Profit before tax / Total Assets × 100%
Size of the board of commissioners	Number of board members in the company	∑ The size of the board of commissioners
Size of the board of directors	Number of board members in the company	∑ Size of the board of directors
Independent board of commissioners	Members of the board of commissioners who are not affiliated with other members of the board of directors, board of directors or controlling shareholders, and are free from business relations	Number of Independent Commissioners / Total Board of Commissioners × 100%
Institutional Ownership	Number of shares owned by the institution	Number of shares owned by the Institution/ Number of shares outstanding × 100%

3.2. Analysis Method

Data analysis in this study used multiple regression to test hypotheses. Next, do a descriptive statistical test to provide an overview of the data that has been collected and then analyzed. Description of the data seen from the mean, standard deviation, maximum variance, minimum, sum, range kurtosis, and skewness. Hypothesis testing uses multiple linear regression analysis. Multiple linear analysis was performed by the coefficient of determination test (R2), the simultaneous regression coefficient test (F test), and the test for the significance of Individual parameters (t test).

3.3. Result and Discussion

In multiple regression analysis, the data must meet several requirements such as normally distributed data, multicollinearity, autocorrelation, and heteroscedasticity. It aims to get an unbiased regression model. Based on the results obtained from the classical assumption test, it can be concluded that the model

used in this study has fulfilled the requirements for multiple regression analysis. Multiple regression analysis aims to determine the relationship of independent variables to the dependent variable.

Variable	N	Minimum	Maximum	Mean	Std. Deviation
ROA	235	-36,79	55.25	4.2529	10.25598
DD	235	2	16	5.19	2.341
DK	235	2	13	4.31	1.787
PDKI	235	.00	1.00	.4055	.1929
IO	235	.00	52.45	38.1420	41.3980
LEV	235	.00	113.77	25.5214	21.46806
Valid N (listwise)	235				

Table 4. Descriptive Statistics of Research Variables
Source: Data processed, 2019

Coefficients[a]						
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	-5.766	1.859		-3.102	.002
	DK	-.067	.195	-.024	-.342	.732
	Log_DD	9.890	2.238	.310	4.420	.000
	PDKI	11.788	3.144	.225	3.749	.000
	Log_IOWN	.493	.417	.070	1.182	.238
a. Dependent Variable: ROA						

Table 5. Test Results t
Source: Secondary data processed, 2019

Based on these results multiple linear regression equations can be formed as follows:

ROA = -5.766 - 0.067 DK + 9.890 LogDD + 11.788 PDKI + 0.493 LogIOWN

This study has four hypotheses that are used to examine the factors that affect financial performance in manufacturing companies listed on the Indonesia Stock Exchange. Hypothesis 1 test results show the coefficient for the size of the board of commissioners of -0.342 with a significance of 0.732 (p> 0.05). It was concluded that the size of the board of commissioners variable had no significant negative effect on financial performance, so H1 was rejected. These results mean an increase in the size of the board of commissioners does not have an effect on improving financial performance. Agency Theory explains that company management must be monitored and controlled to ensure that company management is carried out in accordance with applicable rules and regulations. If the management of the company is not supervised properly, it can cause agency problems between the principal and the agent. The supervisory function in managing the company is carried out by the board of commissioners. However, the question is how many commissioners are ideal for producing good supervision so that it can affect financial performance. According to Yermack, (1996) the greater the number of boards of commissioners, it can cause financial performance to be worse. This is because the large number of board of commissioners will cause difficulties in terms of communication and coordination of work. Including difficulties in monitoring and controlling company management (Supriatna & M. Kusuma, 2009; Veno, 2015) who found an insignificant negative relationship between the size of the board of commissioners and financial performance.

Hypothesis 2 test results show the coefficient for the board size variable is 4.420 with a significance level of 0.000 (p <0.05). It was concluded that the size of the board of directors had a positive effect on financial performance, so H2 was **accepted**. There is a dependent resource view which means the company relies on the board to better manage the company's resources. Therefore, the number of boards of directors is very influential. The greater the number of the board of directors, the more expertise and expertise in a job, and each member understands well the tasks they have. This makes decision making for policies and strategies short-term and long-term better so that managers become more careful in acting. The manager's prudence has an impact on the reduction in agency problems which then affects the decreasing level of agency cost. A low level of agency cost can improve a company's financial performance (Hidayah & Rahmawati, 2019; Johl, Kaur, & Cooper, 2015; Veno, 2015) who found a significant positive relationship between the size of the board of directors on financial performance.

Hypothesis 3 test results showed the coefficient value for the variable proportion of the independent board of commissioners was 3.749 with a significance level of 0,000 (p> 0.05). It was concluded that the proportion of independent commissioners had a significant effect on financial performance, so H3 was **accepted**. These results mean an increase in the proportion of independent commissioners has an influence on improving financial performance. Agency Theory explains that an independent board of commissioners is an important party that can overcome agency problems in the company (Tulung & Ramdani, 2018). According to the Stewardship Theory perspective an independent board of commissioners can access broad information from the internal company so that companies with a relatively higher number of commissioners have more information. Varied information between boards about financial performance can improve financial performance. The description is supported by research conducted by Fuzi, Halim, & Julizaerma, (2016); Supriatna & M. Kusuma, (2009); Taufik, Widyastuti, & Yam, (2017) who found the proportion of independent commissioners to influence financial performance.

Hypothesis 4 test results show the coefficient for institutional ownership of 1.182 with a significance of 0.238 (p <0.05). It was concluded that institutional ownership had no positive effect on financial performance, so H4 was **rejected**. These results mean that the increase in the proportion of institutional ownership does not have an effect on improving financial performance. Jensen & Meckling, (1976) in their theory agency theory explains that institutional ownership is a tool to minimize agency problems. This is in accordance with the function of institutional ownership which plays an important role as a supervisor of management. However, high institutional ownership does not guarantee oversight of manager performance is carried out to the fullest. This is because, the occurrence of information asymmetry in the company causes managers and shareholders to act in their own interests, thereby ignoring the increase in financial performance. According to Hidayah & Rahmawati, (2019) high institutional ownership will have an impact on high risk, the level of losses owned by shareholders will be higher. This is consistent with research conducted by Arora & Sharma, (2016); Hidayah & Rahmawati, (2019); Rashid, (2018) who found an insignificant negative relationship between institutional ownership on financial performance. Based on the description above is presented a summary of the results of testing the hypotheses of each variable as follows:

Hypothesis	Hypothesis Testing Results	Conclusion
The size of the board of commissioners has a positive effect on financial performance	Negative is not significant	Rejected
The size of the board of directors has a positive effect on financial performance	Positive significant	Accepted
The proportion of independent commissioners has a positive effect on financial performance	Negative is not significant	Accepted
Institutional ownership has a positive effect on financial performance	Positive significant	Rejected

Table 6. Hypothesis Testing Results

4. Conclusion

Based on the results of data analysis and discussion, the conclusion of this study is that the size of the board of commissioners has no significant negative effect on financial performance. The size of the board of directors has a significant positive effect on financial performance. The proportion of the size of the board of commissioners has no significant negative

effect on financial performance. Institutional ownership has a significant positive effect on financial performance. The results showed that constitutional ownership had a significant positive effect on financial performance. This means that increasing the value of institutional ownership will increase financial performance. Conversely, a decrease in institutional ownership will reduce financial performance. That way investors can properly monitor the investments they invest in the companies concerned. So if institutional investors want to invest in a company, it is expected to choose a company that has high institutional share ownership to ensure the development of shares that are invested. The size of the board of commissioners and the proportion of independent board of commissioners have a negative and not significant effect on the financial performance of manufacturing companies. The board of commissioners and the board of independent commissioners who have great responsibility for the oversight activities of the management of the company management. It is hoped that they can work better and increase supervision of management. In addition, the management to be more transparent about the information needed by the independent board of commissioners so that agency problems in the company can be minimized, which in turn can improve financial performance.

Limitations Research only uses objects in the manufacturing industry sector, so the results of this study cannot yet be generalized to other sectors of companies in Indonesia or internationally. Future studies are expected to add to the sample in non-financial sector companies other than manufacturing companies. This aims to determine the effect of other industrial sectors on financial performance in order to complement the shortcomings in this study. Suggestions for further research Regarding research on the topic of corporate governance on financial performance, there are still variables that have not been used in this study. Future research is expected to be able to add the variables of board meetings, audit committee meetings, and managerial ownership which are still rarely examined.

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