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GCG, Financial Performance, And Market Performance Of Public Companies In Indonesia

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ABSTRACT

The study objective is to elaborate the implementation of good corporate governance policies to create a healthy business for public companies in the capital markets. Path analysis is the model used to answer the study's questions. The study's population was the public companies that had already implemented good corporate governance and had a ranking at the Corporate Governance Perception Index (CGPI) during the exception regulation for financial institutions and banks. The research sample consisted of 63 companies. The study resulted into two research models. The first hypothesis resulted into the first model, which included corporate governance and investment policy variables affecting the financial performance while the financing policy did not affect the company's financial performance. The second model had hypothesis results, consisting of three variables affecting the market performance with different impacts, namely financing policies, investment policies, and financial performances. It was found that good corporate governance did not affect the market performance. This finding explained that good corporate governance along with the investment policies had a direct impact on the financial performance of the company but good corporate governance did not affect the market performance. It could be interpreted that the implementation of good corporate governance for public companies was only a formality to comply with Bapepam, which was voluntary. Hence, investors in the stock market did not take the good corporate governance variable as one of the indicators used to make investment decisions in the stock market. Another finding was that the financing policy did not affect the financial performance and the market performance of the public companies.

Keywords: Good Corporate Governance, Financial Performance, Market Performance

1. BACKGROUND

Good corporate governance (henceforth, GCG) became popular when the world was experiencing the economic crisis in some parts of the world, including Indonesia which was also influenced by that condition. However, the impact towards the Indonesian economy was not as bad as experienced by the European countries. One of the indicators that points towards the Indonesian economic power was the Indonesia Stock Exchange. Since the beginning of January 2011 until August 2011, the IHSG (Indonesia Composite Index) increased by 9.2 %., while the stock price index of some countries, such as Brazil, Rusia India and China, had fallen significantly (Faisal et al., 2011). Furthermore, in September 2011 when the stock price indexes in the Asian region went down, the IHSG expierenced a significant increase compared to other regional indexes. The IHSG experienced an increase of 4.7%, while the average regional increase was only 2.6%.

One of the reasons why the Indonesian economy did not shake while being attacked by the world crisis storm was its fundamental economic power. The implementation of GCG had probably contributed to the Indonesia fundamental economic power in 2011. GCG had been implemented by about 40% of the registered companies at the Indonesia stock exchange in which 40% of the companies had a great capitalization value in the stock exchange such as the BUMN (IICG, 2012). This condition had made the Indonesian stock market constantly increased its value and had made investment in the Indonesian stock exchange more attractive.

The implementation of the corporate governance in the stock exchange is aimed to increase the investor's trust towards the company, improve its image or the company's reputation as well as the welfare of all stakeholders. The capital market will develop well if the implementation of its GCG is consistent. GCG is not only an accessory, but it is also attached to the values that act as the guidance to behavior. The success is very much determined by some factors, namely the ownership structure, the law enforcement, the economic, social, culture, process systems, as well as excellent performance (Mutamimah, 2009).

The implementation of GCG in Indonesia was quite successful. GCG had a positive relationship with the stock prices at the stock market. The Indonesia stocks consistently outperformed other countries in the pacific region since 2006 and with a larger spread of the API 150 and IDX 400 in 2011. Dramatically, all stocks in Indonesia had jumped and were only partly disturbed during the financial crisis, caused by the collapse of the Lehman Brothers in 2011 (AGGA, 2012). The performance of the Indonesian stock market had not only increased, its adherence to GCG had also had a significant positive correlation towards the stock prices at the capital market (AGGA, 2012), that is, the higher its adherence towards GCG the higher the PER of the Indonesian public corporation. The international investors were getting more interested in companies that had fullfilled its GCG obligations. Companies that had already implemented GCG were considered as companies that had low risks. After the global crisis, the bad results of investments in equities and obligations in Western countries, 979 asset investment institutions with a total value of US$ 30 quintrillion were looking at emerging markets that had good development prospects and when they were selecting the stocks, they would choose companies that had already performed GCG, hoping that these companies would provide profits according to their wishes.

During the last decade, the management of the companies had received greater attention, because of several bad corporate scandals involving the misuse of power and of criminal activities by agents in corporations. Some studies had convinced people that the financial crisis in Asia, the financial scandals of Enron, Worldcom, Global Crossing, CSFB, Morgan Stanley, Merril Lynch and many others as well as the supreme mortgage crisis in America, were, among others, caused by the failure to implement GCG. This had made the macro economy as well as the micro economy became susceptible to the crisis.

McKinsey and Company, in Mutaminah (2009), had indicated that the investment managers in Asia, were willing to pay 26%-30% more for the shares of companies with GCG compared to companies that had doubtful corporate governance. Bapepam-K had made it compulsory that every company registered at the capital market must obey the GCG principles as stated in the 1/1995 law regarding companies with limited responsibility and the 8/1995 law regarding the capital market which requires the public companies to implement GCG.

The study conducted by Pricewaterhouse Coopers regarding the GCG implementation in the Institiutional Investor Survey (2002) had put Indonesia at the lowest sequence together with China and India. Reports on GCG by CLSA (Credit Lyonais Scurities Asia) in 2003 had also put Indonesia at the lowest level with a total value of 3,2. The GCG report of 2004 of the same institute had showed better GCG, although it was still at the lowest level among the Asian countries.

The market ranking of GCG conducted by the Asian Corporate Governance Association in September 2012 for the years 2007-2012, had placed Indonesia at the lowest level below the Phillipines. In 2007, the score was 37 points, increased by 3 points, in 2012 it became 40, and in September 2012 the Indonesian score went down again to 37. This result showed the decrease in the implementation of GCG, but with the new regulation, it is expected that it will help to improve the Indonesian ranking with regard to the implementation of GCG.

The Indonesia GCG indicator score was still at the lowest ranking with regard to four elements consisting of the GCG rules and practice, enforcement, political & regulatory, and IGAAF, with the following respective scores: 35, 22, 33, 62. In the mean time, the GCG culture had a ranking of 9, above China and the Phillipines with a score of 33. This increase was caused by an increase in the corporate governance culture which began to be implemented for betterment. The Indonesian Market Category Scores at Enforcement was 22. This was because there was no betterment of the market for the last two years and the hesitation towards a fair and consistent regulation system. With regard to the political and regulatory environment, Indonesia had scored 33. This was a challenge for the government to increase and correct its corporate governance policy and reformation in Indonesia. Although the IGAAP scores (accounting and auditing) were at the lowest compared to the other ten countries, the difference was not substantial, and these scores were the highest scores among other indicators for Indonesia. This means that the regulation and auditing quality in Indonesia was approximately the same as the other ten countries, such as Singapore, Hongkong, Malaysia, Taiwan, Korea, the Phillipines, and others.

Although the survey's result and the market ranking conducted by the GCG institutions in Asia had indicated that Indonesia was at the lowest level, the implementation of GCG in Indonesia had shown a positive result. From year to year, it showed that the corporate governance performance index had increased (IICG, 2011). This fact was supported by the dividend yield value at the Indonesia Stock Exchange. Although it was not the highest, the investors seemed to consider other factors which were more important such as the endurance of the Indonesia economy towards the international financial turbulence, and a better managed business sector as well as an increase of GCG. The impact was the increase of the Indonesian investment grade. The increase of value which is the goal of the company can be implemented through the financial policy, that is the financing and investment policy. In order that the decision taken is in accordance with the goal of the company, many companies have begun implementing and applying good management, namely GCG. Based on this concept, the problem of this study is: What are the interaction and influence of GCG on the financial and market performance of the public companies in Indonesia?

The goal of this study is to understand the interaction and influence of GCG, as well as the financial performance and the market performance of the public companies in Indonesia. In general this study is aimed to add and develop the financial management concept, especially at the Indonesian capital market in relation with the implementation of the GCG policy in order to create a healthy business climate for the public companies and for the investors at the capital market as well as efforts to face a bad global and local financial crisis. It is hoped that this study will provide theoretical and empirical contributions. The theoretical contribution will be provided from the result of this study as an extra material for the study process and as a reference in formulating a hypothesis at an extended study. The empirical contribution can be obtained from this empirical study, which is beneficial for the decision making in public companies, management, creditors, investors, and other parties concerned.

2. LITERATURE REVIEW

Gitman and Zutter (2012) declared that to reach the company's goal, that is, to maximize the company's value, one must conduct financial functions, namely financial policy and investment policy. Maximizing the company's value can be done by increasing the company's stock price (Jensen & Meckling, 1976; Fama, 1978). Some studies conducted in relation with the investment policy were, among others, by Myers (1977); Smith and Watts (1992). Gaver and Gaver (1993) pointed out that the the company's inverstment policy could be estimated from the Investment Opportunity Set (IOS). IOS was defined as a combination between assets in place and investment choices in the coming years with positive NPV (Kallapur & Trombley 2001; AllNajar & Balkaoui, 2001), using three investment opportunity measurement sets, namely market to book assets (MASS), market to book equity (MQV), and earning/price ratio.

Investment policy is an important decision for the company, because it relates to profitability, company's growth, and at the end an increase in the performance of the stock market. To increase the stock value, an investment that creates a positive net present value is advised. Therefore, an investment policy influences the financial performance and the company's stoch value (Fama, 1978; Mc Connel & Muscarrel, 1984; Indari, 1996; Bacidore et al, 1997).

The financing policy is a relevant financial decision, which means that the financing decisions can positively influence the company's value. The financing policies were calculated with three proxis, namely the book to debt equity ratio, book to asset ratio, and the market to equity ratio. Following Kaaro (2002), this study measured the financing policy, using the debt to equity ratio proxy.

The agency theory in general, was used as a basis for business praxis. The first principle of this theory argues for the existence of a relationship between the principal, namely the investor with the agency, which is the manager, in the form of a working cooperation contract, called "nexus of contract". This theory assumes that all individuals act for their self-interests. The stockholder, as the principal, is assumed to be attracted to their investment return of the company. The agent is assumed to receive satisfaction in the form of financial or non-financial compensation. The difference in self-interests can be caused by an information asymmetry between the stockholders and the management.

Stock registration at the capital market can reduce the company's agency conflicts. The capital market will become an effective instrument to create GCG and to lessen the information asymmetry. The capital market can also provide the public with company's asset, so that there is a larger control from the society. Likewise, the GCG implementation can push the company's development by managing it more professionally. In addition, the implementation of GCG in the capital market can increase investors' confidence towards the company, increase the company's reputation, and increase the welfare of all stakeholders.

According to Prasetyantoko (2008), corporate governance tends to be related to the organization's performance, namely the relationship between corporate governance and the increase of the financial performance and of the corporate value. The financial performance is defined by FCGI (2006) as the net profit margin and return on asset, which have a relationship with GCG. According to the Institute of Corporate Governance (IICG, 2011), as adopted from the Cadbury Committee of the United Kingdom, the objective of corporate governance is to create added value to the stakeholders. Furthermore, it states that GCG facilitates the obtaining of capital with a lower cost of capital, so that it can increase the efficiency and has a positive impact on the company's performance.

In 2006, 56% of the blue chips companies, at the Indonesia Stock Exchange applied the two most important GCG approaches, namely the basic ethics approaches and regulations. In 2009, this percentage had increased to 83%. Some studies on GCG and its relationship with corporate performances such as in Hongkong, Brazil, Korea, the Phillipines, Thailand and China, reached the same conclusions that GCG had positive and significant relationship with the increase of the company's market value. Wahyuni (2009) conducted a study regarding the influence of GCG on the performance of public companies in Indonesia during 2004-2008. The study's result concluded that GCG positively and significantly influenced the company's performance. Hopkins and Hopkins (1997) studied the relationship between strategic planning and the bank's financial performance. The financial performance in their study used two indicators, namely net profit and the return on equity (ROE). Furthermore, Bauer and Guenstern (2003) found that companies with high corporate governance rating had a better performance portfolio return than the return portfolio of the company with low corporate governance.

Other studies also concluded that with the increase of the company's corporate governance rating the company's value would increase in the stock exchange. This opinion is parallel with the study conducted by Black, Yang, and Kim (2005) at 560 public companies that were registered at the Korean Stock Exchange. They concluded that the index of corporate governance was positively related to the companies that were measured with Tobin's Q and with the market/book ratio. This was parallel with Renies and Denies (2012) as well as Ratih (2011), who argued that GCG had a positive influence on the company's values. Their studies, however, were different from the study conducted by Setiawan (2012), who concluded that there was no GCG index influence on the company's market value. This result was consistent with the study conducted by Darmawati et al. (2005), which used the IICG (Indonesian Institute of Corporate Governance) survey's report and the SWA magazine report on the GCG implementation in companies in 2001 and 2002. That is, the study used the CGPI (Corporate Governance Perception Index) as a proxy for the corporate governance variable, while the company's performance was proxed with the financial performance (ROE) and the company's values (Tobin's Q). The result of this study showed that the corporate governance variable was statistically significantly influencing the ROE, but it did not influence Tobin's Q as a proxy of the company's value.

3. METODOLOGY

The population of this study came from the public companies at the Indonesian Capital Market, The samples for the study were taken from all companies that had already implemented GCG and which had received ratings from the CGPI Institute during the years 2005-2012, except for banks and non-banking financial institutions. This had been done because in addition to examining the GCG implementation, this study looked at the company's financial performance which had characteristics different from banks and non-banking financial institutions. The criteria for choosing the samples were as follows: 1) the company was registered at the Indonesia stock exchange during the period of 2005-2015; 2) the company was not a bank or a non-banking financial institution; 3) it had already implemented GCG and had a CGPI rating; 4) had a complete financial report needed for this study. The public companies, which had fulfilled the criteria comprising various government companies as well as private companies. These companies did not appear every year at the CGPI reports for 5 years and based on the data pooling, the data from 63 companies was collected.

The data was collected from the results of the survey analysis and from investors which were conducted by the Corporate Governance Perception Index (CGPI) institution and the SWA magazine in the from of quantitative secondary data, while the public company's financial report was obtained from ICMD and from other relevant sources.

The study objective was the GCG index, which was the combination of five principles used as guidance in implementing GCG for the public companies in Indonesia. This index was obtained from CGPI. The CGPI report divided the GCG index into 3 categories of upgrading: (1) realiable, (score 55-69); (2) fairly realiable (score 70-84); (3) highly realiable. Besides the GCG index, it also monitored the impact of the GCG implementation on the company's performance. The performance measurement was the financial ratio connected with the financing policy, the investment policy, and the company's financial performance. The market performance was measured using the PBV.

The investment policy was defined as a combination between assets in place and investment choices of the coming years with a positive net present value. It consists of the following ratios: total assets growth, market to book assets ratio, earning to price ratio, ratio capital expenditure to book value assets, current assets to total assets ratio. This study had given a proxy to the investment policy using the earning to price ratio (EPR). The financing policy is the decision regarding the financial composition chosen by the company. The financial ratio was explained as follows: book to debt equity ratio, book debt to assets ratio, longterm debt equity ratio, market debt equity ratio. In this study, the financing policy used the debt to equity ratio (DER) proxy.

GCG is the rule about the process, and the law where the company operates and is controlled and ruled (Gitman & Zutter, 2012). GCG in this study used the IICG index as produced from the survey's result using the GCG indicator as determined from the survey's result. The GCG index is published every year, consisting of various companies that have already implemented GCG.

The market performance was proxed using the price to book value (PBV). This ratio was a ratio of the stock's market price with the stock's book value. The fincancial performance was proxed using the return on equity (ROE). This ratio explained the company's ability to yield an income on the capital invested by the stockholders.

The study model to solve problems and the hypothesis test in this study was the PATH model. For analysis purposes, the financial data used as an analysis was the one year data after it was obtained from the GCG index from the institution's rating. It is hoped that the rating result had an impact on the financial performance as well as on the studied company. Based on this conceptual frame of thought, the study's hypothesis could be formulated as follows:

H_1: There was an influence of GCG, DER, and EPR on the company's ROE (the fincancial performance)
The test of this first hypothesis was conducted through the multiple regression analysis as follows: Regression model 1: $ROE = a + b_1\,GCG + b_2\,DER + b_3\,EPR + e$

H_2: There was an influence of GCG, DER, EPR and ROE towards PBV (company's market performance)
This second hypothesis test was conducted with the multiple regression analysis as follows: Regression analysis model 2: $PBV = \alpha + \beta_1\,GCG + \beta_2\,DER + \beta_3\,EPR + \beta_4\,ROE + e$

In order to get the best test result and not biased, the classical assumption test was conducted, and the outlier data was eliminated.

4. DATA ANALYSIS

In the first hypothesis test to fullfil the classical assumption prerequisite, from the 63 samples, 2 cases were eliminated (the outlier data), so that the cases that were analysed were 61. The statistical description of the variable studied can be observed in Table 1.

Table 1 Descriptive statistics of the study variable 1

	N	Minimum	Maximum	Mean	Std. Deviation
GCG Index	61	60,55	89,57	79,40	6,62
DER (%)	61	21,00	775,00	158,16	169,03
EPR (%)	61	-2,13	0,42	0,23	0,35
ROE (%)	61	-200,73	47,15	11,40	34,41

In the second hypothesis test to fullfil the classical prerequisite, from the 63 sample cases, 7 cases were eliminated (outlier data), so that 56 cases were analyzed. The descriptive statistic variables that had been examined can be seen in Table 2.

Tabel 2. The descriptive study variable statistics of Model 2

	N	Minimum	Maximum	Mean	Std. Deviation
GCG Index	56	60,55	89,57	79,39	6,90
DER (%)	56	21,00	775,00	152,73	166,45
EPR (%)	56	-1,37	0,42	0,070	0,21
ROE (%)	56	-117,02	47,15	15,67	21,53
PBV (%)	56	32,00	773,00	228,02	158,89

The GCG index that explained the average GCG implementations at the studied companies was the GCG index with the highly realiable category (score 70-84). The GCG score could form the market perception about how the commitment to GCG was implemented in the studied company. As many as 51% companies studied were at the highly realiable category, 11% were in the sufficiently realiable and the rest belonged to the 38% categories of fairly realiable. Companies that belong to the fairly realiable were companies that were active in the property field and transportation.

Debt on equity ratio (DER) as a proxy for the financing policy explained the comparison between the company's debt and the equity used by the company in its effort to reach the compay's goal. The average company's DER investigated during the observation period had shown that debt that was more than the equity in financing the company's DER had a very high standard deviation. This was probably caused by the large difference between the company's debt ratio in the sample. There were companies with a low DER ratio (21%). However, on average the large company's debt was about two times its owned equity. Companies that had more than 200% DER were 11% with a maximum value of 775%.

The Earning Price Ratio (EPR) as a proxy of the company's investment policy. On average, the EPR was still positive with a minimum value of -2.13%. The low EPR indicated the low portion of the equity value as an attribute to the company's relatively owned asset towards the future growth, was found in companies with negative earnings that had also caused a negative investment.

The price to book value (PBV) was a performance proxy of the company's market. PBV had a relatively high standard deviation, this was because the company's stock price investigated was very fluctuated. In the average the PBV was 228.02% with a 23% minimum value and a maximum value of 773%. The high company's PBV was in general dominated by the mining companies, which were still considered as having a high market value prospect.

The first hypothesis test to understand the GCG influence, the debt policy and the investment decision towards the financial performance were as follows:

Model 1: ROE = 0,618 GCG***-0,008 DER+91,307 EPR***

Statistically, the study model had fulfilled the classic assumption test and the model was declared fit. The statistical test result with an alpha =5% showed that not all variables that had used the GCG variable as well as the investment decision had influenced the company's financial performance while at the same time the debt policy had not influenced the company's financial performance.

The second hypothesis test result to reveal the GCG's influence, the debt policy and the investment decision, and the financial performance towards the stock market performance of the public company were as follows:

Model 2. PBV=-3,544 GCG - 0.012 DER***-1136, 272 EPR***+13,070ROE***

The statistical test result had shown three variables that infuenced the company's stock market performance, namely the debt policy, the investment decision, and the company's financial performance, while GCG did not appear to influence the company's stock market performance. Consider Table 3 below.

Table 3. Influence of the independent variable on the dependent variable

Variabel	GCG			DER			EPR			ROE		
	Direct Effects	Indirect Effects	Total Effects	Direct Effects	Indirect Effects	Total Effects	Direct Effects	Indirect Effects	Total Effects	Direct Effects	Indirect Effects	Total Effects
ROE	0,62		0,62	(0,008)		0,04	91,31		0,93	-	-	-
PBV	(3,54)	8,08	8,695	(0,012)	(0,104)	(0,112)	(1136,27)	1193,38	128,69	13,07	-	13,07

As seen on Table 3, the indirect influence of GCG towards the market performance was higher after having contributed to the company's profit, compared to the direct influence. Directly, the implementation of GCG made the market's performance negative. This means that GCG influenced the market performance after having contributed to the company's profit. In this case the investor at the capital market will look more at the result of the implementation of GCG in creating profit that had resulted in a positive and significant influence. DER as a proxy of the company's debt policy had indirectly a higher influence compared with the negative influence. It means, directly or indirectly, the higher company's debt will have a negative impact on the stock market performance.

To summarize, the company's investment decision had positively influenced the company's financial performance mirrored at the ROE increase. However, it gave a different impact to the company's market performance. Directly, the investment decision had a negative impact towards the stock market performance and indirectly it was consistent with the impact of the investment policy on the company's financial performance (ROE).

5. DISCUSSION

The first hypothesis test result showed that GCG and the Earning Price Ratio as proxis for the investment decision had significantly influenced the financial performance of the company. This discovery was in accordance with premise that GCG could increase the company's financial performance and the previous findings by Darmawan et. al (2003), Prasetyantoko (2006), and Wahyuni (2009). The impact of the investment policy executed by the company had positively and significantly influenced the company's performance in making profits. This finding was in parallel with Myers (1977), Smith and Watts (1992), Gaver and Gaver (1993), Kallapur and Trombley (2001), AllNajar and Balkaoui (2001), who had concluded that the company's investment decision had yielded a positive net present value so that it increased the company's performance. The financing policy of the company that had been studied and had been implemented in GCG, in effect, would not have an impact on the company's value.

The second hypothesis test was the assumption about the significant influences of GCG, the debt policies, the investment decisions and the financial performances on the company's stockmarket performance. The test result had showed that only the financial performance had a positive influence, DER and the investment policy had a negative influence, and the GCG had no influence. The GCG had no influence on the stock market performance was still in parallel with the empirical studies that had been conducted in various countries such as in Korea (Black, Yang & Kim, 2003) and in Holland (Bauer & Gunster, 2003). The negative (insignificant) influence of GCG on the stock market performance in Indonesia was probably caused by its implementation that was done as a formality to fulfill the Bapepam's regulation.

The results of the Asia Survey Institution (ACGA, 2012), as well as of the indigenous survey institution (IICG, 2009), have found the existence of an increase in the implementation of GCG in Indonesia. However, if compared with other East Asian countries, Indonesia is indeed still at the lowest level, although the index value has increased significantly. It appears that the present positive development has not yet been able to change the inverstor's perception at the capital market regarding the implementation of GCG which could have yielded a positive value for the public company. This probably explains why GCG still has no influence on the company's stock market performance. The Bapepam's regulation regarding GCG implementation, even for the public company, is still voluntary, so that there is no sanction for a company if it does not implement GCG. For the company, internally, the implementation of GCG positively influences the increase of the financial performance, especially in its effort to increase the ROE. However, the implementation of GCG has not yet been able to increase the owner's funding to provide loans as a source of the external funding of the company. The debt policy, significantly influence the market performance of the company's stocks, showed that the investors in the capital market understood the investment risk based on the company's financial risk. This may have occurred if the investor at the capital market was more oriented towards the long run or he/she was using the fundamental analysis when valuating the company's stock. If connected to the relevant theory of capital structure, the investor at the Indonesian Stock Exchange, considered debt that can still be paid as having influence yet towards the company's value.

6. CONCLUSION

Based on the results of the present study, the following conclusions can be derived. Firstly, GCG influenced the financial performance and the stock market performance with different impacts. On the company's financial performance, GCG has a positive influence, however, on the market performance it does not have a significant influence. The GCG's indirect influence via the financial performance on the market performance has a positive impact. Secondly, the indirect financing policy has a significant influence on the financial performance as well as on the stock market performance, directly or indirectly. Third, the investment policy positively influences the financial performance, although it negatively influences the company's market performance. Indirectly, via the financial performance, the investment policy has a positive impact on the company's stock market performance. Lastly, the financial performance positively influences the company's stock market performance.

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