IMPACT OF GOOD CORPORATE GOVERNANCE IN CORPORATE PERFORMANCE

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Abstract - The purpose of this research is to analyze impact of good corporate governance on performance of a corporation. This research uses companies which are listed on Indonesia Stock Exchange and companies which are participated on The Indonesian Institute Corporate Governance (IICG) period 2009-2012 consecutively as the samples. Panel Data Analysis test was conducted to shows its relation. The result of this research shows that implementation of GCG not impact corporate performance as measured by EVA. This research is expected to provide information for investors and potential investors in making investment decisions, and further study regarding the topics based on previous studies.

Keywords - Good Corporate Governance, Corporate Performance, Economic Value Added

I. INTRODUCTION

In mid-1997 the concept of GCG began much discussed in Asia, including Indonesia. The Indonesia economy experienced a slowdown growth. Not only Political and Social crisis, but Indonesia also faced Economic and Financial crisis, which made the companies unable to pay debts to banks and bonds in foreign currencies. Companies' values have decreased when they are not capable to overcome the crisis and be able to pay the debts. As an impact of crisis, many of companies couldn’t survive and eventually collapsed. The success that already gained wasn’t built on a strong foundation based on principles of good corporate governance should be one of the reason why the companies failed in facing the crisis.

Spirit of reformation in 1998 has brought Indonesian people a lot of changes and learning. Enforcement of democracy and good governance has been an issue into national agenda, including Good Corporate Governance (GCG). GCG introduced, discussed and became a strategic for a corporation as an effort to recovery of Indonesian economic. Founded in 1999, the National Committee on Corporate Governance or “Komite Nasional Kebijakan Corporate Governance (KNKCG)” a lot of regulations and policy issued with the aim of encouraging the rule of GCG in Indonesia. This effort also welcomed by the State Ministry of State Owned Enterprises (SOE), Indonesia Stock Exchange, and Bank Indonesia to issue various rules and policies as well as evaluation of GCG implementation to companies that are under their surveillance since 2000.

From academic perception, there are four broad theories to explain and elucidate corporate governance. First of all, Corporate Governance is related to principal-agent theory. Principal-agent theory in its simplest form proposes that the firm’s owners (principals) hire managers (agents) and then delegate the firm’s day-to-day operating decisions to these managers. (Baker, H. Kent, and Ronald Anderson; 2010). Both owners and managers seek to maximize their pertinence. Managers may prefer their own interest before shareholder wealth maximization, thus generating a principal-agent conflict. Agency theory is used to prevent conflicts between the firm’s principals and agents; conflicts that arise because different interest must be managed therefore don’t bring any disadvantages for both parties.

Yet other theories have different managerial motivations and parties to the relationship. In contrast to agency theory, stewardship theory analyzes the relationship between principals and stewards, who are not motivated by individual goals, but whose interests are rather aligned with the interests of their principals (Bender, Marko;2011). A steward’s behavior will alienate with the interests of his/her organizations. Good Corporate Governance is also related to stakeholder theory. Stakeholder theory argues that many constituents; related to firm; such as employees, customers, and suppliers, have important stakes in the firm and their interests should be considered along with those of shareholders. A Corporation needs to protect stakeholders with the implementation of GCG. But, stakeholder theory is often criticized, because the application in corporations is not applicable.

The last one is Sociological Theory; Fernando (2009) stated that this theory is mainly focused on board compositions and the implications for power and wealth distribution in society. Under this theory, board composition, financial reporting, and disclosure and auditing are of utmost importance to realize the socio-economic objectives of corporations.

An early definition of Corporate Governance can be seen in Cadbury Committee Report in 1992: “Corporate Governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders’ role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. “

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Meanwhile in April 1998, The Organization for Economic Co-operation and Development (OECD) extends the definition by stating that:

“A set of relationships between a company’s management, its board, its shareholders and other stakeholders (that provides) a structure through which the objectives of the company are set and the means of attaining those objectives and monitoring performance are determined”

Usually the way to determine the performance of a corporation is always profit. The greater the profits obtained, show that, the better management manages the company. But, in order to assess a corporate performance, only profit isn’t enough.

In the early 1980, Joel Stern and G. Bennett Steward III developed Economic Added Value (EVA). This economic profit measure gained early acceptance in the corporate community because of its innovative way of looking at profit net of overall cost of capital, including debt and equity capital costs. Many companies have used EVA principles to design incentive compensation programs that provide value-based incentives for managers (agents) to make wealth-enhancing decisions for the shareholders (principals).

From the information that already stated above, it can be concluded that Good Corporate Governance is a very necessary to be implemented and evaluated by companies. Since year 2001, The Indonesian Institute for Corporate Governance (IICG) has collaborated with SWA Magazine to do a research and ranking Corporate Governance Perception Index (CGPI). The research has been going until now, and being done every end of the year. CGPI as a form of GCG will be linked with EVA as a form of corporate performance. Therefore, the author entitled the study as “Impact of Good Corporate Governance in Corporate Performance”

II. LITERATURE REVIEW

2.1 Good Corporate Governance

In General term, Good Corporate Governance (GCG) is a system to control and setting up the company, which can be seen from mechanism relationship among all parties that related to the company. Aware of this, Ministerial Decision on Implementation of Stated-Owned Enterprise (SOE) or “SuratKeputusanMenteri BUMN No. Kep-117/M-MBU/2002” about Good Corporate Governance practices at Stated-Owned Enterprise and is already enhanced by “PeraturanMenteri Negara BUMN Nomor: PER – 01/MBU/2011” about Good Corporate Governance Implementation at Stated-Owned Enterprise. It was conveyed that each SOE must implement GCG consistently and or make a GCG as basis operational, which basically aim to boost business success and accountability of company in order to reach shareholders’ concern and stakeholders, based on ethics value and law.

In order to assess GCG implementation in company, The Indonesia Institute for Corporate Governance (IICG) has a program called Corporate Governance Perception index (CGPI) and has been going since 2001 until now. CGPI is a research program and ranking of GCG implementation for companies in Indonesia through research design, which encourages company to keep improving practice of corporate governance (CG) with continuous improvement by doing evaluation and benchmarking. IICG has emphasized eleven basic aspects of CGPI assessment, those are: Commitment, Transparency, Accountability, Responsibility, Independency, Fairness, Competency, Leadership, Strategies, Ethics, and Knowledge Management.

2.2 Economic Value Added

Joel Stern and G. Bennett Steward III developed Economic Value Added (EVA) in 1982. Stern states that “EVA is not used only for measuring company performance but also a management system consisting of financial policies, procedures, methods and measurements that guide the operations of a company and strategies” (Mouritsen, 1998).

Steward, as a founder and CEO of evadimensions.com states that “Economic value added or economic profit is a special way to measure profit that is better than all others. It measures "economic profit" as opposed to accounting profit. It is measured after deducting the full "opportunity" cost of all the capital invested in business assets. It doesn't measure profit until all investors, shareholders included, have earned a minimum return for bearing risk. EVA, in short, turns the balance sheet into another charge to earnings, just like cost of goods sold.”

From the statement above, it can be told that EVA use as a performance measurement that focus on creating value. Using EVA is caused a management to increase their responsibility to increase the shareholder value. Assess company performance using EVA cause the objective of management fitting with shareholder interest. Management will choose the investment that maximize return and minimize the cost of capital thus the value of the firm will increase automatically. EVA could be considered as measure of corporate success (corporate performance) because it is regulated with the requirement of shareholders’ wealth-maximization.

2.3 Theoretical Framework

Figure 2.1 Theoretical Framework

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III. METHODOLOGY

3.1 Data Collection
This research, the data resources is annual report of The Indonesian Institute for Corporate Governance (IICG) and annual financial report of 8 public companies that listed in Indonesia Stock Exchange (IDX). The data period of this research is 4 years, from 2009 to 2012.

3.1.1 Corporate Governance Perception index (CGPI)
Annual report of IICG is used to calculate each factor that determines CGPI which is self-assessment, document, paper and observation. Every factor has its own weight and different each year. Value of each factor that achieved from IICG will be divided by weight value in order to get the real value of each factor.

3.1.2 Economic Value Added
Annual financial report of each company is used to calculate economic value added (EVA) or economic profit. EVA is defined as the difference between the firm’s net operating profit after tax (NOPAT) and its weighted-average cost of capital (Grant, 2003). The steps that are used in calculating EVA such as: Net profit after taxes (NOPAT), Invested Capital, Weighted average cost of capital, Capital Charges and the last one is calculating Economic value added. There are several ways to calculate EVA. In this research, the author uses a way that already stated by Widjaja, 2001. Those steps are:

1. Net Profit After Taxes (NOPAT)
In finding economic value added, the first step is to calculate NOPAT. NOPAT is an acronym that stands for Net Operating Profit after Tax, is the amount of profit that company would generate before deducted with interest but after deducted with taxes.

\[
\text{NOPAT} = \text{EBIT} (1 - \text{Tax})
\]

where
 Earnings before Interest and Tax (EBIT) = net sales – operating cost

2. Invested Capital
Invested Capital is total funds that collected from shareholders, lenders and any other financing sources have made in a company. Calculating invested capital is also an important step to find economic value added, because if the company wants to generate a positive EVA, it must cover the cost of using the invested capital as well.

\[
\text{Invested Capital} = \frac{\text{Total Debt and Equity}}{\text{Short Term Loans Without Interest}}
\]

3. Weighted Average Cost of Capital
Weighted Average Cost of Capital (WACC) is a calculation of firm’s cost of capital in which each category of capital has their own weight. In order to calculate WACC, we need a cost of debt and a cost of equity. Calculating the WACC is by multiplying the each cost of capital with its weight in the firm’s capital structure and sums the weighted values. As an equation, the weighted average cost of capital, can be specified as follows:

\[
WACC = (\text{D} \times \text{rd}) (1 - \text{Tax}) + (\text{E} \times \text{re})
\]

where

- \( \text{Capital Levels (D)} \)  
- \( \text{Cost of Debt (rd)} \)  
- \( \text{Level of Capital and Equity (E)} \)  
- \( \text{Level of Capital} & \text{Equity} (\text{E}) \)  
- \( \text{Level of Tax (Tax)} \)
- \( \text{CapitalCharges} = \text{WACC} \times \text{InvestedCapital} \)

4. Capital Charges
A capital charge is total funds that have made in a company multiplied by the weighted average cost of capital.

\[
\text{CapitalCharges} = \text{WACC} \times \text{InvestedCapital}
\]

5. Economic Value Added
After all of the elements to perform the EVA calculation, below is stated the equation of EVA:

\[
\text{EVA} = \text{NOPAT} - \text{CapitalCharges}
\]

Fernández (2002a) interprets that there are several parameters that used to assess corporate performance as measured by EVA:

1. If EVA > 0, the relevant company or its departments gain more than weighted average value of the capital, therefore value creation occurs. The positive value of the EVA value shows an efficient use of the capital and represents an index of company value increase.

2. If EVA = 0, the analyzed company or its departments gain exactly as the capital cost level, meaning that the relevant company has the same value as in the moment investments were made in it. This is a notable feat, because the company capital owners recovered their investment and compensated the assumed risk.

3. If EVA < 0, the analyzed company or some of its departments do not recover the capital cost. Investors could have obtained a higher profit elsewhere, with the same risk. The negative value of the EVA indicator
shows an inefficient use of the capital and a decrease of the company value.

3.2 Population and Sample
The population in this research is all companies listed on IDX period 2009-2012 and all companies that participated on the research of The Indonesian Institute Corporate Governance (IICG) from 2009-2012 continuously. The sampling technique that is used is Purposive Sampling Technique, which is a sampling technique intentionally with specified criteria. The criteria used to select the sample are as follows:

1. Go Public Companies in period 2009-2012 that consistently publish annual reports and financial reports on the website of IDX, as well as company website.
2. All companies that participated on the research of The Indonesian Institute Corporate Governance (IICG) from 2009-2012 continuously.
3. All companies both private and state-owned enterprises, except banking companies. In calculating Economic Value Added, the author needs to calculate liabilities of company. Liability in normal business company and Bank Company are different, because in normal business company, liability is used to operating the company business, as fund. In the other hand, Bank Company uses liability as an object that being sold. Therefore, in this research, the author decided to choose a normal business company because the amount of samples that is much bigger than Bank Company.

3.3 Research Variable
In this research, there are two groups of variables; they are independent variables and dependent variable. Independent variables is Good Corporate Governance as measured by Corporate Governance Performance Index (CGPI) which consists of: self-assessment, document, paper, and observation. In the other hand, dependent variable in this research is Corporate Performance as measured by Economic Value Added (EVA).

3.4 Hypothesis
The following hypothesis was made in order to achieve the purpose of this research:

H0: There is no significant impact of GCG towards Corporate Performance (EVA).
H1: There is significant impact of GCG towards Corporate Performance (EVA).

3.5 Data analysis
3.5.1 Multi Regression Model
Regression analysis is a statistical process to know the relationships among variables. The focus is on the relationship between dependent variable and one or more independent variables.

\[ EVA = \alpha + \beta S + \beta D + \beta P + \beta O + \varepsilon \]

3.6.2 Panel Data Analysis
This research uses linear regression analysis (panel data method or also known as longitudinal or cross-sectional time-series data). This research uses panel data because it measures variables that change over time but not across entities. Linear regression analysis is done to identify which variables that significant statistically.

IV. RESULTS AND DISCUSSION
4.1 Regression Analysis (Panel Data Method)
Regression analysis has a purpose to find the relation between GCG variables and Corporate Performance variable, which GCG variables are statistically significant affect Corporate Performance. Before doing fixed and random test, Hausman test is needed to choose between which tests should be used in this research.

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<th>Table 3.2 Research Variables</th>
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<td>Variable</td>
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Figure 4.1 Hausman Test

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<th>Table 3.1 Company List</th>
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The result of Hausman test in Figure 4.1, recommend this research to use random test since prob>chi2 greater than 0.05. (0.2766)

![Figure 4.2 Random Test](image)

The regression analysis is done using robust standard error. From figure 4.2, it shows that EVA is not statistically significant affecting GCG, because all P>|Z| are bigger than 0.05. The information that we can get from the picture above is also, for every increase in 1 unit of observation will decrease GCG by -1.71e+10 units, since the coefficient is negative. The value of R-sq means the ability of GCG in explaining EVA is very limited because it is below 0.5 (0.0895).

CONCLUSIONS

Based on the analysis and hypothesis tests, it can be concluded that there is no significant impact of implementation of Good Corporate Governance consisted of Corporate Governance Perception Index (CGPI): Self-assessment, document, paper and observation on corporate performance as measured by EVA.

SUGGESTION

For recommendations, future research is expected to use more sample. Since Corporate Governance Performance Index (CGPI) has a limited data, because the companies that participated are different each year and only several companies that already listed in Indonesia Stock Exchange (IDX). Lack of number of samples might impact the result of data. (since sample representsthe population).

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