

# **The Impact of Good Corporate Governance towards Firm Market Value in Indonesia**

## **1.1. Research Background**

Financial scandals lead to the collapses of big finance institution long time ago do affect world of economics. Enron Corp, World.com, and Xerox are the examples of manipulation scandals at past time. This also affect Indonesia in the economic and political sector. Fraud, embezzlement, and manipulation are often occurred in most of corporation. It happened most in government organizations, financial institution and even banking industries. These event lead to the emergence of corporate governance to improve corporate credibility and professionalism.

Corporate governance practices in Indonesia is not well implicated, was stated by the Head of National Committee of Good Corporate Governance, Achmad Daniri. It is proved by many financial institution especially banking industries that do most of fraud activity and financial scandals. The emergence of GCG triggered by the monetary crisis of banking industry in 1998-2000. Many banks got bankruptcy and liquidated caused of the inconsistence practices of GCG. Gained information from Tempo.co, a financial scandal of Bank Mayapada in May 2016, followed by Bank Danamon in September 2016 and Bank Maybank in December 2016 harmed client and country up to hundred million rupiah. The scandals occurred because of the lack of human resources management, the fraud and piercing done by its employees and low responsibility from the company

management. Even the manager does not know the problem until reported by the client itself.

The scandals has decreasing the quality of the institution itself, and therefore lowering down people trust. Moreover, it seems accused what Muliaman Hadad stated in *beritasatu.com* that corporate governance in banking industry showed better performance rather than in finance and insurance company. The case has occurred because of indifferent goal of shareholders and the management. Each party is on the same way to get their own benefit. The conflict further known as *the agency theory*.

The agency theory describes the relationships between the shareholder as the principal and the manager as the agent. There are indifferent purpose between both of them and the desire of fulfilling their own needs and wants. This gaps create the possibility of negative behavior and affect the performance of the company therefore will impact the company market value. Third party is needed to control and mitigate the risk of this problem. A mechanism believed could reduce the agency cost that is the practice of good corporate governance. Kaen (2003) in Laila (2011) stated, corporate governance is basically about who should control the operational activity and why it should be controlled. The word 'who' refers to the shareholders and 'why' refers to the relationship between those parties.

L'Huillier (2014) argued, corporate governance is the system or rules, practices and processes by which a company is directed and controlled. It essentially involves balancing interests of a company's many stakeholders, such as shareholders, management, customers, suppliers, financiers, government and the community. Hence, Ehikioya (2009) stated in his study, a good corporate

governance is centered on the principles of accountability, transparency, fairness, independency, and responsibility. The institution of corporate governance in a firm is an attempt to ensure the separation of ownership and control, and this often results agency problems within the firms (Jensen and Meckling, 1976; Byrnes et al., 2003). As a result, managers may take actions that are not for the best interest of the shareholders. Because the shareholders are usually dispersed and do not have the capabilities to directly monitor and control managers' actions, performance of the firm may be harmed. Agency theory further states that the main purpose of corporate governance is to provide assurance to the shareholders that managers are working toward achieving outcomes in the shareholders' interests (Shleifer and Vishny, 1997).

The corporate governance, in the last few years, has shown profound interest in the accounting literature. Corporate governance's key purpose is to give direction to the organization and control it. The practice of corporate governance in Indonesia is still developing and not quiet maintained compared to other countries. As the Head of National Committee of Good Corporate Governance, Achmad Daniri had said corporate governance in Indonesia is complex and still need many improvements. Low quality of the economic and political environment due to the low quality of the people itself. Illegal charges, bribes and corruptions still in everywhere and hard to be controlled. Settlement of corporate governance had been regulated by Indonesia Financial Authority Services, Peraturan Otoritas Jasa Keuangan Nomor 21/POJK.04/2015 tentang Penerapan Pedoman Tata Kelola Perusahaan Terbuka (Lembaran Negara Republik Indonesia Tahun 2015 Nomor 276, Tambahan Lembaran Negara Republik Indonesia Nomor 5765).

Company is succeed determined by its strategic characteristic and management planning. The strategy includes the corporate governance practices in the company. And share price is one of the way how to measure the success of the company. High share price not only construct an image of good company performance today but also good prospect for the future. Moreover, it brings significant advantages for the investors. Higher company market value, higher prosperity of the investors (Kusumanilaga, 2010 in Randy, Juniarti, 2013).

Brealey et. al (2007:46) defines firm value as investors' collective assessment of how well a corporate condition today and in the future. It reflected through its share prices, higher the share price so do the firm value and the reverse. Cited from Investopedia, firm value is investors perception of firm success level which often related with the share prices. It basically measured by the share price because it reflects investors assessment of each equity they owned. It plays as the barometer of firm performance. As maximizing market value is the ultimate purpose of financing decision, corporate governance is substantial to be applied. Based on the *theory of the firm*, one of the firms goal is to increase firm value. Recently, a corporation needs more factors to improve its market value not just the financial factors such as income level, sales volume, etc. An article from Newell and Wilson (2002) "*A Premium for Good Governance*" stated, the appliance of corporate governance could increase market value, firm performance, and reduce risks of agency problems.

Muliaman Hadad also stated in beritasatu.com, companies with low governance in Unites States are observed through its share prices in the market, hence good corporate governance is not only be a motivation but also something to sell to the public. Achievement in financial terms such as ROE (*return on*

*equity*), or high profit will not be corresponded without good corporate governance practices. By having corresponding advantages, financing activity will be work well and so do the investors interests to the company.

Many researchers have debated this topics for previous years, a study from Black et al. (2003), Fadila and Rahadian (2013), and Pranata (2007) showed that corporate governance has a significant impact to the market value. Oppositely, there are some studies found that corporate governance brings negative impact to the firm market value. It was proved by a research conducted by Dwarachandra (2007) and Ramadhani (2009).

According to the research background explained above and the inconsistency of previous research results bring new curiosity to conduct new research with title **“The Impact of Good Corporate Governance towards Firm Market Value in Indonesia”**.

### **1.2. Research Problem**

Corporate governance in Indonesia is not well-implicated. GCG problem in Indonesia is complex which shown in the practice of illegal charges and bribes in either government organization or private companies. This were diclosed by the Head of National Committee of Good Corporate Governance, Achmad Daniri. He stated this caused the lower economic quality and unbalanced growth. Moreover, it raises a question whether the practice of corporate governance could affect the firm market value either increasing or decreasing its share prices.

This problem lead to the question, does Good Corporate Governance (GCG) practices affect firm market value in Indonesia?

### **1.3. Research Objectives**

Purpose of conducting this research as follows :

- To provide an overview about the importance of good corporate governance practices in Indonesia.
- To investigate how the implication of corporate governance in Indonesia affect the firm market value.

#### **1.4. Research Contribution**

By learning how the impact of corporate governance towards market value in Indonesia, hopefully this research could give more benefit in developing knowledge and for the need of related parties :

##### **1. Theoretical Contribution**

This research purposed to give knowledge and archival form in accounting literature. The result of this research could be the reference for the next reserach topics. Give insights and ideas about what have to be search in the future, give guidance and comparation for the development of this country and the world of economies.

##### **2. Practical Contribution**

###### **a. For the Academic**

Would be an honour to have this research as the main reference for the future researcher. And to develop more research by gaining more datas and variables that is not included in this research.

###### **b. For the Investors**

To give insight that there is one aspect of corporate governance need to be considered besides the common quantitative data in making investment

decision. Investors could put the importance of corporate governance in balance with the other financial data to value a corporation.

### **1.5. Writing Structure**

This research was prepared systematically as the following :

#### **CHAPTER I INTRODUCTION**

Chapter I is an introduction in the preparation of the research which consists of background, research problem, research objectives, research contribution and writing structure.

#### **CHAPTER II LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT**

Chapter II contains os theoritical framework and previous literature review used to support the critical thinking and used as references to construct the framework and hypothesis development.

#### **CHAPTER III RESEARCH METHOD**

Chapter III contains of data related to the research, it includes population and sample, sample criteria, data collection method, measurement variable, data analysis techniques, and hypothesis testing method.

#### **CHAPTER IV DATA ANALYSIS AND DISCUSSION**

Chapter IV contains the result and discussion of the reseacrh by observing the data processing result and

analysis. This chapter provides information whether the hypothesis meet the criteria, accepted or rejected.

## **CHAPTER V CONCLUSION**

Chapter V contains conclusion of the research, limitation and suggestion for future research.

