CHAPTER 1

INTRODUCTION

1.1. Research Background

The separation of management and ownership of the modern public corporation presents agency-related problems including conflicts of interest and immoral management. Conflicts of interests and immoral management are represented by managerial behavior devoid of eny ethical principles. The operating strategy is exploitation of opportunities for personal gain to the extent that no other consideration matters (Bonna, 2012). Agency theory is a theory governing the relationship between a principal and an agent, where one party (the principal) delegates a job to the other (the agent). Agency theory tries to explain the relationship of contract mechanism (Jensen and Meckling, 1976).

The principal has to provide funds and other important resources that needed in order to support the operations of the company, while the agent, as the manager of the company, is obliged to manage the company. The principal may not verify that the agent has performed and taken the appropriate policies to the principal's interest. Agency theory is highly considerate for solving problems in which the principal and the agent may prefer different actions due to different risk preferences. Managers' and stakeholders' different interests may result in agency problems or agency conflicts (Wahyudin and Solikhah, 2017).

Firm value is a value that achieved by a company as an image of society's trust on the company after a period of time since the company is established (Noerirawan, 2012). Firm value is necessary to a company because of its impact to the shareholders' wealth. Depending on its condition, shareholders' wealth will increase if the firm value is getting better. According to Fama (1978) in Sianturi (2015) a firm value can be reflected through company's shares price. In other word firm value is the perception of investors and potential investors to the success of the company that often related to the share price of company. The higher shares price, the higher firm value will be, and these condition will encourage market trust on the company. Corporate governance is an important system that expected to change the market perception on firm value. After market perception on firm value getting better, the demand of firm's stock will possibly increase that will also lead company to have a higher price of stock. This condition will reflect the increase in firm value in the perspective of shareholders but also in market.

The need to study corporate governance would not be necessary if economic theories, accounting standards, and legislations had been effective in mittigating conflicts of interest and enhancing firm's value in public corporations. Therefore, corporate governance is in demand as the solution of agency problem that incurred in company. Corporate Governance is a system which regulates the relation among interested parties (Stakeholders) in order to achieve company's objectives. This concept lately has been implemented massively around the world. Good Corporate Governance (GCG) is performed in order to keep the company under the control of strong and discipline management. Many companies implemented this concept in order to prevent any disorder that may cause financial and non-financial loss. This concept is also implemented in the government of any country. Indonesian Government right now has already used this concept as a guidance to create clean and great government.

In 1998, Indonesia experienced a prolonged crisis which drives businesses suffered loss and even bankruptcy. After this prolonged crisis Government is expected to restore the economic condition in order to make improvement. But still the improvement and restoration working slowly. One of the issues arises then is that there is no adequate governance in government and also public companies. Then, Good Corporate Governance becomes demanded and considerable as it may provides better improvement to government and companies. The precense of good corporate governance is absolutely required by an organization, considering GCG requires a good governance system which can assist in building shareholder confidence and ensure that all stakeholders are treated equally. A good system will provide effective protection to shareholders to recover their investment reasonably, appropriately, and efficiently, and ensure that management acts for the benefit of the company (Soewarno, 2018).

Later in 2004, Indonesian Government has changed the *Komite Nasional Kebijakan Corporate Governance* to *Komite Nasional Kebijakan Governance* which is consist of *Public Sub-Committee* and *Corporate Sub-Committee.* This *Corporate Sub-Committee* is expected to provide a guidelines to businesses in implementing Good Corporate Governance. Two years after, National Committee issued Code of Good Corporate Governance that includes five basic principles. Those principles are Transparency, Accountability, Responsibility, Independency and Fairness. Transparency means that company is expected to be more initiative to disclose not only the problem that regulated by the law, but also important things that are required by investors, creditors and stakeholders related to decision making process. Company is also expected to be able to provide relevant information that is easily accessible and understandable to stakeholders. Accountability means that company have to be responsible to their performance transparently and reasonable. Therefore, company have to be properly managed, meeasurable and in accordance with the interests of company and still concern with the interest of shareholders and other stakeholders. Responsibility means Company have to obey the regulations which is set by the government, company also have to perform the responsibility to society and environment to keep the continuity of business. Independency means In order to keep the principles of Good Corporate Governance performed well, company must be managed profesionally and independently. Company also have to be managed without conflict of interest and influence or pressure from any party that is not in accordance with regulations and law. The last, Fairness means that in doing the activities, company have to be able to recognize the interests of shareholders and stakeholders based on the principles of fairness and equality. Fairness defines that company must protect and pay attention to shareholders and stakeholders rights.

Based on Indonesia Economy Report in 2017 by BPS (Badan Pusat Statistik) in 2016 world economy has to face some risks that may be interfere global economic condition. Those are declining in economic growth and low commodity prices. World economic growth in 2016 is 3,1 percent which is lower than 2015 economic growth for 3,4 percent. This situation leads to the decreasing in price of global commodity especially energy commodity such as petroleum price that drastically decreased. Nevertheless, in ASEAN region (The Association of South East Asian Nations) economic growth increased for 0,1 percent from 4,6 to 4,7 percent. It is occured because of the increasing of economic growth in several ASEAN country suh as Philippines, Singapore, Thailand, and Indonesia. Indonesia economic growth is measured with GDP (Gross Domestic Product) which in 2016 increased from 4,88 percent in 2015 to 5,02 percent. The interesting thing that can be found in this report from BPS is that mining indutry that suffered for minus GDP growth in 2015 for -3,42 percent can rise up in a year after for 1, 06 percent. Altough 1,06 percent is the lowest number of economic growth compared to other industries, but this industry is still considered as five biggest contributor imdustries to economic growth. As this good performance of mining industry might be affected by good corporate governance that implemented on each companies in mining industry.

In implementing corporate governance, there are several factors that may be concern to support the basic principles of corporate governance itself. Those factors are; the ownership of a company, size of the board, and the indepency of board. The ownership might include managerial ownership and institutional ownership as each type may perform different impact to the implementation of corporate governance principles. It is good for company to implement this idea to improve the economic condition through every industries including mining industry. These factors wil be considered as variables of this study, also expected to represent the principles of corporate governance which consist of transparency, accountability, responsibility, independency, and fairness. Acording to Jensen and Meckling (1976), managerial ownership and institutional ownership are the two main corporate governance mechanism that help control agency problems. Managerial ownership is ownership of shares by the company management as measured by percentage of shares owned by management (Sujono and Soebiantoro, 2007).

There are several studies that are conducted to analyze the impact of corporate governance to a firm. The results was varied depends on the mehcnism that used, the variables and also research methodologies. Based on the previous researches, the results are more likely stated that corporate governance provide positive impacts to company. Based on the background description above, this study took title: **“The Impact of Corporate Governance on Firm Value of Mining Companies that are listed in Indonesian Stock Exchange in Period 2015-2017”.**

1.2. Research Problem

Based on the explanation in research background previously, the problems conducted on this research is:

1) Does board size of the company as one of corporate governance mechanism affect firm value in Indonesian listed mining firms for the period of 2015-2017?
2) Does board independency as one of corporate governance mechanism affect firm value in Indonesian listed mining firms for the period of 2015-2017?
3) Does managerial ownership as one of corporate governance mechanism affect firm value in Indonesian listed mining firms for the period of 2015-2017?
4) Does institutional ownership as one of corporate governance mechanism affect firm value in Indonesian listed mining firms for the period of 2015-2017?

1.3. Research Objective

Based on the research problem stated previously, the aims of this study is:

1) This study objoective is to analyze and understand the impact of corporate govrnance mechanism to financial performance of indonesian listed mining firms through year 2015-2017.

1.4. Research Contribution

The results of this study are hopefully being useful and provide benefits to:

1) Managers, as an important reference in order to improve the implementation of corporate governance concept.
2) Investors, as valuable information so that investors may perform better in decision making process related to investment activities.
3) Researcher/reader, as a reference in order to conduct a better research that may not provided by the author.

1.5. Data Analysis

Data that have been collected will be processed with using classic assumption test to test the feasibility of using regression models and the feasibility of independent variables. If classical assumptions are not met, it will lead to bias in research results. Classic assumtption test is expected to generate good parameter value so that research can be more reliable. The hypotheses in this study were tested using multiple linear regression analysis.

1.6. Systematical Discussion

The systematical discussion are as the following:

CHAPTER 1 Introduction

This chapter consist of introduction of research, research problem, research objective, researh contribution and systematical discussion.

CHAPTER 2 Theorethical Framework and Hypothesis Development

This chapter consist of supporting theories and description of corporate governance, firm value, description of previous research and the development of hypothesis.

CHAPTER 3 Research Methodology

This chapter consist of method used in the reearch that contains population and sample, data used, source of the data, data collecting technique, research variables, variable measurements and also method analysis that consist of classical assumption test and hypothesis testing.

CHAPTER 4 Results and Analysis

This chapter consist of the result of research and further analysis of the result regards to the impact of corporate governance to the firm value.

CHAPTER 5 Discussion and Conclusion

This chapter consist of research conclusion that based on the analysis result, also consisting the research limitation and suggestions to the next related research.