



Corporate Financial Performance on Corporate Governance Mechanism and Corporate Value: Evidence from Indonesia

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ABSTRACT

This study offers a contribution to the theories of corporate governance mechanism and corporate financial performance and their effects on the corporate value. It also recommends references for the corporates about corporate value and for the prospective investors about investing in particular corporate with precise, effective, and efficient investment decision. This study performed an assessment of mediating effect of corporate financial performance on correlation between corporate governance mechanism and corporate value. This study used internal mechanism as independent variable under the argument that internal mechanism was easier to be controlled by the corporate. The study applied four internal mechanisms of the corporate governance as independent variables, i.e. managerial ownership, institutional ownership, independent commissioner, and audit committee. Population for the study were financial firms listed in the Indonesia Stock Exchange selected through a purposive sampling technique. This study applied a path analysis method to test the hypothesis and sobel test on the mediation of the corporate financial performance. The study found a significant effect of the corporate governance mechanisms (managerial ownership, institutional ownership, independent commissioner, and audit committee) on corporate value. Therefore, it was proven that the corporate financial performance had mediated the effect of the corporate governance mechanism on the corporate value.

INTRODUCTION

This study aims to assess the effect of corporate governance mechanisms on corporate value. Previous study finds that the corporate governance mechanisms are necessary to minimize prob-

lems during the efforts towards a good corporate governance (Luthan et al., 2016). Problems related to good corporate governance (GCG) occur because of involvement from externalities (e.g. investors) in funding the corporate activities, investment and growth. The external involvement in funding the corporate may separate the involving parties to the corporate activities (Liu et al., 2016). Among the involving parties are principal as the corporate capital owner and agent, the corporate management, as the ones who manage the corporate. The principal-agent separation may rise different interest (Liu et al., 2016). The principal's interest relates to great benefit that affects the return, whereas the agent's interest relates to reward as a compensation of his or her achievement in working for the corporate. The difference in interest offers potential benefit for certain individuals, in particular the agent at the expense of the principal (Wang 2017b; Mansour 2014). The agent takes the opportunity of having more information to gain personal benefit (Mu et al., 2016). Corporate governance mechanisms are introduced to minimize the self-fulfilment behavior of the agent at the expense of the principal (Luthan et al., 2016). The corporate governance mechanisms are expected to be a series of control mechanisms for the agent to improve the corporate management and to increase the corporate value (Kusnadi, 2011; Lozano et al., 2016).

Previous studies have generally proven a positive and significant effect of corporate governance mechanisms on corporate value. Kusnadi (2011); Lozano et al., (2016); Schmidt and Fahlenbrach (2017) find that the corporate governance mechanism affected the corporate value. A Research conducted by Lozano et al., (2016), who assessed the effect of corporate governance mechanism on earning quality and corporate value, find a significant effect of the corporate governance mechanism on the corporate value. Gill and Obradovich (2012), in their study on the effect of corporate governance mechanisms and financial leverage on the corporate value in the United States also find a significant effect. Lozano et al., (2016), who tested the effect of the corporate governance mechanisms on corporate value, find that managerial ownership had a positive and significant effect on the corporate value. However, some other researchers revealed the opposite results where either negative effect or no effect was found. Corporate governance mechanisms did not have a significant effect on corporate value. Chabachib et al., (2019) investigates the effect of corporate governance mechanisms on corporate value of financial firms in Indonesia and finds an not significant effect, arguing that investors in Indonesia tended to buy stakes for capital gain and to buy and sell them on daily basis without considering the corporate long-term sustainability. Chabachib et al., (2019) who investigated the effect of corporate governance mechanisms on corporate value also find that institutional ownership and audit committee had a positive but not significant effect on corporate value.

There have been various conclusions of the effect of corporate governance mechanisms on corporate value. In other words, a research gap has been found. The researchers expected mediating variable that links the corporate governance mechanisms to the corporate value (Baron and Kenny, 1986). Such expectation has led the current study to add in corporate financial performance as a mediating variable that linked the effect of corporate governance mechanisms to corporate value. Argument that became a reason for adding in the corporate financial performance as the mediating variable was that the corporate governance mechanisms are basically a system (input, process, output) and a series of regulation, which regulate stakeholders. More specifically, a regulation that binds shareholders, board of commissioner, and board of directors, towards the corporate goals (Luthan et al., 2016). Corporate financial performance is one of factors considered by prospective investors to determine stock investment (Chabachib et al., (2019). For a corporate, keeping and improving financial performance are mandatory for the existence of the stock and for attracting the investors (Abreu, 2016; Vo and Ellis 2016; Wang, 2017a). Corporate governance mechanisms become key elements in improving efficiency and economic value. It involves relationship between management, board of commissioner, shareholders, and stakeholders (Li and Zaiats, 2017). Corporate governance mechanisms also provide a structure that facilitates the goal determination of the corporate and a performance monitoring technique.

Concerning the corporate financial performance, financial statement published by the corporate is a reflection of the corporate financial performance. Financial statement is the end process of an accounting that aims to provide financial information to explain the corporate condition in a particular period (Abreu, 2016). Measuring financial performance has become an indicator used by the investors to evaluate a corporate as reflected by its stock value displayed in the Indonesia Stock Exchange. The better the corporate performance, the higher return the investors will gain (Weng and Chen, 2016). Usually investors will look for corporates with the best performance where they invest their capital.

1. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

1.1 Corporate Value

Corporate value is defined as market value. It is reflected by the corporate stock market value (price). The company's value becomes a reference for investors regarding their interest in investing. The value of the company can be seen from the price of shares and company profits that are a result of investors investing in companies. Company value is investors' perception of the level of success of a company that is often associated with stock prices. High stock prices make the value of the company also high, and increase market confidence not only in the company's current performance but also in the company's future prospects. Maximizing the value of the company is very important for a company, because maximizing the value of the company also means maximizing the company's main goals. Increasing the value of the company is an achievement in accordance with the wishes of its owners, because with increasing company value, the welfare of the owners will also increase. Chabachib et al., (2019) defines corporate value as a price the prospective buyers agree to pay when the corporate is being sold. Corporate value is important because it can provide a maximum prosperity to the shareholders when the value increases (Chabachib et al., 2019). The higher the stock price, the higher the corporate value, and, in turn, the higher the gain the shareholders will obtain (Brigham and Gapenski, 1996). The shareholders and corporate richness are represented by the stock price in the market place as a result of investment decision, financial and asset management (Brigham and Gapenski, 1996). To obtain the corporate value, investors delegate the corporate management to professionals as managers or commissioners.

1.2 Corporate Governance Mechanism

Corporate governance mechanism aims to assure that the actions taken by the management team is truly for the shareholders' interest. Iskander and Chamlou (2000) argue that monitoring mechanism in the corporate governance can be divided into two categories, i.e. internal mechanism and external mechanism. The former relates to board or commissioner/directors, managerial ownership, institutional ownership, size of audit committee and executive composition. The latter relates to market control and debt financing. This study used internal mechanism as independent variable under the argument that internal mechanism was easier to be controlled by the corporate. The study used four corporate governance internal mechanisms to find out the effect on the corporate value, i.e. managerial ownership, institutional ownership, independent commissioner, and audit committee. Managerial ownership is a situation where managers become corporate shareholders. In financial statement such condition is illustrated by the percentage of the corporate shareholding by the managers. It is an important information for the users of the financial statement. Therefore, managerial ownership is disclosed in the financial statement. Managerial ownership is a proportion of shareholders from the management who actively participate into the corporate decision-making (directors and commissioners). The managerial ownership may lead to an interesting assumption that the corporate value increases when the managerial ownership in-

creases (Ryu and Yoo, 2011). Managerial ownership indicates the uniformed interest between the management and the shareholders. The greater the corporate managerial ownership, the better the corporate performance for the shareholders' and the corporate interest (Ryu and Yoo, 2011).

Institutional Ownership is a shareholding by government, financial institution, legal body, foreign institution, surrogate financing, and other institutions in the year-end. The public corporate ownership structure in Indonesia is very institutionally concentrated. The institution, instead of individual, owns the public corporation. Jensen and Meckling (1976) contend that institutional ownership plays an important role in minimizing agency conflict between managers and shareholders. The presence of institutional investors is believed to help to perform effective monitoring mechanism in each decision made by the managers (Schmidt and Fahlenbrach, 2017). It is because the institutional investors are involved in strategic decision-making, so that they do not necessarily trust in gain manipulation (Lin and Fu, 2017). The greater institutional ownership, the more efficient the corporate asset use. Therefore, the proportion of the institutional ownership acts preventively against excessive spending by the management. The greater institutional ownership can motivate the managers to be more focused on the corporate performance, which in turn prevents opportunistic and self-fulfilling behaviors of the managers (Hsu et al. 2015; Jafarnejad et al. 2015; Gao et al. 2016; Rong et al. 2017). The percentage of stocks owned by the institution can affect the process of financial statement formulation, which allows accrualization by the management interest.

Independent commissioner is a member of board of commissioner with no affiliation to the management, other members of commissioner board, as well as controlled shareholders. Independent commissioner is free of business and other relationships that affect his or her ability to act independently for the corporate interest. Independent commissioner acts neutrally and urges the practice of Good Corporate Governance to prevent potential frauds by the management in presenting the financial statement (Fuzi et al., 2016). Audit Committee is a committee organized by board of commissioner to perform a monitoring of the corporate management (Rustam et al., 2013). The committee connects shareholders and board of commissioner to management in case of control problems. The independent commissioner provides an audit committee to make the corporate to run optimally. It is expected that transparency becomes the priority for the corporate management in providing the financial statement (Dănescu et al., 2015).

1.3 Corporate Financial Performance

Corporate financial performance is a result of many individual decisions made continually by a corporate management (Vo and Ellis, 2016). Implicitly, performance is an efficiency of ratio or comparison between input and output. Corporate performance as an issuer in stock market is an achievement that illustrates the financial condition and result of the corporate operation, in which funding is measured by its financial ratios (Vo and Ellis, 2016). Financial performance will determine the stock price in the stock market. The better financial performance, the higher the stock price. The higher stock price, the higher the corporate value (Abreu, 2016). Corporate financial performance is an aspect the corporate must maintain to keep its stock price high and intended to the investors. A good corporate financial performance is a result of a good corporate management. The good corporate management is obtained by a corporate governance mechanism (Vo and Ellis, 2016; Abreu, 2016).

Based on the above arguments, we propose the following hypothesis:

- H₁: Managerial ownership had a significant effect on Corporate Value*
- H₂: Institutional Ownership had a significant effect on Corporate Value*
- H₃: Independent Commissioner had a significant effect on Corporate Value*
- H₄: Audit Committee had a significant effect on Corporate Value*
- H₅: Corporate Financial Performance had an effect on Corporate Value*

H₆: Corporate Financial Performance mediated Effect of Managerial Ownership on Corporate Value

H₇: Corporate Financial Performance mediated Effect of Institutional Ownership on Corporate Value

H₈: Corporate Financial Performance mediated Effect of Independent Commissioner on Corporate Value

H₉: Corporate Financial Performance mediated Effect of Audit Committee on Corporate Value

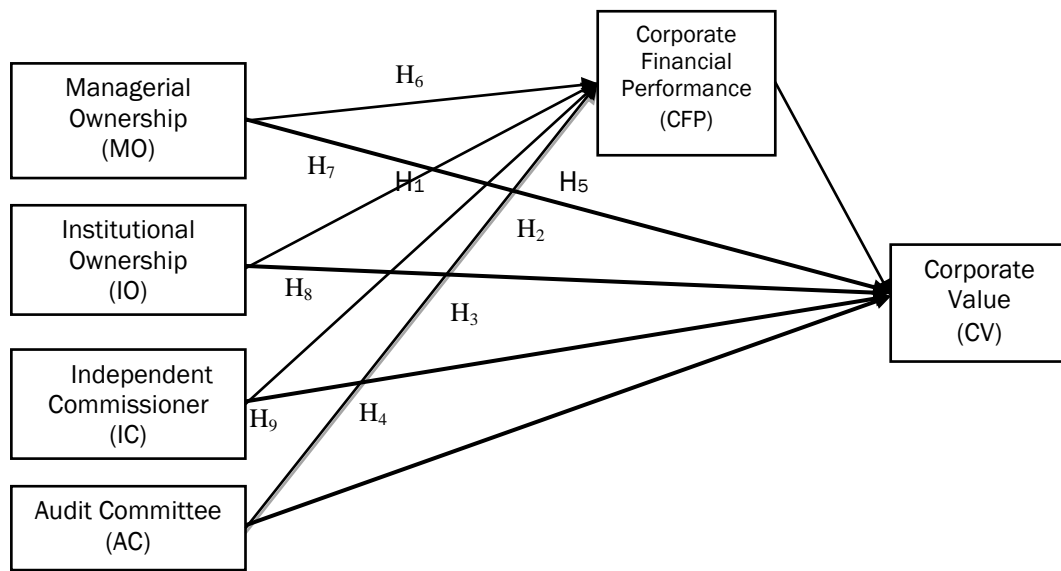


Figure 1: Proposed Research Model

2. METHODS

Population of this study consisted of financial statements of banking firms listed in the Indonesia Stock Exchange 2016-2018. Samples were collected by a purposive sampling technique, a method following the research objective. The study collected 75 firms that complied with sample criteria as determined by sample analysis unit. Path analysis and sobel test were applied to analyzing the data. The study used four exogenous variables, i.e. managerial ownership, institutional ownership, independent commissioner, and audit committee. In addition to these exogenous variables, the study also used an endogenous variable, i.e. corporate value, and a mediating variable, i.e. corporate financial performance.

Path analysis was developed from a regression model for fit test of two or more correlation matrices compared by the researchers. Path analysis was used for measuring direct or indirect correlation between variables in the model, whereas sobel test was used for finding out indirect correlation significance in the model. The study applied path analysis with Eviews software to perform data analysis. The study also applied goodness of fit test on the data to ensure the empirical output. The goodness of fit test deals with test of data normality using Jarque Bera test, multicollinearity test using Variance Inflation Factor (VIF) test, autocorrelation using Durbin Watson and Godfrey tests, and heteroscedasticity using White test.

3. RESULTS AND DISCUSSION

3.1 Uji Goodness of Fit

Goodness of fit of this study applied Jarque Bera value and probability Chi Square Jarque Bera for data normality, multicollinearity based on Variance Inflation Factor (VIF), autocorrelation based on Durbin Watson and probability Godfrey, and heteroscedasticity according to White. The goodness of fit analysis revealed no problems, as evidenced by Jarque Bera of 0.530487 and probability Chi Square of 3.62146. When Jarque Bera was smaller than Probability Chi Square ($0.530487 < 3.62146$), the data was normally distributed.

Multicollinearity test revealed VIF of less than 5 (1.011). In other words, there was not multicollinearity problem in the research data. The Durbin Watson value obtained was 1.934113 ($d_L < 1.934113 < d_U$) and probability Godfrey of 0.6654 ($0.6654 > 0.05$). The Durbin Watson and probability Godfrey proved no autocorrelation problems during the research. The final goodness of fit test was on heteroscedasticity, which resulted in probability Obs*R-squared of higher than α ($0.1620 > 0.05$). Therefore, it could be concluded that no heteroscedasticity problem in this study. Table 1 summarizes the research goodness of fit test results.

Table 1. Goodness of Fit Summary

Test	Index	Value	Threshold	Remark
Normality	JB	0.530487		Fit
Probability	3.62146	JB < Probability		Fit
Multicollinearity	VIF	1.011	VIF < 5	Fit
Autocorrelation	DW	1.934113	$d_L < 1.934113 < d_U$	Fit
Prob Godfrey	0.6654	> 0.05		Fit
Heteroscedasticity	prob Obs*R-squared	0.1620	> 0.05	Fit

3.2 Hypothetical Test Hypothesis

Exogenous Hypothesis Test, this research model consisted of four exogenous variables, i.e. managerial ownership, institutional ownership, independent commissioner, and audit commissioner; an endogenous variable, i.e. corporate value; and a mediating variable, i.e. corporate financial performance. The hypothesis H1, H2, H3, and H4 tested the effect of each exogenous variable on the endogenous variable, whereas hypothesis H5 tested the effect of mediating variable on endogenous variable.

Table 2. Path Analysis of Exogenous and Mediation to Endogenous

	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	T	Sig.
(Constant)	46.408	6.013 7.718	.007		
MO	.210	.013	.092	2.273	.025
IO	.075	.019	.3722	.703	.012
IC	.014	.017	.766	2.472	.003
AC	.009	.022	.1502	.210	.000
CFP	.259	.116	.840	2.621	.000

Dependent Variable: Corporate value

Regression Model: $FV = \alpha + \beta_1MO + \beta_2IO + \beta_3IC + \beta_4AC + \beta_5CFP + e$

Table 2. presents results of exogenous and mediating variables test on endogenous variable. The effect of managerial ownership on corporate value had t-value > t-table of 2.273 > 1.98; the H1 was accepted. Test on the effect of institutional ownership on corporate value resulted in t-value > t-table of 2.703 > 1.98; H2 was accepted. Test on the effect of independent commissioner on corporate value resulted in t-value > t-table of 2.472 > 1.98; H3 was accepted. Test on the effect of audit committee on corporate value had the t-value > t-table of 2.210 > 1.98; H4 was accepted. Finally, test on the effect of corporate performance on corporate value resulted in t-value > t-table of 2.621 > 1.98; H5 was accepted. Baron and Kenny (1986) illustrate a variable correlation with a mediator as follow:

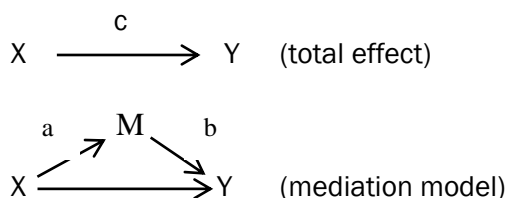


Figure 2: Variable Correlation with a Mediator

This study applied a causal step strategy in testing the detection of the mediating effect. The causal step strategy approach according to Baron and Kenny (1986), consists of three regression equations, i.e. (1) exogenous regression on mediator, (2) exogenous on endogenous, and (3) exogenous and mediator on endogenous. Table 3 presents results of the path analysis of the exogenous variables on the mediating variable, showing all exogenous variables proposed had a significant effect on the mediating variable.

Table 3. Path Analysis of Exogenous to Mediation

	Unstandardized	Standardized Coef-			
	Coefficients	ficients			
	B	Std. Error Beta	t	Sig	Std. Error Beta
(Constant)	16.069	22.143		.726	.000
MO	.320	.908	.108	3.135	.005
IO	.359	.476	.198	2.741	.009
IC	.283	.775	.077	2.110	.020
AC	.362	.023	.389	4.965	.000

Dependent Variable: Corporate Financial Performance

Regression Model: $CFP = \alpha + \beta_1MO + \beta_2IO + \beta_3IC + \beta_4AC + e$

3.3 Direct and Indirect Effect

Effect between variables can be indirect or indirect. The rate of direct effect is a coefficient of all coefficient path with one arrow tip, whereas the rate of indirect effect the effect of an exogenous variable on endogenous variable through mediating variable as the result of multiplication of two paths connecting the indirect effect. The following table explains the direct effect and indirect effect of this study. Table 4. shows that audit committee had the strongest effect (0.389) on corporate financial performance. The strongest direct effect on the corporate value was corporate financial performance (0.840). The strongest indirect effect (0.840) was given by independent commis-

sioner. Therefore, independent commissioner would give a greater value to the corporate when the corporate had a better financial performance.

Table 4. Direct Effect, Indirect Effect, Total Effect

Effect Between Variables	Direct Effect	Indirect Effect Through Mediator	Total Effect
MO → CFP	0.108		0.108
IO → CFP	0.198		0.198
IC → CFP	0.077		0.077
AC → CFP	0.389		0.389
CFP → CV	0.840		0.840
MO → CV	CV 0.183	(0.108)(0.840) = 0.091	0.183
IO → CV	CV 0.538	(0.198)(0.840) = 0.166	0.538
IC → CV	CV 0.831	(0.077)(0.840) = 0.065	0.831
AC → CV	CV 0.477	(0.389)(0.840) = 0.327	0.477

3.4 Mediation Hypothesis Test

Detection test of mediating effect by Sobel Test requires that if $t\text{-value} < t\text{-table}$, H_0 is accepted and H_1 is rejected, and vice versa. The test of the corporate financial performance mediation of the effect of managerial ownership on corporate value resulted in $t\text{-value}$ of 2.222, higher than $t\text{-table}$ of 1.96. in other words, H_6 was accepted.

Test on corporate financial performance in mediating the correlation between institutional ownership and corporate value resulted in $t\text{-value}$ of 2.214, higher than $t\text{-table}$ of 1.96. Therefore, H_7 was accepted. Test on corporate financial performance in mediating the correlation between independent commissioner and corporate value resulted in $t\text{-value}$ of 2.209, higher than $t\text{-table}$ of 1.96. therefore, H_8 was accepted. Finally, test on corporate financial performance in mediating the correlation between audit committee and corporate value resulted in $t\text{-value}$ of 2.208, higher than $t\text{-table}$ of 1.96. therefore, H_9 was also accepted.

Table 5. Results of Sobel Test

	$t\text{-value}$	$t\text{-table}$	Threshold	Remark
MO → CFP → CV	2.222	1.96	$t\text{-value} > t\text{-table}$	Significant
IO → CFP → CV	2.214	1.96	$t\text{-value} > t\text{-table}$	Significant
IC → CFP → CV	2.209	1.96	$t\text{-value} > t\text{-table}$	Significant
AC → CFP → CV	2.208	1.96	$t\text{-value} > t\text{-table}$	Significant

The results proved that managerial ownership became one of indicators that was able to affect the corporate value. Managerial ownership was an effective mechanism to overcome agency conflicting interests between principal and agent. Jensen and Meckling (1976) argue that principal-agent conflict can be overcome by equalling interests between them. Results of this study supported the previous study Chabachib et al. (2019); Mukhtaruddin et al. (2014) by proving that corporate managerial ownership had a positive and significant effect on corporate value. However, it is not in line with Lozano et al. (2016) who found that managerial ownership had a negative effect on corporate value. The evidence in the current study indicated that institutional ownership was one of indicators that had an ability to affect the corporate value. It supported agency theory, which requires that institutional ownership has a very important role in minimizing agency conflicts. The conflicts may

lead to agency cost at the expense of the corporate. One of ways to minimize the agency cost is by increasing the institutional ownership. In other words, the higher institutional ownership, the stronger control by externalities over the corporate, therefore the agency cost that occurred within the corporate will be lower and the corporate value will be higher. So, institutional ownership had a positive effect on corporate value. However, they were opposite to Chabachib et al. (2019) who found that institutional ownership did not significantly affect corporate value.

The evidence in the current study indicated that independent commissioner affected corporate value. It was the best position to perform a monitoring function towards good corporate governance. The higher the proportion of independent commissioner, the more successful board of commissioner in performing their monitoring, such as giving selective advice to the directors, and the more efficient the works will be for adding the corporate value. The results agreed with Chabachib et al., (2019) who found that independent commissioner had a positive and significant effect on corporate value.

Results of this study proved that audit committee was one of indicators capable of affecting corporate value. It supported the agency theory that predicts an audit committee as helping resolve agency problem. The existence of the audit committee in a corporate proved to be a controlling mechanism in financial statement formulation, therefore, affecting the increase in corporate value. The results agreed with Gill and Obradovich (2012) who had proven that audit committee significantly affected the corporate value. However, they were opposed to Mukhtaruddin et al. (2014) who found that audit committee did not have significant effect on corporate value.

Results of the study revealed that corporate financial performance mediated the effect of corporate governance mechanism on corporate value and were in line with the previous studies. The managerial and institutional ownerships structure is believed to affect the flow of the corporate, which, in turn, to affect the corporate performance towards its goals by maximizing the corporate value. It is because of control they possess. Therefore, managerial and institutional ownerships have a positive effect on corporate value. Corporate value was determined by earnings power of the corporate assets. The positive results proved that the higher earnings powers, the more efficient the assets circulation, and/or, the higher profit margin the corporate gained. It would affect the corporate value. ROA had a positive and significant effect on stock return for the next period. Therefore, ROA became one of factors that affect the corporate value. Return on Asset had a significant effect on stock price. The higher ratio rate, the greater the corporate profit. It gave a good signal to the investors to invest into the corporate for return. The high (or the low) return gained by the investors might reflect the corporate value.

CONCLUSION

This study assessed the effect of the corporate governance mechanisms on the corporate value. Results of the study proved that the corporate value of financial business in Indonesia for the period of 2016-2018 was affected by the corporate governance mechanisms, i.e. institutional ownership, independent commissioner, and audit committee. The study also proved that the corporate financial performance had a mediating role for the effect the managerial ownership, institutional ownership, independent commissioner, and audit committee on the corporate value. This study offered a theoretical and empirical contribution to the literature, such as empirical evidence that the corporate financial performance mediated the effect of the corporate governance mechanisms on the corporate value.

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APPENDIX A. Variable Measurement

<i>Variable and Concept</i>	<i>Measurement</i>
Managerial Ownership (X ₁) Percentage of stock managerial ownership compared to total ongoing stocks	$\frac{\text{Stocks owned by manager}}{\text{Total ongoing stocks}} \times 100\%$
Institutional Ownership (X ₂) Corporate stock ownership by institution compared to total ongoing stocks	$\frac{\text{Stocks owned by institution}}{\text{Total ongoing stocks}} \times 100\%$
Independent Commissioner (X ₃) Ratio of size of commissioner outside the corporate (independent commissioner) to total size of board of commissioner	$\frac{\text{Size of independent commissioner}}{\text{Size of board of commissioner}} \times 100\%$
Audit Committee (X ₄) A committee of at least three from independent commissioners and those outside the issuer or public corporate and acknowledge by independent commissioner	Size of member of audit committee within the corporate
Corporate Financial Performance (Intervening) Reflecting corporate fundamental performance	ROE = Net gain before tax / Total equity
Corporate Value (Y) Investors' perception towards corporate represented within the ratio of stock price	Tobin's Q = (Stock price x Number of stock) + Debt