

Stock return and financial performance as moderation variable in influence of good corporate governance towards corporate value

Suhadak, Kurniaty, Siti Ragil Handayani and Sri Mangesti Rahayu
*Department of Business Administration, Faculty of Administrative Science,
Brawijaya University, Malang, Indonesia*

Abstract

Purpose – The purpose of this paper is to evaluate how much influence good corporate governance (GCG) has on corporate value, as well as moderating effect of stock return and financial performance on the influence of GCG on corporate value.

Design/methodology/approach – This study was an explanatory study. The unit of analysis was the companies listed in LQ45 in Indonesian Stock Exchange and the sources of data were ICMD, annual report and financial reports of the companies. Indonesian Stock Exchange was selected as the setting of the study since Indonesian Stock Exchange is one of trading places for various types of companies in Indonesia, and it provides complete information on company's financial data and stock price. The population was 84 companies listed in LQ45 in Indonesian Stock Exchange between 2010 and 2016.

Findings – The higher GCG, independent commissioners proportion, institutional managerial and public ownerships resulted in higher corporate value. MBE and PER stock return is a moderating variable in the influence of GCG on corporate value. Financial performance is moderating variable in the influence of GCG on corporate value.

Originality/value – Based on the previous studies, it may be concluded that there is a gap between the influence of GCG on corporate value and the influence of stock return on financial performance, and moderating variable is needed to evaluate the influence of GCG on company performance, more particularly stock return and financial performance. This discrepancy creates opportunity for conducting an in-depth study on those variables. Its novelty is correlation between stock return and financial performance as moderation. Previous studies used these as mediating variables. This study is going to generate different finding as it is conducted in different setting (country where this study is conducted), type of industry, research period and using different method of analysis.

Keywords Stock return, Financial performance, Good corporate governance, Corporate value

Paper type Research paper

1. Introduction

The objective of this study is to evaluate how much influence good corporate governance (GCG) has on corporate value, as well as moderating effect of stock return and financial performance on the influence of GCG on corporate value. Goal of every company is to increase the amount of money shareholders receive. Maximum corporate value will result in increasing profit for shareholders (Husnan, 2012). Agency problem is an obstacle in achieving the goal. Agency problem is derived from separation between corporate ownership and corporate management. Professional managers who do not have any share



or very little share in company are the ones responsible for running majority of large companies. As a result, these managers feel they have authority to run companies without taking shareholder's interest into account. They are not foreign to ask for high salary and certain facilities.

Cornel and Alan mentioned three sources of agency problem: the first is manager's tendency to ask for not only luxurious facilities and requirement but also rights to make strategic decision. The second is manager's tendency to make risky investment. Most managers do not own any share in a company and therefore, do not have as much sense of belonging as shareholders. They do not take further consideration to use company profit for various investments. Because of their fixed salary and limited stock ownership, these managers do not spend optimum energy or pay maximum attention to run the company as much shareholders expected. The third source of agency problem is manager's tendency to minimize risk resulting in company losing profitable investment.

Investor's motive to make investment in stock market is to get return in the form of dividend or capital gain as well as company ownership. Prior to investment, investors will take stock return they are going to accept and corporate value into account. Stock price represents the corporate value of public companies. Higher stock price equals to higher corporate value (Husnan, 2012).

There are intensive discussions on dividend policy until recently. Arthur and David (1997) explained three basic perspectives about dividend: first, dividend policy is neither relevant nor requires specific estimation, second, the amount of dividend is linear to stock price and third, there is a negative correlation between dividend policy and stock price, meaning that lower dividend results in higher stock price. Miller and Modigliani's (1961) dividend irrelevance theory states that dividend has zero influence on corporate value and has been a topic of some debates for the last four decades. Miller and Modigliani's refusal on the bird in the hand theory is the cause of these debates. Black (1976) called the debate dividend puzzle that until recently has left behind some unanswered questions, namely, why do corporation pay dividend? And why do investors pay attention to dividend?. Some experts, for example Feldstein and Green (1983), attempted to answer Black's question explaining that company pays dividend in order to meet or accommodate: different shareholder's preference on tax fee from each type of shareholder and shareholder's tendency to conduct their investment portfolio to overcome uncertainty. Bortz and Rust (1984) postulated that dividend plays a significant role for investor to create a balance between risk and return from portfolio the investors have. Bhattacharya's (1979) dividend signaling model stated that when there is asymmetric information between company and investor, dividend becomes mechanism or instrument that provides information for shareholders (investors). According to Black and Scholes (1974), there are three types of investor, namely, investor who prefers stock with high dividend yield, investor who prefers return from dividend and capital gain and investor who prefers stock with low dividend yield.

Financial performance shows how effective and efficient an organization is in achieving its goals. Effectiveness refers to the ability of management to select accurate goal or instrument to achieve specific goals. Efficiency refers to ratio between input and output in which suitable input will result in optimum output. Increasing financial performance becomes requirement for a company in order to attract investors. Published financial statement represents financial performance of a company. Financial statement is the final outcome of accounting process carried out in order to provide information about financial condition of a company. Investors or managers use the report to make decision about investment. Financial report provides "relatively raw data." Managers need information, instead of raw data. The significance of financial reports depends on individuals who need them or when the reports are needed.

According to Brigham *et al.* (2007), in order to maximize corporate value, management should make use of strength and minimize weaknesses a company has. Financial analysis shows performance difference between companies in the same industry, and company's current financial position or trend. This study helps management identifying weaknesses and finding solution to minimize or even eliminate them. Prior to making long-term investment, investor will analyze profitability, future prospect and risk of making investment a company has. Analyst needs certain indicators to make interpretation and run analysis on financial report of a company. The most frequently used indicator in financial analysis is "ratio." Ross *et al.* (2009) described five kinds of frequently used financial ratio, namely, liquidity, activity, leverage, profitability and market value ratio. Brigham *et al.*'s (2007) return on equity (ROE) is one of the most important ratios for measuring the profitability of a company. ROE refers to net profit for shareholders divided by total shareholder equity. Shareholders expect high return from investment they made and ROE shows how much they get. High ROE will result in high stock price and activities of which purpose is to increase ROE which will also increase the stock price.

Stock market is a medium for the public to invest their money in the form of deposit, gold, piece of land or house. As an addition, public can also make investment in the form of stock or obligation. Investing in stock or obligation requires far less amount of money compared to investing in house or a piece of land. Stock market is a suitable place for people who are interested in making investment without having to spend a lot of money. Stock market will result in social welfare if it is stable, running well, has stable growth and not highly fluctuated. However, Indonesian stock market does not provide much contribution to the national economy. There are several cases that prove that the national stock market is not running well, for instance delisting issuers, price fraud and fraud that involve Duta Bank and Pikko Bank, two private banks in Indonesia (Samsul, 2006).

Both practitioners and academics agree upon the lack of awareness and understanding toward the principles of GCG as one of the reasons why Indonesian stock market does not have enough contribution toward the national economy. On the other hand, Asian Development Bank concluded two reasons that cause economic crisis in Asian countries in including Indonesia; they are ineffective in supervising the role of commissary board and audit committee of a company in protecting shareholder's interest. It is expected that implementation of GCG in Indonesia increases professionalism and shareholder's welfare without putting aside stakeholder's interest.

Growing popularity of GCG in the last ten years is hard to deny. Not only is the terminology becoming more popular, but it also has been put in a respected position. First of all, GCG is one of the successful keys for company to grow, make long-term profit and win global business competition. Second, the unsuccessful implementation of GCG is believed to cause economic crisis in Asia and Latin America.

Having established Financial Services Authority or *Otoritas Jasa Keuangan* (OJK), Indonesia has reformed their financial sector supervision framework recently. The 2011 Decree number 21 is the regulation for the establishment of the Financial Services Authority or OJK. The new framework emphasizes on how important fundamental, sustainable and healthy financial system that is able to protect consumer and public interest is. Implementation of good practice of management is one of the main contributors to achieve the objective of the framework. Its successful implementation will result in increasing economic performance and sustainable economic growth (Muliaman, 2004).

Indonesia has participated in ASEAN Economic Zone in 2015 and therefore, there is need and motivation for Indonesian companies to improve their business activities and competitive advantage. In order to survive business competition in South East Asia, Indonesian companies should improve their management system, improve both financial and operating performance, increase investor's level of trust and create access for investors.

Corporate governance aspects adopted Jensen and Meckling's (1976) theory as the basis in order to create balance between management, shareholder and stakeholder's interest. Perspectives of corporate governance actually consist of shareholder and stakeholder's paradigm. This difference refers to understanding toward conception on purpose to establish a company that influences need for governance instrument. The perspective changes mindset of a company in which company should pay attention to shareholder and stakeholder's interest because its activities will affect the society considering that the company has developed relationship with various organizations or institutions inside or outside the company. Therefore, trust and business ethics should become bases for this relationship.

Legal approach of corporate governance means that the key mechanism of corporate governance is protecting external investors, both shareholders and creditors, through the legal system, which can be interpreted by law and its implementation, although the reputations and ideas that managers have can assist in getting investment. Variations in law and its implementation are central to understanding why companies in some countries are more likely to get investment than other companies.

Some examples of vertical agency problem that occurs in Indonesia are asymmetric information (Alwy and Schech, 2004), profit manipulation (Herawati, 2008), excessive utilization of debt (Wiliandri, 2011) and reluctant to distribute free cash flow in dividends to shareholders (Mai, 2010). Horizontal agency problems in developing countries, including Indonesia, are caused by concentrated ownership (institutional shareholders), which further encourages controlling shareholders to expropriate minority shareholders (Alwy and Schech, 2004). In addition, the controlling shareholder can cooperate with managerial to override the interests of other shareholders or take advantage of their controlling power. On the other hand, institutional shareholders as controlling shareholders can more effectively monitor managerial behavior because they are more capable and have more professional resources than individual shareholders (Lotto, 2013).

Signaling theory states that a good company will deliberately signal the market, thus the market is expected to be able to distinguish between good and bad companies. An effective signal is one that market can capture and perceive. The quality of a company is demonstrated through GCG, which, in turn, will provide a signal by delivering the financial statements along with the corporate governance information achieved by the company in a certain period on time. The signal given by a good company is considered a good news but the signal given by a bad company is considered a bad news.

Dividend and capital gain are types of return investors are looking forward to and according to the residual theory of dividend, company establishes dividend policy after all profitable investments are financed. The paid dividend is a residual after all the profitable investment proposals have been financed (Hanafi, 2008). Companies that are still in their growth stage will require a significant amount of money to expand their business and one source of money to use is profit they have gained. If the company during its business expansion is using profit, it will reduce the amount of dividend distribution. According to Bender and Ward (2009), companies at the growth stage tend to set a relatively small dividend payout ratio compared to well-established ones.

Several previous studies discuss correlation between GCG and corporate value. Wahab *et al.* (2007) who observed 440 companies listed in Malaysian Stock Exchange found a significant increase in Corporate Governance Index and it had a significant influence on shareholder's welfare measured using market to book value of equity. Connelly *et al.* (2012) revealed that corporate governance (Board Size, Board Independence) had a negative influence on corporate value (Tobin's Q, ROA, Firm Size, Capital Expenditures, Financial Leverage, Corporate Index and Family Ownership). Jauhar (2014) stated that corporate governance (Independent Audit Committee Proportion, Independent Commissioner Proportion)

had a significant and positive influence on corporate value (MBR, Tobin's Q and Closing Price). Different from Wulandari Widaryanti (2009), Sulong and dan Mat (2008) argued that GCG did not have any influence on corporate value.

Based on the previous studies, it may be concluded that there is a gap between the influence of GCG on corporate value and influence of stock return toward financial performance, and moderating variable is needed to evaluate the influence of GCG on company performance, more particularly stock return and financial performance. This discrepancy creates opportunity for conducting an in-depth study on those variables.

This study is basically an extended replication from the previous studies. Its novelty is correlation between stock return and financial performance as moderation. Previous studies used these as mediating variables. This study is going to generate different finding as it is conducted in different setting (country where this study is conducted), type of industry, research period and using different method of analysis.

This study is conducted in public company listed in Indonesian Stock Exchange and LQ45 index between 2010 and 2016. The companies listed in the LQ45 index were selected as object of the study because their stocks will return and they have good performance and fundamental (blue chips stock). LQ45 index consists of 45 stocks selected based on several criteria and therefore, these stocks have high liquidity, market capacity, future prospect and financial condition. In addition, the companies listed in LQ45 index work in various different sectors that represent all companies listed in Indonesian Stock Exchange.

2. Conceptual framework and hypothesis building

Agency theory is applied in work contract that will regulate proportion of rights and obligations of each party while still taking into account the overall benefit. A work contract is a set of rules governing profit-sharing mechanisms, whether in the form of profits, returns or risks approved by principals and agents. It works optimally if the contract is fair, that is, it is able to keep balance between the principal and the agent that mathematically shows the optimal implementation of the agent's obligations and granting of satisfactory special incentives/rewards from the principal to the agent. Basis of the agency theory is the proper design of contracts to align the principal and the agent's interests when conflict of interest or agency problem occurs (Scott *et al.*, 1997).

The limitation of the agency theory is that the theory discusses relationship between managers, owners of companies and creditors of companies in a complex environment which demands connection between various parties including employees, society and government only. Stakeholders are individuals other than owner of a company and creditors who are involved in both internal and external environment of the companies such as employees, community and the government. The concept of GCG that discusses a wider range of relationships between managers and all interested parties emerges to control a company (Arifin, 2005). La Porta *et al.* (1999) explained that the concept of GCG was affected by law instrument to protect interests of various parties associated with a company, more particularly minority owners. In developing countries, ownership structures tend to be concentrated where conflicts of interest between majority and minority owners occur. These conflicts of interest happen due to different interests and power imbalances resulting in the exploitation and imbalance of system (Syahroza, 2005).

Related to the agency problems, the concept of GCG is expected to become instrument to convince investors that they will gain return from their investment. Shleifer and Vishny (1997) stated that GCG focuses on how investors control managers to provide profits and behave honestly in corporate resources management. Messier *et al.* (2000) revealed that GCG system is required to supervise and guide managers in investing and managing corporate resources. Thus, corporate governance consists of all stakeholders, processes and activities placed to ensure the accuracy of company's asset management.

Types of return investors expected are dividends and capital gains, and according to the residual theory of dividend, company sets dividend policy after all profitable investments are financed. Residual dividend policy thus pays dividends only if there is some amount of money left after the company marks all proposed investments that have a positive NPV (only investment policies affecting Corporate Value). This residual dividend theory is supported by Bender and Ward, who stated that companies in the growth stage tend to establish a relatively small dividend policy compared to more established companies.

Demand and offer are two elements affecting stock price. These elements are also affected by both rational and irrational variables. Examples of the rational variables are financial performance, interest level, inflation, growth level, foreign exchange rate or price of stock from other countries, while examples of the irrational variables are market rumor, peer suggestion, or dream. In general, increase and decrease of stock price occur at the same time and these will result in reverse flow when it continues for days. It proves that some errors cause an increase or decrease in stock price. When price of stock keeps increasing, it will crash in the following period. Overreaction means feeling too optimistic or pesimistic about certain event that is predicted to have an influence on performance of company in the future. It accelerates increasing or decreasing stock price that leads to mispricing in certain period. Thus, investor should take into account sharp increase or decline of stock price.

The composite stock price index (JCI) is a composite index of all types of shares listed in Indonesian Stock Exchanges. The index is issued by Indonesia Stock Exchange. Increasing composite stock price index does not necessarily mean that prices of all types of stocks are going up and, at the same time, decline in the composite stock price index does not mean that prices of all types of stocks listed on the stock exchange have decreased. The composite stock price index is a reflection of stock price fluctuation that is represented in number and is based on a certain basic rate. The basic rate is the initial index number before the market figure is formed. It is established by each stock exchange, as well as market price when the stock price index changes for the first time, either above or below the basic rate. The composite stock price index will change as stock prices in the market change. The share price index may also change due to change in the total value of basic stock rate.

Signaling theory discusses which types of signal company should give to financial report users or types of information managers should provide for owners of the company. The signal is in the form of GCG, stock return, financial performance, corporate value or other information that shows competitive advantage of a company over other companies. Objective of signaling is to eliminate asymmetric information. Asymmetric information indicates that some individuals in a company, such as management, generally have more complete information about condition, plan and future prospect of the company than other individuals such as investor, creditor and the government, who use particular indicators or facilities to evaluate the quality of the company (Gumanti, 2011). "Melalui teori sinyal, ketimpangan informasi dapat dikurangi dengan menghasilkan kualitas atau integritas informasi laporan keuangan. Untuk memastikan pihak-pihak yang berkepentingan meyakini akan keandalan informasi keuangan yang disampaikan pihak perusahaan, diperlukan opini dari pihak luar bebas memberikan pendapat tentang laporan keuangan suatu perusahaan."

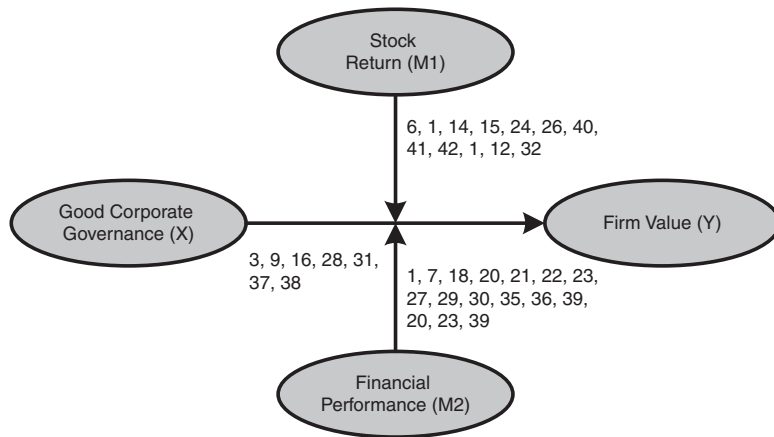
Signals are actions taken by company's management to provide guidance for shareholders about management's perspective on the company's prospects. Companies with lucrative prospects will try to avoid sale of shares and strive for any new capital required in other ways, such as utilizing debt that exceeds targeted capital structure. Companies with less favorable outlooks will tend to sell their shares. Announcement of a stock's emission by a company is generally a signal that management is not sure about company's prospects. If a company offers new share sales more often than usual, then its stock price will go down, because it gives a negative signal which then can suppress its stock price even if the company prospects are bright.

The signaling theory suggests that a good quality company will deliberately signal the market, thus the market is expected to be able to distinguish between good and bad quality companies. Effective signal is one that market can capture and has good perception, and not easily imitated by poor quality companies. A good quality company is demonstrated through GCG. This company will then give signal by reporting its financial statements along with information about governance achieved by the company in certain period of time in a timely manner. The signal given by a good quality company is considered as a good news, whereas the signal given by a poor quality company is considered as a bad news (Figure 1).

This study has 3 hypotheses. The hypotheses and their underlying theories including previous empirical research are discussed in the following sections.

Influence of GCG toward corporate value

Agency theory is a theory that discusses how much influence GCG has on corporate value (Jensen and Meckling, 1976). This theory focuses on how to design contracts that can motivate a rational agent to act on behalf of a principal when the agent's interest is against the principal's interests. The assumption in this study is that company and its owners are two separate entities. The agency relationship is a contract between one or more persons as owner with another person as an agent to act in the interests of the owner, including delegating



Notes:¹Biddle *et al.* (1997), ²Barnhart and Rosentein (1998), ³Faccio dan lasfer (1999), ⁴Demsetz and Villalonga (2001), ⁵de Jong and Bus (2002), ⁶Lombardo and Pagano (2002), ⁷Drobetz *et al.* (2003), ⁸Gompers *et al.* (2003), ⁹Hiraki *et al.* (2003), ¹⁰Kemp and Trueman (2003), ¹¹Riley *et al.* (2003), ¹²Bauer *et al.* (2004), ¹³Chung *et al.* (2003), ¹⁴Moorman *et al.* (2004), ¹⁵Chen *et al.* (2004), ¹⁶Baek *et al.* (2004), ¹⁷Klapper and Love (2003), ¹⁸Hutchinson and gul (2004), ¹⁹Johnson, Moorman and Sorescu (2005), ²⁰Coleman *et al.* (2007), ²¹Bauer *et al.* (2008), ²²Mashayekhi and Bazaz (2008), ²³Abdullah *et al.* (2008), ²⁴Chae *et al.* (2009), ²⁵Anderson and Gupta (2009), ²⁶Brammer *et al.* (2009), ²⁷Sueyoshi *et al.* (2010), ²⁸Ammann *et al.* (2011), ²⁹Sami *et al.* (2011), ³⁰Chaghadari (2011), ³¹Kusnadi (2011), ³²Huang *et al.* (2010), ³³Gill and Mathur (2011), ³⁴Jiao (2011), ³⁵Erkens *et al.* (2012), ³⁶Gordon *et al.* (2012), ³⁷Bae *et al.* (2012), ³⁸Connelly *et al.* (2012), ³⁹Fallatah and Dickins (2012), ⁴⁰Fuenzalida, Mongrut, Artega, Erausquin (2013), ⁴¹Van Kauwenbergh *et al.* (2013), ⁴²Rani *et al.* (2013)

Figure 1.
Conceptual framework

decision-making authority to agent in order to maximize corporate value. If both parties (owners and agents) have a conflict of interest, where the agent does not always act in the best interests of the owner, this conflict can be minimized through agency costs, i.e. total of the owner's supervision fees, the agency's cost of engagement and residual loss.

Fallatah and Dickins (2012) observed the influence of corporate governance on firm value. Indicators of corporate governance were board size, independent board, independent audit committee and director stock ownership, while those for firm value were MBE and Tobin's Q. The finding showed that the corporate governance had an influence on the firm value.

Wahyu (2013) also analyzed the influence of corporate governance on firm value. Indicators of corporate governance were proportion of non-executive director, managerial ownership, independent commissioners, independent audit and institutional ownership, while those of firm value were Tobin's Q, PER and closing price. The finding showed that the corporate governance had a significant, positive influence on the firm value.

Jauhar (2014) conducted another study that observed the influence of corporate governance on firm value. Indicators of corporate governance were independent audit commissioner proportion and independent commissioner proportion, while indicators of firm value were MBR, closing price and Tobin's Q. The finding showed that the corporate governance had a significant, negative influence on the firm value.

Yulianto (2014) evaluated the influence of GCG on corporate value. Indicators of GCG were managerial and institutional ownership, while those of corporate value were price book value, stock price and Tobin's Q. The finding showed that GCG had a significant positive influence on corporate value.

Having reviewed the related theories and previous studies, it can be concluded that GCG had a significant influence on corporate value. Therefore, the first hypothesis proposed in this study states:

H1. GCG had a significant influence on corporate value.

Moderating effect of stock return toward financial performance

The bird in hand theory (Gordon, 1959; Lintner, 1956), a theory that claims the influence of stock return toward corporate value, states that dividend policy will increase corporate value due to uncertainty in cash flow company in the future making dividend more interested for investor than capital gains. Some previous studies have discussed the effect of stock return on corporate value, for example Huang *et al.* (2011), who found out that investors should seriously assess corporate governance when making investment decisions because not only did it have a positive effect on good governance, but also was able to stabilize stock prices during the crisis. The general conclusion from this theory and previous studies is that stock return has a significant influence on corporate value. Therefore, the second hypothesis proposed in this study states:

H2. Stock return is moderating variable in the influence of GCG on corporate value.

Moderating effect of financial performance toward corporate value

Some theories suggest that financial performance has an influence on corporate value, namely, conduct empirical evaluation toward the asymmetry theory which states that some parties who have a close relationship to a company do not get similar information about the company's prospect and risk. Managers usually have better information than investors, signaling theory (Ross, 1977) on types of signal a company gives for the users of its financial report or information about efforts manager has taken to achieve owner's expectation. Information about financial performance is one type of signal company may send.

For shareholders, profit is one of the factors that determine dividend policy; higher profit will increase dividends and stock prices as the market's response. For go public companies, corporate value is reflected in its share price. Higher stock price equals to higher corporate value (Husnan, 2012). Previous researchers have shown the influence of financial performance on corporate value. Fallatah and Dickins (2012) conducted a study that analyzed the effect of firm performance on firm value. ROA and ROE were the indicators of firm performance, while MBE and Tobin's Q were the indicators of firm value. The finding indicated that the firm performance had influence on firm value.

Wahyu (2013) observed the influence of financial performance on firm value. Indicators of financial performance were ROI, ROE and NPM, while those of firm value were Tobin's Q, PER and closing price. The finding showed that financial performance had a significant, positive influence on firm value. Jauhar (2014) also analyzed the influence of financial performance on firm value. Financial performance was measured using ROA and ROE, while firm value was measured using MBR, closing price and Tobin's Q. The finding showed that financial performance had a significant, positive influence on firm value.

Marius *et al.* (2015) analyzed the influence of financial performance on corporate value. Financial performance was measured using ROA, ROE and NPM, while corporate value was measured using Tobin's Q, price book value and stock return. The finding showed that in large companies with a lot of assets, financial performance had a significant, positive influence on corporate value. Therefore, general conclusion from the theories and previous studies was that financial performance had a significant influence on corporate value. Therefore, the third hypothesis proposed in this study states:

H3. Financial performance is a moderating variable in the influence of GCG on corporate value.

3. Design, methods and approach

Research is a planned and systematic process to solve particular issues or answer a set of research questions. This study was an explanatory study. The unit of analysis was the companies listed in LQ45 in Indonesian Stock Exchange and the sources of data were ICMD, annual report and financial reports of the companies. Indonesian Stock Exchange was selected as the setting of the study since Indonesian Stock Exchange is one of trading places for various types of companies in Indonesia; it provides complete information on company's financial data and stock price.

The population was 84 companies listed in LQ45 in Indonesian Stock Exchange between 2010 and 2016. "Non-probability random sampling" was the approach used to select the samples while the sampling method was "purposive sampling," in which criteria were used to select the samples (Solimun *et al.*, 2017). The criteria were: companies listed in LQ45 Index between 2010 and 2016; companies that published their financial report between 2010 and 2016; companies that shared their dividend between 2010 and 2016; companies that implemented the principles of GCG. The samples were LQ45 companies listed in Indonesian Stock Exchange between 2010 and 2016 with continuous annual financial report and ICMD. The total samples were 22 companies \times 7 years = 154 observation.

In this study, GCG was measured based on four indicators namely independent commissioner proportion, institutional ownership, managerial ownership and public ownership; indicators of stock return were abnormal return and dividend yields indicators of financial performance were free cash flow, return on asset and ROE indicators of corporate value were market to book value of equity and price earning ratio. The analysis instrument was WarpPLS involving structural model and moderating variable (Solimun *et al.*, 2017).

4. Analysis result and discussion

Influence of GCG toward corporate value

H1 was rejected with coefficient line of 0.334 and *P* of 0.015. Direction of the influence of good corporate governance on corporate value was positive that meant higher GCG (independent commissioner's proportion, institutional, managerial and public ownerships) resulted in higher corporate value (MBE and PER). It was in line with the theories and previous studies, the bases for the hypothesis (Figure 2).

Based on theoretical-academic theory, corporate governance is derived from separation between shareholders and management. Jensen and Meckling's (1976) agency theory was derived from this concept. When there is separation between ownership and management function, agency problem occurs, in which managers as agents are given authority from shareholders to run companies based on the shareholder's interests. Independent commissioner board shareholders appointed to supervise and advise company have yet to work effectively since the board has very little managerial ownership and is unable to balance corporate value-oriented interests. Wen Jio explained that when they have a very little share of managerial ownership, these managers and institutional shareholders tend to conduct the act of collusion to take advantage of company's resources for their personal interests. Morck *et al.* (1988) stated that the consequence of giving very little proportion of managerial proportion to the managers is that they will put aside corporate value in their decision-making process.

The finding of this study confirmed findings of the previous studies on the influence of GCG on corporate value. Fallatah and Dickins' (2012) study showed that corporate governance had an influence on firm value. In addition, Wahyu (2013) described that corporate governance had a positive influence on firm value. Jauhar's (2014) study also showed the positive influence of corporate governance on firm value.

Moderating effect of stock return in the influence of GCG toward corporate value

H2 was accepted with coefficient line of 0.233 and *P* of 0.041. The higher the stock was, the stronger the influence of GCG on corporate value.

The finding of this study supported the agency theory which states that GCG should have had influence on stock return (abnormal return and dividend yield). The finding of this study also confirmed findings of the previous studies that showed the influence of GCG on stock return. Brammer *et al.*'s (2009) study showed that the companies categorized as top 100 companies had negative abnormal return but these companies were still in their

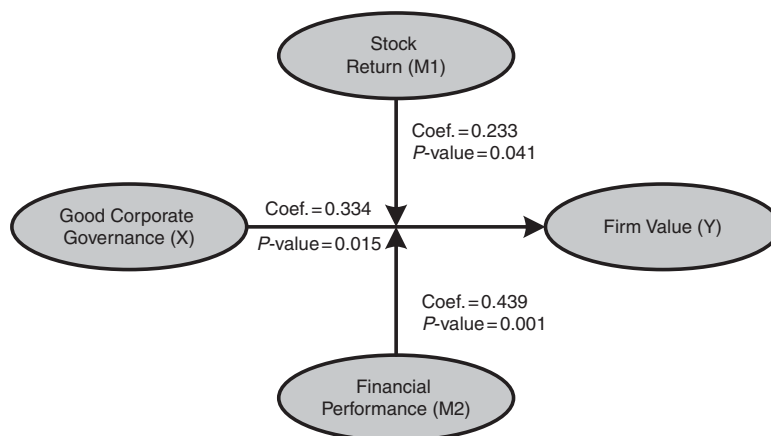


Figure 2.
Analysis result

growing stage. Erkens *et al.* (2012) described that during crisis, high independent board and institutional ownership resulted in worse stock return. Fuenzalida, Mongrut, Artega, Erausquin (2013) study showed the opposite, claiming that the companies listed in GCG index had positive abnormal return. In addition, Rani *et al.* (2013) stated that companies with high corporate governance had positive abnormal return.

The bird in the hand theory (Gordon, 1959; Lintner, 1956), stating that dividend policy will increase corporate value due to uncertain cash flow in the future, is a suitable theory to discuss the influence of stock return on corporate value. Stock price tends to increase when dividend is higher and at the opposite, stock price tends to decrease when dividend is low (Hanafi, 2012). Corporate value of go public companies is represented in their stock price. The higher their stock price is, the higher the companies' corporate value is (Husnan, 2012).

Dividend signaling theory states that change in dividend is a signal that future prospect of company is changing. Decreasing dividend by investor is categorized as bad news because it means company is in bad condition resulting in decreasing stock price. At the opposite, increasing dividend by company to shareholders is good news because it means future prospect of a company is getting better, resulting in positive response from investors and increasing stock price. High dividend also means that a company has high profitability level (cash flow signaling hypothesis). Besides that, company that pays dividend to shareholders has low risk. Papadopoulos and Charalambidis (2007) stated that dividend represented not only future prospect of a company but also instrument to increase stock price.

The finding of this study is in line with that of the previous related studies. Researchers have proven the influence of stock return on corporate value empirically. Akhigbe *et al.* (1993) and Denis *et al.*'s (1994) study showed positive correlation between increase in dividend and stock price. Johnson, Moorman and Sorescu (2005) described that stock return had a significant influence on corporate value. Jiao (2010) showed higher stock return resulted in higher shareholder's trust as well as improving performance and corporate value.

Moderating effect of financial performance in the influence of GCG toward corporate value
H3, financial performance is a moderating variable in the influence of GCG on corporate value, was accepted with coefficient line of 0.439 and *P* of 0.001. Signaling theory (Ross, 1977), explaining what types of information company should give to users of their financial report in order that the users understand the company's financial performance, is the most suitable theory to discuss the influence of financial performance on corporate value. Easterbrook (1984) argued that there are more affordable methods companies may choose to give signal to investors, for example, publishing announcement about prospect and ability of companies to create profit by hiring individuals or organizations outside the companies to analyze their financial reports and give opinion whether or not their managers have run the companies well.

Separated function between management and shareholders is the foundation of the agency theory proposed by Jensen and Meckling (1976). When they have conflict of interests, in which managers may sometimes take actions shareholders disagree upon, agency cost should minimize this conflict using total of supervising cost by owners through commissioner board, institutional ownership and public ownership as instrument, mechanism and structure used to evaluate managerial behavior that benefits managers themselves (self-serving). Objective of evaluating the self-serving behavior is to increase efficiency and eventually improve financial performance of a company. However, in practice, appointed independent commissioners responsible for supervision and giving advice are unable to carry out their responsibility optimally. At the same time, small proportion of managerial ownership is unable to keep balance between management and shareholder's interest.

Brigham *et al.* (2007) argued that in order to maximize corporate value, management should utilize strength and solve issues companies have. An investor, interested in buying share with long-term orientation, will evaluate company's ability to create profit, future prospect and risk. Therefore, good financial performance is a signal that a company has ability to increase its corporate value.

The finding also confirms findings of several previous studies particularly one discussing the influence of financial performance on corporate value. The finding of Varaiya *et al.* (1987) showed that financial performance had a positive influence on corporate value. Wahyu (2013) explained financial performance, measured using ROA, ROE and NPM as the indicators, had a significant influence on firm value, measured using Tobin's Q, PER and closing price. Jauhar's (2014) study revealed that financial performance of which indicators were ROA and ROE had a positive influence on firm value of which indicators were MBR, Tobin's Q and closing price. At the opposite, Manaje's study showed financial performance had a negative influence on corporate value.

5. Limitation, suggestion and recommendation

Limitation of the study

The study has several limitations, namely, first, managerial ownership is one of the indicators of GCG that is expected to minimize discrepancy between manager and shareholder's interests, help managers get direct advantage from decision they are making and take consequence from the decision. The argument indicates how important managerial ownership is in ownership structure of a company. The finding of this study revealed that managerial ownership was very limited. Having observed 22 companies, only 6 companies allow their managers become shareholders. These managers own less than 1 percent of stock in the companies where they work; second, public ownership is an indicator of good corporate governance that represents public trust toward a company. Public trust has massive influence on company performance. Based on the data, the percentage of public ownership was 38.35 percent or higher than the minimum 7.5 percent from Indonesian Stock Exchange. However, this percentage does not represent any relationship with GCG.

Suggestions

Based on the finding and limitation of the study, future researchers are expected to: conduct similar study while involving other exogenous variables such as intellectual capital and financial psychology. This study used one exogenous variable only (GCG); observed several types of industry and made comparison between companies that apply the principles of GCG and those which do not.

Based on the discussions, the researchers propose some recommendations for management, investors and the government: first, management is expected to carry out the principles of GCG consistently, high fluctuation of stock price results in higher risk and decreasing public trust. Therefore, the management should make careful observation on the current stock price. Second, investors are expected to depend upon dividend rather than capital gain because predicting the future is quite a challenge, take into account how much dividend company will pay and capital gain as well as conduct analysis on financial performance of a company. Third, some suggestions for the government are framework of GCG should guarantee there is strategic guidance for a company as well as accountability of board of commissioners toward shareholders and that board of commissioners conduct effective supervision on management; there is urgency for ownership structure because institutional shareholders may result in opportunistic behavior due to the act of collusion between the board of commissioners and the management.

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Corresponding author

Suhadak can be contacted at: suhadak.ub.jp@gmail.com