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THE IMPACT OF CORPORATE GOVERNANCE ON ROA AND STOCK RETURN

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Abtract

This paper aims to examine the effect of corporate governance on company performance. This study uses components of corporate governance, namely, independent ownership, concentrated ownership, board independence and board size as independent variables. The dependent variable used to describe the company's performance is return on assets and stock return. This research population is companies listed on IDX and samples taken from companies from the manufacturing sector from 2016 to 2019 collected 540 samples. Based on the results of the research analysis, board independence and board size variables have a significant positive effect on the return on assets variable that supports agency theory and ownership concentration variables have an influence on stock returns that support signal theory

Keywords: Corporate governance, Return on assets, Stock return, concentrated ownership, institutional ownership,board size, board independence

1. INTRODUCTION

Corporate governance is a system that can improve the relationship between managers and shareholders. The existence of corporate governance puts managers and owners in the same view and makes the operational performance increase so that the company can grow better. The concept of corporate governance is the importance of shareholder rights in obtaining all company information, including the organization's obligation to disclose accurate, precise, and transparent reports on organizational performance.

In research (Tehranian et al., 2011) studies on corporate governance increased rapidly along with the opening of large-scale financial scandals such as the Enron, Tyco, Worldcom, Merck, Global Crossing scandals, the majority of other companies in the United States involving accountants, one of the important elements of good corporate governance. The manipulation occurs due to the company's desire to attract capital owners to invest in the company. The case illustrates the ineffective role of managers in carrying out their functions. This also causes potential agency conflicts between managers and shareholders or owners. To minimize the potential for conflict, it is necessary to implement good corporate governance. The implementation of effective governance is based on agency theory, the main responsibility of the board of directors is to monitor and protect shareholders from conflicts of interest that will arise because there is a separation of ownership and control (Jensen & Meckling, 1976)

One of the steps in implementing corporate governance is mitigating agency problems by concentrating company ownership or ownership concentration. The presence of concentrated shareholders can oversee the company in making strategic decisions. Ownership concentration also increases the speed of decision-making (Anjani & Jatmiko, 2015). In practice, concentration ownership also has the potential for conflict between large and small owners, as large owners can encourage companies to act efficiently in buying or selling assets.

(Chung & Zhang, 2011) define institutional ownership as the share of shares held by an institution and has a good governance structure. (Del Guercio, 1996) says that many institutional investors are more inclined to stocks that are seen as wise investments for their portfolios. It can be said that institutional investors are more likely to choose stocks that have good governance than individual investors. This is because companies that have good governance tend to need little supervision, have high stock market liquidity, and are easier to fulfill their fiduciary responsibilities.

In its implementation, corporate governance needs to be supported by all company organs to achieve company goals. Corporate governance problems are caused by demands for transparency and independence. This can be seen from the emergence of company demands to increase independent commissioners to oversee the company's performance. In the corporate governance regulations in Indonesia, the number of independent commissioners is not stated how much the limit. According to OJK regulations, Bapepam-LK regulations, companies that have been listed on the stock exchange have at least one independent commissioner. IDX requires at least 30% of the board of commissioners are independent commissioners.

There are differences in the composition of the board in companies in Indonesia. Because there are two types of board structures, the first is a one-tier system. In this system, the roles of the board of the commissioners as supervisors and the board of directors as executives are combined. Next, there is a two-tier system, i.e. there are two separate boards. The board of the commissioners performs the function of monitoring and supervision. The board of directors is responsible for making policy. The separation of duties of the board is intended to avoid any conflicting interests. Indonesia itself adopts a two-tier system, while the one-tier system is widely used by the United States, Britain, and Canada.

(Ehikioya, 2009) said that the size of the board of directors is considered to influence performance. Directors are given the responsibility to oversee the company and its activities, but there is no agreement as to whether a large number of directors or a small number of directors is best. According to (Yermack, 1996), the smaller the number of the board of directors the better, because a small number speeds up decision-making and lower costs. There is also another thought that believes that a company with a large number of boards of directors can encourage their managers to pursue lower costs of debt and improve performance (Anderson et al., 2004).

(Sheikh et al., 2013), conducted a test on corporate governance on company performance. The research was conducted in non-financial companies from 2004 to 2008 which were listed on the Karachi Stock Exchange. There is a positive relationship between board size and ownership concentration on ROA. (Andreou et al., 2014), in a study of corporate governance and financial management decisions, found the influence of corporate governance factors such as insider ownership and board size on company performance.(Sheikh et al., 2013), examined corporate governance which includes board size, outside directors, CEO duality, managerial ownership, and ownership concentration. The result is that board size has a positive effect on ROA, EPS, and market-to-book (MB), while outside directors and managerial ownership have a negative effect. (Lee, 2008) examined the effect of an ownership structure on the company's financial performance. He considered two criteria of ownership concentration and shareholder nature as ownership structure criteria and investigated companies that existed on the South Korean stock exchange in the period 2000 to 2006 using panel data. From the research, it is found that performance can be improved by increasing ownership concentration, but the effects of institutional ownership and foreign ownership have no effect.

(Koerniadi et al., 2014) analyzed the effect of corporate governance on stock returns, there are components such as board composition and shareholder rights associated with a low level of risk.

2. DATA AND METHODOLOGY

In this research, an analysis method is used by combining time series data and cross section data. These data were obtained from IDX and ICMD manufacturing companies listed on the Indonesia Stock Exchange in 2016-2019 and then each variable indicator was compiled and recorded in MS Excel. Furthermore, it is calculated using the Ordinary Least Square regression analysis technique through the SPSS program. The equations used in the regression are:

$$\text{ROA i,t} = \alpha + \beta 1 Own\ i,t + \beta 2 Ins\ i,t + \beta 3 Bin\ i,t + \beta 4 Bsz\ i,t + \varepsilon i,t$$

$$\text{R i,t} = \alpha + \beta 1 Own\ i,t + \beta 2 Ins\ i,t + \beta 3 Bin\ i,t + \beta 4 Bsz\ i,t + \varepsilon i,t$$

Tabel 1 Summary statistics

	N	Minimum	Maximum	Mean	Std. Deviation
X1	540	0,25	0,9977	0,709	16,738
X2	540	0	0,9977	0,665	23,768
X3	540	0,20	1	0,414	0,115
X4	540	2	15	4,95	2,259
Y1	540	0,452	1,495	1,037	0,091
Y2	540	0,047	10,264	1,125	0,740

Tabel 1 presents the summary statistics of the data in this research. A total 540 data have been collected on IDX from 2016 to 2019.

3. EMPIRICAL TEST

Tabel 2 Results of ROA

	Coefficients	t	sig
Constant		69.300	0.000
Concentrated ownership	-0.068	-1.186	0.236
Institutional ownership	0.010	0.176	0.860
Board Independence	0.097	2.009	0.045
Board size	0.257	5.246	0.000

From the results above, it can be concluded that there is a positive and significant relationship between board independence and board size variables with return on assets. Meanwhile, the concentrated ownership and institutional ownership variables do not seem to have any effect on the return on assets variable.

Tabel 3 Result of Stock Return

	Coefficients	t	sig
Constant		9.626	0.000
Concentrated ownership	0.124	2.114	0.035
Institutional ownership	0.044	0.742	0.458
Board Independence	0.057	1.154	0.249
Board size	-0.029	-0.573	0.567

Based on table 3, it is known that the concentrated ownership variable has a positive and significant effect on the stock return variable. In other variables, namely institutional ownership, board independence and board size, there is no effect on stock returns.

4. CONCLUSION

This study shows that there are several corporate governance variables that support agency theory. It can be seen from the results of this study where board independence and board size have a significant positive effect on the return on assets. The results of this study prove the agency theory (Jensen & Meckling, 1976) which states that the existence of supervision by the owner increases the company's operational efficiency which in turn can improve financial performance. Meanwhile, the variables of concentration ownership and institutional ownership have no effect on return on assets.

This study also found the results of increasing ownership concentration increasing stock returns. These results refer to signaling theory (Ross, 1977) which states that companies provide signals to potential investors, in the form of information about what managers have done in realizing the owner's wishes. Signals can be in the form of financial statements or company reports that inform the company is in better condition, where the level of concentration of ownership of a company becomes a signal or sign for investors to invest and increase stock returns.

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