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Factors Affecting Firm Performance: Does Corporate Governance Implementation Matter?

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ABSTRACT

Purpose – This study aims to investigate the impact of corporate governance implementation on the dynamics of firm performance in the non-financial sector firms listed on the Indonesia Stock Exchange (IDX).
Methodology/approach – This study uses secondary data from the financial statements of non-financial sector firms, between 2010 and 2018. The number of samples that met the established criteria was 88 firms, which were further analyzed using panel regression analysis common effect model.
Findings – This study concludes that the implementation of corporate governance (board meeting and board size) in the non-financial sector, has a positive impact on firm performance. Low frequency of board meetings will worsen firm performance, whereas a high frequency of board meetings can improve company performance. In addition, financial information (i.e., leverage, sales growth, and asset turnover), and firm size has a significant impact on firm performance.
Novelty/value – This study contributes to providing more general and robust conclusion regarding the effect of implementing corporate governance mechanisms on firm performance listed on IDX, especially in non-financial sector.

Keywords: Corporate Governance, Board Meeting, Board Size, Firm Performance, Non-Financial Sectors

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INTRODUCTION

Profitability becomes crucial for every company, because it is an important performance indicator and the first concern of stakeholders in the tight vortex of business competition. It has been proven that a business will not survive if it is not profitable, and highly profitable businesses have the ability to reward their owners with high returns on investment (Alarussi & Alhaderi, 2018). To create a profitable business, professionals who are able to manage the business well, such as the CEO and executive team are needed (Foss & Stea, 2014). However, the separation of company management is prone to agency problems, that is differences in interests between the owner (principal) and the manager (agent) (Jensen & Meckling, 1976).

One of the causes of agency problems is due to information asymmetry (Andreas & Zarefar, 2022), managers as the party that better known about the company's operational and financial activities have more information than the principal. If managers take selfish actions by ignoring the interests of investors, it will cause investors' expectations about the return on the investment they have invested, disappear. For this reason, it is necessary to have a mechanism to reduce the possibility of conflicts of

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interest between various parties. Companies need to have a system that is able to manage the company and provide protection to stakeholders and creditors. Good corporate governance can be the answer to this problem. Buachoom (2018); Jensen & Meckling (1976) argues that, to eliminate the negative impact of agency problems on company performance, monitoring activities under the corporate governance framework are needed. Corporate governance is defined as a system that controls and directs a company to ensure the survival of the company and maximize the interests of shareholders (Danoshana dan Ravivathani, 2013; Lukviarman, 2016).

The implementation of good corporate governance has a significant impact on the company's financial performance (Agustiningsih et al., 2016; Buachoom, 2018; Utama & Utama, 2019). Company performance is a factor that shows the efficiency and effectiveness of the company in achieving its goals. Previous studies have found that board meetings (Brick & Chidambaran, 2010; Buachoom, 2018; García-Ramos & García-Olalla, 2011), board size (Bansal & Sharma, 2016; Bhattacharya, 2015; Herdjionob & Sari, 2017; Kutum, 2015) have a significant effect on company performance. In family-run business firms in Europe, a positive relationship was found between the number of board meetings and company performance (García-Ramos & García-Olalla, 2011). Brick & Chidambaran (2010) reported an increase in company performance following an increase in the number of annual board meetings. However, few studies also report that board meetings (Bhattacharya, 2015), board size (Evita & Christina, 2019; Hassan et al., 2016) have no significant effect on company performance.

Several studies have been conducted to examine the effect of corporate governance on firm performance, but the results have not been consistent, depending on the specific conditions of each firm and the period used. Therefore, this study aims to provide a more general and robust conclusion regarding the effect of implementing corporate governance mechanisms on firm performance, especially in the non-financial sector by using periods, samples, and variables that are more detailed, long and complete, and a robustness test is carried out in order to obtain more accurate and reliable results so as to enrich the literature review related to the implementation of corporate governance on firm performance.

LITERATURE REVIEW

Profitability Theory

Profitability is one of the fundamental analyzes to analyze a company's ability to generate both positive and negative profits. In addition, profitability is one of the fundamental analysis proxies to measure and analyze company sustainability and is the basis for calculating company performance (Etale et al., 2021). Sanyal (2019) divides profit theories into five categories: frictional theory of profits, monopoly theory of profits, innovations theory of profits, risk and uncertainty theory of profits and managerial efficiency theory of profits. According to the managerial efficiency theory of profit, managers that are able to manage their policies and resources efficiently and consistently over time will generate higher profits, that makes them possible to compete in business (Bolarinwa et al., 2021; Salvatore, 2019; Sanyal, 2019; Soesetio, Waffiudin, et al., 2022c). Makadok (2011) argued that company's ability to manage operations, strategic time and external factors can provide additional advantages, even if competitors have the same resources and information.

Agency Theory and Stakeholder Theory

From the point of view of agency theory, managers will tend to prioritize their own interests because of the superiority of their information which will eventually lead to agency problems (Jensen & Meckling, 1976). This agency problem will harm all company activities, which in turn will have an impact on decreasing company performance (Naciti, 2019). Therefore, corporate governance is needed to minimize the occurrence of these problems (Tjahjadi et al., 2021). Corporate governance will improve the oversight function, so that the possibility of managers committing irregularities can be minimized (Hamad et al., 2020). In addition, corporate governance will increase the efficiency of the company because the implementation of corporate governance will form a system of direction, control and supervision that is right on target (Andreas & Zarefar, 2022; Hamad et al., 2020; Wahyudin & Solikhah, 2017).

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Stakeholder theory, which was popularized by Edward Freeman in the 1980s, defines a stakeholder as "any group or individual who can affect or be affected by the achievement of organizational goals" (Littlewood, 2020). Shareholders are an important stakeholder group for business, as well as employees, customers, communities, suppliers, government and even the environment (Bello & Abu, 2021; Littlewood, 2020). While many perceive clear differences between a shareholder and a stakeholder, stakeholder theory states that shareholders are special stakeholders (Sousa, 2012). These stakeholders provide resources, influence the business environment, benefit the company, and influence efficiency (Donaldson & Preston, 1995; Freudenreich et al., 2020). The stakeholder theory of corporate governance focuses on the effects of corporate activities on all identifiable stakeholders of the firm. This theory argues that corporate managers must consider the interests of each stakeholder in the governance process. This includes taking efforts to reduce or lessen conflicts between stakeholder interests.

Apart from the board of commissioners, Liu & Fong (2010); Musallam (2020) argues that the board of directors is the most important corporate governance mechanism and the governance structure that protects a company and its shareholders. The responsibility of the board of directors is to perform a variety of monitoring tasks, that are overseeing management practices to minimize agency costs, aligning the interests of shareholders and management and appointing and firing management staff and monitoring the chief executive officer (CEO) behavior (Amran et al., 2010). The board of directors will be able to play a significant role in improving the company's performance and play an important role in the company's strategic decision making (Fama & Jensen, 1983).

METHOD

The research population is all non-financial firms listed on the IDX in, 2010-2018 as many as, 526 firms. Using purposive sampling method, the criteria is all the data needed is available, so as many as, 88 firm are obtained as an analysis unit. This quantitative research paper uses secondary data from the financial statements of non-financial sector firms. Measurements of each variable are detailed presented in the table 1:

The use of ROE and NPM as a measure of firm performance are for robustness tests. Common effect model (CEM) panel regression analysis is used as an analytical tool to answer hypotheses that have first passed all classical assumption tests. The regression model used:

$$ROE = \alpha + \beta_1 MEET1 + \beta_2 MEET2 + \beta_3 BSIZE + \beta_4 LEV + \beta_5 SGR + \beta_6 AT + \beta_7 SIZE + e \quad (1)$$

$$NPM = \alpha + \beta_1 MEET1 + \beta_2 MEET2 + \beta_3 BSIZE + \beta_4 LEV + \beta_5 SGR + \beta_6 AT + \beta_7 SIZE + e \quad (2)$$

In the model above, ROE is a return on equity, NPM is a net profit margin, MEET is a board meeting, BSIZE is a measure of the board of directors, LEV is a total debt to total asset ratio, SGR shows sales growth, AT shows asset turnover, SIZE is natural logarithm of total asset.

Table 1: Variable Measurement

Variables	Description	Measurement	Source
Return on Equity (ROE)	Measure a firm's ability to make profit from each equity	Earnings After Tax / Equity	(Hasan et al., 2020; Komara et al., 2016; Soesetio, Siswanto, et al., 2022; Sugiarto & Lestari, 2017)
Net Profit Margin (NPM)	Measure a firm's ability to make profit from total sales	Earnings After Tax / Sales	(Bustani, 2020; Mayasari et al., 2018)
Board Meeting	Frequency of board meeting meetings per	Dummy variable MEET1: given value	(Bhattacharya, 2015)

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(MEET)	year	1 if frequency of board meetings > 4 times, 0 otherwise. MEET2: given value 1 if frequency of board meetings > 8 times, 0 otherwise	
Board Size (BSIZE)	Measure a total board of directors	∑ board of directors	(Bhattacharya, 2015)
Leverage (LEV)	Measure how much assets are funded from total debt	Total debt / total asset	(Chang et al., 2019; Handriani & Robiyanto, 2019)
Sales Growth (SGR)	Percentage of sales growth every year	Net sales t – Net sales t-1 / Net sales t-1	(Evita & Christina, 2019)
Asset Turnover (AT)	Measures how effectively the company creates sales from the total assets owned	Net sales / Total asset	(Evita & Christina, 2019)
Firm Size (SIZE)	Measure the amount of assets owned by firms	Ln (total asset)	(Eluyela et al., 2018; Purnama & Nurdiniah, 2019; Singgih et al., 2018)

Source: Processed Data, 2022

RESULT AND DISCUSSION

Based on table 2, the average ROE is 0.113 can be explained that the profit generated is 0.113 from every 1 equity. The average NPM is 0.101, which means that a firm can generate 0.101 profit from every 1 sale. This explains that the ability of non-financial companies to generate profits for the 2010-2018 period is low. The average of low frequency of board meetings (MEET1) is 0.93 and high frequency of board meetings (MEET2) is 0.89 which means that non-financial companies for the 2010-2018 period held more than 4 board of directors' meetings rather than more than 8 times in a year. The average board size of directors is 5.36 which means that in this period, non-financial companies listed on IDX entrusted 5-6 people to become directors.

Table 2: Statistic Descriptive

Variable	Obs	Mean	Std. dev.	Min	Max
ROE	792	0.1134	0.2725	-3.5030	1.6313
NPM	792	0.1013	0.2276	-1.3324	2.4870
MEET1	792	0.9343	0.2478	0	1
MEET2	792	0.8864	0.3176	0	1
BSIZE	792	5.3573	2.2739	2	16
LEV	792	0.4820	0.2018	0.0699	1.2486
SGR	792	0.1338	0.3112	-0.7834	3.6175
AT	792	0.8098	0.6370	0.0480	4.1830
SIZE	792	15.1170	1.8087	10.2846	19.6582

Source: Processed Data, 2022

The average of leverage is 0.48. This shows that on average, 48 percent of company assets are financed by debt. The average sales growth is 0.14, meaning that the company experienced sales growth of 13.38% compared to the previous period. The average of asset turnover is 0.81, meaning that the company is effective in creating sales of 81% of the total assets owned. The average of firm size is 15.12.

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Table 3: Regression Result

VARIABLES	ROE	NPM
MEET1	-0.060***	-0.036**
	(0.021)	(0.015)
MEET2	0.021*	0.020**
	(0.013)	(0.008)
BSIZE	0.006***	0.004**
	(0.002)	(0.002)
LEV	-0.076***	-0.223***
	(0.021)	(0.016)
SGR	0.045***	0.077***
	(0.017)	(0.017)
AT	0.058***	-0.033***
	(0.005)	(0.005)
SIZE	0.012***	0.009***
	(0.002)	(0.002)
Constant	-0.088***	0.070***
	(0.032)	(0.027)
R-squared	0.212	0.345

Source: Processed Data. *, **, *** Significant at 10%, 5%, 1%

Effect of Board Meeting on Firm Financial Performance

Based on the results of the analysis, board meeting 1 (MEET1), which shows that the low frequency of board meetings has a significant negative effect on company performance proxied by return on equity (ROE) and net profit margin (NPM). While board meeting 2 (MEET2), which shows high frequency of board meetings has a significant positive effect on company performance. These results indicate that the more frequent members of the board of directors hold meetings, the company's performance will tend to increase. A board meeting is an organized arrangement, which arranged to gather board of directors to discuss and address relevant issues related to going concern (Eluyela et al., 2018). Regular board meetings will give the board of directors more time to deliberate, set strategy, and assess management performance (Vafeas, 1999). Board of directors that have more time to discuss to equalize perceptions between various parties will be able to produce an appropriate and effective decision for the company because of the communication and coordination that exists between members of the board of directors. These results are in line with Ntim & Osei (2011) which found a positive relationship between the frequency of board meetings and company performance.

These results also support the agency theory that the board of directors has a role in monitoring managers' performance, managers as a party that knows better about the condition of the company will most likely cause interest’s abuse. Therefore, by holding more frequent meetings of the board of directors, they can provide feedback in the process of supervising and monitoring regarding management performance whether it is on target or not. In addition, the frequency of board meetings is considered an important way to increase board effectiveness (Adam & Ferreira, 2009; Johl et al., 2015).

Effect of Board Size on Firm Financial Performance

The results of the analysis show that board size has a significant positive effect on company performance. The board of directors has a role in determining the company's strategy and policies in the short or long term. In addition, the board of directors also plays a role in formulating company operational policies which will then be assigned to each specific area, so that each director has a more focused task and this certainly has a positive impact on stakeholders. Furthermore, the board of directors is also the driving force of the company, because the board of directors has the right to

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exercise control over the management of resources and funds sourced from investors (Amran et al., 2010). The board of directors is the most important corporate governance mechanism and the governance structure that protects a company and its shareholders (Liu & Fong, 2010; Musallam, 2020). The greater the number of board members in a company will increase the heterogeneity in information, knowledge, skills, and information processing behavior, which is conducive to the completeness of decisions in environmental scanning, interpretation, and assessment of strategic options (Rasheed & Kim, 2013).

A greater number of board sizes will provide more consideration regarding information as well as an increase in creativity and more flexibility in processing information. With a greater number of directors, they can provide various perspectives that can be used in the process of making a decision. In addition, the board of directors will be more active in expressing opinions and perspectives in ongoing discussion meetings so that it will increase objectivity in assessing a problem and reduce biased information. Kutum (2015) found a positive relationship between board size and firm performance in Palestine. Next, Bansal & Sharma (2016); Herdjionob & Sari (2017) also found a positive correlation between board size and firm performance. However, the results of this study are not in accordance with Evita & Christina (2019) which found that there is no effect between the size of the board of directors and company performance.

Effect of Leverage on Firm Financial Performance

The results prove that leverage has a negative impact on company performance. Debt financing creates an investment problem for shareholders because the average total cost is higher than the return, especially in emerging markets (Abu-Abbas et al., 2019). The higher the debt, the higher the interest that must be paid, so that the company's profit will be reduced in vain just to pay interest. In addition, the risk of default on debt obligations is also accompanied by low profits which have a negative impact on the company's financial performance (Shafiq et al., 2022). The greater the risk faced by the company, the greater the uncertainty of obtaining future profits and the more difficult to pay off its debts. These results are supported by Dawar (2014); Doan (2020); Sheikh & Wang (2013); Soesetio, Adiningsih, et al. (2022) which found that the debt ratio has a negative effect on company performance.

Effect of Sales Growth on Firm Financial Performance

Sales growth has a positive effect on the firm's financial performance. High sales growth is a sign of the company's business success in the past, and can be used as a tool to predict future developments (Deitiana, 2011). The higher the company's growth rate, the higher the level of investment, so that companies that have high growth opportunities generally have good financial performance. From an investor's point of view, company growth is a sign that the company has a profitable aspect and investors also expect a rate of return from the investment they made, indicates that the company has developed well because it is considered capable of obtaining better profits than the previous period. These results also support previous research from Le Thi Kim et al. (2021); Yazdanfar (2013) which found that sales growth has a positive effect on the company's financial performance.

Effect of Asset Turnover on Firm Financial Performance

Asset turnover (AT) has a significant effect on company performance. According to Le Thi Kim et al. (2021), This ratio helps managers know how efficiently they are using company assets to generate sales. High total asset turnover indicates good company development related to increasing sales, expanding market share, and ultimately improving its financial performance. Empirically, these results support previous studies from Batool & Sahi (2019); Grozdic et al. (2020); Le Thi Kim et al. (2021) which found a positive relationship between asset turnover and firm performance. Nurlaela et al. (2019) analyze empirically the factors that affect the business performance of consumer companies listed on the Indonesia Stock Exchange. They found a significant positive relationship between the company's total asset turnover and financial performance ratios. Seema et al. (2011) evaluate company performance by using total asset turnover, long-term asset turnover and short-term asset turnover. They concluded that low turnover is a sign of inefficiency in the use of available resources and indicates that the company has not been able to maximize the use of its assets. As well as,

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Murtadlo et al. (2014) use total asset turnover to evaluate the company's operating performance. They concluded that the higher the efficiency of the use of assets, the better the efficiency of the company's operations. However, this result is contrary to Rajagukguk & Siagian (2021); Sunjoko, M & Arilyn (2016) which found no significant relationship between asset turnover and firm performance.

Effect of Firm Size on Firm Financial Performance

Firm size positively affects the financial performance. Large companies usually have advantages in terms of resources and capabilities in product development, development of technological innovation, and of course better implementation of business, marketing and e-commerce strategies (Kipesha, 2013). Another advantage of large companies is the ownership of human resources (Hung et al., 2021; Yang & Chen, 2009). They have a large workforce of highly qualified workers and can recruit skilled workers. Therefore, large companies can operate more efficiently because they have good resources with more efficient use of inputs (Halkos & Tzeremes, 2007). In addition, companies with large assets have greater opportunities to be able to increase access to cheaper funding in the form of debt and equity to expand markets (Soesetio et al., 2022c).

CONCLUSION

This study investigates the effects of board characteristics, such as board meeting and board size on firm performance in non-financial companies listed on the IDX for the 2010-2018 period. Overall, corporate governance has proven to be a good control system especially for improving company performance. Board meetings and board size have a positive effect on company performance. The more the number of directors will provide new ideas and perspectives, and the more frequency of board meetings can improve the supervisory function, so that the company's performance can increase. In agency theory perspectives, the results of this study indicate that the implementation of corporate governance can improve the oversight function, so that the possibility of managers committing irregularities can be minimized, and in the end the company's performance will increase.

These results provide an illustration for companies to always pay attention to the frequency of board meetings and the number of directors, because they are the parts that influence the company's performance in the non-financial sector. The addition of the characteristics of the board of commissioners, gender diversity and the use of other proxies for company performance can be developed for further research.

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