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Corporate governance and leverage on firm value: Evidence of Indonesian large firms

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Abstract

This paper aims at the nexus of corporate governance, leverage, and firm value of selected Indonesian large firms in the 2014-2019 period. Specifically, the study is concerned about the effect of independent commissioner board size, institutional ownership, and audit committee size as proxies of corporate governance on firm value. The controlling variables are leverage and firm age. Panel regression analyzed secondary data collected from the LQ-45 index at Indonesia Stock Exchange firms as the large firms. The findings show that institutional ownership positively impacted firm value. However, the independent commissioner and audit committee exerted insignificant influence. The study results further showed that firm age and leverage significantly negatively impact firm value, respectively. Decisively, findings from this paper reflect that corporate governance positively influences firm value significantly. The study recommended that corporate governance dynamics in firms be empowered and re-examined, especially the audit committee's effectiveness. Both firm age and leverage do not affect productivity and firm value. The audit committee's role is more than optimal in carrying out the supervisory and control functions of the corporate management so that the responsibility of the management is considered transparent and results in an increase in shareholder trust. It is also recommended that the increase in firm age and excessive leverage be balanced with the creation of innovation and productivity of large firms.

Keywords : corporate governance; commissioner; audit; ownership; firm age; leverage
JEL Classification : G10, G32

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1. INTRODUCTION

One important consideration in taking decision investment is firm value beside business prospects and profitability of the firm (Santosa et al., 2020). That thing is consideration of investors because the following purpose. The firm's main goal is to maximize shareholders wealth, taking into account business risks and optimal period investment (Jones, 2014). In addition, the holders of stocks are also concerned with aspects

of good corporate governance because of possible push problem agency Among management with the principal, at the same time ensure firm fast appropriate with good governance provisions (Brigham & Houston, 2016). Management is required to ensure that the firm's management process runs efficiently and effectively and requires governance instruments to ensure that no party takes advantage of asymmetric information (Alanazi, 2019). Thus, the firm's operations guarantee two things, first, the the right of shareholders importance to obtain correct and timely data and information, and secondly, the firm's obligation to make accurate, timely, and transparent disclosures of all firm performance, ownership, and *stakeholders*. However, previous studies show a lack of understanding and corporate culture on how important and strategic GCG principles are applied by businessmen and managers in Indonesia (Mukhtaruddin et al., 2019).

Positive changes in the firm are influenced by corporate governance because the better the governance of a firm will have an impact on reducing the potential for agency problems (Santosa et al., 2020). One of the governance proxies that affect firm value is the structure of equity ownership, namely institutional ownership and managerial ownership.

Governance proxies that influence firm value is the structure of equity ownership, namely institutional ownership and managerial ownership. Managerial ownership and family ownership positively impact firm value, whereas institutional ownership negatively impacts (Musallam et al., 2019). The higher the the institution ownership, the more effective the excess control mechanism on management performance, which can reduce the firm value. Furthermore, the proxies of the independent board of commissioners and the audit committee function to oversee the implementation of corporate governance, which have a positive impact on firm value due to increased efficiency while reducing fraud. (Chan & Li, 2008; Abdul-Majid, 2017) .

Leverage is important in measuring the effectiveness of the firm's debt. According to Brigham & Houston (2016), leverage is the ability of a firm to fulfill its obligations to pay debts. The definition of the leverage itself is funds that take advantage of fixed costs, both in the form of real and financial assets. The firm employs leverage to ensure that earnings exceed the cost of capital and other sources of funding, hence enhancing shareholders wealth. The firm's ability to use assets or funds to increase the level of profit for firm owners by increasing leverage means that the level of uncertainty of the returns to be obtained will be higher, but at the same time, it will increase returns that will be obtained (Laly, 2017).

Another factor that could affect the firm value is the firm age. The firm's age is the length of time the firm can compete in the business world (Dewinta & Setiawan, 2016). The firm is obtained from reducing the current year minus the year of establishment. The longer the firm is established, the investors will have more confidence in the firm than in those that have just been established because more assets will generate higher profits and survive, and the integrity is seen so that the share price increases. The firm age is based on its relationship with financial goals in the firm's life cycle explicitly, where the firm's long-term investor is an improvement (Santosa et al., 2020). The firm age is something that investors consider in investing; because it reflects the firm's survival and is proof that the firm can compete and take business opportunities in the current economy (Jamaludin & Hasyim, 2017).

Du et al. (2021) and Bodie et al. (2014) states that the longer the age achieved by the firm, the less efficient the firm will be because companies that have a longer age must reduce costs. After all, the firm has a learning effect from non-financial companies, both the

same and other companies. However, the longer the firm age also determines the firm's ability to generate firm profits. The firm's experience in managing the business can affect the profit. Companies that have been around for a long time and are listed on the Indonesia Stock Exchange should have the ability to compile quality financial reports. According to Du et al. (2021), firm age positively influences firm value depend on productivity and innovation.

The problem in this study is that this is a crucial thing in corporate finance; that is how good corporate governance creates for the firm with minimizing potential agency and information problems asymmetric Among management and principals so that push cost agency. This paper aims to determine the connection between good corporate governance and firm values controlled by firm age and leverage as a novelty.

2. LITERATURE REVIEW AND HYPOTHESIS

Regarding firm value of large corporation activities, economists think that the corporate governance mechanism generally contributes to resolving the agency problem, and they propose several governance strategies for constructing a suitable one for businesses. Consequently, governance mechanisms frequently emphasize the controlling function of management. Corporate governance is corporate governance that focuses on balancing social and economic goals between individuals and groups. The main task of government companies is to achieve efficiency in using these resources. This problem is to equalize individuals, companies, and society. Meanwhile, according to (Ross et al., 2013), GCG is a process and structure used by stakeholders the interests of the firm to improve business success and firm accountability to maintain shareholder values in the long term while taking into account the interests of other stakeholders, laws, and regulations and ethical values (Shefrin, 2017).

Based on the Decree of the Minister of SOE Number Kep-117/M-MBU/2002, Good corporate governance is: "A process and structure used to improve the success and accountability of the firm in maintaining shareholder value in the long term while taking into account stakeholders, regulations and ethical values." The Organization for Economic Co-Operation and Development (OECD) also provides an opinion on the meaning of corporate governance. The OECD defines good corporate governance as the connection between a firm's management, shareholders, and other stakeholders.

The general GCG guidebook by the National Committee on Governance Policy or KNKG (2006) states that to achieve long-term business sustainability, the implementation of GCG needs to be based on the high integrity of management. Therefore we need an application guideline that can reference the firm's organs and all employees in values and business ethics to become part of the firm culture. The main objective of GCG is to create added value for all interested parties.

Efforts to increase the firm value cannot be separated from good performance in every stakeholder in a firm because it is from corporate governance. According to (Miras-Rodriguez et al., 2018), good corporate governance is a system that regulates the relationship between the Board of Commissioners, the role of the Board of Directors, shareholders, and other stakeholders—also referred to as a transparent process of the firm's objectives, management, and assessment. Aulia & Wijaya (2020) think that implementing GCG in Indonesia will still grow and become considered important in modern corporations; therefore, the implementation of GCG requires a strong commitment to making it happen.

Formulation of Hypothesis

The hypothesis is developed based on a framework according to the problem formulation and research questions.

Independent Variables:

The influence of the independent of commissioners on firm value

The first proxy used for GCG is the independent board of commissioners (ICO), which plays an important role in implementing GCG. The board of commissioners is the cornerstone of strong corporate governance; it is responsible for establishing the business's strategy, monitoring managers in their management of the organization, and ensuring accountability is implemented.Since the board of commissioners is responsible for overseeing management that improves the efficiency and competitiveness of the firm, the board of commissioners are central to the firm's resilience and success. (Santosa, 2019; Brigham & Houston, 2019) . The link between independent commissioners and corporate value is bolstered by the board's stance on service and control. Lee et al. (2019) and Ratnadi & Putra (2018) find that the independent board of commissioners affects firm value.

H1: Independent board of commissioners affects firm value (+)

The Effect of Institutional Ownership on Firm Value

The second indicator of GCG, namely shares ownership by parties in institutions such as banks, insurance companies, or other institutions, is referred to as institutional ownership. Institutional ownership can reduce the influence of other interests in the firm, such as the personal interests of managers and debtholders (Brigham & Houston, 2016). Prastuti and Budiasih (2015) state that institutional ownership negatively affects firm value. However, this contradicts Muryati and Suardhika (2009) research, which states that the firm's institutional ownership has a positive effect.

H2: Institutional ownership affects firm value (+)

The influence of the Audit Committee on firm value

The third indicator is the audit committee. The audit committee serves as a connection between the firm's management, the board of commissioners, and other external parties, since the audit committee's purpose is to enhance the firm's management, particularly in the area of supervision.When the firm's control is good, the board of commissioners takes part in the supervision (Santosa et al., 2020; Laily, 2017). Masters & Sirs (2016) and Chan & Li (2008) stated that the audit committee affects firm value. However, (Dirawati Pohan & Dwimulyani, 2017) stated that audit committee effect positively but insignificantly.

H3: Audit committee affects the value of the firm (+)

Control Variable:

The Effect of Firm Age on Firm Value

The longer the age achieved by a firm, the less efficient it will be because companies with a longer age must reduce costs. After all, the firm has a learning effect from companies in the same or different industries. However, the longer the age of the firm also determines the firm's ability to generate firm profits (Santosa, 2020; Subramanyam, 2014). The firm's experience in managing the firm can affect the firm's profit. According to (Santosa 2020), firm age positively or negatively influences firm value. According to (Sugiarto & Santosa, 2018), the firm's age affects its value because it has a longer age than other companies by having a variety of learning within the firm and outside companies with the same or different industries.

Effect of Leverage on firm value

Debt to the firm can be used to measure the firm size because if the debt to the firm is increasing, it will reduce the firm's value. This condition causes investors to look back to invest their capital in the firm. If the firm has high debt, there is also a high investment risk. The higher the firm's debt, the lower the firm's value (Santosa et al., 2020). According to (Albart et al., 2020) and Santosa et al. (2020), research results indicate that *leverage* has a positive and significant effect on firm value because the positive direction means that the higher the *leverage*, the higher the firm value obtained. The higher the leverage ratio of a firm, the more *unsolvable* the firm is, which means the firm cannot pay its short-term or long-term debt or its total debt is greater than its total assets. (Brigham & Houston, 2016) .

3. DATA AND METHODS

Data types and sources

This study uses data in panel sourced from the Indonesia Stock Exchange (IDX), Bank of Indonesia, and the Central Statistics Bureau. *Cross-section* panel data are non-financial sector companies/issuers listed on the IDX and quarterly *time series* in the 2009-2019 period. The emitted sample was selected *purposively* with the selection criteria based on the non-financial LQ-45 Index in where the index represents selected public firm stocks that have high liquidity, large market capitalization value, good fundamentals, and performance.

Variable of study

Variables used in the study are firm value (dependent variable), corporate governance: independent commissioners, institutional ownership, audit committee—the controlling variables: firm age and leverage. Based on theory and research, the definition of the operational variables in the study is detailed in Table 1 below.

Table 1. Description variable study

Variable	Notation	Measurement
Dependent		
Firm Value	FV	Price/Book Value
Independent		
Independent Commissioner	ICO	Number of independent commissioner
Institutional Ownership	INO	Institutional share/outstanding
Audit Committee	ACO	Number of the audit committee
Control		
Firm Age	FAG	Firm age
Leverage	LEV	Total Liabilities/Assets

Source: some references

Panel data analysis

According to Santosa & Hidayat (2014), Panel data is a statistical technique that mixes time series (time series) with cross-sectional data. A time series is a collection of variables observed in a single observation unit over a specified time period. Meanwhile, *cross-section* data is observational data from several observation units. The data analysis technique used is panel data estimation with an econometric analysis model. Models used in the study this referring to some article previously, which has been empirically proven as follows (Santosa et al., 2020; Santosa, 2019; Yanto, 2018; Chan & Li, 2008) :

Model:

$$FV_{it} = \alpha_0 + \sum_{i=1}^{3} \alpha_i Corporate\ Governance + \sum_{i=4}^{5} \alpha_i Control_{it} + \varepsilon_{it}$$

$$FV_{it} = \alpha_0 + \alpha_1 ICO_{it} + \alpha_2 INO_{it} + \alpha_3 ACO_{it} + (\alpha_4 FAG_{it} + \alpha_5 Lev_{it}) + \varepsilon_{it} \quad (1)$$

where:
FV = firm value
$\alpha_1 \ldots \alpha n$ = coefficient intercept / slope
ICO_{it} = Independent Board of Commissioners
INO_{it} = Institutional Ownership
ACO_{it} = Audit Committee
FAG_{it} = Firm age
LEV = *Leverage*
t = period
ε = *error* term

4. RESULTS AND DISCUSSION

Descriptive Statistics

Based on results descriptive statistics, following this is characteristics sample used _ in the study this, namely: the sample means, median, maximum value, minimum value, and standard deviation (SD) for each variable. Below shows that in firm observation *non-financial*, which is listed on the LQ45 index on the Indonesia Stock Exchange for 2014-2019.

Table 1. Descriptive Analysis Results

	FV	ICO	INO	ACO	FAG	LEV
Means	23.4273	2.4500	0.5588	3.4200	49,000	0.4641
Median	0.47800	2.0000	0.5840	3,0000	50,500	0.4310
Maximum	1168.40	6.0000	0.9900	70000	99,000	0.9530
Minimum	-0.13708	1.0000	0.1090	3,0000	15,000	0.1330
Std. Dev.	161.1359	0.8333	0.1942	0.7410	19,656	0.1893

Correlation

Analysis correlation this used for knowing strength connection. Among correlation second variable where variable other considered important controlled. Based on results processing that has been done, show results as table 4.3 below this:

Table 2. Correlation Results

	FV	ICO	INO	ACO	HOMO	LEV
FV	1.0000					
ICO	0.3458	1.0000				
INO	0.2737	0.1538	1.0000			
ACO	-0.1339	0.0937	-0.3421	1.0000		
FAG	0.0713	0.0176	-0.2593	0.1504	1.0000	
LEV	0.0727	0.2375	0.1491	0.1729	0.3906	1.0000

Based on data results examiner Pearson correlation above and table interpretation Pearson correlation then obtained results that variable Board of Commissioners independent own moderate relationship with a correlation of 0.3458 and in the same direction to firm value variable (FV). Variable Ownership institutional own small and

positive correlation with number as big as 0.2737 against firm value variable (FV). Audit Committee own relationship of -0.1339 to firm value (FV). Firm age has a positive relationship of 0.0713 to firm value (FV). Finally, leverage has a positive relationship of 0.0727 to firm value (FV).

Panel Data Analysis Model Estimation

The common effect model (CEM), fixed effect model (FEM), and random effect model (REM) estimate findings are provided in Table 4 in the form of coefficients, probability, and coefficient of determination (R2 and R2 adjusted). Only ICO and INO have a significant influence on company value, according to a CEM study, with the level of significance set at 5% and the coefficients of determination R2 and R2 adjusted for 0.158 and 0.1799, respectively. While the other factors, such as ACO, FAG, and LEV, are all statistically insignificant.

Table 4. Results of the CEM, FEM, and REM Model Data Panel

		CEM		FEM		REM	
Variables	**Hypothesis**	**Coefficient**	**Prob**	**Coefficient**	**Prob**	**Coefficient**	**Prob**
ICO	+	0.3715	0.0012	0.0339	0.1715	0.1691	0.2878
INO	+	1.1383	0.0308	1.3552	0.0729*	0.0058	0.0937*
ACO	+	-0.1584	0.2303	0.1656	0.1061	0.1256	0.2744
FAG	+/-	-0.0036	0.6231	-0.0153	0.0630*	-0.0076	0.0845*
LEV	-	0.7373	0.1597	-1.9882	0.0498	-0.5428	0.0754*
C		0.0168	0.9792	9.7917	0.0000	1.1874	0.1179
R-squared		0.1958		0.8147		0.4266	
R-sq adj		0.1799		0.7944		0.4048	

Analysis FEM found that the effect of INO, FAG, and LEV on firm value was significant at levels = 5% and = 10%. The coefficient of determination of the CEM model is R^2= 0.8147. The Independent variable that is not influential is ICO and ACO. Moreover, REM panel results show similar results with FEM where INO, FAG, and LEV affect firm value significantly, with a coefficient of determination R^2 of 0.3266, at =5%. Analysis CEM, FEM, and REM show amount independent variable significant almost the same, but with different levels of significance. This research conducted the Likelihood test between CEM and FEM; Lagrange multiplier (LM) test between CEM and REM; and Hausman test between the FEM and REM models to get the optimal model.

***Likelihood-* test**

For choosing the best panel data estimation model between CEM or FEM, did examiner *Likelihood-test*. The hypothesis:

Ho: *Common Effect Model*

Ha: *Fixed Effect* Model

basis decision:

If probability from Chi-square > 0.05, then Ho is accepted.

If probability from Chi-square < 0.05, then Ho value is rejected

following is results Likelihood -Test comparing CEM and FEM:

Table 5. Results of Likelihood-Test

Effect Test	Statistics	df	Problem.
Cross-section F	16.377291	(19.75)	0.0000
Chi-square cross-section	163.878574	19	0.0000

The chow test findings in Table 5 indicate that the probability is 0.0000 based on the Chi-square value. Because the chance of additional Chi-square values being less than 0.05 indicates that Ho is rejected, the optimum panel data estimating model based on the findings of the Chow test is the Fixed Effect Model.

Hausman-Test

We will be the compare between FEM and REM with using *Hausman's* test.
Hypothesis namely:

Ho: *Random Effect Model*

Ha*: Fixed Effect* Model

basis decision:
If probability chi-square > 0.05, then Ho is accepted.
If probability chi-square < 0.05, then Ho is rejected.

Table 6. *Hausman* test results

Test Summary	Chi-Sq. Statistics	Chi-Sq. df	Problem.
Random cross-section	31.190040	5	0.0000

According to the result of the examiner Hausman test in Table 6, the probability value is 0.0000 based on the Chi-square value. Because Ho is rejected when the value probability Chi-square is less than 0.05, the optimal panel data estimate model is the Fixed Effects Model (FEM).

Discussion

Based on testing the effect of the independence of the board of commissioners on firm value, presents that independence of the board of commissioners has a positive and no significant effect on firm value. This finding is consistent with the conclusion of (Dirawati Pohan & Dwimulyani, 2017; Rahmadani & Rahayu, 2017; Perdana & Raharja, 2014). Based on the idea that the higher the proportion of independent commissioners in the firm, it is expected that the empowerment of the board of commissioners can carry out supervisory duties and provide advice to the board of directors effectively and added value to the firm (Perdana & Raharja, 2014). However, some study results show the existence of the independent commissioner in firm rated not yet effective enough for monitoring the management firm that why market participants have not fully believed the performance of independent commissioners in the firm, specifically if the influence of family ownership (Kusumaningtyas & Andayani, 2015; Muktadir-Al-Mukit & Keyamoni, 2019).

We also find that the relationship between ownership concentration or institutional ownership with firm value is positive and significant. It is expected that by holding a larger ownership, management can ensure greater participation in corporate affairs and ensure corporate governance implementation and sustainability. Nevertheless, in most cases, they hold the shares to maintain and take advantage of ownership rather than adding value to the firm (Muktadir-Al-Mukit & Keyamoni, 2019; Connelly et al., 2010).

Ownership structure plays a central role in determining the degree to which the interests of owners and managers are aligned to integrate the extensive literature on ownership concentration as a form of corporate governance to support financial performance (Connelly et al., 2010). Institutional ownership generally acts as a monitoring party firm. Firms with large institutional ownership indicate their ability to monitor management (Santosa et al., 2021). The greater the institutional ownership, the more efficient the utilization of firm assets. Thus the proportion of institutional ownership acts

as a precaution against waste by management, on the other hand, the positive and significant effect of audit committee independence on firm value. The more independent audit committee, namely the presence of external members on the committee, the more effective corporate governance practices are to improve financial performance and firm value (Nuryono et al., 2019; Santosa et al., 2020).

Dirawati Pohan & Dwimulyani (2017) stated that investors, analysts and regulators consider the audit committee to contribute to the quality of financial reporting. This demonstrates that the establishment of an audit committee has a favorable and considerable effect on the value of a business. Firms with well-regulated audit committees and independent expert panels, on the other hand, result in less revenue manipulation because they are responsible for financial oversight and control, which ultimately contributes to market performance by ensuring higher-quality disclosed financial reporting. However, our finding is not in line with the hypothesis and this finding is also consistent with previous research (Latif & Abdullah, 2015).

Firm age, as controlling variable, shows how long a firm can survive, compete, and take opportunities existing business in the economy. Firm age is important to firm value because the longer they age, the more information obtained; this will cause trust in consumers and investors to firms. The age of the firm also causes the more experienced firm to build the trust of investors. However, so from the side, productivity tends to decrease the firms age, gradually reducing the firm value (Nanda & Nahumury, 2018). The last variable, leverage, shows the negative and significant influence. This finding shows that if debt ratio increases, the firm value will decrease because of the present value of the tax shield, with the condition of the leverage target being exceeded. In addition, debt financing encourages business expansion, but it can potentially reduce the firm value (Santosa, 2020; Kyriazopoulos, 2017; Rahmadani & Rahayu, 2017).

5. CONCLUSION AND IMPLICATIONS

The nexus between corporate governance mechanisms and firm value attracts less attention than the classical determinants of financial performance. Thus far, empirical findings have been inconsistent, leaving the subject open for additional investigation.The current study tries to re-examine the determinants of firm value, especially concerning corporate governance of a market that has experienced a prolonged decline in investor confidence and some disruption from the capital market.

Regarding the specific determinants of corporate governance of firm value, we find some evidence in line with the of the hypothesis and several recent studies. Specifically, the independent commissioners have a positive but insignificant relationship with firm value, while institutional ownership positively correlate with firm value significantly. Additionally, the audit committee has no influence on business value, indicating that corporate governance has no effect on financial performance. This finding can happen because it is assumed that the audit committee's role is not optimal in carrying out the supervisory and control functions of the corporate management so that the responsibility of the management is considered not transparent and results in a decrease in shareholder trust.

The implication is that the audit services provided by the audit committee do not appear to offer effective and appropriate corporate governance for financial performance. This result can be attributed to the low effectiveness of independent commissioners and

audit committees in the Indonesian capital market, where foreign investors have the largest market investment in trading activities.

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