SIMULTANEOUS DETERMINATION OF CORPORATE GOVERNANCE AND FIRM VALUE

Lela Hindasah[1], Alien Akmalia[2]
[1]Universitas Muhammadiayah Yogyakarta
[2]Universitas Muhammadiayah Yogyakarta

ABSTRACT

This research aims to examine the simultaneous effect of Corporate Governance (CG) and Market Performance (Tobin's Q). This research also intend to investigate determinant GCG and Tobin's Q. CG implementation is measured based on the result of an annual survey by Indonesian Institute for Corporate Governance (IICG) which is in The Report of Corporate Governance Performance Index (CGPI). The samples are listed company in Indonesian Stock Exchange which took part the survey by IICG and scored in CGPI from 2008 to 2014.

This research uses 40 firm years for sample. Using 2 SLS method, this research found that growth and size have positive influence to corporate governance implementation. This research also found that DER and ROA have positive influence to Tobin's Q. There is no simultaneous result GCG and Tobin's Q. Tobin's Q have positive influence to corporate governance but there is no positive impact of GCG implementation to Tobin's Q.

Keywords: Good Corporate Governance, Firm Value, Tobin's Q

INTRODUCTION

One of the most significant governance issues currently facing the managers, director and shareholders of the modern corporation is corporate governance. Saragih et all, (2012) examine Corporate Governance was born out of the concept related to management monitoring in the process of good decision making. The monitoring is reflected in a set off system regulating and controlling a company to create added value for the interests of the entire stakeholders in a company.

Corporate Governance (CG) articulated by Would Bank " CG concerns the system by which companies are directed and controlled. It is about having companies, owners and regulators become more accountable, efficient and transparent, which in turn build trust and confidence. Gregory & Simms (1999) argue Corporate Governance is important because as markets become more open and global, and business becomes more complex, societies around the world are placing greater reliance on the private sector as the engine of economic growth.

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One principle of corporate governance are disclosure and transparency. This principle stipulates that relevant and reliable disclosure is made an all material matter regarding the corporation. By applying this principle information asymmetry can be reduce and thus negative consequences of adverse selection and moral hazard problems can be minimized (Utama, 2003). Corporate governance based on Cadbury Committee of united Kingdom is a set of rules that define the relationship between shareholders, managers, creditors, the government, employees and other internal and external stakeholders in respect to their rights and responsibilities, or the system by which companies are detected and controlled (www.iicg.org). These Principles build on four essential articulated by the OECD (Organization for Economic Co-operation and Development) Business Sector Advisory Group. The four principles of corporate governance articulated in the Millstein Report -- fairness, transparency, accountability and responsibility (Gregory and Simms, 1999).

1. Fairness: The OECD Principles expand on the concept of "fairness" with two separate principles. (1) "The corporate governance framework should protect shareholders' rights." (2) "The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights."

2. Transparency: "The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership and governance of the company."

3. Accountability: "The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders."

4. Responsibility: "responsibility" to mean that: "The corporate governance framework should recognize the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises."

Klapper and Love (2003) provide a study of firm- level corporate governance practices across emerging market. The research explore the determinants of firm level governance and find that governance is correlated with the extent of the asymmetric information and contracting imperfections that firm face. Their Research also find that better corporate governance is highly correlated with better operating performance and market valuation.

Black et all (2003) report evidence that corporate governance is an important factor in explaining the market value of Korean public companies. The research find a strong positive correlation between the overall corporate governance index and firm value, which is robust across OLS, 2SLS and 3SLS regressions, in subsamples, in alternate specifications of the corporate governance index, and with alternate measures of firm value.

Firms with a high proportion of debt in their capital structure are more likely to face creditor monitoring, and may also care less about attracting equity capital, so could evolve weaker governance (a substitution story). In a reverse causation story, worse-governed firms could have less access to equity and thus rely more on debt. Alternatively, creditors could offer better terms to firms with improved governance (Black, 2006). The search found leverage have negative effect to Corporate Governance. (Black et all, 2006; Gillan et all 2003)

Black et all (2003) adopt provides evidence for a causal link between the exogenous component of corporate governance and firm value, and against two alternate explanations for the correlation between corporate governance and firm value. There is some weak evidence from our 3SLS results that firms with high Tobin's q choose better governance rules, but a much stronger implication that better governed firms have higher Tobin's q.

Rajhans and Kaur (2013)makes an approach to identify factors affecting value of a firm. Data of last 10 years. were collected for the analysis. Pooled regression was applied on this data to evaluate the determinants. The outcome suggests that profit, sales, fixed assets and WACC affect value of a firm significantly. Arenet all (2014) investigate the determinants and effects of corporate governance level of the firms operating in Istanbul Stock Exchange. It was drawn that firm value was the most important determinant for corporate governance level to be enhanced. The search found a positive relationship between growing corporate governance implementations of the firms and the firm performance.

Based on the differences results of the studies, we interested to conduct a study: simultaneous determination of corporate governance and firm value. Generally the research aims to (1) analyze simultaneous relationship between corporate governance and firm value (2) analyze the effect of DER, ROA, Growth, Size to Corporate Governance (3) analyze the effect of DER, ROA, Growth, Dividend to Firm Value (Tobin's Q)

Governance Index

This research relies on data from the survey IICG (The Indonesian Institute for Corporate Governance (IICG). Quality of corporate governance is an assessment of corporate governance which in turn strengthen to the company's predicted (consist of the predicate "very reliable",

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"reliable" and fairly reliable") related to how good corporate governance is implemented by a firm. Rating Corporate Governance Perception Index (CGPI) includes four different weight based on value, self-assessment the document completeness, paper, and observation. The rating level of assessment is as follows:

Table 1 The CGPI rating

Implementation quality corporate Governance Criteria	Rating Level CGPI Assessment
Very reliable	80 – 100
Reliable	70 – 84.99
Fairly reliable	55 – 69.99

Firm Value

Stockholder wealth maximization is one of corporation goal, which translate into maximizing the price of the firm's common stock (Brigham and Houston, 2004: 15). High stock prices make the firm"s value is also high, and enhance market confidence not only to the firm"s current performance but also on the firm's prospects for the future. According to Klapper& Love (2003) measurement of the value of the firm can done by using the ratio of Tobin's Q. Tobin'Q ratio is the market value of a firm by comparing the market value of firm on the financial market with a replacement value of the asset of the firm.

Tobin's Q value between 0-1 shows that the company's stock is undervalued. A value of 1 indicates that the market value reflects the value of assets of the company, while if the value of Tobin's Q> 1 indicates that the market value is greater than the value of assets. It can be said that the market value reflects the assets can not be measured from companies such as reputation, or innovation which is the value given by the shareholders or analyzes the company's business (Suryanto and Dai, 2016)

Simulataneous Corporate Governance and Firm Value

Black et all (2003) adopt provide evident for a causal link between corporate governance and firm value, and against two alternate explanations for the correlation between corporate governance and firm value: signaling (firm signal quality by adopting good governance rule) and reverse causality (firm with high Tobin's q choose good governance rule).

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Good governance is positively correlated with market valuation (Klapper and Love, 2003). In the single country study, Black at all (2003) examine the effects of corporate governance structures on the market value of Korean firms and suggest that corporate governance is a significant dynamic ini explaining the market value of Korean public companies. According to agency theory, selfish agents will tend to allocate resources that do not increase the value of the firm. The agency issues would indicate that the value of the firm will increase if the firm owner can control the behavior management in order not to waste resources companies. Hamonangan and Mas'ud, 2006 states that Corporate governance is the system that regulates and controls the firm which is expected to provide and enhance the value of firm through shareholders. Thus, the implementation of Good Corporate Governance is believed to increase the value of the firm.

There are some research to prove the theory and argumentation above. Aren et all (2014) found a positive relationship between growing corporate governance implementations of the firms and the firm performance. Rustiarini (2010) in her research also prove that corporate governance has positive influence to Tobin's Q.

Based on elaborated description above, the hypothesis is formulated as follows:

H1 Tobin's Q has a positive effect on the Good Corporate Governance implementation

H2: Good Corporate Governance has a positive and significant impacton firm value.

Determinant Corporate Governance

Firm with good growth opportunities will need to raise external financing in order to expand and may therefore find it optimal to improve their governance mechanisms as better governance and better minority shareholder protection will be likely to lower their costs of capital (Klapper and Love, 2003). Agency theory suggests that corporate governance controls are associated with information asymmetry. The incidence of information asymmetry is higher for growth firms because managers have private information about the value of future projects and hence their actions are not readily observable to shareholders. Therefore, there are higher shareholder/manager agency costs associated with high growth firms and greater need for corporate controls. (Hutchinsona, and Gulb (2003)

H3 :Growth has a positive effect on the Good Corporate Governance implementation

The effect of size is ambiguous as large firms may have greater agency problems (because it is harder to manitor them or because of the “free cash flows”)argument of Jensen, (1986) and therefore need to compensate with stricter governance mechanisms (Klapper and Love, 2003). small firms had lower CG levels owing to inadequate monitoring by the public (Aren et all, 2014). Darmawati (2006) show that firm size have positive influence to the quality of corporate governance implementation. Black, 2006 argue larger firms are more complex, and therefore may need more refined corporate governance.

H4 Size has a positive effect on the Good Corporate Governance implementation

If need for outside capital influences firms' governance choices, then more profitable firms should have worse governance because they generate more capital internally, therefore have less need to improve governance to attract external capital. Less profitable firms may also improve their governance because they hope this will increase profitability or because investors pressure them to do so. On the other hand, better-governed firms may be more profitable. Higher profitability predicts lower Corporate Governance (Black, 2006)

H5: Profitability has a negative effect on the Good Corporate Governance implementation

Firms with a high proportion of debt in their capital structure are more likely to face creditor monitoring, and creditors could offer better terms to firms with improved governance (Black, 2006). Firm with external financing in order to expand improve their governance as better governance to lower their costs of capital.

H6: DER has a positive effect on the Good Corporate Governance Implementation

Determinant of Firm Value

Pecking Order Theory explained a sequence of funding decision, where the manager firstly will use retained earnings, debt and the issuance of common stock as the last choice (Hanafi, 2004). Bringham (1999) states that companies more likely to use debt than issuing new stock, because cost of debt is cheaper than issuing new stock itself. Fama and French (1998) found that investment resulting from leverage has positive information about the company in the future so it will give positive impact on the firm value. In addition, debt financing can decrease the government tax that can increase the firm value.

Rajhans and Kaur (2013), Hasnawati (2005), Wijaya & Wibawa (2010), Wahyudi & Pawestri (2006) have proved that debt has positive and significant impact on firm value. So, the hypothesis is:

H7: Debt has positive and significant impact on Firm Value.

Profitability is the ability of a firm to generate earnings from its operational activity. Return on Assets (ROA) can be used to account the profitability of a firm. Myers and majluf (1984) found that financial managers use the pecking order theory with retained earnings as a first choice in the fulfilment of the funds and debt as a second choice as well as the issuance of shares as the third choice will always increase the profitability to increase profits. ROA measures the firm's ability to utilize its assets to create profits by comparing profits with the assets that generate the profits. This ratio is considered by prospective investors and shareholders as it relates to the share price and dividends to be received. (Buyung, et all, 2016). If share of a firm has a high valuation by investors, it will make the price of the stock is increased. Finally this condition will increase value of the firm.

Evidence from American firms (Gill Amarjit & Biger Nahum 2012) concluded that profitability, turnover and market ratio has a significant impact on stock return (Khairurizka, Martani, Mulyono (2009).(Rajhans & Kaur, 2013). Rajhans & kaur, 2013 found that profitability was the most significant factor affecting value of the firm.

H8: Profitability has positive and significant impact on a firm value.

Growth expressed as a growth of total assets, where total assets of the past will illustrate profitability and growth in the future (Taswan, 2003). These growth opportunities should also be reflected in the market valuation of the firm, thus creating a positive correlation between governance and Tobin's-Q (Klapper& Love). Ludwina and Ratna (2012) Companies with large investment opportunity indicate a good future prospects and therefore will have a positive impact on the value of the firm. Growth of the firm is important for the investors, because it can be a signal whether a firm has a good prospect or not. Investors expect that they will get a better rate of return from their investment. Esistence of investment opportunity will give positive signal on the growth of the firm so it will increase firm value. Based on elaborated description above, the hypothesis is formulated as follows:

H9: Growth has a positive and significant impact on firm value.

Signaling theory states that high profitability of the firm will show a good prospect of the firm, so investor will give positif respons therefore value of the firm will increase (Bhattarcarya, 1979). Dividend will give positive signal to the external investor, because it can describe the performance of the firm whether it is good or not. Company will be careful on determine it's dividend policies because of that reason. Increasing or decreasing of devidend can be a very sensitive issue for the investors thus cause major effect to the company.

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Easterbook (1984) found that dividend payment can decrease agency cost, because high dividend payout ratio will decrease retained earning ratio and firm will add external finding like new stock emission. The firm using an external funding will be monitored by external, so they will be more careful and can act such as share holders interest. It can decrease agency conflict so can increase the value of the firm.

Related to explained description, the hypothesis is therefore formulated as follows:

H10: Dividend Payout Ratio have a positive and significant effect to the firm value

Research methods

Population and Sample

The population refer to the entire group of people, evens, or things of interest that researcher wishes to investigate (Sakaran, 2013: 240). The population of this research are firms rated in CGPI rating in 2008 – 2014 listed on the Stock Exchange.

Sampling is the process of selecting a sufficient number of the right elements from the population, therefore study of the sample and understanding of its properties or characteristics make it possible to generalize (Sakaran, 2013:244). This research use purposive sampling. Cooper (2008:297) stated that purposive sampling was a non probability sample that conforms to certain criteria. Sampling criteria in this research are:

1. Firms are listed in Indonesia Stock Exchange which have financial data in Indonesian Capital Market Directory or have published financial statements in BEI website (www.idx.co.id) or in firm personal website in 2008-2014 period.

2. Firms are rated in Corporate Governance Perception Index (CGPI) and published by The Indonesian Institute for Corporate Governance (IICG) in SWA magazine during 2008-2014 period.

3. Firms paid dividend cash

4. Financial statements do not have deficiency of equity

5. Firms have complete data related to variables used in this research, namely total asset, total liability, total equity, number of total shares, net profit after tax, market capital information,

Based on criteria above, this research uses 40 firm years for sample.

Research Data

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Type of data from this research is secondary data. Secondary data are data that already exist and do not generate by researcher. Some secondary sources of data are from statistical bulletins, government publications, published or unpublished information available from either inside or outside organization etc (Sekaran 2013:36). Secondary data used in this research are:

1. Corporate Governance Perception Index used by The Indonesian Institute to Corporate Governance during 2008-2014 period and published in SWA magazine.

2. Financial ratio and non financial information from firm financial statement during 2008-2014 period which are published in The Indonesian Capital Market Directory (ICMD) or Indonesian Stock Exchange website (www.idx.co.id).

Definition of Variables and Variable Measurement

The purpose of this research is to analyze determinant Good Corporate Governance and Firm Value.

Endogen Variable

1. GCG (Good Corporate Governance)

The first endogen variable is quality of corporate governance implementation. The quality of corporate governance implementation is measured by the rating of corporate governance implementation published by The Indonesian Institute Corporate Governance namely Corporate Governance Perception Index (CGPI).

The index is called Corporate Governance Perception Index which entitled very trusted, trusted, and fair trusted according with score range. Thus, the result of CGPI is describing the quality of corporate governance implementation of the firms. The formula to calculate CGPI developed throughout 4 assessments namely, Self Assessment, Document Completeness, Paper, and Observation

2. Firm Value

According to Klapper and Love (2003) measurement of firm value used ratio of Tobin's Q (market value of asset/book value of asset.

Exogenous variables

There are 5 exogenous variables used in this research: FIRM SIZE, DER, GROWTH, DPR, ROA

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Empirical Result

Descriptive Statistic

Descriptive statistic is intended to give description of any characteristic samples used in this research. Descriptive statistic consists of maximum score, minimum score, mean, and standard deviation from processed data. Table 5 explain that descriptive statistic (GCG, DPR, SIZE, GROWTH, DER, ROA, TOBIN'S Q).

Table 5 Descriptive statistic

	N	Minimum	Maximum	Mean	Std. Deviation
GCG	40	65.9400	90.5800	7.979850E1	5.8954479
DPR	40	.0500	1.1100	.375525	.2212794
SIZE	40	28.1790	32.3440	3.026640E1	.9964091
GROWTH	40	-.1300	.7570	.198300	.1770935
DER	40	.2740	3.7450	1.111175E0	.8738071
ROA	40	.0110	.2900	.123750	.0740470
TOBIN_Q	40	.5170	6.9400	2.274525E0	1.6189155
Valid N (listwise)	40				

Hypothesis Testing

This brief review of the relationship between corporate governance and corporate performance, from an econometric viewpoint can be described by the equation below:

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GCG = α + β1**Tobin_Q** + β2DER + β3ROA + β4GROWTH + β5SIZE + e

Tobin_Q = α + β6 **GCG** + β7 DER + β8ROA + β9 GROWTH + β10DPR + e

GCG= Corporate Governance Perception Index

Tobin_Q= Market to Book Value/Total Asset

DER = Debt to Equity Ratio

GROWTH = Growth of Total Asset

SIZE = According to Black, et al. (2003), Drobetz et all, (2004) firm size can be measured by Log Natural (Ln) firm total assets

DPR= Dividen Payout Ratio

α = Constanta

e = Error

β1 – β8 = Regression coefficient.

In a model of M simultaneous equations, in order for an equation to be identified, it must exclude at least M-1 variables (endogenous as well as predetermined) appearing in the model. If it excludes exactly M-1 variables, the equation is just identified. If it excludes more than M-1 variables, it is over identified. (Gujarati, 2013:699)

If K-k > m-1 the equations is over identified

If K-k =m-1 the equation just /exact identified

If K-k <m-1 the equation under identified

To understand the order and rank conditions, This research introduce the following notations:

M=number of endogenous variable in the model

m=number of endogenous variable in a given equation

K=number of predetermined variable in the model including the intercept

k= number of predetermined variable in a given equation

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Table 3 Order condition This model:

Stuctural equation	K-k	m-1	Order condition of identifiability
Tobin's Q	7-5	2-1	overidenfied
CGPI	7-5	2-1	overidentified

The method of Two Stage Least Square (2 SLS) is especially designed for over identified equations (Gujarati, 2013:730)

Table 4 Estimated coefficients for good corporate governance and Tobin's Q Equations using Two Stage Least Square (2SLS)

Independent variables	Dependent Variables	
	GCG	Tobin's Q
Constant	-5.720024 (-0.302936)	4.523604 (0.736531)
GCG		-0.062497 (-0.724446)
Tobins'Q	5.512640 (2.809799)***	
DER	-0.708199 (-0.570354)	0.622056 (1.699049)*
ROA	-42.21709 (-1.700316)*	11.07297 (2.229034)**
Growth	14.64927 (3.390654)***	-0.071781 (-0.041730)
Size	2.513885	

	(3.907693)***	
Divident		1.839682 (0.1796)
Adjusted R-squared F-statistic	0.595484 (6.812158)***	0.150951 (3.218979)**

Significant coefficients at the 1% ***

Significant coefficients at the 5% **

Significant coefficient at the 10% *

Simultaneous Corporate Governance and Firm Value

Firm Value. has effected the Corporate governance This result accordance with Black et all (2003) argue that firm with high Tobin's Q choose good governance policy.

Corporate governance has not effect the Firm Value. This result in accordance with Klapper and Love, 2003 and Rustiarini, 2010. Rustiarini found that corporate governance has positive influence to Tobin's Q. While the research of Klapper and Love, 2003 show that Improvement in firm level governance, improves performance and market valuation.

Result of this research accordance with Ratih (2011). CGPI is not effecting a firm value, it indicates that this information is not considered by ivestor. Investor concluded that eventhough the company has a rank in The Indonesian Most Trusted Company, it doesn't give more economic value for them (Ratih, 2011).

Determinant of Corporate Governance

According to this research result, it is shown that Growth of total assets has positive and significant effect on the Corporate Governance. This is accordance with Klapper and Love (2003), firm with good growth opportunities will need to raise external financing in order to expand and may therefore find it optimal to improve their governance mechanisms as better governance and better minority shareholder protection will be likely to lower their costs of capital. Hutchinsona, and Gulb (2003) argue that higher shareholder/manager agency costs associated with high growth firms and greater need for corporate controls.

The research result shown that Firm size has positive and significant effect on Corporate Governance. This research accordance with Darmawati (2006) shown that firm size have positive influence to quality of corporate governance implementation. Black et all (2006) argue larger firms are more complex, and therefore may need more refined corporate governance. Arenet all (2014) argue that small firms had lower CG levels owing to inadequate monitoring by the public.

According to this research result, it is shown that the profitability of a firm has positive effect on the Corporate Governance. This research accordance with Black (2006), If need for outside capital influences firms' governance choices, then more profitable firms should have worse governance because they generate more capital internally, and thus have less need to improve governance to attract outside capital. Less profitable firms may also improve their governance because they hope this will improve profitability or because investors pressure them to do. Higher profitability predicts lower Corporate Governance.

Debt has no significant effect on Corporate Governance. This result is not in accordance with Black (2006). Firms with a high proportion of debt in their capital structure are more likely to face creditor monitoring, and may also care less about governance.

Determinant of Firm Value

The research result shows that debt has positive and significant effect on Firm Value. Investment resulting from leverage has positive information about the company in the future so it will give positive impact on the firm value (Fama and French, 1998). Besides that, debt financing can decrease the government tax that finally it can also increase the firm value. This result accordance with Rajhans and Kaur (2013), Hasnawati (2005), Wijaya & Wibawa (2010) and Wahyudi & Pawestri (2006).

According to this research result, it is shown that the profitability of a firm has positive effect on the firm value. ROA measures the firm’s ability to utilize its assets to create profits by comparing profits with the assets that generate the profits. This ratio is considered by prospective investors and shareholders as it relates to the share price and dividends to be received. (Buyung, et all, 2016). If share of a firm has a high valuation by investors, it will make the price of the stock is increased. Finally this condition will increase value of the firm. This result accordance with Rajhans & kaur, 2013

Growth has no significant effect on firm value. This is not in accordance with Ludwina and Ratna (2012) who stated that Companies with large investment opportunity indicate a good future prospects and therefore will have a positive impact on the value of the firm.

This result in accordance with Subekti (2001). His research shown that growth has insignificant effect on firm value. High growth of a firm will make capital expenditure is increased. It means that cost of investment will be increased and investor will get fewer return. Company that has high growth will have a fewer amount of funding available for their investors. Investors are more confidence to invest their fund in the companies that already established rather than growing companies. Even though growth of a firm is high, it will not effect the intention of investors and value of a firm.

Dividend payout ratio has no significant effect on firm value. This result is not in accordance with Easterbrook (1984).This research accordance with Yangs (2010) and Herawati (2011). Irrelevant dividend theory support the result of this research. There are some assumption used in this theory which make there is no effect between dividend policy and stock price or firm value. In general, investor focused on total of return from their investment decision. The investor less focused on the resource of return, whether it from capital gain or dividend. Therefore, investors will not consider whether profitability of the firm will distribute as a dividend or hold as retained earning and it will not effect the value of the firm.

Conclusion

This research intends to investigate the determinant GCG and Tobin's Q. This research also aims to examine simultaneous effect of Corporate Governance (CG) and Market Performance (Tobin's Q). The samples are from listed company in Indonesian Stock Exchange which took part the survey by IICG and scored in CGPI during 2008 to 2014 period. The result of this research mainly concludes as follow:

1. By using 2 SLS method, there is no simultaneous result GCG and Tobin's Q. Tobin's Q have positive influence to corporate governance but there is no positive impact of GCG implementation to Tobin's Q.

2. This research found that growth and size have positive influence to corporate governance implementation

3. Debt to Equity Ratio and ROA have positive influence to Tobin's Q

Contribution for Future Research:

This research use CG implementation measured based on the result of an annual survey by Indonesian Institute for Corporate Governance (IICG) which is in The Report of Corporate Governance Performance Index (CGPI). The future research can use corporate governance disclosure as a proxy of corporate governance. Banks can also be use as objects of research in the next research. The proxy of corporate governance for Bank use corporate governance regulate by Otoritas Jasa Keuangan (OJK).

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