www.bircu-journal.com/index.php/birci
Budapest International Research and Critics Institute-Journal (BIRCI-Journal)
Humanities and Social Sciences
ISSN 2615-3076 Online)
ISSN 2615-1715 (Print)
Budapest Institute

The Effect of Governance on Firm Value with Financial Performance as a Mediation Variable in Go Public Companies in Indonesia

Kurniati W. Andani[1], Yusbardini[2]
[1,2]Faculty of Economics and Business, Universitas Tarumanagara, Indonesia

Abstract

The purpose of this study is to analyze corporate governance on firm value with financial performance as a mediating variable in manufacturing companies on the Indonesia Stock Exchange (IDX) with corporate governance indicators consisting of CEO Duality and CEO Tenure. The benefit of this research is that good governance will increase financial performance and firm value. The sample used in this study consisted of the annual financial statements of all companies listed on the Indonesia Stock Exchange. The sample of this study was 44 companies selected through purposive sampling method. The company data for this sample selection was taken from financial reports and annual reports from the official website of the Indonesia Stock Exchange, namely idx.co.id and the company's official website. Data processing is done using Eviews. The results of this study can show the effect of CEO Duality and CEO Tenure on firm value and financial performance as mediating variables. The results show that CEO Duality, CEO Tenure has an effect on, financial performance and, CEO Duality, CEO Tenure has an effect on firm value, financial performance is able to mediate, CEO Duality and firm Value and financial performance is not able to mediate CEO Tenure and Firm Value.

Keywords
CEO Duality; CEO Tenure; financial performance; firm value

I. Introduction

Every company must aim to maximize the welfare of its shareholders. The welfare of shareholders can be improved through company performance, where company performance is the company's ability to achieve company goals by using efficient and effective resources (Daft, 2010). In addition to improving financial performance, every company will also try to increase the value of the company because when the company's value is high, investors will be more interested in investing in the company. Various ways will be taken by management in order to increase the value of the company, one of which is by increasing the welfare of shareholders as reflected in stock prices (Brigham & Joel, 2006). Firm value can be said as the result of a company's performance in one period. The better the financial performance of a company, the possibility of investors to invest their funds in the company will increase. This is because when a company's performance is getting better, the value of the stock will increase so that it can finally provide the return expected by investors (Weston & Copeland, 1997). Company performance can be improved by applying the principles of good corporate governance. The principles of good corporate governance applied by the company will not only improve performance and bring big profits for the company, but will also increase corporate social responsibility (Corporate Social Responsibility) itself (Fuzi et al., 2016).

DOI: https://doi.org/10.33258/birci.v5i3.6994

Budapest International Research and Critics Institute-Journal (BIRCI-Journal)
Volume 5, No 3, August 2022, Page: 28675-28684
e-ISSN: 2615-3076 (Online), p-ISSN: 2615-1715 (Print)
www.bircu-journal.com/index.php/birci
email: birci.journal@gmail.com

The implementation of good corporate governance also contributes to maintaining the continuity of a healthy, structured and competitive company's operations in the long term. All parties in the company's organizational structure are required to implement the principles of good corporate governance in order to improve company performance. Each company has an organizational structure consisting of a board of directors, a board of commissioners, an independent board of commissioners, managers and other company employees. This principle will create an independent, equal, responsible and transparent working environment. According to Meier, (2005) “Good corporate governance will provide impetus to the board and management to achieve company goals. In a good corporate governance system, the company board has a very important role.” Boot et al. (2002) stated that in general, the company's board is divided into two, namely, the board of commissioners and the board of directors. Errors in the selection of the board of directors and the board of commissioners will have an impact on the performance produced by the company. The debate is whether a Duality CEO is needed in a company. CEO Duality is someone who has 2 positions at once, namely as Chairman of the Board (Board of commissioners) and Chief Executive Officer (Board of directors) in a company.” According to Harlan & Dalton, (1997) “The fundamental question surrounding CEO Duality's leadership is whether the position of the board of commissioners should be filled by the CEO or by a different person. In addition, the term of office of the directors is also considered to affect the company's performance. The term of office that has been carried out by a Chief Executive Officer from the time he was first appointed until the end of the year he served is called CEO Tenure.” Ahmadi et al., (2018)” found that knowing the average CEO tenure can help determine the possibility of a convergence of interests or abuse of power protected by the CEO's control rights. An increase in the tenure of the CEO by one year or an increase in the CEO Tenure will also reduce the company's performance."

II. Review of Literature

2.1 Theoretical Background

Jensen and Meckling (1976) "describe agency theory as the relationship between company owners (principals) and company management (agents)". According to Mahrani & Soewarno, (2018) "There are different interests between the capital owner (principal) and the company management (agent), the capital owner will try to increase the company's profits in order to get a profitable return, on the contrary the company management will try to maximize profits for a large commission to meet his economic and psychological needs. This difference in interests can cause both parties to act according to their respective interests and give birth to a conflict called an agency conflict. With this agency theory, agents are expected to make the right decisions so as to reduce or even avoid conflicts between management and shareholders. The management consisting of the board of directors, board of commissioners and other members of the company has the responsibility to manage assets and all operational activities of the company so that the company's goals can be achieved. On the other hand, the shareholders also expect that every decision taken by the management is the best decision that will benefit the shareholders. Therefore, the existence of a good relationship and disciplined attitude between the agent and the principal will greatly affect the company's performance. According to Dayton, (1984) "Agency theory supports the separation of the roles of the board of directors and the board of commissioners because this theory believes that CEO Duality can reduce the monitoring role of the board of directors over executive managers, so that later it will have a negative impact on company performance. The board of commissioners who are independent from the board of directors can control conflicts of interest so as to protect the interests of shareholders. Likewise, CEO tenure, the average CEO tenure can help determine the possibility of a convergence of interests or abuse of power protected by the CEO's control rights. An increase in the tenure of the CEO by one year or an increase in the CEO Tenure will also reduce the company's performance".

2.2 Research Hypothesis

a. The Effect of CEO Duality on Firm Value

"CEO Duality within the company can be used to reduce decision-making costs, especially in terms of speed in making and implementing decisions." According to Williamson, (1985) "In CEO Duality, it is possible for the CEO to act in the interests of the shareholders when the interests of the CEO coincide and are in line with the interests of the shareholders." According to Rechner & Dalton, (1991) "The conflict of interest involved with CEO Duality can be the reason why a separation of the Board of Directors and the Board of Commissioners is needed because the function of the board is to monitor the performance of top management, so the separation of the Board of Directors and the Board of Commissioners needs to be done in order to maintain checks. and balances. When the checks and balances have stabilized, the value of the company will increase in the eyes of investors."

H1: CEO Duality has an effect on Firm Value

b. The Effect of CEO Duality on Financial Performance

McWilliams, & Sen, (2001) "suggested that CEO Duality can hinder the board from the board's duties and responsibilities, including assessing and monitoring management performance, which in turn can reduce the company's overall performance. Finkelstein & D'Aveni, (1994) stated "CEO Duality can improve company performance because with the same person who doubles as the board of directors and board of commissioners, that person can monitor the company clearly and can have unique orders throughout the company.

H2: CEO Duality has an effect on Financial Performance

c. The Effect of Financial Performance on Firm Value

Obradovich & Gill, (2013) stated that financial performance is measured using Return on Assets (ROA) where ROA is able to measure the company's ability to generate profits by using total assets in the past which are then projected in the future. So it can be said that ROA can measure the company's performance in empowering its assets. An increase in the company's financial performance will lead to an increase in the value of the company. This means that the higher the rate of return on assets, the better the position of the owner of the company. This causes investors' assessment of the company to increase which ultimately has an impact on increasing share prices and company value.

H3: Financial Performance has an effect on Firm Value

d. The Effect of CEO Tenure on Firm Value

Research by Raymond et al (2010) "his study in America found that the average tenure of board members (CEO Tenure) had a significant positive effect on firm value." Similarly, the research by Cook and Burrest (2010) which "found a positive effect of the tenure of the board (CEO Tenure) on firm value." Vafeas (2015)" agrees that a long term of office for a member of the board can provide greater experience, competence and

commitment to a member of the Board of Directors, because with a long term of office the Board of Directors has more knowledge about the company and the business environment.
H4: CEO Tenure has a positive effect on firm value.

e. The Effect of CEO Tenure on Financial Performance

Saleh et al., 2020" found that CEO tenure is positively related to company performance because CEOs with longer tenures have broad insight into the company's potential benefits so that they can help improve company performance." Rostami et al., (2016) "also stated in their research that CEO Tenure has a positive and significant influence on company performance as measured by ROA."
H5: CEO Tenure has an effect on company performance

f. Firm Performance can mediate CEO Tenure and Firm Value

Research on CEO tenure and company performance shows mixed results, either positive, negative or even not having an effect on company performance. Research by Raymond et al (2010) "his study in America found that the average tenure of board members (CEO Tenure) had a significant positive effect on firm value." Similarly, the research by Cook and Burrest (2010) which "found a positive effect of the tenure of the board (CEO Tenure) on firm value."
H6 : Firm Performance can mediate CEO Tenure and Firm Value

g. Firm Performance can mediate CEO Duality and Firm Value

CEO Dualitycan improve company performance because with the same person who doubles as the board of directors and the board of commissioners, that person can monitor the company clearly and can have unique orders throughout the company. CEO Duality can be the reason why there is a need for a separation of the Board of Directors and the Board of Commissioners because the function of the board is to monitor the performance of top management, so the separation of the Board of Directors and the Board of Commissioners needs to be done in order to maintain checks and balances. When the checks and balances have stabilized, the value of the company will increase in the eyes of investors."
H7 : Firm Performance can mediate CEO Duality and Firm Value

III. Research Method

3.1 Population and Sample

The population in this study are manufacturing companies in various industrial sectors listed on the Indonesia Stock Exchange (IDX) during the 2016-2020 period. As the sample selection method, we used purposive sampling, in which 44 companies were obtained as samples.

3.2 Operationalization of Variables

Table 1. Operationalization of Variables

Variable	Definition	Proxy	Formula	Scale
Firm Performance (ROA)	Ratio which compare total profit after tax with total Asset	1. ProfitAfter Tax 2. TotalAsset	*Return On Assets*(ROA) = $\frac{\text{Profit after tax}}{\text{Total Assets}}$	Ratio

Firm Value	Ratio that compares n Market value of all outstanding shares and Debt with total assets	stock market value and debt Total assets	*Tobin'sQ = (MVS + D) / Total Assets*	Ratio
CEO Duality (CDUAL)	Somebody who plays a role doubleas *Chief*	Variable *dummy*	CDUAL : 1 = If there is duality CEO within the company 0 = If there is no	Nominal
	Executive Officer and *Chairmanof TheBoard* during which together		CEO duality within company	
CEO Tenure (CTNR)	Time period take office a *Chief Executive Officer* in aperiod fiscal.	Total period time take office a CEO in company	*CTNR*= Term Incumbent CEO	Nominal

3.3 Data Analysis

a. Panel Data Multiple Linear Regression

The three methods used in panel data modeling are shown as follows:

1. Common Effect, used if there is no difference between individuals and differences between times, because it has the same intersection point (α) and slope (β). The model is formulated as follows: Yit = 0 + 1X1it + 2X2it + 3X3it + … + nXnit + it (1)
2. Fixed Effect, is used whenever there is a possible omitted variable problem, such as a change in intercept in time series or cross-sectional data. The model is formulated as follows: Yit = 1 + 2D2 + ..+ nDn +1X1it + .+ nXnit + it, (2)
3. Random Effect. This model increases efficiency in the least squares process by calculating the time series and cross-sectional data errors. The model is formulated as follows: Yit = 0+ 1X1it + ... + nXnit + it+ it (3).

   The selection of the best model from the three estimation models mentioned above was carried out by the Chow-Test, Housman Test, and the Lagrange Multiplier Test.

b. Path Analysis and Sobel Test

"Path analysis is a technique to analyze the cause and effect relationship occurs in multiple regression if the independent variable affects the dependent variable directly and indirectly the effect relationship occurs in multiple regression if the independent variable affects the dependent variable directly and indirectly "[23]. The Sobel test was used to demonstrate the significant impact of the resulting mediating variables on path analysis. The Sobel test was carried out by testing the strength of the indirect effect of the independent variables X1 and X2 on the dependent variable Y through the mediation of variable Z. The indirect effect was calculated by multiplying the paths [28] as follows:

X1→ Z (a), Z -→ Y (b), X2-→ Z (c), Z--→Y (d)

The standard error of sab and scd of indirect effect is calculated using the following formulas:

$$s_{ab} = \sqrt{b^2 s_a^2 + a^2 s_b^2 + s_a^2 s_b^2} \text{ (Path I)}$$

$$s_{cd} = \sqrt{d^2 s_c^2 + c^2 s_d^2 + s_c^2 s_d^2} \text{ (path II)}$$

The value of t statistic is calculated using the formula:

formula: $t = \frac{ab}{s_{ab}}$ and $t = \frac{cd}{s_{cd}}$

IV. Results and Discussion

4.1 Model Selection Results

The selection of model 1 and model 2 was carried out using Chow-Test, Housman-Test and LM-Test. The result is as follows:

Table 2. Results of Model Selection

	Chow Cross section F. Prob	Hausman Cross Section Random Prob	Lm (cross section Breusch Pagan Prob)	Best Model Selected
Model I	0.0000	0.0496	There isn't any	Fixed effect
Model II	0.0000	0.047	There isn't any	Fixed effect

Based on the results of Chow-Test, Hausman-Test and LM-Test, the best estimates obtained for both model 1 and model 2 are Random Effect models as follows:

ROA = 7.421333 -6.776821CDUAL -6.776821CTNR + it

FVit=1.860650 + 0.018139ROAit -0.621940CDUALit -0.048382CTNRit + it

4.2 Test of Goodness of the Model

The results of the determination test from Model 1 show that capital structure and firm size have a contribution of 92% in explaining profitability (ROA), while Model 2 shows that capital structure, firm size, and profitability contribute only 92.6% in explaining FV.

4.3 Statistical T-Test Results

For Model 1, the results of the statistical t-test are as follows:

Table 3. T statistic results on the ROA variable

Variable	Coefficient	Std. Error	t-Statistic	Prob.	Conclusion
C	7.421333	0.641251	11.57321	0.0000	Sig.
CDUAL	-6.776821	2.385261	-2.841123	0.0050	Sig.
CTNR	-6.776821	0.044597	-5.484139	0.0000	Sig.

From Table 3, it can be seen that Duality has a negative and significant effect on (ROA), while having CEO Tenure (CTNR) also has a negative and significant effect on profitability.

For model II, the results of the statistical t-test are as follows:

Table 4. The results of the t-statistical test on the FV variable

Variable	Coefficient	Std. Error	t-Statistic	Prob.	Conclusion
C	1.860650	0.046469	40.04040	0.0000	Sig.
CDUAL	-0.621940	0.156213	-3.981369	0.0001	Sig.
CTNR	-0.048382	0.003259	-14,84520	0.0000	Sig.
ROA	0.018139	0.003404	5.328299	0.0000	Sig.

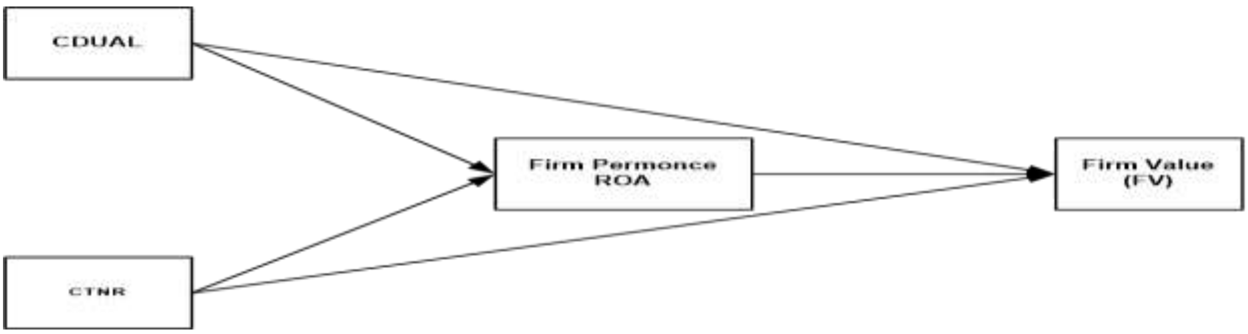
From the results that presented in Table 4, it can be seen that CEO Duality and CEO Tenure have a significant negative effect on FV but ROA has a significant positive effect on FV.

4.4 Path Analysis Hypothesis Test Results

In this study, the effect of capital structure and firm size on firm value is mediated by profitability. The path coefficients for both models are shown as follows:

Table 5. Summary of Path Coefficients

Variable	Coefficient	Std. Error	t-Statistic	Prob.	Conclusion
CDUAL□ROA	-6.776821	2.385261	-2.841123	0.0050	Sig.
CTNR□ROA	-6.776821	0.044597	-5.484139	0.0000	Sig.
CDUAL□FV	-0.621940	0.156213	-3.981369	0.0001	Sig.
CTNR□FV	-0.048382	0.003259	-14,84520	0.0000	Sig.
ROA□FV	0.018139	0.003404	5.328299	0.0000	Sig.



4.5 Sobel Test Results in Detecting the Effect of Mediation Variables

The results of the Sobel test are shown in Table 6 below:

Table 6. Sobel Test Results

	Indirect effect	Standard error of indirect effect	T statistics	Conclusion
Part I	CDUAL→ROA(a)=-6,778 ROA →FV (b)=0,01873	Sat=0.426283	**-2.50741453**	Significant
Part II	CTNR→ ROA(c) =-0,2445 ROA→FV (d)=0,0813	Sdc=0.051206	-3.82654304	significant

4.6 Discussion

H1: CEO Duality has an effect on Firm Performance.

The results of the t-test can be seen in the table above explaining that CEO Duality has a significant negative - 6.776821 effect on ROA with a probability of 0.0050 meaning that an increase in the number of positions of CEO Duality will affect the decline in company performance Financial performance (ROA) Conflicts of interest involved with CEO Duality can be The reason why there is a need for a separation of the Board of Directors and the Board of Commissioners is because the function of the board is to monitor the performance of top management, so the separation of the Board of Directors and the Board of Commissioners needs to be done in order to maintain checks and balances. The more positions held by someone will actually reduce the company's performance. This could be due to the CEO's lack of focus on one position. The results of this study are in accordance with the research of Shoeyb Rostamia, Zeynab Rostamib, Samin Kohansala (2016), which states that CEO Duality has a negative effect on company performance.

H2: CEO Tenure has an effect on Firm Performance

The results of the t-test can be seen in the table above explaining that the Tenur CEO has a negative effect - 6.776821 and is significant on Financial Performance (ROA) with a probability of 0.000. This means that if the CEO Tenure increases, the Financial performance (ROA) will decrease. One of the most important elements that can affect the company's performance is the CEO Tenure. The term of office of a CEO can affect his attitude in decision making and the results will affect shareholder wealth. As a CEO's tenure increases, the ability in communication and knowledge of the company also increased. In this study, it can be seen that a long term of office will worsen the company's performance. This matter. This could be due to boredom in leadership.

H3: CEO Duality affects Firm Value

The effect of CEO Duality on Firm Value is significant negative with a significance level of 0.000 with a regression coefficient of -0.621940 meaning that if CEO Duality increases, Firm Value will decrease.CEO Duality, it is very possible for the CEO to act in the interests of shareholders when the interests of the CEO also coincide and are in line with those of shareholders (Williamson, 1985). The conflict of interest involved with CEO Duality can be the reason why there is a need for a separation of the Board of Directors and the Board of Commissioners because the function of the board is to monitor the performance of top management, so the separation of the Board of Directors and the Board of Commissioners needs to be done in order to maintain checks and balances. (Rechner & Dalton, 1991). When checks and balances have stabilized, the value of the company will increase in the eyes of investors.

H4: CEO Tenure has an effect on Firm Value.

The influence of Tenur CEO on Firm Value is significant negative with a significance level of 0.0001 and a regression coefficient of -0.048382, meaning that if the Tenur CEO increases, the firm Value will decrease. This illustrates that the time required for a new Board of Directors to gain an adequate understanding of the company will range between 3 and five years." Vafeas (2015)" agrees that a long term of office for a member of the board can provide greater experience, competence and commitment to a member of the Board of Directors, because with a longer term of office the Board of Directors has more knowledge about the company and the business environment. Hambrick, (1998) However, in general, Directors with long tenures can maintain the status quo regarding organizational practices and policies in order to be in line with the expectations of company leaders and have loyalty to company executives.

H5: Firm Performance has an effect on Firm Value

From the table above, it can be seen that the effect of financial performance (ROA) on Firm Value is significant positive, meaning that if financial performance (ROA) increases, firm value (company value) will increase with a significance level of 0.000. And the regression coefficient is + 0.018139. The results of the study indicate that H3: Financial Performance has an effect on Firm Value received. There is a positive relationship between Financial Performance and Firm Value, which means that the lower the company's financial performance, the lower the company's value. This is because Financial Performance is measured using Return on Assets (ROA) where ROA is able to measure the company's ability to generate profits using total assets in the past which are then projected in the future. So it can be said that ROA can measure the company's performance in empowering its assets. An increase in the company's financial performance will lead to an increase in the value of the company (Obradovich & Gill, 2013).

H6 : Firm Performance can mediate CEO Duality and Firm Value

Sobel test results show the results of t-statistics =2.24244896 (>1.96 with a positive direction) indicates a significant meaningFirm Performance(ROA) mediates CDUAL to FV.The more positions held by someone will actually reduce the company's performance. This could be due to the CEO's lack of focus on one position. The conflict of interest involved with CEO Duality can be the reason why there is a need for a separation of the Board of Directors and the Board of Commissioners because the function of the board is to monitor the performance of top management, so the separation of the Board of Directors and the Board of Commissioners needs to be done in order to maintain checks and balances. When checks and balances have stabilized, the value of the company will increase in the eyes of investors.

H7 : Firm Performance cannot mediate CEO Tenure and Firm Value

Sobel test resultsshow Result t-statistic =0.0932960 (<1.96 with positive direction) was not significant meaning that ROA did not mediate CTNR to FV.Vafeas (2015)" agrees that a long term of office for a member of the board can provide greater experience, competence and commitment to a member of the Board of Directors, because with a longer term of office the Board of Directors has more knowledge about the company and the business environment. Hambrick, (1998) However, in general, the Board of Directors with a long term of office can maintain the status quo regarding organizational practices and policies so that they are in line with the expectations of company leaders and have loyalty to company executives. The longer the tenure of the CEO, the smaller the company's performance. This is what explains that firm performance or company performance can mediate CEO Tenure on Firm Value.

V. Conclusion

The conclusion of the analysis in this study are:

1. CEO Duality effect on Firm Performance.
2. CEO Tenure effect on Firm Performance
3. CEO Duality affect Firm Value
4. CEO Tenure effect on Firm Value.
5. Firm Performanc eaffect Firm Value
6. Firm Performance can mediate CEO Duality and Firm Value
7. Firm Performance can mediate CEO Tenure and Firm Value

In corporate governance, the determination of CEO Duality and CEO Tenur needs to be considered because it greatly affects financial performance and Firm Value

References

Abels, PB, & Martelli, JT (2013). CEO Duality: how many hats are too many?. Corporate Governance: The international journal of business in society, 13(2), 135-147.

Abdillah, W., and Jogiyanto, HM 2009. Concepts and Applications of PLS for Empirical Research. First Edition, BPFE-Yogyakarta

Baliga, BR, Moyer, RC, & Rao, RS (1996). CEO Duality and firm performance: What's the fuss?. Strategic Management Journal, 17(1), 41-53.

Blose, LE, & Shieh, JC (1997). Tobin's q-Ratio and Market Reaction to Capital Investment Announcements. Financial Review, 32(3), 449-476.

Boyd, BK (1995). CEO Duality and firm performance: A contingency model. Strategic Management Journal, 16(3), 301-312.

Brickley, JA, Coles, JL, & Jarrell, G. (1997). Leadership structure: Separating the CEO and chairman of the board. Journal of Corporate Finance, 3(3), 189-220.

Coles, JW, McWilliams,VB, & Sen, N. (2001). An examination of the relationship of governance mechanisms to performance. Journal of management, 27(1), 23-50.

Combs, JG, Crook, TR, & Shook, CL (2005). The dimensionality of organizational performance and its implications for strategic management research. Research methodology in strategy and management, 2(05), 259-286.

Cronqvist, H., & Nilsson, M. (2003). Agency costs of controlling minority shareholders. Journal of Financial and Quantitative analysis, 38(04), 695-719.

Dahya, J., & McConnell, JJ (2005). Outside directors and corporate board decisions. Journal of Corporate Finance, 11(1), 37-60.

Daily, CM, Dalton, DR, Ellstrand, AE, & Johnson, JL (1998). Meta-analytic reviews of board composition, leadership structure, and financial performance. Strategic management journal, 19(3), 269-290. 336 BUSINESS ACCOUNTING REVIEW, Vol. 4, NO. 1, JANUARY 2017 (325-336)

Daily CM, Dalton DR, Canella AA (2003). Corporate Governance: Decades of Dialogue and Data, Aca. Manage. Rev. 28(3): 371-383.

Dalton, DR, Daily, CM, Johnson, JL, & Ellstrand, AE (1999). Number of directors and financial performance: A metaanalysis. Academy of Management journal, 42(6), 674-686.

Dayton, KN (1984), Corporate Governance: The Other Side of the Coins, Harvard Business Review, 62 (1): 34-47.