An empirical assessment of corporate governance components and their impact on profitability: evidence of listed banks in Indonesia

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Abstract

This study aims to determine the effect of business size, capital structure, audit committee, board of directors, and board of commissioners on company profitability in banking companies listed on the Indonesia Stock Exchange from 2018 to 2021. A total of 42 banking companies are the study sample. A purposive sampling technique was used to get 10 sample companies for 4 years with 40 observations. The research data comes from a sample of companies from the Indonesian Stock Exchange website. Multiple regression analysis and descriptive statistical analysis are the data analysis methods used. The research findings show that company size affects profitability, but the board of directors, board of commissioners, audit committee, and capital structure do not affect company profitability.

Keywords: Capital structure, Company size, Good corporate governance, Profitability

JEL Classification: H41, L25, H54, D61

INTRODUCTION

A unique draw for investors is profitability because it represents the gains that are their legal entitlements and is the outcome of managing the money they invested (Hapsoro & Falih, 2020). Companies that have gone public typically aim to do so in order to boost the wealth of their owners or shareholders by raising the company's worth (Salvatore, 2005). A high corporate value will lead to a high level of shareholder wealth; hence firm value is essential (Brigham & Houston, 2010). Knowing a company's value is crucial since it may be used as a benchmark for evaluating a company because it represents corporate performance and affects investors' perceptions of its performance (Al-Matari et al., 2014). According to Istighfarin et al. (2005), the higher the profitability of a business entity, the more guaranteed the company's ability to maintain its survival will be. Profitability, or the ability to earn a profit, is a percentage measure used to assess the extent to which a company can generate profits at an acceptable level (Asadi et al., 2021). Profitability ratios will provide an overview of the extent to which the effectiveness of company management (Nurmayanti & Lovita, 2020; Purbawangsa & Suana, 2019; Aprianingsih & Yushita, 2016). Information about profits helps companies to predict how much profit can be generated for future periods;

the size of profits also describes how the performance of companies run by management in generating profits to pay investors, creditor interest, and government taxes (Agasva & Budiantoro, 2014)

Weak corporate governance systems create loopholes for conflicts of interest regarding the evaluation process (Doidge et al., 2007). Anjani & Yadnya (2017) found that Good Corporate Governance (GCG) positively and significantly affects company profitability. GCG is necessary to realize good company operations. Durgut & Gashi (2022) said that the financial industry must establish a CG agency and strictly enforce legal directives. Corporate governance is the process used through legal, regulatory, contractual, and market-based processes to significantly increase shareholder value while safeguarding the interests of other shareholders (Risnaningsih et al., 2020). A corporation is founded to maximize profit in order to ensure that its operations are always guaranteed, along with an improvement in the company's value both qualitatively and quantitatively (Triyani et al., 2018; Ekasari & Noegroho, 2020). Corporate governance that adheres to the values of openness, responsibility, accountability, independence, and fairness is called GCG (Zarkasy, 2008). Financial success is the primary signal that investors use to make decisions, according to the signaling theory from Lintner (1956). Companies with strong financial performance can give potential investors a good reason to buy shares of the business. A number of variables can be used to gauge business performance. Based on GCG, one of them is evaluated. A GCG system, according to Sutedi (2012), is a procedure and framework used by corporate organs (shareholders/capital owners, commissioners/ supervisory boards of directors) in order to improve the success of corporate accountability initiatives in order to realize shareholder value over the long term by taking into account the interests of other stakeholders.

The agency theory put forth by Jensen & Meckling (1976) states that the total number of investment shares held by shareholders or investors constitutes share ownership and that those managing our managers (agents), whose duty it is to maximize the rate of return or can be said to be profit from the shares, are held by investors. Corporate governance plays an important role in determining the company's capital structure. The board oversees and influences management decisions to maintain shareholder value. All decisions taken from management will seek approval from the previous board so that the board of directors greatly influences the decisions to be taken (Widijaya & Peny, 2020). In this study, the elements of GCG used are the board of commissioners (Nurmayanti & Lovita, 2020).

The principles of GCG are expected to improve the quality of financial reports because the timeliness of financial reporting is an important factor in presenting relevant information (Clatworthy & Peel, 2013). Submission of financial reports that take a long time will be associated with lower information quality because information availability delays cause the information to have a lower value (Kusumayani et al., 2019). Implementing GCG can increase the timeliness of disclosure of financial information, prevent fraud and increase transparency in reporting so that non-compliance becomes the responsibility of top company officials (Adinegara & Sukamulya, 2021). The main components of GCG that are recognized to influence funding decisions are board size, board independence, executive compensation, and executive camp. Implementing GCG can prevent decision-making mistakes that automatically increase the company's value, which is reflected in profitability (Durguti & Kryeziu, 2021). Research conducted by Anjani & Yadnya (2017) found that GCG positively and significantly affects company

profitability. So that a hypothesis can be developed regarding the capital structure on firm value as follows: GCG has a positive effect on bank profitability.

Company size is a scale that classifies companies according to their size based on factors including total assets, sales, share value, and other factors (Rachmawati, 2015). The scale of the company's measurement is related to the size of the firm, and the larger the scale of the company can be converted into the higher the performance. The bigger the company, the greater the chance to create profits or higher performance (Dang et al., 2018; Surjandari & Minarni, 2019). Greater corporations guarantee performance (Ananda, 2016). Earnings management includes information on financial reports to deceive stakeholders interested in learning about the performance and state of the organization (Hendra et al., 2018). Although large businesses have more financial resources to assist performance, they also experience more agency issues (Nurcahya et al., 2014; Panjaitan & Muslih, 2019). A high company size indicates that the business is growing, which will appeal to investors and raise the company's worth. Audina (2016) discovered that company size has a favorable and significant impact on firm value. So that the following hypothesis can be set up in relation to the ratio of the company's size to its value: Profitability of banks is positively impacted by firm size.

In addition, company performance can also be measured through the capital structure that can be used to determine the company's financial performance. According to research by Kartika (2021), capital structure significantly and favorably affects bank profitability. The capital structure shows the relationship between owned capital, which is derived from long-term debt (long-term liabilities), and own capital (shareholders' equity), which serves as a source of funding for a long-term organization (Nurmayanti & Lovita, 2020). Financing decisions greatly impact the company's business expansion and competition between competitors (Widijaya & Peny, 2020). Financing decisions are directly related to risk and approach, so companies must choose the right financing for the company's capital structure. An optimal capital structure can increase company value and competitiveness, but a capital structure that is not optimal will impact high capital costs. Put forward the theory that companies can carry out optimal capital structure composition to make tax savings and avoid bankruptcy risk (Raharjaputra, 2009; Widijaya & Peny, 2020; Modigliani & Miller, 1963). Chirinko & Singha (2000) revealed that in this theory, companies try to balance the advantages of debt. The advantages and disadvantages of debt include tax reduction because interest expenses can reduce income so that companies will pay less tax. However, according to the capital structure theory, the company's finance strategy will adhere to a hierarchy of funding operations (Donaldson, 1961). It was discovered that the company's condition influenced its funding choice policy in addition to the quickly expanding business development (Ross, 1977). But when the trade-off theory, pecking order theory, and free cash flow theory are tested, none of them can adequately explain how businesses support themselves as a whole because every business weighs the costs and benefits when determining its funding approach (Myers, 2001). The long-term financial structure of the organization includes a capital structure that blends debt and equity. Because a firm's capital structure directly affects its financial situation, which affects its value, capital structure is a crucial issue for businesses. Capital structure is measured by the leverage ratio, which compares total debt to total assets. Because each business will weigh the costs and benefits in determining its funding approach, neither the pecking order theory nor the free cash flow theory can adequately explain how companies generally behave regarding funding (Brigham & Houston, 2010 and Myers, 2001). There are various benefits to using debt in the capital structure. According to the

Exchange Theory, using debt results in investors receiving a larger portion of the company's operating profit. As a result, the value and price of corporations' shares rise the more debt they employ (Febriana et al., 2016). Research conducted by Kartika (2021) found that capital structure positively and significantly affects bank profitability. So that a hypothesis can be formulated regarding the capital structure on firm value as follows: Capital structure has a positive effect on bank profitability.

This study aims to ascertain the impact of the audit committee, business size, board of directors, board of commissioners, and capital structure on company profitability in Indonesian bank banking companies. Novelty provides a profitability model measured based on the company's GCG components (proxied through the board of directors, board of commissioners, and audit committee) and company size and capital structure simultaneously.

METHODS

Research design

Associative research is the term used to describe the methodology used in this study. This research adopted a quantitative methodology. Secondary data was the data source for this study. Based on the secondary data employed in this study, which were acquired through online research and the documentation approach.

Population and research sample

The population of this study consists of 42 conventional banking companies listed on the Indonesia Stock Exchange for the years 2018 through 2021. Purposive sampling is the method of sampling used in this investigation. The 10 samples of banking businesses listed on the Indonesia Stock Exchange (IDX) in the years 2018 through 2021 match the criteria for this study.

Variable identification

The board of directors is the number of members of the board of directors in a company (Hendra et al., 2018). The existence of a board of directors serves as the main internal control mechanism to monitor company managers.

The board of commissioners will help decide whether an investment can be provided efficiently (Chen, 2013; Saputra & Wardhani, 2017). The number of members of the board of commissioners measures the size of the board of commissioners.

The audit committee is a small committee of the board of directors, independent and outside the directors (Anas, 2021). The size of the audit committee is measured by the number of audit committee members

Company size, measured by company assets, shows the company's assets (Nugraha et al., 2021). Company size is measured by natural logs (Ln) total assets

The capital structure combines debt and equity in the company's long-term financial structure. Capital structure is an important issue for companies because the good or bad capital structure will directly affect the company's financial position, ultimately affecting company value (Brigham & Houston, 2010). To measure capital structure is the leverage ratio, namely total debt to total asset.

Profitability is the most appropriate indicator to measure bank performance (Ananda, 2016). The profitability in this study uses return on equity (ROE).

Data and data collection methods

The data used in this research is cross-sectional data. The data needed are audited financial report data at the end of the year from banking sector companies during the research period, namely 2018-2021, while for GCG indicators obtained from the corporate governance list of banking company annual reports for 2018-2021, all data obtained from the Indonesia Stock Exchange (www.idx.co.id). The data collection method in this study is the documentation method. Data analysis techniques in this study were carried out using multiple regression analysis techniques.

Data analysis technique

In this study, data analysis techniques were performed using multiple regression analysis techniques.

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e$$

Description:

Y = Profitability
α = Constant coefficient
X_1 = Good corporate governance
X_2 = Company size
X_3 = Capital structure
$\beta_1 - \beta_3$ = Regression coefficients
e = Error

Hypothesis test

This study examines the effect of GCG, company size, and capital structure on profitability. There are 3 independent variables, namely GCG, company size, and structure, with one dependent variable, profitability. Multiple regression tests do testing. Hypothesis testing in this study used a simultaneous test (F-test) and a partial test (t-test).

RESULTS AND DISCUSSION

Descriptive statistical test results

Descriptive analysis descriptive statistical analysis aims to provide an overview or description of data seen from the minimum, maximum, average (mean), and standard deviation values of each research variable. One dependent variable and three independent variables were utilized as the variables in this study. The study's dependent variable is banking profitability, assessed by return on equity (ROE). GCG, as determined by three indicators, including the number of boards of directors, members of the board of commissioners, and audit committees, as well as company size as determined by Ln company assets and capital structure as determined by the debt to equity ratio, serves as the study's independent variable (DER).

Table 1. Descriptive statistics test output results

	N	Minimum	Maximum	Means	std. Deviation
Board of Directors	40	4	14	9.67	2,411
Board of Commissioners	40	2	12	7.23	2,496
Audit Committee	40	3	10	4.53	1,569
Company Size	40	18.24	23.60	19.7800	1.17474
Capital Structure	40	.03	.16	.0590	.03070
Profitability	40	010	.234	.12963	.053197
Valid N (listwise)	40				

Classic assumption test

Normality test

The normality test aims to determine whether the residuals, confounding factors, or regression model have a normal distribution. A regression model is good when all the data are normally distributed or very close to it. By examining the normal probability plot graph and utilizing one-sample Kolmogorov-Smirnov non-parametric statistical analysis, this study was able to identify the normal distribution.

Table 2. One sample of Kolmogorov-Smirnov test results

N		40
Normal Parameters, b	Means	.0000000
	Std. Deviation	.04701339
Most Extreme Differences	Absolute	.114
	Positive	082
	Negative	-.114
Test Statistics		.114
Asymp. Sig. (2-tailed)		.200c,d

a. Test distribution is Normal; b. Calculated from data; c. Lilliefors Significance Correction; d. This is a lower bound of the true significance

Table 2 shows that the Asymp. Sig. (2-tailed) of 0.200 > 0.05. Therefore, it can be stated that the regression model in this study satisfies the assumption of normality because these results show that the data in this study are regularly distributed.

Multicollinearity test

In order to determine whether the regression model identified a correlation between independent (independent) variables, the multicollinearity test is used. Independent (independent) variables shouldn't correlate with a suitable regression model. The tolerance value and the opposing variance inflation factor (VIF) can be used to determine whether multicollinearity is present. Comparing the values of the tolerance and variance inflation factors will reveal multicollinearity (VIF). Multicollinearity occurs when the tolerance value is > 0.10, and the VIF value is < 10.

Table 3. Multicollinearity test results

Model	Collinearity Statistics	
	Tolerance	**VIF**
Board of Directors	.203	4,917
Board of Commissioners	.256	3,910
Audit Committee	.294	3,406
Company Size	.237	4,226
Capital Structure	.793	1,262

Table 3 demonstrates that the capital structure, company size, audit committee, and board of directors independent variables have tolerance values > 0.10 and VIF values of 10. Therefore, it may be said that the regression models are not multicollinear.

Heteroscedasticity test

Heteroscedasticity testing aims to test whether, in regression, the variance of the residuals is not the same from one observation to another. The criteria for deciding on the heteroscedasticity test are carried out if the data distribution (points) is located around the value 0 of the X and Y axes and does not form a pattern.

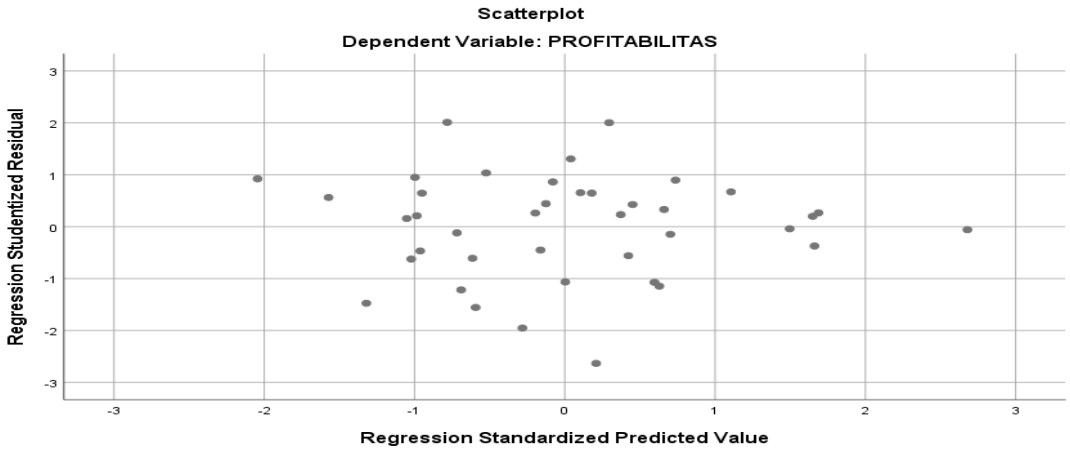

Figure 1. Output results of the heteroscedasticity test

The scatterplot graph based on Figure 1 reveals that the dots are randomly distributed above and below the 0 on the Y axis. It can be said that the regression model does not have heteroscedasticity.

Multiple regression analysis

Simultaneous test (F test)

The F test is used to determine whether there is a simultaneous (simultaneous) effect of the independent (free) variables on the dependent (bound) variable.

Table 5. Simultaneous test (F-test)

	Model	Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	024	5	005	1906	.119b
	residual	086	34	003		
	Total	.110	39			

a. Dependent Variable: Profitability
b. Predictors: (Constant), Capital Structure, Audit Committee, Company Size, Board of Commissioners, Board of Directors

The results of the F test obtained the value of F count > F table, namely 1.906 > 2.494 with a significance level of 0.119 > 0.05, which means that the board of directors, board of commissioners, audit committee, company size, and capital structure simultaneously have no significant effect on profitability company.

The determination coefficient (R^2)

The coefficient of determination is a value (proportion value) that measures the ability of the independent variables used in the regression equation to explain the variation of the dependent variable.

Table 6. The coefficient of determination (R2)

Model	R	R Square	Adjusted R square	Std. Error of the Estimate
1	.502a	.252	.142	.049661

Based on Table 6, the SPSS output results show that R Square (R^2) is 0.142 or 14.2%. This means that the independent variables of the board of directors, board of commissioners, audit committee, capital structure, and company size contribute 14.2% to financial performance, which is the dependent variable of this study. While the remaining (100% - 14.2%) 86.8% can be influenced by other variables outside this study.

Partial test (t-test)

The t-test is used to determine the effect of each independent variable, namely the board of directors, board of commissioners, audit committee, company size, and capital structure on company profitability

Table 4. Partial test (t-test)

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	std. Error	Betas		
(Constant)	-.447	.218		-2,052	048
Board of Directors	-.010	007	-.444	-1,322	.195
Board of Commissioners	-.004	006	-.188	-.627	.535
Audit Committee	-.008	.009	-.230	-.824	.416
Company Size	.037	014	.826	2,651	012
Capital Structure	-.075	.295	-.043	-.254	.801

Discussion of research results

Influence of the board of directors on company profitability

This study indicates that the board of directors variable partially has no significant effect on the profitability of banking companies. As a result, it can be said that H1 in this study cannot be accepted because the size of the board of directors has no bearing on profitability. The findings of this study are consistent with those of Bukhori's (2012) investigation, which found that the board of directors' decisions have no bearing on the metrics used to gauge corporate performance.

Influence of the board of commissioners on company profitability

This study indicates that the board of commissioners' variable partially has no significant effect on the profitability of banking companies. Therefore it is concluded that H1 in this study is rejected because the proportion of the board of commissioners does not affect profitability.

It follows research conducted by (Dwiputra & Suryanawa, 2016), namely, the more commissioners, the higher the negative relationship between profitability and the number of commissioners. With a large number of commissioners, various decisions will be made.

The influence of the audit committee on company profitability

This study indicates that the Audit Committee variable partially has no significant effect on the profitability of banking companies. As a result, it may be said that H1 in this study cannot be accepted because the profitability is unaffected by the proportion of the audit committee. Research by Dalton et al. (1999) found that audit committees with many members tended to lose focus and were less participatory than those with smaller sizes, which lends validity to this claim. The more members of the audit committee, sometimes it becomes even more difficult agreement on decisions in carrying out their performance which affects the decline in company profitability. In addition, this occurs because there is a possibility that the formation of audit committees within companies is only based on regulations, where each company must form an audit committee. The existence of an audit committee cannot guarantee the financial quality, the supervisory and controlling functions of company management so that it does not affect profitability

Effect of company size on company profitability

The regression coefficient value between firm size and profitability (Y) is positive. This study's results align with research conducted by Audina (2016) and Damayanti et al. (2021); company size positively affects profitability. This indicates

that large companies will have a larger credit limit than small companies. In addition, large companies also have more access to the capital market and banking than small companies. In other words, large companies have great access to funding sources, both the capital market and banking, to finance their investments to increase company profits. Therefore, the larger a company, the higher its profitability

Effect of capital structure on company profitability.

It can be said that a company's profitability variable is unaffected by its capital structure. Research by Audina (2016), which found that the debt-to-equity ratio (DER) variable did not affect profitability, supports the study's findings. The trade-off hypothesis indicates that any increase in debt will improve the company's value and vice versa if the capital structure is below the optimal point. The board of directors, board of commissioners, and audit committee's concurrent research findings indicate that company size and capital structure have no appreciable impact on a company's profitability. These conclusions suggest improving performance through profitability.

CONCLUSIONS AND RECOMMENDATIONS

Conclusion

The proportion of the board of directors has no positive and insignificant effect on company profitability. It happens because the number of different members of the board of directors can affect the different characteristics of the company, so the effectiveness of the board of directors in managing the performance of resource management is less than optimal, which causes the company's profitability to decrease.

The size of the board of commissioners has no positive and insignificant effect on company profitability. It happens because the more commissioners, the higher the negative relationship between profitability and the number of commissioners. With a large number of commissioners, various decisions will be made. That will disrupt the company's performance, impacting unstable company profitability.

Audit committee size has no positive and insignificant effect on company profitability. It is because audit committees with many members tend to lose focus and are less participatory than those with a smaller size. The more members of the audit committee sometimes make it difficult to agree on decisions in carrying out their performance which affects the decrease in company profitability.

Company size has a significant positive effect on company profitability (ROE). It happens because if the size of the company gets bigger. Good management will enable the company to increase its profits that performance will increase its profits.

Capital structure has no positive and insignificant effect on company profitability (ROE). This happens because the higher the Debt to Equity Ratio (DER) indicates, the greater the obligation or debt burden borne by the company to outsiders so that it can reduce the amount of profit received by the company.

Recommendation

Future researchers should not only use dimensions in terms of return on equity only, but also from other ratios such as return on assets, NPM, GPM, and others so that we can compare which is better between the percentage level of profitability when measured by return on equity or other ratios. The addition of indicators of good corporate governance, such as the activities of the board of commissioners, the board of directors, the remuneration committee, etc., would improve the ability of the research findings to forecast the impact of GCG on business profitability. Future research can use more corporate sectors. It is intended that the research results can be more useful for other companies in Indonesia.

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