Corporate governance implementation rating in Indonesia and its effects on financial performance

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Abstract

Purpose – *The purpose of this paper is to investigate the effect of corporate governance (CG) implementation rating conducted by the Indonesian Institute for Corporate Governance (IICG) on the financial performance of the selected companies.*

Design/methodology/approach – *This paper is a hypothesis testing study to analyze CG implementation of 88 firms listed on the Indonesian Stock Exchange. The samples are companies that participated in the Corporate Governance Perception Index (CGPI) Awards in 2008-2012. A panel data regression analysis is conducted on the data collected from IICG reports and its financial statements.*

Findings – *The awareness regarding good corporate governance (GCG) enforcement in Indonesian companies has already increased. The listed companies that participated in CGPI Awards during 2008-2012 always experience an increase in both quantity and quality. CG rating of go-public companies in Indonesia affects their accounting-based financial performance, such as return on assets, return on equity and earnings per share. However, CG implementation rating is not directly responded by the Indonesian stock market and has not yet been able to increase the company's growth in the short term.*

Research limitations/implications – *In this study, CGPI rating in a related year is linked to market performance in the same year. Thus, further research may link CGPI rating to market performance in the next year, as the findings of this study show that GCG implementation is not directly responded by the market.*

Practical implications – *GCG implementation is required by stakeholders, as it may give a long-term positive impact. Thus, the government needs to stipulate regulations to increase the commitment of the company in implementing GCG. The company can improve the internal factors of the organization that does not support the establishment of GCG based on the findings during the survey of CGPI. Finally, investors and creditors may consider the CGPI rating for their investment decisions.*

Originality/value – *This study contributes to the literature in two ways. First, this study uses the comprehensive CG rating in Indonesia. Previous studies on CG rating focused on internal mechanism; in this study, the rating was assessed using four stages of continuous assessment: self-assessment, document evaluation, paper assessment and company visit, which was conducted by an independent team. Second, this study uses the CG index (compliance, conformance and performance) associated with a variety of accounting-based and market-based performance variables: financial performance, market value and growth.*

Keywords *Corporate governance, Corporate governance index, Accounting-based performance, Market-based performance*

Paper type *Research paper*

Introduction

Awareness of the importance of corporate governance (CG) is on the rise after the crisis in mid-1997 in Asian countries, including Indonesia. Iskander and Chamlou (2000) stated that the economic crisis is not only due to macroeconomic factors but also because of weak CG in these countries, such as the lack of legal and accounting standards, financial audit has

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not been established, the capital markets are under-regulated, lack of a supervision commissioner and disregard for the rights of minority shareholders. This means that the implementation of good corporate governance (GCG) will give a positive impact on both shareholders and national economic growth.

Public attention and research on CG have grown in importance in recent years in various countries. CG has been a well-known topic of academic research, and CG mechanisms vary across the world (Mutairi *et al.*, 2012). GCG assists with sustainable economic development by improving the performance of companies (GRI, 2006). Some research studies (Dittmar *et al.*, 2003; Nam and Nam, 2004; Rashid and Islam, 2013) show that CG has an important role in affecting company performance in the financial markets. Moreover, the main goal of establishing a company is to improve the welfare of company owners or stakeholders or to maximize stakeholders' property by increasing company value (Brigham and Houston, 2006). The objective of a company is to optimize stakeholder value that can be achieved through the implementation of financial management function (Wahyudin, 2012). Financial decisions may affect other financial decisions and lead to an increase in the company value. The CG framework recommends that stakeholder value maximization is the outcome of those CG mechanisms (Mutairi *et al.*, 2012).

CG is concerned with the relationships of managers, the board of directors, employees, controlling, minority and other stakeholders. Abor (2007) explained that CG refers to how a company is supposed to be run, regulated and controlled. According to Kaihatu (2006), the essence of CG is improving company performance by supervising or monitoring the management performance and accountability of the other stakeholders, based on the framework of applicable rules and regulations. CG may generate goodwill and confidence of investors. Findings of Gompers *et al.* (2003) explain that GCG may improve the assessments and supports from investors.

Various responses resulting from CG issues arise from many countries. In Indonesia, academics are interested in studying CG issues. Furthermore, academicians and practitioners also establish various forums, such as the Forum for Corporate Governance in Indonesia (FCGI), the Indonesian Institute for Corporate Governance (IICG) and the Center for Good Corporate Governance of Faculty of Economics and Business of Gadjah Mada University. The FCGI in collaboration with the Asian Development Bank (ADB) has developed a self-assessment as an instrument to assess companies' CG implementation in Indonesia. On the other hand, the IICG in collaboration with the National Committee on Governance (NCG) conducts research studies and rating of CG implementation in public and private companies, banks and state-owned enterprises in Indonesia. The results are then nationally and internationally published by *SWA Magazine* and the IICG website.

A research conducted by the IICG in 2002 found that the companies' main reason to apply CG is regulatory compliance. Corporate Governance Perception Index (CGPI) rating does not only consider the quality of CG but also invites companies to increase commitment and quality of governance through dissemination, benchmarking, evaluation and grading and continuous improvements. The companies believe that CG implementation is another form of business and work ethic enforcement that has become companies' commitment, and related to company image improvement. The companies implementing CG may improve their image and firm value. CG implementation in Indonesia is measured by the IICG. The IICG has measured CG implementation in Indonesia since 2001. Hence, this study aims to explore the effect of the CGPI rating on accounting-based and market-based performance.

Studies on CG associated with a company's financial decision-making have been conducted by some researchers, including Wen *et al.* (2002), Anderson *et al.* (2004), Abor (2007), Rocca (2007), Sheikh and Wang (2012), Reddy *et al.* (2010), Mollah *et al.* (2012), Sheikh *et al.* (2013) and Hassan and Halbouni (2013). The empirical evidence shows that some CG attributes affect a company's financial decision-making (Sheikh and Wang, 2012. However, those studies show various results.

This paper has made significant contributions to literature; most of the previous studies (Hassan and Halbouni, 2013; Sheikh *et al.*, 2013; Mollah *et al.*, 2012; Reddy *et al.*, 2010) use the mechanisms of CG such as board structure, outside directors, board committees and ownership structure. Nevertheless, the CG implementation in this paper was measured using a unique and comprehensive indicators were assessed by four stage: self-assessment, documents evaluation, paper reviews, and company visit. Different from past studies that used the CG rating (Yarram, 2015; Berthelot *et al.*, 2010; Bebchuk *et al.*, 2009; Donker and Zahir, 2008; Gompers *et al.*, 2003), CGPI valuation methods in this paper involve a self-assessment of internal and external stakeholders, assessment of documents linked to the process of CG implementation, paper valuation and company visits. The model developed in this study is more complete, with previous research linking CG rating to return on assets (ROA), return on equity (ROE) and earnings per share (EPS) partially; this paper examined the effect of CG rating on accounting-based performance and market-based performance.

The remainder of the paper is prepared as follows: In Section 2, we review the relevant literature and hypothesis developments. In Section 3, we describe our data and the research methodology. In Section 4, we present and discuss our results of the analysis. Finally, in the last section, we summarize, conclude and suggest potential avenues for future research.

Corporate Governance Perception Index

CGPI is the result of research and rating programs conducted by the IICG. The IICG was established on 2 June 2000 by the Indonesian Transparency Society and community leaders to promote concepts, practices and benefits of GCG. IICG is one of civil society's roles to encourage the establishment of an Indonesian business atmosphere that is reliable, ethical and dignified. As an independent and non-profit organization, IICG has a commitment to encourage the implementation of GCG in Indonesia and to support and assist companies in applying the concept of CG.

One program that has continuously been implemented since 2001 is CGPI. The CGPI is a research and rating program for GCG implementation of companies in Indonesia. CGPI is conducted through a research design that encourages companies to improve the implementation quality of the CG concept by conducting an evaluation and benchmarking.

CGPI has been organized by IICG as an annual program since 2001 in cooperation with *SWA Magazine* as a tribute to initiatives and results of a company's efforts in realizing ethical and dignified business. CGPI participation is voluntary and involves active participations of all stakeholders and companies to meet the required phases of CGPI implementation programs. More importantly, CGPI encourages and demands companies' participation to repair or improve their CG implementation in their environment.

In conducting research and rating, IICG has four phases, including self-assessment, document evaluation, paper review and company visit. The CGPI program uses three scopes of GCG implementation, including compliance, conformance and performance aspect. GCG implementation assessment only narrowly covers company commitments and rules, whereas it broadly covers commitment and relationship between companies and stakeholders:

1. The compliance aspect of GCG implementation is a fulfillment of various demands of laws and regulations stipulated by the regulator. This aspect ensures that all company business operations have been performed well and are not in conflict with the applicable rules.

2. The conformity aspect of GCG implementation is appropriateness of policies and company's operations with the norms, ethics and values believed.
3. The performance aspect of GCG implementation is the company achievement in fulfilling the demands of ethical and dignified operations.

The evaluation weights conducted using the four continual stages of self-assessment, document evaluation, paper reviews and company visit/field observation are listed in Table I.

The questionnaire used in the self-assessment phase consists of several aspects that must be answered by some members of the company (internal and external stakeholders in Appendix 1). Respondents were asked to give their opinion objectively related to the implementation of GCG in their company. The questionnaire was developed based on the problems of CG implementation. In the document evaluation phase, CGPI participants must submit at least 36 types of required documents in accordance with the company status. At the third stage, each participant should prepare a paper that describes the CG implementation and present it during company visits. The last stage is company visit, where an independent team will clarify and ensure the CG practices. Observations on each company were conducted through presentations and discussions with the board of commissioners, directors and management, as well as other related parties.

The rating results of the CGPI program use norm assessment based on a range of scores achieved by the CGPI participants, and then categorized based on the quality level of GCG implementation using the term "trusted". CGPI assessment norm is explained in Table II.

Literature reviews and hypothesis developments

Agency theory

Agency theory is a theory governing the relationship between a principal and an agent, where one party (the principal) delegates a job to the other (the agent). Agency theory tries to explain the relationship of contract mechanisms (Jensen and Meckling, 1976). The principal provides funds and other resources to fulfill the company's needs for its operations, while the agent, as the company manager, is obliged to manage the company mandated by the company owner. In exchange, the agent may receive a salary, bonuses and various other compensations. The principal may not verify that the agent has performed and taken the appropriate policies to the principal's interest. Agency theory is highly considerate for solving problems in which the principal and the agent may prefer different actions due to different risk preferences. Managers' and stakeholders' different interests may result in conflicts called agency conflicts.

Table I Stages and weights of CGPI Awards

Stage	*Weight (%)*
Self-assessment	17
Document evaluation	35
Paper reviews	13
Company visit/observation	35
Total	100

Table II Assessment categories of CGPI Awards

Score	*Category*
55.00-69.99	Fairly trusted
70.00-84.99	Trusted
85.00-100	Highly trusted

According to Jensen and Meckling (1976), a company which separates its managerial and ownership functions probably leads to agency conflicts. Agency conflicts or agency problems can be minimized through a supervision mechanism to align the interests and then lead to agency cost.

The problems of GCG arise due to dependence on external capitals (equity and loan capital) used to finance company activities, investment and growth (FCGI, 2011). Wahyudin (2012) states that GCG arises as a result of agency problems that there are behaviors generating personal benefits especially from the agent by inflicting interests of another party (the principal). It may occur because of interest separation between the principal and the agent.

GCG influences upon financial performance

The agency problems in the relationship between the agent and the principal may arise in the form of a moral hazard, e.g. the manager or the agent does not perform their duties as agreed in the employment contract (Jensen and Meckling, 1976). In addition, GCG implementation has vital and strategic roles in maintaining companies' business process credibility and companies' supervisory. Thus, by having GCG and companies' advisory functional operation, the financial performance may be improved.

Companies' GCG implementation may create a system for directing, controlling and supervising the entire resources efficiently and effectively. GCG is assumed to maintain various interests in balance which may provide benefits for the company. A company with a higher CGPI rating means that the company has been managed with transparency, accountability, responsibility, independency and fairness. Therefore, there will be an impact on the outputs of good corporate performance, such as ROA, ROE and EPS.

The research conducted by Gompers *et al.* (2003), using the same governance index, found that companies with stronger stakeholder rights tend to have higher profits. Sheikh *et al.* (2013) also found a positive relationship between board size and company performance. These results are congruent with the previous research conducted by Jackling and Johl (2009), Ehikioya (2009) and Abor and Biekpe (2007). A research on non-financial companies listed on the Karachi Stock Exchange of Pakistan by Sheikh *et al.* (2013) proved that ownership concentration positively influences ROA, ROE and EPS. While in New Zealand, a research conducted by Reddy *et al.* (2010) found that the compliance upon New Zealand Securities Commission (NZSC) requirements has improved the company financial performance. Thus, the first hypothesis is formulated as follows:

Ha1. A company with better CG implementation may have higher financial performance.

GCG influences upon company value

The World Bank defines GCG as a collection of laws, regulations and rules that must be completed, which may encourage the performance of company resources to operate efficiently and produce a long-term sustainable economic value for both stakeholders and the society. GCG implementation is expected to be beneficial to increase and maximize the company value. Hasan and Butt (2009) define that companies' CG philosophy and mechanisms are related to the establishment of stakeholders' value. Furthermore, Hasan and Butt (2009) state that the principles implied within CG may ensure investors' and creditors' trust.

CGPI rating obtained by a company and published to the public may attract the stakeholders' interest and immediately responded by a market. The higher CGPI score shows that the company is increasingly more trusted by the related parties, the company may attract investors and the company's value may be eventually enhanced. The improvement of the company's value makes investors attracted to invest their funds. The company's stock price describes the company's value because the company may maximize its value through the establishment of stock prices. Thus, company value can be reflected in stock price, with the higher the stock price, the higher the value of the firm. A higher company value may increase the stakeholders' prosperity and attract them to invest their capital. CG is another form of business ethics and working ethic enforcement as the company's commitment and company's image improvement. More importantly, a company practicing CG may have its image improved and company value increased.

Based on agency theory, the stakeholders as the principal expect returns for the investment they made. Siallagan and Machfoedz (2006) state that CG is a system that regulates and controls a company to provide and improve the company's value to its stakeholders. The implementation of GCG may ensure that the company's financial statements are issued in accordance with the generally acceptable accounting principles. Therefore, the quality of the financial statements reflects on the real state of a company's condition and does not mislead many parties. Investors assess a company by reading the information presented in its financial statements. A good quality of financial reports may improve the company's value.

The previous research held in Indonesia by Siagian *et al.* (2013) found that the CG index positively influences price to book value (PBV) by using 125 samples of companies in the Jakarta Stock Exchange in the year of 2003 and 2004. Furthermore, the research results conducted by Mollah *et al.* (2012) found that companies in Botswana have advanced orientation in market-oriented systems in developing the CG mechanisms. Thus, the second hypothesis is formulated as follows:

Ha2. A company with better CG implementation may improve its company value in the stock markets.

GCG influences upon company growth

GCG general guidance of Indonesia states that one of the purposes of CG implementation is to encourage a company's social awareness and responsibility upon society and preserved environment around the company. More importantly, the implementation of CG may maintain business sustainability in the long term.

GCG as a basic guidance for companies to manage the company better may lead a company to a condition which is conducive to run its operations. Thus, the purpose of its establishment and the interests of stakeholders may be protected from company loss. The conductive condition may not be separated from the implementation of CG principles, including transparency, accountability, responsibility, independency and fairness, appropriately. The implementation of GCG principles also influences a company's long-term operations.

The research results conducted by Tjondro and Wilopo (2011) state that GCG implementation may positively improve the company performance, as the decision-making processes are better taken of. Moreover, optimal decisions may be resulted and ultimately improve the efficiency and create better cultures. A well-managed and supervised company may produce a qualified management and improve the company profitability. Thus, the company profitability may be well maintained in the long term. A company which is able to maintain a continuous profit may be considered as a growing company, as the implementation of GCG concepts basically aims to increase company prosperity in the long term. From the descriptions above, the third hypothesis is formulated as follows:

Ha3. A company with GCG implementation may increase its company growth.

Research design

This study analyzed listed companies which participated in the CGPI Awards. Recently, the CG ranking in Indonesia is voluntary; therefore, only a small number of public companies participated. The sample of this research is made of 37 companies listed on the Indonesia Stock Exchange (BEI) and that particularly participated in the CGPI Awards. We have observed since 2009-2012 that our final sample includes 88 companies as data. The data used in this research are secondary data of CGPI report, audited financial statements of each company and the financial data of Indonesian Capital Market Directory.

Independent variable

The independent variable of this research is the rating of GCG implementation, while the indicator used in this research is the CGPI taken from the research programs and ratings conducted by the IICG.

Dependent variables

The dependent variables used in this research are categorized into three groups, as described in Table III.

Control variables

To obtain a better research model and analysis results, this study used control variables. Following previous studies (Hassan and Halbouni, 2013; Sheikh *et al.*, 2013), this research also uses control variables, including company size, company age, listing age and leverage. The measurements of each control variable are presented in Table IV.

Data analysis technique

The collected data are further examined using descriptive statistical techniques including mean, standard deviation, maximum, minimum values as well as tables and charts. Then, the data were analyzed using panel data regression by EViews software. In the panel data regression, first, we estimated the model using the common effects model, fixed effects model and random effects model. To select the best model used, Chow test, Hausman test and Lagrange multiplier test are used. Moreover, to investigate the relationships between the CG and performance, we applied the following six models.

Table III Dependent variable measurement

No.	*Variable*	*Indicator*	*Measurement*
1	Financial performance	ROA (return on asset)	Net profit after tax/Total assets
		ROE (return on equity)	Net profit after tax/Stakeholders' equity
		EPS (earning per share)	Net profit after tax/Number of shares
2	Firm value	PBV (price to book value)	Share price/Share book value
		PER (price to earnings ratio)	Price per share/Profit per share
3	Company growth	EG (earning growth)	(Profit of year t/Profit of year t-1) - 1 × 100%

Table IV Measurements of control variables

No.	*Variable*	*Measurement*
1	Company size (SIZE)	Natural logarithm of total asset
2	Company age (AGE)	Research year – company establishment year
3	Listing age (LIST_AGE)	Research year – first listing year
4	Leverage (LEV)	Debt book value/Total asset

$$\text{Model 1} \rightarrow \text{ROA} = \beta_0 + \beta_1\text{CGPI} + \beta_2\text{SIZE} + \beta_3\text{AGE} + \beta_4\text{LIST\_AGE} + \beta_5\text{LEV} + e$$
$$\text{Model 2} \rightarrow \text{ROE} = \beta_0 + \beta_1\text{CGPI} + \beta_2\text{SIZE} + \beta_3\text{AGE} + \beta_4\text{LIST\_AGE} + \beta_5\text{LEV} + e$$
$$\text{Model 3} \rightarrow \text{EPS} = \beta_0 + \beta_1\text{CGPI} + \beta_2\text{SIZE} + \beta_3\text{AGE} + \beta_4\text{LIST\_AGE} + \beta_5\text{LEV} + e$$
$$\text{Model 4} \rightarrow \text{PBV} = \beta_0 + \beta_1\text{CGPI} + \beta_2\text{SIZE} + \beta_3\text{AGE} + \beta_4\text{LIST\_AGE} + \beta_5\text{LEV} + e$$
$$\text{Model 5} \rightarrow \text{PER} = \beta_0 + \beta_1\text{CGPI} + \beta_2\text{SIZE} + \beta_3\text{AGE} + \beta_4\text{LIST\_AGE} + \beta_5\text{LEV} + e$$
$$\text{Model 6} \rightarrow \text{EG} = \beta_0 + \beta_1\text{CGPI} + \beta_2\text{SIZE} + \beta_3\text{AGE} + \beta_4\text{LIST\_AGE} + \beta_5\text{LEV} + e$$

Results

CGPI profile

In general, the number of go-public companies in Indonesia participating in CGPI rating increases each year; there were 18 go-public companies in 2009, 21 go-public companies in 2010, 24 go-public companies in 2011 and 25 go-public companies in 2012. On the one hand, the quality of CG implementation has also increased every year. These findings are an indication of company's high awareness upon GCG implementation as a necessity, not only as its compliance to the regulations set by the Government of Indonesia. Moreover, CGPI Awards is a voluntary program that each participant is obliged to pay a registration fee. IICG gives special appreciations to the company members that show sincerity in implementing GCG by awarding as trusted companies. This appreciation is an acknowledgment of their achievements upon GCG implementation in each company's environment and as their seriousness and willingness to be voluntarily assessed by external independent parties as a manifestation of in-depth awareness upon the importance of GCG implementation (Suprayitno *et al.*, 2012) (Table V).

Descriptive statistical analysis

Descriptive statistical calculations consisting of mean, minimum and maximum value of all variables are presented in Table VI. The average calculation of CGPI rating is 80.86. Based on the scales set by IICG, most companies participating in CGPI are categorized as trusted. It means that most companies have implemented CG well. Meanwhile, the financial performance measured by ROA, ROE and EPS shows that most companies have a good performance, as companies participating in CGPI are high-profile companies. Conversely, four companies recorded a negative profit on their financial statements. However, the participation of companies in Indonesia in CGPI events is still voluntary. Thus, companies with truly high commitments upon GCG implementation only may register in CGPI Awards.

The company markets show quite high values of PBV and price to earning ratio (PER). For example, PBV shows an average value of 2.53, which means that the market gives 2.5 times higher price than the asset book value owned by a company. The second market ratio is PER, which is obtained by comparing price and EPS of each company. Investors may interpret that company stock rating and shares are related to the profits generated by the company. Meanwhile, earning growth shows a good value with a growth average of 24 per cent from the previous year's profits. This indicates that the participants of CGPI Awards are companies with good growths.

Table V CGPI profile of listed companies

Description	*2009*	*2010*	*2011*	*2012*
Number of listed companies participating in CGPI Awards	18	21	24	25
The average of GCG index	80.31	80.89	81.10	81.01
Number of recipients with "highly trusted" category	5	8	9	11
CGPI topic	GCG as culture	GCG in ethical perspectives	GCG in risk perspectives	GCG in knowledge perspectives

Table VI Descriptive statistics of variables

Variable	Average	SD	Minimum	Median	Maximum
CGPI	80.86	6.96	66.51	82.39	91.91
ROA	6.26	7.14	−8.33	3.58	28.97
ROE	15.82	12.86	−21.46	16.19	53.09
EPS	377.60	497.70	−107.00	142.00	1624.00
PBV	2.53	1.98	0.09	2.01	9.86
PER	15.78	14.94	−8.98	12.58	96.10
EG	0.24	1.49	−5.40	0.21	8.83
SIZE	17.01	1.82	11.95	16.69	22.73
AGE	38.91	21.32	4.00	38.50	93.00
LIST_AGE	10.60	8.92	0.00	9.00	62.00
LEV	0.59	0.25	0.15	0.57	0.92

Notes: n = 88; Please see Tables III and IV for the descriptions of variables; CGPI is a ranking of corporate governance practices in Indonesian listed companies conducted by IICG; CGPI score drawn from CGPI annual report Age and listing age (List_Age) are measured in a year

Table VII presents the Pearson correlations among test variables. CGPI rating has the highest correlation with the size variable. A high correlation also arises between CGPI rating and accounting indicators, ROA and ROE. Thus, the CGPI was not significantly correlated with market indicators (PBV, PER), growth and age.

Hypothetical testing results

Models 1, 2 and 3 in Table VIII report results of the analyses using accounting firm performance measures. The models are estimated using the fixed-effects estimator (Models 1 and 2) and random-effects estimator (Model 3). The measurements for the financial performance variable in this study are ROA, ROE and EPS. These are used to measure profitability based on a research conducted by Hasan and Halbouni (2013), which used accounting-based measurements of ROA and ROE on the company performance. Our result indicates that the CGPI rating has a significant impact on accounting performance (ROA, ROE and EPS). Well-implemented CG mechanisms are reflected in corporate performance (Sunarto, 2003). These findings strengthen Jensen and Meckling's (1976) statements that companies with good governance may have more efficient operational performance. Managers work effectively and efficiently to reduce capital costs and minimize risks, which may ultimately result in higher profitability.

These findings support a research conducted by Hasan and Halbouni (2013), which found that CG influences the company financial performance. In a research directed by Hasan and Halbouni (2013), CG is measured using CG mechanisms consisting of voluntary disclosure, CEO duality and board size. Meanwhile, a research conducted by Sheikh *et al.* (2013) used more complete measurements of CG internal attributes, including board size, outside directors, CEO duality, managerial ownership and ownership concentration. The results show that board size has a positive influence on ROA, EPS and market-to-book (MB), while outside directors and managerial ownership have a negative influence. This finding is supported with previous research conducted in various countries, such as by Gompers *et al.* (2003), Abor and Biekpe (2007), Jackling and Johl (2009), Ehikioya (2009), Reddy *et al.* (2010), Siagian *et al.* (2013) and Sheikh *et al.* (2013).

Adjusted R^2 in Model 1 and Model 2 showed high scores at 86 per cent and 76 per cent, respectively. This indicated that the variables CGPI, SIZE, AGE, LIST_AGE and LEV explained 88 per cent of the ROA variation and 76 per cent of the ROE variation. However, the variation of the independent and control variables described the variation in variable EPS by 9 per cent only. *P*-Value for *F*-statistic on Model 1 and Model 2 was significant at 0.01 level, whereas on Model 3, it was significant at 0.05 level.

Table VII Correlations between variables

Variable		*CGPI*	*ROA*	*ROE*	*EPS*	*PBV*	*PER*	*EG*	*SIZE*	*AGE*	*LIST_AGE*	*LEV*
CGPI	Pearson correlation	1	0.235**	0.377***	0.224**	−0.141	−0.164	0.036	0.604***	0.136	0.136	0.269**
	Sig. (2-tailed)		0.028	0.000	0.036	0.190	0.128	0.741	0.000	0.207	0.205	0.011
ROA	Pearson correlation	0.235**	1	0.830***	0.570***	−0.017	−0.020	0.031	−0.119	0.110	−0.078	−0.482***
	Sig. (2-tailed)	0.028		0.000	0.000	0.873	0.852	0.776	0.267	0.307	0.469	0.000
ROE	Pearson correlation	0.377***	0.830***	1	0.374***	−0.017	−0.027	0.015	0.107	0.095	−0.053	−0.114
	Sig. (2-tailed)	0.000	0.000		0.000	0.875	0.799	0.892	0.322	0.376	0.627	0.292
EPS	Pearson correlation	0.224**	0.570***	0.374***	1	−0.075	−0.078	0.012	0.094	−0.121	0.042	−0.264**
	Sig. (2-tailed)	0.036	0.000	0.000		0.487	0.468	0.910	0.381	0.260	0.696	0.013
PBV	Pearson correlation	−0.141	−0.017	−0.017	−0.075	1	0.977***	0.607***	0.047	−0.029	−0.118	−0.164
	Sig. (2-tailed)	0.190	0.873	0.875	0.487		0.000	0.000	0.661	0.792	0.274	0.127
PER	Pearson correlation	−0.164	−0.020	−0.027	−0.078	0.977***	1	0.602***	−0.019	−0.048	−0.133	−0.197*
	Sig. (2-tailed)	0.128	0.852	0.799	0.468	0.000		0.000	0.859	0.654	0.218	0.066
EG	Pearson correlation	0.036	0.031	0.015	0.012	0.607***	0.602***	1	0.210**	−0.004	−0.005	−0.146
	Sig. (2-tailed)	0.741	0.776	0.892	0.910	0.000	0.000		0.050	0.970	0.960	0.174
SIZE	Pearson correlation	0.604***	−0.119	0.107	0.094	0.047	−0.019	0.210**	1	0.097	0.098	0.463***
	Sig. (2-tailed)	0.000	0.267	0.322	0.381	0.661	0.859	0.050		0.369	0.363	0.000
AGE	Pearson correlation	0.136	0.110	0.095	−0.121	−0.029	−0.048	−0.004	0.097	1	−0.055	0.121
	Sig. (2-tailed)	0.207	0.307	0.376	0.260	0.792	0.654	0.970	0.369		0.611	0.261
LIST_AGE	Pearson correlation	0.136	−0.078	−0.053	0.042	−0.118	−0.133	−0.005	0.098	−0.055	1	0.007
	Sig. (2−tailed)	0.205	0.469	0.627	0.696	0.274	0.218	0.960	0.363	0.611		0.949
LEV	Pearson correlation	0.269**	−0.482***	−0.114	−0.264**	−0.164	−0.197*	−0.146	0.463***	0.121	0.007	1
	Sig. (2-tailed)	0.011	0.000	0.292	0.013	0.127	0.066	0.174	0.000	0.261	0.949	

Notes: n = 88; Please see Tables III and IV for the descriptions of variables; CGPI is a ranking of corporate governance practices in Indonesian listed companies conducted by IICG; CGPI score drawn from CGPI annual report; ***Correlation is significant at the 0.01 level; **Correlation is significant at the 0.05 level; *Correlation is significant at the 0.10 level

Table VIII Hypothetical testing results

Variable	Model 1		Model 2		Model 3		Model 4		Model 5		Model 6	
Constant	−116.98	0.0026***	−496.24	0.0008***	−549.54	0.0905*	64.75	0.5208	2080.67	0.3407	−1522.45	0.1200
CGPI	1.03	0.0108**	3.49	0.0207**	−0.2634	0.9781	−2.91	0.0556*	−55.12	0.0927*	−1.06	0.9119
SIZE	5.20	0.0020***	25.69	0.0001***	101.85	0.0072***	14.15	0.0240**	228.62	0.0896*	103.05	0.0105**
AGE	0.05	0.5817	0.32	0.3695	−2.17	0.3336	−0.01	0.9861	−1.23	0.0827*	0.42	0.8398
LIST_AGE	−1.65	0.0181**	−6.61	0.0125**	0.76	0.9256	−0.99	0.2874	−23.71	0.2425	3.37	0.5730
LEV	−56.30	0.0026***	−259.30	0.0000***	−1031.98	0.0010***	−77.97	0.0411**	−1687.44	0.0409**	−421.70	0.0828*
Adjusted R^2	0.86		0.76		0.09		0.05		0.04		0.06	
F-statistic	7.03		3.64		2.66		1.93		1.79		2.09	
Prob (*F*-statistics)	0.0000***		0.0000***		0.0278**		0.0976*		0.1242		0.0743*	

Notes: n = 88; Dependent variable Model 1 = ROA; Model 2 = ROE; Model 3 = EPS; Model 4 = PBV; Model 5 = PER; Model 6 = EG; Hypothesis testing using panel data regression; The influence of the independent variable on the dependent variable is analyzed using the fixed-effects model for Models 1 and 2, random-effects model for Models 3 and 6 and common-effects model for Models 4 and 5 *, ** and; ***Significant at 0.10, 0.05 and 0.01 level, respectively

Model 4 and Model 5 in Table VIII demonstrate the effect of CGPI rating on the market-based performance indicator. The results show that CG does not affect the company's market value. Company value measurements in this research are PBV and PER. The examination results on both indicators reject our hypothesis. It means that CG implementation does not significantly influence the increase in stock market price. Companies participating in CG rating programs do not immediately get positive responses from investors in the market. These results support research conducted by Darmawati *et al.* (2005) and Nuswandari (2009), which both used CGPI as a CG implementation indicator in Indonesia. Another study conducted in the UK by Bauer *et al.* (2003) using Deminor's Corporate Governance Rating as a CG implementation measurement also proved that markets are not influenced by CG rating. This is presumably because the information of CG implementation is not directly responded by the market, and response takes time, as it is related to investors' trust level (Nuswandari, 2009).

The CG implementation which is not yet responded by the market occurred due to limited publications of IICG rating results. As the results are only limitedly published by *SWA Magazine* and the IICG website, public literacy on these rating results is not widely spread. Companies' participation in a program of CGPI Awards is their own voluntary initiative. It means that a company may choose whether to participate in the rating. In addition, Indonesian markets are concerned with GCG implementation in companies. Thus, company's bargaining power seems weak when dealing with the management. Finally, the investors have not been able to use GCG scoring results as an additional instrument in assessing the company performance.

These findings are different with a research conducted by Mollah *et al.* (2012). The research, which uses the ordinary least squares method, has provided empirical evidence that accounting-based performance measurements (ROA, ROE and Tobin's Q) are not affected by CG mechanisms. On the other hand, market-based performance measurement (LnMktCap) may explain the role of board characteristics and boards ownership. These research findings imply that companies in Botswana have been improved to market-oriented systems by developing mechanisms for the appropriate CG and reducing the existing agency conflicts. Mollah *et al.* (2012) argue that those accounting numbers are susceptible to accounting manipulations, such as profit management or income smoothing. On the contrary, this research shows different evidence that investors in Indonesia are more interested in accounting-based performance and/or hybrid measurements, such as ROA, ROE and EPS.

The same research linking CG rating with a share price was performed by Berthelot *et al.* (2010). They investigated whether investors take into account the CG rankings published by *The Globe* and *Mail*, a reputed Canadian newspaper, in their evaluation of stock price. The results suggest that investors consider these CG rankings in their stock price evaluations.

The third dependent variable is growth. Firm's growth in this paper was measured using the profit increase this year from the previous year's. Model 6 in Table VIII exhibits that our hypothesis was unsuccessfully proven. Adjusted R^2 in this model is 6 per cent; it means that the variation of growth was only able to be explained by the independent variables by 6 per cent. This research found that the CG implementation does not influence the company growth, which is represented by the earnings growth (EG). The good governance implementation actually provides long-term implications on company performance. Thus, the company growth resulted from GCG implementation may not be accurately measured in the short term. There may be an indirect relationship due to the impact of good governance rating on firm performance, as measured by accounting outcomes (Berthelot *et al.*, 2010). The impact of the implementation of good governance will be seen with a lag time of minimum one year.

The control variables used in this study are company size, company age, listing age and leverage. Firm size affected positively both the accounting and market performance; also, the company size measured by the natural logarithm of total assets had a positive effect on profit growth. This study proved that leverage affects financial performances (ROA, EPS), company values (PBV, PER) and earnings growth (EG). Nevertheless, the regression coefficient was negative; it means that the higher debt portion from the shareholders' equity would reduce financial performance. Age has a positive effect on PER; however, it has no significant effect on other dependent variables. The listing age variable has a positive influence on ROA and ROE at the level of 0.10.

Conclusions and suggestions

The companies participating in CGPI rating always experience an increase in both quantity and quality each year. It means that their awareness on GCG has improved. The CG rating of go-public companies in Indonesia influences companies' accounting-based performance, such as ROA, ROE and EPS. This study also found that there is no significant effect on CGPI rating and company growth. Meanwhile, CG rating does not affect stock market prices. Investors do not respond to CGPI rating quickly, and thus, it seems there is no increase in stock prices. Research on CGPI rankings conducted by IICG every year is not very useful for investors or prospective investors in making their investment decisions in the stock market. Therefore, IICG should publish CGPI rating widely and easily accessible to the public. The government is expected to support IICG to improve the quality of its research and results published. For instance, the government can provide funds for IICG, as they are a non-profit organization. In addition, the stock exchange authority in Indonesia is suggested to create policy for the company to join the CG rating program, as the results of this study indicated that the CG rating could improve performance (Berthelot *et al.*, 2010; Mishra and Mohanty, 2014).

In this study, we identify certain limitations. CGPI rating in related years is associated with market performance at the same years. Thus, it would also be valuable to pay attention in further research to the possibility of CGPI rating being linked in the related years with market performance in the following years, as findings of this study show that GCG implementation is not directly responded by the market. Moreover, the future research may consider comparing companies in the group and those that do not participate in the CG rating to make the results more robust and interesting.

The study discovers that CGPI rating has a positive impact on financial performance. These findings have implications for CG policies. The government may encourage or oblige public companies to participate in the CGPI ranking programs, as it is a voluntary program. Therefore, the government should create conducive situations for GCG enforcement through a regulatory approach on GCG to improve company owners' and managers' commitments on GCG implementation. The company can provide special attention and make improvements to the internal factors of the organization that is not appropriate and does not support the establishment of GCG based on the findings during the survey of CGPI. Companies are expected to implement CG not only to comply with laws and regulations but also to increase their performance. Furthermore, the company might make GCG as part of the corporate culture.

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Appendix 1

Table AI List of self-assessment survey respondents

No.	*Internal*	*External*
1.	President Commissioner	Institutional investor
2.	Chairman of the Sharia Supervisory Board[a]	Minority investor
3.	Commissioner and Independent Commissioner	Suppliers
4.	Sharia Supervisory Board[a]	Financial institutions
5.	Members of the Committee Commissioner[b]	Insurance agencies
6.	President Director	Subsidiary
7.	Director and Unaffiliated Director	Customer
8.	Corporate secretary	External auditor
9.	Managerial employees	Regulator/Supervisor/Government
10.	Executive Committee[c]	Notary public
11.	Non-managerial-level employees	Association followed by the company
12.	Internal auditor	Partner/Joint operation/University
13.	Leaders Corporate University/Learning center/Training center	Consulting Partners (appraisal, functional partners)[d]
14.	Unions representatives	Rating agency/Professional certification agency

Notes: [a]Applicable in *Sharia* banking only; [b]Commissioners Committee is the committee that is in the Board of Commissioners as the Audit Committee, Nomination Committee, Remuneration Committee, Risk Monitoring Committee, Governance Committee and others; [c]The Executive Committee is a committee at the level of the Board of Directors that is personalized to the committee in the company (Ethics Committee, Human Resources Committee, Risk Committee, Credit Committee, etc.); [d]Consultant Partners include consultants for marketing, operations, human resources, finance, IT, etc;
Source: The Indonesian Institute for Corporate Governance (IICG)

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