CHAPTER I

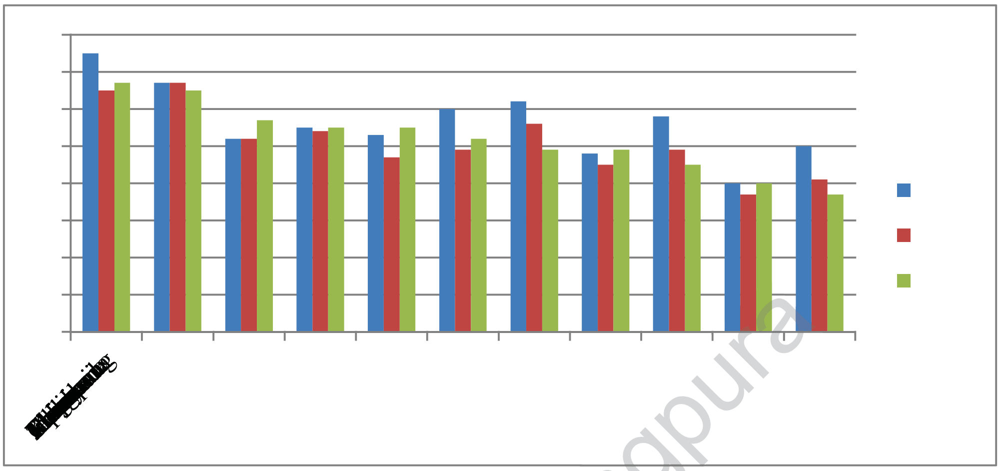
INTRODUCTION

A. Background of study

Good Corporate Governance is a practice of company which aims to control and manage company performance as well and it may create a good relationship within stakeholder by preserving sustainability of obligation of company and accountability to stakeholder.

Good Corporate Governance or called by GCG was introduced firstly in Indonesia during the biggest economic crisis in monetary sector in 1998 (Bpkp.go.id). This crisis caused an imbalance on economic activities and a decreasing of company growth in financial performance. Because the lack of implementing good corporate governance, many unhealthy companies conduct manipulation practices on their financial reports. According to Asian Corporate Governance Association (2010) in 2010, Indonesia corporates have got the lowest corporate governance index score which was 40% much lower than Malaysia at 52% and Singapore at 67%. This means the lack of good corporate governance implementation quality can make company competitiveness slowly. As a result, it may impact the lack of competitiveness between two foreign countries. Futhermore, it will reduce the number of investors who wants to invest or establish new enterprises in this country as they think that the companies in this country cannot provide profitability.

Figure 1.1 in the below, shows the comparison of good corporate governance values between various countries is, as follow:



Source: ACGA (Asian Corporate Governance Association), 2010

Figure 1.1: Comparison of Good Corporate Governance Value

In Indonesia, issues on good corporate governance become important problems when many companies doing manipulation practice into their financial report have been revealed. These cases were revealed in 2013, BUMN or called by state-owned enterprise performed manipulation practice into its financial report by making false report about the increasing of companies profitability, it's not suit with the validity of data acquisition about companies profitability so company tends to make the board of directors rich through huge amount of bonuses (*rmol.co*). This made company unable to earn the trust from neither foreign investors nor domestic investors.

Since the implementation of good corporate governance may increase companies brand image and good will that could attract investor's attention to invest their money into this company, it is expected the companies in

Indonesia may rapidly grow and compete with foreign companies in competitive market.

If many companies in Indonesia do not still realized the importance of implementing good corporate governance and continue to do manipulation practice in their financial reports, it might decrease Indonesia companies' reputation in international market. Investors will invest their money into companies which have implemented good corporate governance. Investors consider companies which have implemented good corporate governance may give higher return of their investment and investors believe it can protect them from investment lossess.

The implementation of good corporate governance has influenced the company financial performance and it gave the biggest impact on developing countries especially Indonesia. According to Klapper and Love (2002; p.23) the practice of good corporate governance on company has the biggest impact toward developing countries than developed countries. In short, the practice of good corporate governance gives a good impact toward country which has weak legal system because investors in these countries will reward more a firm that establishes good corporate governance.

The implementation of good corporate governance principles has generally given good impact toward company because it may maintain the continuity of companies life doing its business activities, thus it may adapt in a competitiveness environment. In general, company which is survived until now has implemented good corporate governance as a proper and right strategy, thus it can adapt and survive in a long-term with higher and new business competitiveness environment.

In Indonesia, companies which have been successfully entered going public companies and received good CGPI score have increased little in recent years which means these companies realized stakeholder would help company to grow and competence by utilizing their investment. For example, PT.Aneka Tambang Tbk has been implementing good corporate governance and classified as the 10 most trusted companies for 13 years consecutively based on IICG survey results. It makes Antam become one of Indonesia's most wanted companies by investors (SWA Edition 27, 2014; p.28). Following this, PT. Bank Mandiri Tbk has been also classified as the 10 most trusted companies for 11 years consecutively from the year of 2004 to 2014, based upon the IICG survey as CGPI ranking scores (SWA Edition 27, 2014; p.28).

According to Setyawan and Putri (2013; p.586) research, implementation of good corporate governance has given positively significant correlation to LPD (Lembaga Perkreditan Desa) financial performance. The implementation of good corporate governance may influence the increasing of company financial performance, because corporate governance is a good technique to measure and assess company financial performance. Thus, the highest score of good corporate implementation will influence the increasing of company financial performance while the lowest score of good corporate implementation will influence the decreasing of company financial performance.

The measuring of company performance especially in financial sector have been implemented good corporate governance, its expected may help company to find out whether it has reached its objective when established its company. It may help company to create good decision making, ensure stakeholder’s right as company owners or investors obtain their dividens, and protect the continuity of company’s life in the future.

When doing investment, investor will make assessment about company financial performance whether it has healthy financial report, thus investor can decide to invest or not. It caused by financial report as one of important compenent that determine in investment decision making. In this study, company financial performance can be analyzed by using profitability ratio as *Return on Equity. “*ROE is measured absolute returns that will be given by the company to the shareholders”, (Walsh, 2004; p.56). The result of profitability ratio is indirectly affected firm value which means the higher of company financial performance; it can increase the firm value. Firm value is able to draw companies condition whether it in better or not.

The highest firm value is able to enhance investor’s confidence to company such as the view of firm value to creditor. For creditor, firm value is related to company liquidity which represents the company’s ability to repay debt that is granted by the creditor. If company has lower firm values, investor will assess company with poor firm value through stock price that issued by company (Suharli, 2006; p.254). In this study, firm value is measured by using *Tobins Q* ratio. This ratio was developed by James Tobin in 1969 as ratio which measured comparation between market firm values to asset's firm value. Bocean and Barbu (2005; p.127) was utilizing Tobin's Q as company performance measurement because Tobin's Q can show accurate firm market values that indicate company's profitability in the future.

Regarding on the explanation in the above, the study of this research is about good corporate governance implementation, board of director, and earning per share toward company financial performance. Although, the research about good corporate governance has done by many researchers but their research are using Lembaga Perkreditan Desa, bank, property and real estate companies that included in CGPI rating as research object, ROA and NPM as dependent variable, and Good corporate governance as independent variable. The difference of this study with previous researchs is utilizing good corporate governance implementation measure by CGPI score including board of director and earning per share as independent variable while firm performance is measuring by ROE and Tobin's q and object research is public companies which listed in Indonesia stock exchange.

B. Problem Statement

Based on the background of problems that have been described, the formulation of problem in this study was, as follows:

1. How does the development of Good Corporate Governance implementation on company financial performance?
2. What is the effect of Good Corporate Governance on Company financial performance?
3. What is the effect of Board of Directors on Company financial performance?
4. What is the effect of Earning per Share on Company financial performance?

C. Problem Limitation

The limitations of this research are given in order to not deviate from the purpose of study thus the scopes of study are, as follows:

1. Variables in this research are GCG Score (CGPI), Board of director, EPS as independent variable and firm performance measured by ROE and Tobin's Q. Corporate Governance Perception Index (CGPI) is a research and rankings program measured according to IICG survey (Indonesia Institute for Corporate Governance).
2. This research analyzes in public companies which listed in IDX and

D. Purpose of the Study

Based on the background of problems that have been raised, then the purpose of this study was, as follow:

1. To explain the development of Good Corporate Governance implementation on company financial performance.
2. To examine the effect of Good Corporate Governance on company financial performance.
3. To examine the effect of Board of Directors on Company financial performance.
4. To examine the effect of Earning per Share on Company financial performance.

E. Benefit of the Study

The results of this study are expected to provide some benefits for, as follow:

1. For Company

   The results of this study are expected to provide some advantages for company which has implemented corporate governance about the effect of implementation good corporate governance toward company financial performance as measure by ROE and Tobin's Q. Then, company can make a good decision making about good corporate governance implementation in the future.

2. For Academy

   The results of this study are expected to provide reference and sources for students that desire to do the same research about the effect of implementing good corporate governance toward company financial performance by changing the variable or adding some variable on their research.

3. For Investor

   The results of this study are expected to provide some information to help investors who are interested in investment decision making.

F. Structure of Thesis Writing

The systematics of this thesis writing is presented, as follows:

Chapter I : Introduction

In chapter I, it explains about background of study, problem statement, significance of the study, benefit of the study, and systematics of thesis writing.

Chapter II : Literature Review

In chapter II, it provides theories that relate to topic issues about good corporate governance and company financial performance, previous research, theoretical framework, and hypothesis development.

Chapter III : Research Method

In chapter III, it contains sample and population, type of research, source of data, method of data collection, and method of analysis.

Chapter IV : Research Result and Discussion

In chapter IV, it explains about object research description, data analysis and discussion that conducted based on tool analysis.

Chapter V : Conclusion and Suggestion

In chapter V, it contains conclusion of this research and recommendation that related to the same research in the future.