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The Effect of Good Corporate Governance, Size of Firm, and Leverage on Financial Performance of Listed Property and Real Estate Companies in Indonesia

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Abstract

The purpose of this study was to examine the determinants of financial performance of Indonesian property and real estate companies listed on the country's Stock Exchange. The effects of good corporate governance, firm size, and leverage were examined (135 observations) during the period from 2015 to 2019. The research method used included a causal quantitative approach and multiple linear regression analysis. The results showed that the size of the audit committee had a significant negative effect on the company's financial performance; no other factor investigated exerted significant effects. Indonesian companies might consider minimizing the number of audit committee members in order to realize higher profits.

Keywords: *Corporate governance, firm size, leverage, financial performance*

Introduction

Indonesia recognizes the need for advanced corporate governance, as it ranked 17th out of 25 markets according to a 2014 KPMG-ACCA study. Hence, Indonesia's financial services authority (OJK) released a roadmap outlining ways to obtain better corporate governance. But at the same time, businesses need to focus on their performance (OJK, 2014). Financial performance is an important part of achieving company goals and is one of the most important things that potential investors pay attention to when making stock investment decisions. According to Friedman (1970), managers have an obligation to always act in the shareholders' long-term-interests. However, agency relationship problems (agency conflicts) exist, where the owner (principal) and manager (agent) have different interests. This is particularly true when the manager as an agent does not fully represent the best interests of the principal. It is essential to align their interests (Jensen & Meckling, 1976).

According to Benhart and Rosestein (1998), one way to reduce agency problems is to adopt good corporate governance. This includes establishing a relationship between company management, the board of commissioners, shareholders, and stakeholders. The main foci are the need for shareholders to obtain correct and timely information, and for the company to disclose information in a timely, transparent, and accurate manner about all matters relating to company performance, ownership, and stakeholders (Yunizar & Rahardjo, 2014).

According to Aprianingsih (2016), the board of commissioners and independent commissioners oversee the running of a company so that it follows the principles of good corporate governance. Then the audit committee will oversee internal supervision of the financial reporting process so as to minimize fraud in financial reports. Moreover, Rifai (2009) argued that the board of directors is also fully responsible for achieving the goals and objectives of the company.

Company size has a significant effect on capital structure, and can be expected to lead to good financial performance (Soewignyo, 2009). The larger the size of the company, the more information about it is usually available to investors (Gusliana & Fadlan, 2017). Company size has a positive and significant effect on financial performance as proxied by return on assets (ROA) (Luckieta et al., 2021). These authors showed that increases in total assets were indicative that a company was also getting bigger. The more the total assets, the greater was the capital invested and the cash flow, which can improve financial performance.

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Tapping into funding sources is required to achieve goals. Assets and fixed cost funding can be used to increase the profit potential of shareholders. Companies can choose the source of funding in the form of debt (Atmaja et al. 2015). According to Brigham and Houston (2001), the use of debt in investment is expected to increase company profits. In addition, higher leverage allows for better creditor monitoring. According to Detthamrong et al. (2017), leverage can help alleviate investment concerns such as investing in value-destroying projects, resulting in enhanced firm performance.

This study was conducted in the property, real estate, and building construction sectors listed on the Indonesia Stock Exchange (IDX) from 2015–2019, in contrast to previous studies (Nurcahya et al., 2014; Tertius & Christiawan, 2015). Currently in Indonesia, the emphasis in on development of vital infrastructure, which in turn may provide support to the nation's economic development. One sector that will benefit from the quality of infrastructure is property and real estate; good infrastructure will stimulate investors to invest in this field (Gitusudarno & Basri, 2008).

In this study, the aim was to investigate the effects of size of a number of features, namely, the board of commissioners and independent commissioners, the board of directors, the audit committee, firm size, and leverage on company's financial performance. In contrast to studies (e.g., Ararat et al., 2017; Asimakopoulos et al., 2009; Detthamrong et al., 2017) that have focused on countries which adopted a one-tier board system, this study focused on the two-tier board system used in Indonesia.

Literature Review

Agency Theory

According to Jensen and Meckling (1976), an agency relationship is a relationship based on a binding contract, where the principal entrusts another person or agent to carry out several responsibilities in decision-making. Because many decisions that financially affect the principal are made by the agent, differences in interests and priorities can arise.

Good Corporate Governance

In good corporate governance, the aim is to create added value for all interested parties (Arifin, 2005). In addition, corporate governance is meant to improve the company's financial performance by supervising or monitoring the performance of management that will guarantee accountability to stakeholders based on the regulatory framework (Farinda et al., 2010).

To ensure the implementation of good corporate governance, it is necessary for a company to disclose timely, transparent, and accurate information on all matters relating to the company's performance, ownership, and stakeholders (Yunizar & Rahardjo, 2014). In this structure, an independent commissioner acts as a mediator in disputes between internal managers, oversees management policies, and provides advice to management. Fama and Jensen (1983) suggested that the greater the proportion of independent commissioners, the more effective was their role in carrying out the supervisory function and protecting all company stakeholders. According to Nugroho and Raharjo (2014), the board of directors has the right to represent the company internally and externally. Therefore, more directors with clear responsibilities will have a positive impact on stakeholders. With the audit committee, a larger size leads to better reporting quality and a higher level of monitoring, leading to optimization of the company's profitability (Sarafina & Saifi, 2017).

Board members are appointed to assist and support the company through their ability to maintain commitments and support from key external stakeholders; keep communication channels open between the firm and external organizations; gain access to resources, particularly information and advice; as well as establish legitimacy (Hillman et al., 2000; Pfeffer & Salancik, 2003).

Company Size

The assets owned by a company represent the rights and obligations, as well as its capital. Large companies, according to Batubara et al. (2017), will get more attention from the public and have a wider circle of stakeholders. The bigger the company's size, the greater the capital investment, which means greater opportunities and the possibility of higher performance.

Leverage

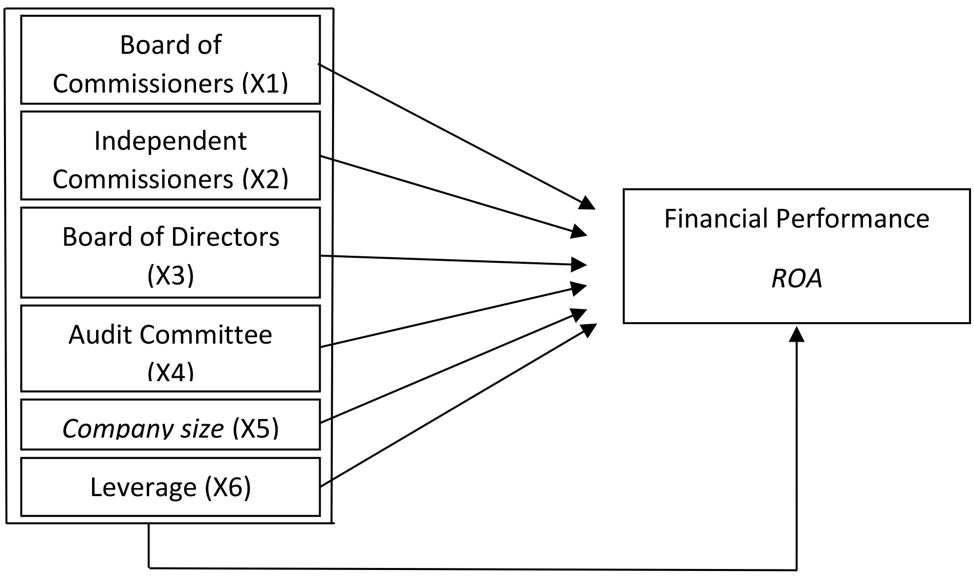
Leverage is the use of assets and sources of funds from companies with fixed costs to increase the profits to shareholders (Sartono, 1997). Fixed costs are not affected unless the company carries out changes in business activities. Leverage clarifies the importance of debt financing by showing the presentation of a company's assets that are supported by the use of debt (Darsono & Azhari, 2005).

Financial Performance

Financial performance is the most crucial obligation of a business entity (Friedman, 1970). Firms must measure their performance to ensure that they are running efficiently and effectively and reaching their objectives. A company's strategy from a long-term financial perspective will affect shareholder value (Nuswandari, 2009). Companies that implement good corporate governance will maintain company growth by working effectively and efficiently, which in turn will reduce the cost of capital, reduce risk, and increase investors and creditors confidence. This will receive a positive response from investors.

In this study, profitability ratio was employed to measure a company’s performance. A company's success within a certain period reflects the level of management effectiveness in carrying out the firm’s operations. Profitability was calculated using return on assets (ROA), following prior studies (Asimakopoulos et al., 2009; Detthamrong et al., 2017). It represents a ratio used to measure a company's ability to generate net income based on certain asset levels.

Figure 1 *Conceptual Framework Used*



Hypothesis Development

The Effect of the Board of Commissioners on Financial Performance

The board of commissioners is responsible for overseeing management policies. The greater the number of board of commissioner members, the more effectively a company can be monitored and fraud minimized, hence potentially increasing profitability (Rahmawati et al., 2017).

H_1: The size of the Board of Commissioners affects a company's financial performance.

The Influence of Independent Commissioners on Financial Performance

Independent commissioners are perceived an effective monitoring tool for management behavior (Rosenstein & Wyatt, 1990). The greater the proportion of independent commissioners on the board of commissioners, the more effective is their role in implementing the supervisory function of management's opportunistic behavior (Fama & Jensen, 1983). Independent commissioners positively affect company profitability (Widyati, 2013). Increasing the number of independent commissioners can encourage commissioners to be objective in taking action and can protect company stakeholders.

H_2: The number of Independent Commissioner affects a company's financial performance.

The Effect of the Board of Directors on Financial Performance

The board of directors has the right to represent the company internally and externally (Nugroho & Raharjo, 2014). According to resource dependency theory, the members of the board are appointed to provide aid and support to the company (Hillman et al., 2000; Pfeffer & Salancik, 2003). Hence, a larger board can provide better stakeholder representation, competence, and experience. Therefore it is posited that the board of director's size has a positive effect on the company's financial performance.

H_3: The size of the Board of Directors affects a company's financial performance.

The Effect of the Audit Committee on Financial Performance

The audit committee has a significant effect on company profitability (Sarafina & Saifi, 2017; Rahmawati et al., 2017). The bigger the audit committee, the better the reporting quality, and the higher the monitoring of management. In turn, the more effective the audit committee's supervision, the greater the company's profitability. Consequently, it can minimize management efforts in dealing with data problems related to finance and accounting procedures and functions to increase company profitability.

H_4: The size of the Audit Committee affects a company's financial performance.

The Effect of Company Size on Financial Performance

The size of the company is one of the criteria for consideration by investors. Size may or may not affect profitability (Dewayanto, 2010; Rahardja, 2014). The failure to realize increased profitability with size may be on account of increased agency problems being experienced in a larger company.

H_5: Company size affects a company's financial performance.

The Effect of Leverage on Financial Performance

If a company's debt increases, its leverage increases, but its potential profit may also increase (Higgins, 2004). However, leverage affects the company's financial performance because the higher the leverage ratio, the higher the risk of inability to pay its obligations. Thus, leverage has a significant effect on company profitability (Wahyuningtyas, 2014). Companies that get funding from debt can determine the impact of corporate loans on company performance. However, the higher the leverage value in the ratio of financial statements, the greater the risk to creditors (Ramdhonah et al., 2019).

H_6: The degree of leverage affects a company's financial performance.

Research Methodology

Research Design

Quantitative and causal methods were used. Trend analysis was utilized together with multiple linear analysis to measure the effect of the independent variables on company profitability.

Table 1 *Operational Definition of Variables*

Variable	Definition	Measurement
Y	Return on Assets (ROA)	$\frac{\text{Net Income}}{\text{Average Total Assets}}$
X_1	Board of Commissioners	∑ Board of Commissioners
X_2	Independent Commissioner	∑ Independent Commissioners
X_3	Board of Directors	∑ Board of Directors
X_4	Audit Committee	∑ Audit Committee
X_5	Company Size	LnTA (Natural Logarithm of Total Assets)
X_6	*Leverage*	DFL (Degree of Financial Leverage) $\frac{\text{\% Changes in EPS}}{\text{\% Changes in EBIT}}$

Table 1 shows the measurements used in this study. Secondary data were used, namely the financial statement data of property and real estate companies that have been audited from 2015–2019 from the official website of the Indonesia Stock Exchange. The basic guidelines for testing the hypothesis were as follows: if the probability value is ≤ .05, the researcher accepted *Ha* and H_0 was rejected. However, if the probability value was > .05, the opposite conclusion was reached.

The equation used in this study was as follows:

$$Y = \alpha + \beta_1 BOC + \beta_2 IC + \beta_3 BOD + \beta_4 AC + \beta_5 Size + \beta_6 Lev + \varepsilon_i$$

Population and Research Sample

The population was property, real estate, and building construction companies listed on the Indonesia Stock Exchange from 2015 to 2019. Purposive sampling was used; namely, selection was according to the criteria adopted for the study (Dolores & Tongco, 2007). The sample selection criteria were as follows:

1. Property and real estate sub-sector companies listed on the IDX for the 2015–2019 period.
2. Property and real estate companies that continued to issue financial reports (audited) during 2015–2019.
3. Property and real estate companies that published financial statements in Indonesian Rupiah.
4. Property and real estate companies that had complete data on good corporate governance measurement, company size, and leverage.

Using these criteria, 27 companies were selected for a total of 135 firm-year observations.

Result and Analysis

Trend Analysis

The trends observed in commissioners, board members, and auditors over the period 2015–2019 are shown in Table 2. A rise was noted in the number of Board of Commissioner members until 2017, after which the number declined. A decrease may occur due to death, fulfilment of the term of office, termination of office based on the decision of the General Meeting of Shareholders, or no longer fulfilling the requirements to be a member of the Board of Commissioners based on the Company Law Article 1 No 2. By contrast, the number of Independent Commissioners and Board of Director members remained relatively stable. The number of directors can change according to the company's needs or by the decision of the General Meeting of Shareholders, but this was apparently not a frequent action. The number of audit committee members fluctuated but tended to increase. An increase in the number of audit committee members reflected company needs and a decision to assist the Board of Commissioners in supervising company activities more effectively (Sari, 2019).

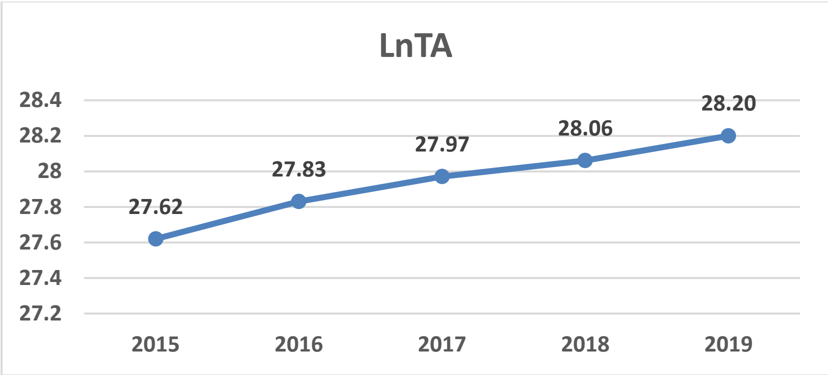
Table 2 *Average Number of Members on Real Estate Company Oversight Committees: 2015 to 2019*

Membership Trends			**Year**		
(Average Number of Members)	2015	2016	2017	2018	2019
Board of Commissioners	2.3	2.4	2.5	2.3	2.2
Independent Commissioners	1.6	1.5	1.6	1.7	1.8
Board of Directors	4.5	4.4	5.2	4.6	4.5
Audit Committee	2.9	3.0	2.8	2.9	3.0

Source: IDX website

Figure 2 shows that each year, the size of the company, as measured by LnTA, tended to increase due to the addition of assets such as land, factories, and investments, and an increase in new product inventories. Another factor that can affect the growth of total assets is financing (Chandra, 2014). Financing is an activity to support planned investments.

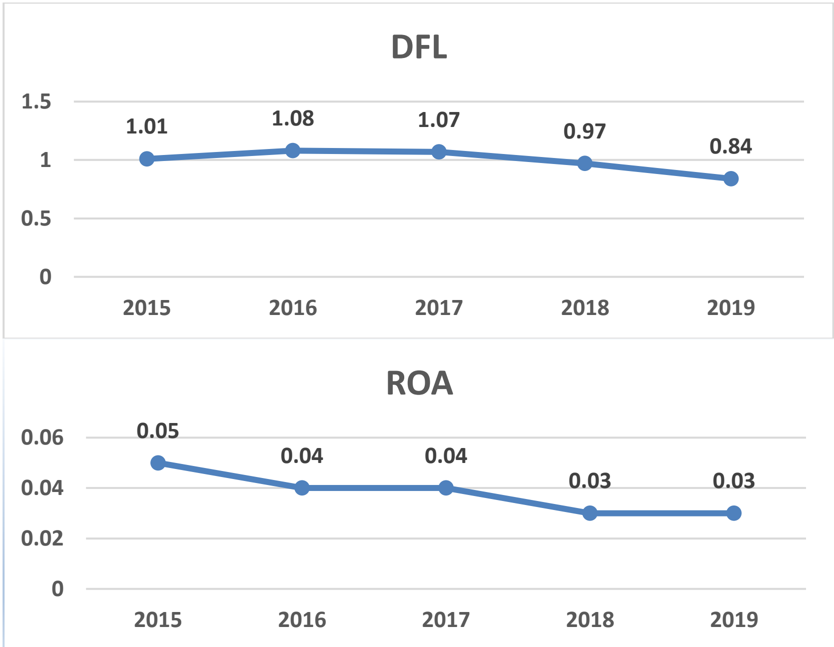
Figure 2 *Average Natural Logarithm of Total Assets (LnTA)*



Source: IDX website

The trend analysis in Figure 3 shows that each year the Degree of Financial Leverage (DFL) tended to decline even though there was a slight increase in 2016. A low use of debt in a company depended on the company's condition. If it was producing high profits, there may have been a significant source of internal funds. Conversely, the high use of debt in a company can be caused by generation of low profits, so the company chooses to increase the level of debt (Myers, 1984). Also in Figure 3, the ROA tended to decline. A decrease in ROA could be caused by the fact that the company is increasingly ineffective in managing assets to generate profits (Munawir, 2007).

Figure 3 *Average Degree of Financial Leverage (DFL) and Average Return On Assets (ROA)*



Source: IDX website

Hypothesis Testing

The test results conducted on the various hypotheses are shown in Table 3 on the following page.

The Effect of the Board of Commissioners on Company Financial Performance

Based on Table 3, it can be concluded that the size of the board of commissioners did not have a significant effect on company profitability, meaning that H_1 was rejected. In this study, the number of company commissioners ranged from three to four people and female commissioners accounted for only 19% of the total number.

The results agreed with other research findings (Sukandar & Rahardja, 2014; Pratiwi, 2018), where it was found that the board of commissioners had no significant effect on company profitability. This may imply that the more the number of commissioners, the lower the profitability. Excess numbers may cause the Board to be ineffective in carrying out its duties, as coordinating among members could hinder the supervisory process.

Table 3 *Partial Test Results (T-Test)*

Variable	Hypothesis	Coefficient	Sig.	Explanation:
BOC	H_1	.000	.921	Rejected
IC	H_2	.006	.320	Rejected
BOD	H_3	.001	.581	Rejected
AC	H_4	-.027	.001	Accepted
DFL	H_5	.005	.366	Rejected
LnTA	H_6	.001	.701	Rejected
Constant		.079	.120	
N		135		
***F*-stat/LR X²**		2,186		
Prob > *F*		.046		
Adj. R^2		.051		

The Effect of Independent Commissioners on Company Financial Performance

From Table 3, it can be concluded that the number of independent commissioners did not have a significant influence on profitability, so H_2 was rejected. The results of this hypothesis test are in line with the research of Fadillah (2017) and Octosiva et al. (2018).

No positive influence on company profitability was found for corporate governance mechanisms related to the number of independent commissioners. According to research conducted by Nurcahya et al. (2014) and Saifi (2019), the larger the size of the independent board of commissioners, the lower the company's profitability. This could be because the supervision by the commissioners in the company are not completely independent. Independent commissioners should not be a company's former directors or commissioners previous periods, as stipulated in Article 25 Paragraph (1) of the Financial Services Authority Regulation Number 33 / POJK.04 / 2014, as this can affect their ability to act independently.

The Influence of the Board of Directors on Company Financial Performance

The number of directors had no significant influence on financial performance (Table 3), so H_3 was rejected. The work of Gill and Obradovich (2012) and Widyati (2013) showed that having more directors can lead to a decline in company finances. The large amount of money spent on the board of directors can cause company finances to decline. In the data analyzed for this study, more directors in property and real estate companies did not significantly improve their performance (Table 3), so H_3 was rejected. The results are in line with the research of Gill and Obradovich (2012) and Widyati (2013), who showed that adding more directors leads to a decline in company finances.

The Effect of the Audit Committee on Company Financial Performance

Data shown in Table 3 indicated that the size of the audit committee had a significant influence on financial performance. This finding agrees with Irma's (2019) research, which indicated that audit committee size had a negative relationship on company profitability. This is possibly because the greater the number of auditors, the more control and supervision will be carried out, and the higher the cost. With a smaller number of audit committee members, the ROA value increases. This means that efforts must be made by the company to reduce the number of auditors, and maximize their functions and duties so that supervision and consideration of company policies is not unduly strict.

Property and real estate companies listed on the IDX had women auditors, but their representation was limited to 26%. This may impact a company's progress, for Abbott and Presley (2012) contended that the presence of one or more women on an audit committee was very influential. Women tend to be independent, flexible, broad-minded, and cooperative in groups. Likewise, recent research has indicated that the presence of women on audit committees had a significant positive effect on profitability (Hartono et al., 2019)

The Influence of Company Size on Company Financial Performance

The data in Table 3 indicated that that large companies did not always perform better than smaller companies. No significant effects were seen, hence H_5 was rejected. The results are consistent with research conducted by Sukandar and Rahardja (2014) and Irma (2019), where company size, as measured by total assets, was not a benchmark that could be used to measure ROA. Many factors must be considered in assessing the size of a company, one of which is how a company can manage its assets efficiently and effectively to obtain maximum profitability (Azis & Hartono, 2017).

The Effect of Leverage on Company Financial Performance

Data in Table 3 showed that leverage had no significant effect, thus H_6 was rejected. This indicates that additional debt will not always have a positive impact on profitability. The results agree with research conducted by Azis & Hartono (2017) and Nasib and Azzahra (2019), who indicated that leverage can have a negative influence on profitability because it involves long-term products. These products have the potential to increase bank debt. Therefore, companies in the property and real estate sector must avoid incurring additional debt.

Conclusions

The conclusions reached are as follows.

1. The Board of Commissioners has an insignificant influence on ROA. The greater the number of commissioners, the lower the profitability. Work undertaken with too many commissioners can be ineffective because of coordination difficulties among board members that hinder the supervisory process.
2. The number of independent commissioners had an insignificant effect on ROA. This may be due to the fact that some commissioners were not fully independent, meaning that the supervision offered by them to the company is not entirely sound. Lack of independence could be the cause of decline in company performance. Independent commissioners should not be former directors or commissioners of a company from previous periods, as this can affect their ability to act independently.
3. The number of directors had an insignificant influence on ROA. This may be due to the relatively large amount of money spent on them that may cause company finances to decline.
4. The size of the Audit Committee had a significant negative effect on company profitability. The larger the number of audit committee members, the more control and supervision will be carried out. More audit committee members will incur extra costs. Thus, a smaller number of members will increase ROA value. Companies need to reduce the number of audit committee members and maximize their functions and duties, so that supervision and consideration of company policies is not so strict that financial performance becomes very difficult to improve.
5. Firm size had no significant effect on ROA. Large companies did not always perform better than smaller companies. After all firm size, as measured by total assets, is not a benchmark that can be used to measure a company's ROA.
6. Leverage had an insignificant effect on ROA. This was because property and real estate sector companies deal with long-term products. Long-term production has the potential to increase bank debt; therefore, companies in the property and real estate sector must avoid additional debt.

Recommendations and Limitations

To improve company financial performance, property and real estate companies might consider reducing the number of audit committee members. The implementation of corporate governance must be improved, carried out, and kept under serious supervision.

In further research studies, it would be advantageous to expand the scope to test the success of good corporate governance by expanding the population and research sample, such as using a sample of companies operating in different industries. In addition, other variables could be investigated such as managerial and institutional ownership and board diversity (e.g., education, experience, age, gender). This could provide a more accurate explanation of the factors that affect a company's financial performance. Lastly, future researchers might look at trends over a greater time span to increase the relevance of research results and strengthen the conclusions.

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