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Corporate Governance on Firm Value: Mediation of Profitability

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ABSTRACT

The phenomenon of global warming causes an increase in greenhouse gas emissions in the atmosphere, where environmentally unfriendly products are the cause. The impact is an increase in the average temperature of the earth, changes in weather patterns that endanger the world's ecosystem. The sustainability of a company can be measured from the performance of the firm's value, where corporate governance through profitability can be a factor that influences the value of the firm. This study aims to see the effect of corporate governance on firm's value with profitability mediation. The research population consisted of 25 SRI-KEHATI Index companies in the 3rd quarter of 2023, and 24 of them were sampled through the purposive sampling method, the data of which was obtained through the official Morningstar Sustainalytics website, and the Indonesia Stock Exchange. The research analysis technique uses the Partial Least Square-SEM method with SmartPLS 4 software. The results of the study show: (1) corporate governance affects the value of the firm in the SRI-KEHATI stock index, and (2) profitability does not mediate the effect of corporate governance on the value of the firm in the SRI KEHATI stock index

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INTRODUCTION

The phenomenon of global warming caused by the process of increasing the average temperature of the atmosphere, sea, and land of the earth and the presence of greenhouse gas emissions in the atmosphere, where environmentally unfriendly products are the cause. The impact is an increase in the average temperature of the earth, changes in weather patterns that threaten the sustainability of the world's ecosystem (Aldieri, Amendola & Candila, 2023). Forest burning activities and activities that can cause other carbon emissions such as burning fossil fuels, industrial activities, will produce a greenhouse effect as a source of global warming activities, and from this activity the impact will be felt in the form of uncertain weather conditions, and also with an increase in hot temperatures (Al-Ghussain, 2018).

The increase in hot temperatures that occurs in Indonesia can be worse, considering local industrial activities, making Indonesia the fifth largest contributor to global warming in the world (Suhadak, Kurniaty, Handayani & Rahayu, 2019). The United Nations (UN) through the Sustainable Development Goals (SDGs) has 17 goals to build a sustainable world as the 2030 agenda, namely gender equality, education, health, social justice, and protecting the environment (Zakari, Khan, Tan, Alvarado & Dagar, 2022). Indonesia supports the UN SDGs through (Presidential Regulation No. 59 of 2017) concerning the implementation of sustainable development. The regulation is to control, overcome and reduce the impact of global warming from companies in Indonesia.

In line with the SDGs policy, various companies support environmental-based corporate management efforts with the aim of gaining community legitimacy. Legitimacy is the practice of gaining organizational existence with a tendency to side with environmental conditions (Jaber & Oftedal, 2020). This legitimacy can be hampered if management focuses on using profits for reinvestment and the company owner has not agreed because the profits are intended as dividends, where the relationship between the interests of both can be explained through agency theory (Deegan, 2019). The relationship between the company owner (principal) and company management (agent), which has different interests and agent theory as a basis for understanding communication between them (Vitolla, Raimo & Rubino, 2020).

The agent-principal relationship can be maintained through signal theory (Yasar, Martin & Kiessling, 2020). Signal theory is an effort to publish information to straighten out asymmetric information from external parties such as investors and creditors (Hussain, Ahmad, Mia, Ahmed & Prommee, 2023). Based on this, companies can gain public legitimacy through environmental aspects, and in practice, agency is needed from management, which can be proven through various related signals. Environmental aspects cannot legitimize a company if there is no signal that shows the influence of environmental aspects on public assessment of the firm's value, so it cannot be recommended or implemented by the firm.

Based on the problems of global warming and corporate interests above, researchers are interested in conducting financial management research that reviews sustainable management practices that are intended to maintain corporate sustainability. The sustainability of the company can be assessed from the performance of the firm's value, where corporate governance through profitability can be a factor that influences firm value (Mahrani & Soewarno (2018); Ararat, Black & Yurtoglu (2017); Zhang, Qin & Liu (2020). This sustainable practice encourages researchers to analyze the effect of corporate governance on firm value mediated by profitability.

Firm value needs to be maintained and improved by the firm. Market expectations about the firm's performance achievements are reflected in the firm's current value (Belo, Gala, Salomao & Vitorino, 2022). Market Value Added, commonly called market capitalization, can be a benchmark for assessing firm performance, which looks at the stock price in the market (Kuvshinov & Zimmermann, 2022). This shows the firm's ability to increase the value of its shares and increase public trust in the firm.

Through Law Number 40 of 2007 concerning Limited Liability Companies, the government hopes that companies can implement good corporate management, while also building a sustainable economy, and have social and environmental responsibilities to be managed properly in corporate governance. Companies can get appreciation from stakeholders by carrying out environmental responsibilities (Bhagat & Bolton, 2019). The implementation of sustainable corporate management can be implemented if the directors feel that the policy can bring benefits to the company. Corporate governance is an application that can provide added value to the firm (Alodat, Salleh, Hashim & Sulong, 2022).

In addition, firm value is also influenced by profitability. Profitability is the ability of a company with its resources to increase profits (Niyas & Kavida, 2023). Management is required to be able to increase the profitability desired by investors, so that the firm's value can increase (Helmina, Sutomo & Respati, 2022; Rahmawati, 2020). Research conducted by Mahrani & Soewarno (2018); Shakri, Yong & Xiang (2022) shows that corporate governance can affect profitability and can mediate firm value. This is not in line with research by Lu, Javeed, Latief, Jiang & Ong (2021); Pham & Nguyen (2019) which shows that profitability does not mediate the influence of corporate governance on firm value. Based on the above phenomenon, the study was conducted with the aim of testing the inconsistency of previous research results by looking at the influence of corporate governance on firm value mediated by profitability.

LITERATURE REVIEW

Firm’s Value

Firm’s value is the impact of high stock prices reflected in the dividend payout ratio to increase shareholder welfare (Akhmadi & Januarsi, 2021). The higher the stock price, the higher the firm's value in the stock market (Ararat, Black & Yurtoglu, 2017). Stock prices cannot be compared between one company and another because of the difference in the number of shares outstanding (Alsayegh, Rahman, & Homayoun, 2023). Firm performance in the market can be evaluated using the Market Value Added proxy, commonly called market capitalization, which is obtained by multiplying the stock price per share by the number of shares outstanding (Lai, Yue & Chen, 2022).

Corporate Governance

Corporate governance is a company management practice with a set of rules and systems to direct and manage the company to achieve the company's goals (Shakri, Yong & Xiang, 2022). Corporate governance is a set of systematic procedures to increase the value of the company with accounting principles (Bhagat & Bolton, 2019). Corporate governance is considered a solution to the problem of a company's agency, which has a habit of abusing authority with a tendency to benefit agents and harm owners. The ability of corporate governance to determine the direction and performance of the company can increase the value of the firm (Mahrani & Soewarno, 2018; Suhadak, Kurniaty, Handayani & Rahayu, 2019).

Profitability

Profitability is a company's effort aimed at generating profits by distributing net profit over the company's equity, as measured by Return on Equity - ROE (Mahrani & Soewarno, 2018). The calculation of ROE is considered more accurate in considering the company's profit ratio, because the existing net profit is compared to investor capital without any assumption of liabilities (Shakri, Yong & Xiang, 2022). The calculation of ROE is a percentage of the division of net profit by total common stock equity, expressed in percent (Ararat, Black & Yurtoglu, 2017).

Corporate Governance on Firm Value

Understanding corporate governance is important to be implemented by a company. The implementation of corporate governance will have a positive impact on the firm, where with the support of existing mechanisms and systems it can direct the company to achieve its goals. Understanding corporate governance is the relationship between many parties in the firm with the aim of providing direction and determining the firm's performance (Bhagat & Bolton, 2019). A corporate governance system that is managed wisely will certainly guide the company with good direction and performance. This is in line with research conducted by Alodat, Salleh, Hashim & Sulong (2022); Mahrani & Soewarno (2018) shows that understanding the direction and performance in corporate governance will have an effect on increasing the firm's value. The ability of corporate governance to determine the direction and performance of the company can increase the firm's value. Based on this, it encourages researchers to formulate the following hypothesis:

H1: Corporate governance has an effect on firm value.

Corporate Governance on Firm Value with Profitability Mediation

Corporate governance can be represented by the composition of the board of commissioners, board of directors, and audit committee which have a positive effect on profitability (Vitolla, Raimo & Rubino, 2020). Based on this, companies with good corporate governance can positively affect profitability, it is also hoped that with the good systems and mechanisms the company can move in a better direction and improve the firm's performance in the future (Mahrani & Soewarno, 2018); Shakri, Yong & Xiang, 2022). Increasing profitability in a positive direction can certainly attract investors' attention, and at the same time will increase the firm's value in the stock market. This is in line with the results of research by Zhang & Berhe (2022) showing that profitability can increase the value of the firm. The better the ability of corporate governance in determining the direction and performance of the firm, it can increase profitability and attract investors to invest in the firm so that it can increase the value of the firm. Based on this, it encourages researchers to formulate the following hypothesis:

H2: Corporate governance affects the value of the firm with the mediation of profitability

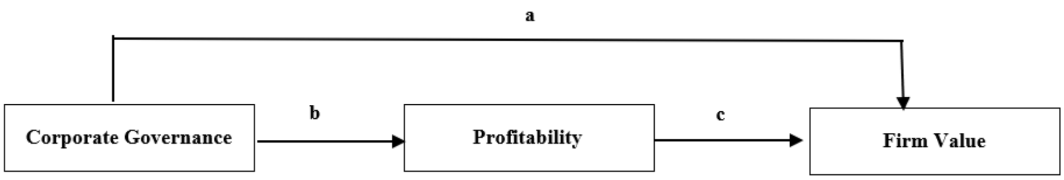

Figure 1. Research Conceptual Framework

Source: Mahrani & Soewarno (2018); Ararat, Black & Yurtoglu (2017); Zhang, Qin & Liu (2020)

METHODOLOGY

The study uses a quantitative method, where this study uses data in the form of numbers and statistics as an analysis tool. The population consists of 25 companies in the SRI-KEHATI stock index (Sustainable and Responsible Investment from the Indonesian Biodiversity Foundation) in the third quarter (Q3) of 2023, totaling 25 companies. The sample of this study consists of 24 samples of companies in the SRI-KEHATI stock index with a purposive sampling method that meets the criteria including (1) companies listed on the SRI-KEHATI indexed stock exchange in July-September 2023 quarter III (Q3); have company reports and financial reports for the third quarter (Q3); and have an ESG value report in Morning Sustainability.

This study uses independent variables in the form of corporate governance with a proxy of the total number of commissioners in the company. The dependent variable is the firm value with a proxy of market capitalization. While the mediating variable is profitability with a proxy of Return on Equity (ROE). Secondary data in the form of financial reports and ESG risk value reports of companies are used as research data collection techniques. Researchers obtain data from the official IDX website to obtain data on the annual reports of related companies, and Morningstar Sustainalytics (to obtain data on the ESG risk value of related companies. The data analysis technique used in this study is Partial Least Square-Structural Equation Modeling (PLS-SEM) because PLS-SEM as a whole is able to provide powerful and flexible tools for researchers who are intended to analyze complex structural equation models (Hair, Hult, Ringle & Sarstedt, 2022).

RESULT

Table 1. Path Coefficient Indirect Effect Estimation Results

No.	Variable	Path Coefficient	P-Value	Information
1.	Corporate Governance – Firm Value	0.280	0.002	Significant
2.	Corporate Governance – Profitability	0.305	0.124	Not significant
3.	Profitability – Firm Value	0.184	0.016	Significant

Source: Data is processed (2024)

Table 2. Specific Indirect Effect Estimation Results

No.	Variable	Path Coefficient	P-Value	Information
1.	Corporate Governance – Profitability - Firm Value	0.018	0.818	Not significant

Source: Data is processed (2024)

Based on Table 1, the results of hypothesis 1 are accepted, because the p-value is 0.002 which is smaller than 0.05 (α = 5%) and the path coefficient value is 0.280. This can be interpreted that corporate governance has an effect on firm value, where the higher the corporate governance, the more it affects the firm value. While Table 2 shows that hypothesis 2 is rejected, because profitability does not mediate the effect of corporate governance on firm value with a p-value of 0.818 which is greater than 0.05 (α = 5%) and a path coefficient value of 0.018. This can be interpreted that profitability does not mediate the effect of corporate governance on firm value.

DISCUSSION

The results of this study indicate that hypothesis 1 is accepted, namely that corporate governance has an effect on firm value. This shows that the higher the corporate governance, the higher the firm value. This is in line with research conducted by Alodat, Salleh, Hashim & Sulong (2022); Mahrani & Soewarno

(2018) showed that understanding the direction and performance of corporate governance will have an effect on increasing firm value. The ability of corporate governance to determine the direction and performance of the company can increase the value of the firm. The sensitivity of changes in the size of the number of Human Resources (HR) in the board of directors and commissioners and the level of education of the president of the board of directors and president of the commissioner states that corporate governance can influence the stigma of investors in assessing a firm's shares, so that it can increase the firm's valuation (Bhagat & Bolton, 2019).

The results of this study indicate that hypothesis 2 is rejected, namely that profitability does not mediate the effect of corporate governance on firm value. This is in line with research conducted by Lu, Javeed, Latief, Jiang & Ong (2021); Pham & Nguyen (2019) which shows that profitability does not mediate the effect of corporate governance on firm value. The results of this study indicate that the company's efforts to increase the number of directors and commissioners and recruit president directors or president commissioners with high levels of education, in fact, cannot support the company to record annual profits so that it cannot also increase the firm's capitalization value in the market.

CONCLUSION AND RECOMMENDATION

The research has the following results (1) corporate governance stated by the size of the human resources of the board of directors and board of commissioners, as well as the level of education of the president of the board of directors and president of the commissioners, these corporate governance factors can affect the firm's value; (2) profitability does not mediate the relationship between corporate governance and firm value, which means that the firm's efforts to increase the number of human resources of the board of directors and commissioners and recruit presidents of the board of directors or presidents of commissioners with a high level of education, which states the corporate governance factor, in fact, this cannot be proven to support the firm to record better annual profitability, so it cannot also strive to increase the firm's value.

The implications of this research result for corporate entities, researchers suggest that Indonesian companies, especially those indexed in Sri-Kehati, can maintain their good ESG risk values, and try to reduce the level of risk, especially for companies with high ESG risk values. This is an effort so that companies can have public trust to be able to run for the long term, and help global efforts in resolving the problem of global warming.

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