

# Return on Assets, Firm Value, and Good Corporate Governance: Empirical at Foreign Exchange Banks In Indonesia

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**Submission date:** 16-Feb-2024 11:53AM (UTC+0530)

**Submission ID:** 2296218571

**File name:** MEC-J\_2020.pdf (560.6K)

**Word count:** 2871

**Character count:** 15663



## Return on Assets, Firm Value, and Good Corporate Governance: Empirical at Foreign Exchange Banks In Indonesia

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### ABSTRACT

Every firm tries to improve the performance in order to achieve its goal, namely maximizing the firm wealth or value (Salvatore, 2005). The purpose of this study was to examine the effect of Return on Assets on firm value with Good Corporate Governance as its moderating variable. This study used 29 Foreign Exchange Banks in LQ45 category and listed in Indonesia Stock Exchange in 2014-2017. The firm value was measured by using Tobin's Q while GCG was measured by Independent commissioner. The results of the study showed that Good corporate governance which is proxied by the independent commissioner weakens the influence of Return on Assets to the firm value.

**Keywords:** Return on Assets, Good Corporate Governance, the Independent Commissioner, Corporate Values.

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I Received December 2019 | Accepted April 2020 | Available online April 2020  
I DOI: <http://dx.doi.org/10.18860/mec-j.v4i1.8314>

### INTRODUCTION

Economic condition of Indonesia shows considerable competitions among firms, whether the firms are similar or not. The competition is occurred at banking firms in Indonesia. The banking firms also compete for issuing mainstay products so the customers feel satisfied with the services of the banks. From this competition each firm tries to improve performance so that its main goal is achieved, namely maximizing the firm wealth or value (Salvatore, 2005). The increasing firm performance will push up on firm stock price since the investors will respond positively as a signal to invest (Spence, 1973; Brigham and Houston, 2014). The firm tries to give a positive signal to the firm outside party or investors by disclosing financial statements on an annual basis (Miller and Whiting, 2005). If the stock market price increases, the firm value will also increase. The firm value is reflected in market price of its stocks (Wahyudi and Pawestri, 2006). One of the factors affecting the firm value is profitability.

Profitability is the ability of a firm to make a profit, in this case related to sales, total assets, and own capital (Sartono, 2001). According to Weston and Copeland (2008) they suggest that the probability is the extent to which firms that generate earnings from

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sales and investment firms. Profitability in this study is proxied by Return on Assets (ROA).

Many studies suggest that Return on Assets positively effect on firm value (Rosikah et al., 2018; Yuniasih and Wirakusuma, 2009). In contrast with the results derived from Suranta and Pratana's study in 2004, Return on Assets influences negatively on firm value. It means that there are other factors affect the Return on Assets to the firm value. Therefore, the researchers added Good Corporate Governance as a moderating variable which allegedly can strengthen or weaken the effect of Return on Assets to the firm value.

Return on Assets is the ratio between profits before tax and total assets. The greater Return on Assets shows, the better performance resulted, it is because the rate of return is greater. Besides, the higher increase of Return on Assets, the higher increase of profitability of the firm, so the impact of the increase in profitability is enjoyed by holders of stocks. In fact, sometimes banks have inability to increase the value of Return on Assets resulting in decline in stock price (Anggitasari, 2012).

One of the ways to get information about the profitability of the go public banking firms for prospective investor party or investors can be done by finding the annual reports listing on Stock Exchange Indonesia. Form this annual reports, the investor or prospective investor party can find out information about financial and non-financial report in which one of the informations regarding on Good Corporate Governance (Jogiyanto, 2010).

Good Corporate governance is a system organizing, managing, and supervising the business control process to increase stockholder value, as well as a form of concern to stakeholders, employees, and communities surrounding (Tunggal, 2012). Good Corporate Governance can be used to explain role and behavior of the board of directors, board of commissioners, managers, and stockholders. In this study Good Corporate Governance was proxied by an independent commissioner. The proportion of Independent Commissioners is measured by the percentage of the number of independent commissioners divided by the total number of commissioners (Al'akbar, 2016). Lupu and Nichitean (2011) also suggest that there are significant differences between the profitability of banks which have implemented Good Corporate Governance and those which have not implemented Good Corporate Governance. If the banking firm does not apply Good Corporate Governance, it will cause low profitability.

The purpose of this study was to examine the effect of Return on Assets on firm value with Good Corporate Governance as its moderating variable. The results of this study can be taken into consideration for investors and prospective investors to invest and also as a material consideration for firms to improve the firm financial performance and value.

### THEORETICAL REVIEW

#### *Firm Value*

Keown (2004) states that the firm value is the stock market value and firm equity. The firm value can be seen from the firm stock value and very is dependent on manager's

value. Management which is based on values is also a process of maximizing the firm value based on calculation which is constantly (Martono, 2012). In this study the firm value is measured by Tobin'Q. According to Smithers and Wright (2008) Tobin'Q is a comparison between the ratio of the firm stock market value and firm equity book value. It becomes the best source information since this study used the ratio of Tobin's Q using all elements of debt, capital stock, as well as a whole asset of the firm (Isti'adah, 2015).

#### <sup>9</sup> Return on Assets

Return on Assets (ROA) is used to measure the bank's profitability since Bank of Indonesia as a mentor and supervisor of banking has more priority to the bank's profitability value so that ROA is measured by assets in which most of its fund is from societies' savings (Dendawijaya, 2009). According to Ang (2007) Return on Assets is an important ratio between the existing profitability ratios. Negative Return on Assets is caused by the firm profit in a negative condition or loss. This shows the ability of the invested capital as a whole which has not been able to generate profits.

#### <sup>17</sup> Good Corporate Governance

Shleifer and Vishny (1997) define Corporate Governance as: "... the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment." While Rezaee (2007) also defines Corporate Governance as : "... is a process effected by legal, regulatory, contractual, and market-based mechanisms and best practices to create substantial stockholder value while protecting the interests of other stockholders."

#### Hypothesis Development

Some studies state that Return on Assets positively effects on firm value (Rosikah et al., 2018; Yuniasih and Wirakusuma, 2009). In contrast, the results of the study done by Suranta and Pratana (2004) define that Return on Assets affects negatively on firm value. This means that there are other factors affecting Return on Assets to the firm value. Therefore, this study added good corporate governance which is proxied by Independent Commissioner as moderating variable which allegedly could strengthens or weakens the effects of Return on Assets to the firm value. Based on description above, then the hypothesis proposed in study was:

H1: Good corporate governance which is proxied by the independent commissioner weakens the effect of Return on Assets on the firm value.

#### METHODOLOGY

##### <sup>24</sup> Population and Sample

The population in this study was National Private Commercial Banks which is in LQ45 category and listed on Indonesia Stock Exchange in 2014-2017 as many as 65 banks. The sampling used purposive sampling method. The samples were selected with the following criteria: 1) LQ45 firms were listed on Indonesia Stock Exchange (IDX) in 2014-2017. 2) National Private Foreign Exchange Commercial Banks were listed on IDX in 2014-

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2017. 3) the Banks really existed or at least still operated in 2014-2017 time period (not frozen or liquidated by the government). 4) the data were published completely (financial statements and GCG) and not loss; and 5) the firm stocks were active in operation until 31 December 2017. Based on criteria above, the samples used in study were 29 banks.

### Data Collection Procedure

The data used in study was the secondary data and in form of panel data or time-series cross-sectional consisted of: 1) published annual financial statement data in period of 2014-2017; 2) quarterly data in form of profitability data, proportion of independent commissioners, the number of stocks outstanding and closing price, and total assets and total equity of the sampled firms.

### Operational Variables and Definitions

#### Dependent Variable

The dependent variable in this study was the firm value. The firm value was measured by using Tobin'Q. According to Smithers and Wright (2008) Tobin'Q is a comparison between the ratio of the firm stock market value and book value of the firm equity, with the formula:

$$Q = \frac{(EMV + D)}{(EBV + D)}$$

where:

- Q = Firm Value
- D = Book value of total debt
- EMV = Market Value of Equity
- EBV = Book value of Equity

#### Independent Variable

The independent variable in this study was Return on Assets (ROA). The ratio was used to measure the bank's profitability with assets in which most of the fund was from society's savings. According to the Circular Letter of FSA No. 14/SEOJK.03/2017, the formula used to calculate the ratio was:

$$ROA = \frac{\text{Profit before Tax}}{\text{Average of Total Assets}} \times 100\%$$

#### Moderating Variable

The moderating variable in this study was Good Corporate Governance which was proxied by Independent Commission. The proportion of Independent Commissioners was measured by the percentage of the number of independent commissioners divided by the total number of members of the board of commissioners. According to Al'akbar (2016) measurements of Good Corporate Governance (GCG) are as follows:

$$KI = \frac{\text{Number of Independent Commissioners}}{\text{Number of Board of Commissioners Members}} \times 100\%$$

**Data Analysis Method**

The analysis method used regression equation as follows:

$$Y = a + b_1X + b_2Z + b_3XZ + e_1$$

Description:

- Y = predicted value
- a = constant
- b1 = regression coefficient for X
- b2 = coefficient of moderating variable
- b3 = coefficient of moderating regression for X
- X = exogenous variable
- Z = moderating variable
- e = residual value

**RESEARCH RESULTS**

This study used samples as many as 29 Foreign Exchange Banks in Indonesia, where researchers used panel data for 4 years so that the observation data obtained were 29 x 4 years = 116 observation data.

This study used linear regression model. The descriptive statistical analysis was used to find out the trend of the research variables, it may be seen in Table 1.

**Table 1. The Results of Descriptive Statistical Analysis of Research Variables**

	Descriptive Statistics		
	Mean	Std. Deviation	N
firm value	.833	.05095	116
ROA	1.5217	.93424	116
GCG	.8874	.70971	116
ROA*GCG	1.4755	1.75148	116

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The results of determination coefficient test can be seen in Table 2.

**Table 2. Determination Coefficient Test**

Model	R	Model Summary		
		R Square	Adjusted R Square	Std. Error of the Estimate
1	.471 <sup>a</sup>	.221	.201	.04556

a. Predictors: (constant), ROA\*GCG, ROA, GCG

Table 2 shows the value of *Adjusted R Square* on *Return on Assets* moderated by good corporate governance which was proxied by independent commissioner (ROA\*GCG) was 0.201. This showed that 20.1%, the variable of the firm value was affected by *Return on Assets*, while the remaining 79.9% was influenced by other variables not added into the model.

While for results of Simultaneous Significance Test (F Test) and T Test in this study can be seen in following table.

**Table 3. Simultaneous Significance Test (F Test)**

Model		Sum of Squares	ANOVA <sup>b</sup>		F	Sig.
			df	Mean Square		
1	Regression	.066	3	.022	10.616	.000 <sup>a</sup>
	Residual	.232	112	.002		
	Total	.229	115			

a. Predictors: (Constant), ROA\*GCG, ROA, GCG

b. Dependent Variable: firm value

Table 3 shows that the simultaneous significance test (F test) showed the significance value which was less than 0.05. This means that the interaction of *Return on Assets* variables has a significant effect on firm value. This regression model can be used to predict Tobins Q or it can be said that *Return on Assets* together affects the firm value.

**Table 4. T test**

Model		Coefficients <sup>a</sup>		t	Sig.
		Unstandardized Coefficients	Standardized Coefficients		
		B	Std. Error		
1	(Constant)	.756	.015	48.983	.000
	ROA	.046	.009	4.986	.000
	GCG	.054	.015	3.602	.000
	ROA*GCG	-.027	.008	-3.418	.001

a. Dependent Variable: firm value



From table 4 above, it shows that the moderating variable in this study was Good Corporate Governance which was proxied by independent commissioner (ROA\*GCG) having t-count of -3.418 with significance value of less than 0.05. The results of the study state that Good Corporate Governance weakens the effect of Return on Assets on firm value. Therefore, the hypothesis is accepted. This is in line with Widnyana's study (2014). The proportion of independent commissioners in banking firm does not guarantee the financial performance to be getting better. Monitoring conducted by the independent commissioner does not preclude the manager to commit fraud, so that the firm value will be increasingly difficult to achieve.

## CONCLUSION

Based on results of the study above, the conclusions composed are Good Corporate Governance which is proxied by independent commissioner weakens the effect of Return on Assets on firm value. Monitoring conducted by the independent commissioner does not preclude the manager to commit fraud, so that the firm value will be increasingly difficult to achieve.

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