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Analysis of The Influence of Corporate Governance and Financial Performance on Firm Value

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Abstract: This article aims to examine how corporate governance and financial performance contribute to increasing firm value. This research uses a literature review study approach, where analysis is carried out based on the results of previous research to understand the relationship between governance and financial performance on firm value. The study results show that the implementation of good governance, such as the principles of transparency and accountability, can increase investor confidence, reduce agency conflicts, and optimize company performance. On the other hand, profitability as an indicator of financial performance is proven to have a positive impact on firm value, reflecting market confidence and long-term growth potential. The implications of this study emphasize the importance of effective governance implementation as well as efforts to improve financial performance to strengthen the competitiveness of companies at the national and international levels.

Keywords: Profitability, Corporate Governance, Firm Value

Introduction

In general, the first reason investors invest their money in an investment instrument is as a way to achieve maximum profit. Initially, before allocating their funds, investors need to consider various factors. One important aspect that must be considered is the company's performance, which is assessed based on the company's value. In practice, efforts to maximize company value often trigger conflicts of interest between managers or agents and stakeholders as principals. Agents tend to prioritize personal goals that are often contrary to the company's main objectives, thus ignoring the interests of the principal. This imbalance of interests is known as agency conflict (Hariati & Rihatiningtyas, 2016). The value of the company can be determined by its ability to pay dividends to shareholders. However, there are times when companies decide to reinvest the profits earned rather than distribute dividends. The amount of dividends paid affects the company's share price. High dividends tend to increase stock prices and firm value, while small dividends can lead to lower stock prices. The company's ability to pay dividends is closely related to the profits it generates. The greater the profit earned, the higher the company's ability to pay dividends, which in turn increases the value of the company (Harjito & Martono, 2005).

In addition, the implementation of good governance contributes to increasing investor confidence, as it ensures that the five main principles of Good Corporate Governance (GCG) - namely transparency, accountability, responsibility, independence and fairness - are optimally implemented. Effective governance also plays a role in identifying and managing potential risks, while reducing conflicts between management and shareholders, thus having a positive impact on increasing company value. Company performance is an important factor in investment decisions. Potential investors consider the financial aspects of the company, because the stability and growth of a business is highly dependent on its financial condition. For companies, maintaining and improving financial performance is crucial so that their shares remain in demand and exist in the market. The published financial statements serve as a source of information that reflects financial performance, a form of management accountability to company owners, an indicator of business success, and a basis for strategic decision making. Previous research conducted by Alfredo et al, (2022) showed that profitability has a positive impact on firm value. An increase in company performance fosters investor confidence, encourages investment interest, and contributes to an increase in stock prices and company value. In addition, companies that have stable performance and the potential to grow look more attractive in the eyes of the market, which in turn further strengthens their competitiveness. Therefore, based on the description of the problems described above, this study is intended to examine the effect of corporate governance, and company performance on firm value. This study is expected to provide in-depth insight into the implementation of effective governance and financial performance that can strengthen the value of the company, while increasing its competitiveness at the national and international levels.

Theory Study

Agency Theory

According to Jensen and Meckling, (1976), agency theory examines the motivation and approach used by management in determining the financial structure of the company. The division of ownership is a crucial factor in achieving production efficiency and increasing the value of the company, which can be measured through its share price. Differences in interests often arise due to the delegation of tasks to agents, which has the potential to cause conflicts.

Agency theory is closely related to the concept of corporate governance (CG), which aims to increase the company's added value in the long term while still considering the interests of stakeholders. CG principles are based on norms, ethics, culture, and regulations that are relevant to the continuity of the company. Conflicts between shareholders and managers often occur in the decision-making process regarding the management of funds and the company's investment strategy. Shareholders generally focus more on the systematic risks associated with investing in company shares, while managers pay more attention to operational risks that are directly related to business continuity (Jamali, 2023).

Corporate Governance

The concept of corporate governance was initially introduced by the Cadbury Committee in 1997 through a report known as the Cadbury Report. This document then developed and became a reference in the implementation of corporate governance in various countries. Awareness of the importance of corporate governance increased after various financial crises occurred, such as the 1997 economic crisis, the collapse of large companies such as WorldCom and Enron and the subprime mortgage crisis in the United States in 2008 (Binus, n.d.). These events became a turning point that emphasized the need for the implementation of good corporate governance as a guarantor of business sustainability and reducing financial risk. With good corporate governance, the company can operate in accordance with the objectives that have been set. Effective governance provides clarity of roles and responsibilities to managers, so that they have the awareness to report the results of their work to stakeholders in a transparent manner. With a good system in place, a company can strengthen its credibility in the market and increase its long-term value to shareholders.

Signaling Theory

According to Brigham and Houston (2019), Signal Theory explains how companies convey information related to their financial stability to external parties, especially investors. The information provided by companies may not always be directly visible to investors, but through positive signals, companies can influence market perceptions and increase company value. Conversely, if the company experiences financial instability, the negative signals that arise can be a factor of consideration for investors before deciding to invest or establish cooperation. Therefore, Signal Theory has a strategic role in shaping market perceptions of the value of a company. When a company is able to provide clear, consistent, and reliable signals, investors tend to view it as a stable and promising entity for long-term investment (Gustiyani, 2024).

Governance

Effective corporate governance plays an important role in increasing investor confidence in investment decisions, thereby contributing to improved company performance. Alhaji et al. (2012) state that the implementation of good corporate governance can regulate various aspects of the relationship between board characteristics and company performance (Aprilliani & Totok, 2018). Nowadays, the implementation of corporate governance is becoming increasingly crucial to gain the trust of the public and the international community. This is the main prerequisite for companies to develop in a healthy and sustainable manner, with the ultimate goals including maximization of operating profit, business continuity, company growth, and improvement of member and community welfare.

The management and implementation of corporate governance requires commitment from all levels of the organization, starting from the establishment of basic policies and internal rules that must be followed. By implementing good governance, companies are expected to be able to improve operational performance, business efficiency, and quality of service to stakeholders. In addition, effective governance also allows companies to obtain funding at a lower cost, thus contributing to an increase in company value. Investors' confidence in the company also increases, encouraging them to invest in Indonesia. In the long run, shareholders will be more satisfied with the company's performance, which in turn will increase shareholders' value and dividends earned (Sutama & Lisa, 2018).

Profitability

Profitability serves as an indicator to assess the effectiveness of management in managing company resources, especially based on the return on loans and investments made. Factors that affect a company's profitability can come from various aspects of financial performance, which are shown through certain indicators (Alimah & Sihono, 2024). Companies with a high level of profitability often try to reduce their tax burden by increasing the debt ratio. The greater the amount of debt, the smaller the tax that must be paid, because interest on loans can reduce the company's tax liability (Indriyani, 2017).

In addition, profitability contributes to an increase in firm value, as it reflects the firm's earnings as well as its ability to generate profits at various operational levels. The profitability ratio is a reflection of overall management effectiveness. If a company is unable to achieve a sufficient level of profitability, then its business continuity may be jeopardized. Therefore, the company needs to seek external funding sources to maintain its operational sustainability (Sutama & Lisa, 2018)The profitability ratio can also be used to measure the level of margin efficiency, where this ratio shows the effectiveness of management in generating profits from sales or investment income (Putra, 2017).

Company Value

Firm value reflects how investors view and assess the success of a company, which is generally measured by its stock price. When the stock price increases, investors give a higher valuation to the company (Rachmawati Dwi, 2015). In other words, the stock price serves as an indicator that shows how the market sees the company's prospects and stability (Fajriah et al., 2022).

Companies with high value not only gain the trust of investors in their current performance, but also foster confidence in the potential and development of the business in the future (Prasetia et al., 2014). One way to measure firm value is through stock returns, given that investors aim to obtain optimal returns by considering investment risk (Irawan & Kusuma, 2019). Although companies have the option to distribute dividends to shareholders, some companies choose to reallocate profits to support business expansion and further development (D, 2022). For both investors and creditors, an understanding of firm value is important. For investors, a high value provides a positive signal to invest, while for creditors, the value of the company shows its capacity to pay off debt obligations, thus increasing the level of confidence in lending (Irawan & Kusuma, 2019). Various factors can affect the value of the company, including limited liability, which helps reduce business risk, company growth, liquidity level, profitability, and the capital structure owned by the company (Saputri, 2022). These factors are important elements in shaping investor perceptions and determining the attractiveness of companies in financial markets.

Research Method

This research utilizes a literature study approach, where the research involves previous research data to examine the influence between each variable and its effect simultaneously. The purpose of this research is to describe, describe, paint a systematic, factual, and accurate picture of the facts, characteristics, and relationships between the various phenomena being investigated (Barus et al, 2019). Sources of data obtained by utilizing the results of previous research, as well as news articles related to the topic being tested. Exploring interrelationships, theories, and influences between variables from scientific articles and books found in libraries, Google Scholar, Garuda, Semantic Scholar, and other information sources (Pujilestari et al, 2024).

Result and Discussion

The Influence Of Corporate Governance On Firm Value

The test researched by Dewanti & Djajadikerta, (2018) examines the impact of corporate governance and company performance on firm value in the telecommunications industry. The results showed that the percentage of institutional ownership has a significant impact partially on firm value. The share ownership structure plays an important role in the company's control system, where an effective control system can improve financial performance. The higher the institutional share ownership, the greater the intensity of monitoring carried out professionally to ensure investments generate optimal returns. In addition, the proportion of independent commissioners is also proven to have a partially significant effect on firm value. The presence of an independent board of commissioners is believed to increase the effectiveness of supervision, strengthen company performance, and minimize the potential for fraud in reporting. The quality of financial reports and trust in company performance also encourage investors to invest, which in turn contributes to an increase in firm value.

In contrast, research by Cynthia Lavenia & Trisakti, (2022) reveals that (managerial ownership) has no significant effect on firm value. According to agency theory, share ownership by management should be able to align the interests of shareholders and management, so that the company is able to optimize its performance to achieve common goals. Although the independent board of commissioners still plays a role in improving supervision and performance and reducing the risk of fraud in reporting, managerial ownership does not directly affect firm value (Sofyaningsih, 2011). Meanwhile, in research conducted by (Purbani et al, 2016). it was found that good corporate governance has a positive impact on firm value. Conflicts of interest that occur due to managers' manipulative behavior can be minimized through a monitoring mechanism that aims to align various interests within the company. With an effective corporate governance system, companies can create a monitoring mechanism that can improve performance, which is ultimately reflected in the company's value in the future.

The Effect Of Financial Performance On Firm Value

The analysis conducted by Aidah et al., (2017) shows that profitability, as one of the financial performance indicators, has a positive influence on firm value. Based on agency theory proposed by Suranta and Merdistusi (2004), conflicts of interest between agents and principals arise due to two main factors: profit-related information used to measure management performance and the separation of functions between management and ownership. Management does not directly feel the impact of inappropriate business decisions, because the risk is fully borne by shareholders.

The profit generated by the company shows its financial performance and is the main concern for investors in assessing the company's future prospects. High profitability indicates good company performance, thereby increasing investor confidence and encouraging stock demand. The increased demand for shares will have an impact on increasing the value of the company. In addition, other studies also show that the greater the return the company provides to shareholders, the higher the value of the company. Profitability reflects the company's ability to generate net profit after interest and tax, which ultimately increases the value of the company as reflected in its stock price.

Conclusion

Previous research shows that corporate governance has a significant influence on firm value, especially in the telecommunications industry. Institutional ownership plays an important role in increasing firm value because institutions have professional expertise in overseeing investments to achieve optimal returns. In addition, the existence of an independent board of commissioners can strengthen the supervisory mechanism and improve the quality of financial reporting, thereby increasing investor confidence and encouraging growth in firm value. However, not all factors in corporate governance have a significant impact. Several studies have found that managerial ownership does not directly affect firm value. Although agency theory states that share ownership by management can align the interests between shareholders and managers, research results show that the effect is not always large. Instead, a good management and supervision system proves to be more effective in preventing manipulation and ensuring that the company's performance remains stable, thus having a positive impact on firm value in the long run. In addition, the relationship between profitability and firm value is also a concern in agency theory. High profitability reflects the financial health of the company and increases its attractiveness to investors. This contributes to increased demand for shares, which in turn leads to an increase in firm value. Conflicts of interest between agents and principals arise due to the separation between management and ownership, so that management does not directly feel the consequences of business decisions taken. The better the company is when providing profits to shareholders, the higher the company value, because net profit after tax and interest is the main factor that reflects the welfare of shareholders.

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