The Impact of Good Corporate Governance on Financial Performance: Evidence from Commercial Banks in Indonesia

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Abstract

This research has the purposes of analyzing and proving empirically, such as: To investigate the effect of good corporate governance (GCG) on financial performance at banks in Indonesia through the mediating role of corporate asset growth. Theoretically, the study’s results were expected to enrich and complete the repertoire of understanding in the financial management area, specifically with those phenomena related to banking financial performance and factors which influenced it. The population of this research was a bank that had a Corporate Governance Perception Index (CGPI) rating from 2011 to 2020. The type of sampling used was saturated sampling; thus, the whole population is sample members. Current data analysis used SEM. GCG has a direct or indirect impact on banking financial performance, according to the findings of this study. Improved GCG results in increased public confidence, which is reflected in an increase in total assets, as well as improved banks’ financial performance. As a result, it can be stated that corporate asset increase largely mitigated the impact of GCG on bank financial performance in Indonesia. Through this rapid growth from corporate assets, Bank can maximize the market expansion which is ultimately able to improve banking financial performance.

Keywords: Good Corporate Governance, Assets Growth, Financial Performance

JEL Classification Code: G21, G34, B26

1. Introduction

A company’s expansion and development can be sustained if it is aided by a number of favorable external and internal variables. Financial capacity, both the ability to create capital from profits and the ability to acquire funds from external sources, is a crucial supporting aspect for a company’s ability to realize its goals and aspirations (Arimbawa & Badera, 2018). The requirement for external funding develops primarily as a result of a company’s desire to expand, which frequently necessitates major financial assistance from banks or other financial organizations. As a result, the banking industry is critical to the corporate and economic sectors.

Financial performance from banks should be brought to the forefront, given the importance of banking enterprises for economic growth. Banking financial success represents not just the company’s ability to expand and develop sustainably as a business but also its ability to contribute to the development of the national economy. Globalization is expected to remove impediments to global economic growth and indirectly promote a competitive economic climate; hence, banking’s role is becoming more significant in the period of globalization. High-income countries can help low-income countries’ economies grow even more (Wuwungan et al., 2015).

The achievement of a company or organization should be informed to stakeholders so that they are aware of the level of company achievement or goals in accordance with the organization’s or company’s mission (Deyganto & Alemu, 2019). Given the importance of banking firms in the economy, as indicated above, assessing their soundness...
becomes critical. As a result, the mechanism for assessing the soundness of private banks must be carried out using the risk-based bank rating (RBBR) technique, which includes a risk profile, GCG, earnings, and capital assessment. Profitability assessment (earnings) is a metric of a bank’s soundness that has been used to justify the study of banking financial performance in relation to GCG and other financial factors (Abidin et al., 2021; Kasmir, 2018).

According to the statistics, the measurement of the soundness of Commercial Private Banks from 2011 to 2020 as evaluated by ROA reveals a decline in average ROA, indicating that ROA and banking financial performance in Indonesia should be scrutinized more closely. Financial ratios, according to Gitman and Zutter (2015), can be used to analyze a company’s financial performance. The financial performance of a company would be good if the managerial performance is also good. Many people, however, believe that the length of the improvement process in Indonesia is due to the very weak GCG adopted in Indonesian organizations.

To fill the gap relating to the inconsistency of the impact of GCG on financial performance as described above, this study examines the role of corporate asset growth as an intervening variable or as a mediating variable because good corporate governance affects a company’s corporate assets growth as well as its financial performance (Alfinur, 2016). As a result, the research is unique in that it examines the function of corporate asset growth as a mediating variable in the impact of GCG on banking financial performance.

2. Literature Review and Hypotheses

2.1. Financial Performance

The ability of a company to maintain and monitor its resources is measured by its financial performance. Using the RBBR technique, the risk profile evaluation, GCG, earnings, and capital can be used to determine the soundness level of private banks. It is the analysis of the profitability element (earnings) that has been used in this study. The earnings are measured by ROA because it is a matrix for calculating the component analysis of the profitability factor (earnings). According to the Bank Indonesia Circular Letter (2011), ROA is the most important measurement of the financial performance of banking companies and concerns the assessment of the Bank Soundness Level. According to Gitman and Zutter (2015), financial performance is divided into two categories: earnings performance and market value; hence, the financial performance referred to in this study is earnings performance, which comprises financial benefits that may be deliberated through ROA (Endri et al., 2020; Sunardi, 2018).

2.2. Good Corporate Governance

GCG is a set of governance systems that govern the relationship between stakeholders and internal-external stakeholders in terms of their rights and obligations to increase added value through the company’s designed arrangements and controls (Effendi, 2016), resulting in improved financial and non-financial performance.


According to Siamat in Setyahadi & Narsa (2020), there are various international guidelines for adopting GCG, such as the use of CGPI. The implementation of GCG must be regularly reviewed and evaluated to ensure that the quality of the implementation is always maintained and that it keeps pace with the evolution of applicable laws and regulations. There are different ways to assess corporate governance implementation, including conducting a self-assessment in accordance with the methods and procedures for corporate governance assessment published by a number of regulators or hiring a GCG consultant to carry out corporate governance through the four stages of the GCGI, which include self-assessment, completeness of documents, presentation of papers, and observations. Furthermore, if the company receives a score of 55.00 percent to 69.99 percent, the most trusted and very trusted predicate will be gathered, and if the company receives a score of 70.00 percent to 84.99 percent and 85.00 percent to 100 percent, the most trusted and very trusted predicate will be gathered (Kurnia et al., 2020).

2.3. Corporate Assets Growth

Asset growth refers to a company’s ability to extend its variety of products as well as its overall assets. Several elements, such as the company’s internal-external dynamics and the local industrial climate, have a significant impact on the company’s growth (Ngo et al., 2020). Capital should be used as a source of support for companies with high progress rates in relation to leverage so that there are no agency costs between shareholders and firm management. Companies with a modest growth range, on the other hand, should use debt as a form of funding because debt requires the company to pay interest on a regular basis. The higher the cost of research and development, the better the chances for the company to grow. Domestic liquidity in the foreign currency market, but still paying attention to the application of prudential rules in banking (Maryanti, 2016). The growth
of the company might be measured by dividing the total assets of the \( n \) year minus the total assets of the \( n-1 \) year by the total assets of the \( n-1 \) year.

### 2.4. Bank Soundness Assessment

Banks are expected to maintain their condition under Law No. 10 of 1998. (the Republic of Indonesia, 1998). The bank soundness level is important since it is a reflection of the bank’s condition and performance, as well as a tool for regulatory authorities to determine where to focus their monitoring and strategy. Individual soundness levels can be assessed using the RBBR approach, especially when it comes to the income aspect (Table 1).

### 2.5. Hypothesis

The importance of good corporate governance in increasing firm success (Agasva & Budiantoro, 2020) is supported by Javaid (2015), who found a positive and significant association between the CGPI and company performance. According to Babatunde and Akeju (2016), corporate governance has increased company profitability in Nigeria. Yoo and Jung support this (2015). According to the research, GCG has a significant positive impact on performance. This is because improved corporate governance increases the public’s trust in the company, thereby causing individuals to be more loyal to the organization.

According to Fadun (2013), the better the corporate governance of a company, the higher its asset growth will be. This is because the better the governance of a company is, the more people will trust it, making it easier to decide to buy shares in the company. Due to the higher flexibility in increasing the company’s assets due to an increase in the number of shares sold, the assets growth will also increase.

According to Jonathan (2018), asset growth has a significant positive impact on profitability (ROA). Javaid (2015) stated that corporate governance has a significant impact on achieving higher company performance. Fadun (2013) stated that the better corporate governance, the better assets growth, and research by Jonathan (2018) stated that company growth has a positive and significant impact on company financial performance, the corporate assets growth has been established to mediate the impact of GCG towards banking financial performance.

- **H1**: GCG has a significant positive effect on banking financial performance in Indonesia.
- **H2**: GCG has a significant positive effect on corporate assets growth in Indonesia.
- **H3**: Assets growth of the company has a significant positive effect on the bank’s financial performance in Indonesia.
- **H4**: The company assets growth capable of mediating the effect of GCG on the financial performance of banks in Indonesia.

### 3. Research Methods and Materials

Explanatory research is a sort of problem-based study. This study gathers data in the form of panel data (time series and cross-section) taken at the same moment throughout a set length of time. The positivist paradigm is used in the research approach.

The population of this study is banking companies that have already registered on the Indonesia Stock Exchange (IDX) and that have complete financial and annual reports, including an assessment from the CGPI in the report of research results and ratings published by the rating agency The Indonesian Institute for Corporate Governance from 2011 to 2020. Saturated sampling was used to get the sample for this study. The data for this study came from Bank Mandiri, Bank CIMB Niaga, Bank BTN, Bank BNI 46, Bank Central Asia, Bank BRI, and Bank DKI’s financial statements and annual reports from 2011 to 2020. Secondary data in the form of imbalanced panel data, which is cross-section data, and time-series data, where each unit of analysis on the data has a separate time period, was used in this study (Ekananda, 2016).

The data in the financial statements and annual reports of all banking companies listed on the IDX that is included in the BUKU 4 Bank category will be examined in this study, with an assessment from the CGPI (Corporate Governance Perception Index) from 2011 to 2020 covering several variables, including financial performance, GCG, and company asset growth.

The descriptive and inferential data analysis methods were used in this study. The goal of descriptive analysis is to describe the data acquired from each variable measured. The properties of each indicator in each of the measured

### Table 1: The Profitability Factor Component Analysis (Earning) ROA

<table>
<thead>
<tr>
<th>Formulation/Ratio</th>
<th>Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA = Profit Before Tax:</td>
<td>Bank soundness rating’s criteria:</td>
</tr>
<tr>
<td>Average of Total Assets</td>
<td>Rating 1: ROA &gt; 1,5% : Very Good</td>
</tr>
<tr>
<td></td>
<td>Rating 2: 1,25% &lt; ROA ≤ 1,5% : Good</td>
</tr>
<tr>
<td></td>
<td>Rating 3: 0,5% &lt; ROA ≤ 1,5% : Fair Good</td>
</tr>
<tr>
<td></td>
<td>Rating 4: 0% &lt; ROA ≤ 1,5% : Less Good</td>
</tr>
<tr>
<td></td>
<td>Rating 5: ROA &lt; 0% : No Good</td>
</tr>
</tbody>
</table>
variables are revealed via descriptive analysis. Inferential analysis using the Partial Least Square (PLS) program and Structural Equation Modeling (SEM).

4. Results and Discussion

The subject of this study is commercial banks in Indonesia that have complete financial reports accompanied by CGPI ratings, a total of 7 institutions from 2011 to 2020, for a total of 51 data points. Bank Mandiri, Bank CIMB Niaga, Bank BTN, Bank BNI 46, Bank Central Asia, Bank BRI, and Bank DKI are the banks involved. Because the capital possessed by each bank is not considered in this study, Bank DKI and Bank BTN are included in the sample, despite the fact that the two banks are in the BUKU 3 category while the other five banks are in the BUKU 4 category. The alignment of the three parts of the governance system, namely governance structure, governance process, and governance outcome, demonstrates the system’s effectiveness in implementing corporate governance.

4.1. Corporate Assets Growth

In this study, there are three variables: GCG, corporate asset growth, and financial success. Self-assessment, document assessment, paper assessment, and observation are the four indicators that make up the GCG variable. The test results show that the average ROA value of Indonesian banks is 2.4941, with a standard deviation of 1.25082, the lowest data is 0.79, and the highest data is 5.15, indicating that it is considered good. GCG has an average score of 86.2635 with a standard deviation of 4.26260, with the lowest data being 76.61 and the highest data being 93.32, indicating that it is dependable to highly reliable. It is stated to be promising when the average value from growth in banking assets in Indonesia is 0.1546 with a standard deviation of 0.07341, the lowest data is 0.01, and the highest data is 0.3.

4.2. Outer Loading

Outer model test with formative indicators as an evaluated based on its substantive content (Ghozali, 2014). The following picture is the result of the PLS algorithm (Figure 1):

The weight significance of the measurement model was used to evaluate it; hence no validity or construct reliability tests were required. However, as shown in Figure 1, there are four (four) indicators in the GCG variable, all of which were accepted, namely self-assessment, completeness of documents, paper presentation, and observations, because they have a weight significance of more than 1.96, and all of the above results have met the convergent validity. As mentioned in Table 2, the results of data processing by bootstrapping produce outer weights.

Because the company’s asset growth variable only contains one (one) indicator, it has a loading factor of 1,000, indicating that the results are convergent. The financial performance variable contains only 1 (one) indicator and a loading factor of 1,000, indicating that the results are convergent.

4.3. Linearity Assumption Test

The linearity test aims to find out whether two variables have a linear correlation or not; this can be seen from each relationship between the 2 variables that were tested partially, if all of them are declared significant, or all are declared insignificant (Ghozali, 2014), seen from Table 3.

4.4. Hypothesis Test

This structural model test was done by looking at the R-square value, which is the goodness-of-fit of the model. This can be seen from the results of the PLS algorithm as outlined in Figure 2. The GCG influence on asset growth
4.4. Results

The following are the findings of a hypothesis test conducted in this study using PLS and the SmartPLS 3.0 program (Table 4):

Based on the hypothesis test, it could be said that the correlation between GCG and Financial performance, both direct and indirect has a $P$-value < 0.05, hence, it can be concluded that the hypothesis is accepted.

4.5. Discussion

Good corporate governance has an impact on the financial performance of Indonesian banks; therefore, the better the GCG, the better the financial performance of Indonesian banks. The findings of this study agreed with those of Agasva and Budiantoro (2020), who stated that corporate governance with government assessment has a positive and significant impact on a company’s financial performance, as well as Babatunde and Akeju (2016). Still, they contradicted Tertius and Christiawan (2015)’s opinion on financial companies. Because the information obtained from managers is greater than that obtained from shareholders, there is a possibility of asymmetry information, and managers are more likely to engage in earnings management. However, with the implementation of GCG, asymmetry information will be reduced, and the community will have a higher level of...
trust in the company. With this growing public trust, it is not ruled out that the general public will purchase the banking company’s products and that investors will increasingly trust the banking company, allowing money market transactions to run smoothly. This could be done by the treasury bank, the finance department that ensures the company’s liquidity. From this description, the implementation of good and correct GCG will certainly increase the profit of the bank so the financial performance of banking companies will increase as well.

CGPI uses four factors to measure good corporate governance: self-assessment, document completeness, paper preparation, and observations. Self-assessment is an objective assessment process from the company itself related to the alignment of the GCG system in all business processes through the establishment, implementation, and evaluation of the company’s strategy to achieve sustainable company goals and targets (strategic management), guided by the GCG principles of transparency, accountability, responsiveness, independence, and fairness. Self-assessment is done by filling out questionnaires for all stakeholders in the firm. This stage requires objectivity and honesty from respondents (stakeholders) in assessing the level of alignment of the GCG system with the implementation of strategic management. This method has been proven effective in conducting internal company evaluations which involve all company stakeholders. The study team will take into account the importance of honesty in providing answers to a number of items on the questionnaire, as well as the 2008 CGPI rating when conducting the observation stage. The minimal Cronbach Alpha reliability coefficient that should be satisfied for assessing the questionnaire’s reliability is 0.7. From the above description, it is very likely that with a higher self-assessment score, the company will be more transparent, accountable, responsive, independent, and fair, resulting in increased consumer confidence and increased use of the company’s products, thereby improving the company’s financial performance.

Furthermore, the more complete the documents are, the more complete the company’s records are, making it easier for employees to serve customers. The more the customer’s faith in the bank, the better the bank’s financial performance will be. The next indicator is the preparation of papers, the better presentation of papers reflects employees’ specialization in the banking company’s operations. By enhancing employees’ banking operations skills, the bank products will be easier to sell, thereby increasing the financial performance of banking companies. The final stage of the assessment is observation, which is an important part of the CGPI research and rating process and involves a direct review by the CGPI assessment team to ensure that the process of implementing a series of GCG implementation programs and management efforts is related to the assessment theme. As a result of making good and right observations, the public’s trust in the bank will grow, and people will be more likely to pick the bank as a partner, so improving the bank’s performance.

CGPI has the potential to boost the assets growth of Indonesian banking companies. This study supports Fadun’s (2013) assertion that there is a significant relationship between good corporate governance and asset growth. This study was also supported by Donaldson and Davis’ (1991) stewardship theory, which states that managers are not motivated by individual goals but rather by the organization’s main results goals. As a result, this theory is based on psychological and sociological assumptions about human nature, and CEOs are based on philosophical ideas about human nature, namely that humans are inherently trustworthy, able to act responsibly, have integrity, and are honest with others. This is reflected by the shareholders’ desire for a fiduciary relationship. In other words, stewardship theory considers management as a trustworthy pledge to act in the best interests of the public in general and shareholders in particular, therefore it is obvious that the better corporate governance, the greater the public’s trust in the organization. People in a bank prefer to believe that the bank is healthy, good, transparent, and so on, which encourages them to buy their shares. With many shares sold, the assets will be even higher, resulting in higher asset growth for the organization.

The higher the asset growth of banking firms, the better the financial performance of Indonesian banks will be. This is because a higher increase in the company’s assets will expand the market. After all, there will be more product offers from banks, both products sold to the general public and products sold to other banks, resulting in a wider market. As a result, profits will rise, and the bank’s financial performance will improve. This study is in accordance with the opinion of Jonathan (2018), which states that the company’s growth has a significant positive effect on profitability as proxied by ROA, with the object of research used being the sector of food and beverages companies listed on the Indonesian stock exchange. This research is also supported by (Fauzi, 2015).

Corporate assets growth could mediate the effect of good corporate governance on banking financial performance in Indonesia. To put it another way, improved corporate governance can improve a company’s financial performance, but if it’s accompanied by significant asset growth, the improvement in banking financial performance in Indonesia will be even greater. This is because, when excellent corporate governance improves, the public’s faith in these financial businesses grows, and people are more likely to use the products offered by these banks. Furthermore, investors’ trust in the bank is growing, which makes them more interested in putting their money in the bank. As a result, it will increase its total assets, and as the company’s assets grow, so will the profit, and as profit grows, so will the financial performance, so it can be concluded that good
corporate governance has an impact on a bank’s financial performance, and that good corporate governance will have an even greater impact on the financial performance of a bank if it is accompanied by an increase in corporate assets growth.

5. Conclusion

According to the analysis results and discussion, it can be said that: 1) GCG affects the banking financial performance in Indonesia, 2) GCG affects the growth of banking company assets in Indonesia, 3) The corporate assets growth has an impact on the banks financial performance in Indonesia; and 4) Corporate asset growth may be able to minimize the effect of GCG on banks financial performance in Indonesia, and if this is supported by increased company asset growth, the increase in banking financial performance in Indonesia would be even greater.

The research findings indicate that the improvement of GCG improves the banks’ financial performance in Indonesia. These outputs strengthen the basis of agency theory by Jensen and Meckling (1976), which will cause asymmetry information, but with GCG, asymmetry information will be suppressed to increase financial performance. The consequences of the research findings further enhance the idea of legitimacy because strong corporate governance will increase the growth of firm assets, implying that many people will trust in this banking company, implying that people believe in and accept its existence. This result supports Gray’s (2007) theory of legitimacy, which states that corporations endeavor to keep their operations within the confines of community ties and norms in their area.

The findings in this research describe that GCG affects the banks’ financial performance and good corporate governance, which consists of 3 indicators, namely presentation of papers, completeness of documents, and observations. This indicates that banks in Indonesia need to implement the GCG, which can represent the governance (structure, system, process, mechanism, output, outcome, and impact). The company assets growth partially mediates the impact of good corporate governance on financial performance, thus, the company’s assets need to be continuously improved so that the financial performance will increase. Meaning without the growth in company assets, the improvement of GCG is followed by the improvement of financial performance, and if it is accompanied by the growth in the company’s assets, the improvement of GCG will be even greater.

Therefore the suggestions that the author can convey such as 1) Companies who want to improve their financial performance can be done by implementing GCG; 2) Companies who aim to improve their financial performance might do so by increasing the growth of the company’s assets.; 3) The next researchers are advised to replicate the conceptual framework model in this research but with different objects and different indicators, which are expected to strengthen the modeling in the research; and 4) The next researchers were advised to distinguish the object of banking research based on the capital which listed in terms of BUKU 3 bank and BUKU 4 bank.

References


