Chapter 1
Introduction

1.1 Background

As the scale and activity of corporations has increased immeasurably, the attention to corporate governance implementation has become more important, corporations need to set the framework in order to ensure that their activity is in accordance with the governance. According to Clarke & Rama (2006), corporate governance is about how corporations are governed - their ownership and control, the objectives they pursue, the rights they respect, the responsibilities they recognize, and how they distribute the value they create – that has become a matter of the greatest importance, not simply for their directors and shareholders, but for the wider communities they serve.

Corporate governance is also defined as a framework by which organizations are directed and controlled. It is about the relationships among the management, board of directors, controlling shareholders, minority shareholders and other stakeholders. Information disclosure, high transparency and accountability are the basic important elements of good corporate governance that strives the sustainability of corporations and society. By implementing good corporate governance practices, companies are believed to be able to improve the access to capital, to operate more efficiently, to avoid mismanagement, as well as to mitigate risk and protect stakeholders. Corporate governance is also believed as a framework that enables company to be more transparent and accountable to the investors, which can minimize expropriation and unfairness for shareholders. Furthermore, corporate governance enables to give the investor the tools to respond to legitimate stakeholder concerns such as sustainable environmental and social development, so that investors will also have a wider understanding regarding the company's performance. It contributes to development and increased access to capital, encourages new investments, boosts economic growth, and provides employment opportunities. (Tsoi, 2017)

A lack of corporate governance could lead to a likelihood of company loss, corruption and dirty image, not only to the corporation, but to the society, or even worse will influence global as a whole. Corporate governance management is designed to limit risk and eliminate destructive elements within an organization. One of the principles of corporate governance that has to be perceived is shareholder recognition, it is a policy that ensures that all shareholders have a contribution in the internal workings of a company. Shareholder recognition is also beneficial to secure the value of a company's stock. Other than shareholder recognition, board responsibility is also important, the rules and responsibilities of board members must also be made clear to make sure that everyone shares the same or similar vision of the company's future. Moreover, stakeholder interest is also one of the principles that should be noticed, it addresses the needs of participants who are not shareholders, it reaches out to non-members which can foster better communication and relationships with members of the press and the community. Furthermore, ethical guidelines of corporate governance are crucial to secure higher profit and keep the company out of legal trouble. These rules apply to employees and board members. Lastly, transparency must be apparent, which should take the form of record keeping and financial reports on income. (Sun, L., n.d)

Tsoi (2017), also mentioned that a poor corporate governance could create potential conflicts of interests, expropriation and unfair of minority shareholders. This kind of practice refers to those who can only benefit the parties who involved, but do not affect value to other stakeholders. Minority shareholders with little impact on the stock price are ruled out to make way for the best interests of majority shareholders and the executive board. This fact can greatly destruct public confidence. Meanwhile, good corporate governance makes a straightforward and transparent set of standards in which shareholder, director and officers have adjusted and aligned incentives. Therefore, most companies strive to have a high level of corporate governance. For some shareholders, it is not adequate enough for a company to be only 'profitable'; it needs to exhibit good corporate governance practice as this factor is also believed to have a huge impact on corporate performance.

In relation to the corporate performance, Heenetigala & Armstrong (2011), finds that there is positive relationship between corporate governance practices with the corporate performance. From their research, the governance practices are including separate leadership, board composition, board committee, while the firm performance are measured by return on equity (ROE) and return on asset (ROA). However, Zangina et al., (2009) finds that board size, leverage and income volatility are the significant factors that affect firm value, while inside ownership has no significant effect on firm value especially in terms of share price. Moreover, previous researches conducted by Ozcan & Riza (2016), Belkhir (2009), and Coles (2008) also claim that the greater composition of board of directors will result the higher financial performance in the company. Accordingly, Malelak & Basana (2015) find that the firm with good corporate governance practices has a potential to earn higher profit and increase the share price performances.

According to Juniarty (2012), good corporate governance is also considered as a tool to lowering the cost of debt ratio in companies. The implementation of Good Corporate Governance in order to lower the cost of debt can be indicated by applying of Good Corporate Governance's principles, such as transparency, accountability, responsibility, fairness and independency. Chen & Jian (2007) also conclude that the transparency in providing information will diminish default risk and finally reduce the Cost of Debt. And therefore, it gives benefits to the company as the investors are more willing to invest their money with lower interest.

According to Halimatusadiah, Sofianty & Ermaya (2015), they explain that the emergence of corporate governance in Indonesia is triggered by the financial crisis that occurred in 1998 as the government expected an improvement of economy and companies' value in Indonesia. Thus, in order to increase the company's value, profitability is the main focus of this study. Based on the results of their hypothesis testing, there is 19.8% effect of Good Corporate Governance implementation on corporate profitability which measured by Return on Assets (ROA) of the sampled companies. Although it is not a significant number, the researchers suggest that a company should always improve the quality of Good Corporate Governance implementation since it is one of the factors that can improve the company performance, specifically financial performance.

It is believed that financial performance will be better and can continue to excel in competition if there are continuous improvements. For this reason, it is necessary to have rules and control mechanisms that effectively direct the company's operational activities and the ability to monitor parties that have different interests. The mechanism to improve and maximize financial performance can be achieved by implementing good governance in the organization, or also known as good corporate governance. (Laksana, 2015). Moreover, Igor Todorovic (2013) in his research also indicates that companies with high corporate governance values will have a higher net profit margin and earnings per share. While companies that have lower corporate governance values will have lower net profit margins and earnings per share. However, Attiya and Robina (2006) indicates that board composition, ownership and shareholdings have a positive relationship with financial performance, while transparency has no effect on financial performance.

In terms of theories explanation, there has been a study try to clarify what theory explaining the Corporate Governance. Abdullah & Valentine (2009), finds that there are several existing theories that can explain corporate governance practice, namely agency theory, stewardship theory, and stakeholder theory, and several other theories. Whereas, Li & Nair (2009) find that Corporate Governance implementation is affected by culture as there are special issues in China and India regarding whether existing theories of corporate governance are applicable in corporate governance implementation in these two countries in Asia. Therefore, from this article, it is concluded that there is no general Corporate Governance implementation to be successful as it needs some adjustments due to the culture differences.

In regards to culture, according to Moeljono (2005: 74-75), corporate culture is the inner side of corporate management, it is become an upstream part of GCG that focus on the basic value of the management which later determined through a system. Corporate Governance concerns on the physical form of company and the behavior of a company, this form can be developed through increasing ability (skill) and increasing knowledge. Meanwhile, corporate culture concerns on the form of attitude. This form of attitude is the personality of the individuals in the company so that it is a collection of attitudes and personality interactions between individuals in the company that will bring character in the company itself, so that it can be said that corporate culture is the core of GCG.

This paper will also emphasize on the significance of Corporate Governance Perception index (CGPI) as it will be the main focus and measurement for the further findings. By the increasing of the Corporate Governance implementation, the enforcement of Corporate Governance Awards among companies has also increased. By this sense, The Indonesia Institute for Corporate Governance (IICG) has a program called Corporate Governance Perception index (CGPI). CGPI is a research program that assessing and ranking Good Corporate Governance implementation in companies in Indonesia through research design that encourages companies to improve the quality of the corporate governance application by implementing evaluation and benchmarking. As corporate governance is supposed to maintain several interests in balance which might give benefits for the company, Corporate Governance Award has a huge impact for company, not only to get the good reputation in society, but also to increase and maintain investor's confidence to invest in their company. Therefore, Corporate Governance Perception Index (CGPI) plays a crucial role in this case. A higher CGPI rating owned by a company symbolizes that they have been managed with transparency, responsibility, accountability, independency and fairness. Therefore, there will be an impact on the corporate performance implementation since investors and creditors are proven to consider the CGPI rating for investment decisions. However, the research shows that CGPI rating is not directly responded by Indonesian stock market and it has not yet been able to improve company's growth in the short term (Wahyudin & Solikhah, 2012).

1.2 Research Question and Objectives

From the previous literature identified, the author would want to investigate the effect of corporate governance towards company's performance. The research questions will be as follows:

"How does corporate governance, based on the CG award affect the company performance of LQ45 firms?"

Based on the above research question that was stated above, then the author would want to state her objectives as follows:

This study aims to examine the relationship between Corporate Governance implementation (based on CG awards) and financial performances of Indonesian *companies in LQ45 firms, as well as providing the empirical evidence of the difference of company performance between awardee and non-awardee.*

1.3 Research Scope

The author will be collecting data as the samples from Indonesia public listed firms of LQ45 in 2017 from Indonesia Stock exchange (IDX), the data will be divided into two categories, namely Good Corporate Governance (GCG) Awardee and Non-GCG Awardee, which will be compared in several aspects based on their different corporate governance. The data will be taken from 2015 until 2017.

1.4 Research Benefit

1. *Publicly Listed Firms*

As this research focusing on the public listed companies, then it would bring insight to those managers in the firms to analyze their corporate governance that would affect their company performance.

2. *Investors*

As this research is focusing on the Corporate Governance, then investors through this research can be enlightened with this research in selecting company to invest their money.

3. *Academician and Students*

This research can help the academicians and students who want to conduct further study on the Corporate Governance. This thesis can be acting as supporting research towards their research for more accurate and reliable results.

4. *Opportunists*

This research can help the people who are opportunists to be able to plan their investment portfolios. Also, this research can be used as their base to make decisions.

5. *Other researches*

This research can help to add into other researchers' literature in order to support their argument for following research to come.

1.5 Research Structure

- Chapter 1: Introduction
  - In this section, the author is explaining in general about corporate governance of the company, and researches that has already been done by other researchers that analyzed the corporate governance. In this section, the research will also include her research questions and objectives to make clearer of the purpose of this research.

- Chapter 2: Literature Review
  - In this section, the author will be discussing some literatures that has already been studied about corporate governance. These literatures are the base for author's arguments for her research.

- Chapter 3: Research methodology
  - In this section, the author will explain about the research design which includes research purpose, approach, strategy, choice, time horizon, data collection techniques and analysis.

- Chapter 4: Findings and Discussions
  - In this section, the author will explain the findings from the data that has already being analyzed and giving discussion on the findings.

- Chapter 5: Conclusions and Recommendations
  - In this chapter, the author will draw conclusion from the findings and also stated the limitations and suggestions for future research that needed to be done.