CHAPTER I

INTRODUCTION

1.1 Background

Nowadays, the act of implementing Good Corporate Governance has become more popular among corporations, to the extent that compliance audit and related consulting firms (such as tax and accounting consulting firms, compliance consultants, regulatory consultants) can establish their business by helping corporations to implement Good Corporate Governance. Moreover, Good Corporate Governance has also been translated into international guidelines, such as the one made by Organization for Economic Cooperation and Development principles (International Finance Corporation & Otoritas Jasa Keuangan, 2018). In Indonesia, Komite Nasional Kebijakan Governance (KNKG) sets detailed guidelines as to how to implement Good Corporate Governance in companies nationwide. The International Finance Corporation (IFC) even established a formal cooperation with Indonesia Financial Services Authority (OJK) to formulate the Indonesia Corporate Governance Manual that serves as a cornerstone to implement Good Corporate Governance in Indonesia.

In general, corporations are mainly classified as public corporations and private corporations. A corporation that goes public is identified as a corporation which is permitted to publicly trade their shares on an exchange that has been officially organized, such as Bursa Efek Indonesia. On the contrary, a private corporation could be known as companies who are not permitted to publicly trade their shares on the so called exchange that has been officially organized (Berk et al., 2015).

Different types of corporations may have different ways of measuring their value through various methods of corporate valuation. Given that, the most common way that can be used to measure the value of either corporation is to have it seen from their financial performance, which can be obtained from their respective financial statements. By following the predetermined formulas, Cornell (2013) states that the value of a corporation can be initially seen through the calculation of financial variables such as Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA). For public corporations, these financial variables are standardized from seeing their market value, which can be obtained from the share prices of a public corporation in the stock exchange (Cornell, 2013).

Analyzing numbers shown in corporate valuation has the potential to plot a storyline of where the figures came from and how it can be further improved in the long run in order to maximize shareholders' wealth. Unfortunately, accounting practices would see it as merely a quantitative element that leads to a disadvantage as it is proven that a lot of different factors also correlate with the numbers shown in a company valuation through their financial performance, including the qualitative elements of a company (Schmidlin, 2014). One of the qualitative elements that companies are starting to implement is Good Corporate Governance, especially those that are classified as a public company. As globalisation continues to evolve along with rapid growth of technology, an effective implementation of corporate governance holds a crucial role for the company and its surroundings as failure to comply would give out undesired impact towards the economy and the society as a whole (Nuryanah & Islam, 2015). In addition, corporate governance also becomes a guidance as to how the company can comply to legal, institutional and cultural regulations it is operating in (Nuryanah & Islam, 2015).

An example of a successful Good Corporate Governance implementation can be seen from the Tylenol case of Johnson and Johnson. In 1982, the company encountered a major incident of 7 deaths due to the presence of cyanide in their tylenol and the company value dropped instantly. This could easily lead to an end for the company, but due to the right way of implementing Good Corporate Governance, managers were able to turn things around for the better. They formed a 'crisis team' and made their next step to recall their Tylenol capsules from stores within the area where the death cases were found. This adds to their financial loss in the short term, but this decision gained their company value back in the long run. Their course of action towards the crisis gained the public trust back and their company value recovered, as well as having Tylenol continue to be one of their top seller products (Adubato, 2008).

Given that, the success rates of Good Corporate Governance implementation are still uncertain as there are still cases in which companies fail to comply. An example is the case of Enron, the company manipulated the amount of profit which was reported in their financial reports, uncovering the fact that that $43 billion of their $74 billion profit was an act of fraud (Lemus, 2014). They centered on performing exceedingly well within the financial aspects that they took the degree of deceiving shareholders and damaging their believe within the company.

To revamp the shareholders’ certainty in contributing and to keep the market lively, Sarbanes-Oxley Act of 2002 was formulated to set out the limits and strict directions to preserve the safeness of the stakeholders’ investment that has been contributed within the company (Lemus, 2014). The case of Enron failure exhibits how monetary execution can be effortlessly manipulating, deceiving and not dependable to observe the long term prospective of a firm. It has the potential to dazzle people’s decision making, and tempt them to not hold into importance their social responsibility towards the stakeholders of a company. Throughout these troubling circumstances, public accounting firms may take the driving part to supply the adjusted viewpoint and conclusion of primary and secondary stakeholders.

The above cases exhibit not only the importance of corporate governance, but also how corporations are bound to face uncertainties in their business, which is also known as risk, that may either be inherited or come from other factors outside of their control. This is where risk management steps in as it involves the identification and understanding of risks in order to lessen the chances or better yet eliminate the probability of the undesired events it may lead to (Steinberg, 2011). Given that, for risk management to be effective in a corporation, it needs to align with their strategy and culture as a whole, which then leads to the importance of proper Enterprise Risk Management (ERM). ERM is a holistic approach to identify and manage risk that could affect the corporation's objectives which encompasses the components of COSO Internal Control Framework. Enterprise risk management not only allows the refinement of focus towards the downside potential, but also the upside potential that each company has. Other than that, ERM are proven to help reduce the audit hours and audit fees needed (Jalilvand & Malliaris, 2011).

Komite Nasional Kebijakan Governance (KNKG) of Indonesia (2012) states several reasons that support the important role of risk management in corporate governance. Firstly, the inseparable role of risk management in corporate governance gives reasonable guarantee to achieve corporate success. Secondly, proper risk management needs to implement principles of Good Corporate Governance such as transparency, accountability, responsibility and independency. Thirdly, risk is an inevitable element that every business faces. Hence, a balanced integration of Good Corporate Governance implementation and proper risk management may guide the company to generate added value in order to gain competitive advantage in the market for the long run.

Previous research done by Mulyadi, et al. (2020) found that Good Corporate Governance gives positive and significant effect towards corporate valuation while Sukamulja (2004) found that Good Corporate Governance does not give significant effect towards corporate valuation. Meanwhile, Purnamawati et al. (2017), Rivandi (2018), Oktaviani (2019), Widianingsih (2018), Muryati & Suardikha (2014) and Rizqia et al. (2013) found contradicting results of impact in regards to Good Corporate Governance mechanisms towards corporate valuation. Other research done by Iswajuni et al. (2018) and Devi et al. (2017) found that Enterprise Risk Management gives positive and significant effect towards corporate valuation. On the other hand, a research done by Lestari, et al. (2020) found that Risk Management and Good Corporate Governance gives no significant impact towards corporate valuation. Rivandi (2018) on his research also aligns with the findings that Enterprise Risk Management gives no significant impact towards corporate value. Meanwhile Desender & Lafuente (2009) states in their research that there is a positive and significant relationship between Good Corporate Governance and Enterprise Risk Management. Burhanuddin et al. (2020) later found in their research that Enterprise Risk Management moderates the impact of Good Corporate Governance towards Corporate Value, as well as Rasmini (2019) finding that Enterprise Risk Management also moderates the impact of Managerial Ownership towards Corporate Value.

Based on the background presented above, the writer would like to examine whether Good Corporate Governance will positively correlate to corporate valuation with the mediation role of Enterprise Risk Management. In conclusion, this thesis takes the title of "THE IMPACT OF GOOD CORPORATE GOVERNANCE TOWARDS CORPORATE VALUATION WITH ENTERPRISE RISK MANAGEMENT AS A MODERATING VARIABLE."

1.2. Research Problem

Based on the background that the writer has described, it is known that the implementation of Good Corporate Governance (GCG) of a company has a crucial role to determine the corporate valuation. To achieve the expected target of this research, writer define research problems as follow:

1. Does Independent Commissioners positively impact Corporate Valuation?
2. Does the Audit Committee positively impact Corporate Valuation?

3. Does Managerial Ownership positively impact Corporate Valuation?

4. Does Enterprise Risk Management moderate the positive impact of Independent Commissioners towards Corporate Valuation?

5. Does Enterprise Risk Management moderate the positive impact of the Audit Committee towards Corporate Valuation?

6. Does Enterprise Risk Management moderate the positive impact of Managerial Ownership towards Corporate Valuation?

1.3. Research Objective

The objective of the research are as follows:

1. Prove empirically that Independent Commissioners positively affects the valuation of a corporation.

2. Prove empirically that the Audit Committee positively affects the valuation of a corporation.

3. Prove empirically that Managerial Ownership positively affects the valuation of a corporation.

4. Prove empirically that Enterprise Risk Management moderate the positive impact of the Independent Commissioners towards the valuation of a corporation.

5. Prove empirically that Enterprise Risk Management moderate the positive impact of the Audit Committee towards the valuation of a corporation.

6. Prove empirically that Enterprise Risk Management moderate the positive impact of Managerial Ownership towards the valuation of a corporation.

1.4. Significance of the Study

1. Writer

This research aims to provide deeper understanding in regards to the issues being discussed, enhance the writer's experience, and become the application of knowledge gained during the process of learning in University of Pelita Harapan, which can later become an added value the writer brings forth to the working industry.

2. Universitas Pelita Harapan

The final product of this research aims to provide additional information regarding implementation of theories taught during the process of learning, that can be considered as an additional material to be taught in the process of learning at class. The study conducted may also be a proper addition to the literature collection of Johannes Oentoro Library.

3. Next researchers

This research may also become additional resources for future examinations in relation to factors affecting Good Corporate Governance, specifically on the impact towards company valuation.

4. Companies

This research aims to provide information that companies may consider in their decision making process to improve their company valuation through the implementation of Good Corporate Governance.

5. Regulators

This research is expected to motivate regulators to enforce strict requirements on implementing proper Good Corporate Governance.

6. Investors

This thesis aims to provide a new perspective for investors in their decision to invest in a company, by looking through the implementation of Good Corporate Governance by the company and how it affects their company valuation in order to gain on their return of investment.

1.5 Scope of the Study

This research puts its focus on public corporations, specifically the banking sector, listed in the Stock Exchange of Indonesia during the period of 2017-2019 by gathering data and information from secondary data of financial information. This research aims to add more knowledge for investors and companies on how significant it is to implement Good Corporate Governance in order to enhance Corporate Valuation through proper Enterprise Risk Management. To achieve the objective, this research will use Independent Commissioners, Audit Committee, and Managerial Ownership as indicators of Good Corporate Governance to empirically prove the impact towards Corporate Value with the moderating variable of Enterprise Risk Management.

1.6 Systematic Discussion

This research paper is systematically divided into five chapters as follows.

CHAPTER I INTRODUCTION

This chapter will discuss subchapters including background, research problem, research objective, significance of the study, scope of the study, as well as systematic discussion.

CHAPTER II THEORETICAL FRAMEWORK AND HYPOTHESES DEVELOPMENT

This chapter will further explain in detail the grand theory, basic concept definitions, related literature review, conceptual framework, and the hypothesis development.

CHAPTER III METHODOLOGY

This chapter will explain in detail what method of research is being used to analyze the data. This includes the population and sample, the empirical model, and method of data analysis.

CHAPTER IV RESULT AND DISCUSSION

This chapter will discuss the result and empirical findings in the research in relation to the impact of good corporate governance towards company valuation.

CHAPTER V CONCLUSION

This chapter consists of conclusion and suggestion from the result and discussion preceding this chapter, along with recommendation for future research.