CHAPTER 1

INTRODUCTION

1.1 Background

As the world economy develops, firms must be able to adapt well so that they can adjust to the development of the world and can also grow. Firms are increasingly operating in a more complex world due to a more diverse, dynamic, and interconnected business environment than ever before, and far more predictable (Reeves, 2016). The firm must continue to strive to improve the performance of the firm so that it can achieve the company's goals of making maximum profits and prospering shareholders. Good performance can also increase the value of the firm along with the firm's stock price.

Firm value is a condition that has been achieved by a company as an illustration of public trust in the firm (Noerirawan, 2012). Firm value can be reflected in the company's stock price. The higher the price, the higher the value of the firm will react. Besides, with the increasing value of the company, shareholders also become prosperous (Fenandar and Surya, 2012).

Firm value can be measured using stock prices using a ratio called the valuation ratio. Valuation Ratio is a ratio related to the assessment of the performance of shares of firms that traded in the capital market (Sudana, 2011: 23). The assessment ratio provides information on how much the community values the firm so that people are interested in buying shares at a price higher than the value of the book. One method is profitability. Profitability ratios are ratios to assess the firm's ability to make a profit (Kasmir, 2011: 196). Thus profitability is a factor that is seen by investors in evaluating a firm. If the profitability of a firm is high, then the shareholders will have a perception that the firm has a good performance so that it can increase the value of a firm. Research conducted by Nikita Vireyto and Sri Sulasmiyati (2007) found the results that ROA has a positive effect on stock price. Unlike Christiana Warouw (2016) which indicates that profitability does not influence the value of the firm. Therefore, researcher includes control variables which are Debt to Equity Ratio and Firm Size as control variables. Debt can have a good or bad influence towards firm value. Firm must be able to cover their obligations to investors and to avoid making unneeded loans. The greater the company's leverage, the greater the borrowing cash flow (Lin et al. 2011), due to the fact that creditors assume the company is aggressive in using financing with debt that can be used by companies to finance the company's growth so that in the future the company is able to generate profit and able to pay off the debt and interest. Debt also used by the firm to increase profitability of the company. As well as the size of the firm. The higher the size of the firm means the higher the total assets. Total assets companies that have a larger size have an influence on increasing the company’s profitability. The profitability of the large companies has several competitive advantages such as setting higher prices than other, economic of scale to reduce cost that will have an impact on increasing the firm’s profitability. To complete this thesis, researcher added one moderating variable which is the quality of good corporate governance.

The quality of Good Corporate Governance as a moderating variable which is thought to help strengthen or weaken that influence. In recent years good corporate governance has become a crucial thing as part of the firm's strategy.

Many firms also focus on short-term strategy and performance rather than long-term resilience. A solid performance like DuPont and Yahoo! which has been part of the index for more than 17 years replaced by Facebook and Incyte Corp.

Many firms have been taken over by competitors or other parties. Firms must also adjust their corporate culture and management so that they can survive and be able to keep up with the world's development. A complex organizational structure is one of the factors of failure of a firm. Enron and Worldcom are some examples of companies that have failed corporate governance. Their failure was caused by the Sarbanes-Oxley Act in 2002, US federal law intended to restore public confidence in corporate governance.

In the book of The Power Of Good Corporate Governance, Arief Effendi (2009) good corporate can briefly interpret as a set of systems that govern and control the firm to create added value for the stakeholder's interests that affect firm performance. Good corporate governance is one of the essential things in the market economy system, even by implementing proper good corporate governance, some believed that it could help firms and economies that are being hit by the crisis to rise towards a healthier direction. Firms that implement good corporate governance are also able to compete dynamically and professional rather than firms who not achieve good corporate governance. Other than that, the role of good corporate governance is as a constrain which prevent any missappropriate activity in order to produce financial statements that do not describe the firm's fundamental value. Crisis in 1997 appeared in Indonesia and financial reporting failures such as Enron, WorldCom, and Xerox then proved to be the example of companies who do not manage their corporate governance responsibly, and ignore regulations and are full of practices like corruption, collusion, nepotism (Budiati, 2012).

The concept of good corporate governance arises because of the separation within the company (Hamdani, 2016: 17). These problems occur because there are differences in interests between agents (responsible to the principals) and principals (the one who give a mandate to the agent) as the main actors in an enterprise (agency problem). One of the factors that causes agency problem is due to information asymmetry. As we know agents are more directly involved with firm management rather than the principle that is why an agent will tend to have the ability to control information related to firms rather than principals. According to Hamdani (2016: 18), two conditions cause information asymmetry, namely moral hazard (an agent violates a work contract that agreed upon) and adverse selection (the principal does not know whether the decision made by the agent is adequately based on the information obtained). Therefore, to reduce conflicts of interest between the agent and the principal, a mechanism is needed to regulate matters this, namely good corporate governance. The application of good corporate governance in Indonesia is expected to improve the professionalism and welfare of shareholders without neglecting the interests of stakeholders (Sutedi, 2012: 2). In general, the aim of investors to invest in stocks is to obtain returns in the form of dividends or capital gains. Dividend is the distribution of firm profits in cash. Whereas capital gains is the difference between the selling price of shares and the purchase price of shares. One way to ensure investors can get a good return is by issuing supervision costs or commonly called agency costs to prevent any moral hazard from the manager. In addition, the supervision of the manager can take the form of internal mechanisms such as the structure of the board of commissioners, managerial ownership and executive compensation. While the external mechanism can be in the form of a market for corporate control, institutional ownership, and the level of funding by debt financing.

The collection of firm funds can be through the sale of shares in the capital market. Investment can be in the form of stocks and bonds. Stocks have market value, namely prices that actually occur on the stock exchange. There are several factors that influence stock prices including legal factors of demand and supply, interest rate factors, foreign exchange factors, foreign funds on the stock exchange, composite stock price index, news, and rumors as well as sector economic policies from the government. From a firm point of view, rising stock prices are an indication of prosperity. For the investors, the company's annual financial statements are essential to gain information to make an investment decision. Through yearly reports, investors can assess the financial performance and growth prospects of the company. A firm that can generate profits from year to year indicates that the firm will be able to provide a good return to the investors.

This research is a replica of research conducted by Anindyati Sarwindah Utami (2011). The difference between this study and previous research is as follows:

1. This thesis adds 2 control variables which are Debt to Equity Ratio and Firm Size.
2. This thesis focuses more on one moderating variable, namely good corporate governance. The data for good corporate governance collected from SWA magazine due to professionalism provided by the SWA team which one of them is Adnan Pandu Praja, ex-commissioner of KPK.
3. This thesis focuses on ROA as representative of firm performance. Due to the fact that ROA has a substantial amount that likely to be less manipulated by others.
4. The sample in this thesis was taken from the top 25th ranking of Indonesia most trusted company registered in SWA magazine which listed in Indonesia Stock Exchange for seven consecutive years namely 2011-2017, while Anindyati Sarwindah Utami (2011) research only took samples of manufacturing companies listed in Indonesia Stock Exchange for the period 2011-2017.

Based on the facts listed above, and still have a research gap that shows the diversity of the results of previous research. This thesis intends to learn more about the relationship between firm performance on firm value with quality of good corporate governance as a moderating variable. Therefore, the researcher take the title **"THE EFFECT OF FIRM PERFORMANCE ON FIRM VALUE WITH QUALITY OF GOOD CORPORATE GOVERNANCE AS MODERATING VARIABLE".**

1.2 Research problem

Based on background presented above, to achieve expected target researcher define research problem as follows:

1. **Does firm performance positively affect firm value?**
2. **Does the quality of good corporate governance positively affect the relationship between firm performance with firm value?**

1.3 Research Objectives

Based on the description above, as for the research objectives to be achieved in this study are:

1. Prove empirically that firm performance has significant and positive affect firm value.
2. Prove empirically that the quality of good corporate governance has significant and positive affect the relationship between firm performance with firm value.

1.4 Significance of study

1. For Corporation

   Hopefully, this study might be useful for decision making in corporation and might contribute to the framework regarding practice related to firm performance or ROA, specifically effect to substantial value with moderating variable good corporate governance. Furthermore, I hope this study would provide a new perspective for a corporation in their decision to make the good corporate structure to produce more transparent financial report than before.

2. For UPH

   I wish this result might give additional information about the consideration of the depth of material to be taught to the student and to provide the real application of the theories being taught in the class.

3. For Regulatory

   The result of this study hopefully can contribute to making new regulator or law to help investors in making decisions from published financial reports. Furthermore, the researcher hopes this result could help the corporation to make any new changes that could lead to a better corporate governance structure.

4. For Next Researcher

   Hopefully, the result of this study could give more knowledge to future researcher regarding the firm performance. As well as new information for moderating variable research.

1.5 Scope of the study

1. This research will examine only one independent variable which is firm performance.
2. This research will examine only one dependent variable which is firm value.
3. This research will examine two control variables which are debt to equity ratio and firm size.
4. This research will have only one moderating variable that is the quality of good corporate governance.
5. This research will focus only from the top 25th ranking of Indonesia most trusted company registered in SWA magazine which listed in Indonesia Stock Exchange for seven consecutive years namely 2011-2017.
6. Researcher will limit the observation only 7 years (2011-2017)

1.6 Systematic discussion

CHAPTER I INTRODUCTION

This chapter will discuss background, research problem, research objective, significance of the study, scope of the study and systematic discussion.

CHAPTER II THEORETICAL FRAMEWORK AND HYPOTHESES DEVELOPMENT

This chapter will discuss basic concept definition, literature review, the hypothesis development, and conceptual framework.

CHAPTER III METHODOLOGY

This chapter will explain about the population, sample, and resource data, data collection technique, empirical model, operational variable definition, problem solving framework, and hypothesis test.

CHAPTER IV RESULT AND DISCUSSION

This chapter will discuss the result and empirical findings in the research in relation to the effect of firm performance on firm value with quality of good corporate governance as moderanting variable.

CHAPTER V CONCLUSION

This chapter consists of conclusion and recommendations from the result and discussion preceding this chapter.