The Impact of State vs Foreign Ownership and Corporate Governance Ranking on Profitability and Firm Value of Banks

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Abstract: The purpose of this study is to analyze the impact of state ownership (Gov), foreign ownership (foreign), and corporate governance (CG) on profitability and the implication on firm value. This study hypothesizes that profitability mediates the impact of Gov, foreign, and CG on firm value. The banking sector was chosen as the object of the research because this sector is quite vulnerable to the global financial crisis. The population of this study consists of banking companies listed on the Indonesia Stock Exchange (IDX) in the period of 2014-2018. Data were analyzed using multiple regression models and processed with SPSS software. The results of the data analysis show that there are significant effects of CG and foreign on profitability, and profitability and foreign on firm value. However, the sign of the foreign effect is negative. The mediating effect of profitability only found on the effect of CG on firm value.

1 INTRODUCTION

The object of observation of this study is the banking industry listed on the Indonesia Stock Exchange (IDX). This study highlights the fundamental factors of a company that determined the bank's performance, which is the concern of previous researchers. These factors are the implementation of Corporate Governance (CG) and ownership structure.

Bank Indonesia (BI), the central bank of Indonesia, issued the Bank Indonesia Regulation No.13/1/PBI /2011 concerning the evaluation of the soundness level of commercial banks. In this regulation, banks are required to conduct self-assessment of their CG implementation. This policy was issued as a response to the weakness of CG implementation in the Indonesian banking industry. However, in 2013, BI imposed sanctions on four banks with poor CG implementation. These four banks are PT. Bank Mega Tbk, PT. Bank Panin Syariah Tbk, PT. Bank Jabar Banten Tbk, and PT. Bank Mestika Dharma.

The ownership structure is important to examine because this factor is important in influencing banking performance. Although the operation of the company is carried out by management, all management policies cannot be separated from the influence of the owner because strategic decisions taken by management must get approval from shareholders. The ownership structure of companies in Indonesia, on average, is still concentrated in the majority owner. Banking in Indonesia, which is listed on the IDX, is dominated by two majority ownership, namely the government and foreign.

Previous studies (Sakai and Asaoka, 2003; Premuroso and Bhattacharaya, 2007; Nurfaza et al., 2017) have analyzed the effect of CG on firm performance. Likewise, also, the ownership structure of bank performance (Novado and Hartono, 2014). However, the studies found different and inconsistent results.

Meanwhile, some previous studies also linked the influence of CG and ownership structure with firm value (Kobeissi, 2010; Rahman and Reja, 2014; Novado and Hartomo, 2014). A good CG implementation should be captured as good news by the market so that it can increase the value of the company as measured by the market value of its equity. Large foreign ownership is also often assumed that there is better management in the company, so the company will perform better. This condition will ultimately be able to increase the value of the company. However, these studies also provide inconsistent results.

For these inconsistent results, this study is interested in reexamining using CG measurements that are different from previous studies. Furthermore,

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this study also models that bank performance as mediating the effect of CG and ownership structure on firm value.

The results of this study provide the following contributions: 1). To find out whether bank ownership factors affect company performance and value, 2) to find out whether the ranking of CG self-assessment results is able to influence company performance and value, 3) to find out whether the bank's performance mediates the effect of ownership and CG on the company's value.

The results of this study are expected to provide benefits for 1) regulators, in making policies regarding the supervision of the implementation of CG and ownership structures in banks, 2) investors, in using their voting rights to encourage management to perform better and ultimately will increase the value of the company.

This paper is organized as follows: the first section provides the introduction of the research, the 2nd section provides a literature review, the 3rd section shows the research method, the 4th section documents the research findings and provides discussion, and the 5th section concludes.

2 LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

2.1 State versus Foreign Ownership, Profitability, and Firm Value

Government ownership is measured as the percentage of the number of shares of companies owned by the government. Whereas foreign ownership is measured as the percentage of shares owned by foreign institutions and individuals.

An opinion says that banks whose shares are majority-owned by the government will perform worse than non-government banks. This opinion is based on that in general, and government banks are involved in the interference of political interests in their decision making (Kumara and Yasushi, 2011). Meanwhile, another opinion suggests that banks owned by foreign parties have advantages, namely innovation and better risk management, and access to wider financial markets (Bonin et al., 2005). This opinion is supported by the results of Cornett (2009), which concludes that state-owned banks in Asian countries generally underperform compared to non-government banks. So are the results of research Kobeissi (2010) and Rahman and Reja (2014), which found a significant negative effect of government ownership on bank profitability.

The results of previous research on the effect of foreign ownership on banks' performance show inconsistent findings. Kobeissi (2010) and Heryanto (2012) research found significant positive influences, while Xu and Hu (2013) and Rahman and Reja (2014) found the opposite results.

For banks in Indonesia, these opinions and findings are supported by the results of Chalid's (2013) study, which concluded that state banks have lower profitability and efficiency levels than national private banks. However, there are also studies that find different things. For example, Sabrina and Muharam (2015) found that government ownership and foreign ownership both positively influenced profitability, while Novado and Hartomo (2014) did not find any significant effect from the two variables.

Based on these arguments, this study proposes these two hypotheses:

H_1: ownership structure affects the profitability of banks.

H_2: ownership structure affects the firm value of banks.

2.2 Corporate Governance, Profitability and Firm Value

Premuroso and Bhattacharaya (2007) show that the profitability of companies measured as ROE and NPM have a significant positive relationship with good corporate governance. So that the better the management of the company, the company will be more able to produce better returns.

Maksum (2005) states that good corporate governance implementation makes a better decision-making process, then will produce optimal decisions. Hence, it will improve efficiency and create a healthier work culture. The results of this study also support the results of previous studies conducted by Sakai and Asaoka (2003), which empirically proved that the implementation of good corporate governance would positively influence company performance. Likewise, the results of Premuroso and Bhattacharaya's research (2007) show that CG has a significant positive effect on profitability.

Siallagan and Machfoedz (2006) argue that CG is a system that can regulate and control the company so that it can provide increased corporate value to shareholders. The implementation of Good Corporate Governance is believed to increase the value of the company. Good Corporate Governance is a system that can regulate and control the company so as to provide increased corporate value to shareholders.

Herawati (2008) and Wahyudi (2010) found that CG is able to influence firm value. However, different results found Nurfaza et al. (2017) which shows that CG measures are not able to have a significant effect on firm value.

So, the next hypotheses are:

H_3: corporate governance affects the profitability of banks

H_4: corporate governance affects the firm value of banks

2.3 Profitability and Firm Value

Profitability is the level of profit achieved by the company when carrying out its operations. Better profitability growth means the prospect of the company in the future is considered better as well. According to the signaling theory, it is good news for the market. If the company's ability to generate profits increases, the share price will also increase (Husnan, 2001: 317). Rising stock prices reflect good company value for investors. Suharli (2006) states that the value of shares will increase if the value of the company increases marked by a high rate of return on investment to shareholders.

The rate of return on investment to shareholders depends on the profits generated by the company. The high level of profit generated, it means that the prospect of a company to carry out its operations in the future is also high so that the company's value which is reflected in the company's share price will also increase.

Soliha and Taswan (2002) suggest that high profits will give an indication of a good company prospect so that it can trigger investors to participate in increasing share demand. Furthermore, increasing stock demand will cause the value of the company to increase. This phenomenon shows that the level of profitability is an incentive for increasing the value of the company.

H_5: Profitability affects the firm value of banks

As explained in the previous hypothesis development, ownership structure, and CG influence the profitability of the firm's value, and profitability also affects the firm's value. Therefore, this study proposes the mediating effect hypothesis as follow:

H_6: profitability mediate the effect of ownership structure and CG on firm value of banks

3 RESEARCH METHOD

The sample includes 31 banks listed on the Indonesian Stock Exchange from 2014 to 2018. This research uses data pooling results in 155 observations. Nine observations were omitted due to data outliers; hence, the final sample consists of 146 observations. The data were obtained from the annual reports of the banks that downloaded from the website of the Indonesia Stock Exchange.

Independent variables are corporate governance (CG), government ownership (Gov), foreign ownership (Foreign). The dependent variable is the firm value (PBV) and profitability (RoA) as an intervening variable. Corporate governance measured as the score of corporate governance self-assessment of the bank. Government ownership measured as a percentage of company shares owned by the government. Foreign ownership measured as percentage shares owned by foreign investors or/and foreign institutions. Profitability is proxied by return on assets. Firm value is proxied by price to book value. This study uses the firm size that proxied by the natural log of total assets as the control variable.

This study used path analysis by estimating two regression models, as follow:

$$RoA_{it} = \alpha + \beta_1 CG_{it} + \beta_2 Gov_{it} + \beta_3 Foreign_{it} + \beta_3 TA_{it} + e \quad (1)$$

$$PBV_{it} = \alpha + \beta_1 CG_{it} + \beta_2 Gov_{it} + \beta_3 Foreign_{it} + \beta_3 RoA_{it} + \beta_4 TA_{it} + e \quad (2)$$

Where:

PBV: price to book value of equity

RoA: return on asset

CG: score of corporate governance self-assessment, the smaller score indicates a better CG implementation.

Gov: government ownership, the percentage of shares held by the government.

Foreign: foreign ownership, the percentage of shares held by foreign institutions/individuals.

TA: log natural of total assets

For Model (1), this study regresses the score of corporate governance self-assessment, government ownership, and foreign ownership on profitability. While, for Model (2), this study regress profitability, the score of corporate governance self-assessment, government ownership, and foreign ownership on firm value. Company size is added as the control variable for both models. Then, this study employed the Sobel test to check the mediating effect of profitability and test the sixth hypothesis.

4 RESULTS AND DISCUSSION

4.1 Descriptive Statistics

Table 1 shows the descriptive statistics of the data consisting of minimum, maximum, mean, and standard deviation for all variables. Firm size (LnTA) has the highest standard deviation. Meanwhile, the profitability (RoA) is the lowest.

Table 1: Descriptive statistics

	N	Min	Max	Mean	Std. Dev.
PBV	146	0.025	5.890	1.399	1.040
ROA	146	-0.011	0.031	0.012	0.008
CG	146	1.000	3.020	1.917	0.437
Gov	146	0.000	0.800	0.145	0.270
Foreign	146	0.000	0.980	0.369	0.336
TA	146	28.010	34.755	3.607	1.652

PBV is the price to book value of equity, RoA is the return on Assets, CG is the score of corporate governance self-assessment, Gov is the percentage of shares held by the government, Foreign is the percentage of shares held by the foreign institutions/individuals, and TA is the Log natural of total assets.

4.2 Regression Analysis

Table 2 shows the adjusted R square and F value for the model (1) and (2). The results in both models show a significant F value. Table 3 and Table 4 present the coefficient variable, t statistics, and significant value as the results of the regression model (1) and (2). Then, Table 5 figure out the output from the Sobel test.

For model (1), this study found that CG, foreign ownership, and size have a significant effect on profitability. Meanwhile, from the model (2), this study found only profitability and foreign ownership, which have significant effects on firm value. From the Sobel test result, this study found that profitability has a significant value to mediate the effect of CG on firm value.

Table 2: Goodness of Fit Model

	Adj. R Square	F	Sig.
Model (1)	0.308	17.097	0.000
Model (2)	0.074	3.303	0.008

Table 3: Regression Analysis Results of Model (1)

	Coef.	t-stat	Sig.	
CG -->RoA	-0.004	-2.373	0.019	**
Gov -->RoA	0.000	0.895	0.372	
Foreign--> RoA	0.000	-1.816	0.072	*
TA --> RoA	0.002	5.067	0.000	***

RoA is the return on Assets, CG is the score of corporate governance self-assessment, Gov is the percentage of shares held by the government, Foreign is the percentage of shares held by the foreign institutions/individuals, and TA is the Log natural of total assets.

Table 4: Regression Analysis Results of Model (2)

	Coef.	t-stat	Sig.	
RoA -->PBV	30.805	2.577	0.011	**
CG -->PBV	0.054	0.249	0.804	
Gov -->PBV	-0.005	-1.355	0.178	
Foreign--> PBV	-0.008	-2.682	0.008	***
TA --> PBV	0.034	0.449	0.654	

PBV is the price to book value of equity, RoA is the return on Assets, CG is the score of corporate governance self-assessment, Gov is the percentage of shares held by the government, Foreign is the percentage of shares held by the foreign institutions/individuals, and TA is the Log natural of total assets.

Table 5: Results of Sobel Test

	Sobel t stat.	Sig	
CG-->RoA-->PBV	-216.632	0.030	**
Gov-->RoA-->PBV	0.932	0.351	
Foreign-->RoA-->PBV	0	1	

PBV is the price to book value of equity, RoA is the return on Assets, CG is the score of corporate governance self-assessment, Gov is the percentage of shares held by the government, and Foreign is the percentage of shares held by the foreign institutions/individuals.

4.3 Discussion

Regression results from the model (1) show a significant effect of CG, foreign ownership, and total assets on RoA. The first implication of this result is that the better the implementation of CG, the higher the profitability achieved by the bank. Remember that a smaller CG self-assessment score indicates better CG quality. This finding supports the results of research by Sakai and Asaoka (2003) and Premuroso and Bhattacharaya (2007), which concluded that the implementation of CG would be able to support companies to achieve good performance.

This study found no significant effect of government ownership on bank profitability. Meanwhile, foreign ownership has a negative influence on profitability. This result shows that the sample of banks used in the study, the greater the foreign ownership has lower financial performance. This finding does not support the opinion that foreign-owned banks perform better, and banks owned by the government perform worse. This result is in line with the findings of Novado and Hartomo (2014).

Regression results from the model (2) show that only profitability and foreign ownership have a significant effect on firm value. Meanwhile, CG, government ownership, and company size were unable to influence firm value significantly.

As predicted, profitability has a significant positive effect on firm value. This finding confirms the signaling theory, which states that good profitability is a positive signal for the market, so when profitability achieved by banks improves, it will be reflected in an increase in its stock price. These results support the results of the study of Sumarno et al. (2016) and Makhdalena (2016). This study concluded that the profitability of companies has an important role in influencing the value of companies in Indonesia.

Meanwhile, CG does not have a significant influence on firm value. But this influence becomes significant when mediated by profitability. This effect can be inferred from the Sobel test results (Table 5), which show that the Sobel test value is significant on the effect of RoA meditation on the influence of CG on PBV. These results answer the findings of previous studies, which found no significant effect of CG on firm value (Nurfaza et al., 2017). This can be interpreted as when the market finds that the CG implementation of a company is good, but profitability is not good, then that signal can not influence the market decisions.

The results for the effect of ownership on firm value also show different results. The effect of government ownership on company value is not significant, while foreign ownership has a negative effect. These results are linear with the effect of these variables on profitability. Foreign ownership has a negative effect on profitability, as well as its effect on the value of the company.

5 CONCLUSIONS

Good governance in the bank industry is very important to implement. As an industry that receives public trust to manage their finances, banks must have accounting systems and procedures. Management guarantee from the banking industry is influenced by the monitoring function in the banking sector. This monitoring function can be seen from the ownership structure and corporate governance. This study aims to obtain evidence of whether corporate governance, the ownership structure of the bank industry, affects profitability, and corporate value.

The results of this research show that there is a significant effect of CG, foreign ownership, and total assets on profitability. The better implementation of CG will have an impact on higher profitability achieved by the bank. However, this study does not found the impact of government ownership on bank profitability. Meanwhile, foreign ownership has a negative influence on profitability. This result shows that the sample of banks used in the study, the greater the foreign ownership has lower financial performance.

This study also found that profitability and foreign ownership have a significant effect on firm value. Meanwhile, CG, government ownership, and company size were unable to influence firm value significantly. This study found a mediating effect of profitability on the effect of CG on firm value.

This study subject to several limitations. First, the study only uses a proxy of profitability. Using more than one indicator of profitability may give different insights. Second, this study observes the ownership structure as the monitoring functions of the management. This variable does not impact significantly on firm value. Further study can develop other variables of monitoring function of the bank that may effect firm value.

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