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The Relationship Between Company Value and Good Financial Governance: Empirical Evidence from Indonesia

Diyah Santi HARIYANI[1], Tri RATNAWATI[2], Nekky RAHMIYATI[3]

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Abstract

State-Owned Enterprises (SOEs) are business entities that are owned mainly by the state. Good financial governance (GFG) is as important for SOEs as for the private sector companies. Prudence and GFG can affect the value of the company. This research aims to test the impact of macroeconomics, investment decisions, and financing decisions on prudence, Corporate Social Responsibility Disclosure (CSRD), dividend policy, and company value of SOEs registered on the IDX from 2014–2019. GFG and financing decisions are moderating variables. The population in this study is 16 SOEs listed on the Indonesia Stock Exchange from 2014–2019. The research method is quantitative and uses Partial Least Squares (PLS), which is an approach to Structural Equation Models (SEM) that allows researchers to analyze the relationships simultaneously. The results showed that macroeconomic factors, investment decisions, financing decisions, and prudence directly affect the company's value. However, CSRD and dividend policy directly do not affect the company's value. Prudence can mediate the influence of financing decisions on company value. GFG moderates the relationship between prudence and company value. Thus, GFG is key to producing compliant regulatory reports and disclosures. GFG aims at facilitating effective monitoring and efficient control of the business. Its essence lies in fairness and transparency in operations and enhanced disclosures for protecting the interest of different stakeholders.

Keywords: Company's Value, Financing Decisions, Good Financial Governance, Prudence

JEL Classification Code: G32, G34, G35

1. Introduction

State-owned enterprises (SOEs) play a strategic role in the Indonesian economy. In Indonesia, SOEs have contributed around 16.41% to the Indonesian state budget. Many Indonesian SOEs have listed their stocks on the Indonesia Stock Exchange (IDX). According to Lintner (1962), a company's share price depends on the dividend. The ability to pay dividends is closely related to the company's ability to earn profit. If the company makes a large profit, the ability to pay dividends is also great. Therefore, a hefty dividend will increase the value of the company (Al Sa'Eed, 2018; Dang et al., 2020; Isshaq et al., 2009). Investors also see a dividend payment as a sign of a company's strength and a sign that management has positive expectations for future earnings, which makes the stock more attractive. Greater demand for a company's stock will increase its price. Paying dividends sends a clear, powerful message about a company's future prospects and performance, and its willingness and ability to pay steady dividends over time provides a solid demonstration of its financial strength.

The company's goal in financial management is to increase the company's value indicated by the share price (Ozyesil, 2019; Sukesti et al., 2021). The company's value is influenced by external and internal factors (Winarsari & Handini, 2020). External factors are macroeconomic factors (Ali & Siddiqui, 2020; Assagaf et al., 2019; Egbunike & Okerekeoti, 2018; Olokoyo et al., 2020). A company's value is influenced by internal factors such as the investment

[1]First Author and Corresponding Author. [1] Lecturer, Department of Management, Faculty of Economics and Business, Universitas PGRI Madiun, Indonesia [2] Doctoral Student, Faculty of Economics and Business, Universitas 17 Agustus 1945 Surabaya, Indonesia [Postal Address: Jl. Setia Budi 85, Madiun, East Java, 63118, Indonesia] Email: diyah.santi@unipma.ac.id
[2]Lecturer, Faculty of Economics and Business, Universitas 17 Agustus 1945 Surabaya, Indonesia.
Email: triratnawati@untag-sby.ac.id
[3]Lecturer, Faculty of Economics and Business, Universitas 17 Agustus 1945 Surabaya, Indonesia. Email: nekky@untag-sby.ac.id

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decisions, funding decisions, and the dividend policies of the company (Fama, 1978; Ulfa et al., 2019). CSR disclosure can provide positive signals to stakeholders (Liu, 2020; Oh & Park, 2015; Olubisi et al., 2021; Ullah et al., 2020). The prudence concept of accounting states that an entity must not overestimate its revenues, assets, and profits, besides this it must not underestimate its liabilities, losses, and expenses. The prudence concept is a very fundamental concept of accounting that increases the trustworthiness of the figures that are reported in the financial statements of a business (Marabel-Romo et al., 2017; Shaban et al., 2020).

GFG fosters a culture of integrity and leads to positive performance and sustainable business, which gives the enterprise a great competitive advantage. GFG signals to the market that the organization is well managed and that the interests of management are aligned with other stakeholders. GFG is required for an organization, considering GFG requires a good governance system that can assist in building shareholders' confidence and ensure that all stakeholders are treated equally. A good system will provide effective protection to shareholders to recover their investment reasonably, appropriately, and efficiently, and ensure that management acts for the benefit of the company. Empirical evidence showed that the board of commissioners, board of directors, and audit quality can improve financial performance (Mahrani & Soewarno, 2018). Governance affects the company's value (Balagobei, 2018; Elbadry et al., 2015).

Preparation of financial statements requires the use of professional judgment in the adoption of accountancy policies and estimates. Prudence requires that accountants should exercise a degree of caution in the adoption of policies and significant estimates such that the assets and income of the entity are not overstated whereas liability and expenses are not understated. Based on this phenomenon, this study uses prudence as an intervening variable that can affect the company's value. Profit quality may increase if profit and assets are calculated by conservative accounting. Conservatism supporters argue that conservatism produces higher-quality profits because this principle prevents corporations from exaggerating earnings and helps users of financial statements by presenting non-overstated earnings and assets. Mahrani and Soewarno (2018) stated that the board of commissioners is the ultimate center of control. The board of commissioners must act in good faith, prudently and responsibly carry out their duties in supervising the company and advise the board of directors for the interests of the company and according to the purposes and objectives of the company. To encourage effective corporate management and governance, the board of commissioners, board of directors, and audit committees can influence the behavior of managers in the implementation of prudence policies. So this study uses GFG and prudence as moderating variables.

2. Literature Review

2.1. Prudence

The prudence principle in accounting ensures that the financial statements present a realistic and fair picture of a company's revenue and liabilities. It helps in the minimization of losses (Cerqueira & Pereira, 2020; Măciucă et al., 2015). Prudence is a fundamental accounting, which is the base for the financial statements. It helps the financial statements to show a more realistic picture of the expenses, assets, liabilities, and revenue. It helps in the proactive recognition of expenses and liabilities (Ciocan, 2018). The prudence concept basically urges that financial statements must present a realistic perspective about every possible event that may impact the decision of the users of financial statements. Prudence increases the confidence of various stakeholders (Zhong & Li, 2016). It is a conservative approach of accounting since it is proactive only in respect of accounting for losses, expenses, and liabilities (Ross, 1977). The concept revolves around the logic that the profits, assets, and revenue should not be overstated (i.e. record it only when there is complete confidence about the recoverability of revenue, usage of assets, and realization of profits) and the expenses, liabilities & losses are not understated (i.e. record these even if the chance of occurrence is low). Prudent has a significant effect on the company's value (El-Habashy, 2019; Fariz et al., 2020).

2.2. Good Financial Governance

Sound financial management involves a deliberate and consistent control of all incomes, expenditures, assets, and liabilities to ensure not only sustainability and profitability but also the efficiency of the business. A business needs good profitability to optimize its relationships with other stakeholders — customers, employees, and the environment. Financial governance refers to the way a company collects, manages, monitors and controls financial information. Financial governance includes how companies track financial transactions, manage performance, and control data, compliance, operations, and disclosures (Setyahadi & Narsa, 2020; Setyaningsih & Gunarsih, 2018). Good financial governance can minimize agency costs and also help reduce asymmetry and capital costs (Djokic & Duh, 2016; Jensen & Meckling, 1976). Creating GFG in a business requires a set of systems set up according to applicable standards (Crifo et al., 2019). Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place (Soyemi, 2020). The good corporate governance variable which is proxied by the size of the board of commissioners can strengthen the effect of CSRD on financial performance (ROA) (Permatasari & Widianingsih, 2020)

2.3. Company Value

The purpose of financial management is to increase the company's value as indicated by the share price. Internal and external factors influence the company's value. The completeness, accuracy, and timeliness of information can help investors and business players to make investment decisions. Information can give positive and negative signals, which can be known from the market's reaction toward the information (Widagdo et al., 2020). Stable macroeconomic conditions will create an investment climate conducive to business development. Positive information about macroeconomic factors is a good signal and will be responded to positively by investors so that the share price will rise (Olokoyo et al., 2020). There is a significant relationship between macroeconomic factors and stock returns (Abbas et al., 2019; Lee & Brahmasrene, 2020).

According to Berk and DeMarzo (2020), the financial manager's most important job is to make the firm's investment decisions. The financial manager must weigh the costs and benefits of each investment or project and decide which of them qualify as good uses of the money stockholders have invested in the firm (Subagyo, 2021). These investment decisions fundamentally shape what the firm does and whether it will add value. The concept of the investment opportunity set (IOS), which was first noted by Myers (1977), plays an important role in the capital market because it implies future growth, which is relevant in predicting the shareholders' expected wealth. According to Kallapur and Trombley (1999), IOS proxies are classified into three types, namely: (1) price-based proxies; (2) investment-based proxies; (3) variance measure. The IOS proxy used by Smith and Watts (1992) is the book to the market value of the assets.

The funding decision, according to Berk and DeMarzo (2017), is the decision taken by the financial manager to decide whether to raise more money from the new and existing owners by selling more shares (equity) or borrowing money (debt). Funding decisions (debt) have a significant impact on the value of the company (Danila et al., 2020)

Corporate social responsibility disclosure (CSRD) discloses information on what the firms have done for the sake of the community (D'Amato & Falivena, 2020). It also shows the disclosure of firms' actions on what they have been contributing to the welfare of the society and what they will do in the future for the welfare and interest of the society (Ting, 2021). The purpose of corporate social responsibility is to give back to the community, take part in philanthropic causes, and provide positive social value. Businesses are increasingly turning to CSR to make a difference and build a positive brand around their company (Liu et al., 2018). CSR not only benefits communities but also provides businesses with new and varied opportunities and can often be of mutual benefit for both businesses and the community (McGuire et al., 1988). Legitimacy theory relies on the notion that there is a 'social contract' between a company and the society which it operates (Dowling & Pfeffer, 1975). CSR disclosure is expected to improve the company's image and increase sales (Saeidi et al., 2014). CSR can improve the company's performance, which will increase the company's value (Li et al., 2020; Michelon et al., 2015).

A company's dividend policy dictates the amount of dividends paid out by the company to its shareholders and the frequency with which the dividends are paid out. When a company makes a profit, they need to decide on what to do with it. They can either retain the profits in the company (retained earnings on the balance sheet), or they can distribute the money to shareholders in the form of dividends (Gordon, 1963; Lintner, 1962). A company's share price depends on its dividend payout ratio. Dividend policy affects the company's value (Danila et al., 2020; Kolawole et al., 2018).

3. Research Methods and Materials

In this study, 16 SOEs listed on the Indonesia Stock Exchange from 2014–2019 are used as samples. The research method uses a quantitative approach. The annual report (balance sheets, profit, and loss, capital report, cash flow, board of commissioners, board of directors, audit committees) and sustainability report can be accessed from the official website of each company and www.bei.co.id. Inflation, exchange rate, and inflation data can be accessed from www.bi.go.id.

This study used construct variables (latent variables) and manifest variables (indicators). Variables in this study consisted of exogenous variables (macroeconomic factors, investment decisions, financing decisions), endogenous variables (prudence, corporate social responsibility disclosure, dividend policy, corporate value), and moderating variables (prudence, good financial governance). The analysis method used in this study was the structural equation model (SEM) based on variance Partial Least Square (PLS). PLS-SEM is a method of structural equation modeling that allows estimating complex cause-effect relationship models with latent variables. The research model is shown in Figure 1.

4. Results and Discussion

SEM-PLS hypothesis testing is done using bootstrapping technique that is to randomly calculate sample data to obtain *t*-statistics value on each path. Structural models are

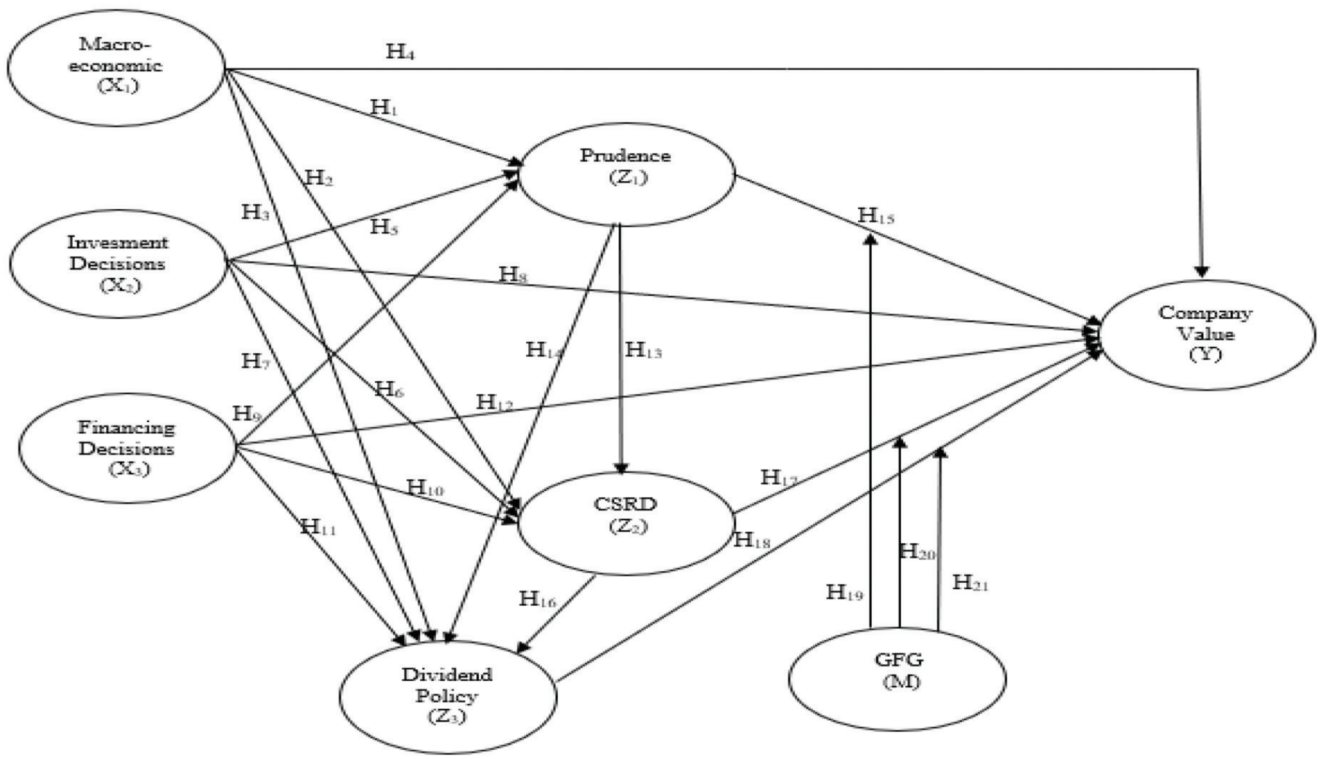

Figure 1: Research Model

significant if the value *t*-statistics > 1.96 or using probability if the *p*-value ≤ level of significance (α = 5%), Hypothesis test results in Table 1.

Based on data processing results using PLS, hypothesis 1 is rejected which states that macroeconomic factors have a significant effect on prudence. Hypothesis 2 is rejected which states that macroeconomic factors have a significant effect on CSRD. Changes or instability of macroeconomic factors do not affect CSRD. There are some companies that do not report CSRD with completeness according to GRI-G4 indicators. The existence of government ownership has a moderator effect on the association between corporate governance mechanisms and CSRD. Also, audit committee characteristics become more effective in improving the firm's CSRD when the government owns shares in the organization. (Farhan & Freihat, 2021). Hypothesis 3 is rejected which states that macroeconomic factors have a significant effect on dividend policy. The determination of dividend policy of SOEs has been determined based on other considerations. The changes in macroeconomic factors do not directly impact dividends. This study supports research by Winarsari and Handini (2020) who stated that the company's external factors significantly do not affect the dividend policy. Hypothesis 4 is accepted which states that macroeconomic factors have a significant negative effect on the company's value. This indicates that changes in macroeconomic factors decrease operational costs, which will increase the company's profit. Increasing corporate profits will increase the share price, and this will have an impact on the increase in the value of the company (Assagaf et al., 2019; Iqmal & Putra, 2020)

Hypothesis 5 is rejected which states that investment decisions have a significant effect on prudence. SOEs that cannot use investment opportunities will experience a higher expenditure. Hence, there is no influence of IOS on prudence. This research supports the research conducted by Sugiarto and Fachrurrozie (2018) who showed that IOS has no effect on accounting conservatism (prudence). Hypothesis 6 is accepted which states that investment decisions have a significant negative effect on CSRD. SOEs with high growth opportunities tend to take the initiative to disclose social responsibility. Companies with high growth opportunities have a solid commitment to continue CSRD (Gray et al., 1995; Musfialdy, 2019). Hypothesis 7 is accepted which states that investment decisions have a significant negative effect on dividend policy. This study supports the residual theory of dividends which states that companies will pay dividends only when profits are not retained to invest in new projects. In a residual dividend policy model, dividend amounts tend to follow the curvature of a company's net income. Companies with high investment opportunities will pay low dividends. So SOEs will distribute dividends

Table 1: Hypothesis Test Results

Hypothesis	Variables	Path Coefficients	*T*-statistics	*P*-values	Conclusion
H_1	Macroeconomic factors → Prudence	–0.049	0.566	0.295	Rejected
H_2	Macroeconomic factors → CSRD	0.131	1.613	0.075	Rejected
H_3	Macroeconomic factors → Dividend Policy	–0.098	1.287	0.120	Rejected
H_4	Macroeconomic factors → Company Value	–0.029	2.380*	0.024*	Accepted
H_5	Invesment Decisions → Prudence	–0.039	0.780	0.230	Rejected
H_6	Invesment Decisions → CSRD	–0.176	3.177*	0.008*	Accepted
H_7	Invesment Decisions → Dividend Policy	–0.217	3.137*	0.008*	Accepted
H_8	Invesment Decisions → Company Value	0.965	67.374*	0.000*	Accepted
H_9	Financing Decisions → Prudence	–0.195	3.898*	0.003*	Accepted
H_{10}	Financing Decisions → CSRD	0.366	5.022*	0.001*	Accepted
H_{11}	Financing Decisions → Dividend Policy	–0.184	0.574	0.292	Accepted
H_{12}	Financing Decisions → Company Value	–0.116	2.016*	0.042*	Accepted
H_{13}	Prudence → CSRD	0.057	0.607	0.281	Rejected
H_{14}	Prudence → Dividend Policy	0.023	0.146	0.444	Rejected
H_{15}	Prudence → Company Value	0.036	2.325*	0.027*	Accepted
H_{16}	CSRD → Dividend Policy	0.181	1.343	0.111	Rejected
H_{17}	CSRD → Company Value	0.022	1.281	0.120	Rejected
H_{18}	Dividend Policy → Company Value	–0.008	0.197	0.425	Rejected
H_{19}	GFG × Prudence → Company Value	–0.043	2.020*	0.042*	Accepted
H_{20}	GFG × CSRD → Company Value	0.032	1.253	0.125	Rejected
H_{21}	GFG × Dividend Policy → Company Value	0.032	1.641	0.072	Rejected
H_{22}	Financing Decisions → Prudence → Company Value	–0.007	2.270*	0.029*	Accepted

Description: *significant on α = 0.05.

after financing all profitable projects (investments), namely investments that generate positive net present value (NPV). High growth rates can lead to a decrease in dividend payments. Hypothesis 8 is accepted which states that investment decisions have a significant positive effect on the value of the company. The theory underlying investment decisions is the signaling theory expressed by Ross (1977). The theory states that investment expenditures positively signal the company's future growth, thus increasing the share price (Ulfa et al., 2019).

Hypothesis 9 is accepted which states that financing decisions have a significant negative effect on prudence. When SOEs choose to increase financing through loans, the company will show good performance to get loans from creditors. The company's management will tend to be careful in presenting financial statements or optimistic by noting a higher debt load to increase revenue value which will lead to a low prudence policy. The higher the debt level, the more likely conflicts will arise between shareholders and bondholders, ultimately affecting contractual demand for conservative accounting (LaFond & Watts, 2007; Utama & Titik, 2019). Hypothesis 10 is accepted which states that financing decisions have a significant positive effect on CSRD. When SOEs have debt, then the company's management will face pressure from the main creditors who want to check the company's financial resources. Therefore, the disclosure of social information is necessary to dispel the creditors' doubts over their rights. This study supports agency theory (Jensen & Meckling, 1976), which predicts that companies with high funding levels will reveal their corporate social information more broadly. Hypothesis 11 is accepted which states that financing decisions have a significant negative effect on dividend policy. If the debt owed by the company is large, then the interest to be paid will be high anyway, and the company will use the profit to pay the debt and will rule out the distribution of dividends. Hypothesis 12 is accepted which states that financing decisions have a significant negative effect on the value of the company. SOEs use debt more in their capital structure when compared to their equities. This decrease in profit will reduce the net income that shareholders will receive. A reduction in net income per share will affect the share price and impact the company's value. Based on the theory of capital structure and trade-off theory, debt will increase the company's value (Miller & Modigliani, 1961). The results of this study support the results of the research by Siti et al. (2019) who stated that dividend policy has a negative and significant effect on profitability and value of the firm directly and indirectly.

Hypothesis 13 is rejected which states that prudence has a significant effect on CSRD. It indicates the costs incurred for CSRD do not affect the implementation of prudence actions. The increase in CSRD is because of mandatory CSR activities for all companies listed on the Indonesia Stock Exchange as stipulated in the Indonesian Capital Market and Securities law. So SOEs commit to CSRD solely because of regulations imposed by the government. Hypothesis14 is rejected which states that prudence has a significant effect on dividend policy. SOEs have managed to provide an image as a company controlled by the government to believe that investing in SOEs can increase capital gain firmly. This research is in line with the research results of Rosharlianti (2018) who stated that prudence has no effect on dividend policy. Hypothesis 15 is accepted which states that prudence has a significant positive effect on the value of the company. If BUMN applies the principle of prudence, it will present quality financial statements to be responded to positively by the market and impact the increase in the share price.

Hypothesis 16 is rejected which states that CSRD has a significant effect on dividend policy. Companies tend to allocate their funds for CSRD rather than distributing to shareholders in the form of dividends. The results of the study are inconsistent with the results of the study by Dewasiri and Abeysekera (2020) who stated there is a positive impact from environmental and social CSR on both the likelihood to pay dividends and its payout. Hypothesis 17 is rejected which states that CSRD has a significant effect on the value of the company. This is because CSRD has not provided good signals to which the market has responded positively; therefore, the company does not get the expected reciprocity which can positively impact the company's value.

Hypothesis 18 is rejected which states that dividend policy has a significant effect on the value of the company. These findings are consistent with the dividend irrelevance theory developed by Miller and Modigliani (1961), which states that the dividend policy does not affect the company's value because a company's declaration and payment of dividends should have little to no impact on the stock price. If this theory holds true, it would mean that dividends do not add value to a company's stock price. The results of the study also are not in line with the study conducted by Amaliyah and Herwiyanti (2020) who stated that investment decisions, company size, funding decisions, and dividend policy do not have a significant effect on a firm value.

Hypothesis 19 is accepted which states that good financial governance could moderate the relationship between prudence and company value. GFG as a moderation variable can monitor the behavior of managers in performing actions that are conservative in generating more quality profit. The prudence concept of accounting states that an entity must not overestimate its revenues, assets, and profits, besides this it must not underestimate its liabilities, losses, and expenses. Simultaneously a company must always adopt a proactive approach towards the recognition of liabilities, losses, and expenses. Hypothesis 20 is rejected which states that GFG moderates the relationship between CSRD and corporate value. GFG is unable to encourage CSRD aimed at optimizing the company's value. This study agrees with the results of the study by Permatasari andWidianingsih (2020) who stated that the GCG variable, which is proxied by the size of the board of commissioners and the independent board of commissioners, cannot moderate the effect of CSRD on financial performance (ROE). While the independent board of commissioners can weaken the effect of CSRD on financial performance (ROA). The GCG variable, which is proxied by the size of the board of commissioners and the independent board of commissioners, cannot moderate the effect of CSRD on financial performance (ROE).

Hypothesis 21 is rejected which states that GFG moderates the relationship between dividend policy and the company's value. This research is in contrast with the agency's theory that states that GFG can serve as a tool to convince investors that they will receive a return from invested funds. This study shows that the number of board of commissioners, board of directors, and audit committee does not contribute to the dividend policy or the company's value because dividends are seen from profits earned by the company rather than based on the number of shares owned by management. This study is in line with the results of Nurdin and Kasim (2018) who stated that the dividend policy has no significant effect on firm value and corporate governance generally cannot moderate the relationship between the firm value and the company's financial performance.

Hypothesis 22 is accepted which states that financing decisions negatively affect the value of the company through prudence. Financing decision has a significant negative effect on prudence. If the company has high debt, then the application of prudence will be low. Financing decisions have a significant negative impact on the company's value. If the level of debt is high, it will lead to a decrease in the company's profit due to high-interest rates of debt. The indirect relationship between financing decisions on the value of the company through prudence produces a significant negative influence. Therefore, when the company has high debt, it leads to the application of low prudence and this will impact the company's value.

5. Conclusion

This research aims to test the impact of macroeconomics, investment decisions, and financing decisions on prudence, Corporate Social Responsibility Disclosure (CSRD), dividend policy, and company value of SOEs registered on the IDX from 2014–2019. GFG and financing decisions are moderating variables. The population in this study is 16 SOEs listed on the Indonesia Stock Exchange from 2014–2019. The results of analysis and hypothesis tests that have been conducted show that macroeconomic factors, investment growth, and prudence can signal good news as well as bad news to which the market will quickly respond. Based on the theory of capital structure and trade-off theory that debt will have a good impact on the company's value, this study found that an increase in debt will lead to a decrease in the company's value. GFG as a moderation variable can monitor the behavior of managers in performing actions that are conservative in generating more quality profit. The indirect relationship between financing decisions on the value of the company through prudence produces a significant negative influence. Therefore, when the company has high debt, it leads to the application of low prudence and will impact the company's value.

SOEs need to increase their investment opportunities. This research shows that companies need to manage the company's share capital to increase productive assets so that it increases the company's growth potential. Prudence can mediate the influence of financing decisions on company value. GFG moderates the relationship between prudence and company value. Thus, GFG is key to producing compliant regulatory reports and disclosures. GFG aims at facilitating effective monitoring and efficient control of the business. Its essence lies in fairness and transparency in operations and enhanced disclosures for protecting the interest of different stakeholders.

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