

Does Corporate Governance Affect Firm Performance? Evidence From Indonesian & Australian Consumer (Non-Cyclical) Sector

Liliana Inggrit Wijaya* , Evan Felix, Bertha Silvia Sutejo

University of Surabaya, Surabaya, Indonesia

*Corresponding author. Email: liliana@staff.ubaya.ac.id

ABSTRACT

This research seeks to examine how board size, independence, and diversity, alongside firm size and leverage as control variables, impact the performance of companies in the consumer (non-cyclical) sector listed on the Indonesia and Australia Stock Exchanges between 2018 and 2022. The findings indicate that board size significantly influences firm performance in Indonesia, whereas board diversity significantly affects firm performance in Australia.

Keywords: *Corporate Governance, Board Size, Board Independence, Board Diversity*

1. INTRODUCTION

In practice, the separation between principal and agent has the potential to create new problems, where there is a disparity between the owner's goals and the manager's goals, known as agency conflict or agency problem (Jensen & Meckling, 1976). A recent example of agency conflict comes from the collapse of the crypto giant FTX, which is said to be the largest fraud in the history of modern US finance, due to fraud amounting to more than 100 trillion rupiahs committed by the CEO of the company (Miller & Oliver, 2023). In discussions regarding efforts to minimize agency conflicts, corporate governance plays a crucial role, defined as the framework of procedures for company leadership by the CEO, board of directors, and management (Fama & Jensen, 1983). The significant role of corporate governance in minimizing agency conflicts is achieved through its supervisory and control functions to ensure that the impacts of agency conflicts can be effectively mitigated (Ross et al., 2018).

According to the research by Pucheta-Martínez & Gallego-Álvarez (2020), a larger board of directors positively impacts company performance significantly. This aligns with agency theory, where the board of directors presence in a company holds corporate governance power, enabling oversight and advisory functions that affect company performance (Potharla & Amirishetty, 2021). Given their diverse experiences, expertise, and knowledge, previous studies suggest that a larger board of directors generally leads to better company performance (Pucheta-Martínez & Gallego-Álvarez, 2020).

According to Puni & Anlesinya (2020), the presence of independent directors has a significant positive impact on company performance. Independent directors are instrumental in reducing agency conflicts by overseeing, managing, and controlling the behavior of company management (Alves, 2023). Being unaffiliated with the company's management, independent directors are anticipated to fulfill their responsibilities objectively, with diligence and accountability toward stakeholders' interests, offering diverse perspectives based on their expertise and experience (Hambrick & Jackson, 2000).

According to Lim et al. (2019), the representation of female directors has a significant adverse impact on company performance. The existence of gender diversity in the board is perceived to possibly reduce decision-making effectiveness due to divergent viewpoints that result in heightened conflict (Wellalage & Locke, 2013). Additionally, Darmadi (2013) observes that increased board diversity tends to correlate with heightened boardroom conflicts and excessive monitoring.

2. RESEARCH METHOD

This study represents fundamental research designed to investigate how independent variables influence the dependent variable. This study centers on examining companies within the consumer (non-cyclical) sector, comprising 56 firms listed on the Indonesia Stock Exchange (IDX) and 42 firms listed on the Australia Stock Exchange (ASX), spanning a five-year period from 2018 to 2022. The total sample size encompasses 280 firm-years for Indonesia and 210 firm-years for Australia. The dependent variable in focus is company performance, specifically measured through Tobin's Q, which combines market capitalization with total liabilities and then divides the result by total assets. Among the independent variables, board size is determined by the number of directors on the board, board independence is assessed by the ratio of independent directors to total directors, and board diversity is measured by the percentage of

female board members. Control variables include firm size, calculated as the natural logarithm of total assets, and leverage, calculated as total liabilities divided by total assets. The equation used is as follows:

$$FIRMPERF_{i,t} = \alpha + \beta_1. BSi,t + \beta_2. BI_{i,t} + \beta_3. BDi,t + \beta_4. FSi,t + \beta_5. LVGi,t + e \quad \dots (1)$$

After identifying all consumer (non-cyclical) sector companies listed on both the Indonesia Stock Exchange and the Australia Stock Exchange from 2018 to 2022, the data underwent analysis using E-views 12. Classical assumption tests, encompassing normality, multicollinearity, and heteroscedasticity tests, were carried out. Additionally, Chow and Hausman's tests were utilized to ascertain the most suitable model for the analysis.

3. RESULTS AND DISCUSSION

In this section, we will delve into the outcomes and examine the discoveries from the data analysis. Analysis for the study was executed through Eviews 12 software utilizing the multiple linear regression approach.

Table 1. Chow test result.

Effect Test	Indonesia		Australia	
	Statistic	Prob	Statistic	Prob
Cross- section F	18.927596	0.0000***	9.796789	0.0000***
Cross-section Chi-Square	489.946626	0.0000***	260.922560	0.0000***

From the Chow test conducted for Indonesia and Australia indicates that the fixed effects model is more suitable than the common effects model.

Table 2. Hausman test result.

Test summary	Indonesia		Australia	
	Chi-Sq. Statistics	Prob	Chi-Sq. Statistics	Prob
Cross- section random	13.095448	0.0225**	11.889720	0.0363**

From the Hausman test conducted for Indonesia and Australia indicates that the fixed effects model is more suitable than the random effects model. Furthermore, based on the multicollinearity assessment, it's noted that the correlation values among the independent variables are below 0.7. Consequently, it can be inferred that there is no sign of multicollinearity among the independent variables in both Indonesia and Australia as examined in the study.

Table 3. Heteroscedasticity test result.

Variables	Indonesia		Australia	
	Coefficient	Prob	Statistic	Prob
C	3.612366	0.3158	0.082856	0.9543
BS	0.034638	0.3203	0.026828	0.4658
BI	-0.542516	0.1689	-0.090669	0.6797
BD	0.274089	0.3183	-0.081061	0.7885
FS	-0.111308	0.3708	0.014292	0.8530
LVG	0.016357	0.9047	0.017803	0.9349

According to the heteroskedasticity tests conducted for Indonesia and Australia, it's determined that the probability values of all independent variables, as per the Glejser test, exceed 0.05. Thus, it can be inferred that there is no indication of heteroskedasticity among the independent variables examined in the study.

Table 4. Tobin's Q regression analysis result

Var	Indonesia				Australia			
	Coeff	Prob	H	Note	Coeff	Prob	H	Note
C	25.52	0.00			12.12	0.00		
BS	0.20	0.00***	+	Accept	0.005	0.62	+	Reject
BI	-1.41	0.09*	+	Reject	0.130	0.84	+	Reject
BD	0.72	0.21	-	Reject	-2.87	0.00***	-	Accept

Table 4. Tobin's Q regression analysis result (Cont)

Var	Indonesia				Australia			
	Coeff	Prob	H	Note	Coeff	Prob	H	Note
FS	-0.84	0.00**	-	Accept	-0.54	0.02**	-	Accept
LVG	0.74	0.01***	+	Accept	0.07	0.91	+	Reject
R2	0.827485				0.718363			
Adj R2	0.780220				0.638883			
F-stat	17.50754				9.038259			
F-stat	0.00				0.00			

Note: * Significance at 10%, ** Significance at 5%, *** Significance at 1%

The board size variable exhibits a significant positive impact on TBQ within Indonesia's consumer (non-cyclical) sector companies. This finding aligns with the study by Pucheta-Martínez & Gallego-Álvarez (2020), a large board comprising professionals with varied backgrounds, experiences, skills, and knowledge contributes to enhanced decision-making quality through a spectrum of perspectives and advice (Ahmed Sheikh et al., 2013). Conversely, in Australian companies, this relationship lacks significance, consistent with Tran et al. (2022) findings. Their research suggests that while a larger board may offer both positive and negative effects, the net impact can be nullified, with the potential for increased differences in opinion and elevated conflict posing a risk to company performance (Guest, 2009).

The board independence variable within Indonesia's consumer (non-cyclical) sector companies exhibits an insignificant negative impact on TBQ, a finding consistent with Bin Khidmat et al. (2020) research. Conversely, in Australian companies, the results are insignificantly positive, aligning with the findings of Chatterjee & Nag (2023). These insignificant outcomes may be explained by the fact that independent directors often retain ties—be they economic, financial, familial, or social—with company management or owners, despite being declared independent (Ararat et al., 2010). Moreover, directors may strategically appoint seemingly independent individuals lacking relevant abilities or backgrounds, thus undermining the oversight function of independent directors (Fuzi et al., 2016).

In Indonesia's consumer (non-cyclical) sector companies, the board diversity variable demonstrates an insignificant positive impact on TBQ, supporting the findings of Wang et al. (2020). Conversely, in Australian companies, the results exhibit a significant negative correlation, consistent with Lim et al. (2019). These significant negative findings can be attributed to the insights provided by Darmadi (2013), who suggests that augmenting board gender diversity may impede decision-making processes by fostering divergent opinions that lead to heightened conflict. Additionally, Abdullah, (2014) research indicates that higher board gender diversity tends to result in increased over-monitoring, further exacerbating the situation.

In the consumer (non-cyclical) sector of Indonesia and Australia, firm size has a significant negative impact on Tobin's Q (TBQ). According to Olawale et al. (2017), this may occur because as total assets increase, inefficiencies may emerge, reducing profitability. In Indonesian companies, firm leverage has a significant positive effect on TBQ, while in Australian companies, leverage shows an insignificant positive effect. Leverage can positively impact company performance when profits exceed the interest costs (Robb & Robinson, 2014).

4. CONCLUSION

The study's findings reveal that in Indonesian consumer (non-cyclical) sector, Tobin's Q is significantly improved by board size and firm leverage, yet significantly diminished by firm size. However, neither board independence nor board diversity shows a notable effect on Tobin's Q. In contrast, in Australian consumer (non-cyclical) sector, Tobin's Q is significantly reduced by board diversity and firm size. Nevertheless, there's no significant influence detected for board size, board independence, or firm leverage on Tobin's Q.

REFERENCES

- Abdullah, S. N. (2014). The causes of gender diversity in Malaysian large firms. *Journal of Management & Governance*, 18, 1137–1159.
- Ahmed Sheikh, N., Wang, Z., & Khan, S. (2013). The impact of internal attributes of corporate governance on firm performance: Evidence from Pakistan. *International Journal of Commerce and Management*, 23(1), 38–55.
- Alves, S. (2023). CEO duality, earnings quality and board independence. *Journal of Financial Reporting and Accounting*, 21(2), 217–231.
- Ararat, M., Orbay, H., & Yurtoglu, B. B. (2010). The effects of board independence in controlled firms: Evidence from Turkey. Available at SSRN 1663403.

- Bin Khidmat, W., Ayub Khan, M., & Ullah, H. (2020). The effect of board diversity on firm performance: Evidence from Chinese L listed companies. *Indian Journal of Corporate Governance*, 13(1), 9–33.
- Chatterjee, C., & Nag, T. (2023). Do women on boards enhance firm performance? Evidence from top Indian companies. *International Journal of Disclosure and Governance*, 20(2), 155–167.
- Darmadi, S. (2013). Do women in top management affect firm performance? Evidence from Indonesia. *Corporate Governance: The International Journal of Business in Society*, 13(3), 288–304.
- Fama, E. F., & Jensen, M. C. (1983). Separation of ownership and control. *The Journal of Law and Economics*, 26(2), 301–325.
- Fuzi, S. F. S., Halim, S. A. A., & Julizaerma, M. K. (2016). Board independence and firm performance. *Procedia Economics and Finance*, 37, 460–465.
- Guest, P. M. (2009). The impact of board size on firm performance: evidence from the UK. *The European Journal of Finance*, 15(4), 385–404.
- Hambrick, D. C., & Jackson, E. M. (2000). Outside directors with a stake: The linchpin in improving governance. *California Management Review*, 42(4), 108–127.
- Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3(4), 305–360. [https://doi.org/https://doi.org/10.1016/0304-405X\(76\)90026-X](https://doi.org/https://doi.org/10.1016/0304-405X(76)90026-X)
- Lim, K. P., Lye, C.-T., Yuen, Y. Y., & Teoh, W. M. Y. (2019). Women directors and performance: evidence from Malaysia. *Equality, Diversity and Inclusion: An International Journal*, 38(8), 841–856.
- Miller, J., & Oliver, J. (2023, November 3). Sam Bankman-Fried convicted of fraud over FTX collapse. *Financial Times*.
- Olawale, L. S., Ilo, B. M., & Lawal, F. K. (2017). The effect of firm size on performance of firms in Nigeria. *Aestimatio: The IEB International Journal of Finance*, 15, 68–87.
- Potharla, S., & Amirishetty, B. (2021). Non-linear relationship of board size and board independence with firm performance—evidence from India. *Journal of Indian Business Research*, 13(4), 503–532.
- Pucheta-Martínez, M. C., & Gallego-Álvarez, I. (2020). Do board characteristics drive firm performance? An international perspective. *Review of Managerial Science*, 14(6), 1251–1297.
- Puni, A., & Anlesinya, A. (2020). Corporate governance mechanisms and firm performance in a developing country. *International Journal of Law and Management*, 62(2), 147–169.
- Robb, A. M., & Robinson, D. T. (2014). The capital structure decisions of new firms. *The Review of Financial Studies*, 27(1), 153–179.
- Ross, S., Westerfield, R., & Jordan, B. (2018). *Fundamentals of Corporate Finance* (12th ed., Vol. 1). McGraw Hill.
- Tran, C. D., Nguyen, T. T., & Wang, J.-Y. (2022). Revisiting the interconnection between governance mechanisms and firm performance: evidence from Vietnamese listed firms. *Journal of Enterprising Communities: People and Places in the Global Economy*, 16(1), 146–167.
- Wang, Y., Abbasi, K., Babajide, B., & Yekini, K. C. (2020). Corporate governance mechanisms and firm performance: evidence from the emerging market following the revised CG code. *Corporate Governance: The International Journal of Business in Society*, 20(1), 158–174.
- Wellalage, N. H., & Locke, S. (2013). Women on board, firm financial performance and agency costs. *Asian Journal of Business Ethics*, 2, 113–127.