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### THE CONCEPTUAL OF EFFECT BETWEEN CORPORATE GOVERNANCE, PROFITABILITY, AND COMPANY SIZE TOWARD FIRM VALUE WITH INTELLECTUAL CAPITAL IN INDONESIA STOCK EXCHANGE

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#### **ABSTRACT**

This analysis shown that about corporate governance, profitability, and company size to firm value and intellectual capital as an intervening variables. For the method analysis is used by quantitative methods with conceptual frameworks. Some part of this research is available in Indonesia Stock Exchange registered with companies. There are many things that company can maximize their value such as welfare for labor, profitability, and corporate governance to firm value. Moreover, the intellectual capital is a reflection like uniqueness as a firm value and increase share price in Indonesia Stock Exchange in companies. Additionally, this research can get decision to estimate a results for company values in the future.

#### **INTRODUCTION**

Firm value is the investor's perception of the company's success rate which is often associated with the stock price. High company value makes the company's stock price high, and increases market confidence not only in the company's current performance but also in the company's future prospects. Maximizing company value is very important for a company, because maximizing company value means maximizing the company's main objective, such the welfare of shareholders. The increase in company value is an achievement in accordance with the wishes of the owners, because with the increase in company value, the welfare of the owners will also increase.

For investors, firm value is very important, because increasing firm value shows an increase in shareholder prosperity (Brigham and Houston, 2011). Information related to company financial factors affects the firm value estimate (Tandelilin 2010). Financial reports are the most common source of information for investment and credit decisions. Financial information is widely believed to be able to move markets and businesses (Lev and Gu, 2016). However, investors often respond differently to the company's book value which is reflected in the financial statements.

According to investors, firm value is different from the company's book value in the financial statements. Share prices, total debt and total assets are aspects that can affect the ups and downs of firm value (Chung and Pruitt, 1994). Pulic (2000) explains that the firm's market value (MV) is made not only by the capital used (physical and financial), but also IC by identifying that there is a significant correlation between the mean value of the company's VAIC and MV. According to Pulic (1998), the main objective of a knowledge-based economy is to create added value (VA), while to create a VA requires an exact measure of physical capital and intellectual potential. He further stated that intellectual ability or VAIC<sup>TM</sup> shows the extent to which both resources (physical capital and intellectual potential) have been used efficiently by the company.

Companies that are able to manage their intellectual resources effectively and efficiently, their financial performance will improve. Increasing financial performance will have a positive impact on the response from the market so that company value will increase (Ermawati et al., 2017). Intellectual capital can also contribute to increasing share prices (Feimianti & Anantadjaya, 2015), which can attract investors and influence investor decisions and company value (Chung and Zhang, 2011). Thus, intellectual capital creates added value as a competitive advantage for companies that can increase company value.

Management needs a strategy to increase intellectual capital. According to Brigham and Daves (2011) it can be done by managing corporate risk. This risk management includes internal and external risk management in order to achieve company goals. Good governance must be carried out by the company. This is known as corporate governance. Furthermore, with this activity, there is a decrease in investment risk which increases investor confidence and there is an increase in profitability, so that an increase in long-term firm value is achieved.

Market confidence in company performance results in fluctuating stock prices (Brigham and Daves, 2011). Profitability information, which is part of the company's financial statements, is important information for management and other parties who need it, such as investors (Brigham and Houston, 2011). This is in line with the signaling theory, which states that the sender of information (company management) provides relevant information to be used by the recipient of information. Then the receiver adjusts the behavior according to the understanding of the signal (Spence, 1973). The high profitability of the company is a positive signal for the company's prospects. This shows that the company's goal of

prospering shareholders has been achieved, so that it has an impact on high firm value (Brigham and Houston, 2011).

Research by Wang (2015) in Taiwan found that intellectual capital has a positive effect on firm value. Maditinos, et al., (2011) in Greece found no statistically significant relationship between human capital efficiency and firm value. Research by Ermawati et al., (2017) in Indonesia found that the value added intellectual coefficient (VAIC™) has a positive and insignificant effect on firm value (market to book value / MtBV). Papatungan et al., (2019) in Indonesia found that intellectual capital has a significant positive effect on firm value. The same results were also found by Utami (2018) in Indonesia and Suherman (2017) in Indonesia.

Cases of weakening stock prices were followed by a decline in firm value and bankruptcy of companies abroad, including in the United States in 2001, namely the case of Enron and Worldcom. In Indonesia, several companies experienced a case of falling share prices which resulted in a decline in firm value, which eventually led the IDX authorities to force delisting issuers. During 2009 to 2018, there were 40 delisted companies on the Indonesia Stock Exchange. The issues that have surfaced are mostly related to the worrying business continuity. In line with the statement of Lev and Gu (2016) that it is very important to assess a company in achieving and maintaining a sustainable competitive advantage. Companies are important to convey information to investors and potential investors to increase firm value. Information on company financial statements needs to be completed to make it feasible for investment and loan decisions.

Nur'ainy et al. (2013) and Siagian et al. (2013) conducted research on public companies in Indonesia and found that corporate governance increases firm value, which is proxied by tobin's q. The sensitivity analysis with ROA and PBV was carried out by Siagian et al., (2013). Research by Lozano et al. (2016) in 16 European countries and Li et al., (2012) in Russia using market capitalization to measure firm value, found the same result. Using ROA as a measure of firm value. Huang (2010) founded that corporate governance increases firm value. This finding shows the effect of a positive relationship between corporate governance and firm value.

Research on the relationship between profitability and firm value has been conducted in several countries and has yielded mixed results, including Vietnam, Kenya, the Philippines and Indonesia. The results show that profitability is positively related to firm value as measured by EV, tobin's q, price (Hung et al., 2018). Similar results using tobin's q as a measure of firm value are found in Kenya (Kodongo, et al., 2014). Sucuahi and Cambarihan (2016) examined 86 companies in the Philippines using tobin's q as a measure of firm value, finding the same results. Likewise, Hermuningsih (2013) who examined 150 companies

in Indonesia using *tobins'q* as a measure of firm value, provides the same empirical evidence. These findings indicate that increasing profitability increases firm value.

Research on company size and firm value relationships has been conducted in several countries and has given mixed results, including Vietnam and Kenya. The results show company size is positively related to firm value as measured by EV, *tobins'q*, price (Hung et al., 2018). Mule et al., (2015) examined 53 companies in Kenya using *tobins'q* as a measure of firm value, finding that firm size had no significant effect on firm value.

Corporate governance increases investor confidence by providing security for investment, along with improved performance and guarantees of corporate sustainability. The safety of this investment will improve the company's and corporate image has the opportunity to increase the company's intellectual capital. Several research results indicate that corporate governance has a significant effect on Intellectual Capital. (Buallay and Hamdan, 2018; Yan, 2017; Jamei, 2017). Apart from implementing corporate governance, companies must also pay attention to profitability and company size to increase their Intellectual Capital. Research on profitability to improve intellectual capital has been carried out in India and Malaysia (Pal and Soriya, 2012; Yen et al., 2019). Research on company size affecting intellectual capital has been conducted in Indonesia, Iran, Hong Kong, (Solikhah and Subowo, 2016; Bani et al., 2014; Petty and Cuganesan, 2005, Afshari et al., 2014). However, Bukh (2005) founded that different company size did not affect Intellectual Capital. However, most of the empirical evidence presents company size affecting intellectual capital.

Based on the description above, that intellectual capital is the determinant of firm value, the company's management will always strive for intellectual capital to increase firm value. Corporate governance profitability and company size are important to increase firm value. However, the implementation of corporate governance in public companies in Indonesia has not shown significant progress. This is also due to the absence of regulations that regulate reporting standards. Corporate governance reporting is mandatory, but the format and content are voluntary. This results in external users having difficulty accessing information. Standard reporting regulations are important, as a guide for companies to produce standard reports. The role of the regulator in this case OJK is very much needed.

The results of previous research studies on the relationship between research variables show (1) the inconsistency of the findings on the influence of corporate governance on firm value, (2) inconsistent findings of the effect of profitability on firm value, (3) inconsistent findings of the influence of company size on firm value. The findings may have an indirect influence on corporate governance, profitability and company size firm value. Intellectual capital in this study is positioned as a variable that mediates the influence of corporate governance, profitability and company size on firm value. This is based on the argumentation that the results of previous studies show (1) intellectual capital increases firm value; (2) corporate governance increases intellectual capital; (3)

profitability increases intellectual capital; (4) company size increases intellectual capital. The implementation of corporate governance, profitability and company size enhances the company's image, thus providing opportunities for companies to increase intellectual capital. Based on the background that has been stated, this study aims to develop the financial literature by examining a model that can provide a new understanding of "the influence of corporate governance, profitability and company size on intellectual capital and its impact on firm value.

### *teoretical framework*

#### *Corporate Governance*

Corporate Governance according to Sutojo and Aldridge (2005), the word governance is taken from the Latin word, such governance which means directing and controlling. In business management, the word is adapted into corporate governance, which means an effort to direct and control the activities of an organization, including the company. According to The Indonesia Institute for Corporate Governance (IICG), corporate governance is a series of mechanisms that direct and control a company so that the company's operations run according to the expectations of stakeholders.

According to the Forum for Corporate Governance in Indonesia (FCGI) (2001), the definition of corporate governance is: "A set of regulations governing the relationship between shareholders, management, creditors, government, employees and other internal and external stakeholders with respect to rights and their obligations, or in other words the system that directs and controls the company. The objective of corporate governance is to create added value for all stakeholders".

The definition of corporate governance based on the Decree of the Minister of BUMN Number Kep-117 / M-MBU / 2002 is: "A process and structure used by BUMN organizations to increase business success and corporate accountability in order to realize shareholder value in the long term while still paying attention to stakeholder interests based on laws and ethical values".

#### *Profitability*

Profitability or the ability to earn profits is a measure in percentage used to assess the extent to which a company is able to generate profits at an acceptable level. Profitability figures are stated, among others, in the figures of profit before or after tax, investment profit, income per share and sales profit. The value of profitability becomes the norm for measuring company health. Munawir (2007) argues that profitability is the company's ability to generate profits. According to Sudana (2011) said that a profitability is "the ability of a company to generate profits by using resources such as assets, capital or company sales".

#### *Company Size*

Company size according to Brigham and Houston (2010) is a measure of the

size of a company that is indicated or valued by total assets, total sales, total profits, tax expenses and others. According to Hartono (2008) company size (firm size) is the total assets / size of the company's assets using the calculation of the logarithmic value of total assets. Meanwhile, according to Consoladi et al. in Oktaviani (2014) states that: "company size can affect the social performance of the company because large companies have a more distant view, so they participate more in growing the company's social performance".

### *Intellectual Capital*

Intellectual capital is knowledge that can be turned into profit. Intellectual capital does not only concern the knowledge and skills of employees, but also includes company infrastructure, customer relations, information systems, technology, the ability to innovate and be creative (Maditinos, 2011).

### *Firm Value*

Firm value is defined as market value because company value can provide maximum prosperity for shareholders if the company's share price increases. Various policies have been taken by management in an effort to increase the value of the company by increasing the prosperity of the owners and shareholders, which is reflected in the share price (Bringham and Houston, 2006).

### *Conceptual Framework*

Based on the theoretical study that has been described previously as well as concepts and empirical evidence from previous research, this section is summarized again briefly to be used as a reference in developing a conceptual research model. Increase in firm value can be done through increasing intellectual capital and the company will always strive for high intellectual capital. It is important for companies to pay attention to corporate governance, profitability and campaign size to achieve these goals. Empirical research shows that high intellectual capital increases firm value (Ermawati et al., 2017; Paputangan et al., 2020; Wang, 2015; Maditinos et al., 2011; Utami, 2018; Suherman, 2017).

The increase in intellectual capital is a reflection of the uniqueness of the firm value. Related to increasing intellectual capital with the implementation of corporate governance, profitability and campaign size, there are 3 things that can be explained. Corporate governance mechanisms, profitability and campaign size can: (1) increasing company performance, because the company has been well managed, resulting in efficiency and effectiveness, as well as increased employee productivity with profitability and company size; (2) increase the company's positive image. Corporate governance, profitability and campaign size forming a positive image of the company; (3) provide opportunities for companies to increase intellectual capital due to increased investor confidence.

Empirical investigations on the relationship between corporate governance and firm value still vary. Researchers found that corporate governance increases firm value (Huang, 2010; Ammann et al., 2011; Connelly et al., 2012; Li et al.,

2012; Nur'ainy et al., 2013; Siagian et al., 2013; Lozano et al., 2016; Villanueva-Villar et al., 2016; Ararat et al., 2017). On the other hand, several other researchers found that corporate governance has a weak role, has no effect, and has a negative effect on firm value (Hidalgo et al., 2011; Jo and Harjoto, 2011; Berthelot et al., 2012; Kumar and Singh, 2013; Mouselli and Hussainey, 2014; Zabri et al., 2015). This finding confirms that the effect of corporate governance in increasing firm value is unclear.

According to legitimacy theory, companies need to have legitimacy in the sense of a social license to operate (Deegan, 2002). This theory shows that companies are involved in sustainability reporting to seek legitimacy and this is very important for companies (Haniffa & Cooke, 2005). Companies must prioritize stakeholder interests and gain legitimacy in society to achieve long-term sustainability and gain the trust of investors and the public. Investor and public confidence in this long-term sustainability, in turn, increases firm value.

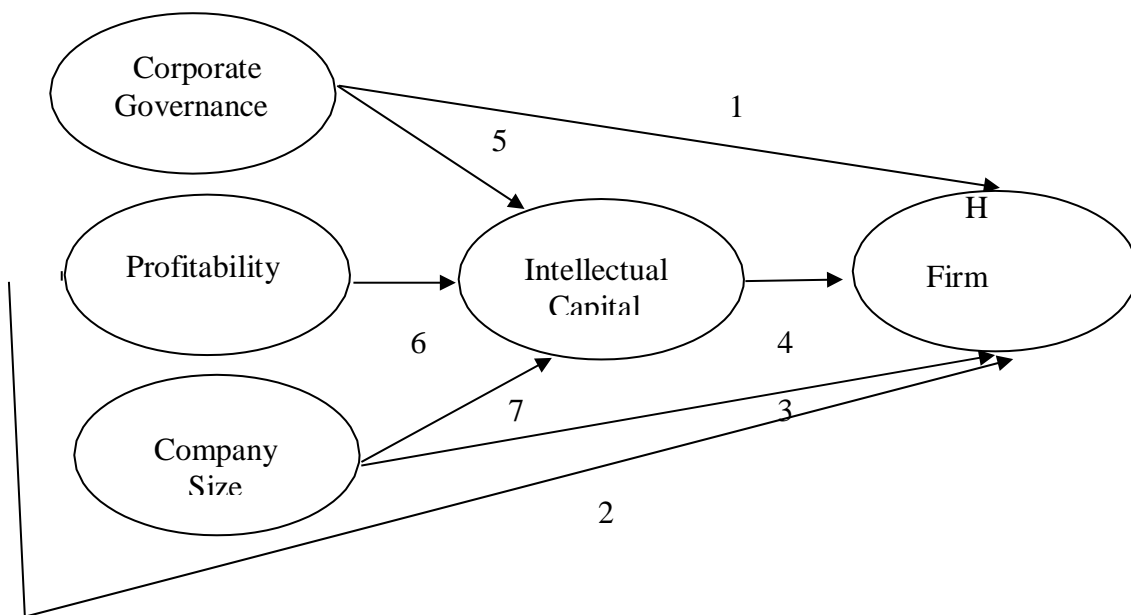
The empirical investigation of the relationship between profitability and firm value still varies. Researchers found that profitability increases firm value (Hung et al., 2018; Kodongo et al., 2014; Sucuahi and Cambarihan., 2016; Hermuningsih., 2013). On the other hand, several other researchers have found the opposite result that profitability reduces firm value (Fernandes and Ferreira., 2007; Anggraini., 2011; Gill et al., 2013; Mukhtaruddin et al., 2014). These findings indicate that there is no clear direction of the relationship between profitability and firm value.

Empirical investigations on the relationship between company size and firm value still vary. Researchers found company size increases firm value (Hung et al., 2018). On the other hand, several other researchers found the opposite result that company size reduces firm value (Mule et al., 2015). These findings indicate that there is no clear direction of the relationship between company size and firm value.

Empirical research provides evidence that profitability can increase intellectual capital (Pal and Soriya., 2012; Yen et al., 2019) and company size can increase intellectual capital (Solikhah and Subowo., 2019; Bani et al., 2014; Petty and Cuganesan., 2005; Afshari et al., 2014). In contrast Bukh et al. (2005) provide empirical evidence that company size reduces intellectual capital. The results of this study do not clearly inform the effect of company size in increasing or decreasing intellectual capital. However, most of the empirical evidence shows that company size increases intellectual capital.

Corporate governance, profitability and company size support good business management, thereby increasing intellectual capital. It is expected that intellectual capital will give good signals to investors about the company's performance and have an impact on increasing firm value.

Based on the description above, this research is important to do. In summary, the research conceptual framework is presented in Figure 1 below:



**Figure 1.** Schematic Conceptual Framework

**Reference sources are:**

(Wang, 2015; Saputra, 2010; Salisu et al., 2019; Gherghina, 2015; Ammann et al., 2011; Ararat et al., 2016; Mouselli and Hussainey, 2014, Villar et al., 2016); (Hung et al., 2018; Kodongo et al., 2014; Sucuahi and Cambarihan, 2016; Hermuningsih, 2013); (Ermawati et al., 2017; Paputangan et al., 2020; Wang, 2015; Maditinos et al., 2011; Utami, 2018; Suherman, 2017); (Buallay and Hamdan, 2018; Yan, 2017; Jamei, 2017); (Pal and Soriya, 2012; Yen et al., 2019); (Solikhah and Subowo, 2016; Bani, et al., 2014; Bukh et al., 2005; Petty and Cuganesan, 2005; Afshari et al., 2014)

**METHODOLOGY**

The research approach taken is positivism. Positivism is a philosophy of science based on the view that in both social and natural sciences, data derived from sensory experience together with the exclusive source of all authentic knowledge, logically and mathematically, obtain "verification" so that it can be accepted as known as empirical evidence. This view is analogous to society operating in accordance with law such as the physical world. Introspective and



intuitive attempts to acquire knowledge are rejected. Although the positivist approach has been a recurring theme in the history of western thought, the concept was originally developed in the early 19<sup>th</sup> century by the founding philosopher and sociologist Auguste Comte. Comte argues that society operates according to its own laws, just as the physical world operates according to the gravity of other natural laws (Comte, 1798-1857 in Martineau, Harriet, 1896).

A suitable approach from this paradigm is a quantitative approach because the data used in this study is a ratio. With the quantitative method, as an effort to justify existing knowledge (science, theory), so that some call it confirmatory research. It is different from research with the qualitative method, namely the effort to find knowledge (science, theory), so that there are those who call it exploratory research. In this study, analysis and prediction are carried out on the influence of corporate governance, profitability and company size on firm value with the intervening intellectual capital variable in companies listed on the Indonesia Stock Exchange.

#### **POPULATION AND RESEARCH SAMPLE**

The company is listed on the Indonesian Stock Exchange (IDX) for the period 2012 - 2018. Publish a corporate governance report contained in the annual report 2012 - 2018 and can be accessed through the Indonesia Stock Exchange (IDX) website and the company's official website. The company is presents a complete financial report for 2012 - 2018 in rupiah currency, this criterion is intended so that researchers do not make adjustments that are feared to cause miscalculations and interpretations.

#### ***Types and Sources of Data***

The type of data in this study is quantitative data and secondary data is used in this study, which is taken from the annual reports of public companies in Indonesia from 2012 to 2018. The company's annual reports include: annual reports, sustainability reports. , corporate governance reports, and financial reports. All data is taken from ICMD publications, the Indonesia Stock Exchange website, company websites, and other media (<http://finance.yahoo.com> and <http://ticmi.com>). Annual reports published by the company are used in this study because they have high credibility and are used by stakeholders as a source of information (Deegan and Rankin, 1997).

#### **CLASSIFICATION OF RESEARCH VARIABLES**

Based on the conceptual framework described earlier, there are three independent variables in this study, namely Corporate Governance, Profitability and Company Size and one dependent variable, namely Firm Value. Meanwhile, the intervening variable was Intellectual Capital.

## DESCRIPTIVE ANALYSIS METHOD

Using descriptive statistics with the aim, to analyze the collected data as it is without intending to make general or generalized conclusions. By using descriptive statistical analysis can provide a description of all research variables.

### *Structural Equation Model - Partial Least Square (PLS)*

Data analysis was performed using Partial Least Square (PLS) analysis and path analysis (parth analysis). PLS (Partial Least Square) is a model an alternative to covariance based SEM. PLS were intended for causal predictive analysis with high complexity situations and low theory support (Ghozali, 2014). The purpose of PLS is to find the optimal predictive linear relationship that exists in the data. Although PLS can also be used to confirm a theory, it can also be used to explain whether or not there is a relationship between latent variables. As stated by Wold in Ghozali (2014) Partial Least Square (PLS) is a powerful analysis method because it is not based on many assumptions, the data does not have to be normally distributed multivariate, and the sample does not have to be large.

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