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The Effect of Good Corporate Governance on Financial Performance (Empirical Study on Rural Banks in Denpasar City Period 2018-2020)

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ABSTRACT : Financial performance is a picture of the state of an organization or company as measured through financial analysis, so that the condition of a company can be known whether it is in good condition or not within a certain period of time. The implementation of good corporate governance mechanism will lead to an increase in the financial performance of a company. The purpose of this study was to obtain empirical evidence regarding the effect of good corporate governance on financial performance. This research was conducted at BPRs in the Denpasar City area for the 2018-2020 period. The number of samples used was 19 BPRs with non-probability sampling method. Data was collected using non-participant observation methods. The data collected was then analyzed using multiple linear regression analysis techniques. The results of this study indicate that good corporate governance has a positive effect on financial performance. Theoretically, this study contributes to agency theory in explaining financial performance. The practical implication of this research for BPRs is to maximize the application of good corporate governance mechanisms in order to achieve better financial performance and for people who want to invest in BPRs, it can be considered in determining the location to invest.

KEYWORDS: *Good corporate governance, Financial performance, Size, Rural Banks*

I. INTRODUCTION

Financial performance is often used as a basis for evaluating company performance, it can be interpreted as a company condition that requires certain actions to analyze the financial performance of a company (Widuri et al., 2019). In the current era of globalization, every company is required to continue to improve its performance so that it can still have an advantage in competing. Financial institutions are financial intermediaries for industries in Indonesia, one of which is the Rural Bank (Bank Perkreditan Rakyat). Based on data from OJK, there are 133 BPRs in Bali Province spread across all regencies and cities in Bali Province.

Table 1. Number of BPR Head Offices in Bali Province

No	Regencies/Cities	Number of BPR
1	Badung Regency	48
2	Bangli Regency	3
3	Buleleng Regency	25
4	Gianyar Regency	6
5	Jembrana Regency	1
6	Karangasem Regency	3
7	Klungkung Regency	5
8	Tabanan Regency	18
9	Denpasar City	24
	Total	133

Source: *www.ojk.co.id*

Table 1. shows that the largest number of BPRs are in Badung Regency with a total of 48 BPRs, but the largest BPR in Bali and one of the BPRs with the largest assets in Indonesia, namely BPR Lestari Bali, has its head office in Denpasar City. News reported from Wareza (2019) Financial Services Authority revoked the business license from BPR Legian due to management problems that did not refer to good governance and negative intervention from Controlling Shareholders in its operational activities, this resulted in its financial performance not meeting applicable standards.

In addition to the BPR Legian case, the Financial Services Authority press release, which was reported by Prabowo (2018), revealed that there was a case of fraud at BPR KS Bali Agung Sedana. The main director of BPR KS Bali Agung Sedana committed this fraud in relation to extending credit to 54 debtors who were deemed not to comply with procedures and did not take steps to ensure BPR compliance with banking regulations.

The results of measuring performance achievement become the basis for company management or managers to improve performance in the next period and are used as a basis for reward and punishment (Mahrani and Soewarno, 2018). An important objective of corporate governance is to protect different shareholders and partners from harmful behavior from the corporate sector (Ur Rahman et al., 2020). Weak implementation of good corporate governance is the cause of economic instability which has an impact on decreasing banking financial performance (Dewi and Tenaya, 2017).

This study uses agency theory. Agency theory explains that there is a contract with one or more people, who order another person (agent) to provide services on behalf of the principal and authorizes the agent to make the best decisions for the principal. However, on the other hand, agency theory can also imply information asymmetry. Agency conflict is a conflict between owners and managers, in which managers tend to prioritize personal goals over company goals. If the company's internal authorization structure is not clear, agency conflicts can also occur.

Nopiani et al (2015) stated that large companies may have large agency problems, thus requiring better corporate governance. The larger the size of the company, the greater the responsibility that must be carried out and this is manifested by the many aspects that must be disclosed both voluntarily and based on regulations (Susilowati, 2020). Company size determines the use of external funds that will be used by the company. This is because large companies will need large funds to carry out their company's operational activities. In general, total assets are used as the basis for measuring the size of the company because it has a long-term nature. This study will use company size as a control variable. Researchers believe that company size will affect the implementation of good corporate governance.

There are several studies conducted to examine the effect of good corporate governance on financial performance in banking institutions in Indonesia. Pracinthea (2019) conducted research on BPRs in West Java. The results of the study show that the GCG structure as a proxy for the managerial and institutional shareholding structure as well as the number of commissioners and the board of directors have a significant effect on ROA which is a measure of BPR performance in West Java. Kangmartono (2018) conducted research on BPRs in Indonesia. The results of the study show that the corporate governance mechanism represented by the Capital Adequacy Ratio, the number of the Board of Commissioners and the number of the Board of Directors can improve the performance of BPRs. Yana and Sari (2019) conducted research on BPRs in the city of Padang. The results of the study show that the number of commissioners has no significant effect on company performance and the number of directors has no significant effect on company performance.

II. CONCEPTUAL MODEL AND HYPOTHESIS

Based on agency theory according to Jensen and Meckling (1976), agency relationship is defined as a contractual agreement between one or several owners of capital (principal) with another party called the manager (agent) to carry out an activity in the interest of the principal. However, basically this agency relationship can also cause problems such as conflicts of interest between principals and agents. Good corporate governance is one way to reduce agency costs arising from agency conflicts.

The application of good corporate governance shows how important it is in supporting the achievement of company goals and the basis for making company policies so as to provide benefits to various interested parties (Situmorang and Simanjuntak, 2019). With good corporate governance, companies can run their business efficiently, so they can achieve company goals, namely maximum profits (Sianipar & Wiksuana, 2019). Research by Crisnandani et al., (2021) stated that good corporate governance has a positive effect on financial performance. This is in line with the research by Prawira and Rasmini (2020), Situmorang and Simanjuntak (2019) and Sianipar and Wiksuana (2019).

H_a: Good corporate governance has a positive effect on the financial performance of BPRs in Denpasar City

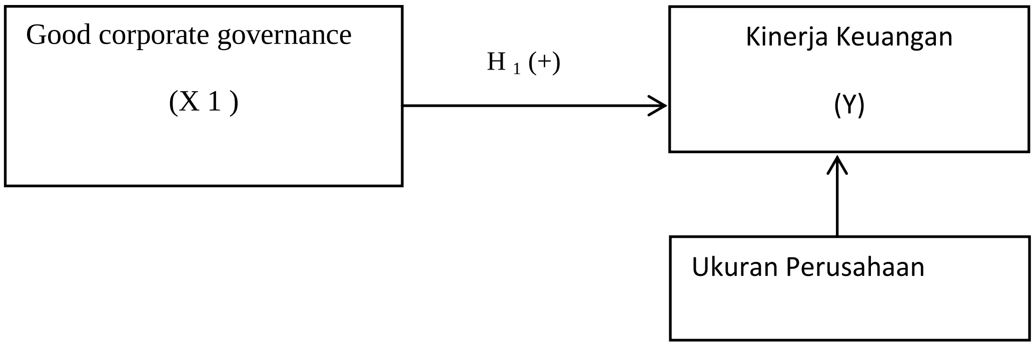

Figure 1. Conceptual Framework

III. RESEARCH METHODS

This research was conducted at rural banks in Denpasar City. Data is obtained by accessing and downloading data from the Financial Services Authority's website. The operational definitions of the variables in this study are as follows:

1) Financial performance (ROA)
In this study, BPR financial performance is measured using ROA. Return on Assets (ROA) is a proxy used to measure financial performance because ROA can take into account how a bank's management is able to obtain its profitability by utilizing the entire company's assets and ROA is considered capable of representing other parameters. The higher the ROA value, the better the bank's financial performance. (Dewi and Yadnyana, 2019).

$$ROA = \frac{Net\ Profit}{Total\ Assets} \qquad (1)$$

2) Good Corporate Governance (GCG)
The proxies used are proxies that pass the factor analysis test and can explain GCG. GCG proxies consist of:

a) Managerial Ownership
Managerial ownership is the ownership of company shares owned by the management. The measurement of this variable refers to the research by Pracinthea (2019) and Nopiani et al., (2015).

$$MO = \frac{the\ number\ of\ shares\ owned\ by\ management}{total\ company\ shares\ outstanding}\ x\ 100\% \qquad (2)$$

b) Institutional Ownership
Institutional ownership is the ownership of company shares owned by other companies or institutions. The measurement of this variable refers to the research by Pracinthea (2019) and Rahardjo et al., (2021).

$$IO = \frac{the\ number\ of\ shares\ owned\ by\ institution}{total\ company\ shares\ outstanding}\ x\ 100\% \qquad (3)$$

c) Board of Commissioners
The Board of Commissioners is a board within a company that has duties and responsibilities in supervising and providing advice or input to the board of directors in managing the company. The measurement of this variable refers to the research by Pracinthea (2019) and Rahardjo et al., (2021).

$$BOC = \sum Total\ commissioners \qquad (4)$$

d) Board of Directors
The board of directors is a board whose members are elected by the company's shareholders to represent the interests of the company whose task is to run the company's management. The measurement of this variable refers to the research by Pracinthea (2019) and Rahardjo et al., (2021).

$$BOD = \sum Total\ directors \qquad (5)$$

3) Company Size
The size of the company is seen from all the assets owned by the company that can be used for the company's operations. The measurement of this variable refers to the research by Pracinthea (2019) and Damai and Yulinda (2019).
SIZE = LN (Total Assets)...(6)

The population in this study was 133 Rural Banks (BPR) in the Province of Bali. Denpasar City was chosen as the research location because there were cases of misappropriation of funds and problematic governance at several BPRs in Denpasar City. The sample in this study was determined using a non-probability sampling method with a purposive sampling technique taking into account the following criteria:
1) BPR registered with the Financial Services Authority in the Denpasar City area.
2) BPRs that have published financial reports on the website of the Financial Services Authority for the 2018-2020 period.
The data needed in this research are financial reports and governance reports from BPRs in Denpasar City for the 2018-2020 period. Data analysis techniques in this study consisted of factor analysis, descriptive statistical analysis, classical assumption test, multiple linear regression analysis, and hypothesis testing.

IV. RESULTS AND DISCUSSION

The process and results of sample selection based on predetermined criteria, obtained observational data of 19 BPRs as samples and overall observational data for the period 2018 - 2020 of 57 observational data. Details of the selection of BPR as the research sample are presented in Table 2 as follows.

No.	Criteria	Number of Company
1	BPRs registered with the Financial Services Authority in the Denpasar City area.	24
2	BPRs that do not publish financial reports on the Financial Services Authority's website for the 2018-2020 period.	(4)
	The number of companies that have met the sample criteria	20
	BPR that contains outlier data	(1)
	Number of BPR samples	19
	Total observation data for the 2018-2020 period	**57**

Source: *www.ojk.co.id, 2021*

Factor analysis test results
The confirmatory factor analysis test aims to determine the variables that will represent good corporate governance variables. The summary of the results is presented as follows:

Table 3. KMO Test Results and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		0,602
Bartlett's Test of Sphericity	Approx. Chi-Square	69,839
	df	6
	Sig.	0,000

Source: Secondary data processed, 2022

The Kaiser Meyer Olkin test was used to determine sample adequacy. Factor analysis is considered feasible if the KMO value has a minimum value of 0.5. The Kaiser Meyer Olkin value in table 3. is 0.602 which is greater than 0.5 which means that each GCG indicator consisting of MO, IO, BOC and BOD has sufficient samples for factor analysis.

Table 4. Measure of Sampling Adequancy (MSA)

Anti-image Correlation	MO	.631[a]			
	IO		.607[a]		
	BOC			.568[a]	
	BOD				.649[a]

Source: Secondary data processed, 2022

The feasibility of the factor test model for each variable can be seen from the Measure of Sampling Adequacy (MSA) value. In table 4. the MSA value of each variable is greater than 0.5. The MSA value of the MO variable is 0.631, the IO variable is 0.607, the BOC variable is 0.568 and the BOD variable is 0.649. This means that the four GCG proxies are feasible for factor analysis.

Table 5. Component Analysis Factors of GCG Variable

	Communalities
MO	0,203
IO	0,687
BOC	0,790
BOD	0,573

Source: Secondary data processed, 2022

The ability to explain the Good Corporate Governance variable is shown by the communalities number as presented in Table 5. The communalities value for MO is 0.203, IO is 0.687, BOC is 0.790 and BOD is 0.573. The MO communalities value is less than 0.5. Thus, MO must be eliminated and factor analysis is carried out again.

Table 6. KMO Test Results and Bartlett's Test Second Analysis

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		0,602
Bartlett's Test of Sphericity	Approx. Chi-Square	63,310
	df	3
	Sig.	0,000

Source: Secondary data processed, 2022

In Table 6. The KMO value of 0.602 is greater than 0.5. The value means that each GCG indicator consisting of MO, IO, BOC, and BOD has sufficient samples for factor analysis.

Table 1. Measure of Sampling Adequancy (MSA) Second Analysis

Anti-image Correlation				
	IO	617[a]		
	BOC		565[a]	
	BOD			653[a]

Source: Secondary data processed, 2022

In Table 7. the MSA value of each variable is greater than 0.5. The MSA value for the IO variable is 0.617, the BOC variable is 0.565 and the BOD variable is 0.653. This means that the three GCG proxies are feasible for factor analysis.

Table 2. Percentage of Variance Second Analysis

Component	Initial Eigenvalues		
	Total	% of Variance	Cumulative %
1	2,130	70,999	70,999
2	0,620	20,658	91,657
3	0,250	8,343	100,000

Source: Secondary data processed, 2022

The total initial eigen value shows the relative importance of each factor in calculating the variance of each indicator to be analyzed. The eigen value in this study is more than one and the percentage of variance value of the GCG variable is more than 60 percent, so it can be concluded that the GCG variable studied is valid and the factor score obtained is suitable for further analysis.

Table 9. Component Factor Analysis of GCG Variables Second Analysis

	Communalities
KI	0,673
DK	0,848
DD	0,609

Source: Secondary data processed, 2022

The ability to explain the Good Corporate Governance variable is shown by the communalities number as presented in Table 4.9. The communalities value, IO is 0.673, BOC is 0.848 and BOD is 0.609. The MO communalities value is less than 0.5. Thus, the three GCG proxies are appropriate to use to represent GCG variables. The three GCG mechanisms are averaged to obtain results that can be generalized from all GCG indicators used, to obtain good results.

Table 10. Multiple Linear Regression Analysis

Model		Unstandardiezed Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig
	(Constant)	-21,193	11,591		-1,828	0,073
	GCG	5,715	2,145	0,342	2,665	0,010
	SIZE	0,583	0,475	0,157	1,226	0,226

Source: Secondary data processed, 2022

Based on the results in Table 10. above, the equation model can be drawn as follows:
ROA = -21,193 + 5,715GCG + 0,583SIZE

The Effect of Good Corporate Governance on Financial Performance

The alternative hypothesis in this study indicates that good corporate governance has a positive and significant effect on financial performance. Based on the results of multiple regression analysis in table 10., the coefficient value of Good Corporate Governance is 5.715 and the significance value is 0.010 or less than 0.05, thus the alternative hypothesis is accepted. Based on agency theory, there are agency costs consisting of monitoring costs, bonding costs, and residual costs. To overcome one of the agency costs that arise, namely bonding costs or bonding costs, good corporate governance can be applied within a company. Good corporate governance implementation within a company can overcome agency conflicts that arise in a company.

Sianipar and Wiksuana (2019), the application of GCG in financial institutions is very important in order to improve their financial performance. According to Irawati et al. (2019) The application of GCG principles in company operations, especially those engaged in the financial sector such as banks, is very important. Because in its operations, bankers are required to always apply the principle of bank prudence in providing financial services and services to the public. The results of GCG research have a positive effect on financial performance in accordance with the results of Sianipar and Wiksuana's research (2019) which state that corporate governance has a positive effect on BPD financial performance. Sawitri and Ramantha (2018) state that GCG has a positive effect on the financial performance of BPRs in Denpasar City.

The Effect of Company Size on Financial Performance

In this study, company size is used as a control variable. Based on the results of multiple linear regression analysis in table 4.16, the coefficient value for firm size is 0.583 and the significance value is 0.226 or greater than 0.05. The results of this study indicate that company size has no effect on financial performance. With a control variable that has no effect, it shows that GCG does have an influence on the financial performance of BPRs. The larger the size of the BPR is not followed by a large change in financial performance. The large size of BPRs in Denpasar City is not in line with the ability of BPRs to use all of the assets owned by BPRs in generating profits to improve the financial performance of BPRs. Salim and Christiawan (2017) state that company size has no significant effect on financial performance. Pracinthea (2019) states that BPR size has no significant effect on ROA as a measure of BPR performance.

V. CONCLUSION

Based on the results and discussion that have been explained, it can be concluded that good corporate governance has a positive effect on the financial performance of rural credit banks in Denpasar City for the 2018-2020 period. The better implementation of good corporate governance within the BPR can improve the financial performance of the BPR. Suggestions related to the results of this study are that BPRs are expected to improve the quality of governance by implementing GCG, namely institutional ownership, the number of boards of commissioners, and the number of boards of directors which are proven to influence the financial performance of BPRs for the better. For future researchers, they can add other independent variables that can affect financial performance such as capital structure, net profit margin, and leverage, or make observations in a wider area which includes provinces or all regions of Indonesia.

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