CHAPTER II
THEORETICAL FRAMEWORK AND HYPOTHESIS DEVELOPMENT

2.1. Firm Performance

Every company has different performance developments. Firm performance is an illustration of the achievement of the implementation of an activity in realizing the goals and objectives of the company and is one of the important things evaluated by investors around the world at this time (Al-matari et al., 2014). Performance assessment can be seen from the company's financial statements. Good performance can strengthen management in the quality of disclosure (Heydari et al., 2015; Al-matari et al., 2014)

In addition, firm performance can also be measured using financial ratios. Measurements using financial ratios are traditional ways but are an useful tool for decision making (Delen et al., 2013). Financial ratio is a comparison of the numbers contained in financial statements, especially the balance sheet and income statement that is used to assess the financial condition or financial performance of the company (Kakanda et al., 2016). This financial ratio consists of liquidity, profitability, long-term solvency and asset utilization or turnover ratios. Liquidity evaluates the company's ability to meet short-term debt, while long-term solvency investigates investment risks for creditors. Profitability shows the ability of a company to generate profits from sales, equity and assets. Whereas asset utilization or turnover ratios measures how companies succeed in gaining income from asset utilization, receipt of receivables and inventory sales (Delen et al., 2013).

Firm performance is very important for the survival and growth of the company (Kakanda et al., 2016). The firm performance is related to the process where the resources available in the company are used effectively and efficiently to achieve the company's general goals (Marn & Romuald, 2012; Yasser et al., 2011). Good performance results good company development so investors are interested in investing in the company (Ezazi et al., 2011).

2.2. Literature Review

Azam, Usmani, and Abassi (2011) conducted a study in Pakistan about the influence of corporate governance to company performance on 14 companies within 2005 to 2010. The dependent variable in this study was the company's performance measured using ROA, ROE, and Net Profit Margin. While the independent variable was measured by CEO duality, ownership concentration, board independence, and effective audit committee. The results of the study indicate that corporate governance has a significant positive relationship with company performance. This research is in line with research from Khan, Nemati, & Ifthikar (2011) which uses data from Tobacco industry companies in Pakistan with the period 2004 to 2008. The company's performance as the dependent variable measured using ROA and ROE. Ownership concentration, CEO duality, and board independence as an independent variables in this study.

Sami, Wang, and Zhou (2011) conducted a research about performance of companies in China. The data used comes from the financial statements of companies listed on the Shanghai Stock Exchange and Shenzhen Stock Exchange

with the period 2001 to 2003. CEO duality, independent director, CEO successor, 10 largest shareholders, state ownership, foreign ownership, institutional ownership, managerial ownership and the largest percentage of share ownership were used in this research.

Research of Detthamrong, Chancharat, and Vithessonthi (2017) regarding corporate governance, capital structure and company performance used data samples of 493 non-financial companies in Thailand with the period 2001 to 2014. The dependent variable in this study was the company's performance measured using ROA and ROE. Financial leverage as a mediating variable and independent variables using board size, board independence, CEO duality, ownership concentration, audit reputation (Big 4), size of the audit committee, and female directorship. Study result show that part of corporate governance has no impact on financial leverage and company performance. While financial leverage has a mediating effect between the audit committee size and company performance.

Gugong, Dandogo, and Arugu (2014) investigated the influence of ownership structures on corporate performance in Nigeria. Two factors of ownership structure used in this study were managerial ownership and institutional ownership as independent variables. This study concludes ownership structure has positive significant effect to corporate performance.

Alabdullah (2018) also did a research about ownership structure and corporate performance on the Amman Stock Market. Corporate performance was measured using market share and independent variables consisting of managerial

ownership with foreign ownership. Company size and industry type in this study as control variables. From the research conducted shows that managerial ownership has a significant positive relationship to company performance while foreign ownership does not have influence to corporate performance.

In prior research, Ujunwa (2012) conducted research on the characteristics of the board and company performance. The sample data used were 122 companies in Nigeria in 1991 and 2008. The study used board size, board skill, board nationality, board gender, board ethnicity, CEO duality as independent variables and company performance as the dependent variable. From the study concluded that board size, CEO duality, board gender had a negative relationship to company performance while board skill, board nationality, board ethnicity had a significant positive relationship to company performance.

Akpan and Amran (2014) conducted a study of the characteristics of the board with company performance and used a data sample of 90 companies listed on the Nigerian Stock Exchange with the period 2010 to 2012. From this study, the characteristics of the board used as an independent variable consisted of board size, board independence, board age, board education, gender diversity and board equity. While the company's performance as the dependent variable. The research shows that board size and board education have a significant positive relationship to company performance and there is no relationship between board independence, board age and board equity to the performance of the company. Gender diversity has a significant negative relationship to company performance.

Bhatt and Bhattacharya (2015) conducted a study of the structure of the board with company performance. The study used a sample of data from 114 companies in the information and technology sector in India with the period 2006 to 2011. The board structure used in this study was board size, board independence, board meeting, board attendance as the independent variable on the dependent variable, namely company performance. The research shows that board attendance has a positive effect on company performance while board independence and board meeting have no relation to company performance.

Dabor, Isiavwe, Ajagbe, and Oke (2015) conducted the research regarding to the influence of corporate governance on company performance by using data samples of 248 companies listed on the Nigerian Stock Exchange for the period 2004 to 2013. The dependent variable in this study was measured company performance using ROA and ROE and board size, board independence, ownership structure, board diversity as independent variables. The results show no influence between ownership structure, board independence and board diversity on company performance, but there is a negative significant relationship between board size and company performance.

Liu, Miletkov, Wei, and Yang (2015) investigated board independence on the performance of companies in China. The data samples used were 2057 companies listed on the Shenzhen and Shanghai Stock Exchanges with the period 1999 to 2012. The dependent variable was company performance while the independent variable was a board independence and the results showed that board independence had a positive influence on company performance.

Tornyeva and Wereko (2012) examined the relationship between corporate governance and company performance in insurance companies in Ghana with a financial report 2005 to 2009. The independent variable is corporate governance consisting of board size, board capability, managerial ability, size audit committee, independence audit committee, foreign ownership, institutional ownership and divided policy. While company performance is used as the dependent variable in this study. The results show that the corporate governance variable has a significant positive relationship to company performance.

Muthoni (2018) conducted the research regarding to the influence of mediation of the capital structure on the relationship between ownership structure and company performance with a sample of company data used as many as 35 companies listed on the Nairobi Stock Exchange with the 2008 to 2017 financial period. Managerial ownership, institutional ownership, government ownership and retail ownership as independent variables, capital structure as a mediating variable measured using leverage ratios and company performance as the dependent variable measured by ROCE and Tobin's Q. The results of the study concluded that the mediating variable namely capital structure is not can mediate the relationship between managerial ownership, government ownership and retail ownership of company performance but there is a partial influence of mediation on capital structure variables on the relationship between institutional ownership and company performance.

Heydari, Fatemeh, Razeghi, and Sharifi (2015) investigated the relationship between institutional ownership structures to company performance.

The data sample used is 90 companies listed on the Tehran Stock Exchange. The financial period used is 2006 to 2010. The variable used is institutional ownership as an independent variable. Dividend policy, financial leverage, and company performance as the dependent variable. The study concluded that institutional ownership has a significant positive effect on dividend policy and company performance but has a negative impact on financial leverage.

2.3. Hypothesis Development

2.3.1. Effect of Board Attributes on Firm Performance

The task of the board of directors is to ensure that companies can take full advantage of the opportunities and market value of the company can increase. Board size is closely related to the operational performance of companies where Arora and Sharma (2018) suggest that the small size of the board is more effective than the size of the board in large numbers because the large size of the board makes it easier for the CEO to control the company but difficulties in decision making. Increasing board size can increase conflict so that agency problems increase which affect company performance (Abdurrouf, 2011; Nanka-Bruce, 2011). But Fauzi and Locke (2012) and Kakanda et al. (2016) explained that the size of a large board produces different capabilities and knowledge that can be efficiently and efficiently used in determining corporate strategy decisions and planning.

While board independence are an important part of companies that monitor the performance of company management to create good corporate

governance (Azam et al., 2011). The minimum proportion of independent commissioners is 30% based on the regulations of the Financial Services Authority (OJK) No.33 / POJK.04 / 2014 Article 20 paragraph (3). The large number of independent commissioners will increase the strict supervision of company management performance so that the company's operations can run smoothly and neatly in order (Abbasi et al., 2012). However, the large size of the board of commissioners can also provide difficulties for the board of commissioners in communicating and coordinating with other members of the board of commissioners as well as difficulties in making decisions that will affect the company's performance.

Research from Ujunwa (2012) and Gill and Obradovich (2012) concluded that there is a negative significant relationship between board size and firm performance. This finding is in line with the study conducted by Ibrahim and Abdul Samed (2011), Lin (2011), Guo and Kumara (2012), Uwuigbe and Fakile (2012), Adebayo et al. (2013), Ali and Nasir (2014) and Dabor et al. (2015). But not in accordance with the results of Yasser et al. (2011), Renee and Mehran (2012), Al-matari et al. (2014), Akpan and Amran (2014), Bhatt and Bhattacharya (2015) and Arora and Sharma (2018) which show that there is a positive relationship between board size and firm performance.

Research from Azam et al. (2011) shows that there is a significant positive relationship between board independence and firm performance. This research is accordance to research of Abbasi et al. (2012), El-Chaarani (2014) and Liu et al. (2015). While the research from Vo and Nguyen (2014) concluded that

board independence had a negative relationship to firm performance. This finding is in line with the research from Shukeri et al. (2012) and Dabor et al. (2015). But it is not in accordance with research from Rehman and Shah (2013) and Sulistyowati (2017) which show that board independence have no significant influence to firm performance.

H1 = There is a positive significant effect between board size and firm performance.

H2 = There is a positive significant effect between board independence and firm performance.

2.3.2. Effect of the Ownership Structure on Firm Performance

Ownership structure is one mechanism to reduce agency problems. Ownership structure has an important role in improving company performance (Ezazi et al., 2011). The conflict between shareholders and managers can be reduced by managerial ownership and also build unity relationship between each other. Higher proportion shares held by managers impact the better company performance. Managers will work harder and be motivated to improve company performance and strive to maximize company value (Ruan et al., 2011).

Institutional ownership as an important part that monitor the operational effectiveness of the company (Abbasi et al., 2012). High level of institutional ownership will reducing the agency cost, also higher oversight efforts by institut shareholders. The monitoring mechanism of decisions which taken by manager will be tightly because the existence of institutional shareholders so that manager will be more careful when making decision. (Heydari et al., 2015).

Research from Fauzi and Locke (2012) states that the managerial ownership structure have a positive significant effect on firm performance. This result is in accordance with the study of Sami et al. (2011), Kumar and Singh (2013), Gugong et al. (2014) and Alabdullah (2018). However, research from Sheikh et al. (2013) shows that the relationship between managerial ownership and firm performance is significantly negative.

Abbasi et al. (2012) and Tornyeva and Wereko (2012) prove the relationship between institutional ownership and firm performance is significant positive. This finding is same with research from Gugong et al. (2014) and Heydari et al. (2015). Where as the results of Mollah et al. (2012) and Dabor et al. (2015) shows that institutional ownership have a significant negative impact on firm performance. Research from Pirzada et al. (2015) shows that institutional ownership has no significant effect on firm performance.

H3 = There is a positive significant effect between managerial ownership and firm performance.

H4 = There is a positive significant effect between institutional ownership and firm performance.

2.3.3. Effect of Board Attributes, Ownership Structure on Firm Performance and Capital Structure as a Mediating Variable

Companies that have good governance can produce effective operational levels. The large number of boards in a company can affect the effectiveness of company performance. The large proportion of shares owned by managers and corporate institutions can also affect the high or low performance of the company.

Good corporate governance can motivate company management to maximize shareholder wealth but also by reducing capital costs (Sheikh & Wang, 2012). Success in the selection and use of capital is a key element of the company's financial strategy (Velnampy & Niresh, 2012).

A successful company must have an effective board in planning and in making decisions related to funding (Jaradat, 2015). Supervision of the performance of company managers is also very important to monitor company management in using debt optimally (Ahmadpour et al., 2012). The use of optimal debt can improve company performance so as to generate profits for the company. Research from Muthoni (2018) states that there is no significant relationship between ownership structure and company performance mediated by capital structure. But research from Detthamrong et al. (2017) concluded that there is a partial mediation effect from capital structure as a mediating variable that mediates the relationship between corporate governance and company performance.

H5 = Capital structure mediates the relationship between board attributes, ownership structure and firm performance.

2.4. Research Model

The research model was prepared to study the effect of board attributes, ownership structure on the performance of the company with capital structure as a mediating variable. The following is the model applied in the study:

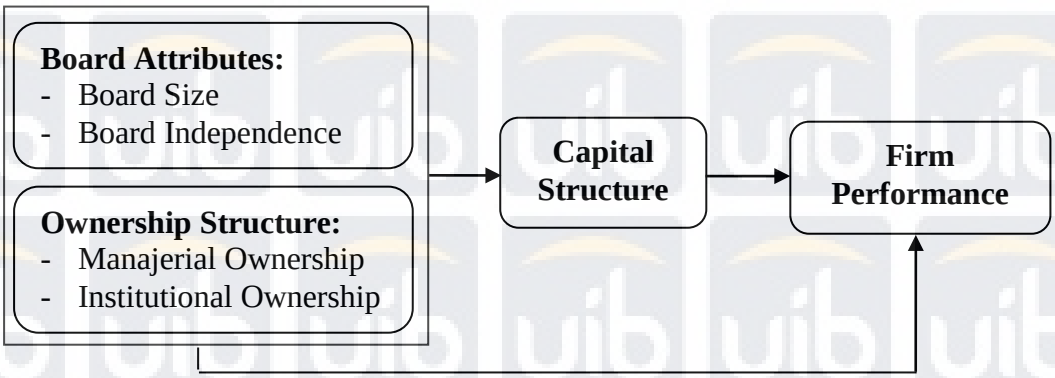

Figure 1 Model of The Effect of Board Attributes and Ownership Structure on Firm Performance with Capital Structure as Mediating Variable.