The Role of Corporate Governance and Financial Performance on Company's Stock Return (Study Case LQ-45 period of 2010-2015)

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ABSTRACT

This research aimed to study role of internal corporate governance and financial performance on stock return. In this research the internal corporate governance mechanism used were Board Process, Board Structure, and Board Characteristics, while the Financial performance measures used Return on Assets (ROA) and Return on Equity (ROE). These independent variables are being studied regarding its role and significance in affecting the Stock Return of firms. This research is the explanatory study with a quantitative approach. The population of this research are companies under LQ-45 IDX nomination within the year 2010-2015. There are 11 sample companies. The data used were secondary data in the form of annual financial statements and annual reports. The data were processed by Microsoft Excel and analyzed using SPSS and explanatory quantitative technique. This research found that Board Structure, Board Characteristics, Return on Assets, and Return on Equity has a positive influence on Stock Return. Board Characteristics and Return on Equity have most positive and significant influence on Stock Return while Board Structure and Return on Assets positively influencing but less significant. However, Board Process has negative and less significant influence to Stock Return Values.

Keywords: Board Structure, Board Process, Board Characteristics, Return on Equity, Return on Assets, Stock Return.

ABSTRAK

Penelitian ini bertujuan untuk mempelajari peran internal tata kelola perusahaan dan kinerja keuangan terhadap return saham. Dalam penelitian ini internal tata kelola perusahaan yang digunakan adalah Proses Dewan, Struktur Dewan dan Karakteristik Dewan sedangkan untuk ukuran kinerja Keuangan menggunakan Pengembalian Aset (ROA) dan Pengembalian Ekuitas (ROE). Variabel independen ini sedang dipelajari dampaknya dalam mempengaruhi Return Saham perusahaan. Penelitian ini menggunakan pendekatan kuantitatif. Populasi penelitian ini adalah perusahaan-perusahaan di bawah nominasi LQ-45 IDX dalam tahun 2010-2015. Sampel penelitian ini ada 11 perusahaan selama 6 tahun. Data yang digunakan adalah data sekunder berupa laporan keuangan tahunan dan laporan tahunan. Data diproses oleh Microsoft Excel dan dianalisis menggunakan aplikasi SPSS dan teknik deskriptif kuantitatif. Penelitian ini menemukan bahwa Struktur Dewan, Karakteristik Dewan, Pengembalian Aset dan Pengembalian Modal memiliki efek positif terhadap Pengembalian Saham. Karakteristik Dewan dan Pengembalian Ekuitas memiliki dampak positif dan sangat signifikan pada Pengembalian Saham sementara Struktur Dewan dan Pengembalian Aset berdampak positif tetapi kurang signifikan. Namun Proses Dewan, memiliki dampak negatif dan tidak signifikan terhadap nilai Pengembalian Saham

Kata kunci : Struktur Dewan, Proses Dewan, Karakteristik Dewan, Pengembalian Modal, Pengembalian Aset, Pengembalian Saham.

INTRODUCTION

Capital market is one source of economic development for companies and supports resources for the public to buy shares (Fredholm and Taghavi-Awal, 2006). The capital market is also alternative financing for the company to get capital at a relatively low cost and also for short-term and long-term investments (Sheppard, 2003; Husnan, 2003). One most popular types of investments on capital markets in Indonesia and worldwide are stocks (Subhan and Suryansyah, 2019; Anwaar, 2016). Stock is securities or investments shown the ownership of a person or legal entity towards the company stock issuers (Johan, Young, and Hansun, 2020). In deciding on investments, investors often use stock return as a measure. Stock return can also be described as a result obtained from investment or level of profit gained by investors for investment. The stock return will be moved in the direction of the company's fundamental performance. Company fundamental performance has a positive and significant effect on the stock return of the company (Anwaar, 2016). Therefore, company shareholders need managers to improve firm performance and value, which will result in increased stock returns.

In owning stocks, there are also risk associated which are unpredictable and can occur at any time. The two types of risk involved in investment are systematic risk and unsystematic risk. Systematic risk is the risk related to market risk, which is not-diversifiable. It can also be described as the external factors that are uncontrollable. Unsystematic risk or specific risk is part of a security's risk associated with random events and it can be eliminated by proper diversification (Brigham and Houston, 2007). Or in other words, unsystematic risk is risk due to internal and controllable factors. Examples of systematic risk are the interest rate risk, inflation risk, maturity risk, liquidity risk, exchange rate risk and political risk (Besley and Brigham, 2009). While business risk, financial risk, default risk are examples of unsystematic risk.

Stock market returns are the returns that investors obtained from the stock market. This return could be in the form of profit through trading or in the form of dividends given by the company to its shareholders from time-to-time. In 2010-2015, the growth of stock market return in Indonesia has decreased from 54.35% to -0.01%. According to Rostami et al. (2016), one of the factors that led to the declining stock return is corporate governance. Recently, Indonesia has the lowest ranking of corporate governance score after the Philippines based on CLSA versus ACGA (Asian Corporate Governance Association) ranking in December 2018 (Acga-asia.org, 2019). Being in the lowest score means that Indonesia has the worst performance and implementation of corporate governance and it is considered to be relatively poor compared to other Asian countries (Primadhyta, 2019). These rankings show that the implementation and the practice of good corporate governance (GCG) in Indonesia are left far behind compared to neighboring countries.

A survey by Deakin and Konzelman in 2004 has proven that weak governance caused big companies such as Enron, Tyco, WorldCom, and Adelfa to encounter stock crash (Deakin and Konzelman, 2004). The big companies are also indicated weak corporate governance, such as lack of transparency in the management of the company, inadequate enforcement of the law by government, and poor financial regulation at the time (Hidayah, 2008). Therefore, investors need protection regarding investor's interests and wealth.

Corporate governance is a system that directs and controls companies and organizations (Khan, 2011) with the purpose of achieving a balance between authority needed by the company to ensure its continued existence and accountability to stakeholders. Quality of corporate governance is crucial to the company's stock return (Owala, 2010). A more competent corporate governance system causes the interest of owners and managers to be in line (Fama and Jensen, 1983), and the goals of the company can be achieved. A survey has proven that investors trust companies with good corporate governance systems (McKinsey and Company, 2002). As a result, the correlation between corporate governance and stock markets in predicting future stock returns is significant. The outcome of empirical studies done in other countries suggested that the formulation of a good governance system resulted in better performance of the companies (Balatbat et al., 2004; Gompers et al., 2003).

Internal elements of corporate governance, namely board process, board structure, and board characteristics, are also important in contributing higher corporate governance efficiency. Board process is considered important, since the decision making of the boards takes place as the board process. The board structure is also a foundation for an effective board. It focuses on the background interest, affiliations, and positions of its members.

The right structure also needs to be implemented together with the boarding process. Phan (1998) has noted that having simply a good structure is not enough. Right processes must also take place to support the structure. Further evidence by Limpaphayom and Connelly (2006) mention on the need and the effective characteristic of the role of the board of the directors in overseeing management.

Company profitability is one factor seen by potential investors to determine stock investment. Company profitability is one measure of how well a firm can use assets from its primary mode of business and generate revenues. The analytical tool that is often used to measure company profitability is financial ratios (Najjar, 2013). Investors considered performance measures such as return on equity (ROE), return on asset (ROA), and Return on Investment (ROI) to make investment decisions accordingly. Anwaar (2016) found that return on assets has a significant positive impact on stock return, and Denziana and Patmarina (2015) has proved that return on equity does affect the stock return. Return on Assets and Equity are both has been used in measuring the company's capability to create profits using total owned assets and capital. The higher the profitability of a company, the higher the average stock returns will be (Balvers et al., 2017). Based on utility theory, investors who invest resources in a company are required to obtain profits based on what invested. Therefore, a higher value of return on assets and return on equity explained that companies have a higher potential to gain profit, which can give higher value to the company's stockholder. But the research by Putra, Nurlaela and Samrotun (2018) states that Return on Assets does not influence the stock return.

The presence of good corporate governance (GCG) and good company profitability is required by a company. Especially for companies listed in LQ-45 of Indonesia Stock Exchange. Companies listed in LQ-45 of Indonesia Stock Exchange are top 45 companies with highest market capitalization, highest transaction value, and good financial conditions, prospect of growth, high transaction value, and frequency. Moreover these companies has the highest company liquidation. Even though these companies are in top positions, it is very important to maintain to be in LQ-45. It is because all stocks are monitored by IDX, and once any criteria are not fulfilled, the company will be removed from the list. Companies listed in LQ-45 are mostly big companies that have good performance, which also has faster rate in attracting and inviting investors to invest. For a company, maintaining and enhancing company profitability and corporate governance implementation will increase the attractiveness for investors. Research by Ningsih and Atmadja (2017) found that debt to equity ratio has a significant positive effect on company performance and a significant negative effect on stock returns. In contrast, research by Budiharjo (2016) shown results that corporate governance has no effect on stock return, but corporate governance positively influences stock returns through profitability.

LITERATURE REVIEW

Agency Theory

The main theory related to corporate governance is Agency theory. Agency theory is described as a contract in which one or more (principal) asks another person (agent) to perform certain services in the interests of the principal, by delegating the authority to him (Jensen and Meckling, 1976). In the context of financial management, agency relationship appears between (1) shareholders with the managers and (2) shareholders with the creditors. The main point from the agency relationship is the separation between the ownership (principal/investor) and control (agent/manager). Ownership is represented by investors delegating the rights to the agent. In this context, managers are given rights to manage investor's wealth, which in turn investors will gain revenue in the future (Darmawati, 2003).

One important point in financial management is the purpose of a firm to maximize shareholder's prosperity (Berle and Means, 1932), which assumed to be the maximized stock return. However, in reality, sometimes the manager would have goals that conflict with these main objectives. Principals and agents are utility maximizers with dissimilar interests, and that because of information asymmetry, agents will not always perform in the best interests of the principals. Managers are selected by the shareholder; thus, managers are supposed to act according to the will of shareholders, but within this process, conflicts often occur. Agency conflicts occur when parties involved have different purpose and goals. Therefore, the conflict between investors and agents (managers) arises. Agency problems can occur in companies where the managers have less than a hundred percent of shares in the company. In large companies, agency problems have bigger potential to occur because managers have smaller shares.

Principals can limit the differences in interest by establishing suitable motivation for the agent and by issuing costs called agency costs. Human character is associated with this agency theory in which humans are ordinarily self-interested, usually have limited thinking about perception in the future (bounded-rationality), and humans always tends to avoid risk (risk-averse). The company owner gives authority to the manager to take care of the company, such as managing funds and making corporate decisions. Agency theory is contentious. Advocator claim either that it is a 'powerful' organizational theory (Jensen, 1983) or that it suggests, unique insight into information systems, outcome uncertainty, incentive and risk (Eisenhardt, 1989). Opponents argue that agency theory relies on a certain expectation of human behavior. Agency theory depicts managers as "inherently tending to act in opportunistic, self-serving, guileful, and lazy ways-at cost to their employers," and that it lacks concepts for acknowledging a more positive view of management motives and behavior (Donaldson, 1990).

According to Rezaee, Tsui, Cheng, and Zhou (2019), in the Indonesian capital market, companies adopt a two-tier board system; this means that owners and management of the companies are separated. This could lead to a higher possibility of a conflict of interest. One way that could be done to control the contract issues within management and investors and limit the opportunistic behavior of management is by the implementation of good corporate governance (Mahrani and Soewarno, 2018). Corporate governance can be used to change rules under which agents operate and restore the principal interest.

Capital Market

Capital Market Definition

Capital market is described as a market in which buyers and sellers involve in exchange for financial securities such as stocks, bonds, etc. It includes longer-term, relative riskier securities (Bodie et al., 2011). Capital markets are made up of debt and equity markets, and its purpose is to match the demand and supply of funds (Sach, 2014). Capital market is also diversified into two categories (outside of debt and equity), which are primary and secondary markets. Primary markets are where new issues of stocks, bonds, or other securities or typically are market to the public by investment bankers. In contrast, trading of already-issued securities among investors occurs in the secondary market (Bodie et al., 2011).

Stock Return

The investor's goals are to maximize the portfolio's expected return, subject to an acceptable level of risk (or minimize risk, subject to an acceptable, expected return) (James, 2001). Return is the benefits gained from investing. In stock market, it does not always promise a definite return for investors. But there are components of stock return which investors can get these profits are dividends and capital gain.

Dividend is refers to cash paid out of earnings (Prabakaran, 2019) and capital gain is defined as the profit received because of the difference between the selling price and the purchase price of an investment. Of course, not all investment provide return in the form of capital gains or capital losses. Capital gain is very dependent on the market price of the investment instrument. Investments that can provide capital gains are stocks, while those that do not provide a component of return on capital gains are such as certificates deposits and savings.

Other terms associated with stock return are the stock prices and stock values. These two terms have different meanings. Stock prices are prices of stocks formed in stock market due to selling and buying transactions that occur between investors (Sakti, 2013). Stock prices is the price at which the stocks are being sell or buy. The difference between prices in stocks could lead into capital gain or capital loss. While values of stock means the value stock is a company that has had low income and profit growth in the past. Stock valuation is used predict future market prices, or more generally, potential market prices, and shares that are judged undervalued (in relation to their theoretical value) are bought, while stocks that are valued overvalued are sold, with the hope that shares that are undervalued are the whole will increase in value, while stocks that are overvalued will generally experience a decline in value.

Return can be diversified into two, realized return, and expected return. Realized return is the return that is counted according to the data in the history (Grabowski and Pratt, 2010). This return is important because it is used as one measurement in measuring the company performance and as the benchmark of risk and return in the future. Meanwhile, the expected return is the return that investor want to receive in the future and with

uncertainty (Jogiyanto, 2003). The bigger return expected from the investment, the bigger risk that investors has to face (High risk-high return, low risk-low return) (Pamane and Vikpossi, 2014). There are two main components of stock return, yield, and capital gain (loss). Yield is one component of return that reflects the cash flow or income received periodically from investing (Wahyono, 2014).

Corporate Governance

Corporate Governance Definitions

The term corporate governance was first introduced by the Cadbury Report in 1992. This report was considered as the turning point that determines corporate governance practices all over the world. A firm need to concentrate on their economic and social aspect. So, it must be fair with producers, shareholders, customers and so on. It has various responsibilities towards employees, customers, communities, and at last towards governance (Al-ahdal et al., 2016).

In a brief understanding, according to the Indonesian government, it is described as a principle that is underlying a process and corporate management mechanism based on legislation and business ethics (Kepmen BUMN, Kep-100/MBU/2002). Corporate governance is a functional and structural system, which pursue to ensure the company is managed and controlled in a strategic, integrative, entrepreneurial systems and meets ethical guidelines (Cadbury, 1992; Hilb, 2006).

Corporate governance explains the relationships between various participants in the company that determine the direction of company performance (Faizal, 2004). The significance of corporate governance is in the form of improving company performance through monitoring management performance and the existence of management accountability to stakeholders and other stakeholders. In this case, management is more directed at achieving management goals and not preoccupied with things that are not the targets of management performance achievement (Effendi, 2009). Corporate governance helps to assure that shareholders will get a return on the investments made (Ali, 2016).

Principles of Corporate Governance

A good corporate governance system demands the development and implementation of corporate governance principles. Through this, profit orientation and service to communities engaged will be balanced. There are five principle of corporate governance according to National Governance Policy Committee (KNKG, 2006), there are:

1. Transparency
2. Accountability
3. Responsibility
4. Independency
5. Fairness

Internal Corporate Governance Mechanism

Corporate Governance Mechanism is the mechanism controlling an organization, or a firm, in attaining its goals, which was arranged to maximize the long-term benefits of the shareholders (Abu-Tapanjeh, 2006). Supervision is an integral part of the management process. Supervising means seeing and considering what is done (realistically) in accordance with what was agreed (plan). The mechanism in overseeing corporate governance is divided into two types, namely external and internal mechanisms of corporate governance. According to Lastanti (2004), external mechanism is a way to influence the company other than by using internal mechanisms, such as controlling the company with market mechanisms. According to Wijayanti et al. (2017), internal corporate governance mechanism is the factor that operates within a company. This is a common supervisory of board of commissioners, and/or committee involved in conducting controlling and monitoring activities in order to protect investor's and public interest. The internal mechanism is a way to control a company by using internal structures and processes such as the general meeting of shareholders, composition of the board of directors, composition of the board of commissioners, audit committee, and meetings with the board of directors (Peruno, 2015). According to this, board structure, board process, and board characteristics of the boards play important roles in maximising company value, thus will lead to higher company stock return (Zahra and Pearce, 1989).

Internal Corporate Governance Mechanism Indicator and Stock Return

Board Process and Stock Return

Board Process is defined as decision-making activities of the boards, styles of the board, length of the board meetings, board cultures of director's

performances (Korac-Kakabadse et al., 2001; Zahra & Pearce, 1989; Ong & Wan, 2008). Dulewicz, MacMillan, and Herbert (1995) denote board process as the organizing and running of the board, which need to be performed so that the objectives of the board can be achieved. Therefore, the study of numbers of board meetings are important element of the board process. Rashidah (2006) suggests that the board meeting time is an important resource in improving the effectiveness of a board. Boards should meet regularly in a year and it should be disclosed. It is believed that the greater number of meetings will result in a better standard of statements as more time is taken to deliberate the content and more efficient time in decision making.

Board process related to how boards make a decision, in agency theory there is a need for boards to be independent and effective in monitoring and controlling the activities of management (Ayuso & Argandona, 2007; Bonn et al., 2004; Chen et al., 2006; Davis, 1991; Eisenhardt, 1989; Fama & Jensen, 1983; Jensen & Meckling, 1976), and as protectors of shareholders' welfare (Fama & Jensen, 1983; Hermalin & Weisbach, 1988; Hill & Snell, 1988). Anderson and Anthony (1988) note that the board process pertains to the healthy and sometimes rigorous discussion on corporate issues and problems so that decisions can be reached and supported. Research by Prasertsri and Sangboonnak (2016) finds that there is a relationship between board structure as a dimension of corporate governance to the stock return.

Board Structure and Stock Return

Wijayanti et al. (2017) state that board structure has a positive effect on investor's confidence. Previous researchers have also indicated that board structure could enhance monitoring and accounting transparency within a firm (Leuz, Nanda, and Wwysocki, 2003), which reduced the variability of fundamental annual return on assets, accounting accruals and reduced information asymmetry (Chung, Elder, and Kim, 2010). Based on Tricker (1994), board structure is distinguished between those directors who hold a management position in the company and those who do not. Zahra and Pearce (1989) identify other dimensions of board structure, such as number and types of board committees, committee membership, the flow of information among these committees, and patterns of committee membership.

Board Structure and board processes are crucial for a company. Dalton and Daily (1999) mentioned that in several decades of research designed to link the relationship between board structure and company fundamental performance, results had been described as "vexing," "contradictory," "mixed" and "inconsistent." A meta-analysis of more than 40 years of data from 159 studies by these two researchers concluded that there is no evidence of a substantive relationship between board structure and financial performance, regardless of the type of performance measures, size of the firm, or the manner board composition is defined.

Phan (1998) notes that having simply a structure is not sufficient. The right processes must be in place to support the structure. Analogously, Buchanan, and Huczynski (1997) argue that the performance of any group/team is as much a function of its structure and process. If a group/team does not work well, one must analyse the status, power, liking, role, and communication structures. If the structure is in place, one must examine which roles are performed and not performed, and how these decisions are made. Malekzadeh, McWilliams, and Sen (1998) find that the structure of the board influenced the stock market return. Corporate governance practices were proven by Malekzadeh et al. to have impact on return abnormality, and it has a significant effect.

Board Characteristics and Stock Return

Based on Wijayanti et al. (2017), board characteristics refe possibility of disciplinary management turnover (Bhagat and Bolton, 2006), mitigate any possibility of the adverse takeover (Sivdasani, 1993), and improving the engagement of board members to perform strategic control (Johnson, Hoskisson & Hitt, 1993).

A corporate board is assigned with the task of controlling th to some researchers for the past decades (Adams et al., 2010). Evidence points much to the thinking that the failure of financial services entities to meet stakeholders' expectations is due to poor internal corporate governance. This has been observed in incidences of inadequate internal controls and dominance of individuals resulting in inefficiencies and inflated costs of operations, such as the cases at Navistar Insurance Brokers, Altfin Insurance, Jupiter Insurance, Standard Fire, and General Insurance and Global Insurance Company (Insurance and Pensions Commission, 2014).

The subsequent sections will examine the key variables of t effective characteristic of the role of the board of the directors in overseeing management.

Financial Performance

Financial Performance Measures

GCG has a relationship with company performances. Companies that are ranked in the top 100 in implementing co governance will correlate to higher operating performance.

Financial performance is one measuring instrument used to measure and determine the success quality of the company. The performance of a company can be seen from its financial report. The financial report can also determine as the achievement that measured quantitatively either from the management or from the movement towards the goals. Financial performance is crucial for the company. The financial performance is measured through the growth of Return on Assets (ROA) and Return on Equity (ROE). Financial performance is used to know the firm's overall financial health over a given period of time and can also be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. Dhaliwal et al. (2007) mentioned that the quality of financial reporting and effectiveness of the audit committee are correlated to each other. Good quality of financial performance report is required by investors to make correct judgments and decisions.

Company Profitability Measures and Stock Return

Return on Equity (ROE)

Generally, there are two approaches used by an investor to analyze the values stock in the stock market, fundamenta the more efficient the use of own capital by the company management. This means that the position of the owner of the company is getting stronger, and vice versa. Companies can use the profitability ratio as a whole or only a part of the existing profitability ratios. The use of ratios, in part, means that companies only use certain types of ratios that are deemed necessary to know (Hery, 2016).

According to Brigham and Houston (2017), the most important financial ratio is Return on Equity (ROE). In measuring the company's financial performance, ROE is included in the profitability ratio as a tool used by investors to value stocks. ROE is used to measure the company's ability to obtain profits available for shareholders. ROE is a closely watched financial ratio among equity investors. It is a strong measure of how well the management of a firm creates value for its shareholders.

Researchers have found that Return on Equity as a profitability ratio has a positive and significant impact on stock return. Therefore, the higher the value of Return on Equity, the higher value of the stock return will be (Balvers, Gu, Huang, 2015). Li et al. (2009) argue along the lines of the pure investment-based approach that higher profitability facilitates investment, and that, in turn, higher investment implies lower investment returns and stock returns. Empirically, Li et al. (2009) support this prediction by identifying a positive interaction effect between profit and investment, which affects returns in addition to the investment link by itself. Saryadi (2017) states that return on equity has a positive effect on company's stock return.

Return on Assets (ROA)

Return on Assets (ROA) is one of the profitability ratios. In financial statement analysis, this ratio is most highlighted; it is because the ratio is capable of showing the success of a company in generating its profit. ROA is adequate in measuring the ability of the company to generate profit in the past and use it to predict profits in the future. Assets referred to is the entire assets of the company, obtained from its own capital or foreign capital that has been changed by the company into company assets that are used for survival company life.

The fundamental analysis showed that in investor's decision making, the decision always moves rationally and depending on firms' stock price and the firm's conditions. Investors believe that a good fundamental performance of a company reflects a better company's value (Hediyanasari, 2014). Return on Asset is used to measure the company's capability to create profits using total owned assets by a company in the future, higher return on assets (ROA) of a company performance will lead to a more effective company. Return on assets (ROA) is one of the profitability ratios. In the analysis of financial statements, this ratio is most often highlighted, because it is able to indicate company success to create profits. Return on assets is able to measure the company's ability to generate profits in the past to be then projected in the future. Assets in question are overall company properties, obtained from the capital itself or from foreign capital that has been converted into company assets used for corporate sustainability (Prananingrum et al., 2018).

Researchers found that Return on Assets as a profitability ratio has a positive and significant impact on stock return. Saragih (2018) states higher value of this ratio means the company is more

effective in utilizing the assets to generate net income. Thus, the higher ROA means the company performance more effective because the rate of return will be greater. This will further increase the company attractiveness to investors. Increased attractiveness of the company causes the company increasingly in demand by investors because it can provide great benefits (return) for investors. In other words, ROA will have an effect on stock returns that will be accepted by investors. Therefore, the higher the value of Return on Assets, the higher value of the stock return will be for a company (Balvers, Gu, Huang, 2015; Saryadi, 2017). Higher profitability means that the firm is more sensitive to the risk of current productivity shocks and therefore has a higher expected return (Berk, Green, Naik, 1999). Kogan and Papanikolaou (2013) observe a positive correlation between profitability and expected stock returns.

Hypothesis

H_1: Internal Corporate Governance indicator of Board Process (X1) has a positive and significant influence on stock return(Y).

H_2: Internal Corporate Governance indicator of Board Structure(X2) has a positive and significant influence on stock return(Y).

H_3: Internal Corporate Governance indicator of Board Characteristics(X3) have a positive and significant influence on stock return(Y).

H_4: Company Profitability measured by Return on Assets (ROA)(X4) has a positive and significant influence on stock return(Y).

H_5: Company Profitability measured by Return on Equity(ROE)(X5) has a positive and significant influence on stock return(Y).

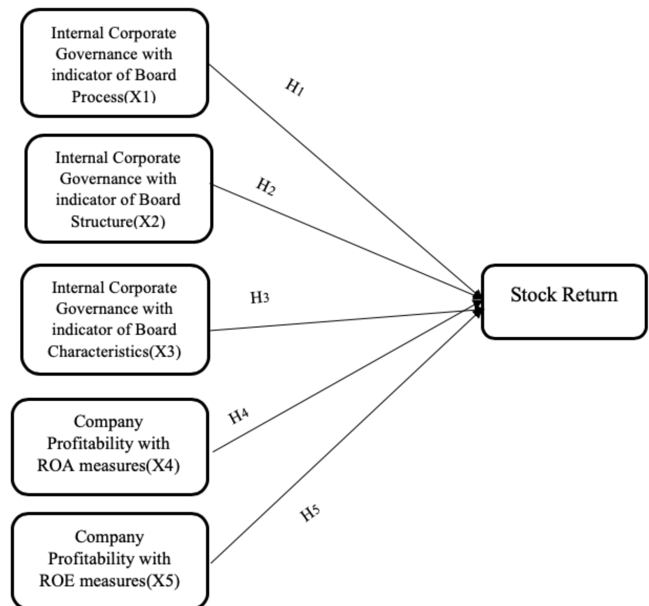

Figure 1: Research Model

RESEARCH METHOD

This research is an explanatory study with a quantitative approach. In this research, the independent variables are Internal Corporate Governance Indicator of Board Process (X_1), Internal Corporate Governance Indicator of Board Structure (X_2), Internal Corporate Governance Indicator of Board Characteristics (X_3), Company Profitability measured by ROA (X_4), and Company Profitability measured by ROE (X_5). The dependend variable is Stock Return (Y). The research population are all company listed in LQ-45 continuously during 2010-2015. Therefore, the number of populations in this study is 90 companies. This research used several criteria in determining population, namely:

1. Company listed in LQ-45 index in the Indonesian Stock Exchange during 2010-2015.
2. Company that included in LQ-45 index for 6 years in a row (2010-2015).
3. Company disclosed the annual report and financial report in currency Rupiah and the reports have been audited for the year ended 2010-2015.
4. Company is a non-banking industry.

Through the sample selection process which was using saturated sampling, this research derived 11 companies listed in LQ45 during 6 years (2010-2015) range, posted financial reports, and annual reports on company's official websites and are from non-banking industry.

Measures

1. **Internal Corporate Governance Mechanism**

The internal corporate governance mechanism was measured by three proxies. The three themes were built by referring to Wijayanti et. al. (2017) and each item refer to parts of items used in Wijayanti et. al. (2017).

Table 1. The Measure of Each Indicator of Internal Corporate Governance Mechanism

Indicator	*Measures*
Board Process	Total number of the attributes of Board Process
Board Structure	Total number of the attributes of Board Structure
Board Characteristics	Total number of the attributes of Board Characteristics

2. Company's Profitability

The company's profitability used in this research is ROA and ROE. The formula used to calculate is according to Brigham and Houston (2017).

$$ROA = \frac{\text{Earnings After Tax(EAT)}}{\text{Total Assets}} \times 100\%$$

$$ROE = \frac{\text{Earnings After Tax(EAT)}}{\text{Equity}} \times 100\%$$

RESEARCH RESULTS AND DISCUSSIONS

Table 2. Regressions Results

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-4.467	7.650		-.584	.561
	X1	-.317	.609	-.060	-.520	.605
	X2	.830	1.220	.086	.680	.499
	X3	.999	.311	.390	3.216	.002
	X4	.008	.137	.007	.058	.954
	X5	.330	.157	.299	2.103	.040

a. Dependent Variable: Y

Based on table, regression equation was obtained as follows:

$$\mathbf{Y = -4,467 - 0,317\, X_1 + 0.830\, X_2 + 0.999\, X_3 + 0.008\, X_4 + 0.330\, X_5}$$

The classical assumptions test was run through the data; the classical assumptions test consisted of a normality test, an autocorrelation test, a multicollinearity test, and a heteroscedasticity test. The results of the normality test where the test was carried out using the Kolmogorov-Smirnov method, with a significant value greater than 0.05, which means it has normal distribution.

Then, the second was autocorrelation test, the test carried out with Durbin-Watson test. It has a value of 1.890 which means there is no sign of autocorrelation. The third test was multicollinearity test, with a Tolerance value of each variable greater than 0.1 and a VIF value greater than 10. It can be concluded that there was no multicollinearity between the independent variables. The fourth test was the heteroscedasticity test using a Scatterplot diagram which resulted of no specific pattern, so there is no heteroscedasticity. So, it can be concluded that the remainder had a homogeneous variety (constant) or in other words, there were no symptoms of heteroscedasticity.

In hypothesis testing, Coefficient of Determinant(R^2), goodness of fit test (F-Test), and

Partial Test (T-Test) was used to examine the hypothesis. The research method used multiple linear regression analysis techniques with the findings in the regression equation table. In Coefficient of Determination test, the value of R^2 obtained was 0.343 which means 34.3% of the variation of stock return variable can be influenced by the variation of independent variable. In F-test, the value of F-count is 7.790 which means the regression analysis model is significant and can be well predicted. Partial Test (T-test) value showed that variables of X1 (Internal Corporate Governance Indicator of Board Process), X2 (Internal Corporate Governance Indicator of Board Structure), X4 (Company Profitability measured by ROA) and Y (Stock Return) shows that the influence is not significant. While the test results the influence independent variables of X3 (Internal Corporate Governance Indicator of Board Characteristics) and X5 (Company Profitability measured by ROE) on Y (Stock Return) is significant.

From the above equation can be interpreted that Internal Corporate Governance Indicator of Board Structure, Internal Corporate Governance Indicator of Board Characteristics, Company Profitability measured by ROA, and Company Profitability measured by ROE has a positive effect on the Stock Return (Y) of a company. Internal Corporate Governance Indicator of Board Process has an insignificant and negative impact on Stock Return (Y) value.

The Influence of Internal Corporate Governance with indicator of Board Process to Stock Return

Based on the hypothesis test results of Internal Corporate Governance using Board Process as an indicator (X1) to Stock Return (Y), it is found that the Internal Coporate Governance indicator of Board Process shows insignificant influence toward a stock return. The discovery is contrary with research results of Prasertsri and Sangboonnak (2016) showing that there is a positive relationship between board process as a dimension of corporate governance and stock return and Anusakumar et al. (2017) stated that information about the quality of Board Process should be interpreted as positive attributes to increase investor confidence and investor confidence positively influence stock return. The findings are in line with Wijayanti et al. (2017) who state board process is negatively related to investor confidence.

Most companies have considered Board Process as one important internal corporate governance factor for company success. Board meetings and audit committee meetings as dimensions of board process should have important information for investors so that it is important for companies to consider the frequency of board of commissioner's meeting and audit committee meetings. Based on BAPEPAM rule about the obligation for interim report quarterly, it is better for a company to have more than 12 board commissioners and audit committee internal meetings. Higher frequency of meetings will avoid mismanagement by the management of the company.

However, this study found an insignificant effect of board meetings on stock return. This finding showed that investors do not really consider information related to the frequency of board meetings. Other authors found that Board meetings are not always beneficial for shareholders. Vafeas (1999) argues that board meetings are usually conducted with limited time, so those board meetings are often considered not used for exchanging ideas that are meaningful for company development. Moreover, a company that undergone financial distress, troubles, and challenges would have a higher frequency of boards meetings and boards activity (Lasfer, 2007; Jay and Maclver, 1989). Therefore, the greater number of boards meetings may not be an effective way to detect effective meetings within the boards and audit committee.

In addition, the relationship of key management in a company should also be an important information for investors. This information should be one of the essential information for analyzing the quality of the board process in managing related parties in companies' operation. This study identifies whether the company disclosed information about related parties' transactions and the relationship between the related parties and the board of directors. The insignificant finding may be caused by most of the sample companies which did not disclose the information related to the relationship between the board of directors and related parties' transactions. This evident exists probably because investors did not really care for that information. According to Bistrova and Lace (2011), board commissioners performance evaluations are crucial in determining the riskiness of investments. Whereby in this study, the presence of boards commissioner performance evaluation is considered to have negative and insignificant relationships. It is probably because information of performance evaluation required by investors is not only information on performance

evaluation of the board commissioners; other performances evaluation is also required as considerations in an investment.

To summarize, Internal Corporate Governance indicator of Board Process has an insignificant effect to Stock Return value. Companies have to still consider Board Process to sustain the company's values and meet shareholder's interest and maximize shareholder's prosperity (Berle and Means, 1932).

The Influence of Board Structure to Stock Return

According to the hypothesis test results of Internal Corporate Governance using Board Structure as an indicator (X2) to Stock Return (Y), it is found that indicator of Board Structure has a positive and insignificant influence toward the stock return. The findings are in line with research results of Wijayanti et al. (2017) and Prasetsri & Sangboonnak (2016) which state that Board Structures is positively related to investor's confidence and investor confidence has a significant and positive influence to stock return (Anusakumar et al., 2017).

However, based on the research, not all companies pay attention to the effectiveness of its Board Structure. Some of the research sample does not publish information needed by investors. In order to have an effective Board Structure that must contain an independent audit committee with no family relationship or business relationship to the company (Anderson and Reeb, 2004). It is believed that an independent audit committee would have more integrity than those that are not independent. A firm must contain more than five board commissioners, and at least three (Lim R., 2011) and additional directorship of an independent board must present (Certo, Daily & Dalton, 2001; Zajac & Wectphal, 1996). According to BAPEPAM rule number IX.1.5 in letter number Kep-29/PM/2004, the ideal number of audit committee is three and a maximum number of seven people for a company and audit committee has to have financial education and expertise related to audit committee task. Effective board structure has to have an independent commissioner as the chairman of the audit committee and president commissioner, presence of nomination, remunerating and other committee, and a complete description on what committee has done. According to the regulation, the number of board commissioners has to be more than 30% of the total values of the board commissioner.

However, this study found that there is an insignificant effect of the independency audit committee on stock return. This study findings prove that investors do not really consider audit committee independence in determining their investments. Bronson et al. (2009) stated that the audit committee can be significantly influencing if members are proved to be completely independent and does not involved in any untrustworthy prejudice. This statement also supports that chairman of board commissioner and audit committee might be effective if proven to be totally independent. Size of board commissioners are agreed that it could help in providing unbiased views and strategy. However, a larger number of board commissioners could be ineffective in terms of decision making. Members of board commissioners who stay for a longer time in the company may build a good relationship with directors, which may impact the decision-making and independent judgement of board commissioners in terms of enhancing the firm performance (Amran, 2016). Dalton et al. (1999) stated that audit committee becomes ineffective when the size is too large or too small. Bigger size of audit committee members tends to lose focus and will be less participative compared to those of a smaller size. While having a small number of members might bring up a lack of diversity of skills and knowledge, and thus becomes ineffective. Right amount, equal skills, experience, and expertise would be the best interests for stakeholders (Balagobei and Velnampy, 2018).

Reputation is one important measure of someone's capability, but it does not mean someone with less attractive reputations is not capable for having good decision making; thus, reputations of independent board commissioners would not be an effective measure. The existence of a financial expertise of audit committee members is not really considered by investors, and in doing its task, it is obvious that members have to have financial knowledge and expertise. The presence of Nomination, Remuneration and other committees in the purpose of helping Board Commissioners carrying out duties does not really consider by investors as a measure. According to Borlea, Achim, and Mare (2017), the existence of Nomination Committees, Remunerations, and other committees focusing on most companies in the sample does not ensure the functioning and performance of such committees within the company.

The conclusion that can be derived is that Internal Corporate Governance indicator of Board Structure does have a positive effect on the Stock Return Value, but this effect is insignificant. Companies have to consider and improve Board

Structure score as internal corporate governance in order to fulfil investor's interest in receiving a profitable stock return (Carson, 2002; Bhana, 2010; Anusakumar, Ali, Wooi, 2017).

The Influence of Board Characteristics to Stock Return

Based on data analysis, it is found that Internal Corporate Governance indicator of Board Characteristics has a positive effect on Stock Return. The effect is discovered to be significant in influencing Stock Return values. This finding is supported by research results of Monks and Minnow (1995) who stated that indicator Board Characteristics has a positive effect on the Investor's confidence and in determining company's success. Anusakumar et al. (2017) stated that these will influence the Stock Return. Internal corporate governance indicator of Board Characteristics is proven to be significant and has a dominant effect on Stock Return from the value of T-test result of 3.216. Furthermore, research by Limpaphayom and Connelly (2006) supported that effective internal indicator of Board Characteristics plays an important role in overseeing management.

Based on collected data, companies are not aware of the importance of considering Board Characteristics yet. To have effective Board Characteristics, companies have to have more than 50% of the board of commissioners aged below 60 years (Darmadi, 2011; Morkc et al., 1989), top executives have to have either minor or no share ownership, and company must provide and reported detailed information of top executives' compensation.

To sum up, Internal Corporate Governance indicator of Board Characteristics have to be considered the most in order to increase the company's values and fulfil shareholder's interest towards the company. This study proves that effective Internal Corporate Governance indicator of Board Characteristics will lead to a higher efficiency of management and lead to higher profitability of the company.

The Influence of Return on Assets to Stock Return

The research findings have concluded that Company Profitability measured by Return on Assets has an insignificant relationship with the Stock Return. This result is supported by Budiharjo (2016) and Kristianto (2012) who stated that Company Profitability measured by Return on Assets (ROA) has a positive effect on stock return. However, unlike Budiharjo (2016) and Kristianto (2012), in this finding, the effect is considered insignificant.

It suggests that a high Return on Assets does not attract and considered by investors in a capital market. Atidhira and Yustina (2020) stated that a good profitability performance of the company can be really seen when the investor also considering other profitability ratios such as OPM, NPM, ROE, ROIC, and P/E ratio. So, ROA by itself alone could not be the only profitability ratios used by investors in determining investments and stock returns. Moreover, a bad economic condition also can lead to the decrease of stock return, even though the ROA is increasing.

Although Company Profitability measured by Return on Assets has an insignificant effect on Stock Return, companies still have to maintain good performance of Company Profitability measured by ROA in order to also gain Investor' trust and confidence. It is because the company is able to manage and produce profits out of assets owned by the company and have a better prospect of the future.

The Influence of Return on Equity to Stock Return

In this study, it is found that Company Profitability measured by Return on Equity has a positive and significant effect on Stock Return. This result is supported by Wulandari (2005), Permatasari (2014), and Taufik (2007) that Company Profitability measured by Return on Equity has a positive and significant effect on Stock Return. It proves that companies use their own capital effectively. The findings indicated that high or low Company Profitability measured by returns of equity would influence the stock return.

This is because Company Profitability measured by Return on Equity is a company's ability to generate net profit of the company through capital owned by the company. Management of the company might use capital effectively in net income that would affect rising stock returns. Ifrani (2014) states Return on Equity as the most crucial indicator of fundamental performance, because it describes the company's capability to distribute profits to shareholders. In addition, investors are willing to pay higher price for stocks with higher Return o Equity.

Company has to maintain a good percentage of Company Profitability measured by Return on Equity because ROE plays an important role in defining company's Stock Return values. Furthermore, Company Profitability measured by

ROE is also indicated as one factor that is used by the investor to determine their investment towards a company. Through this study, it is proven that higher Company Profitability measured by ROE will also lead to better values of Stock Return.

CONCLUSIONS AND SUGGESTIONS

Based on research that had been done, it can be concluded and derived that corporate governance internal mechanism does have influence on stock return of a company but the influence level varies. This variety depends on the indicator used to determine the corporate governance internal mechanism. Company's profitability also does influence company's stock return measured using return and assets and return on equity.

The corporate governance indicator of board process shows insignificant and negative influence on company's stock return. The possible reason for the negative relationship between board process and stock return are that higher frequency of meetings does not always represent the effectiveness of the decision made. According to Danoshana and Ravivathani (2013), board process represented by board meeting frequency increased management costs. While higher meeting frequency sometimes indicate the company is under distress. Another reason, information on performance evaluation of the board commissioners are not the only essentials performance evaluation to be disclosed.

Moreover, board structure and return on assets show positive and insignificant influence on stock return. The possible reason is that audit committee can be significantly influencing if members are proved to be completely independent and does not involved in any untrustworthy prejudice (Bronson et al., 2009). The number of board commissioners could also help in preparing unbiased views and strategy, however, there must be right amount of board commissioner not to large or small (Dalton et al., 1999). According to Balagobel and Velnampy(2018), the right number, equal skills, experience and expertise would be best interest to stakeholder. While return on assets represents that the ability of a company to generate profit from their assets does have an influence to the stock return. But the influence is not significant, it may because a good profitability performance of a company can be really seen the influence when other profitability ratios(OPM,NPM, ROIC and P/E ratio) are also considered in the study. Return on assets alone are not sufficient in determining investment. Moreover, bad economic conditions would lead to a decrease of stock return although return on assets are increasing.

Futhermore, board characteristics and return and equity show positive and significant influence to stock return. The reason might due to board of commissioners that are more than 50% and less than 100% aged above 60 are usually has age diversity which prevents biased leadership and decision-making styles of the boards towards a particular age segment of the market (Abdullah and Ismail, 2013). While company that disclosed executive ownership and most boards had minor ownership, tends to prevent any direct or indirect special control through voting rights towards the company and avoid potential conflict of interest in the future (Leipziger, 2017). Return on equity influence stock valuations, higher the return on equity, higher the intrinsic value of a company. Investors can use the model of return on assets to predicts about future and to identify riskiness of stocks because a stock that is growing slower than its sustainable rate could be undervalued or the market may be discounting risky signs from the company.

SUGGESTIONS

Based on the conclusions above, several suggestions can be put forward which can be useful for the company and other parties. Companies are advised to manage and control their internal corporate governance mechanism, especially Board Characteristics and Return on Equity values. In contrast, these variables are also having an important role in defining stock return values.

Considering that independent variables in this study are vital in influencing Stock Return, it is expected that the results of this study can be used as a reference for future researchers to develop this study by considering other variables, which outside the variables included in this study.

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