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# Profitability, Good Corporate Governance, Dividend Policy, and Firm Value at ISSI

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**Abstract**
This study aims to determine the relationship between profitability, good corporate governance, dividend policy, and firm value from 2016-2018 in manufacturing companies at ISSI. This study uses classical assumption tests and path analysis. The results show that the board of commissioners has a significant negative effect on profitability and has no impact on firm value. The audit committee and dividend policy do not affect profitability and firm value. Profitability has a significant positive effect on firm value. Profitability mediates the impact of the board of commissioners and dividend policy but does not mediate the audit committee on firm value. This finding shows a relationship between variables that impact firm value. The implication of this research is to suggest that investors need to look at the company's prospects by paying attention to the company's value and analyzing the company's performance by considering the influencing factors.

**Keywords:**
good corporate governance, dividend policy, firm value, profitability

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## INTRODUCTION

The primary purpose of a company is to earn a profit. A company with the ability to generate optimal profits will increase the value of a company (Brigham and Houston, 2009). An increase in the value of a company gives a positive response to investors to invest in the company. Its share price can show the rise and fall of its value. Companies with a high level of company value are considered to prosper shareholders. Therefore, the higher the share price, the more the firm value and the prosperity of shareholders (Rachman et al., 2015). The high share price will increase investors' confidence in its current performance and its prospects for the future. Fundamentally, the firm value will be influenced by the company's financial performance (profitability). Because of high profitability, the company is expected to pay dividends, which will increase the share price (Fajaria & Isnalita, 2018).

Meanwhile, the PT Saratoga Investama Sedaya Tbk (SRTG) case recorded a net loss of 6.2 trillion rupiahs in 2018, in contrast to 2017, which still managed to record a profit of Rp. 3.3 trillion. The company explained the losses suffered due to the decline in the share price of the subsidiary owned by the company. From these cases, it is clear that the decline in stock prices had significant consequences for investors, so it is essential to increase the company's value because an increase in the value of the company is considered to determine the welfare of its shareholders (Ararat et al., 2017). The importance of the company's worth for investors is necessary to analyze what factors affect the company, some of which are through Good Corporate Governance (GCG) dividend policy and profitability.

Implementing sound corporate governance in the company will provide direction for managers and employees to work better so that it is expected to improve the company's performance or profitability (Yameen et al., 2019). The implementation of GCG will also increase investor confidence so that investors will prefer that company shares. In addition to increasing productivity, it will also increase firm value (Ciftci et al., (2019). The effectiveness of good corporate governance in the long term can improve company performance, benefit stock performance, and increase company value. Corporate governance has received considerable attention due to a series of scandals and corporate failures that seemed to be attributed to the implementation of different accounting and disclosure practices (Gerged & Agwili, 2019). A conflict of interest arises between managers and shareholders in maximizing the company's value, known as the agency problem. Managers have goals that differ from the company's main objectives for all shareholders. This happens because managers prioritize personal interests (Irwanti & Ratnadi, 2021). On the other hand, shareholders feel aggrieved by the manager because the manager's behavior can increase costs in the form of agency costs for the company, which causes a decrease in company profits.

Financial statement fraud cases are a phenomenon that often occurs and is repeated, as in the case of PT. Garuda Indonesia. The financial audit agency said Garuda was suspected of fabricating financial statements, which showed the company was reporting profits. This finding makes the Financial Services Authority oblige the company to improve


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the report. After the repairs, the report indicates that Garuda recorded a loss of US$175 million, or equivalent to 2.45 trillion rupiahs. Whereas in the previous statement, the company claimed to have made a net profit of US$ 5 million or 699.9 billion rupiahs. One of the causes of weak governance practices in developing countries is auditors' soft supervision practice. This allows companies in Indonesia to realize the importance of internal audits, proven by forming audit committees and boards of commissioners in each company. Therefore corporate governance aims to create a control and balance system (checks and balances) to prevent misuse of company resources and encourage growth (Pibri, 2021).

A dividend policy is needed to reduce agency problems and costs by increasing the dividend payout ratio. Djabid (2009) states that dividend payments will give shareholders additional returns and capital gains. Dividends also provide shareholders with certainty and reduce the agency costs of equity. Management's actions on the company's cash flow decrease monitoring costs because shareholders believe management's policies will benefit them, increasing value (Kusumawati & Harijono, 2021). Investors often consider dividend policy as a sign of giving value to the company because it can affect the firm's value. Investors will prefer companies that can provide certainty of return on investment in the form of dividends. The higher the rewards distributed, the company is considered profitable and has good performance.

The effectiveness of good corporate governance and dividend policy to reduce agency problems and create firm value will positively impact profitability. Profitability is one information that can signal investors that the company has good financial performance (Ararat et al., 2017). Profitability shows the company's financial performance, which is used to indicate the company's good and evil. The amount of profitability demonstrates that the company's management is working effectively and efficiently (Tui et al., 2017). Many requests for company shares will trigger the share price in the capital market, thus affecting the company's value. This means that an increase in stock prices in the capital market will undoubtedly positively impact the increasing importance of the company (Fajaria & Isnalita, 2018). According to Rahmawati et al. (2021), this is in line with signal theory, an action taken by a company's management that gives investors instructions on how to view the company's prospects. In this case, the improvement of suitable corporate governance mechanisms and profitability is a positive signal for outside investors regarding the company's opportunities in the future. Therefore, this study uses the profitability variable, which is considered to mediate all variables in increasing firm value.

Pibri (2021) research provides empirical evidence that good corporate governance is projected by the board of directors, independent commissioners, and the audit committee, which positively affects company value. Pibri (2021) shows that several things that can cause corporate governance to affect company value, namely: (1) the high awareness of companies to implement GCG as a necessity, not just compliance with existing regulations, (2) company management is interested in the long-term benefits of implementing GCG, (3) the increase in share ownership by management and institutional investors has led to tremendous pressure on companies to implement GCG, (4) the existence of the board of commissioners and audit committees within the company can monitor the company in implementing GCG.

In addition, dividend policy shows that investors prefer companies that distribute dividends because of the apparent certainty of their investment returns (Kusumawati, & Harijono, 2021; Rahmawati et al., 2021). This means that the greater the dividend distributed by the company to shareholders, the company's performance is considered excellent and profitable. A similar study was also conducted by Anjani and Yadnya (2017) that implementing good and correct good corporate governance must choose the board of commissioners, board of directors, and audit committee more selectively because these positions greatly determine the success and improvement of company performance. Competent and professional independent commissioners will be able to properly monitor the board of directors' performance in implementing strategies and policies within the company so that their performance is always controlled and the company's performance will increase.

A competent board of directors in determining the company's strategy will significantly affect the company's progress. Then choose an audit committee that is truly independent and can carry out internal supervision of the company because the role of the audit committee is crucial to assist the board of commissioners in supervising the company's internals so that the work environment becomes more conducive and acts of fraud and manipulation can be minimized. Similar research on dividend policy by Kusumawati (2021). The results of this study are in line with the bird in the hand theory, where the high dividends distributed by the company will have an impact on the company's high value. In addition, investors also prefer companies that distribute dividends due to their investment. The higher the level of DPR, the higher the company's value. Profitability has affected the firm value because the substantial value has positive sentiment on the achievement of profit to justify the payment of dividends so that the stock price will increase. Further research was conducted by Sabrin et al. (2016), Irwanti and Ratnadi (2021), and Tui et al. (2017), research is also supported by research. After all, the company showed a positive signal to pay dividends.

The empirical literature reviewed above shows that firm value is influenced by various supporting factors and is used to increase the value of a company to attract investors. Previous studies have not extensively conducted research that focuses on the relationship between good corporate governance, dividend policy, and firm value mediated by profitability. Therefore, researchers are interested in working on the test because good corporate governance, dividend policy, and profitability can be essential elements in a company. Weak corporate governance and low dividend and profitability policies can affect company value and decrease stock prices. Second, researchers want to know whether good corporate governance, dividend policy, and profitability in manufacturing companies listed on ISSI influence firm value. Third, until the completion of this research, researchers have not found any study that specifically examines the effect of good corporate governance and dividend policy on firm value in manufacturing companies listed on ISSI.


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Fourth, the researchers have not found any research that explicitly examines profitability as mediating variable. This research is expected to contribute to the theoretical and practical dimensions. It is expected to be useful for companies, especially manufacturing companies listed on ISSI, as a consideration used by investors to prevent a decline in company value.

## METHODS

This research is quantitative research using secondary data obtained through www.idx.co.id. The population used in this study are all manufacturing companies indexed in the Indonesian Sharia Stock Index (ISSI) for the 2016 – 2018 period, namely 92 companies and 11 companies used by purposive sampling. The purposive sampling method takes samples taken by following the research objectives set.

The criteria for the companies that are sampled in this study are: First, Manufacturing companies listed on the Indonesian Sharia Stock Index (ISSI) for 2016 – 2018; Second, The company did not experience delisting (never leaving) from ISSI during the research period; Third, Manufacturing companies have published annual reports or financial statements that an independent auditor has audited during the research year; Fourth, Manufacturing companies listed on the Indonesian Sharia Stock Index (ISSI) for 2016 – 2018 and implementing a dividend policy.

There are three research variables used in this study: First, the independent variable is good corporate governance announced by the commissioners and audit committee. The dividend policy used is the dividend payout ratio. Second, the dependent variable in this study is the value of the company used price to book value. Third, the intervening variable profitability used return on assets. This research uses signal theory as the theoretical basis. Signal theory suggests how companies should signal users of financial statements. The principle of signal theory shows that every action contains information because the information is asymmetrical. In this case, the increase in dividends and the mechanism of good corporate governance is a positive signal for outside investors regarding the company's prospects in the future. Companies that have opportunities, in the end, mean that they have a high value. They always generate profits for investors and signal their company which is relatively not easy to go bankrupt.

The analysis technique in this study uses path analysis to test the intervening variables. This study uses analytical methods with the help of IBM SPSS version 22. Path analysis is used to assess variables (directly or indirectly) on the dependent (dependent) variable. (Ghozali, 2016) Path analysis is an extension of multiple regression analysis that can help see the magnitude of the coefficients directly and indirectly. In conducting data analysis, several forms of tests are used, namely the Classical Assumption Test in the form of normality test, linearity test, multicollinearity test, autocorrelation test, and heteroscedasticity test. The steps in path analysis can be done as follows:


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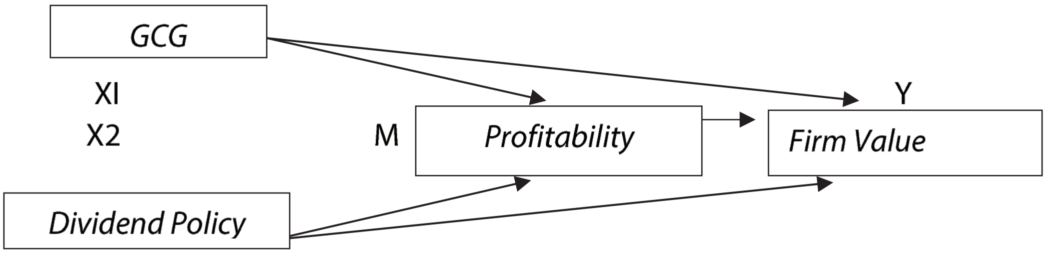
**Stage I.** Define a path diagram based on the variable relationship paradigm shows in Figure 1.

**Figure 1. Path Diagram**




**Stage II.** Determine the structural equation as follows:

M (Profitability) = (X1a) + (X1b) + (X2) + e (1)

Y (Company Value) = (X1a) + (X1b) + (X2) + (M) + e (2)

Where:

X1a: Board of Commissioners

X1b: Audit Committee

X2: Dividend Policy

E: Equation

M: Profitability

**Stage III.** Analysis for substructural one and substructural 2:

**Substructural analysis I**

M (Profitability) = (X1a) + (X1b) + (X2) + e

**Steps to calculate the regression equation.** Implementation of SPSS calculation results based on regression analysis values and determining structural equations based on predetermined path diagrams.

**Substructural analysis II**

Y (firm value) = (X1a) + (X1b) + (X2) + (M) + e

**Steps to calculate the regression equation.** The implementation of SPSS calculation is based on the value of regression analysis and determines the structural equation based on the specified path diagram.

## RESULTS AND DISCUSSION

This research uses secondary data obtained or collected through specific sources. The data in this study was obtained through manufacturing companies listed and published on the Indonesian Sharia Stock Index from 2016 to 2018. The descriptive statistical results in this study are shown in Table 1.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The board of commissioners, audit committee, dividend policy, and profitability are positive, while only the company's value is in an adverse order. It can be seen that the standard deviation for firm value is the highest among the five variables. If the standard deviation exceeds 0.05%, this indicates that the null hypothesis of the normal distribution for the series is rejected at this significance level. A maximum of 4.60% shows that most dividend policies are high, while the company value shows the lowest percentage of -4.61%.

**Table 1. Descriptive Statistics**

| | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| BC | 33 | 0.69 | 2.48 | 1.6866 | 0.40855 |
| Air conditioning | 33 | 1.10 | 1.39 | 1.1248 | 0.08399 |
| DP | 33 | 2.34 | 4.60 | 3.7395 | 0.61944 |
| FV | 33 | -4.61 | 4.41 | 0.7560 | 1.53533 |
| PROF | 33 | 1.03 | 3.84 | 2.1780 | 0.71402 |
| Valid N (listwise) | 33 | | | | |

Source: SPSS output, data processing.

The results of the Jarque Bera test in Table 2 show that the jarque bera value in model 1 is 7.92 and significant at 0.05. The jarque bera value in model 2 is 14.19 and effective at 0.05. The result of the two models shows that the linear regression model built in this study has normally distributed data.

**Table 2. Normality Test Results**

| | N | Skewness | | Kurtosis | | Count |
|---|---|---|---|---|---|---|
| | Statistics | Statistics | Std. Error | Statistics | Std. Error | Jarque Bera |
| Model 1 | 33 | 0.854 | 0.409 | 1.303 | 0.798 | 7.92 |
| Model 2 | 33 | -0.497 | 0.409 | -0.057 | 0.798 | 14.19 |
| Valid N (listwise) | 33 | | | | | |

Source: SPSS output, data processing.

Information:
Model 1: Effect of good corporate governance and dividend policy on profitability
Model 2: Effect of good corporate governance, dividend policy, and profitability on firm value

Table 3 shows that the independent variables used in models 1 and 2 have no symptoms of multicollinearity between the independent variables. This result shows from the VIF value <10 and tolerance value> 0.1, which means there are no symptoms of multicollinearity.

**Table 3. Multicollinearity Test Results**

| Variable | Model 1 | | Model 2 | |
|---|---|---|---|---|
| | TOLL | VIF | TOLL | VIF |
| BC | 0.544 | 1.840 | 0.465 | 2.151 |
| air conditioning | 0.657 | 1.522 | 0.630 | 1.587 |
| DP | 0.790 | 1.265 | 0.748 | 1.336 |
| PROF | - | - | 0.719 | 1.391 |

Source: SPSS output, data processing.

Table 4 shows that the significant value for all model variables is > 0.05. it can be concluded that all model variables are free from heteroscedasticity or do not experience symptoms of heteroscedasticity. Table 5 shows that in model 1, the board of commissioners shows t-statistic test results obtained t-count of -2.217 and a significance level of 0.035. It is concluded that the board of commissioners has a significant negative effect on profitability. The audit committee obtained a t-count of 1.117 and a significance level of 0.273. concluded that the audit committee does not affect profitability. Meanwhile, dividend policy received a t-count of 1.76 and a significance level of 0.261, which concluded that dividend policy does not affect profitability.

**Table 4. Heteroscedasticity Test Results**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Durbin-Watson |
|---|---|---|---|---|---|
| 1 | 0.530a | 0.281 | 0.207 | 0.63599 | 1.073 |
| 2 | 0.793a | 0.629 | 0.576 | 0.36048 | 1.638 |

Source: data processing.

In model 2, the board of commissioners obtains t-count is 0.058, and the significance level is 0.954, concluding that the board of commissioners does not affect firm value. In table 2, the audit committee obtained a t-count of 1.035 and a significance level of 0.310, concluding that the audit committee does not involve substantial value. In the dividend policy, the earnt-count is 0.100, and the significance level is 0.921, concluding that dividend policy does not affect firm value. Meanwhile, profitability obtained a t-count of 5.840 and a significance level of 0.000, which conclude that profitability has a positive and significant effect on firm value.

**Table 5. Hypothesis Test Results**

| Variable | Model 1 | | | Model 2 | | |
|---|---|---|---|---|---|---|
| | B | T | Sig | B | T | Sig |
| (Constant) | 0.525 | 0.291 | 0.773 | -1.758 | -1.720 | 0.097 |
| BC | -0.827 | -2.217 | 0.035 | 0.013 | 0.058 | 0.954 |
| air conditioning | 1.844 | 1.117 | 0.273 | 0.989 | 1.035 | 0.310 |
| DP | 0.261 | 1.276 | 0.212 | 0.012 | 0.100 | 0.921 |
| PROF | - | - | - | 0.615 | 5840 | 0.000 |

Source: data processing

Based on the research results, good corporate governance, which is proxied by the commissioners, has a significant negative effect on profitability. This means that the increase in the presence of the board of commissioners will increase the amount of expenditure to reduce returns. The board of commissioners is a party that is not allowed to have any relationship relating to the company's management. It shows that the implementation of the board of commissioners is not concerned in terms of assets management will be more efficient, so that management has not been able to produce


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high rates of return (Anjani and Yadnya, 2021). Therefore, the higher the number of the board of commissioners, the lower the rate of return returns. This is due to the high expenditure required to implement the board of commissioners. The results of this study are consistent with research conducted by Anjani and Yadnya (2021) and Sutrisno (2020).

Based on the research results, good corporate governance, which is proxied by the audit committee, does not affect profitability. This study indicates that increasing and decreasing the number of members on the audit committee does not guarantee that a company's performance will improve. Hence, investors consider the existence of an audit committee is not a factor that can be used as consideration in increasing the value of the company that can affect returns. There is no influence on the number of audit committees in a company because the audit committee's role is less than optimal in carrying out the supervisory and control functions in the company's management (Feviana and Supatmi, 2021). Therefore the audit committee in the company is still considered as compliance with regulations and formalities only so that its performance does not affect the level of profitability. The results of this study are consistent with research conducted by Rimardhani et al. (2016) and Ekasari and Noegroho (2020).

Based on the study results, dividend policy does not affect profitability. The results of this study do not support the signal theory, which explains that the increase in dividends above the expected amount is a signal for investors that company management is predicting good earnings in the future. This shows that changes in dividends do not convey information about future profitability and good company prospects. Companies with a high level of profitability will distribute dividends in low amounts, and conversely, if the company gets low profitability, the company will increase dividend payments. This is intended to maintain the company's reputation to remain reasonable in the eyes of investors. Therefore, dividend policy does not affect profitability and is not material for future consideration in predicting increased returns. The results of this study are consistent with the results of research conducted by Mudzakar (2019) and Tamrin et al. (2017).

Based on the research results, good corporate governance, which the commissioners proxied, does not affect firm value. The board members of commissioners must be professional, with integrity and the ability to carry out their functions properly, including ensuring that they pay attention to all the interests of other position holders. The company's board of commissioners meets the needs without optimizing the role of the board of commissioners as supervisor of management performance in managing the company. Therefore, the existence of the board of commissioners does not affect increasing the company's value. The results of this study are consistent with the research results conducted by Susanti and Nidar (2016).

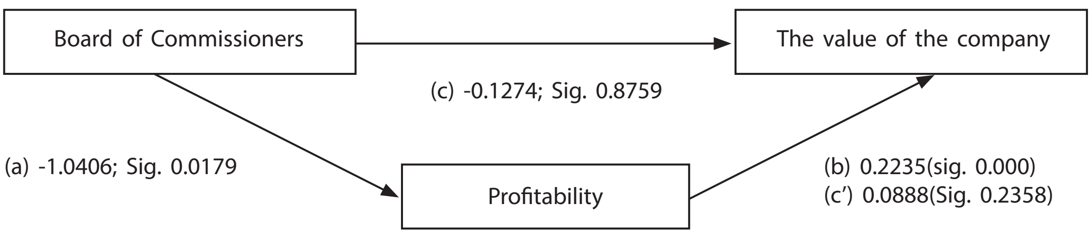
Based on the research results, good corporate governance, which is proxied by the audit committee, does not affect firm value. These results indicate that the existence of the audit committee cannot influence the effectiveness of the company's performance. This statement is caused because the company's appointment of the audit committee is only made for compliance with regulations or formalities (Feviana and Supatmi, 2021).

This is Contrary to the functioning of the audit committee effectively and efficiently, the control of the company will be much better (Anjani and Yadnya, 2017). So investors consider the existence of an audit committee is not a factor that can be used as a material consideration in increasing the company's value. Therefore, the presence of an audit committee does not affect expanding the company's value. The results of this study are in line with the results of research conducted by Ramadan and Raharja (2014).

Based on the study results, dividend policy does not affect company value. This study indicates that the high and low amount of dividends cannot tell the future investment opportunities for companies. The high ratio of dividend payments makes the company's internal funds inadequate for investment, leading to increased profits obtained in the future, thus making the company unable to conduct investment activities. This has led to uncertainty about future investment returns that can cause investors to choose to release their shares to affect the company's value adversely. The results of this study do not support the signal theory that explains that an increase in dividends will attract investors to invest in increasing share prices, affecting the company's value. Therefore, dividend policy does not affect expanding the value of the company. The results of this study are consistent with the research results conducted by Desy (2017).

Based on the study results, profitability has a significant positive effect on firm value. The results of this study state that an increase in profitability shows a better prospect of the company, which will be considered a positive signal by investors (Fajaria & Isnalita, 2018). This means that when profitability has increased, the company value will automatically increase (Tui et al., 2017). So a company must be in a favorable condition because without profit, it will be difficult for companies to attract investors to invest their funds in company shares. Therefore, efforts to increase profitability are essential for the survival and future of the company because it has a positive effect on the company's value. The results of this study are consistent with the results of research conducted by Kumalasari and Pratikto (2018) and Irwanti and Ratnadi (2021).

**Figure 2. The board of commissioners on the value of the company through profitability**



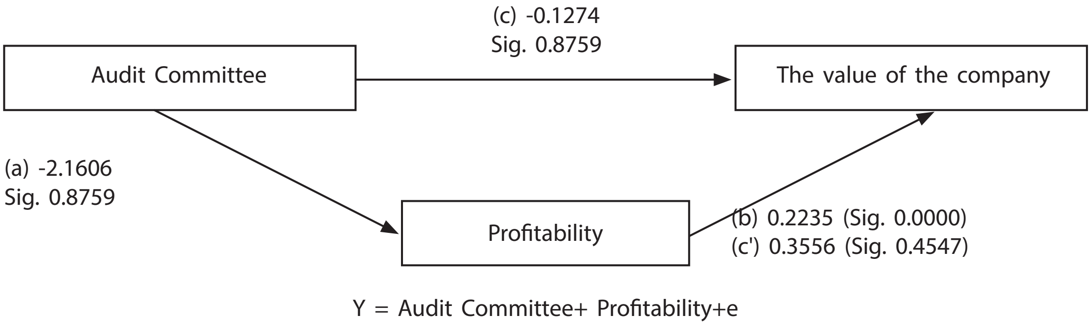

Y = Board of Commissioners+ Profitability+e

The analysis results found evidence that profitability is significant to firm value. The significance value is 0.0000 < = 0.05 and the regression coefficient (b) = 0.2351. Then it is found that the direct effect of c' is 0.0888, which is greater than c =

-0.1559. The effect of the board of commissioners on firm value is 0.2015 that larger than 0.05 after being mediated by profitability (see Figure 2). It can be said that this model is a complete mediation, which means that the board of commissioners is fully engaged in the value of the company, which is mediated by profitability. Chabachib et al. (2019) explained that the board of commissioners is the core of good corporate governance which is tasked with ensuring company strategy and supervising managers in managing the company so that the board of commissioners has a powerful influence on firm value.

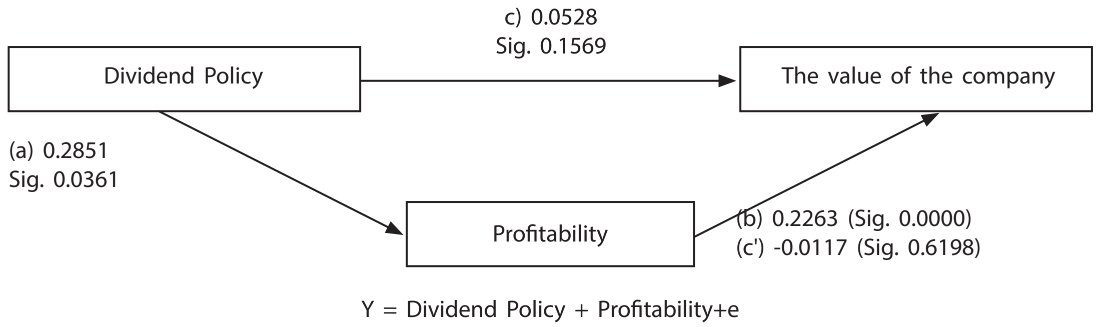
The results of the analysis found evidence that profitability was significant to firm value with a significance value of 0.000 ≤ 0.05 and a regression coefficient (b) = 0.2235. Then it is proved that the direct effect of c' is 0.3556, which is greater than c = -0.1274. The impact of the audit committee on firm value with a significance of 0.8759 ≥ 0.05 after being mediated by profitability (See Figure 3). It can be said that this model is Unmediated, which means that the audit committee does not affect firm value judged by profitability. The effectiveness audit committee does not increase the investor's response to earnings reported by the company (Hermawan, 2011; Feviana & Supatmi, 2021).

**Figure 3. The audit committee on the value of the company through profitability**




The analysis results found evidence that profitability is significant to firm value. The significance value is 0.0000 ≤ 0.05 and the regression coefficient (b) = 0.2263. Then it was found that the direct effect of c' was -0.0117, which was greater than c = 0.0528. The effect of dividend policy on firm value with a significance of 0.1569 ≥ 0.05 after being mediated by profitability (See Figure 4). It can be said that this model is a complete mediation, which means that dividend policy has a full effect on firm value after being mediated by profitability. Companies that have a high level of profitability show that management of companies is managing resources companies can achieve high incomes. High profits will also distribute a high dividend, and it will attract investors and increase demand for stocks. This will lead to the better value of the company (Fajaria & Isnalita, 2018). This result follows the signaling theory, which states that a company with a high DPR level will signal investors and gain high trust from investors (Kusumawati and Harijono, 2021).

**Figure 4. Dividend Policy on firm value through profitability**




## CONCLUSION

This study examines the effect of good corporate governance and dividend policy on firm value with profitability as an intervening variable. This study indicates that good corporate governance as proxied by the board of commissioners and the audit committee has a significant negative effect and has no impact on profitability. This result shows that the increase in the number of the board of commissioners will increase the amount of expenditure to reduce returns. The conclusion also means the addition and reduction of the number of audit committee members are not considered to increase returns. Meanwhile, dividend policy also does not affect profitability.

Furthermore, the study results also show that the board of commissioners, audit committee and dividend policy do not affect firm value. So, the board of commissioners, audit committee, and dividend policy are not the determining factors to increase substantial value. This condition is inversely proportional, and profitability positively influences the company. The results of this study state that an increase in profitability indicates a good prospect for the company, which is considered a positive signal by investors. This result means that when profitability increases, the company value automatically increases.

After mediating all variables, it shows that profitability as a mediating variable can fully moderate the board of commissioners and dividend policy. This role can be used as a reference for investors in investing in a company. However, profitability cannot mediate the audit committee's role on firm value, which indicates that the audit committee's role is not a determining factor in increasing the value of a company. The implication of this research for the investors is to pay more attention to fundamental factors that affect the company's value before investing. As for the capital market, the supervisory agency issues related rules to increase company value.

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