The Mediating Role Of Capital Structure In Corporate Governance On Firm Performance Of Family Companies

Iskandar Itan[1*], Vinnie Chelencia[2]
[1,2]Fakultas Bisnis dan Manajemen, Universitas Internasional Batam
email: [1]iskandar@uib.ac.id
[2]vinniechelencia13@gmail.com

Abstract

This study looks into the relationship of the performance of family businesses in Indonesia and its corporate governance. It also investigates the mediation effect of capital structure on this relationship. Board size, independent commissioner, female director, ownership concentration, managerial ownership, audit committee meetings are used as indicators of GCG measurement. Capital structure is measured by leverage. ROA and Tobin's Q are used as indicators of measurement of firm performance. The panel data approach will be employed, using a sample of 117 companies registered on the Indonesia Stock Exchange between 2016-2020. The result of the study revealed the significant effect of board size, managerial ownership, and ownership concentration on the performance of the family businesses analysed, as measured by ROA. However, the result of the analysis using Tobin's Q measure shows an insignificant effect. Furthermore, this study found capital structure to have a mediation effect on GCG and performance of a family business, through ownership concentration and managerial ownership.

Keywords: *capital structure, firm performance, GCG.*

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INTRODUCTION

Good Corporate Governance (GCG) and capital structure are essential aspects used to maximize shareholders' wealth. GCG is an indication that investors will get a return on capital with an optimal rate of return on investment. An optimal capital structure will minimize the risk and possibility of firm bankruptcy. The fundamental goal of corporate governance is to optimize profits of shareholders and owners of the firm, where shareholder profits are defined as the market price of the common shares outstanding. Companies can achieve the goal by balancing financial decision making with respect to optimal capital structure and financial decisions to help minimize capital costs. Furthermore, capital structure also includes debt and preferred stock and equity (Ahmed, Talreja, & Kashif, 2019).

Poor corporate governance as well as inefficient capital structure utilization may result in decreased firm performance. BBC News Indonesia (2019) reported that the Minister of State-Owned Enterprises Erick Tohir dismissed four directors of PT Garuda Indonesia in November 2019. The four directors were dismissed for allegedly being involved in luxury goods smuggling cases and customs violations. As a result of this case, PT Garuda Indonesia was fined by the Ministry of Transportation for not recording the cargo that entered the plane's flight.

According to Taouab & Issor (2019), performance refers to certain

results obtained in economics, marketing, and management that give the firm the characteristics of efficiency, effectiveness and competitiveness and its structural and procedural components. Firm performance focuses on a firm's ability to efficiently maximize available resources to achieve consistent goals. Performance needs to be measured in order to learn and identify management strategies, predict future internal and external situations, monitor circumstances and actions relative to firm goals, and make decisions within the required period. The most important function of measuring firm performance is evaluating the achievement of the firm's strategy.

A family business generally starts as a small and local operation. Then, usually due to the leadership and vision of the founders, it could develop into a large multinational company, and becomes competitive with global public companies. Such transformation usually take several generations. During this time, the focus of the company moves from short-term business survival into long-term goals of diversification, professionalisation and internationalisation. The evolution usually goes hand in hand with profound shifts in the company's strategy and corporate governance.

Zeitun (2014) conducted a study regarding GCG and ownership structure on firm performance in Qatar, Kuwait, Arab Saudi, Bahrain, and Oman. Ownership structure, growth, size of the company, as well as age of the company were shown to have a positive effect on ROA, and leverage did not have a mediating role. Okiro & Aduda (2015) conducted a study using a similar model on companies listed on the East African Stock Exchange Community. It was found that GCG has a positive, significant effect firm performance, while capital structure has no significant mediating role. Ahmed et al. (2019) conducted a study on the effect of GCG on the performance of companies in the automobile and fertilizer sector in Pakistan. Board size, current ratio, and non-current debt ratio have a positive effect on ROA. PeiZhi & Ramzan (2020) also conducted a study on how capital structure and GCG affects the performance of a company. In their study, GCG and capital structure were found to positively affect firm performance. In Indonesia, Chabachib et al. (2020) conducted a study on how GCG affects the performance of a company through its capital structure in 2018. The results show that only institutional ownership affects the firm's performance significantly and negatively and the debt-to-equity ratio also mediates GCG's effect on financial performance.

Issues pertaining to GCG and capital structure remain a challenge for companies. In Indonesia, there are still many cases of poor GCG and inefficient use of capital structure. The impact of these cases is very detrimental to firm's stakeholders. The scarcity of studies on the role of both capital structure and GCG on the performance of Indonesian companies, coupled with variable results from previous studies emphasize the importance of this study, particularly to determine the mediating role of capital structure in the relationship of GCG and performance of a company. A deeper investigation of the mediating effect of capital structure will add to the understanding of the occurrence of differences in firm performance.

Board size refers to the board of directors of a firm as a whole. Chabachib et al. (2020) found a positive, significant

effect of board size on firm performance. More members of the board mean that the firm have more resources to improve firm performance. In line with the results, Adekunle & Aghedo (2014), Ahmed et al. (2019), Detthamrong et al. (2017), Hamdan (2015), and Warrad & Khaddam (2020) also found a positive and significant effect. Therefore, the first hypothesis of this study is as follows:

H_1: Firm performance is significantly and positively affected by board size

An independent commissioner is a neutral person who has no affiliation with the board of directors, board of commissioners and shareholders Perdana & Raharja (2014). Chabachib et al. (2020) found a significant and positive effect of independent commissioners on firm performance. The higher the number of independent members on the board of commissioners, the better the oversight of management policies to improve firm performance. Nugroho & Agustia (2017) and Tulung & Ramdani (2018) found a significant and positive effect. Therefore, the second hypothesis of this study is as follows:

H_2: Firm performance is significantly and positively affected by independent commissioners

Female directorship reflect the diverse characteristics of the board. Detthamrong et al. (2017) found a significant and positive effect of female directorship on firm performance. The number of female directorship can offer different perspectives on firm management so as to improve firm performance. In line with the results, Habib (2016) and PeiZhi & Ramzan (2020) also found a similar result. Therefore, the third hypothesis of this study is as follows:

H_3: Firm performance is significantly and positively affected by female directorship

Ownership concentration is an internal technique by which shareholders can control and influence the firm's management to maintain certain interests. Detthamrong et al. (2017) found ownership concentration to have a significant, positive effect on firm performance. High ownership concentration tends to result in better oversight of management to maximize firm performance. Agency problems between owner and manager can be avoided by concentration of ownership. Al-Matari & Al-Arussi (2016), Okiro & Aduda (2015) and (Itan & Junnestine, 2021) found a significant and positive effect. Therefore, the fourth hypothesis of this study is as follows:

H_4: Firm performance is significantly and positively affected by ownership concentration

Managerial ownership refers to shares owned by directors and commissioners of the firm. Chabachib et al. (2020) found a significant, positive effect of managerial ownership on firm performance. Managers would feel a sense of ownership of the firm and will align their interests with the firm's principal goals so as to improve firm performance. Therefore, the fifth hypothesis of this study is as follows:

H_5: Firm performance is significantly and positively affected by managerial ownership

An audit committee is a committee within the firm that is responsible for

overseeing the performance of external and internal auditors with regular supervision of the financial reporting process. Yameen et al. (2019) found audit committee meetings to significantly and positively affect firm performance. Frequent audit committee meetings tend to minimize problems in recording financial statements because should problems arise, further action on the matter will be decided by the audit committee in the meeting. Therefore, the sixth hypothesis of this study is as follows:

H_6: Firm performance is significantly and positively affected by audit committee meetings

Capital structure leads to firm's strategies in operationalizing its assets through equity and debt. Bashir et al. (2020) conducted a study using capital structure as the mediating variable and demonstrated a positive effect. Companies with high leverage invest in better projects thereby improving their performance. High leverage decreases the agency costs of external equity, improving the performance of the firm by motivating the managers to take debt-taking decisions in the interests of shareholders. Therefore, the seventh hypothesis of this study is as follows:

H_7: Capital structure mediates the effect of GCG on firm performance

Based on the hypotheses above, the study's conceptual framework is formulated as follows:

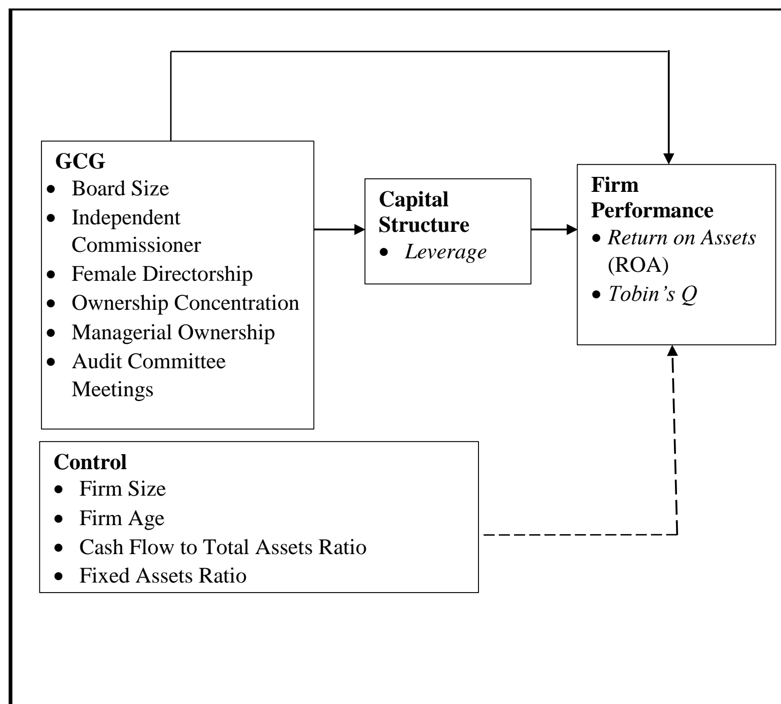

Figure 1
Conceptual Framework

RESEARCH METHODS

This study is conducted with quantitative method and was developed using hypothesis testing to determine the relationship between independent variables and dependent variables. The variables tested were measured using numbers and there was the involvement of statistical measures in testing these numbers. Based on the characteristics of the problem, this study was a comparative causal study, where there were causal relations between variables. This study examined the effect of board size, independent commissioners, female directorship, ownership concentration, managerial ownership, audit reputation, audit committee size, and capital structure on ROA and Tobin's Q in 117 family companies that met the criteria listed on the IDX from 2016 to 2020. Secondary data was used in this study which was sourced from other parties through an existing media intermediary, not directly from the source.

Table 1
Measurement of Variables

Acronym	Variable	Measurement
Dependent (Firm Performance):		
ROA	Return on Assets	Earnings before interest and tax divided by book value of total assets
Q	Tobin’s Q	Market value of ordinary shares divided by book value of total assets.
Independent (Corporate Governance):		
BD_SIZE	Board Size	Total number of directors sitting on board
COMM_IND	Independent Commissioner	Percentage of independent commissioners divided by total commissioners
BD_WOMEN	Female Directorship	Percentage of female directors divided by total directors
OWN_TOP3	Ownership Concentration	Percentage of top three shareholders
MAN_OWN	Managerial Ownership	Percentage of shares owned by directors and commissioners divided by total number of shares issued
AUD_MEET	Audit Committee Meetings	Total meetings held by audit committee in one year
Mediating (Capital Structure):		

LEV	Leverage	Total debt divided by total assets
Control:		
LNTA	Firm Size	The natural logarithm of total assets.
LNFAGE	Firm Age	The natural logarithm of the number of years since the firm was listed.
NCFOTA	Cash Flow to Total Assets Ratio	The ratio of net cash flow from operating to total assets.
PPETA	Fixed Asset Ratio	The ratio of net property, plant, and equipment to total assets.

In line with the study by De Massis et al. (2013), this study defined a cut-off point of 25% share ownership of a family and at least 2 (two) people occupying positions in the company in order to be qualified as a family company. A panel regression analysis method was used to analyze the data. This method was used to determine whether there was a relation between variables based on longitudinal (merging of cross sectional and time series data). For the purposes data analysis, this paper will make use of Eviews to do panel regression.

DISCUSSION

Table 2
Statistic Descriptive

Variable	N	Min	Max	Mean	Std. Deviation
ROA	526	-1.08	0.47	0.03	0.09
Q	526	0.01	5.37	0.70	0.68
BD_SIZE	526	2.00	12.00	4.81	1.88
COMM_IND	526	0.00	1.00	0.40	0.12
BD_WOMEN	526	0.00	0.66	0.14	0.17
OWN_TOP3	526	35.54	97.69	68.19	15.41
MAN_OWN	526	0.00	76.93	10.56	18.64
AUD_MEET	526	0.00	52.00	6.26	4.90
LEV	526	0.01	1.91	0.48	0.23
Asset*	526	46.760	163.136.516	13.123.257	22.187.000
LNFAGE	526	0.00	31.00	16.29	9.03
NCFOTA	526	-0.25	0.48	0.06	0.08
PPETA	526	0.00	0.92	0.34	0.24

* = in million
Source: Data Author, 2021

According to Forbes Advisor (2021), a good average ROA is 5%, thus, it can be concluded that companies listed on the IDX have not achieved a good ROA target. The Tobin's Q showed an average of 0.700, indicating that on average the companies have a market value of 70% of the total assets owned. An average of 4.811 was found on the board size indicating that on average the companies have at least 4 directors. Independent commissioners showed an average of 0.403 which indicates that 40.30% of the board of commissioners are independent. According to the Regulation of Financial Services Authority Number 33/POJK.04/2014, companies are required to have independent commissioners of 30% of the total commissioners, thus, it can be concluded that the majority of the companies on the IDX have complied with the applicable policy. Female directorship showed an average of 0.141, indicating that female directorship in the companies make up 14.10% of the total number of directors. This shows that female director composition is relatively low in the IDX companies. Ownership concentration showed an average of 68.196, indicating
that that on average the three largest shareholders of companies on the IDX own 68.20% of the company's shares. Managerial ownership showed an average of 10.563, indicating that the average company management owns 10.56% of the company's shares. Audit committee meetings showed an average of 6.263, indicating that audit committees conduct at least 6 meetings in a year. Leverage showed an average of 0.489, indicating that on average the companies have a debt proportion of 48.90% of the total assets.

Baron & Kenny (1986) presented the following three steps regression for testing the mediation. The first step is to regress the mediator on the independent variable (Step 1). This is to verify the independent variable as a significant predictor of the mediator. Then, regress the dependent variable on the independent variable (Step 2). This will be to verify the independent variable as a significant predictor of the dependent variable. Lastly, regress the dependent variable on the mediator as well as the independent variable (Step 3). This verifies the mediator as a significant predictor of the dependent variable, whilst controlling for the independent variable.

Table 3
Regression Result - ROA

Variable	Coeffici	Prob.
Step 1 (GCG » ROA)		
C	-2.19	0.00
BD_SIZE	0.01	0.02
COMM_IND	0.01	0.78
BD_WOMEN	-0.00	0.84
OWN_TOP3	0.00	0.00
MAN_OWN	-0.00	0.00
AUD_MEET	0.00	0.89
LEV	0.07	0.00
LNTA	-0.07	0.00
LNFAGE	0.31	0.00
NCFOTA	0.13	0.00
R-squared	0.68	
Adjusted R-squared	0.59	
Step 2 (GCG » LEV)		
C	2.57	0.00
BD_SIZE	-0.01	0.05
COMM_IND	0.01	0.77

BD_WOMEN	-0.05	0.25
OWN_TOP3	-0.00	0.00
MAN_OWN	0.00	0.00
AUD_MEET	0.00	0.32
LNTA	0.09	0.00
LNFAGE	-0.13	0.07
NCFOTA	-0.05	0.45
R-squared	0.90	
Adjusted R-squared	0.86	
Step 3 (GCG » LEV »ROA)		
C	-1.49	0.00
BD_SIZE	0.00	0.12
COMM_IND	0.01	0.67
BD_WOMEN	-0.02	0.49
OWN_TOP3	0.00	0.00
MAN_OWN	-0.00	0.05
AUD_MEET	0.00	0.58
LEV	-0.27	0.00
LNTA	0.05	0.00
LNFAGE	0.05	0.00
NCFOTA	0.28	0.00
PPETA	0.12	0.01
R-squared	0.90	
Adjusted R-squared	0.86	

Source: Data Author, 2021

In the first step, board size showed a positive significant effect on ROA, so hypothesis 1 is supported. A large number of directors can improve company performance. According to Yameen et al. (2019), the bigger the size of the board, the more accurate the decision will be because the more experienced and knowledgeable people can improve the company's performance. This result support the findings of Adekunle & Aghedo (2014), Ahmed et al. (2019), Detthamrong et al. (2017), Hamdan (2015), and Warrad & Khaddam (2020). Independent commissioners showed a positive effect on ROA, meaning that a large number of directors may improve company performance but not significantly. According to Chabachib et al. (2020), a high composition of independent commissioners, as objective parties, will improve the company's performance because it increases the supervisory role in managing the company and reduces the possibility of conflicts of interest arising. The existence of an independent commissioner as an independent and objective party balances interests between stakeholders such as managers, creditors, debtors, or other parties concerned in the interests of the company (Nugroho & Agustia (2017). The result support the findings of Nugroho & Agustia (2017), Putra (2016), and Tulung & Ramdani (2018). Female directorship showed a negative effect on ROA, so hypothesis 3 is not supported. The greater the composition of female directorship, the company's performance will decrease. According to Damardi (2011), gender diversity can increase the likelihood of conflict, lengthy decision-making processes, and differing views on how to respond to risk, ultimately resulting in lower company performance. This result support the findings of Damardi (2011). Ownership concentration showed a positive effect on ROA. Company performance will improve in line with the increasing share proportion of the three major shareholders. According to Detthamrong et al. (2017), high concentration of ownership will put pressure on company management so that company performance increases. This result support the findings of Al-Matari & Al-Arussi (2016) and Okiro & Aduda (2015). Managerial ownership showed a negative effect on ROA, so hypothesis 5 is not supported. Company performance will decrease along with the

increase in the proportion of shares owned by directors and commissioners. According to Al-Matari & Al-Arussi (2016), dominant managerial ownership will reduce external involvement in providing different resources and experiences to maximize company performance. This result support the findings of Al-Matari & Al-Arussi (2016) and Saepudin & Yunita (2019). Audit committee meetings showed a positive effect on ROA. The more frequent meetings are held by the audit committee, the higher the company's performance. According to Darko et al. (2016), the audit committee does not carry out its supervisory role effectively if the audit committee is not active. Therefore, this result support the findings of Tertius & Christiawan (2015).

In the second step, ownership concentration showed significant negative effect on leverage. The company's leverage will decrease along with the increase in the proportion of shares of the three major shareholders. The higher the leverage level, the higher the risk level. Major shareholders tend to avoid high levels of risk that can jeopardize the survival of the company. Meanwhile, with a low level of leverage, the company will be limited by the resources that can be utilized to improve the company's performance. Managerial ownership showed a significant positive effect on leverage. The level of leverage will be higher in line with the increase in the proportion of shares of directors and commissioners. Directors and commissioners who own shares in the company will try to improve the company's performance through increasing leverage to open access to resources that can maximize profits for the company so that directors and commissioners can also benefit as shareholders. The ownership concentration and managerial ownership variables have met the second requirement of the mediation test. Meanwhile, the board size variable was eliminated since it does not affect leverage significantly.

In the third step, ownership concentration showed a coefficient of 0.002, indicating a positive relation, and a significance value of 0.000, indicating a significant effect. The coefficient of the ownership concentration variable saw a decrease of 0.001 from 0.003 to 0.002. The results suggest a partial mediation of ownership concentration on company performance. When company's leverage level can be controlled with the possibility of high profits, the major shareholders may lower their concern for the company's survival risk. Managerial ownership showed a coefficient of -0.002, indicating a negative relation, and a significance value of 0.052, indicating an insignificant effect. These results suggest a full mediating effect, where when leverage is controlled, managerial ownership no longer significantly affects company performance. When the company has leverage that can provide the company access to resources that can improve the company's performance, the directors and commissioners who own shares in the company are less likely to create conflicts of interest that can affect the company's performance. These results support the proof of hypothesis 6.

Table 4
Regression Result - Tobin's Q

Variable	Coefficient	Prob.
C	8.44	0.00
BD_SIZE	-0.01	0.47
COMM_IND	-0.10	0.66
BD_WOMEN	-0.09	0.60

OWN_TOP3	0.00	0.26
MAN_OWN	0.00	0.48
AUD_MEET	-0.00	0.93
LEV	-0.25	0.00
LNTA	-0.07	0.27
LNFAGE	0.61	0.02
NCFOTA	-0.57	0.03
R-squared	0.84	
Adjusted R-squared	0.79	

Source: Data Author, 2021

Board size showed a negative effect on Tobin's Q, so hypothesis 1 is not supported. According to Mohamed et al. (2013), large board sizes are less efficient due to slow decision-making and difficulty arranging board meetings. This result support the findings of Darko et al. (2016). Independent commissioner showed a negative effect on Tobin's Q, so hypothesis 2 is not supported. The greater the composition of independent performance will decrease. However, the addition or reduction of the number of independent commissioners does not significantly affect the company's performance. This result support the findings of Lukas & Basuki (2015). Female directorship showed a negative effect on Tobin's Q, so hypothesis 3 is not supported. Gender diversity can increase the likelihood of conflict, lengthy decision-making processes, and differing views on how to respond to risk, ultimately resulting in lower company performance (Damardi, 2011). This result support the findings of Darko et al. (2016). Ownership concentration showed a positive effect on Tobin's Q. High concentration of ownership will put pressure on company management so that company performance increases (Detthamrong et al., 2017). This result support the findings of Mohamed et al. (2013). Managerial ownership showed a positive effect on Tobin's Q. Managers would feel a sense of ownership of the firm and will align their interests with the firm's principal goals so as to improve firm performance (Chabachib et al., 2020). Audit committee meetings showed a negative effect on Tobin's Q, so hypothesis 6 is not supported. The frequency of audit committee meetings does not significantly affect the company's performance. This result support the findings of Darko et al. (2016).

There are no GCG variables that have a significant effect on the company performance as measured with Tobin's Q, thereby not meeting the criteria established by Baron & Kenny (1986) for testing the mediating role of leverage.

CONCLUSION

Leverage is found to mediate ROA through ownership concentration partially and managerial ownership fully. When company's leverage level can be controlled with the possibility of high profits, the major shareholders may lower their concern for the company's survival risk. When leverage is controlled, managerial ownership no longer significantly affects company performance. When the company has leverage that can provide the company access to resources that can improve the company's performance, the directors and commissioners who own shares in the company are less likely to create conflicts of interest that can affect the company's performance.

Family companies should implement effective corporate governance and there is a need also to appoint independent commissioners that are really independent with experience and skills in specific areas in order for the companies to perform better.

Some limitations of this study are the sample in this study only comprises companies categorized as family companies and only uses data with a period of 5 years. Therefore, for future research, it is recommended to expand the sample scale beyond 5 years, expand the scope of the sample, develop a research topic by broaden the research object.

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