

The Effect of Good Corporate Governance Mechanism, Leverage, and Firm Size on Firm Value

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Abstract; The objectives of this research are to examine (1) the effect of the good corporate governance mechanism (audit committee, size of the commissioner's board, and proportion of independent commissioner's board) on firm value, (2) The effect of the leverage on firm value, (3) The effect of the firm size on firm value, and (4) The effect of good corporate governance mechanism (audit committee, size of the commissioner's board, and proportion of independent commissioner's board), leverage, and firm size on firm value. The population in this research is the entire manufacture firm which listed in IDX 2007-2011. Sampling technique used in this research is judgment sampling, with the sum of the sample 28 firm for 5 years (2007-2011). Double linier regression is used as data analysis technique, both t test and F test. The results of this research are (1) Good corporate governance's mechanism, which including the size of commissioner's board affect on the firm value, meanwhile audit committee and the proportion of independent commissioner's board doesn't affect on the firm value; (2) Leverage doesn't affect on the firm value; (3) The firm size affects on the firm value; and (4) good corporate governance mechanisms (audit committee, size of the commissioner's board, and proportion of independent commissioner's board), leverage, and firm size affect on the firm value.

Key words: *Firm size, Firm value, Good corporate governance mechanism, Leverage*

I. INTRODUCTION

The increase of the company's high value is a long-term goal that should be achieved and will be reflected in its stock market price. This is because investor assessment for the firm can be observed through the company's stock price traded on the stock exchange for companies that have gone public. The higher shareholder value indicates the greater public confidence in the company. Salvatore (2005) states that the primary goal of companies that have going public is to increase the prosperity of the owner or shareholders by increasing the value of the firm.

There are many factors that can determine the firm value, one of which is Good Corporate Governance (GCG).

A good set of GCG practices and policies is positively related to firm value. The conceptual framework of corporate governance studies was developed over the premise that there are potential problems derived from the separation between ownership and control. In the process maximizing the company value, there would be conflict of interest between managers and shareholders (the company owner) that is often called the agency problem. It is not rare that the management company managers have different goals and interests that conflict with company main objective and often ignore the shareholder interests. A different interest between managers and shareholders has resulted in conflicts commonly called agency conflict. This happens because managers prioritize personal interests; otherwise shareholders do not like the personal interests of managers because of what the manager will add to costs for the company resulting decrease in corporate profits and the effect on stock prices thus lowering the firm value (Jensen and Meckling, 1976)

Based on above explanation, there is a need for GCG arising in connection with the principal-agency theory. Implementation of GCG expected to be useful to increase and maximize the firm value. GCG is expected to seek a balance between the various interests that can provide benefits to the company comprehensively. GCG implementation can be reflected in firm value as seen from the company's stock price. Results of the previous studies show that the effect of corporate governance on firm value has not been consistent. Eberhart (2012), Machfoedz (2006) which found that GCG has positive effect on firm value. However research conducted by Debby et al. (2013) found two important findings. Firstly managerial ownership has negatively effects firm value, secondly audit committee has negatively effects firm value.

Value of the firm can also be influenced by the size of the leverage generated by the company. In corporate finance theory, the debt finance and equity finance are main sources of external finance. However the matter is how them to be composes of to minimize the agency costs and maximize the firm value. Leverage reflects the extent to which debt and preferred stock are used in addition to common stock. Leverage is used to amplify firm profit rate over the business cycle (Hirschey, 2010).

Manuscript received July 6, 2013.

The seminal work by Modigliani and Miller argues that financial leverage is irrelevant to firm value. Further studies by researchers have reached a paradoxical stage where an empirical issue has been raised that whether debt financing enhances or destroys firm value. The debt financing can create value because of the tax advantage and it can also destroy value because of the accompanying bankruptcy costs. As the financial leverage increases, the risk to stockholders increases because the higher leverage will cause greater volatility in earnings and greater volatility in the stock price. Researchers have a different view point on the impact of leverage structure on the value of the firm. The researchers have found that impact on the value of the firm has proven inconclusive. Research conducted by Cheng and Tzeng (2009), Sharma (2006), Choudhary (2010) showed a positive effect of leverage on firm value. While the studies done by Biabani Kaviani (2012), Mahendra (2011) and Adelegan (2007) found a negative effect of leverage on firm value.

The concept of leverage is very important to demonstrate the financial analysis in view of the tradeoff between risks and benefit ratio of the best decisions using various angles. This is become financial manager task to make the plan, analysis and control activities. Companies that have a high level of financial leverage can result in a financial hardship (financial distress) to be able to settle its debt obligations. In other words, financial leverage has particularly good effects and bad for the company, may cause the company to develop better performance, but also can result bad performance, or can even result in bankruptcy or insolvent condition.

Beside GCG and leverage, another variable which is also identified to have an impact on firm value is firm size. Firm size is scale in which the size of the company can be classified according to various ways, including: total assets, log size, stock market value, etc. Firm size is considered that able to influence firm value since the larger size or scale of the company, the easier the firm to get funding sources in both internal and external. Variable firm size is chosen because there are differences in the results of previous studies. From the results of research Taswan and Soliha (2002) and Yunita (2010) show that firm size has a positive effect on firm value. While research Indrajaya and Setiadi (2011) found different results, firm size has no effect on firm value.

Related with the description above, as supported by the results of previous studies which contradiction, then the research problems can be formulated as follows: (1) how the mechanisms of corporate governance (audit committee, board size, and the proportion of independent board) affect the value of firm?; (2) Is the leverage effect on firm value?; and (3) whether the firm size effect on the value of firm? Meanwhile, the goal of this study are: (1) to determine the effect of good corporate governance mechanisms (audit committee, board size, and the proportion of independent board) on firm value, (2) to determine the effect of leverage on firm value, (3) to determine the effect of firm size on firm value, and (4) to determine the mechanisms of good corporate governance (audit committee, board size, and the proportion of independent board), leverage, and firm size on firm value.

II. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Value of the Company (Firm Value)

According Febrina (2010) the firm value is selling firm or growing value for shareholders, the firm value will be reflected in the market price of its shares. According Febrina (2010) firm value is selling firm or growing value for shareholders, the firm value will be reflected in the market price of its shares. Firm value according to Rika and Islahudin (2008:7) is defined as the market value. Value of the company can provide maximum shareholder wealth if the stock price increased. The higher the stock price will result on the higher the shareholder wealth. To reach the general firm value investors handed over its management to the professionals. A professional is positioned as a manager or commissioner.

Firm value can be indicated or implied from a number of variables or signals inherent in the company if the owner cannot afford imply its value, then they will only receive compensation for the value of the average firm. As a result, the firm which has good quality, the value to be received will be below the true value, whereas a poor quality firm will receive a score above the true value (Gumanti: 1998). In this study, the firm value is proxy by Price to Book Value (PBV). Price to Book Value is the ratio between the market price and the book value of shares (Arifin, 2005). In other words, increasing Price to Book Value would raise the stock price.

Good Corporate Governance Mechanisms

Corporate governance is the exercise of authority over the members of a corporate community based on formal structures, rules and processes. This authority is exercised in accordance with a body of rules that define the rights and powers of shareholders, boards of directors and managers (Steiner and Steiner, 2010). Corporate governance is control systems that help corporations effectively administer economic resources (Hirschey, 2010). Corporate Governance is a mechanism used to reduce agency problems between managers and stockholders, including inside decisions and control systems and outside market effects (Yang and Shan, 2008). In this paper three variables of GCG mechanisms will be analyzed namely audit committee, size of the commissioner's board and proportion of independent commissioner's board.

The audit committee has important role and strategic in terms of maintaining the credibility of financial statements preparation process as well as to create adequate supervisory system for company and the implementation of good corporate governance. The mission of audit committee, who are hire by the board, is to examine the firm's accounting control system and give their opinion as to whether or not the firm's financial statements offer a fair representation of the of the firm's financial position. If the audit committee work effectively, the control of the company would be better so that the commissioners board composition play a role in oversight.

Board of directors evolved to perform the critical role of monitoring hired manager. Shareholders elect people on the

board of directors to represent stockholders interests. The board is charged with four broad functions (Hirschey, 2010) : (1) hire, evaluate, and perhaps even replace management, (2) approve major operating proposals (large capital expenditures, acquisitions etc), (3) approve major financial problems (issuance of stocks and bonds, dividend payments, stock repurchases etc), and (4) offer expert operating and strategic advice to management. The higher the proportion of independent commissioners in the company, the board is expected to perform supervisory tasks and provide advice to the of directors effectively, for example independent commissioners may actively encourage management to adopt policies that will increase tock market values. The composition of the board may affect the management in preparing the financial statements in order to obtain a qualified profit (Rachmawati and Triatmoko, 2007).

Independent auditor – also known as outside director - means a director who is not connected or associated with the company in any manner and works only to safeguard the interest of shareholders. The existence of independent directors is expected to increase the role of the board in order to create good corporate governance within the company. Outside directors act as experts in decision control and signal their expertise to the labor market by acting in shareholders' interests (Coulton and Taylor, 2004). Many evidences show that the existence outside auditors can enhance GCG. Share prices of take over bidders whose boards are controlled by outside directors rise significantly more when their bids are announced than do the shares of other bidders controlled by insiders (Byrd and Hickman, 1992). Firms with outsider – controlled boards are less likely to engage in questionable accounting practices (Bushman et al.,2002)

Firm size

Basically, the size of the company can be expressed on total assets, log size, sales and market capitalization. Large firms have a lower risk than small firm. This is because large companies have better control of the market conditions, so that they are able to face economic competition. In addition, large firms have more resources to enhance the firm value because it has better access to sources of external information than small firm (Yunita, 2010). Meanwhile, firm size also determines the level of investor confidence. The bigger the firm will result on more well known by the public, which means getting easier to obtain information that will enhance shareholder value. Even large companies that have total assets with substantial value of the assets attract investors to invest in the company. In terms of firm size seen from the total assets owned by the company, it can be used for the company's operations.

Companies that have total assets of the firm shows that it has reached a stage of maturity in this stage where firm

has a positive cash flow and is considered to have good prospects in a relatively long period of time, but it also reflects that the firm is relatively more stable and better able to make a profit compared with the total assets of which firm small.

In connection with the above exposure, the greater the firm size, usually the information available to the investor in making an investment decision with respect to the shares of the company more and more (Siregar and Utama, 2005). Firm size in this study is proxy to total assets in logarithm (Nuringsih, 2005).

Leverage

Leverage is an important tool in measuring the effectiveness of corporate debt. By using leverage, companies will earn profits but on the other hand companies will face losses also (Weston and Copeland, 1997).

The leverage concept is an important consideration for investors in making stock assessment. Investors generally tend to avoid risk. Risk arising in the use of financial leverage is financial risk that called the additional risk imposed on shareholders as a result of the use of debt by the company. The higher the leverage will result on the greater the financial risk (Horne and Marchowicz, 2005). Expenditure decisions, could affect the ability of companies to generate profits for shareholders. On economic conditions, companies using greater debt portion greater than capital itself have greater capability to generate profit for shareholder than the company that use less than its own capital. In contrast, in poor economic conditions, companies that use the portion of the debt greater than capital itself will generate a return for shareholders smaller than the share of firms use less debt than its own capital. Debt ratio is a ratio that measures the proportion of funds coming from corporate debt to finance assets (Sudana, 2009:23). The greater the ratio, the greater the debt portion of the use of debt to finance investments in property, which means that the risk of increased corporate finance and the other way around. The creditors generally prefer that the company's debt ratio is lower because the lower the debt ratio, the higher the level of funding provided by the company's shareholders and the greater protection to creditors over unpaid debt risk. Companies with high leverage strategy is likely to face a more aggressive strategy of competitors who have lower levels of leverage and may lose market share in the product market oligopoly

Conceptual Framework and Hypothesis Formulation

Based on the explanation above the conceptual framework of the study is shown in Figure 1 below.

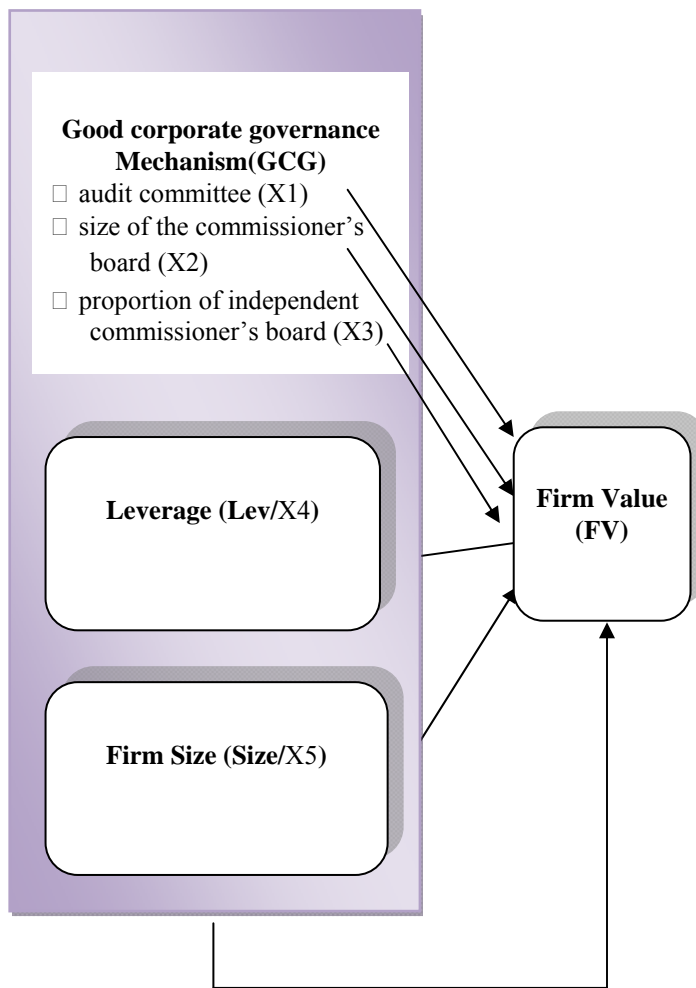


Figure 1
Conceptual Framework of the Present Study

Based on the conceptual framework in Figure 1 above, the research hypotheses are formulated as follows:

- H₁: Good Corporate governance mechanisms affect firm value
- H₂: Leverage affects firm value
- H₃: Firm Size affects firm value
- H₄: GCG mechanisms, leverage and firm size affect firm value

III RESEARCH METHOD

Population and Sampling Techniques

The population used in this research were all manufacturing companies listed on the stock exchanges of Indonesia from 2007-2011. Sampling technique used in this study is judgment sampling. The sample selection is related to the variables used data from this study. The sample used in this study consisted of 28 companies for 5 years (2007-2011).

Research Variables

Variables in this study can be classified into two, that is (1) the independent variable in this case GCG (audit

committee, board size, and board of commissioners), leverage, and size. Meanwhile, the dependent variable is firm value.

Data analysis

Data analysis used in this study is multiple regression analysis. Before the regression test, there are several assumptions that must be fulfilled so that the resulting regression equation becomes valid. Classical assumption test consists of a test for normality, multicollinearity test, heteroskedasticity, and autocorrelation. This study used five independent variables and the dependent variable, the regression models are as follows:

$$FV = \beta_0 + \beta_1 AC + \beta_2 BCSIZE + \beta_3 PIB + \beta_4 LEV + \beta_5 FSIZE + \epsilon$$

Description:

- β_0 = Intercept
- $\beta_1 - \beta_5$ = Regression coefficient
- AC = Audit Committee
- BCSIZE = size of board commissioners
- PIB = proportion of independent board
- LEV = Leverage
- FSIZE = Firm size
- FV = Firm value
- ϵ = error

IV RESEARCH FINDINGS

Based on SPSS output, multiple linear regression equation can be arranged as follows:

Table 1
Summary Regression Analysis Results

Variable	Regression Coefficient(beta)	T Count	Probability (p)	Information
AC	-0.022	-0.860	0.775	Rejected
BCSIZE	0.061	1.690	0.010	Accepted
PIB	-0.830	-8.350	0.116	Rejected
LEV	-0.141	-1.410	0.164	Rejected
FSIZE	0.661	6.760	0.011	Accepted
Constanta	= -1.735			
F count	= 49.668			
Probability (Sig)	= 0,000			
Adjusted R square	= 0.299			

Source: Primary data (processed), 2013

From Table 1 above, it can be seen that the adjusted R square value of 0.299 and the calculated F value is equal to 49.668 with a probability rate of 0.000 ($p < 0.05$). These represent hypothesis stated there is significant influence acceptable. GCG variable (audit committee/AC, board size / BCSIZE, the proportion of independent board/PIB), leverage / LEV, and firm size/FSIZE are simultaneously towards firm values /FV acceptable.

Meanwhile, for the partial tests are detailed in Table 1 will be described as follows:

1. The first hypothesis (H_1), i.e.:GCG mechanism (audit committee, board size, and the proportion of independent board) effect on firm value. Based on the results of the regression analysis are discussed hypothesis on each of the following variables:
 - a) H_{1a} : the influence of the audit committee (AC) on firm value (FV), it turns out the findings show that AC have no effect on firm value (FV) at the 0.05 level ($P > 0.05$), so that H_0 is accepted and H_1 rejected. This can be proved by the magnitude of the regression (b_1) of -0.022; t count of -0.860; and a probability of 0.775 ($p > 0.05$).
 - b) H_{1b} : Influence of board size (BCSIZE) on firm value (FV), it turns out the findings indicate that BCSIZE has significant influence on firm value (FV) at the 0.05 level ($P < 0.05$), so H_0 is rejected and H_1 is accepted. This can be proved by the magnitude of regression (b_2) of 0.061 and t count of 1,690 and a probability of 0.010 ($p < 0,05$).
 - c) H_{1c} : Influence of the independent board proportion (PIB) on firm value (FV), it turns out the findings indicate that PIB no effect on firm value (FV) at the 0.05 level ($P > 0.05$), so that H_0 is accepted and H_1 rejected. This can be proved by the magnitude of regression (b_3) is -0.830 and -8.350 and t calculates equal probability of 0.116 ($p > 0,05$).
2. The second hypothesis (H_2), i.e.: leverage (LEV) effect on firm value (FV), the analysis showed that the LEV has no effect on firm value (FV) at the 0.05 level ($P > 0.05$), so that H_0 is accepted and H_1 rejected. This can be proved by the magnitude of regression (b_4) -0.141 dan t count -1410, and a probability of 0.164 ($p > 0.05$).
3. The third hypothesis (H_3), i.e.: firm size (FSIZE) on firm value (FV). The analysis showed that FSIZE has significant influence on firm value (FV) at the 0.05 level ($P < 0.05$), so H_0 is rejected and H_1 is accepted. This can be proved by the magnitude of regression (b_5) i.e. 0.661 and amounted to 6.760 t and a probability of 0.011 ($p < 0.05$).

Based on the results of multiple regression analysis shown in Table 1, it can produce regression equation as follows:

$$FV = BCSIZE - 1.735 - 0.022AC + 0.061BCSIZE - 0.830PIB - 0.141LEV + 0.661FSIZE + \varepsilon$$

V DISCUSSION, LIMITATION AND CONCLUSIONS

Based on the results of multiple regression analysis, The F test shows that there is a significant relationship between corporate governance variables (audit committee/AC, board size/DKSIZE, the proportion of independent board / PIB), leverage/LEV, and firm size/FSIZE simultaneously to firm values/FV. It is also with the results of a partial analysis, particularly on the hypothesis (H_{1b}) and Hypothesis three (H_3) suggests that board size (BCSIZE) and firm size (FSIZE) effect on firm value (FV).

Meanwhile, the results of partial analysis by using t-test showed that the hypothesis 1 (H_{1b}) is accepted which means that the board size (BCSIZE) have an influence on firm value (FV). This indicates that the size of the company's board size

will determine the effectiveness of board functions and related monitoring functions, so that if the monitoring function is performed by the board of commissioners running as expected the targets to be achieved by the company to maximize firm value will be achieved. This finding supports the findings Siallagan and Machfoedz (2006) that stated GCG had positive effect on firm value.

The next hypothesis three (H_3) is also accepted, i.e.: firm size (FSIZE) effect on firm value (FV). These findings indicate that the firm size (FSIZE) would be great to have high commitment to continuously improve its performance, so the market will want to pay more expensive to acquire its shares because it believes will get favorable returns from the company. This finding supports Soliha and Taswan (2002) and Yunita (2010) stated that firm size has a positive effect on firm value. While research Indrajaya and Setiadi (2011) found different results, which do not influence firm size effect on firm value.

In contrast to the analysis of the first hypothesis (H_{1a} and H_{1c}), the second hypothesis (H_2) indicates that the findings do not support the firm value. Hypothesis 1 (H_{1a}), which states the audit committee (AC) has an effect on firm value (FV), was rejected because it was not supported empirically. This means that the audit committee of the company will result in the lower value of the company and vice versa. These results are consistent with research Rachnawati and Triatmoko (2007), but different with Siallagan and Machfoedz (2006). It can be explained that there is a possibility of the existence of an audit committee is not a guarantee that the company's performance will be better, so that the market assumes the existence of an audit committee is not a factor that they consider to appreciate firm value.

Hypothesis 1 (H_{1c}), which states the proportion of independent board (PIB) have an influence on firm value (FV), was rejected because it was not supported empirically. This means that the higher the proportion of independent board within the company, then the company will be the lower value, and vice versa. These results are consistent with research Rachmawati and Triatmoko (2007). It can be explained that a small proportion of the independent directors in the board of the company is not a guarantee that the company is not in financial reporting fraud company. Monitoring functions are performed independent board cannot reduce the behavior of managers to maximize their own interests. This causes the goal to maximize firm value will be hampered because of the difference in interest.

Hypothesis 2 (H_2) which states have the effect of leverage on firm value (FV) was rejected because it was not supported empirically. This means that companies tend to use their assets to fund their own capital (internal financing) derived from retained earnings and share capital rather than using debt. The adequacy of the company's funds to finance its assets derived from capital itself makes companies reduce the proportion of debt. The excessive use of debt will reduce the benefits received for the use of debt because of the benefits received are not comparable to the costs incurred, so that a low proportion of debt that could increase the value of the company, otherwise the increase in debt can lower the value of the company. The result is contrary to previous research

conducted by Adelegan (2007) which states that the leverage has a negative effect on firm value.

Several limitations of this study may be noted. First, this study focus only on three factors that influence Firm value. Other factors that influence firm value may exist that were not examined in this study. Previous studies suggest the others variable that might influence firm value, such as integration and diversification, human capital. Second, this study only use three GCG mechanisms, there are others GCG mechanisms that may affect the value of the firm, such as ownership structure, transparency.

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