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## Article

# Do corporate governance, capital structure predict financial performance and firm value?(empirical study of Jakarta Islamic index)

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## ACCOUNTING, CORPORATE GOVERNANCE & BUSINESS ETHICS | RESEARCH ARTICLE

# Do corporate governance, capital structure predict financial performance and firm value? (empirical study of Jakarta Islamic index)

Dian Ferriswara<sup>1</sup>, Nur Sayidah<sup>2\*</sup> and Edwin Agus Buniarto<sup>3</sup>

**Abstract:** This study examines corporate governance, capital structure, financial performance, and firm value in the Jakarta Islamic Index. The technique of data analysis uses Partial Least Square (PLS), with structural equations (SEM) based on components or variants, on annual data from 2015 to 2021 to examine the variables that affect firm value on the Jakarta Islamic Index (JII). The findings show that two determinants significantly affect firm value from the five hypotheses proposed. Financial performance has a significant effect on firm value. Corporate governance and capital structure factors do not affect firm value, but corporate governance positively and negatively impacts financial performance. The practical implications of this study emphasize the critical role of corporate governance and capital structure in improving financial performance and firm value. Investors will respond to good corporate governance as a positive signal that the company is superior to other companies. The corporate governance variable has a significant effect on financial performance with a negative coefficient direction, indicating that corporate governance has not been implemented optimally in the proxy company with low proportion of independent commissioners and independent audit committees.

**Subjects:** Accounting; Financial Management; Corporate Governance

**Keywords:** Corporate Governance; Capital Structure; Financial Performance; Firm Value; Jakarta Stock Exchange; Jakarta Islamic Index

### 1. Introduction

The Islamic Capital Market has recently experienced rapid development as part of the world's financial markets. Capitalist countries such as America implemented Islamic capital markets through the Dow Jones Islamic Market Index (DJIMI), Dow Jones Islamic Average and Financial Times Stock Exchange (FTSE) Sharia Capital Market. In India, there is the Bombay Stock Exchange TASI Shariah 50 Index, Security Policy Group International Board Market Index (SPGI BMI) Republic of Korea Shariah in Korea; S&P Japan 500 Shariah in Japan; Financial Times Stock Exchange (FTSE) Shariah China in China; SPGI BMI Philippines Shariah in the Philippines and SPGI BMI Singapore Shariah in Singapore, SPGI Hong Kong Shariah in Hong Kong and several other Muslim minority countries (Hakim & Rashidian, 2002).

In Indonesia, the Islamic capital market emerged in 2000. At that time, the Indonesia Stock Exchange, in collaboration with PT Danareksa Investment Management, launched the Jakarta

Islamic Index (JII) as shown in Figure 1. JII is a benchmark for performance in choosing a halal stock portfolio (Indonesia Stock Exchange, 2012). In 2011, the Indonesia Stock Exchange launched the Indonesian Sharia Stock Index. Launching the Indonesian Sharia Stock Index (ISSI) complements the existing sharia index, namely JII (Pasaribu & Firdaus, 2013). The Indonesian Sharia Stock Index (ISSI) is one of the indices listed on the Indonesia Stock Exchange, which contains sharia shares. The difference between ISSI and JII sharia shares is that ISSI sharia shares include all members of sharia shares listed on the Indonesia Stock Exchange. At the same time, JII itself is part of ISSI sharia shares (Sutedi, 2011). The establishment of ISSI and JII aims to increase investor confidence in making sharia-based stock investments (Pasaribu & Firdaus, 2013).

The Indonesia Stock Exchange (IDX) noted that since the Covid-19 case in Indonesia was first announced on 2 March 2020 to 31 March 2021, ISSI has strengthened by 13.9%. Meanwhile, JII70 was up 12.3%, and JII was up 7.8%. The movement of the three sharia indices is better than the LQ45 and IDX30. The activities of the three sharia indices were better than LQ45 and IDX30, which rose 5.1% and 2.4%, respectively. For comparison, in the period before the January–February 2020 pandemic, Performance of ISSI fell by 16.5%. Meanwhile, JII70 and JII eroded 18.4% and 19.1%, respectively. (<https://investasi.kontan.co.id>, 2021).

The high stock price will increase the company’s value and investors’ prosperity. The low stock price also influences the company’s low value, which impacts investors’ perception of a bad company (Agustina 2017). The stock price illustrates the actual value of the company’s assets which investment opportunities can influence. Meidiawati and Mildawati (2016) argue that the presence of investment opportunities will provide a positive signal related to the company’s growth in the future and can increase stock prices.

Financial performance, capital structure, and corporate governance can affect firm value. Several empirical studies that examine the relationship between financial performance and firm value find different evidence. Research by Harahap et al. (2020) found evidence that return on equity negatively influenced company value, while net profit margin, total asset turnover, and debt-to-asset ratio had positive impact. The current ratio did not affect firm value. Amalia et al. (2019) found evidence that financial performance measured using return on assets (ROA) and return on equity (ROE) positively affected company value. Companies with good asset capabilities tend to be more financially healthy (Sayidah et al., 2019).

Research by Murni, Sabijono, and Tulung (2018) on the role of financial performance in determining the firm value found evidence that the debt–equity ratio significantly negatively affects ROE. Santosa et al. (2020) found evidence that profitability have a positive effect, leverage has a negative impact, but liquidity does not affect the firm value. High leverage can increase financial

**Figure 1. JII movement from 2 March 2020, to 31 March 2021.**

Source: Indonesia Stock Exchange



health if management uses debt to finance projects that generate higher marginal revenue than marginal costs (Sayidah & Assagaf, 2020).

The causal relationship between capital structure, financial performance, and firm value also shows different results. Ngatno et al. (2021) found a positive relationship between capital structure, represented by total debt, and firm performance, represented by ROA and ROE. This results indicate a positive contribution of capital structure financing decisions on financial performance. Other research found evidence that long-term debt to equity, total debt, and total debt to equity positively impact ROA. In contrast, total debt to total assets has a negative impact on ROA (Osagie & Dan Enadeghe, 2022). Alfisah et al. (2022) also found evidence that the capital structure measured using the Debt Assets Ratio and Debt to Equity Ratio has no significant effect on firm value. Asante et al. (2022) found negative relationship between capital structure and financial performance. Debt maturity did not affect the relationship between capital structure and financial performance. Uzliawati et al. (2018) found a positive correlation between the debt-to-equity ratio (DER) and long-term debt-to-asset ratio (LDAR) to firm value, and a negative correlation between long-term debt-to-equity ratio (LDER) to firm value. Luu (2021) found evidence that the capital structure correlated with the firm value of listed chemical companies. Rizki et al. (2018) found capital structure, measured by debt to asset ratio (DAR) and equity to asset ratio (EAR), does not affect firm value, measured by price book value (PBV). Capital structure, measured by debt to equity ratio (DER), has an effect on firm value, measured by price book value (PBV).

Several empirical studies regarding the relationship between corporate governance and financial performance and firm value also show different results. Mahrani and Soewarno's research (2018) indicates that the good corporate governance (GCG) mechanism and corporate social responsibility (CSR) positively affect financial performance and earnings management. At a certain level, earnings management does not affect the company's financial condition (Sayidah et al., 2020). Nizam and Tee (2020) show that overall corporate governance variables (board structure, CEO duality, audit/risk management committee, and corporate reporting) have no significant impact on explaining the performance of the listed companies. Research by Ochejo et al. (2019) found that corporate governance had a significant positive effect on firm value of commercial banks in Kenya. The study concluded that commercial banks in Kenya with high firm value have GCG and better financial performance.

Adila and Arifin (2021) found evidence that the independent commissioner doesn't affect values and company performance, and the board of directors affects company value positively; the board of directors doesn't affect Company Performance. The audit committee doesn't affect the company's value. The audit committee affects the company performance positively. Furthermore, Afiani and Bernawati (2019) found evidence that institutional ownership negatively influences firm value, independent commissioners positively influence firm value, while managerial ownership and corporate secretary have no significant influence on firm value. Khan, Tanveer and Malik (2017) found evidence that the board of commissioners and CEO duality negatively impacted firm value, and non-executive directors and audit committees had a positive and significant impact on firm value. The presence of the board of commissioners and the duality of the CEO will reduce information asymmetry and agency costs between shareholders and management, thereby reducing firm value. Ramadhan et al. (2022) found that board size, board meetings, and institutional ownership positively affect firm value, audit committee meetings and managerial ownership negatively affect firm value, while public ownership and ownership concentration do not affect on the value of a company.

The inconsistent results of previous studies motivate researchers to study corporate governance, capital structure on financial performance, and firm value in one model. The results of this study contribute to investors in making investment decisions, especially the factors that affect the performance and value of companies in the Indonesian Islamic capital market. The originality of

this research is to create a more comprehensive model related to empirical findings to test existing financial models and the consistency of previous findings in the Islamic stock market.

## 2. Literature review

### 2.1. Integrating corporate governance on financial performance and firm value

Corporate governance is a set of provisions that enable the stockholders to exercise voting power to compel those in operating control of the firm to respect their interests (Wallace & Zinkin, 2005). Good corporate governance will motivate the board and management to achieve goals in the company's and its shareholders' interests (Gendron & Be, 2006). Implementing good corporate governance, eliminating moral hazard and creating a healthier business climate, can increase investor and creditor confidence. Good corporate governance will give investors a positive response to financial performance. Effective corporate governance can increase managers' probability of investing in projects with a positive net present value. Better-governed companies have better performance (Brown & Caylor, 2004)

Good corporate governance can signal the existence of aligned interests between all stakeholders, thereby reducing conflict. In addition, company management can achieve company goals and increase company value (Widuri et al., 2017). Achieving high-quality good corporate governance requires the role of an independent board of commissioners and an audit committee. Independent commissioner's function is to equalize as a balancer in decision-making, having members of the board of commissioners from outside the company (Kusumaningtyas & Andayani, 2015). The audit committee is one of the main corporate governance mechanisms that is the basis for stakeholders in limiting the behavior of managers in the company (Gendron & Be, 2006).

An independent commissioner as a proxy for corporate governance is based on the fact that one of the main functions of an independent commissioner is to carry out an independent monitoring function on the performance of the company's management. The existence of a commissioner can balance the power of the management (especially the CEO) in managing the company through a monitoring function. With a large proportion of independent members in the structure of the board of commissioners, it will provide a better supervisory effect and can limit the need for managerial fraud (Eng and Mak, 2003). The audit committee also plays an essential role in increasing the company's value by applying corporate governance principles. The corporate governance principles indicate that the audit committee must work independently and professionally. The audit committee monitors structures that improve the quality of information flow between shareholders and managers (Rouf, 2011).

The main benefit of independent directors and independent commissioners is to protect the interests of minority shareholders and other stakeholders and maintain equality (Meindarto & Lukiastuti, 2017). Independent commissioners are the proportion of the number of independent commissioners on the board of commissioners (Sofia & Januarti, 2022). The Indonesia Stock Exchange (IDX) requires establishing and having an audit committee known by an independent commissioner because the audit committee is an essential component that must exist in companies listed on the Indonesia Stock Exchange. The proportion of independent audit committees measures the independent audit committee compared to the total number of audit committees (Hidayat et al., 2021).

An empirical study found that corporate governance positively affects the financial performance (Danquah et al., 2022; Kiptoo et al., 2021; Mahrani et al., 2018; Ochego et al., 2019). Good corporate governance practices can increase the company's value, improve financial performance, reduce the risk that the board may take with decisions that benefit themselves, and increase investor confidence. On the other hand, poor corporate governance practices can reduce the level of investor confidence (Newell & Dan Wilson, 2002). This study is reinforced by a survey conducted

by McKinsey and Company (2002) which shows that corporate governance is the primary concern of investors, financial performance, and growth potential, especially for emerging markets. In this case, investors tend to avoid companies that are bad in implementing corporate governance. Corporate governance is seen as a determining qualitative criterion. According to investor perception, Indonesia is one of the worst countries in Asia (very poor) in implementing good corporate governance.

Alfisah et al. (2022) found that the board of directors affects Company Value positively, Afiani and Dan Bernawati (2019) found independent commissioners have a significant positive influence on firm value. Ararat, Ararat et al. (2016) also find evidence of a strong relationship between corporate governance and the company's market value. Ramadhan et al. (2022) found that board size, board meetings, and institutional ownership positively affect firm value. Dan Djuminah (2019) found that the board of commissioners and audit committee positively influence firm value. The implementation of good corporate governance is an essential step in building market confidence and encouraging a more stable, long-term investment flow

Based on the above literature and arguments, the hypotheses:

H1: Corporate governance has a significant effect on financial performance.

H2: Corporate governance has a significant effect on firm value

## **2.2. Integrating capital structure on financial performance and firm value**

Sartono (2011) states that the capital structure balances permanent short-term debt, long-term debt, preferred stock, and common stock. Weston and Copeland (2007) stated that financial structure refers to financing the firm's assets. The financial structure is represented by the entire right-hand side of the balance sheet. Capital structure or the firm's capitalization is the permanent financing represented by long-term debt, preferred stock, and shareholder's equity. Capital structure is a part of financial structure. The book value of shareholder's equity includes common stock, paid-in capital, and retained earning. Van Horne and Wachowicz (2008) stated that capital structure as a long-term financing method combines the firm's preferred share capital, equity capital, and debt capital. Contrary, Besley and Eugene (2008) conceptualized capital structure as a combination of long-term debt capital, preferred share capital, and net worth, which is used as a method of permanent financing. The capital structure has been traditionally conceptualized as a combination of long-term debt and equity capital and thus neglects short-term debt capital. The company uses capital structure to finance a firm's business development.

The capital structure variable was measured using four indicators: long term debt to total asset ratio, long-term debt to total equity ratio, debt ratio, and debt to equity. The long-term debt to total asset ratio (LTDTA) is a ratio that reflects the company's funding originating from long-term debt. This ratio compares the long-term debt and total assets of a company. (Ngatno et al., 2021). The long-term debt to total equity ratio (LTDE) is the provision of funds from shareholders for long-term debt. This ratio compares long-term debt and capital stock (Osagie & Dan Enadeghe, 2022). The ratio of debt to total assets shows the total debt to total assets owned by the company (Dinh & Pham, 2020). Debt to equity ratio (DER) is a simple calculation that compares a company's total debt from shareholder capital. The higher this ratio also indicates the larger the portion of capital financed from debt/foreign capital sources, and vice versa (Alfisah et al., 2022).

According to Tax Shields Theory (Franco & Miller, 1963), funding from debt will improve the company's financial performance due to tax savings from interest payments. Capital structure decisions will affect financial performance. Increasing the level of use of debt at a certain point (optimal limit) in capital structure decisions will have a positive effect on financial performance,

this is because the amount of profit available to shareholders has increased. However, the greater the proportion of debt used in the capital structure, the greater the fixed obligations in the form of debt and interest payments borne by the company, so that the amount of profit available to shareholders will decrease. Therefore, the effect of capital structure on financial performance can be positive or negative. Jensen and Meckling (1976) relate agency costs to debt in the Capital Structure. Agency theory states that in determining the capital structure, it is necessary to consider the costs incurred, given the differences in interests between the owner and the management of the company. Based on this theory, Capital Structure positively affects the probability of bankruptcy, liquidation value, and the reputation of managers.

Ngatno et al. (2021) found that financing decisions positively contribute to financial performance. Dinh and Pham (2020) found financial leverage ratio (LR), long-term asset ratio (LAR), and debt-to-assets ratio (DR) have a positive relationship with firm performance. Osagie and Dan Enadeghe (2022) found that the capital structure in the form of long-term debt to equity, total debt, and total debt to equity positively impacts ROA performance. The primary capital structure policy is the relationship between the financing and investment decision to align with the company's goals. The optimal capital structure must balance risk and return that maximizes the share price (Brigham & Houston, 2006).

Firm value is a linear function of capital structure, meaning that different debt ratios affect the consistency of firm value. To improve the capital structure, using debt can lead to two possibilities: debt has a positive effect and increases the value of the company or debt will have a negative effect and reduce the company's value. (Cuong, 2014). A high debt ratio is used as a tool to reduce cash flow expenditures by managers or as an emphasis on using cash flows for debt repayment. In this situation, debt will positively affect firm value (Margaritis & Psillaki, 2010).

Rizki et al. (2018) found that capital structure has an insignificant effect on firm value as proxied by Price Book Value (PBV), while the Debt to Equity Ratio (DER) has a significant influence on firm value. Capital structure, which is measured with debt to asset ratio (DAR) and debt to equity ratio (DER) simultaneously has significant effect on firm value, which is measured with price book value (PBV).

H3: Capital Structure has a significant effect on Financial Performance.

H4: Capital Structure has a significant effect on Firm Value

### **2.3. Integrating Financial performance and firm value**

Gitman and Zutter (2012) state that financial performance results from all activities utilizing their financial resources. In other words, the company's financial performance is the result of many individual decisions made continuously by management in a company, which can assess the company's performance as a whole. Financial performance is an analysis to see the extent to which a company has implemented by using the rules of financial implementation properly and correctly. Such as by making a financial report, which has met the financial accounting standards (Fahmi, 2011).

Financial performance in this study is measured by the productivity ratio proxied by the assets turn over (ATO), the profitability ratio proxied by return on assets (ROA), Return on Equity and Earning per Share. Productivity describes the relationship between the company's operating level with the assets needed for the company's operations. Productivity can be measured by the activity ratio. The activity ratio can be measured by asset turnover (ATO). Asset Turn over is calculated by dividing the total revenue or sales by the company's total assets (Khatiwada & Sum, 2007). According to Brigham and Houston (2006), Return on Equity (ROE) is a net ratio to ordinary equity



measuring the rate of return on investment of ordinary shareholders. Return on Equity (ROE) is a ratio for measuring net income after tax with own equity. Return on Assets (ROA) is a ratio that is intended to measure a company's ability to utilize its assets to obtain profits. Return on assets (ROA) can reflect the business benefits and efficiency of the company in the utilization of total assets in the company. The higher the value of ROA, the more efficient the company is in using its assets, and of course it will generate profits for the company (Amalia et al., 2019).

A significant relationship between financial performance and firm value will be seen from the company's main goal to obtain maximum profit, an increase in profit shows that good financial performance and will be able to motivate investors to invest (Hermawan & Ajimat, 2020). Signaling theory explains the reasons why companies provide financial statement information to outside parties such as the capital market and how companies should provide signals to financial statement users. Signal theory shows information asymmetry between company management and parties with an interest in the information. To reduce information asymmetry, financial information is provided to outsiders. With reduced information asymmetry, firm value can increase (Ross, 1977)

Weston and Copeland (2007) stated that valuation ratios are the most comprehensive performance measures for a company because they reflect the combined effect of return and risk. Furthermore, Weston and Copeland (2007) suggested that there are three ratios that can be used to measure management's ability to achieve market values, namely: a. The ratio of market price per share to earnings per share (price earning ratio), b. Ratio of market price per share to book value (market to book ratio), q Tobin ratio which is defined as the market value of all securities divided by the replacement cost of assets.

In their research, Marsha and Dan Murtaqi (2017) found that financial performance significantly influences firm value. ROA and Current Ratio have a positive relationship with firm value, while the Acid Test Ratio has a negative relationship. Furthermore, Monika and Dan Khafid (2016) found evidence that the financial performance variable, proxied by the profitability ratio, namely return on equity (ROE), affects firm value. Dan Agsutin (2017) examine Financial Performance towards the value of firms in the basic and chemicals industry. The research findings show that profit growth significantly negatively affects Price Book Value. Current ratio has a significant negative effect on Price Book Value. Debt Equity Ratio has a significant negative impact on Price Book Value, and Return on Assets has a significant positive effect on Price Book Value. Based on above literature and arguments, following hypotheses are generated

H5: Financial Performance has a significant effect on Firm Value

### 3. Research Method

#### 3.1. Data

This study examines the impact of corporate governance and capital structure on financial performance and firm value. The research sample was 13 companies selected through the purposive sampling method. The sample criteria are companies listed on the Jakarta Islamic Index (JII) for seven consecutive years, starting from 2015 to 2021. Based on these criteria, the number of research observations is 91 (13 × 7). This study uses data on the financial statements of the selected companies as samples sourced from the <https://www.idx.co.id>.

#### 3.2. Variable

Variables in this study include independent, namely corporate governance, and capital structure, and dependent variables, namely financial performance and firm value. The explanation of the indicators and measurement of variables is in Table 1 below.

**Table 1. Measurement of variables**

No	Variable	Indicator	Measurement
1	Corporate Governance	The proportion of Independent Commissioners (Percentage of independent directors on the board of commissioners)	$IC = \frac{\text{Number of Independent Commissioners}}{\text{Total Number of Board of Commissioners}}$
		The proportion of Independent Audit Committee (Percentage of Independent Audits on the audit board)	$IAC = \frac{\text{Number of Independent Audits}}{\text{Total Number of Audit Committees}}$
2	Capital Structure	Debt Assets ratio	$DAR = \frac{\text{Total Debt}}{\text{Total Assets}}$
		Debt to Equity Ratio	$DER = \frac{\text{Total Debt}}{\text{Total Equity}}$
		Long Term Debt to Total Equity ratio	$LTDTE = \frac{\text{Long term Debt}}{\text{Total Equity}}$
		Long Term Debt to Total Asset ratio (LTDTA)	$LTDTA = \frac{\text{Long term Debt}}{\text{Total Assets}}$
3	Financial Performance	Return On Assets	$ROA = \frac{\text{Earning After Tax}}{\text{Total Assets}} \times 100\%$
		Return on Equity	$ROE = \frac{\text{Earning After Tax}}{\text{Total Equity}} \times 100\%$
		Earning per Share	$EPS = \frac{\text{EAT}}{\text{Number of shares}} \times 100\%$
		Assets Turn Over	$ATO = \frac{\text{Sales}}{\text{Total Assets}} \times 100$
4	Firm Value	Price Earning Ratio	$PER = \frac{\text{market price per share}}{\text{earning per share}}$
		Price book Value Ratio	$PBV = \frac{\text{market price per share}}{\text{Book Value per Share}}$
		Closing Price	Stock Price = Logaritma Natural Closing Price

### 3.3. Estimating model

This study employed structural equation model (SEM) using partial least square (PLS) with component-based or variance-based structural equations (SEM). Analysis using PLS is done by analyzing the outer or measurement model and assessing the inner or structural model.

## 4. Result

### 4.1. Descriptive statistics

This analysis examines the effect of Corporate Governance, capital structure on Financial Performance and Firm Value of the Jakarta Islamic Index, using a balanced panel of 13 companies over a seven-year period from 2015 to 2021. Table 2 illustrates a summary of descriptive statistics of Corporate Governance, capital structure on Financial performance and Firm Value of the Jakarta Islamic Index

The descriptive results of Corporate Governance, capital structure, Financial performance and Firm Value are presented in Table 2. Corporate Governance as measured by the Independent Commissioner (IC) during the study period was 35.3%. This indicates that the average composition of independent commissioners compared to the total board of commissioners in Jakarta Islamic Index companies is still relatively small, so it only contributes a little to the company's supervisory function. The average Independent Audit Committee (AC) during the study period was 36.7%, meaning that the average composition of the independent auditors in the company from the total of all audit committees was still low. The number of independent audit committees will affect the contribution of the supervisory function to the company's performance.

The capital structure measured using the Long-Term Debt to Total Asset Ratio (LTDTA) during the study period is 17%, this means that the Jakarta Islamic Index companies use long-term debt

**Table 2. Descriptive Statistics**

Variable	Obs	Indicator	Mean	Minimum	Maximum	Std. Deviation
Corporate Governance	91	IC	0.35	0.17	0.67	0.09
	91	IAC	0.36	0.17	0.67	0.14
Capital Structure	91	LTDTA	0.17	0.03	0.43	0.08
	91	LTDTE	0.36	0.04	0.89	0.21
	91	DAR	0.47	0.13	0.77	0.16
	91	DER	1.15	0.14	3.41	0.84
Financial Performance	91	ROA	4.86	-0.7	46.66	9.64
	91	ROE	2.86	-0.84	45.09	32.73
	91	EPS	463.92	-59.96	2985.05	617.01
	91	ATO	0.95	0.24	12.23	1.33
Firm Value	91	PER	26.02	-230.18	421.47	59.02
	91	PBV	5.26	0	82.44	12.78
	91	CL	6.55	2.25	10.93	2.82

to fund the company's assets on average 17%. The average Long-Term Debt to Total Equity Ratio (LTDTE) is 36.6%, meaning that the Jakarta Islamic Index companies use long-term debt from equity an average of 36.6%. Debt to Total Asset Ratio of the Jakarta Islamic Index company is 47.7%, meaning that the average operational funding of JII companies from debt reaches 47.7% of the total assets owned. On average, the Debt to Equity Ratio at the JII company is 115.5%, meaning that the average ratio between the total debt and the company's total equity is 115.5%.

Financial performance as measured by Return on Assets is 486%, meaning that within five years the average company's overall ability to generate profits with the total assets available within the company reaches 486%. The average Return on Equity of JII companies is 286%, meaning that the overall company's ability to generate profits with the total amount of own capital or equity available in the company reaches 286%. The average Earning Per Share is 463.9, meaning that the average ability of the JII company as a whole in generating net income per share reaches Rp. 463.9. The average Asset Turn Over of the JII company in one year rotates 0.95 times, meaning that every Rp. 1.00 of assets invested a year can generate revenue of Rp. 0.95.

Firm Value which is measured using Price earning ratio, the average for seven years is 26.02, which can be interpreted as the share acquisition price of Rp. 26.02 can generate a profit of Rp 1. The market value of the shares increased by 26.02 compared to the profit given by the company to investors. The average price book value (PBV) of JII companies listed on the IDX is 5.26 times. It can be interpreted that the market price of the stock value has increased by an average of 5.26. The average closing price of JII companies is Rp. 6551.4.

#### **4.2. Evaluation of the structural model (inner model) and testing hypotheses**

The suitability test between the theoretical and empirical models can be seen at the level of goodness-of-fit statistics. A model is said to be fit if the covariance matrix of a model is the same as the covariance of the data matrix (observed). Model fit indices and P values display the results of 10 fit indicators as shown in [Table 3](#).

The R-square value of financial performance is 0.158 as shown in [Table 4](#), this means that the contribution of Corporate Governance and Capital Structure to Financial Performance is 15.8%, the

**Table 3. Model fit and quality indices**

Model Fit and Quality Indices	Fit Criteria	Result	Explanation
Average path coefficient (APC)	$P < 0.05$	0.295; 0.001	good
Average R-Squared (ARS)	$P < 0.05$	0.438, $P < 0.001$	good
Average Adjusted R-Squared (AARS)	$P < 0.05$	423, $P < 0.001$	good
Average block VIF (AVIF)	acceptable if $\leq 5$ , ideally $\leq 3.3$	1.088	ideal
Average full collinearity VIF (AFVIF)	acceptable if $\leq 5$ , ideally $\leq 3.3$	2.56	ideal
Tenenhaus GoF (GoF)	small $\geq 0.1$ , medium $\geq 0.25$ , large $\geq 0.36$	0.526	good
Sympson's paradox ratio (SPR)	acceptable if $\geq 0.7$ , ideally = 1	0.6	Marginal
R-squared contribution ratio (RSCR)	acceptable if $\geq 0.9$ , ideally = 1	0.965	good
Statistical suppression ratio (SSR)	acceptable if $\geq 0.7$	1,000	good
Nonlinear bivariate causality direction ratio (NLBCDR)	acceptable if $\geq 0.7$	0.6	Marginal

**Table 4. R-square**

	R Square
Financial Performance	0.158
Firm Value	0.717

**Table 5. Hypothesis testing**

Relationship between Variables (Explanatory Variable Response Variable)		Path Coefficient	p-value	Explanation
Corporate Governance	Financial Performance	-0.42	<0.001	Significant
Corporate Governance	Firm Value	0.029	0.39	Non-Significant
Capital Structure	Financial Performance	-0.135	0.092	Non-Significant
Capital Structure	Firm Value	-0.051	0.311	Non-Significant
Financial Performance	Firm Value	0.839	<0.001	Significant

R-square Firm Value is 0.717, this means that the contribution of Corporate Governance, Capital Structure and Financial Performance to Firm Value is 71.7 %

Hypothesis 1: Corporate Governance has a significant effect on Financial Performance

Table 5 explains the direct influence of Corporate Governance on Financial Performance produces a path coefficient of -0.42 with p-value <0.001. This effect is very significant with a negative

sign which means that increasing Corporate Governance will reduce Financial Performance. These results indicate that corporate governance is a determining factor for Financial Performance

Hypothesis 2: Corporate Governance has a significant effect on Firm Value

The direct influence of Corporate Governance on Firm value produces a path coefficient of 0.029 with a p-value of 0.39. This effect is not significant with a positive sign which means that increasing corporate governance will increase firm value. These results indicate that corporate governance is not a determining factor for firm value

Hypothesis 3: Capital Structure has a significant effect on Financial Performance

The direct effect of capital structure on financial performance produces a path coefficient of  $-0.135$  with a p-value of 0.092. This effect is not significant with a negative sign which means that increasing capital structure will reduce financial performance. These results indicate that capital structure is not a determinant of financial performance

Hypothesis 4: Capital Structure has a significant effect on Firm value

The direct effect of capital structure on firm value produces a path coefficient of  $-0.051$  with a p-value of 0.311. This effect is not significant with a negative sign which means that an increase in the capital structure will reduce the firm value. These results indicate that the capital structure is not a determining factor for firm value.

Hypothesis 5: Financial Performance has a significant effect on Firm value

The direct influence of Financial Performance on Firm value produces a path coefficient of 0.839 with p-value  $<0.001$ . This effect is significant with a positive sign which means that increasing Financial Performance will increase Firm value. These results indicate that Financial Performance is a determining factor for firm value.

## 5. Discussion

The study findings show that Corporate Governance significantly affects the Financial Performance of the Jakarta Islamic Index. The direction of the negative coefficient of the influence of Corporate Governance on Financial Performance. This implied that JII companies with a low proportion of independent commissioners have poorer financial performance than companies with a higher proportion of independent commissioners. Therefore, companies that are included in the JII must adopt a policy of increasing the proportion of independent commissioners. The company can maintain the integrity by ensuring that the supervisory and advisory functions are carried out properly. An independent board of commissioners generally has better management oversight, thereby influencing the possibility of fraud in presenting financial statements by managers. In other words, the more competent the board of commissioners is, the more it reduces the possibility of fraud in financial reporting. The findings also indicated that the average composition of independent auditors in the company from the total of all audit committees is still low. JII companies with a larger ratio of independent audit committees will perform better than companies with a smaller proportion of independent audit committees. Therefore, JII companies must ensure that an independent audit committee can play an important role in creating good corporate governance in the company. The audit committee can provide independent professional input to the board of commissioners on the financial statements submitted by the board of directors. In addition, the audit committee is more responsible for overseeing the company's financial statements, overseeing external audits and observing the company's internal control system. The research findings are supported by Wati (2012) opinion that there is an influence between the internal corporate governance index and performance. Investors are more confident investing in companies with low ICGI ratings. The internal corporate governance index (ICGI) assessment is used to measure the company's relationship with all things related to the company. It will be

highly considered by the public to assess the relationship between the company and its external environment. The lower the ICGI level, the better the impact on public judgment.

Findings proved that Corporate Governance had no significant effect on Firm value. This implies that JII companies with a low proportion of independent commissioners will attract less investors to invest their capital, compared to companies with a higher proportion of independent commissioners. For this reason, JII companies must ensure that the independent board of commissioners is able to carry out internal control mechanisms and is responsible for monitoring top-management policies. Based on agency theory, a large number of independent commissioners will make it easier to control top management and the monitoring function will be more effective, which will increase the company's value. The findings show that independent auditor composition does not affect firm value. This implies that JII companies with a larger ratio of independent audit committees will have better value for investors than companies with a smaller proportion of independent audit committees. For this reason, JII companies must ensure that the audit committee has a good job in protecting the interests of shareholders from earnings management actions that are usually carried out by management. If the audit committee's effectiveness can be achieved, then the transparency of the company's management accountability will be trusted. This will increase the confidence of investors. The existence of supervision from the audit committee will ensure the achievement of the company's performance and be able to increase the value of the company.

The study found that Capital structure has no significant effect on Financial Performance and firm value. This implies that JII companies with the use of debt proportions in the capital structure will reduce financial performance and firm value. The results of this study also illustrate that the greater the debt used in the capital structure, the greater the fixed obligations in the form of payment of debt installments and interest borne by the company so that the amount of profit will decrease. The capital structure shows the level of risk of a company where the higher the capital structure, the higher the risk that will occur in the company because the company's funding consists of debt rather than own capital. The larger the capital structure indicates the high risk of the company so that investors avoid stocks that have a high level of capital structure and reduce the interest of investors to invest in the company. For this reason, JII companies must pay more attention to the use of debt more optimally, using debt in more profitable operations.

Financial performance has a significant effect on Firm value. This implies that JII companies with good financial performance are more attractive to investors than companies with poor financial performance. For this reason, JII companies with low financial performance pay more attention to the CG mechanism and the use of debt in the company's capital structure. This findings are in line with signaling theory. The better the financial performance, is considered a signal that the better the firm value. Financial performance has a significant positive effect on a firm value indicating profit influences increasing firm value. Vam Horne (2005) argues that financial performance is one measure of a company's success. The measure of success is contained in the financial statements in the form of financial ratios. Financial reports are analytical tools for creditors to analyze short-term information, namely the company's liquidity. Bondholders will analyze long-term information, namely the company's capital structure.

## 6. Conclusions

This study explores the effect of corporate governance, capital structure on financial performance and firm value of JII companies, based on data from 2015 to 2021. The results show corporate governance has a significant effect on financial performance and financial performance can have an impact on firm value. Further findings prove that capital structure has no impact on financial performance and firm value, as well as corporate governance has no impact on firm value.

Several limitations that may impact results have been noted in this study. CG in this study only takes the element of the CG mechanism; therefore, future studies may include more variations of

CG variables such as board characteristics, ownership structure, decision-making mechanisms to examine the effect of CG on and firm performance and value. Recommendations for the development of this research adding qualitative external factors such as socio-political conditions, security, culture, legal certainty, capital market regulations, technology, and government policies related to financial performance and company value.

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