CHAPTER II
LITERATURE REVIEW

2.0 Introduction

This chapter provides information about the previous empirical review of the concept of Board Size, Board Independence and Audit Committee on the performance of mining industry sector companies listed on the Indonesia Stock Exchange (IDX). This chapter explains the application of theory and determines how the independent variables affect the dependent variable variables and the conceptual framework that will be proposed for this study as well as the hypotheses proposed in this study.

2.1 Literature Review

2.1.1Good Corporate Governance

A mechanism is a systemized way of working something to fulfill certain requirements. Corporate governance mechanism governance mechanism is a clear procedure and relationship between those who make decisions and those who control or supervise decisions. "Mechanisms in corporate governance supervision are divided into two groups, namely internal and external"(Nugrahanti and Novia, 2012).

Internal mechanisms or internal mechanisms, is a a way to control the company by using internal structures and processes, such as the General Meeting of Shareholders Meeting (GMS), composition of the board of directors, composition of the board of commissioners and also meetings with the board of directors. board of commissioners and also meetings with the board of directors. While external mechanisms or external mechanisms is a way of influencing the company other than using internal mechanisms, for example such as control by the company and market control.Good Corporate Governance in this study is proxied by proxied by four mechanisms, namely Insider Shareholder,Board Size,Board Independence,and Audit Committe , as follows:

a. Board Size

"The theories of economics show that the board of directors size and composition of the board of directors with increased effectiveness of supervision and company performance" (Bhagat, S., & Bolton, B, 2008).

The concern of shareholders has to do with whether the board of director is capable to monitor/control managers to act in the interest of the owners. The general notion is that companies that have a large board size are likely to have effective supervision that can improve firm performance (Anderson, Mansib, and Reeb,2004).

"An resources and improve company performance because of information asymmetry" (Nicholson & Kiel, 2007).

b. Board Independence

According to the agency theory, the board of directors can monitor effectively if these are independent from the management The argument is that incentives exist for outside directors to protect their reputation that motivate them to exercise decisional control (Christensen et al., 2010).

Yekini,Adelopo,Andriko Poulos,and Yekini (2015),employing content analysis and panel data set from UK FTSE350 companies, discovered a significant relationship between board independent and information disclosure measured by the proportion of non-executive directors.

Their research shows that firms with non-executive directors are more likely than others to disclose information which can improve company performance.

The proportion of independent directors and their impact on company performance shows that their presence can increase stock prices and financial performance, independent directors have an important role in increasing company value, especially in the context of separation of ownership and control (Nguyen and Nielsen, 2010).

Both Yekini et al. (2015) "support the view of agency theory that non-executive directors can improve company performance because of ability to monitor managers".

c. Audit Committe

The role of the audit committee is to ensure that the integrity financial reporting of the corporation meets corporate governance council standard. "It also ensures compliance of entities such as mandatory disclosures" Davidson, Goodwin-Stewart, & Kent (2005). Kent and Stewart (2008) "discovered that the quantity of disclosure was positively related to frequency of board and audit committee meetings held". However, there is some conflicting evidence from other scholars work. "Audit committee characteristics, such as meeting frequency and member attendance, have a positive influence on the quality of financial reporting and company performance" (Wang et.al,2014).

2.1.2 Financial Performance

According to Rudianto (2013: 189), " Company performance is a description of the company's financial condition analyzed with financial analysis tools, so that the performance of the company in a certain period can be known”.

Performance of the company in a certain period.The company's financial performance is closely closely related to performance measurement and assessment. Performance measurement used in the company to make an improvement to the company's company's operations in order to compete with other companies. Financial performance can be assessed with several analytical tools.According to Munawir (2012: 31) argues that the objectives of measuring financial performance are:

1. Knowing the level of liquidity.

   This liquidity shows how a company's ability to fulfill financial obligations that should be immediately to fulfill financial obligations that should be immediately settled by the company when billed.

2. Knowing the level of solvency.

   Solvency shows a company's ability to fulfill its financial obligations if the company is liquidated, both short-term and long-term finances long term.

3. Knowing the level of profitability.

   Rentability or commonly known as profitability is shows a company's ability to generate profit during a certain period.

4. Knowing the level of stability.

   This stability shows a company's ability to conduct its business in a stable manner, which is measured by considering the company's ability to pay its debts and pay the interest expense of its debts at the specified time has been determined.

Company performance measurement is carried out to make an improvement and control of its operational activities in order to compete with other companies. In addition, performance measurement is also needed to determine the right strategy in order to achieve company goals. In other words, measuring company performance is the foundation on which effective control is built.

Measurement of financial performance can use Return On Asset (ROA), “Return on assets is a ratio that shows the return on the number of assets used in the company” Kasmi (2012). ROA can be used to measure effectiveness of the company to generate a profit byby utilizing the assets owned by the company. ROA is also one form of profitability ratio which is intended to measure the ability of a company on the overall funds that have been invested in the company's operating activities which aim to generate profits by utilizing the assets owned by the company generate profits by utilizing the assets owned by the company.

Tobin's Q is used as one of the indicators to test market efficiency. In this case regarding efficient markets, which state that stock prices fully reflect all available information, The adoption of stricter environmental regulations tends to have a positive impact on Tobin's Q ratio, indicating that firms with good environmental policies are valued more highly by the market (Fu et.al, 2021).

Tobin's Q is a powerful tool in evaluating company performance from various perspectives, including innovation, ownership structure, corporate governance, social responsibility,and regulation. Research by Christensen et al. (2010),Demsetz& Villalonga (2001),Ehikioya (2009), Rodriguez Fernandez (2016), “show that these various factors can significantly influence how the market assesses the value of corporate assets relative to their replacement cost”. Each of these studies provides insight into the specific ways in which these factors interact with market valuation and firm value.

2.2 Underpinning Theory

2.2.1Agency Theory

Agency theory was chosen as the basis for concept development in this study. “ Agency theory is a theory that describes the relationship between one or more people (principals) and other people (agents) who work together to provide a service and facilitate the exchange of ideas with the agent” (Hendrastuti, R., & Harahap, R. F., 2023) In the concept of agency theory, it states that conflicts occur due to differences in interests between principals and agents.Conflicts between principals and agents can occur in any relationship.Greater and dividend profitability of the company is crossed by shareholders, and management is an agent who is encouraged to optimize the action of financial and psychological needs. Management is encouraged by agency and principal relationships to present financial statements with earnings management. One technique to ensure the integrity of the investor-manager relationship is to implement good corporate governance.

2.2.1 Stewardship Theory

In terms of its psychological and sociological roots, “the stewardship theory is a theory theory that is designed to describe situations where managers act as stewards and act in accordance with the interests of the owners” (Acciarini et al,2021).

In addition, the stewardship theory asserts that empowering managers to work with integrity can encourage them to perform their jobs more effectively. The participants in this debate seem to agree that managerial risk is not just caused by financial mismanagement but also requires sound management practices to enable them to maximize stock market returns.

In addition, Managers' representation and their perception of career success play an important role in motivating managers to prioritize shareholder interests, awareness of reputation and failure risks contributes to more careful decision making, thereby improving firm performance (Davis et al,2021).

2.3 Conseptual Framework

The framework describes the relationship between research variables in the form of scheme. This study uses dependent variables, independent variables, and control variables.

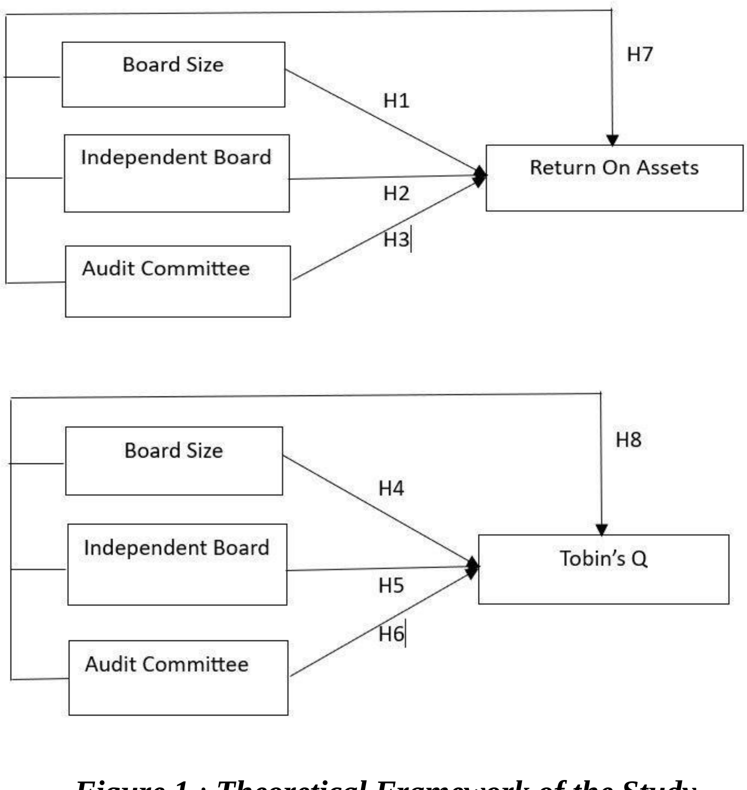

Figure 1 : Theoretical Framework of the Study

Where,

H1: Board Size is related to Return on Assets

H2: Independent Board is related to Return on Assets

H3: Audit Committee is related to Return on Assets

H4: Board Size is related to Tobin's Q

H5: Independent Board is related to Tobin's Q

H6: Audit Committe is related to Tobin's Q

H7: Board Size, Independet Board, and Audit Committee is related to Return on Asssets

H8: Board Size, Independet Board, and Audit Committee is related to Tobin's Q

This study will prove that good corporate governanceas an independent variable measured by indicators of managerial size and institutional ownership has an influence on financial performance. and institutional ownership have an influence on the financial performance of mining as the dependent variable measured using the mining financial performance as the dependent variable measured using the indicator Return On Assets (ROA) and Tobin's Q.

2.4 Hypotheses Development

The supervisory function of the board of directors is to oversee the policies of the directors in running the company and provide advice to the directors. With a large number of members of the board of commissioners, the supervision of the board of directors becomes much better, suggestions and input for the board of directors become more. So that the performance of the management becomes better and also affects the performance of the Company.

According to Anderson et al (2004) explores "how the composition and independence of the board of directors can affect company performance". A more independent board is usually considered more effective in overseeing management and protecting shareholder interests. "The existence of an independent board of directors can be a bulwark to prevent manipulation of financial statements", but contrary to the opinion Modugu. K. Prince et al (2012). "States that beyond a certain point, a larger board can experience coordination problems and a slower decision-making process, which can negatively affect company performance" Bhagat, S., & Bolton, B (2008) argue that by having an independent and well-functioning board of directors,companies can improve supervision of management, reduce the risk of adverse agency behaviour, and increase company value.

H1: Board Size has no Effect and is not Significant to ROA

H2 : Board Size has a Significant Effect on Tobin's Q

The Independent Board of Commissioners is an important organ in the company that has the right expertise and integrity to align the interests of stakeholders. The Board of Commissioners plays a role in mediating disputes between internal management and overseeing policies created by management and providing advice. Similar to the President Director, the Independent Board of Commissioners is responsible for achieving corporate effectiveness but by influencing decision-making rather than controlling the company's operations. Zubeltzu-Jaka et al (2021) "conducted a meta-analysis study covering 126 independent samples and found that board independence has a positive effect on corporate financial performance". This study shows that this effect varies depending on the social and institutional context in which the company operates. Uyar et al (2021), "show that despite the focus on audit committees and independence, their impact on ROA is not always consistent across industries and firm types, indicating the complexity in this relationship". This means that in the context of the study, there is no significant relationship between the presence of independent directors in a company and financial performance as measured by ROA. Christensen et al (2010) "that a strong independent board is a solution to agency problems and will reduce costs, therefore it will be able to improve financial performance" . Based on this explanation, the hypotheses in this study are:

H3: Independent Board has a Significant Effect on ROA

H4 : Independent Board has no Effect and is not Significant to Tobin's Q

The existence and effectiveness of audit committees have a significant impact on the financial performance of mining companies. In general, an active, independent, and competent audit committee tends to improve internal control, reduce the risk of financial statement manipulation, and increase transparency, which in turn can increase ROA and Tobin's Q. The more the number of audit committees owned by the company, the more the financial performance of a company will increase.The more the number of audit committees owned by the company, the more the financial performance of a company will increase. company. Thus, improving performance through the audit committee can increase investor confidence in the company through increasing investor confidence in the company through supervision within the company and the application of GCG principles.This is in line with research conducted by Kent and Stew-art (2008) that “the frequency of audit committee meetings has no predictive ability of financial performance, the less the number of frequencies at the audit committee meeting, the better the financial performance of a company”. Weir et al (2002) argue that “the frequency of audit committee meetings has no effect on financial performance, therefore, the number of audit committee meetings will not be a problem and has no effect on financial performance”. Based on this description, the the hypothesis is as follows:

H5: Audit Committee has a Significant Effect on ROA

H6 : Audit Committee has a Significant Effect to Tobin's Q

2.5 Simultaneous Conclusion

The following is an explanation of the conclusions from the results of the Hypothesis on Board Size, Independent Board, and Audit Committee to Return On Assets:

1. Board Size: Based on H1, board size does not have a significant effect on ROA. This means that the number of board members does not directly affect the company's efficiency in using its assets to generate profits.
2. Independent Board: Based on H3, an independent board has a significant effect on ROA. This shows that the existence of a more independent board can improve the company's supervision and operational efficiency, which has a positive impact on financial performance.
3. Audit Committee: Based on H5, the audit committee also has a significant effect on ROA. This shows that strict financial supervision through the audit committee can improve the efficiency of asset use and management of the company's financial resources.

H7: So it can be concluded simultaneously that the significant influence on ROA is more determined by supervisory governance, such as the existence of an independent board and audit committee, which helps improve the company's operational performance. However, board size does not have a direct impact on operational efficiency.

The following is an explanation of the conclusions from the results of the Hypothesis on Board Size, Independent Board, and Audit Committee to Tobin's Q:

1. Board Size: Based on H2, board size has a significant effect on Tobin’s Q. This means that board size affects market perception and investor valuation of the company, where a larger board may be viewed as a sign of stability or diversity of thought in strategic decision-making.
2. Independent Board: Based on H4, independent boards do not have a significant effect on Tobin’s Q. This suggests that while independent boards are important in improving internal performance, their presence may not be viewed as a major factor influencing market value or investor perception.
3. Audit Committee: Based on H6, the audit committee has a significant effect on Tobin’s Q. Strong financial reporting oversight through the audit committee provides more confidence to investors, which increases market valuation of the company.

H8: it can be concluded simultaneously that Market Perception (Tobin’s Q) is more influenced by the size of the board and the existence of an audit committee, which provides a signal of stability and transparency to investors. However, the existence of an independent board is not considered significant in shaping investor perception.