CHAPTER II
LITERATURE REVIEW

2.0 Introduction

This chapter provides information on previous empirical reviews of the concept of corporate governance mechanisms on the performance of consumer goods industry companies listed on the Indonesia Stock Exchange. This chapter explains the implementation of the theories and determines how the independent variables affect the dependent variable as well as the proposed conceptual framework used to conduct this investigation and also the hypotheses set out in this study.

2.1 Literature Review

2.1.1 Background of Firm Performance

Performance is very important for a company because the success of the company is actually seen through its performance within a certain period of time, and also the company's performance shows how good the company's management is. Many elements affect company performance, but over time, technological advances such as the era of the industrial revolution 4.0, so that this becomes a durable source of strength for a company and becomes one of the favored forms.

Business performance refers to the strategy that has been implemented by the company. There are several resources that can provide information about the company, such as financial statements and the role of management staff, for investors and shareholders. The factors considered include the following: response rate, response consistency, response profitability, and response efficiency. Each ratio in question has a different purpose or set of purposes to provide the necessary information (Edi & Felicia, 2022).

2.1.2 Background of Corporate Governance

Corporate governance and financial performance have become popular among academics and researchers in recent decades. Corporate governance is a global phenomenon that affects the financial performance of companies, but the concept still lacks an accepted theoretical background until recently. Corporate governance began to receive attention after the 19th century through major events, namely, the financial crises in Brazil, Russia, Asia and large-scale blowing up of large companies, so that corporate governance evolved over time.

Over the years, extensive study has been conducted on topics related to corporate governance (CG) and ownership structure, as well as how these factors affect a firm's success (Queiri et al., 2021). The ideas of accountability, transparency, responsibility, and risk management form the foundation of corporate governance. The efficacy of the corporate governance framework is gauged by the corporate governance index (CGI). It consists of five sub indices, covering control over related party transactions, shareholders' rights, board procedures, ownership structure, and disclosure. Each sub-index has a collection of indicators that show how well a company adheres to the corporate governance code. higher compliance is anticipated to lead to higher company performance as well as better corporate behavior on the side of the firm (Mahmood et al., 2023).

2.2 Underpinning Theory

2.2.1 Agency Theory

The agency is one of the prevalent theories that highlight the difficulties in putting good stewardship into practice. The basic principle of agency theory is that executives act on the basis of self-interest and, therefore, do not always protect the interests of shareholders. Agency theory is as a contract where one or more people (the primary) hire another person (the agent) to execute a service on their behalf and transfer some decision-making authority to the agent. The assumption of this theory is that the interests of the principle and the agent are not necessarily congruent. The agency problem and subsequent costs are caused by the conflict of interest between the principal (shareholders) and agent (managers) (Zungu et al., 2023).

From the perspective of the agency, if corporate governance procedures are in place to reduce agency conflict, the performance of the firm will be improved and guaranteed. On the other hand, agency mechanisms, according to the stewardship theory, result in transactional relationships between executives and shareholders. Executives who lack inner motivation are unable to reach their desired levels of good business performance. Therefore, according to stewardship theory, a company's performance improves when executives and shareholders have mutual trust and respect (Puni & Anlesinya, 2020).

2.3 Conceptual Framework

This study aims investigate the relationship between board size, board committees, and board meeting toward firm performance in manufacturing on the Indonesia Stock Exchange. The suggested research model is shown in the following figure:

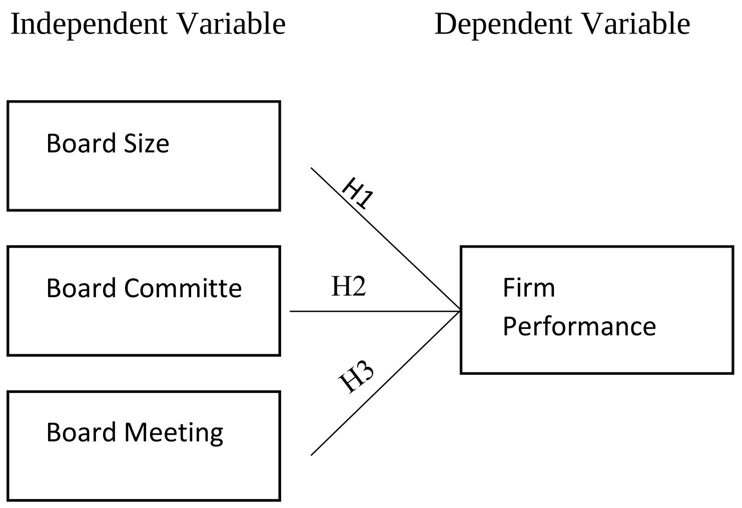

Figure 2.1 Conceptual Framework of the Relationship IV and DV

The relevant research on the topic's independent and dependent variables is review in this section. The current study's research model combines the relationship between two variables, firm performance (DV) and board size, board committees, and board meeting (IV).

2.4 Hypotheses Development

2.4.1 Board Size

The number of directors on a company's board, including both outside and inside independent directors, is referred to as board size. (Malik & Makhdoom, 2016). According to agency theory, the corporate board carries out a number of tasks that force management to look out for interest the shareholders (Waheed & Malik, 2019).

In theory, the firm's board of directors protects the interests of each and every equity stakeholder. According to several studies, there is a mixed relationship between board size and business success. The relationship between board size and firm evaluation models in the context of firm variables found evidence of a negative relationship. Firms gain financially from increasing board size, as it brings a diversity of ideas, talent, and critical resources. According to (Hearn et al., 2017)board composition and size have an important role in determining executive compensation and stabilizing corporate governance practices during difficult economic times.

Nonetheless presents an opposing critical viewpoint that favors smaller boards due to their lower costs to the firm. Moreover, a CEO with greater authority can more easily manage a smaller board, which speeds up the decision-making process. Suggest that the ideal number of directors for a corporate board is between seven and nine. In this context, it shows that there is a positive correlation between board size and firm-level attributes such as firm size, firm value and financial performance (Waheed & Malik, 2019). Thus, the following hypothesis has been formulated:

H1 Board Size positively influences firm performance.

2.4.2 Board Committe

The board committees are where the internal operations of the board reside. Agency theory also recommends that for board committees to function properly, most of them should be independent outside directors and composed of experts. After all, board committees serve as an important check on the authority of the CEO (Puni & Anlesinya, 2020). Board committees serve as an important check on the authority of the CEO and provide advice to the board. (Prashar & Gupta, 2020)

According to agency theory, the board serves as the primary oversight tool to resolve agency problems. Clearly, the proposition that board committee has significant influence on firm performance is contestable; therefore, the following hypothesis is formulated:

H2 Board Committe positively influences firm performance.

2.4.3 Board Meeting

The effectiveness of board responsibilities and functions can be determined by the frequency of board meetings. The results of decisions from board meetings are effective in minimizing conflicts of interest and agency costs, the frequency of board meetings also allows directors to evaluate and improve ongoing performance strategies.

On the contrary, (Puni & Anlesinya, 2020) contends that the frequency of board meetings has no bearing on maximizing shareholder value because most of the board's proceedings are devoted to discussing management reports and other standard board procedures, rather than the board using the allotted time to discuss strategies. There is less time available for outside directors who are not involved in the day-to-day operations of the company to ask important questions of top management, which limits the monitoring role, raises agency costs, and lowers corporate performance.

Additionally, there are expenses related to board meetings, such as the cost of directors' time, managerial time, and travel expenses (Puni & Anlesinya, 2020), which may have an impact on performance. This might have a detrimental effect on output. Similarly, some academics have contended that infrequent board meetings might not give members enough opportunity to talk about important topics that require attention. The following hypothesis is put forth to investigate if the frequency of board meetings influences the success of the firm:

H3 Board Meeting positively influences firm performance.