The Effects of Good Corporate Governance Mechanisms on Profitability of Company Shares

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ABSTRACT

This study aims to determine the effects of Good Corporate Governance, proxied by controlling shareholder, foreign ownership, government ownership, board of commissioners' size and independent commissioners, on the profitability of company shares. The population of this study is the firms in the Trade, Service, and Investment sector as many as 174 companies. The sampling technique used was purposive sampling. The samples were the companies from Retail Trade sub-sector, Resto, Hotel and Tourism sub-sector, Investment sub-sector, and other sub-sectors as many as 42 companies listed at the Indonesia Stock Exchange in 2016-2019. The data analysis technique used is logistic regression analysis. The results of the study conclude that the controlling shareholder and foreign ownership have positive effects on the profitability of company shares, while government ownership, board of commissioners' size, and independent commissioners do not affect the profitability of company shares. There are three implications which this research infers. First, the position of controlling shareholder has the power to determine which parties to be involved in the managerial team so that the increase in share profitability can be pursued as much as possible. In addition, foreign ownership has a big role in creating better performance. Also, it is important to encourage an active, effective, and efficient role of the government to support good corporate governance.

Keywords: Corporate Governance Mechanism, Profitability of Company Shares, Earning Per Share

1. INTRODUCTION

The implementation of Good Corporate Governance (GCG) is an unavoidable necessity considering the complex needs for good governance in an organization (Meidiawati & Mildawati, 2016). There is a belief that the proper implementation of GCG can be the embodiment of business ethics and work ethics enforcement. Ethics have long been intended as a commitment in a company. Performance improvement is also seen as another implication of GCG implementation. since the implementation of GCG can encourage and help improve performance, which is a sign of a company's ability to survive in the business competition, including gaining trusts from the company's externals.

According to Triwahyuningtias and Muharam (2012) Corporate Governance is defined as a system, process, and set of rules with the aim at creating many relationships with various corresponding parties within a company. This concept was launched to realize the welfare of the shareholders and serves as the operational procedures to run the company according to the objectives of the company. Fundamentally, GCG has the principles and several implementation mechanisms that are regulated by the authorized committees.

National Committee for Governance Policy is an institution authorized to formulate and develop Corporate Governance in Indonesia and to issue the General Guidelines for the

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implementation of Good Corporate Governance in Indonesia. The principles of implementing good corporate governance include several things, namely transparency, accountability, responsibility, independence, and reasonableness. The principle of transparency is able to encourage the emergence of fair disclosure as very basic information is needed by the shareholders, creditors, and related stakeholders.

The mechanism in corporate governance is the control of a company which is reflected through various regulations regarding the mechanism for profit sharing; in this case is in the forms of profits, returns, as well as various risks with the approval of the principal and agent. This mechanism is an internal company mechanism that involves board of directors, board of commissioners, institutional ownership, and audit committee (Djazilah & Kurnia, 2016).

The main objective of the implementation of Good Corporate Governance mechanism is the realization of a control and balance system (check and balance). Furthermore, this mechanism is expected to be able to prevent the misuse of resources and encourage the company development (Putra & Nuzula, 2017). Good Corporate Governance can be seen from the availability of appropriate incentives for the boards and the management. The goal is to achieve the goals and interests of the company and the shareholders, as well as to exercise the control effectively (Setiawati & Veronica, 2020). The implementation of good corporate governance aims to ensure that firms are more responsive to their stakeholders' interests will eventually improve trust to the firms (Rakhmini Juwita, 2019).

Control and supervision can be carried out by an audit committee whose role is to produce an adequate supervisory system in the implementation of GCG. The supervision can promote and maintain the consistency of credibility shown in a company's financial statements. If there are more and more independent audit committees, the supervision can be carried out properly and will certainly have an impact on improving performance. The committee has a position as another form of oversight mechanism for several management-related parties and external parties. These efforts are expected to minimize agency conflicts due to the imbalance of information. In addition, the independent audit committee is seen as capable of improving the company's performance through the supervision (Udayana, 2018).

This research is motivated by the following research. First, the research conducted by Putra and Nuzula (2017) which uses the variables of the proportion of independent commissioners, audit committee, managerial ownership, and institutional ownership. In addition, there is also the study performed by Nugroho and Rahardjo (2014) which assesses CSR, size of board of commissioners, and size of board of directors. Both the studies carried out by Situmorang and Simanjuntak (2019) which employs size of board of directors, independent commissioners, and institutional ownership, and by Yusniar (2019) which researched independent board of commissioners, directors, and institutional ownership variables also give insights to this study. From those aforementioned previous studies, two variables were taken, namely independent commissioners and size of board of commissioners. The researcher also added the variables of controlling shareholder, foreign ownership, and government ownership as the independent variables. Meanwhile, profitability of company shares is used as the dependent variable in this study.

This study is to investigate the effect of good corporate governance on stock profitability. The research questions whether good corporate governance proxied by controlling shareholder, foreign ownership, government ownership, size of board of commissioners, and independent commissioners affect share profitability. The population of this study is the go-public companies listed at the Indonesia Stock Exchange (IDX). Share is very influential in a company's performance. If Good Corporate Governance mechanism is not implemented properly and correctly, investors' confidence in the company will decrease. This mechanism is expected to keep the profitability of company shares increasing.

The results of this study are expected to contribute to the development of theories, especially in the study of financial accounting regarding Agency Theory and Good Corporate

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Governance. In addition, the findings are also expected to increase the knowledge about the effect of good corporate governance mechanism on profitability of company shares, especially in the companies categorized as the Trade, Services, and Investment sector. The practitioners such as investors can also use this study to do an initial analysis before investing in a company so as to increase the profitability of the company's shares.

2. LITERATURE REVIEW

2.1. Agency Theory

The main theory related to corporate governance is Agency Theory. This theory is put forward by Jensen and Meckling (1976) who argue that the relationship in an agency can be expressed in the form of a contract where one person (principal), or in another form more than one, asks another person (agent) to perform certain services in the interests of the principal. Administrators are an agent who is responsible for preparing financial statements to report the organization’s financial position and achievement to the shareholders, or also known as principal in the Agency Theory (Kamolsakulchai, 2015).

The principal or owner of a company delegates his authority to an agent to manage the company which causes two conflicting interests between the shareholders and the management. The shareholder basically wants to increase wealth, while the manager tends to maximize personal interests and sacrifices the interests of the shareholder which can trigger agency problems (Nugroho & Rahardjo, 2014).

Agency problem that occurs within a company can be overcome by the implementation of Good Corporate Governance (GCG). In this case, GCG has an important role to supervise and control the management of the company. In addition, GCG also plays an important role to ensure that the management of the company is carried out in accordance with the applicable rules and regulations. For the shareholders, the implementation of GCG is to guarantee that their funds that have been invested in the company are managed properly and can provide adequate returns (Taduga & Nofal, 2019).

The implementation of GCG may lead to agency costs that must be incurred by the company. However, this cost is at least considered to have advantage in overcoming losses due to non-compliance experienced by their counterparts with enforcement costs. Jensen and Meckling (1976) argue that agency costs that arise consist of the following: Monitoring expenditure by the principal which is the cost spent for monitoring the behavior of the agent in managing the company and incurred by the principal. In addition, there is also bounding expenditure by the agent which is the cost from the agent as a form of guarantee that the presence of the agent in a company is important for the principal. The last is the residual loss which is a form of loss due to a decision made by the agent and borne by the principal. This happens because the decision deviates from the decision of the company owner.

2.2 Corporate Governance

Corporate Governance is a set of regulations used to control the relationship between several parties, including shareholders, company managers, creditors, government, employees, and stakeholders in both company's internal and external areas. This is certainly related with their rights and obligations. GCG is also a system that has a power to regulate and control the strategic directions and performance of a company (Istiana, Hasiolan, & Fathoni, 2018).

GCG is a necessary tool to minimize the agency problems in the relationship between owner and manager. GCG is also a good corporate governance system to explain the relationship among the various parties in determining the direction of the company policies (Mahardika & Riyadi, 2018). The General Guidelines for Good Corporate Governance in Indonesia are a basic reference for companies to implement GCG in order to encourage

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corporate sustainability through the governance based on GCG principles, including transparency, accountability, responsibility, independence and fairness, as well as equality. The principles encourage the empowerment of the functions and independence of each section in the company, namely Board of Commissioners, Board of Directors, and General Meeting of Shareholders. Furthermore, they also encourage the shareholders, members of Board of Commissioners and Board of Directors to make decisions, carry out their actions with high moral values, and comply with the laws and regulations. Other functions of the principles include encouraging awareness and social responsibility of the company for the community and environmental sustainability, especially around the company; optimizing the value of the company for the shareholders while still paying attention to other stakeholders, and increasing the competitiveness of the company nationally and internationally so as to increase market confidence that can encourage investment flows and sustainable national economic growth. In other words, good corporate governance is expected to reduce agency costs.

Corporate governance is a mechanism of working or the totality of workflow taken in a systematic implementation to meet the certain requirements in an organization. The mechanism includes a clear regulation, procedure, and relationship between the related parties to make good decisions and supervise the decision implementation (Udayana, 2018).

According to Gillan (2006), corporate governance mechanism is divided into internal mechanism and external mechanism. Internal mechanism is a way of controlling through internal structures and processes, such as board of directors, managerial incentives, share ownership structure, as well as laws and regulations enacted in an agreement, or in this case, often called a charter. Meanwhile, external mechanism is an influential effort that is not only carried out internally but also can be carried out by means of control or regulation, capital market, and personal external sources of supervision.

The research conducted by Djazilah and Kurnia (2016) states that the mechanism in corporate governance is a form of control by making rules that regulate the profit-sharing mechanism. This profit sharing is in the form of profits, returns, and various risks that are agreed upon by the principal and the agent. This mechanism is included in the internal corporate governance mechanism which consists of board of directors, board of commissioners, institutional ownership, and audit committee.

3. HYPOTHESIS DEVELOPMENT

A controlling shareholder is a person or legal entity that owns more than half of a company's shares or the majority of outstanding shares of a company. According to the research conducted by Jensen and Meckling (1976) based on Agency Theory, difference in interests between managers and shareholders can lead to conflicts which are often called agency conflicts. This very potential conflict of interests imposes the importance of an implemented and useful mechanism to protect the interests of shareholders.

Al-Homaidi, Almaqtari, and Ahmad (2019) in their research state that controlling shareholders are able to influence a company's profitability. This is because the control and operations of the company are carried out entirely by the company's management. If the controlling shareholder as an investor holds 25% of shares or more, the controlling shareholder is able to influence the company because the controlling shareholder is declared authorized in making decisions or policies to increase share profitability. Other studies that show similar results are the research conducted by Istiana, Hasiolan, and Fathoni (2018) as well as that by Al-Homaidi, Almaqtari, and Ahmad (2019) which conclude that controlling shareholders have a positive effect on stock profitability. Based on these elaboration, the first hypothesis is formulated as follows.

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H1: Controlling shareholders have a positive effect on the profitability of company shares.

Foreign ownership is the portion of outstanding shares owned by foreign investors from the total outstanding share capital. Foreign ownership has a significant impact on the companies in developing countries. The more foreign parties own the shares of a company, the more improved the performance of the company because foreign parties investing their capital usually have good management system, technology, innovation, expertise, and marketing which result in positive influences for the company (Altawalbeh, 2020).

A similar study conducted by Fang et al. (2019) states that foreign ownership has a positive effect on company profitability. They argue that according to Agency Theory, in foreign ownership, the foreigners as the majority shareholder would appoint a foreigner to serve on board of commissioners or board of directors. Thus, an agreement to achieve the objectives and to maximize the profitability of the company's shares will be realized because there is a similarity in principle between foreign shareholder and the company management in which the foreign party also serves as a part.

The research conducted by Altawalbeh (2020), Ramos et al. (2020), and Owiredu and Kwakye (2020) reveal that foreign ownership has an effect on stock profitability. Based on the explanation, the hypothesis is composed as follows.

H2: Foreign ownership has a positive effect on the profitability of company shares.

Government ownership is the number of shares owned by government from the total share capital outstanding and managed by state-owned companies such as Perum, Perjan, and Persero that go public. Angela et al. (2019) show that the concentration of government ownership can encourage a negative influence on the profitability of a company. In addition, government also slows down the performance of the company because government is not yet able to manage the company properly. Even, government can intervene in the company's performance for the sake of the government's interest which causes the profitability of the shares to decrease.

Basuki (2020) states that government companies controlled by bureaucrats have goals based on political interests and not for the welfare of the community and the company itself. The Agency Theory explains that in the relationship between shareholders and managers, government as the controlling shareholder should be able to monitor or control the performance of the managers, but government often has other goals than to increase the profitability of the stocks.

The research conducted by Mahardika and Riyadi (2018) also concludes that government has social interests rather than thinking about how to increase the profitability of a company's shares. This condition will have an impact on poor government control in corporate governance. The research conducted by Angela et al. (2019), Mahardika and Riyadi (2018), and Basuki (2020) deduces that government ownership has a negative effect on stock profitability. Based on the delineation, the following hypothesis is proposed.

H3: Government ownership has a negative effect on the profitability of company shares.

Board of commissioners is the board whose job is to provide supervision and advice to directors of a company. In Indonesia, Board of Commissioners is appointed by General Meeting of Shareholders (GMS) pursuant to Law (UU) No. 40 of 2007 concerning Limited Liability Companies. The role of Board of Commissioners can be seen from one of the

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characteristics of its membership composition. The size of Board of Commissioners is the number of the members of Board of Commissioners in a company (Putra & Nuzula, 2017). The research conducted by Yusniar (2019) explains that the more members of Board of Commissioners, the better the supervision toward Board of Directors and the more inputs or options that the directors will get.

Another study performed by Nugroho and Rahardjo (2014) has found that size of Board of Commissioners is positively related to profitability. In relation to the Agency Theory, this shows that the larger the size of Board of Commissioners, the more stringent the supervision of the financial statements and the objectives of a company so that the profitability of the company's shares will increase. The research conducted by Nugroho and Rahardjo (2014), Putra and Nuzula (2017), and Yusniar (2019) are in agreement that size of Board of Commissioners has a positive effect on stock profitability. Based on the above mentioned descriptions, the following hypothesis is formulated.

H4: Size of Board of Commissioners has a positive effect on the profitability of company shares.

Independent Commissioner is a member of Board of Commissioners whose position is not related to the finance, management, and share ownership of a company, and who has no family relationship with other members of Board of Commissioners, Board of Directors, and/or controlling shareholders, or with the company that may hinder or hinder his position to act independently in accordance with the principles of Good Corporate Governance. Independent commissioners are also responsible for supervising and representing the interests of minority shareholders.

The research conducted by Situmorang and Simanjuntak (2019) states that independent commissioner can act as a mediator in a dispute between internal managers, as well as to oversee the management policies and provide advice to the management. Independent commissioner is in the best position to carry out the monitoring function so that a company with good corporate governance can be created. Independent commissioner is expected to minimize the agency problems that arise between Board of Directors and shareholders. The research conducted by Ramos et al. (2020) states that based on the Agency Theory, if there are more independent commissioners, the supervision will be more stringent and the number of agency problems will decrease.

The greater the number of independent commissioners, the more independent the preparation of financial statements and free from personal interest elements. This is expected the financial statements can be prepared properly and presented in accordance with the rules. The higher the percentage of independent commissioners, the better the employees' performance. This is expected to increase the profitability of the company's shares. The research conducted by Situmorang and Simanjuntak (2019) and Ramos et al. (2020) concludes that independent commissioner has a positive effect on stock profitability. Based on those assumption, the following hypothesis is formulated.

H5: Independent commissioner has a positive effect on the profitability of company shares.

4. RESEARCH METHOD

4.1. Population and Samples

The population in this study is the companies in the Trade, Services, and Investment sector which were listed at the Indonesia Stock Exchange for the period 2016 -2019. The sampling

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

method used was purposive sampling. Based on the established criteria, there were 165 data companies that met the research criteria. Table 1 presents the data on the population and samples of this study.

Table 1: Research Samples

Description	Number	Accumulated
Population	174	174
Sample Criteria:		
Companies in the Trade, Services. and Investment sector delisted from the Indonesia Stock Exchange (IDX) in the period of 2016-2019.	(20)	154
Companies that were not in the Retail Trade sub-sector; Resto, Hotel and Tourism sub-sector; Investment sub-sector for the period of 2016-2019 which were listed at the IDX.	(74)	80
Companies in the Trade, Services, and Investment sector that did not publish the complete and consecutive financial reports in 2016-2019.	(38)	42
Companies in the Trade, Services, and Investment sector companies that did not list the names of their shareholders, board of commissioners, and independent commissioners consecutively in 2016-2019.	0	42
Number of company samples		42
Research period (2016-2019)		4
Total company samples during research (42*4)		168
Outliers	(3)	165

Source: Data processed by researchers (2021)

4.2. Measurement of Research Variables

The controlling shareholder is a person or legal entity that owns 25% or more of the total outstanding shares in the company. Controlling shareholder in this research is a dummy variable, thus the shareholder with 25% of the total shares of the company was valued 1, on the other hand, the ownership lower than 25% was rated 0.

Foreign ownership is a portion of outstanding shares owned by foreign investor which results in a significant control that enables the investor to monitor the company's activities thus reducing agency costs. Foreign owners tend to be long-term investors. Foreign ownership in this research is a dummy variable. Hence, if the company had foreign ownership of 5% or more. it was given the value of 1; otherwise the value was 0. The limit of share ownership is 5% because the ownership above 5% refers to one shareholder.

Government ownership is the number of a company's shares owned by the government from the total outstanding shares in the company and managed by state-owned companies. Government ownership in this research is a dummy variable. If the company had government ownership of 5% or more, it was rated 1, whereas the ownership below 5% was rated 0.

Board of Commissioners is a board that has the duty to provide supervision and advice to the directors of a company. Size of Board of Commissioners is the number of Board of Commissioners' members in a company. In this study, Board of Commissioners' size was measured using the indicator for the number of Board members.

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

Independent Commissioner is a member of Board of Commissioners who has no share ownership in a company and no financial, management, and/or family relationship with the members of Board of Commissioners, Board of Directors, and/or controlling shareholders, and/or the company that may hinder or hinder his position to act independently in accordance with the GCG principles. The variable of independent commissioner in this study was measured by the number of independent commissioners from the total members of board of commissioners.

Earnings Per Share (EPS) is the ratio of the amount of profit (return) obtained by investors or shareholders. Higher EPS value will indirectly increase the shareholders and investors' trusts in a company, increase the stock price, and show that the company has good performance. EPS is calculated using the following formula (Badruzaman, 2017).

$$EPS = \frac{\text{Net Income}}{\text{Number of shares outstanding}}$$

4.3. Data analysis

4.3.1. Descriptive Statistics

Table 2: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
FO	165	0	1	.56	.497
GO	165	0	1	.03	.172
SBC	165	1	10	4.36	1.808
IC	165	.00	1.00	.3406	.27804
EPS	165	0	1	.76	.426
Valid N (Listwise)	165				

Source: Data processed by researchers (2021)

4.3.2. Logistic Regression

The inferential analysis was used to assess the Overall Model Fit. The result showed that in the beginning the -2 Likelihood value was 180.461, and after using the method or when all the influencing variables were entered, the value of -2 Likelihood was 166.821. As indicated, there was a decrease of 13.64 in -2 Likelihood value. When the value of -2 Likelihood decreases from stage 0 to stage 1, it can be interpreted that there is an independent variable which can improve or strengthen the fit of the model used. From the test results, it can be concluded that the regression model used in this study is suitable.

The coefficient of determination (Nagelkerke R Square) value was 0.119 which indicates that the dependent variable is affected by the independent variables as much as 11.9%. The remaining 88.1% can be explained by other variables which are not involved in this study.

The feasibility test of the regression model (Goodness of Fit test) demonstrated the Chi Square value of 10.117 and significance value of 0.182. Because the significance value is 0.182 which is greater than the significance level of 5%, it can be concluded that H0 is accepted and the model used in this study is feasible, so the model is accepted. The model matches the data used and can perform further analysis.

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

Table 3: Variables of Equation

		B	S.E.	Sig.
Step 1[a]	X1	.075	.026	.005
	X2	.054	.005	.017
	X3	20.799	17180.452	.999
	X4	-.003	.109	.977
	X5	.143	.705	.840
	Constant	2.315	.637	.000

[a.] Variable(s) entered on step 1: X1, X2, X3, X4, X5

Source: Data processed by researchers (2021)

Based on Table 3, the regression model in this study is in the form of logistic regression as follows:

$$EPS = 2.315+ 0.075\ CS+ 0.054\ FO + 20.779\ GO - 0.003\ SBC + 0.143\ IC$$

where:

EPS : Earnings Per Share
CS : Controlling Shareholder
FO : Foreign Ownership
GO : Government Ownership
SBC. : Size of Board of Commissioners
IC : Independent Commissioner

5. RESULTS AND DISCUSSION

The regression results show that the controlling shareholder variable has a positive effect on the profitability of company shares (Earnings Per Share). This result is in accordance with the Agency Theory because the controlling shareholders benefit the company since they generally have a long-term interest in the company and are willing to closely monitor the actions of the senior managers and reduce the agency costs between the shareholders and the management. They are also in the position to expropriate company assets, especially when they are actively involved in the management. Therefore, it is likely that their position is able to provide control and influence on the company profitability (Hamza, 2009).

Foreign ownership has a positive effect on the profitability of company shares (Earnings Per Share). This result is consistent with the Agency Theory and the fact of foreign ownership in Indonesia, where the high, stable, and long-term foreign ownership benefits the domestic companies due to the effective supervision, advanced technological facilities, international market development, and professional management. This study supports the results of other studies in the context of profitability where foreign share ownership has a positive and significant impact on companies, such as those of Nofal, (2020) and Wiranata and Nugrahanti (2013).

Government ownership does not have a significant effect on the profitability of company shares (Earnings Per Share). Government ownership ensures the national control over the vast natural resources used and that the company headquarter will still remain in Indonesia. If the government does not have the adequate instruments and good ability to manage the company, the company performance will be affected. As mentioned by Klungland and Sunde (2009), government ownership in a company has no effect on the company profitability and performance.

Size of board of commissioners does not have a significant effect on the profitability of company shares (Earnings Per Share) and is not in accordance with the Agency Theory which states that the larger the size of board of commissioners, the more stringent and objective the supervision of financial statements will be. On the other hand, the

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

result of this study indicates that the larger the size of board of commissioners, the lower the level of supervision of financial statements which causes the level of stock profitability to decrease. This result is in line with Susanti's (2016) research which states that board of commissioners can be weakened when confronted with conflicts and can then limit its authority in supervising the company management, thus resulting in low profitability.

Independent commissioner does not have a significant effect on the profitability of company shares (Earnings Per Share). This is not in accordance with the Agency Theory which states that the greater the number of independent commissioners, the more independent the preparation of financial statements and free from the elements of personal interest. This is probably because an independent commissioner has a task to supervise the management in managing the company. Independent commissioner is not directly involved in making both practical and strategic decisions which is carried out by the management, including the decision to distribute profits to the shareholders. Independent commissioner must remain neutral and professional in order to maintain the integrity and sustainability of the company (Harianto, 2017).

6. CONCLUSION, SUGGESTIONS, AND IMPLICATIONS

6.1. Conclusion

The results of this research on the influences of controlling shareholders, foreign ownership, government ownership, size of board of commissioners, and independent commissioners on stock profitability (EPS) conclude that: (1) Controlling shareholder has a positive effect on the profitability of company shares; (2) Foreign ownership has a positive effect on the profitability of company shares; (3) Government ownership has no effect on the profitability of company shares; (4) Size of board of commissioners has no effect on the profitability of company shares; and (5) Independent commissioners has no effect on the profitability of company shares.

6.2. Suggestions

The coefficient of determination (Nagelkerke R Square) value is 0.119 which indicates that the dependent variable is affected by the independent variables as much as 11.9%. The remaining 88.1% is explained by other variables which are not involved in this study. Future studies are suggested to include other variables that might influence the profitability of company shares.

6.3. Implications

There are at least three implications which this research infers. First, the position of controlling shareholder has the power to determine which parties to be involved in the managerial team so that the increase in share profitability can be pursued as much as possible. In addition, foreign ownership has a big role in creating better performance. Also, it is important to encourage an active, effective, and efficient role of the government to support good corporate governance.

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