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Corporate Governance and Financial Performance: Empirical Evidence from LQ-45 Firms in Indonesia

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Abstract. This study examines the effect of corporate governance on the financial performance of firms listed in the LQ-45 index of the Indonesia Stock Exchange during the 2020–2024 period. This study is among the first to investigate governance effectiveness in the post-COVID-19 period by focusing on blue-chip firms in an emerging market context. Using panel data analysis and a Random Effects Model, corporate governance is measured through a composite governance disclosure index, while financial performance is proxied by Return on Assets (ROA). The empirical results indicate that corporate governance has a positive and statistically significant effect on firm performance. These findings support agency theory, suggesting that stronger governance mechanisms improve managerial efficiency and mitigate agency conflicts, particularly under post-pandemic economic uncertainty. By providing updated evidence from highly liquid Indonesian firms, this study contributes to the corporate governance literature and offers practical implications for regulators, corporate managers, and investors seeking to enhance firm performance through improved governance practices.

Keywords: Corporate governance, financial performance, LQ-45, agency theory

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1. Introduction

Corporate governance has become a central issue in corporate finance, particularly in emerging economies where institutional frameworks and regulatory enforcement mechanisms are still developing. The growing separation between ownership and managerial control intensifies agency problems, making governance mechanisms crucial for ensuring accountability, transparency, and sustainable corporate performance. Weak governance structures may lead to inefficient decision-making, expropriation of minority shareholders, and declining firm value, especially in environments characterized by information asymmetry and limited legal protection (Shleifer & Vishny, 1997; La Porta et al., 2000).

From a theoretical standpoint, agency theory provides a fundamental explanation for the role of corporate governance. Jensen and Meckling (1976) argue that conflicts of interest arise when managers, acting as agents, possess greater discretion and information than shareholders, potentially encouraging opportunistic behavior. Governance mechanisms such as board independence, audit committees, and disclosure requirements serve as monitoring and control tools to align managerial actions with shareholder interests and reduce agency costs (Fama & Jensen, 1983; Eisenhardt, 1989).

Empirical evidence from developed markets largely supports these theoretical predictions. Gompers, Ishii, and Metrick (2003) document that firms with stronger governance structures tend to exhibit higher firm valuation, while Bhagat and Bolton (2008) find a positive association between governance quality and firm profitability. More recent studies continue to confirm that effective



governance contributes to better financial performance, risk management, and long-term firm value, particularly in transparent and well-regulated markets.

However, the governance performance relationship is more complex in emerging markets. Concentrated ownership structures, weak investor protection, and heterogeneous institutional quality often limit the effectiveness of formal governance mechanisms (Claessens & Yurtoglu, 2013). In such contexts, internal governance arrangements play a more critical role in protecting shareholder interests and mitigating agency problems (La Porta et al., 2000). Consequently, the impact of corporate governance on firm performance in emerging economies tends to be highly context-dependent and empirically inconclusive.

Indonesia offers a particularly relevant setting for examining this issue. Regulatory reforms introduced by the Financial Services Authority (Otoritas Jasa Keuangan/OJK) have strengthened corporate governance practices through mandatory disclosures, board composition requirements, and enhanced transparency standards. Nevertheless, empirical studies indicate that the implementation of governance mechanisms among Indonesian firms remains uneven, reflecting variations in ownership concentration, managerial professionalism, and regulatory compliance (Setiawan et al., 2021; Siallagan & Machfoedz, 2006).

This issue is especially salient among firms listed in the LQ-45 index. Although these firms are classified as blue-chip companies due to their high liquidity and large market capitalization, their financial performance varies considerably over time. Prior research suggests that firm size and market dominance do not necessarily guarantee superior performance, emphasizing the importance of governance quality as a determinant of firm outcomes (Klapper & Love, 2004; Brown & Caylor, 2006).

Despite the growing body of literature, prior empirical findings on the relationship between corporate governance and financial performance in Indonesia remain mixed. Some studies report a positive and significant relationship, while others find insignificant or even negative effects depending on the governance proxies, methodological approaches, and observation periods employed (Siregar & Utama, 2008; Prasinta, 2012). Moreover, much of the existing literature relies on relatively outdated data and focuses on pre-COVID-19 conditions, limiting its relevance in explaining firm behavior in the post-pandemic environment.

This study addresses several important gaps in the existing literature. First, empirical evidence on the effectiveness of corporate governance in the post-COVID-19 period remains limited, particularly in emerging markets where the pandemic significantly altered governance practices, risk management strategies, and financial performance dynamics. Second, few studies explicitly focus on blue-chip firms, such as those included in the LQ-45 index, despite their strategic importance, high public visibility, and role as benchmarks for market confidence. Third, many prior studies rely on individual governance proxies, which may fail to capture the multidimensional nature of corporate governance.

Accordingly, this study extends prior research by examining post-pandemic corporate governance effectiveness among blue-chip firms in Indonesia using a composite corporate governance index. By focusing on the 2020–2024 period and employing panel data analysis, this research provides updated and robust empirical evidence on whether corporate governance continues to play a significant role in enhancing financial performance in Indonesia's capital market. The findings are expected to contribute to the corporate governance literature by clarifying the governance performance nexus in an emerging market context and offering practical implications for regulators, corporate managers, and investors.

2. Methods

This study employs a quantitative research design using a panel data approach to examine the effect of corporate governance on financial performance among firms listed in the LQ-45 Index of the Indonesia Stock Exchange (IDX). A quantitative approach is considered appropriate because it enables the objective measurement of relationships between variables and allows for statistical inference based on empirical data (Creswell, 2014). Panel data analysis is particularly suitable for this study, as it combines cross-sectional and time-series dimensions, thereby increasing the number of observations and improving the efficiency and reliability of parameter estimation (Baltagi, 2005).

In addition, the use of panel data allows for better control of unobservable firm-specific characteristics that may influence financial performance but remain constant over time, such as managerial culture or organizational structure. This methodological advantage helps reduce potential estimation bias and enhances the robustness of the empirical results (Hsiao, 2014).

The population of this study comprises all companies listed on the Indonesia Stock Exchange (IDX). The sample is limited to firms included in the LQ-45 index over the 2020–2024 period, which represents companies with high market liquidity, large market capitalization, and active trading intensity. As such, LQ-45 firms serve as an appropriate proxy for well-established and closely monitored companies within the Indonesian capital market. A purposive sampling technique was employed to ensure data suitability and consistency, based on the following criteria:

- a) Firms that were consistently listed in the LQ-45 index throughout the observation period;
- b) Firms that published complete annual reports and audited financial statements for the 2020–2024 period;
- c) Firms with publicly available corporate governance disclosures and financial data required for the analysis; and
- d) Firms that did not experience delisting or prolonged trading suspension during the study period.

Financial Performance

Financial performance is the dependent variable in this study and is measured using accounting-based performance indicators, namely Return on Assets (ROA) and Return on Equity (ROE). These measures are widely used in corporate finance and governance research to evaluate managerial efficiency and firm profitability (Brigham & Ehrhardt, 2017). ROA reflects a firm's ability to generate earnings from its total asset base, indicating operational efficiency, while ROE captures the return generated for shareholders by measuring profitability relative to equity investment. Together, these indicators provide a comprehensive assessment of both internal efficiency and shareholder value creation, making them particularly relevant in studies examining the effectiveness of corporate governance mechanisms (Bhagat & Bolton, 2008; Al-Najjar, 2017). To enhance the robustness of the analysis, financial performance in this study is represented by a composite performance index constructed from ROA and ROE. This approach is consistent with prior empirical research that employs aggregated performance measures to mitigate measurement error and reduce potential bias associated with reliance on a single performance indicator (Klapper & Love, 2004).

Good Corporate Governance

Corporate governance is the independent variable of interest in this study. It is measured using a composite corporate governance index constructed from governance disclosure and compliance indicators reported in firms' annual reports. The index captures key governance dimensions, including board structure, audit committee effectiveness, transparency and disclosure practices, and shareholder protection mechanisms. The governance index consists of indicators developed based on the Indonesian Financial Services Authority (Otoritas Jasa Keuangan/OJK) regulations and the National Committee on Governance Policy (Komite Nasional Kebijakan Governance/KNKG) guidelines, which serve as the primary regulatory framework for corporate governance implementation in Indonesia. Each indicator is assessed using a binary scoring scheme, where a score of 1 is assigned if the firm discloses or complies with the relevant governance item, and 0 otherwise. The overall governance score is calculated as the ratio of disclosed items to the total number of indicators.

Examples of key governance items included in the index are the proportion of independent commissioners, the existence and independence of the audit committee, the frequency of board meetings, and the disclosure of risk management and internal control policies. The use of a composite governance index is consistent with prior studies suggesting that individual governance mechanisms may not fully capture governance quality when examined in isolation (Gompers et al., 2003; Brown & Caylor, 2006). A higher governance score indicates stronger governance practices and greater adherence to good corporate governance principles.

Data Analysis Technique

The data were analyzed using panel data regression techniques. This approach was chosen because it allows the examination of relationships across firms and over time while controlling for

unobserved heterogeneity. Panel data analysis is widely applied in corporate governance and finance research due to its ability to generate more reliable and efficient parameter estimates than purely cross-sectional or time-series methods (Baltagi, 2005).

To identify the most appropriate estimation model, several panel data model selection procedures were conducted to compare alternative specifications. Based on the results of these tests, the final estimation employed a random-effects model. This approach is appropriate when firm-specific effects are assumed to be uncorrelated with the explanatory variables and when the objective is to generalize the findings beyond the sampled firms (Gujarati & Porter, 2009).

Statistical significance was assessed using t-tests at the 5 percent significance level. The empirical results were subsequently interpreted in light of relevant theoretical frameworks and prior empirical studies to ensure consistency and theoretical validity.

3. Results and Discussion

Result

Table 1 presents the descriptive statistics of the variables used in this study. Financial performance, measured using a composite indicator derived from ROA and ROE, has a mean value of 2.0208, indicating that, on average, firms included in the LQ-45 index exhibit relatively strong financial performance during the 2020-2024 period. The minimum and maximum values range from 1.0000 to 3.2500, reflecting notable variation in profitability levels across firms. The standard deviation of 0.4439 indicates moderate dispersion, suggesting that although LQ-45 firms are generally regarded as well-performing entities, their financial outcomes differ substantially. This variation supports the relevance of investigating firm-specific determinants particularly corporate governance to explain differences in performance.

With respect to corporate governance, the average governance score reported in Table 1 is 0.6732, with minimum and maximum values of 0.5297 and 0.8205, respectively. The relatively high mean value suggests that, in general, LQ-45 firms have implemented governance mechanisms at a reasonably good level. However, the observed variation (standard deviation = 0.0475) indicates that governance quality is not uniform across firms, thereby justifying its inclusion as an explanatory variable. Overall, the descriptive statistics in Table 1 are consistent with prior studies indicating that even among large and highly liquid firms, governance practices may vary considerably and influence firm outcomes (Klapper & Love, 2004; Brown & Caylor, 2006).

Tabel 1. Descriptive Statistics

Variable	Mean	Median	Maximum	Minimum	Std. Deviation
Financial Performance	2.0208	2.0000	3.2500	1.0000	0.4439
Corporate Governance	0.6732	0.6706	0.8205	0.5297	0.0475

Note: Financial performance is measured using a composite indicator based on ROA and ROE. Corporate governance is measured using a governance index derived from company disclosures

The panel data regression analysis was conducted using the Random Effects Model, which was identified as the most appropriate estimation approach based on the model selection procedures. Table 2 presents the regression results of the panel data analysis. The empirical findings indicate that corporate governance has a positive and statistically significant effect on financial performance. The estimated coefficient for corporate governance is 1.2163, with a probability value of 0.0087, indicating significance at the 1 percent level. This result suggests that improvements in governance quality are associated with higher levels of firm performance, supporting the argument that stronger governance mechanisms enhance managerial efficiency and contribute to superior financial outcomes.

Tabel 2. Random Effects Regression Results

Variable	Coefficient	Std. Error	t-Statistic	Probability
Constant	1.0252	0.4740	2.1630	0.0331
Corporate Governance	1.2163	0.7003	1.7368	0.0087***
Item	Value			

Variable	Coefficient	Std. Err
Estimation Method	Random Effects	
	Model	
Number of Firms	24	
Observation Period	2020–2024	
Total Observations	120	
Significance Level	1%, 5%, 10%	

*Significant at 1% level

The positive coefficient indicates that a one-unit increase in the corporate governance index is associated with an approximate 1.216-unit increase in financial performance, holding other factors constant. This finding provides strong empirical support for the proposed hypothesis and confirms that corporate governance mechanisms play a substantive role in enhancing firm performance. The constant term is also statistically significant, suggesting that firms exhibit a baseline level of financial performance even in the absence of improvements in governance quality. Nevertheless, the magnitude and statistical significance of the governance coefficient indicate that higher governance quality substantially strengthens firm outcomes beyond this baseline level, underscoring the critical role of effective governance in driving superior corporate performance.

Discussion

The findings of this study provide strong empirical support for agency theory, which posits that effective corporate governance mechanisms reduce agency conflicts and enhance managerial efficiency (Jensen & Meckling, 1976). The positive and statistically significant relationship between corporate governance and financial performance indicates that governance mechanisms function as effective monitoring tools that align managerial actions with shareholder interests.

These results are consistent with prior empirical evidence from both developed and emerging markets. Studies by Gompers et al. (2003) and Bhagat and Bolton (2008) demonstrate that firms with stronger governance structures tend to achieve superior performance and higher firm value. Similarly, Klapper and Love (2004) show that governance quality plays a particularly critical role in countries with weaker institutional environments, where internal governance mechanisms serve as an important substitute for external legal protection.

This study extends the existing literature by demonstrating that corporate governance remains a key determinant of performance even among firms classified as blue-chip companies. Despite their strong market positions, high liquidity, and public visibility, firms included in the LQ-45 index continue to exhibit substantial performance variation, which can be explained by differences in governance quality. This finding suggests that market dominance alone does not guarantee operational efficiency and that effective governance mechanisms remain essential for sustaining firm performance.

Moreover, the results indicate that corporate governance in LQ-45 firms functions not only as a control mechanism but also as a strategic resource. Strong governance practices enhance transparency, reduce information asymmetry, and strengthen investor confidence, which may improve access to external financing and lower the cost of capital. This interpretation is consistent with the resource-based view, which conceptualizes governance structures as intangible organizational assets that contribute to sustained competitive advantage (Barney, 1991).

The significance of governance during the 2020–2024 period is particularly noteworthy given the economic uncertainty associated with the post-pandemic recovery phase. During periods of heightened volatility, firms with stronger governance frameworks are better positioned to manage risk, maintain stakeholder trust, and sustain financial performance. This finding reinforces the argument that governance quality becomes increasingly important in times of economic disruption and uncertainty (OECD, 2021).

Overall, the results confirm that corporate governance plays a decisive role in enhancing financial performance among Indonesian listed firms. The findings provide empirical support for ongoing regulatory efforts to strengthen governance practices and underscore the importance of continuous governance improvement, even among firms that are already regarded as market leaders.

4. Conclusion and Recommendation

Conclusion

This study examines the effect of corporate governance on financial performance among firms listed in the LQ-45 Index of the Indonesia Stock Exchange during the 2020–2024 period. The empirical findings demonstrate that corporate governance has a positive and statistically significant impact on firm performance, indicating that stronger governance mechanisms contribute to improved financial outcomes. These results provide robust empirical support for agency theory, confirming that effective governance reduces agency conflicts, enhances managerial accountability, and improves decision-making efficiency.

The study further reveals that even among highly liquid and well-established firms, variations in governance quality remain a key factor explaining differences in financial performance. This finding suggests that market prominence and firm size alone do not guarantee superior performance, highlighting the continued importance of effective governance practices in sustaining firm value. Overall, the results reinforce the view that corporate governance is not merely a compliance requirement but a strategic mechanism that plays a crucial role in enhancing firm performance in emerging market contexts.

Recommendation

Based on the findings, several recommendations can be proposed. First, corporate managers are encouraged to strengthen governance practices beyond minimum regulatory compliance by improving board effectiveness, transparency, and internal control systems, as these measures can enhance firm performance and long-term competitiveness. Second, investors should incorporate governance quality as a key consideration in their investment decision-making, as it serves as an important signal of firm credibility and risk management capability.

From a regulatory perspective, policymakers and regulators are advised to continue strengthening governance enforcement and disclosure standards to ensure consistent and effective implementation across firms. Enhanced monitoring and stricter compliance mechanisms may further improve governance quality and market confidence.

Finally, future research is recommended to extend the scope of analysis to include firms beyond the LQ-45 index, incorporate non-financial performance indicators such as sustainability or environmental, social, and governance (ESG) outcomes, and employ alternative governance measures to capture internal governance effectiveness more comprehensively. Such extensions would provide deeper insights into the role of corporate governance in shaping firm performance across different market segments.

5. References

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