

THE EFFECT OF GOOD CORPORATE GOVERNANCE ON THE FINANCIAL PERFORMANCE OF MANUFACTURING COMPANIES LISTED ON THE INDONESIA STOCK EXCHANGE IN 2011-2013

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ABSTRACT

This study aims to determine the effect of Good Corporate Governance consisting of Institutional Ownership, Board Structure, Audit Committees, Audit Quality, Managerial Ownership, Board Size, Board Commissioners to Financial Performance as measured by ROA. Sampling method in this study using purposive sampling with a sample of 16 companies listed on the Indonesian Stock Exchange in the period is 2011 until 2013. The result show that Institutional Ownership Board Structure, Audit Quality, and the size of the Board of Commissioners positive effect on the company's Financial Performance as measured by ROA. Meanwhile, other test result showed that the Audit Committee, Managerial Ownership and the size of the Board of directors does not affect the company's Financial Performance as measured by ROA.

Keywords: GCG, Financial Performance, ROA

INTRODUCTION

A company's financial performance is an overview of the financial condition of a company that is analyzed with financial analysis tools, so that it can be known about the good or bad financial condition of a company that reflects work performance in a certain period. Through this assessment, companies can choose strategies to maximize performance in achieving the company's targets. One way to achieve this is to implement good corporate governance that is effective in the long term so that it can help control the company's operations so that it runs in accordance with the company's goals and in accordance with the expectations of shareholders. Good corporate governance allows companies to operate more effectively and improve the performance of the company. In addition to

having good financial performance, the company is also expected to have good governance.

The concept of corporate governance arises because of the limitations of agency theory in overcoming agency problems. Overall, the concept of corporate governance arises as an effort to control or overcome selfish management behavior. Jensen and Mekling (1976) stated that an agency relationship is a contract between a manager (agent) and an investor (principal). The issue of corporate governance has become the world's concern after the revelation of the largest case in the United States involving the Enron company and in Indonesia itself there is a case of PT. Kimia Farma Tbk.

In Indonesia itself, good corporate governance is still relatively weak. In 2002, based on a study by Pricewaterhouse

Coopers published in the Report on Institutional Investor Survey, Indonesia was still at the bottom with China and India with a score of 1.96 for transparency or openness in the implementation of good corporate governance. In 2004 CLSA (Credit Lyonnais Securities Asia) results from the survey, Indonesia was still at the bottom in Asia in the implementation of good corporate governance. According to the results of the ACGA (Asian Corporate Governance Association) survey in 11 countries of foreign business people in Asia placed Indonesia as the worst country in the field of corporate governance, in 2010 Indonesia was ranked 10th, in 2012 Indonesia was 11th and in 2014 Indonesia was the last.

This research is a development of research conducted by Utomo (2014). Based on the study, it shows an adjusted R square value of 10.3%, indicating that 89.7% of independent variables are still influenced by variables outside the study. The study provides suggestions so that future researchers can consider the possibility of adding independent variables that can affect the company's financial performance. The variables added in this study are managerial ownership, size of the board of directors and size of the board of commissioners.

In addition, the previous research year was conducted in the period 2010-2012. Previous research object in a manufacturing company listed on the Indonesia Stock Exchange. Therefore, the researcher will conduct research in the latest 3-year period in the 2011-2013 period and on the same object, namely manufacturing companies listed on the Indonesia Stock Exchange.

Octavianto (2014) conducted a study on the influence of good corporate governance on company performance stating that the size of the board of commissioners has a positive effect on the company's performance but the independence of the audit committee, the independence of the board of commissioners, managerial ownership, the

number of meetings of the board of commissioners and the number of audit committee meetings have no effect on the company's performance.

Research conducted by Rini (2012) on the influence of institutional shareholders, independent commissioners and audit committees on profitability shows that institutional shareholders do not have a significant influence on the company's profitability, Independent Commissioners and audit committees have a positive and significant effect on profitability levels.

Lestari's (2011) research on the influence of good corporate governance on financial performance (case study on banking companies listed on the Indonesia Stock Exchange in 2007-2009) shows that the activities of the board of commissioners and the audit committee have a positive and significant effect on financial performance, but the board of directors and the independent board of commissioners have a negative and significant effect on financial performance.

Susanti's (2013) research on the influence of the implementation of good corporate governance, institutional ownership and leverage on financial performance (a study on manufacturing companies on the Indonesia Stock Exchange in 2009 – 2011) shows that independent commissioners have no influence on performance. Institutional ownership has a significant positive influence on performance.

LITERATURE REVIEW

The Influence of Institutional Ownership on Financial Performance

Jensen and Meckling stated that institutional ownership has a very important role in minimizing agency conflicts that occur between managers and shareholders. The existence of institutional investors is considered to be an effective monitoring mechanism in every decision taken by managers. This is because institutional investors are involved in strategic take-it-all, so it is not easy to believe in profit

manipulation.

Institutional ownership replaces managerial ownership in controlling *agency costs*. The greater the ownership by financial institutions, the greater the voting power and encouragement of financial institutions to supervise management and consequently will provide a greater impetus to optimize the value of the company so that the company's performance will also increase. Institutional ownership is considered as a controller for the company to create good and increasing performance. Based on this description, the hypothesis of this study is:

H1: Institutional ownership has a positive influence on a company's financial performance

The Influence of the Structure of the Board of Commissioners on the Company's Financial Performance

The agency theory arises because of the difference in interests between *agents* and *principals*, so that in a company it is necessary to have a party that independently supervises management performance so as not to harm the interests of shareholders. Independent Commissioners are parties that can act as management supervisors in implementing the *corporate governance system*.

Independent commissioners can contribute to the company's performance through evaluation activities and strategic decisions. The larger the number of independent board of commissioners in the company, the more effective it will be in monitoring the manager and ultimately the company's performance will also increase. Jensen and Meckling (1976) revealed that the more monitors there are, the lower the likelihood of conflict. The research is supported by research by Rini (2012) stating that independent commissioners have a significant and positive effect on company performance as measured by ROA. Based on this description, the following hypothesis is formulated:

H2: The structure of the Board of

Commissioners has a positive effect on the company's financial performance

The Influence of the Audit Committee on the Company's Financial Performance

The agency theory emerged because of the difference in interests between *agents* and *principals* so that in a company there is a need for a party to supervise financial reporting and help the board of commissioners run the company properly. The audit committee has an important and strategic role in terms of maintaining the credibility of the financial report preparation process as well as maintaining the creation of an adequate corporate supervision system and the implementation of *Good Corporate Governance*. With the effective functioning of the audit committee, the *control* over the company will be better, so that agency conflicts that occur due to management's desire to improve their own welfare can be minimized.

Effendi (2005) concluded that the existence of an audit committee is very important in order to improve the company's performance, especially from the control aspect. This is because the larger the size of the audit committee, the more effective the role of the audit committee in controlling and monitoring top management. The existence of an effective audit committee is one of the aspects of *a good corporate governance mechanism*. From the description above, the following hypothesis can be formulated:

H3: The audit committee has a positive effect on the company's financial performance

The Influence of Auditor Quality on the Company's Financial Performance

Agency Theory is a difference in interests between *agents* and *principals*, for which quality auditors are needed to reduce agency conflicts. Audit is an important element of an efficient capital market because it can increase the credibility of

financial information, directly supporting better *corporate governance* practices through transparent financial reporting. In addition, (Dye, 1993) in Arifin, 2010 states that large audit firms tend to provide higher quality audits than small firms, because more prosperity is at stake in large audit firms. They will also suffer greater losses through reputational damage if the quality of their audits does not meet the accepted quality standards.

In addition, as Mitton (2002) said, since quality audits are also an aspect of *corporate governance*, it is suspected that companies audited by one of the *Big Four* audit firms (as a proxy for auditor quality) will have better market performance and greater transparency. *Big Four* auditors provide higher quality audits than non-*Big* auditors. Based on the description above, it can be hypothesized as follows:

H4 : The quality of auditors has a positive effect on the company's financial performance

The Influence of Managerial Ownership on the Company's Financial Performance

Share ownership is the percentage of share ownership owned by the management, namely the directors, managers and board of commissioners who actively participate in the company's decision-making or in other words the manager is also a shareholder. Managerial stock ownership can unite the interests of management and shareholders. Through managerial stock ownership, managers are expected to act more in the interests of shareholders after owning a certain portion of shares in the company because managers have the same financial risks as *stakeholders* so that they demand managers to have better performance.

Agency theory raises arguments against the existence of conflicts between owners, namely shareholders, and managers. The conflict arose as a result of differences of interest between the two parties. In agency theory, it is suggested that

there is an incentive mechanism to encourage management to act in accordance with the interests of *stakeholders*. Management will not think like *stakeholders* if they are not *stakeholders*. The existence of managerial share ownership makes the position between shareholders and managers can be aligned.

According to Anggraini (2006), the greater the managerial ownership in the company, the more productive the manager's actions in maximizing the company's performance, in other words, the lower the cost of contracting and supervision. From the description above, the following hypotheses can be formulated:

H5: The Company's Managerial Ownership has a positive effect on the company's financial performance

The Influence of the Size of the Board of Directors on the Company's Financial Performance

The Board of Directors is one of the indicators in the implementation of *corporate governance* which is tasked and responsible for carrying out the company's management. Therefore, the proportion of the board of directors (both the board of directors and the board of commissioners) plays a role in the company's performance and can minimize the possibility of agency problems in the company.

Based on the theory of agency which states the difference in interests between *agents* and *principals*, the existence of a board of directors can reduce agency conflicts because it functions to supervise management to act according to the wishes of shareholders. S. Beiner, *et al* (2003) in Purwaningtyas (2011) emphasized that the board of directors can help solve agency problems inherent in public companies. Beiner S., *et al* (2003) also emphasized that the board of directors is an important *governance mechanism*, because the board of directors can ensure that managers follow the interests of shareholders. From the description above, the following

hypothesis can be formulated:

H6: The size of the board of directors has a positive effect on the company's financial performance

Effect of the Size of the Board of Commissioners on the Company' s Financial Performance

The agency theory arose because of the difference in interests between *agents* and *principals* so that in a company there is a need for a party to supervise the running of the company. The role of the board of commissioners in a company is more emphasized on *the monitoring function* of the implementation of board of directors policies. The role of this commissioner is expected to minimize agency problems that arise between the board of directors and shareholders. Therefore, the board of commissioners should be able to supervise the performance of the board of directors so that the resulting performance is in accordance with the interests of shareholders (Wardhani, 2006). The *monitoring function* carried out by the commissioner is taken from the agency theory.

The size of the board of commissioners is the right number so that the board of commissioners can work effectively and carry out *corporate governance* by being accountable to shareholders. So, the size of the board of commissioners is an amount that is considered proportional to represent the company's shareholders so that the board of commissioners can work effectively and carry out *corporate governance* by being accountable to shareholders. From the description above, the following hypothesis can be formulated:

H7: The size of the board of commissioners has a positive effect on the company's financial performance.

RESEARCH METHODS

Population and Sample

The population in this study is manufacturing companies listed on the

Indonesia Stock Exchange (IDX) in the period 2011 – 2013. The sampling technique is carried out by *purposive sampling* with the aim of obtaining a representative sample in accordance with the specified criteria. The *purposive sampling* method is a sample determination technique with certain considerations (Sugiyono, 2007), with the following criteria:

1. Manufacturing companies listed on the IDX for the observation period in 2011 – 2013.
2. Manufacturing companies that presented financial statements consistently during the observation period of 2011 – 2013.
3. The company that presents complete information on the required variables (institutional ownership, structure of the board of commissioners, audit committee, auditor quality, managerial ownership, board of directors and board of commissioners).

Data Collection Methods

The data collection method in this study is as follows:

a. Documentation

Documentation is collecting data by recording documents related to this research. The data used in this study are the financial statements of manufacturing companies listed on the IDX in 2011 – 2013. (www.idx.co.id)

b. study book

The literature study method is by examining various literature such as journals, papers, and other sources related to research.

Data Analysis Methods

The entire data collected is then analyzed to be able to provide answers to the problems discussed in this study. The data analysis method used in this study is a quantitative method. The quantitative method is a research method by analyzing a

problem that is manifested by numbers. Statistical calculations and hypothesis testing in this study were processed with the help of the SPSS 21.0 computer program.

Operational Definition

Dependent Variables

The financial performance variable is proxied by *Return on Asset*, this ROA measures the company's ability to generate profits based on the assets owned by the company. To obtain the ROA value, it can be calculated by the formula:

$$ROA = \frac{\text{Laba Bersih Setelah Pajak}}{\text{Total Aset}}$$

Independent Variables

Institutional Ownership

Institutional ownership is the proportion of stock ownership by the institution. With this ownership, the institution can professionally monitor the development of its investment, so that the potential for fraud can be suppressed, formulated as follows: KI =

$$KI = \frac{\text{Jumlah Kepemilikan Saham Institusi}}{\text{Jumlah Saham Beredar}}$$

Structure of the Board of Commissioners

The variable structure of the board of commissioners is seen from the proportion of independent commissioners in the board of commissioners in the company. The result is a percentage calculated from the following formula:

$$SDK = \frac{\text{Jumlah Komisaris Independen}}{\text{Jumlah Dewan Komisaris}}$$

Audit Committee

The audit committee in this study is measured using an interval scale, namely by calculating the number of audit committee members in the company's annual report. This can be formulated with the following concepts: UKA = \sum Komite Audit

Auditor Quality

The quality of auditors can be measured by using a size proxy in Public Accounting Firms (KAP). Susiana Arleen

(2007) in her article said that the audit quality measurement tool is a dummy variable where the number 1 is given if the auditor who audits the company is an auditor from the big four KAP, and 0 if the one who audits the company is from the non-big four KAP.

Managerial Ownership

Managerial ownership is measured by calculating the percentage of the number of shares owned by management compared to the total number of outstanding shares of the company. This variable is calculated by the following formula: KM = $\frac{\sum \text{Saham Yang Dimiliki Manajemen}}{\sum \text{Saham Beredar}}$

Size of the Board of Directors

The size of the board of directors referred to in this study is the number of boards of directors in a company. The measurements are as follows: UDD = \sum Dewan Direksi

Size of the Board of Commissioners

The size of the board of commissioners is measured using the number of members of the board of commissioners both from within the company and from outside the company. The size of the board of commissioners is calculated using the following formula: UDK = \sum Anggota Dewan Komisaris

RESULTS AND DISCUSSION

Descriptive Statistical Analysis

Descriptive statistical analysis aims to explain or describe a data in variables seen from the mean value, minimum, maximum and standard deviation (Ghozali, 2011). Descriptive statistics for institutional ownership variables, structure of the board of commissioners, audit committee, auditor quality, managerial ownership, size of the board of directors and size of the board of commissioners on the financial performance of companies proxied by ROA include: mean, maximum, minimum and standard deviation.

Hypothesis Testing

The Effect of Institutional Ownership on the Company's Financial Performance (ROA)

Based on the results of the t-test, it can be seen that Institutional Ownership has a coefficient value of 0.0004 and a significant value of 0.048. This shows that the significance level is $0.048 < 0.05$, then H_0 is rejected and H_a is accepted. Thus, H_1 which states that Institutional Ownership has a positive effect on the Company's Financial Performance which is proxied with ROA is accepted. Based on the agency theory which states that there is a difference in interests between *agents* and *principals* so that it can be minimized by institutional ownership. Where institutional ownership is tasked with monitoring the company that has the largest percentage of ownership. This explains that institutional ownership of shares will increase the company's chances of higher performance. The influence of institutional shareholding in a company on ROA can indicate a good control in supervising the company's management.

The Influence of the Board of Commissioners Structure on the Company's Financial Performance (ROA)

Based on the results of the t-test, it can be seen that the Independent Board of Commissioners has a coefficient value of 0.046 and a significant value of 0.047. This shows that the significance level is $0.047 < 0.05$, then H_0 is rejected and H_a is accepted. Thus, H_2 states that the Structure of the Board of Commissioners has a positive effect on the Company's Financial Performance, which is proxied with ROA received. Based on the agency theory which states that the difference in interests between the *agent* and *the principal* can be minimized by the structure of the board of commissioners. This shows that the structure of the board of commissioners plays an important role because the board of commissioners ensures the implementation of the company's strategy, supervises

management in managing the company and requires the implementation of accountability. Therefore, with the increasing percentage of independent board of commissioners, it will improve the performance of the company concerned.

The Influence of the Audit Committee on the Company's Financial Performance (ROA)

Based on the results of the t-test, it can be seen that the Audit Committee has a coefficient value of -0.002 and a significant value of 0.916. This shows that the significance level is $0.916 > 0.05$, then H_0 is accepted and H_a is rejected. Thus, H_3 which states that the Audit Committee has a positive effect on the Company's Financial Performance which is proxied with ROA is rejected. It is not in accordance with the agency theory which states that the role of the audit committee is very important in overseeing the company's financial reporting and helping the board of commissioners to minimize conflicts of interest in the company. The role of the audit committee in assisting the board of commissioners also seems to be less effective and effective, so that supervision of the board of directors becomes less effective. As a result, the audit committee is not able to provide important considerations for commissioners to supervise the performance of the board of directors.

The Effect of Auditor Quality on the Company's Financial Performance (ROA)

Based on the results of the t-test, it can be seen that the Quality of Auditors has a coefficient value of 0.034 and a significant value of 0.047. This shows that the significance level is $0.024 < 0.05$, then H_0 is rejected and H_a is accepted. Thus, H_4 states that the Quality of the Auditor has a positive effect on the Company's Financial Performance which is proxied with the ROA received. Based on the theory of agency quality, auditors can minimize agency conflicts that occur in the company

because the quality of auditors functions to supervise the company so that the company runs according to applicable regulations. This shows that companies audited by auditors who are increasingly qualified from the *Big Four* KAP type tend to have better performance. Companies that have a high ROA tend to choose the *Big Four* KAP to audit their financial statements to remind investors of their confidence in the company.

The Effect of Managerial Ownership on the Company's Financial Performance (ROA)

Based on the results of the t-test, it can be seen that Managerial Ownership has a coefficient value of 0.001 and a significant value of 0.916. This shows that the significance level is $0.366 > 0.05$, then H_0 is accepted and H_a is rejected. Thus, H_5 which states that Managerial Ownership has a positive effect on the Company's Financial Performance which is proxied with ROA is rejected. It is not in accordance with the theory of agency which states that agency conflicts can be minimized by managerial ownership, where a manager can act as a manager of the company as well as the owner of the company. This can be due to the management owning a small number of shares, which results in the management not feeling that they own the company because not all benefits can be enjoyed by the management which causes the management to be motivated to maximize its utility to the detriment of shareholders.

Effect of the Size of the Board of Directors on the Company's Financial Performance (ROA)

Based on the results of the t-test, it can be seen that the Size of the Board of Directors has a coefficient value of 0.003 and a significant value of 0.916. This shows that the significance level is $0.181 > 0.05$, then H_0 is accepted and H_a is rejected. Thus, H_6 which states that the Size of the Board of Directors has a positive effect on the Company's Financial Performance which is

proxied with ROA is rejected. This is not in accordance with the theory of agency where the board of directors acts to supervise management in managing the company to act in accordance with the company's wishes. However, the larger the number of the board of directors, the greater the fraud in financial reporting and the ability of the board of directors to monitor will decrease with the increasing number of the board of directors because it will cause problems in coordination, communication and decision-making.

The Effect of the Size of the Board of Commissioners on the Company's Financial Performance (ROA)

Based on the results of the t-test, it can be seen that the Size of the Board of Commissioners has a coefficient value of 0.006 and a significant value of 0.047. This shows that the significance level is $0.039 < 0.05$, then H_0 is rejected and H_a is accepted. Thus H_7 states that the Size of the Board of Commissioners has a positive effect on the Company's Financial Performance which is proxied with the ROA received. Based on the theory of agency which states that agency conflicts can be minimized by the existence of a board of commissioners, where the board of commissioners functions to oversee the running of the company. This shows that in accordance with its function, the role of the board of commissioners in a company is more emphasized on the monitoring function of the implementation of board of directors policies. The role of this commissioner is expected to minimize agency problems that arise between the board of directors and shareholders, namely to improve the quality of profits by limiting fraudulent actions in the form of profit management levels through the monitoring function of financial reporting. The more board of commissioners, the more effective the restriction on fraudulent acts can be carried out, so that it will improve the company's performance.

CONCLUSIONS AND SUGGESTIONS

Based on the discussion and results of hypothesis testing that has been carried out by the researcher using multiple linear regression, the following findings are produced:

1. Institutional ownership has a positive effect on the financial performance of companies that are proxied with ROA. This explains that the ownership of shares owned by institutions will increase the chances of higher company performance.
2. The structure of the Board of Commissioners has a positive effect on the financial performance of the company which is proxied with ROA. This indicates that independent commissioners play an important role in a company, the higher the percentage of independent board of commissioners will improve the performance of the company concerned.
3. The Audit Committee has no effect on the financial performance of the company that is proxied with ROA. This shows that the audit committee is not able to provide important considerations for commissioners to supervise the performance of the board of directors.
4. The quality of the auditor has a positive effect on the financial performance of the company which is proxied with ROA. This shows that companies audited by auditors who are increasingly qualified from the *Big Four* KAP type tend to have better performance.
5. Managerial ownership has no effect on the financial performance of the company that is proxied with ROA. This can be because the management who owns a small number of shares, will make other shareholders try to supervise and influence management decision-

making so that the decision-making process becomes inflexible and slow.

6. The size of the Board of Directors has no effect on the financial performance of the company that is proxied with ROA. The larger the size of the board of directors, the greater the fraud which results in decreased performance.
7. The size of the Board of Commissioners has a positive effect on the financial performance of the company that is proxied with ROA. The more board of commissioners, the more effective the restriction on fraudulent acts can be carried out, so that it will improve the company's performance.

The limitations of this study still need to be improved because the *Adjusted R Square* value is still low at 49.7%.

Based on the limitations of this study, for future research, it should be possible to consider adding other independent variables such as foreign ownership, family ownership, number of board of commissioner meetings, and number of audit committee meetings.

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