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Catalyzing Growth: The Interplay of Governance and Market Development in Achieving SDGs

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ABSTRACT

Stock market development is influenced by various factors, including governance quality. This study analyzes the impact of the World Governance Indicators (WGI) on stock market development in Indonesia from 2008 to 2022 using regression analysis and non-parametric robustness tests. The WGI indicators examined include Voice and Accountability, Political Stability, Government Effectiveness, Regulatory Quality, Rule of Law, and Control of Corruption. The regression analysis results indicate that none of these indicators significantly affect stock market capitalization. However, the robustness test using Spearman correlation with quartile-based categorization reveals that Rule of Law and Voice & Accountability significantly correlate with stock market capitalization, highlighting the importance of institutional quality in investor confidence. Additionally, inflation negatively impacts market capitalization, while GDP growth does not exhibit a significant effect. The findings suggest that strengthening legal frameworks and enhancing government transparency are crucial for fostering a stable and attractive investment climate.

ABSTRAK

Perkembangan pasar modal dipengaruhi oleh berbagai faktor, termasuk kualitas tata kelola. Penelitian ini menganalisis pengaruh World Governance Indicators (WGI) terhadap perkembangan pasar modal di Indonesia selama periode 2008-2022 dengan menggunakan analisis regresi serta pengujian robustnes non-parametrik. Indikator WGI yang diteliti mencakup Voice and Accountability, Political Stability, Government Effectiveness, Regulatory Quality, Rule of Law, dan Control of Corruption. Hasil regresi menunjukkan bahwa tidak ada indikator ini yang secara signifikan mempengaruhi kapitalisasi pasar. Namun, uji robustnes menggunakan korelasi Spearman dengan kategorisasi kuartil mengungkapkan bahwa Rule of Law dan Voice & Accountability memiliki korelasi signifikan dengan kapitalisasi pasar, menegaskan pentingnya kualitas institusi dalam meningkatkan kepercayaan investor. Selain itu, inflasi memiliki dampak negatif terhadap kapitalisasi pasar, sedangkan pertumbuhan PDB tidak menunjukkan pengaruh signifikan. Temuan ini menekankan bahwa penguatan kerangka hukum dan peningkatan transparansi pemerintahan sangat penting untuk menciptakan iklim investasi yang stabil dan menarik.

1. Introduction

Sustainable development represents a major challenge for humanity, where good governance and institutional effectiveness are closely linked to long-term development and the success of sustainability (Buckley et al., 2021). Achieving the Sustainable Development Goals (SDGs) requires enhancing institutional quality and reducing country risk (Barbier & Burgess, 2021). In developing and emerging market economies (EMDEs), natural capital and environmental management, along with effective governance, are key factors for progress towards the SDGs (Barbier & Burgess, 2021).

However, despite the extensive literature linking governance to economic and stock market development, most prior research has focused on developed countries or utilized cross-country comparisons (El Wassal, 2013; Modugu & Dempere, 2020; Aali-Bujari et al., 2017). These studies provide limited insight into country-specific dynamics in developing economies, where governance structures often differ substantially from those in developed countries.

SDG Indicator 16 emphasizes the importance of strong governance in creating a conducive business environment for economic growth and development (World Bank, 2021). Strong institutions are capable of driving complex and productive economic activities, while stock markets play a crucial role in channeling savings into investment financing (Baumol, 1965). Macroeconomic and institutional factors influence stock market performance, and governments can promote stock market development to drive economic progress (El Wassal, 2013).

Indonesia, as one of the largest developing economies in Southeast Asia, represents an ideal context for examining this relationship due to its unique governance and market dynamics. Unlike developed countries, Indonesia faces distinct challenges in improving governance quality while fostering stock market development, presenting a research gap that this study aims to address. High-quality governance in GCC Countries is essential for stock market stability, liquidity, and efficiency (Modugu & Dempere, 2020), which also serve as drivers of economic growth (Aali-Bujari et al., 2017; Shahbaz et al., 2008). National governance quality is often more important to investors than corporate governance, and it can affect corporate performance in stock markets (Modugu & Dempere, 2020). Institutional quality is also a prerequisite for financial development and helps reduce transaction costs and agency risks (Ali Imran et al., 2020). While similar studies have highlighted governance's role in financial and economic outcomes in regions such as the GCC (Modugu & Dempere, 2020) and developed countries (Aali-Bujari et al., 2017), there is limited research focused specifically on Indonesia. This study seeks to fill this gap by exploring how Indonesia's governance quality, as measured by the Worldwide Governance Indicators (WGIs), impacts its capital market performance.

In this context, governments are responsible for ensuring that markets operate with transparency and equitable access for all economic actors (Yustika, 2012). Weak governance can hinder economic growth, while strong governance can reduce stock market volatility (Eldomiaty et al., 2016). Effective regulation and law enforcement are key to improving governance (Aman et al., 2023), which in turn can reduce volatility and enhance stock market efficiency in developing countries (Duppati et al., 2019). Building on these insights, this study contributes to the existing literature by narrowing its focus to Indonesia—a single-country context—where governance quality and stock market development intersect amid emerging market challenges.

Based on this evidence, this research focuses on the relationship between national governance and stock market development in Indonesia, one of the developing countries. In this regard, Indonesia's capital market experienced positive growth throughout 2023, as reflected by the 6.62% increase in the Jakarta Composite Index (JCI) as of December 28, 2023, from the close of 2022, reaching a level of 7,303.89 with a record-high market capitalization on December 28, 2023, amounting to Rp11,762 trillion (IDX Press Release, 2023). This research uses global governance indicators from the World Governance Indicators (WGIs) issued by the World Bank as proxies to evaluate the impact of governance on capital market capitalization relative to GDP.

The novelty of this study lies in three aspects: (1) examining the linkage between government governance and the performance of Indonesia's capital market, (2) providing a specific perspective on emerging markets, and (3) relating this research to the achievement of the SDGs, particularly Indicator 16, which emphasizes the importance of peace, justice, and strong institutions.

2. Literature Review and Hypothesis Development

2.1. Literature Review

This research is based on two theories: the Efficient Market Hypothesis (EMH) and Institutional Theory. EMH, also known as the Random Walk Theory (RWT), posits that current stock prices fully reflect all available information about a firm's value, and there is no way to earn excess profits by any market participant using available information known to all market participants (Modugu & Dempere, 2020).

The term "efficient market" was first introduced by Fama (1965). Gumanti (2019) explains that the efficient market hypothesis assumes a market is considered efficient if it is impossible to gain economic profit through trading activities based on information already disseminated in the market. This research argues that in an efficient market, all else being equal, competition will cause new information to be instantly reflected in actual stock prices (Modugu & Dempere, 2020).

According to Fama (1965), there are three different levels of market efficiency. The first is the weak form, which means that current stock prices already reflect all information contained in historical prices. The second is the semi-strong form, meaning that stock prices already reflect all publicly available information. The third is the strong form, which implies that stock prices reflect all information, including that which is not available to the public.

This study is based on the theoretical foundation that governance quality indicators are public information provided by the World Bank, and investors investigate these indicators before making investment decisions. Therefore, as stated by (Modugu & Dempere (2020), the a priori expectation is that investors' perception of these indicators' rankings will directly influence stock market investment decisions and, broadly, stock market capitalization.

The second theoretical foundation for this research is Institutional Theory. Institutional Theory is a socio-political theory that deals with how rules, norms, cultures, policies, and regulations are established and managed by higher authorities as authoritative guidelines for social behavior within an ecosystem (Modugu & Dempere, 2020). According to Scott (2005), institutions are social structures that have achieved a high degree of resilience, consisting of cultural-cognitive, normative, and regulative elements, which, together with associated activities and resources, provide stability and meaning to social life. The fundamental focus of Institutional Theory is that individual actions or omissions are structured by higher-level authorities beyond the individual level, which either restrict or shape actors' interests and participation (Clemens & Cook, 1999).

This theory aligns with the present research because stock markets cannot exist without an institutional and regulatory environment. These governance structures affect investor confidence in market efficiency and, consequently, determine their level of participation and the ultimate impact on the stock market (Modugu & Dempere, 2020).

Stock Market Performance Measurement

The performance of the stock market significantly influences a country's overall economy. Previous studies, including those by (Asongu, 2014; Asongu, 2012; S. A. Asongu, 2013) and Chen et al (2009) have highlighted that well-developed stock markets facilitate efficient capital allocation, which in turn leads to a reduction in the cost of capital. Additionally, a robust stock market positively impacts the financial sector, fostering stability and promoting confidence within the economy (Umutlu et al., 2010).

The performance of a country's stock market can be reflected in stock market capitalization (stock market capitalization ratio), which confirms that the size of the stock market is identified by the market capitalization of listed companies relative to GDP (Kuvshinov & Zimmermann, 2022; Vithessonthi, 2014; Zeqiraj et al., 2020). This determinant indicates the stock market's ability to provide capital to the economy and offer more opportunities for investors. Therefore, an increase in SMC contributes to stimulating economic activity (Aali-Bujari et al., 2017; Narayan et al., 2011; Shahbaz et al., 2016).

Institutional Quality and Stock Market Performance

Institutional quality can be broadly described as guidelines for regulating and directing the formation of human expectations toward one another (Winful et al., 2016). The purpose of this study is to examine the impact of six dimensions of the World Governance Indicators (WGIs) on several

stock market development indicators. The institutional measurement variable, measured by the World Bank's World Governance Indicators, serves as a core measure of institutions. In line with Khan et al. (2020), the institutional measurement by the World Governance Indicators consists of a set of indicators: (1) Voice and Accountability, (2) Political Stability and Absence of Violence, (3) Government Effectiveness, (4) Regulatory Quality, (5) Rule of Law, and (6) Control of Corruption. The six aggregate indicators are presented in two formats: (1) in standard normal units, typically ranging from about -2.5 to 2.5, and (2) as percentile ranks from 0 to 100, where higher values indicate more favorable results. Low scores indicate poor institutional frameworks, while high scores indicate stable institutions (Aman et al., 2023).

Governance quality is designed to encompass the overall institutional environment of a country rather than focusing on a single dimension of quality (Ali Imran et al., 2020). The study divides governance quality into three groups, as discussed below.

a) Group One: Voice and Accountability - Political Stability

The World Bank defines the "Voice & Accountability" indicator as the perception of the extent to which a country's citizens can participate in selecting their government, as well as the freedom of expression, freedom of association, and a free media. Additionally, the World Bank explains the "Political Stability and Absence of Violence" indicator as "perceptions of the likelihood of political instability and/or politically motivated violence, including terrorism." Ali Imran et al. (2020) describe the Voice and Accountability (VA) indicator as measuring political processes such as civil liberties and political rights.

This indicator also considers media freedom, which plays a critical role in monitoring and holding authorities accountable for their actions. Furthermore, the Political Stability (PS) indicator reflects the extent to which disruptive changes in government undermine governance quality and policy continuity in a country. Lower VA indicators and political instability result in reduced investor confidence, which further increases market volatility in a downward direction and vice versa (Ali Imran et al., 2020).

b) Group Two: Government Effectiveness - Regulatory Quality

The World Bank defines the "Government Effectiveness" indicator as the perception of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. Furthermore, the World Bank defines "Regulatory Quality" as "the perception of the government's ability to formulate and implement sound policies and regulations that allow and promote the development of the private sector."

Ali Imran et al. (2020) explain that Government Effectiveness (GE) and Regulatory Quality (RQ) provide deep insights into the extent to which a government can formulate and implement policies. GE reflects the level of quality in public service delivery, bureaucracy, the provision and competence of civil services without political interference, as well as the integrity of the government's commitment to policies. In contrast, RQ indicates market-unfriendly policies, such as inadequate banking supervision and price controls (Ali Imran et al., 2020).

Moreover, Ali Imran et al. (2020) also note that the Regulatory Quality (RQ) indicator highlights excessive and inconsistent regulations in foreign trade and business development. Government authorities and RQ formulate specific policies to prevent any stock market activities that may harm public or investor interests. Additionally, RQ compels companies to fully disclose information to prevent insider trading opportunities (Ali Imran et al., 2020).

c) Group Three: Rule of Law - Control of Corruption

The World Bank defines the "Rule of Law" indicator as a dimension that captures the perception of the extent to which agents have confidence in and abide by the rules of society, particularly the quality of contract enforcement, property rights, police, and courts, as well as the likelihood of crime and violence. The "Control of Corruption" indicator is defined by the World Bank as the perception of the extent to which public power is exercised for private gain, including both petty and grand corruption, as well as "state capture" by elites and private interests.

Rule of Law (RL) and Control of Corruption (CC) are among the most crucial indicators, particularly in terms of how they provide detailed insights into the relationship between citizens and

institutions within a country (Ali Imran et al., 2020). RL measures how effective, enforceable, and predictable a country's judicial system is. Additionally, Ali Imran et al. (2020).explains how well the law protects contractual obligations and property rights. This indicator can also serve as a proxy for how a nation achieves success and fosters an environment conducive to social interaction and economic progress. In the context of financial development, RL holds significant importance, as it explains investors' perceptions and trust in a country's legal system, while the CC indicator summarizes the level of corruption within state institutions and the extent of public power abuse for personal gain (Ali Imran et al., 2020).

This study also includes typical economic factors such as GDP Growth and inflation, as previous research has established the relationship between economic growth and inflation with stock market development. Economic growth is measured by GDP per capita, which not only indicates the average income per individual but also reflects the new value of goods and services divided by the total population in a specific period. An increase in GDP per capita encourages investors to engage and raise their capital in the stock market, thus boosting stock market capitalization (Aman et al., 2023; Bui, 2023; Khan et al., 2020; Winful et al., 2016). Inflation is measured by the annual inflation rate.

2.2. Hypothesis Development

The relationship between governance quality and stock market development is well-documented in previous studies (Ali Imran et al., 2020).Governance quality, as measured by the World Governance Indicators (WGIs), provides a comprehensive framework to evaluate the institutional environment of a country. The following section develops hypotheses for each WGI indicator, supported by theories and empirical findings from existing literature:

a) Voice and Accountability (VA)
The "Voice and Accountability" indicator reflects the extent to which citizens can participate in selecting their government, as well as the level of freedom of expression, association, and media independence (World Bank, 2021). Active citizen participation, supported by media freedom, enhances public accountability and creates a transparent investment environment, which fosters investor confidence. Ali Imran et al., (2020) argued that higher levels of VA correlate positively with stock market growth by reducing market volatility and promoting a stable investment climate.
H1: The higher the level of Voice and Accountability (VA), the more positive its impact on stock market growth in Indonesia.

b) Political Stability and No Violence (PS)
Political stability is crucial in reducing uncertainties and risks that deter investment. The "Political Stability and Absence of Violence" indicator measures perceptions of political instability and violence, including terrorism (World Bank, 2021). Political stability ensures policy continuity, which is critical for investor confidence. Studies Eldomiaty et al. (2016) and Ali Imran et al (2020) have shown that stable political environments attract foreign and domestic investment, positively impacting stock market performance.
H2: A high level of Political Stability and Absence of Violence (PS) positively correlates with stock market growth in Indonesia.

c) Government Effectiveness (GE)
The "Government Effectiveness" indicator captures the quality of public services, policy formulation, and implementation, as well as the government's commitment to credible policies (World Bank, 2021). Effective governance fosters a conducive business environment by reducing bureaucratic inefficiencies and ensuring the reliable delivery of public services. Ali Imran et al. (2020) found that government effectiveness strengthens stock market performance by increasing investor trust in institutional quality.
H3: The more effective the government (GE), the greater its positive impact on stock market development in Indonesia.

d) Regulatory Quality (RQ)
Regulatory Quality refers to the government's ability to formulate and enforce sound policies and regulations that promote private sector development (World Bank, 2021). Efficient

regulatory frameworks reduce transaction costs, increase transparency, and protect investors from market abuses, such as insider trading (Ali Imran et al., 2020). These factors contribute to a stable and reliable market environment, which supports stock market growth.
H4: A high level of Regulatory Quality (RQ) positively influences stock market growth in Indonesia.

e) Rule of Law (RL)
The "Rule of Law" indicator reflects confidence in the legal system, the quality of contract enforcement, property rights, and the effectiveness of the judiciary (World Bank, 2021). Robust legal institutions enhance investor confidence by providing legal protections and ensuring contract enforcement (Ali Imran et al., 2020).Countries with strong Rule of Law experience lower transaction risks and higher capital inflows, contributing to stock market stability.
H5: The stronger the Rule of Law (RL), the more positive its impact on stock market growth in Indonesia.

f) Control of Corruption (CC)
The "Control of Corruption" indicator measures the extent to which public power is exercised for private gain, including both petty and grand corruption (World Bank, 2021). High levels of corruption deter investment by increasing transaction costs and reducing market transparency. Ali Imran et al. (2020) found that improved control of corruption fosters trust in the institutional environment, thereby enhancing stock market development.
H6: A high level of Control of Corruption (CC) positively impacts stock market growth in Indonesia.

g) GDP Growth
Economic growth, often measured by GDP per capita, is a key driver of stock market development. GDP growth reflects overall economic activity, which attracts investors and increases capital flows to stock markets (Aman et al., 2023; Khan et al., 2020). Previous studies have demonstrated that higher GDP growth correlates positively with stock market capitalization, as it signals economic strength and investment opportunities.
H7: High GDP growth positively impacts stock market development in Indonesia.

h) Inflation
Inflation, measured by the annual inflation rate, reflects the stability of a country's macroeconomic environment. While moderate inflation may indicate economic growth, high inflation erodes purchasing power and increases production costs, which negatively affect corporate profitability and investor confidence (Winful et al., 2016). Studies by Aman et al. (2023) and Bui (2023) have established that rising inflation rates are negatively associated with stock market performance.
H8: Higher inflation negatively impacts stock market development in Indonesia.

3. Research Methods

This study analyzes the relationship between governance quality and stock market development in Indonesia using the Worldwide Governance Indicators (WGI) from the World Bank. The data covers the period from 2008 to 2022 and involves various independent variables such as the WGI indicators, GDP growth, and inflation. The dependent variable used is the stock market capitalization-to-GDP ratio (Market Cap to GDP Ratio).

3.1. Variable Measurement

Dependent Variable

The proxy for stock market development in this research utilizes the stock market capitalization ratio variable, as applied in studies by (Bui, 2023; Eldomiaty et al., 2019; Khan et al., 2020; Winful et al., 2016).

Main Independent Variable

The World Governance Indicators (WGIs) can serve as a suitable proxy for "Governance Indicators" based on the understanding that governments are the initiators of governance rules and

regulations. The independent variables in this research are the six WGIs, compiled and published by the World Bank.

Group et al (2010) explain the WGI methodology in detail. The six indicators are: (1) Voice and Accountability, (2) Political Stability and Absence of Violence/Terrorism, (3) Government Effectiveness, (4) Regulatory Quality, (5) Rule of Law, and (6) Control of Corruption. Governance estimates are provided in percentile ranks ranging from 0 to 100. Low ranks indicate a poor institutional framework, while high ranks signify institutional stability.

Additionally, economic growth is measured using GDP growth, and inflation is included as a typical economic factor to assess its impact on stock market growth in Indonesia. A summary of the research variables can be seen in the following table.

Table 1. Summary of Research Variables

Variable	Symbol	Description	References
Dependent			
Stock Market Capitalization	MCAP	Stock Market Capitalization Relative To GDP	(Bui, 2023; Eldomiaty et al., 2019; Khan et al., 2020; Winful et al., 2016)
Independent			
Voice and Accountability	VA	Perception of the extent to which a country's citizens can participate in selecting their government, as well as the freedom of expression, freedom of association, and a free media.	
Political Stability and no Violence	PS	Perception of the likelihood of political instability and/or politically motivated violence, including terrorism.	The indicators are presented in a percentile rank form ranging from 0 to 100. Lower ranks indicate a poor institutional framework, while higher ranks denote institutional stability.
Government Effectiveness	GE	Perception of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to these policies.	*Source*: *World Governance Indicator Website*.
Regulatory Quality	RQ	Perception of the government's ability to formulate and implement sound policies and regulations that enable and promote the development of the private sector.	(Ali Imran et al., 2020; Aman et al., 2023; Bui, 2023; Duppati et al., 2019; Eldomiaty et al., 2019; Ismail & Basyariah, 2022; Khan et al., 2020; Mai et al., 2023; Modugu & Dempere, 2020; Winful et al., 2016)
Rule of Law	RL	Perception of the extent to which agents have confidence in and abide by the rules of society, particularly the quality of contract enforcement, property rights, policing, and justice, as well as the likelihood of crime and violence.	
Control of Corruption	CC	Perception of the extent to which public power is used for private gain.	
Typical Economic Factor			
Economic growth	GDP	Measured by the annual growth rate of GDP	(Aman et al., 2023; Bui, 2023; Khan et al., 2020; Winful et al., 2016)
Inflasi	INF	Inflation rate per year	(Bui, 2023; Eldomiaty et al., 2020)

3.2. Research Model

Multiple regression analysis is a statistical method used to analyse the relationship between one dependent variable and two or more independent variables. This method is useful for understanding the extent to which the independent variables influence the dependent variable and how strong that relationship is. The analysis can help identify the relationship between governance quality and stock

market performance, as well as inform policy implications that may be considered in the future. Based on the explanations in the previous chapters, the research model is formulated as follows:

$$MCAP_{i,t} = \alpha + \beta_1 VA_t + \beta_2 PS_t + \beta_3 GE_t + \beta_4 RQ_t + \beta_5 RL_t + \beta_6 CC_t + \beta_7 GDP_t - \beta_8 INF_t + \varepsilon_{it}$$

Due to the limited sample size, a non-parametric approach using Spearman's correlation was additionally employed to enhance the robustness of the research findings. This supplementary test provides a more reliable assessment of the relationships when traditional parametric assumptions might be challenged.

Furthermore, the WGI indicators are categorized into four quartiles to better capture the variation in governance quality across different levels. By stratifying the data in this manner, the analysis can more effectively detect subtle differences and trends within the governance metrics, thereby enriching the overall interpretation of their impact on stock market performance.

4. Results and Discussion

The descriptive statistics of this study provide an overview of the key variables used in analyzing the relationship between governance quality and stock market development in Indonesia. By summarizing the data, descriptive statistics offer insights into the central tendencies, variability, and distribution of both independent and dependent variables across the sample period from 2008 to 2022. This includes measures such as the mean, standard deviation, minimum, and maximum values for the Worldwide Governance Indicators (WGI), GDP growth, inflation, and stock market capitalization-to-GDP ratio. Understanding these descriptive statistics is crucial for interpreting the overall trends and characteristics of the data, as well as for evaluating the relative influence of governance factors on stock market performance.

Table 2. Descriptive Statistics of Research Data

	MCAP	VA	PS	GE	RQ	RL	CC	GDP	INF
Mean	44.59236	50.96413	25.69563	52.09935	50.35220	38.28159	33.28803	4.783273	4.654055
Median	46.39364	51.72414	26.89000	50.00000	51.90476	40.00000	35.24000	5.069786	4.279500
Maximum	51.89462	53.69458	32.38095	66.03773	60.95238	45.28302	45.23809	6.223854	10.23000
Minimum	19.35615	47.11538	15.86539	42.86000	39.23445	30.28846	20.57000	-2.065512	1.560130
Std. Dev.	7.569191	2.006495	4.392102	8.392001	6.940257	5.191127	7.409729	2.008008	2.155592
Skewness	-2.641539	-0.701381	-0.713585	0.514524	-0.031542	-0.277510	-0.223678	-2.852083	0.959096
Kurtosis	9.563904	2.184960	2.817691	1.714400	1.750714	1.679767	2.248357	10.42533	4.095071
Jarque-Bera	44.37234	1.645021	1.293782	1.694816	0.977935	1.281914	0.478184	54.79563	3.049149
Probability	0.000000	0.439327	0.523671	0.428524	0.613259	0.526788	0.787342	0.000000	0.217714
Sum	668.8854	764.4620	385.4345	781.4902	755.2830	574.2238	499.3205	71.74909	69.81083
Sum Sq. Dev.	802.0971	56.36432	270.0679	985.9596	674.3403	377.2692	768.6573	56.44934	65.05208
Obs.	15	15	15	15	15	15	15	15	15

Note: MCAP (Market Capitalization), VA (*Voice and Accountability),* PS (*Political Stability and no Violence*), GE (*Government Effectiveness*), RQ (Regulatory Quality), RL (Rule of Law), CC (Control of Corruption), GDP dan Inflasi

This study utilizes annual data from the period 2008 to 2022 to measure stock market development on the Indonesia Stock Exchange using the Market Capitalization to GDP Ratio, along with governance indicators provided by the Worldwide Governance Indicators (WGI), and macroeconomic data such as GDP growth and inflation.

According to the descriptive statistics, Government Effectiveness (GE) has the highest average (52.10), indicating that the government's effectiveness is relatively strong compared to other indicators. Voice and Accountability (VA), while relatively positive and stable with an average of 50.96, shows that public accountability and freedom of expression in Indonesia still have room for improvement, particularly in addressing the decline in quality observed during certain periods. Regulatory Quality (RQ) reflects a fairly consistent and favourable regulatory environment in

Indonesia, with an average of 50.35, although there remains potential for further improvement to ensure regulations are more adaptive and effective across various sectors.

The Rule of Law (RL) requires greater attention, as the application of law remains weak (average 38.28), and variations in performance between periods highlight instability in law enforcement. Control of Corruption (CC) has a relatively low average (33.29) and a high standard deviation, indicating significant disparities in the observations regarding corruption control. Its skewness also suggests that there are outliers with lower-than-expected values. Political Stability and No Violence (PS) also warrants attention, as its low average (25.70) indicates that political stability in Indonesia remains vulnerable.

Testing of Classical Assumption

According to Gujarati (2009), the classical assumption test aims to ensure that the research results are valid, with the data used theoretically being unbiased, consistent, and providing efficient regression coefficient estimates.

Normality Test

It should be noted that the assumption of normality in linear regression applies to the residuals, not the variables. If the probability value is > α and the Jarque-Bera (JB) value is less than the Chi-Square Table value, it can be concluded that the residuals are normally distributed (Ghozali, 2013).

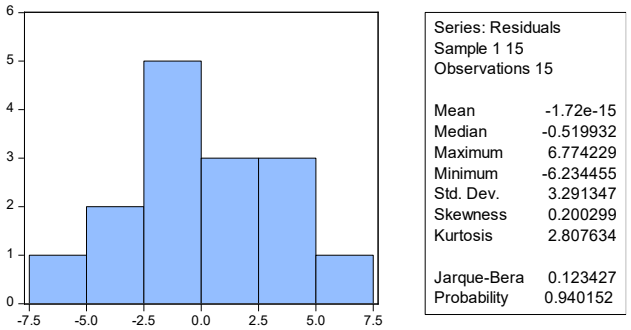

Figure 1. Normality Test Results

Based on the output of the residual normality test, the Jarque-Bera value is 0.123427 with a probability (p-value) of 0.9401, which is greater than 0.05. Therefore, it can be concluded that the residual data is normally distributed.

Table 3. Summary of Classical Assumption Test Results

Classical Assumption	**Results**
Multicollinearity	Fulfilled (1,666102 - 6,945547 < 10)
Heteroscedasticity	Breush-Pagan-Godfrey (0.1791>0,05)
Autocorrelation	Breusch-Godfrey Serial Correlation LM Test (0,0964 >0,05)

Based on the test output above, the Centered VIF values for all variables are less than 10, ranging from 1.666102 to 6.945547. Thus, it can be concluded that the assumption of no multicollinearity is satisfied. According to the heteroscedasticity assumption output using the Breusch-Pagan-Godfrey test, the probability chi-square value for ObsR-Squared is 0.1791, which is greater than 0.05, indicating that there is no heteroscedasticity. Furthermore, based on the autocorrelation assumption output using the Breusch-Godfrey Serial Correlation LM Test, the probability chi-square value for ObsR-Squared is 0.0964, which is greater than 0.05, indicating that no autocorrelation is present.

Analysis Results of Regression

The results of the multiple linear regression analysis indicate that the tested variables present varied insights regarding their influence on stock market capitalization (Market Cap to GDP Ratio)

on the Indonesia Stock Exchange. The partial test results demonstrate that while some variables show a statistically significant impact, others exhibit weaker or insignificant effects.

These findings offer a nuanced understanding of how governance indicators, alongside macroeconomic variables such as GDP growth and inflation, contribute differently to the overall development of the Indonesian stock market. This variation highlights the complexity of market dynamics and the role of institutional quality in shaping investor confidence and market performance.

Table 4. Regression Results

Regression Results *Variabel Dependent:* MCAP		
Variabel Independent	*Coefficient*	*Prob.*
C	13.55712	0.8464
VA	0.653689	0.6650
PS	0.715594	0.3466
GE	0.026035	0.9652
RQ	*-0.616592*	0.4919
RL	0.504464	0.5981
CC	*-0.103207*	0.7548
GDP	0.890403	0.3424
INF	**-2.387581**	**0.0466***
R-squared	0.810919	
Adjusted R-squared	0.558811	
F-stat	3.216550	
Prob F-stat	0.030088	

Note: MCAP (Kapitalisasi Pasar), VA (*Voice and Accountability),* PS (*Political Stability and no Violence*), GE (*Government Effectiveness*), RQ (*Regulatory Quality*), RL (*Rule of Law*), CC (*Control of Corruption*), GDP and Inflation.

Based on the F-test, the probability value of the F-statistic for the regression model is $0.03 < \alpha = 0.05$, and the F-statistic (3.2165) > F-table ($F(0.05, 8/15) = 2.6407$), leading to the rejection of H0 and acceptance of H1. This means that the independent variables (VA, PS, GE, RQ, RL, CC, GDP, Inflation) collectively (simultaneously) have a significant effect on the dependent variable, namely Market Capitalization (MCAP).

The R-squared value is 0.8109, indicating that 81.09% of the variation in the dependent variable (MCAP) is explained by the independent variables together, while the remaining (100% - 81.09% = 18.91%) is influenced by other variables not included in this study or the multiple linear regression model.

Discussion of WGI Indicators on Stock Market Development in Indonesia

The results of this study show that although there is no statistically significant influence of the WGI indicators on stock market development in Indonesia, the direction of the regression coefficients for each indicator provides important insights into the institutional quality required. Overall, the analysis suggests that Voice and Accountability (VA), Political Stability (PS), Government Effectiveness (GE), and Rule of Law (RL) have positive regression coefficients, while Regulatory Quality (RQ) and Control of Corruption (CC) show negative regression coefficients.

Voice and Accountability (VA) shows a positive regression coefficient, indicating that improvements in accountability and citizen participation have the potential to enhance stock market development. However, while this relationship is positive, it is not statistically significant, highlighting the need for further investigation into other factors that may significantly influence its impact. According to Winful et al. (2016), voice and accountability encompass the extent to which citizens participate in government and policymaking processes. To improve the quality of this

indicator, civil rights and political rights must not only be adequately protected systematically but also significantly enhanced. The media should be able to publish or broadcast news of their choosing without fear of censorship. These findings contrast with those of Eldomiaty et al. (2019) and Modugu & Dempere (2020), who argue that voice and accountability show a negative relationship with stock market performance, suggesting that these factors may introduce uncertainties or inefficiencies into the market.

Political Stability and Absence of Violence (PS) also shows a positive coefficient. This aligns with previous research asserting that political stability and reduced violence contribute positively to stock market performance. However, this study's findings indicate that while there is a positive direction of influence, the impact is not statistically strong enough to be fully relied upon. The Political Stability and Absence of Violence (PS) variable does not show a significant influence, with a probability value of 0.3466 and a t-statistic of 1.0211, which is lower than the critical t-value. The regression coefficient of 0.715594 for PS suggests that, theoretically, political stability and the avoidance of violence can support market capitalization. However, the lack of significance might reflect that political stability in Indonesia remained relatively steady during the study period or that its impact on the stock market is not substantial enough to be detected. Winful et al. (2016) explain that political stability and the absence of violence include factors that disrupt political stability, such as ethnic, religious, and regional conflicts, violent actions by underground political organizations, as well as violent social conflicts and external public security. It also covers the fragmentation of the political spectrum, the strength of political factions, as well as divisions based on language, ethnicity, or religion, and the restrictive measures necessary to maintain power. Social conflicts like demonstrations, strikes, street violence, the risk of military coups, insurgencies, political terrorism, political assassinations, urban riots, armed conflicts, and states of emergency or martial law are key determinants. This indicator contributes to a more stable and predictable investment environment, which is beneficial for stock market growth.

The impact of political stability and the absence of violence on stock market performance has shown significant results in various countries. Modugu & Dempere (2020) found that political stability and the absence of violence significantly positively impacted stock market performance in Gulf Cooperation Council (GCC) countries. This highlights that improved governance quality, particularly in terms of political stability and the rule of law, enhances stock market returns. It shows that investors are more confident and willing to invest in markets where political risk is minimized (Modugu & Dempere, 2020). Furthermore, Mai et al. (2023) demonstrated that political stability increases investor confidence, which in turn boosts foreign investment and overall economic growth in Pakistan. This study underscores the importance of a stable political environment for stock market development in developing countries. Related research on political crises by Hillier & Loncan (2019) shows that political stability is critical to maintaining stock market performance. This study highlights that political uncertainty leads to stock market crashes, emphasizing the importance of political stability in maintaining investor confidence and market performance.

Government Effectiveness (GE) shows a positive coefficient, indicating that government effectiveness, including the quality of public services and policies, has the potential to enhance stock market development. Although the direction of the coefficient is positive, the statistical results do not indicate strong significance, suggesting that other factors may also play an important role. Government Effectiveness (GE) has a very high probability value of 0.9652 and a very low t-statistic of 0.0455, indicating that government effectiveness does not have a significant impact on market capitalization. Although the GE regression coefficient is 0.026035, which is positive, these results are not strong enough to draw a conclusion. This may suggest that while government effectiveness is important, its impact on market capitalization may not be clearly observed during this study period, or other variables may be more dominant. The influence of government effectiveness on stock market performance has a positive relationship, consistent with the findings of Eldomiaty et al. (2019) and Modugu & Dempere (2020). Strong governance quality, including government effectiveness, is positively and significantly related to stock market development. This is evident from reduced stock market volatility and increased foreign investment, both of which are crucial for stock market growth and stability in developing countries (Ming & Jais, 2020).

Winful et al. (2016) explain that government effectiveness measures the quality of public service delivery and the formulation and implementation of policies, thereby indicating the credibility of government commitments to those policies. It encompasses the relationship between the government and citizens, the quality of public goods and services provision, and the capacity of political authorities. Empirical findings suggest that government effectiveness, along with other governance indicators such as political stability and regulatory quality, positively impacts stock market development in various regions of the world (Eldomiaty et al., 2019).

Regulatory Quality (RQ) shows a negative coefficient, indicating that poor regulatory quality could potentially hinder stock market development. Although the results are not significant, this suggests that improving regulatory quality should be a priority to support stock market growth. Regulatory Quality (RQ) has a negative coefficient of -0.616592 and a probability value of 0.4919, indicating no significant influence on market capitalization. This lack of significance may be due to insufficient changes in regulatory quality or the variable's insensitivity to reveal a clear impact on the stock market.

Winful et al. (2016) state that regulatory quality (RQ) in WGI refers to the government's capacity to formulate and implement policies and regulations that support and promote private sector development. This includes the formalities of business establishment, the difference between government-regulated administrative prices and market prices, ease of market entry for new companies, and regulation of competition between businesses. Other factors influencing regulatory quality include the transparency of financial institutions, public sector contracts open to foreign bidders, anti-protectionism measures against other countries, and reductions in subsidies for certain industries (Winful et al., 2016).

In some cases, overly stringent regulations can negatively impact stock market performance. For example, excessive regulatory requirements may increase compliance costs for firms, deterring market participation and reducing overall market activity (Modugu & Dempere, 2020). Additionally, certain aspects of regulatory quality, such as voice and accountability, have been found to have a significantly negative relationship with stock market performance. This suggests that while regulatory quality is important, there must be a balance with other governance factors to avoid negative impacts on the market (Modugu & Dempere, 2020).

Rule of Law (RL) has a positive coefficient, indicating that improvements in law enforcement and confidence in the legal system could support stock market development. However, as with other indicators, while there is a positive relationship, the impact is not statistically significant. Rule of Law (RL), with a regression coefficient of 0.504464 and a probability value of 0.5981, also does not significantly influence market capitalization. Although improvements in law enforcement could be expected to support the stock market, this lack of significance may suggest that legal aspects did not undergo substantial changes, or the impact was not detectable within the study period.

Winful et al. (2016) describe the rule of law as the enforcement of laws by the government, including the prevention of financial fraud, money laundering, organized crime, and the impact and costs of crime. It also encompasses the quality of policing, the judiciary's independence from political influence, and more. The influence of the rule of law on stock market performance aligns with findings from Eldomiaty et al. (2019) and Modugu & Dempere (2020). The positive impact of rule of law on stock market development tends to always lead to the improvement of laws and regulations to support stock market progress (Eldomiaty et al., 2019).

Control of Corruption (CC) shows a negative coefficient, suggesting that corruption may negatively impact stock market development. The absence of statistical significance indicates that while controlling corruption is an important factor, more effective strategies are needed to address corruption and facilitate stock market growth. Control of Corruption (CC) also does not show a significant influence, with a negative coefficient of -0.103207 and a probability value of 0.7548. The negative coefficient suggests that, in theory, corruption control could reduce market capitalization, but this result is not significant. This may be due to consistent levels of corruption or the variable not being sensitive enough to measure the impact of corruption on the stock market. The control of corruption indicator is measured by the frequency of corruption occurrences, nepotism, and government efforts to combat corruption (Winful et al., 2016).

The results of this study show that the Control of Corruption (CC) indicator has a negative impact on stock market development. In this context, it is important for Indonesia, as an emerging market, to pay more attention to controlling corruption. Improving corruption control contributes to more

effective financial resource allocation. Although the study results show no significant impact of other WGI indicators on the stock market, controlling corruption remains an important factor. The positive relationship between corruption control and stock market performance contrasts with the findings of Eldomiaty et al. (2019) and Modugu & Dempere (2020). The negative impact was reported by Lau et al. (2013), who argued that corruption and bribery might help in gaining information about the market, leading to higher returns. In general, Indonesia needs to promote a sound macroeconomic environment and strengthen corruption control to support stock market development. To achieve sustainable development, these economies need a comprehensive combination of both aspects, not just one in isolation.

As for GDP, a probability value of 0.3424 and a t-statistic of 1.0308 show that economic growth does not have a significant impact on market capitalization. Although the GDP regression coefficient is positive at 0.890403, indicating that economic growth could support market capitalization, this result is not strong enough to show a clear impact in this study. It is important for a country's economy to increase GDP and sustain economic growth, thereby increasing foreign investor income and attracting more resources into the stock market. Furthermore, greater attention should be given not only to forecasting economic growth rates but also to other macroeconomic factors. These factors are vital signals and essential fundamentals for creating a conducive investment environment, which significantly contribute to attracting investment into the stock market and fostering its growth. The positive impact of GDP on the stock market aligns with findings from (Bui, 2023).

Conversely, Inflation shows a significant negative impact on market capitalization, with a probability value of 0.0466 and a t-statistic of -2.1690, exceeding the critical t-value. The inflation regression coefficient of -2.387581 indicates that rising inflation significantly reduces market capitalization. This can be explained by the negative effect of high inflation on purchasing power and economic stability, which in turn can reduce investment interest and decrease market capitalization.

Bui (2023)states that excessive inflation increases challenges for investors and businesses. Therefore, it is crucial for these economies to implement proper policies to control corruption and create a conducive macroeconomic environment. This will attract more investment into the stock market, thereby promoting its growth. Inflation has been proven to place firms in conditions of high input costs and weak debt repayment ability. Additionally, high inflation reduces the attractiveness of the stock market. These findings align with those of Bui (2023) and Eldomiaty et al. (2019).

Overall, the analysis results show that only inflation has a significant impact on stock market capitalization during the study period, while other governance and macroeconomic variables do not show significant influence. This may suggest that macroeconomic factors such as inflation have a more direct and significant impact on market capitalization compared to governance aspects, which may not have significantly changed over the period.

These findings are consistent with previous research showing that institutional quality positively affects stock market performance in developing countries. Therefore, it is crucial for policymakers to seriously focus on improving institutional quality. Enhancements in corruption control, government effectiveness, political stability, public accountability, regulatory quality, and fair law enforcement can contribute to better stock market development and greater integration with global stock markets. A sound governance environment not only reduces transaction and agency costs but also increases shareholder returns. For developing countries like Indonesia, developing high-quality institutions can influence the attractiveness of equity investment and overall stock market performance while reducing political risks that are critical in investment decision-making.

This study shows that WGI indicators with positive coefficients indicate potential positive directions for improving governance that can support stock market development. Meanwhile, indicators with negative coefficients highlight areas of weakness that need to be addressed. These findings are consistent with the argument that weaknesses in government governance can negatively impact stock markets, aligning with Méon & Sekkat (2005), who show that weak governance often acts as a barrier in many countries.

Robustness Test

As part of the robustness tests in this study, a non-parametric approach using Spearman's correlation with a quartile-based categorization was employed. This approach aims to address the

limitations imposed by the small sample size and to ensure that the analytical results remain consistent with more flexible methods that do not rely on distributional assumptions.

In this categorization, each of the World Governance Indicators (WGI) is divided into four categories based on its quartile distribution: Low (Q1) for values below the 25th percentile, Medium-Low (Q2) for values between the 25th and 50th percentiles, Medium-High (Q3) for values between the 50th and 75th percentiles, and High (Q4) for values above the 75th percentile. This approach allows for a more precise identification of variation among groups without relying on subjective thresholds

The following table presents the results of the Spearman correlation (r) test, which was conducted to analyze the relationships between the examined variables and the market capitalization (MCAP) data. The r value indicates the strength and direction of the correlation, while the p-value indicates the statistical significance of these relationships at a specified significance level. Based on the results, several variables exhibit a significant correlation, either positive or negative, while others do not demonstrate statistically significant relationships.

Table 5. Spearman Correlation Test (r) Results

Variable	r Value	P-Value	Category	Remarks
VA	0.5527	***0.033****	Mid-High	***Significant (+)***
PS	0.3875	0.154	Mid-Low	Not Significant
GE	0.4916	0.063	Mid-High	Not Significant
RQ	0.4916	0.063	Mid-High	Not Significant
RL	0.7250	***0.002****	High	***Significant (+)***
CC	0.3875	0.154	Mid-Low	Not Significant
GDP	0.0041	0.988	Very Low	Not Significant
INF	-0.3708	0.174	Low	Not Significant

Note: VA (*Voice and Accountability),* PS (*Political Stability and no Violence*), GE (*Government Effectiveness*), RQ (*Regulatory Quality*), RL (*Rule of Law*), CC (*Control of Corruption*), GDP and Inflation

The results of the Spearman correlation test with quartile categorization indicate that the Rule of Law (RL) and Voice & Accountability (VA) indicators have the strongest relationship with market capitalization (MCAP). RL shows the highest correlation ($r = 0.7250$, $p = 0.002$), suggesting that the stronger the legal certainty and rule enforcement, the more developed the capital market becomes. This underscores the importance of legal stability and contract certainty in attracting investors. Additionally, VA also shows a significant correlation ($r = 0.5527$, $p = 0.033$), indicating that the higher the transparency of policies and public participation, the greater the development of market capitalization.

In contrast, other indicators such as Government Effectiveness (GE) and Regulatory Quality (RQ) demonstrate a moderate, yet statistically insignificant, correlation. Meanwhile, Political Stability (PS), Control of Corruption (CC), and economic variables such as GDP and inflation do not show significant relationships with market capitalization. This suggests that certain institutional factors, particularly those related to legal certainty and government transparency, play a more critical role in the development of the capital market than macroeconomic factors such as economic growth and political stability.

These findings further support the previous results, where regression using non-parametric techniques (Spearman correlation test) indicated that the WGI indicators, in general, do not significantly affect market capitalization. However, the direction of the coefficients still provides valuable insights, showing that certain institutional aspects, such as Rule of Law and government accountability, hold more potential for creating a stable and attractive capital market. Therefore, this testing outcome adds further evidence that institutional quality plays a crucial role in supporting the development of capital markets in Indonesia, though its impact may be more complex and not always directly observable in traditional regression models.

Overall, this robustness test demonstrates that the non-parametric approach with quartile categorization is more effective in capturing the relationship patterns between WGI indicators and market capitalization, while also confirming the importance of governance aspects in creating a

conducive investment environment. Therefore, efforts to improve regulatory transparency and legal certainty should be a primary focus in the policy development of capital markets moving forward.

These empirical findings provide policy implications, particularly those related to enhancing institutional credibility through a transparent and fully harmonized institutional framework. Khan et al. (2020) suggest that developing countries have entered a challenging phase in expanding their institutional and financial environments, and not all developing countries have the same institutional and financial capabilities. Therefore, policymakers must carefully understand the crucial role of Institutional Quality (IQ) in ensuring sustainable future growth. Law & Azman-Saini (2012) argue that most low-income countries are located at the lower end of IQ, indicating that further improvements in institutions and governance above the threshold will lead to an upturn in Financial Development (FD). Overall, although the statistical influence of the WGI indicators is not yet fully significant, understanding the direction of these coefficients can provide guidance for governance improvements that focus on aspects supporting stock market development.

5. Conclusion

Based on the analysis results, governance indicators (WGI) such as Voice and Accountability (VA), Political Stability (PS), Government Effectiveness (GE), Regulatory Quality (RQ), Rule of Law (RL), and Control of Corruption (CC) did not show a significant influence on stock market development in Indonesia, as measured by market capitalization to GDP (MCAP/GDP). These findings suggest that, during the study period, national governance may not have fluctuated enough or had a sufficiently strong impact to directly influence stock market capitalization. Although, in theory, good governance can support the stock market, the variability in governance indicators used in this study was not significant enough to serve as a useful proxy for measuring stock market growth in Indonesia.

However, to ensure the robustness of the findings, a non-parametric robustness test was conducted using Spearman correlation analysis, where governance indicators were categorized into quartiles (Low, Mid-Low, Mid-High, High) to capture variations across different governance levels. The robustness test results revealed that Rule of Law (RL) and Voice & Accountability (VA) have significant positive correlations with market capitalization, with RL showing the strongest correlation This suggests that a strong legal framework and enforcement of contracts play a crucial role in shaping investor confidence and stock market performance. Meanwhile, VA also demonstrated a moderate and significant correlation, highlighting the importance of transparency, public participation, and government accountability in fostering an attractive investment environment.

On the other hand, other governance indicators such as PS, GE, RQ, and CC did not show a significant relationship with stock market development, indicating that factors beyond these governance measures might have a stronger influence on market capitalization in Indonesia. These results reinforce the notion that while governance quality is theoretically linked to stock market growth, its effects may not always be immediate or directly measurable within the timeframe of this study.

In addition, GDP growth did not show a significant influence on stock market development, as evidenced by the high probability values and low t-statistics. In contrast, inflation had a significant negative impact on market capitalization, suggesting that high inflation erodes purchasing power and economic stability, reducing investor interest in the stock market. These findings highlight that while macroeconomic factors such as GDP are important, they may not always be the primary determinants of stock market performance compared to structural factors like legal certainty and governance transparency.

This study also aligns with Sustainable Development Goal (SDG) 16, which emphasizes the importance of peace, justice, and strong institutions. While some governance indicators did not show a statistically significant influence in this study, the robustness test confirms that strong institutions—particularly the Rule of Law and government accountability—play a critical role in fostering investor confidence and market stability. Therefore, efforts to strengthen the legal framework, improve regulatory enforcement, and enhance government accountability remain crucial for promoting a stable and growing stock market, ultimately supporting sustainable economic development.

By incorporating the robustness test results, this study underscores the importance of institutional quality in shaping the stock market, even if traditional regression models do not always capture their immediate effects. Future research could explore the long-term impact of governance improvements and interactions with other macroeconomic variables to provide a more comprehensive understanding of governance-market dynamics in Indonesia.

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