Journal of Economics, Finance and Management Studies

ISSN (print): 2644-0490, ISSN (online): 2644-0504

Volume 07 Issue 08 August 2024

Article DOI: : 10.47191/jefms/v7-i8-52,Impact Factor: 8.044

Page No: 5312-5319

Empirical Nexus between Corporate Governance and Corporate Financial Performance: A Common Estimated Approach

Rosa Fitriana[1], Renillyn Mores [2], Wahyudin Zarkasyi[3], Yati Mulyati[4]

[1,4]Widyatama University, Bandung

[2]De La Salle Lipa, Filipina

[3]Padjadjaran University, Bandung

ABSTRACT: The study aims to investigate the association between corporate governance and corporate financial performance. This study is unique and contributing to the body of knowledge by investigating several new and unique relationships between financial management constructs and corporate governance with Common Estimated Method (CEM) which are entirely new to the lite This study will explore corporate financial performance and corporate governance which have not been explored previously in literature especially in context of management accounting firms. Thus, focusing on major objectives are to bridge the gap between study variables in Indonesian economy especially State-Owned Enterprises (SOE). Another contribution is the unique context of Indonesian industry as such relationships has never been explored in this context before. Thus, current study is expected to provide several key policy insights and future research recommendations.

KEYWORDS: corporate governance, corporate financial performance, corporate performance

I. INTRODUCTION

This study will be conducted among management accounting firms, that handle business costs and operations, prepare internal financial reports, records, and accounts to facilitate managers and business in decision making process. Management Accounting Firms mostly deal with cost accounting (Curtis & Taylor, 2018). Corporate Financial Performance deals with how well a company generates revenues and manages its assets, liabilities, and financial interests of its stakeholders (Alshehhi et al., 2018). It is measured through gross profit margin, working capital, current ratio, leverage, and inventory turnover. It is critical for any organization, as it reflects the effectiveness of management (Franco, Caroli, Cappa, & Del Chiappa, 2020). It is linked with individuals and groups contributing towards achieving firm's financial objectives. This study is conducted to analyze the influence of corporate governance in management financial accounting firms. This can help company reduce costs and maximize profits to attain business goals. It improves interaction, and quality of communication within organization. The financial performance address all businesses to translate needs through business solutions. They include generating revenue for market differentiation and growth, by addressing regulatory compliance.

Firms with stronger governance structure help create higher firm value, profits, and sales growth (Esteban-Sanchez, de la Cuesta-Gonzalez, & Paredes-Gazquez, 2017). Corporate financial performance help gain trust of employees, increase revenues and profitability, and increase shareholder confidence in company's ability to manage investment projects successfullly (Aggarwal, 2013). Literature indicates that corporate financial performance is a major source of competitive advantage (Alshehhi et al., 2018). Corporate financial performance helps maintain company's success by keeping in check the costs and profits associated with company's operations (Chen, 2018). Research indicates that corporate financial performance leads to attracting better investors, improving company's overall financial image, and contributing towards achievement of financial objectives (Franco et al., 2020).

Corporate financial performance is analyzed by comparing company's financial statements to evaluate total expenses in comparison to net profits (Xie, Nozawa, Yagi, Fujii, & Managi, 2019). Companies strive their best to maintain overall corporate financial performance and utilize it as a key factor in measuring success of any organization. Another important factor that we will explore in this study is corporate governance, that is related to shareholder value andinstitutional investment for best practices in

maximizing economic performance (Bhagat & Bolton, 2019). It is collection of mechanisms, processes, and relations utilized by various parties to control and operate a corporation. It is the system through which companies are directed and controlled. It determines how resources are allocated, strategic goals are set, and important decisions regarding their achievement are made (Danoshana & Ravivathani, 2019). The main aim of corporate governance is to create an environment of trust, transparency, and accountability in the organization (Adnan, Hay, & van Staden, 2018). Corporate financial performance highly critical for organizations to have a strong system of corporate governance, so that organizational resources and capital is focused on achieving them. Therefore, in this study we will explore how management accounting firms govern utilizing corporate governance for corporate financial performance, which literature has failed to address.

Companies strive to maintain competitive edge by continually creating investment opportunities that promise revenues based on creativity and innovation (Wu, 2013). Corporate governance ensures that company is striving towards achieving quality, growth, and development through constantly improving its services and procedure for goal attainment (Bhagat & Bolton, 2019). Corporate financial performance is hence a measure of how well a company's is achieving its goals and objectives (Danoshana & Ravivathani, 2019). It is also a measure of effectiveness of company policy implementation exhibited through corporate governance (Fleming et al., 2017). Companies require effective information system that help ensure that goals and objectives are translated into performance behaviors to improve quality decision making and compliance (Uadiale, 2010). Research indicates that a reliable management accounting information system can produce information needed by managers to make better decisions in creating a good financial performance (Weshah et al., 2012). The firm's financial performance is an indicator of firm's reliable utilization of resource to fulfill customer needs and increase productivity and technological competitiveness. Previous studies support that corporate governance is based upon leverage and commitment towards achieving firm's strategic goals andfinancial performance (Esteban-Sanchez et al., 2017; Huselid, 1995).

Corporations are now facing the need to address their corporate performance, in addition to the traditional functions. Therefore, in this study we will explore how corporate governance can help organizations achieve corporate financial performance goals. In this context achieving corporate financial performance goals through corporate governance which constitute the economic factors.

II. LITERATURE REVIEW

Corporate financial performance can require companies to formulate highly adaptive plans, that can transform company's threats into successful opportunities for achieving financial objectives. Whereas improved financial performance can lead to customer satisfaction, increase productivity, and overall success of organization (Nilsson et al., 2018). Firm's financial performance is also an indicator of firm's inability to achieve set performance objectives and financial goals in terms of costs increase in relation to profits generated (Danoshana & Ravivathani, 2019). The corporate financial performance helps managers receive a snapshot of overall business functions in relation to assets and liabilities ratio (G. Liu, Shah, & Babakus, 2012). It helps financial managers determine as to what policies are working affectively in terms of company's financial operation (Franco et al., 2020).

Companies or organizations are a part of bigger system based on various stakeholders including government, financial institutions, and public (Adnan et al., 2018). Therefore, policies made and implemented by organizations affect the system integration of all these stakeholders. Corporate governance based on stakeholder's perspective ensure system integration (Wu, 2013). The main role of corporate governance is to maintain differentiated roles and responsibilities of employees, managers, stakeholders to achieve overall performance of organization (Bhagat & Bolton, 2019). It is related to structures and processes for direction and control of enterprise functions. Senior management and board of directors are authorized with responsibility of decision making and policy implementation for allocating, distributing, and maintaining financial and capital resources for fulfilling organizational goals to achieve competitive advantage (Aggarwal, 2013).

Corporate governance is related to monitoring and facilitating effective entrepreneurial management that ensures long-term success of company (Bhagat & Bolton, 2019). It is related toensuring success and effectiveness and goal attainment. Previous research indicates positive correlation between firm's corporate governance and firm's performance (Danoshana & Ravivathani, 2019). But very few studies have investigated the relationship between corporate governance and corporate financial performance. Corporate financial performance is dependent upon organizational factors such as liquidity, leverage, asset utilization, firm size, and market share (Weshah et al., 2012). Study suggest that return on investment and return of equity affects corporate financial performance of a company (Aggarwal, 2013). It is also linked to growth rate, account receivable days, fixed asset investment, capital structure, and business risk (Alshehhi et al., 2018). Corporate governance is linked to improving internal efficiencies of firm due to transparency, and disclosure practices among employees (Adnan et al., 2018). The effectiveness of corporate governance is highly dependent upon getting the board right, performance evaluation of directors, and executive compensation (Xie et al., 2019).

Empirical Nexus Between Corporate Governance and CorporateFinancial Performance: A Common Estimated Approach

Effective corporategovernance that ensures empowerment, transparency, and effective compensation policies can lead to increase in firm's financial performance (Darvishmotevali et al., 2018). Therefore, it is critical for firms to ensure effective corporate governance in order to attain financial goals and improve corporate financial performance. It helps improve overall communication between employees and help address their concerns regarding unprecedented events through contingency planning (Abrhám & Lžičař, 2018).

Firm's financial performance is based upon generating revenues and comparing performance against competitors across industry (Sabherwal et al., 2019). It is calculated by economic outcome and size of earnings by the company (Lonial & Raju, 2001). Ensuring firm's corporate financial performance can be ensured by applying appropriate management strategies and contingency planning to deal with unpredicted events. It is related to increase shareholders return by reducing the uncertainty to underperformance (Butler et al., 2016), and to assessmentof legal liabilities, strategic management errors, and accidental disasters (Teuscher et al., 2006). Companies perceive and predict threats by analyzing customer reports, previous financial statements, competitors' portfolios, and government policies and media reports (Weshah et al., 2012). Firm's corporate financial performance is related to cash on hand, firm size, firm specific strategy, and tangibility (Choe, 2003). Therefore, management allows a company to address these concerns in terms of transforming employees' skills and abilities to adapt to various predicted changes (Teuscher et al., 2006).

III. RESEARCH METHOD

This study aims to determine the best regression model from panel data between Corporate Governance and Corporate Financial Performance. In this study corporate governance reflected by Good Corporate Governance (GCG) data and corporate financial performance reflected by Return on Equtiy (ROE) in non-financial BUMN companies in Indonesia. Panel data regression isa regression model that is formed because the data used is a combination of cross section data and times series data. The following is a general model of panel data regression:

$$Y_{it} = \beta_{it} + \beta X_{it} + e_{it}$$

With:

Y_{it} : The dependent variable for the first time cross section unit in t time period

β_{it} : The intercept is the group/individual effect of the first time cross section unit in t time period

β_{it} : Vector regression coefficient

$X_{it.}$: The independent variable for the first time cross section unit in t time period

$e_{it.}$: Error/residual

There are 3 panel data regression estimation models, namely the Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM). CEM is the simples t panel data regression model because it only combines time series and cross section data with the assumption that the behavior of the cross section/individual unit is the same in various t i m e periods, while FEM assumes that the differences between the cross section units can be accommodated from the differences in intercepts. And in REM it is assumed that the residual variables may be interrelated between time and cross section.

The population in this study were all non-financial BUMN companies in Indonesia. There are 39 companies recorded. Meanwhile, to obtain a sample in accordance with the required data, the author uses a purposive sampling technique. The criteria used are:

1. Is a non-financial state-owned company
2. Published financial reports for the period 2015 – 2020 and has complete ROE and GCG data Based on purposive sampling, from 39 non-financial BUMN company.

IV. RESULT AND DISCUSSION

A. Descriptive Analysis of Good Corporate Government and Company Performance

The data in this study is panel data involving cross section data, namely 16 non-financial BUMN companies and time series data for 6 years of research from 2015 to 2020. GCG assessment in this study is based on a total score involving 6 aspects of assessment, namely commitment to implementing GCG, shareholders and GMS, Board of Commissioners, Board of Directors, information disclosure and transparency and other aspects. The company's performance uses Return on Equity (ROE).

Table 1. Overview of Research Variables

	GCG	ROE
mean	88.03703	5.611965
median	87.99000	6.516213
Maximum	98.15700	127.4628
Minimum	73.04000	-61.37091
Observations	96	96

Source: Processed by the Author (2022*)*

From the table above, it is known that the lowest score of GCG which is 73.04% is owned by PT. Pelayaran Nasional Indonesia (Persero) in 2015, while the highest score of 98.16% was owned by PT. Jasa Marga (Persero) Tbk in 2020. With an average GCG score of 88.04% and a median of 87.99%. Meanwhile, the lowest ROE value of -61.37% is owned by Perum Perumnas in 2020, while the highest ROE value of 127.46 is owned by PT. Garuda Indonesia (Persero) Tbk in 2020.

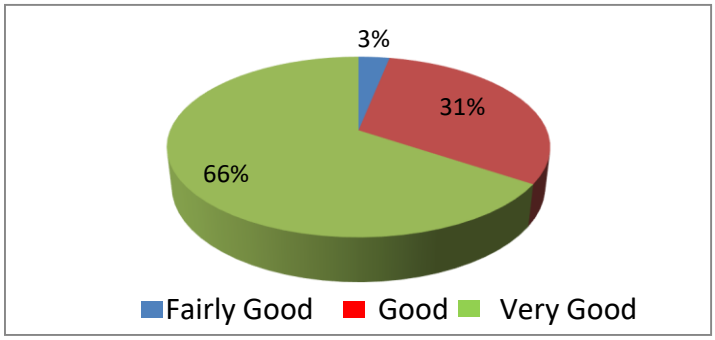

Figure 1. GCG Criteria

From the picture above, it is known that 66% of companies have GCG with very good criteria, 31% companies with good criteria and 3% companies with fairly good criteria.

B. Estimated Common Effect Model (CEM), Fixed Effect Model (FEM) and Random Effect Model (REM)

This study aims to determine the best regression model from panel data consisting of 16 companies (cross section units) in the 2015 – 2020 time period (time series) between GCG and ROE. Based on data processing using Eviews 10 software, the results of the model estimation forCEM are as follows:

Table 2. Estimation of CEM

Dependent Variable: ROE
Method: Least Squares Panel
Samples: 2015 2020
Periods included: 6
Cross-sections included: 16
Total panel (balanced) observations: 96

Variable	Coefficient	Std. Error	t-Statistics	Prob.
C	-85.24788	18.89110	-4.512595	0.0000
GCG	1.067133	0.216171	4.936528	**0.0000**
R-squared	0.205875	Mean dependent var		7.767636
Adjusted R-squared	0.197427	SD dependent var		14,84226
SE of regression	13.29665	Akaike info criterion		8.033515
Sum squared resid	16619.29	Schwarz criterion		8.086939
Likelihood logs	-383.6087	Hannan-Quinn Criter.		8055110
F-statistics Prob(F-statistic)	24.36931	Durbin-Watson stat	0.000003	1.162906

Source: Processed by the Author (2022)

From the table above, the value of Prob is obtained. of the GCG coefficient for the CEM model is 0.0000 (<5%) which means that the GCG variable has a significant effect on ROE. Next, we will compare the results of the model estimation for FEM, the results obtained are as follows:

Table 3. Estimation of FEM

Dependent Variable: ROE Method: Least Squares Panel Samples: 2015-2020
Periods included: 6
Cross-sections included: 16
Total panel (balanced) observations: 96

Variable	Coefficient	Std. Error	t-Statistics	Prob.
C	-141.6421	27.88057	-5.080316	0.0000
GCG	1.714123	0.319499	5.365028	**0.0000**

Effects Specification

ion	13.03150	Akaike info criterion	8.131883
Sum squared resid	13415.78	Schwarz criterion	8.585986
Likelihood logs	-373,3304	Hannan-Quinn Criter.	8.315439
F-statistics	2.764701	Durbin-Watson stat	1.342248
Prob(F-statistic)	0.001479		

Source: Processed by the Author (2022)

The table above shows the GCG coefficients for the FEM model with the Prob value. of0.0000 (<5%) which means that the GCG variable has a significant effect on ROE. To find out which model is more suitable to use from the estimation results of CEM and FEM in this study, we use the Chow test with the following hypothesis:

H0 : CEM is a suitable model
H1 : FEM is a suitable model

Table 4. Chow test

Redundant Fixed Effects Tests
Equation: Untitled
Test cross-section fixed effects

Effects Test	Statistics	df	Prob.
Cross-section F	1.257609	(15.79)	**0.2492**
Cross-section Chi-square	20.556696	15	**0.1516**

Source: Processed by the Author (2022*)*

Based on the results of the Chow test above, the value of Prob is obtained. 0.2492 and 0.1516 (>5%) means that H0 is accepted and H1 is rejected. So it can be concluded that the CEM model is more suitable than the FEM model to be used. And because the CEM model was chosen, we don't need to continue to estimate the REM model. So that the best regression model for panel data formed based on the estimation results in Table 2, is as follows:

ROE = -85.24788 + 1.067133 $\boldsymbol{GCG}$ + $\boldsymbol{e}$

From this model, the regression coefficient of 1.067133 shows that every 1 point increasein GCG score can increase ROE by 1.067133%. The results of the t test and F test yielded the Prob value. of 0.0000 (<5%) indicates that GCG has a positive and significant effect on ROE. The R-squared value of 0.205875 indicates that 20.59% of the variation in ROE can be explained by GCG.

C. Classic Assumption Test

The advantage of panel data regression using CEM or FEM models is that panel data has the implication of not having to test classical assumptions such as normality and autocorrelation. If the number of observations is more than 30, then there is no need to test for normality because the distribution of the sampling error term is close to normal (Ajija, et al, 2011). Because the number of

observations in this study were 96, the normality test could be ignored. The autocorrelation test is used in the regression model for times series data, while in panel data regression the cross section is more dominant than the times series, so the autocorrelation test can also be ignored. Likewise, the multicollinearity test does not need to be carried out in this study because the independent variable used is only 1 variable.

The heteroscedasticity test was carried out using the Glejser test, namely by regressing the absolute value of the residual with the independent variable.

Table 5. Heteroscedasticity Test

Dependent Variable: RESABS
Method: Least Squares Panel
Samples: 2015-2020
Periods included: 6
Cross-sections included: 16
Total panel (balanced) observations: 96

Variable	Coefficient	Std. Error	t-Statistics	Prob.
C	-13.50703	16.63886	-0.811776	0.4190
GCG	0.224586	0.190398	1.179560	0.2412

Source: Processed by the Author (2022)

From the table above, the value of Prob is obtained. for the GCG coefficient of 0.2412 (> 5%), then the GCG regression coefficient on the absolute residual value is not significant, so it can be concluded that there is no heteroscedasticity.

CONCLUSIONS

This study is highly significant in contributing in various ways towards literature. This study explores the role of corporate financial performance in accounting and management firms in State Owned Enterprises (SOE) of Indonesia. As previously they have studied in terms of impacting overall economies of the company. As previous studies have focused on influence of firm's corporate financial performance in relation to generating revenues and assessing business models. The role of corporate financial performance in relevance to firm's corporate governance estimate the dynamics relationship among corporate financial performance on State Owned Enterprises (SOE) in Indonesia used Common Estimated Method (CEM). Based on the Chow test, the results show that the CEM model is the appropriate model for panel data regression between GCG and ROE in non-financial BUMN companies in Indonesia. The CEM model produces a regression coefficient of 1.067133 indicating that every 1 point increase in GCG score can increase ROE by 1.067133% and is significant at the 5% alpha level. And the R- squared value of 0.205875 indicates that 20.59% of the variation of ROE can be explained by GCG.

This study explores the role of corporate governance in achieving corporate financial performance. This study utilizes the accounting management theory to explain the impact of economy in accomplishing corporate financial performance in management accounting firms, which has not been explored the actual data and predictive data previously in this context. Therefore, this study builds upon the theoretical understanding of this theory to explain the relationship between these predictor variables in achieving corporate financial performance.

Along with various above mentioned theoretical contributions this theory has numerous managerial implications for policy makers. First, this study highlight's role of management accounting firms in achieving corporate financial performance, as these firms are responsible for making investment decisions for various projects and clients. Therefore, their commitment towards achieving competitive source for government and financial decision makers. Secondly, this study serves as a guiding principle for various developing countries in exploring factors that influence financial decisions regarding making sustainable decisions and optimizing resources. Financial managers and policy makers can highly benefit from this study by utilizing the factors such as corporate governance to manage, evaluate, and control financial resources and managing them in a way to generate revenues and reduce costs. Finally, this study can serve as a source for implementing policy for State Owned Enterprises (SOE*)*, and various other states of Indonesia,to endure growth and development, and serve as prosperous funding sources for society members.

REFERENCES

1) Abrhám, J., & Lžičař, P. (2018). Risk management in the sustainable development: Analysis of selected key industry. *Journal of Security Sustainability Issues, 8*(2).
2) Adnan, S. M., Hay, D., & van Staden, C. J. (2018). The influence of culture and corporate governance on corporate social responsibility disclosure: A cross country analysis. *Journalof Cleaner Production, 198*, 820-832.
3) Aggarwal, P. (2013). Impact of corporate governance on corporate financial performance. *IOSR Journal of Business Management, 13*(3), 01-05.
4) Ajija, Shochrul Rohmatul, dkk. 2011. *Cara Cerdas Menguasai Eviews*. Jakarta: Salemba Empat.
5) Alshehhi, A., Nobanee, H., & Khare, N. (2018). The impact of sustainability practices on corporate financial performance: Literature trends and future research potential. *Sustainability, 10*(2), 494.
6) Belloumi, M. (2014). The relationship between trade, FDI and economic growth in Tunisia: An application of the autoregressive distributed lag model. *Economic Systems*, 38(2), 269– 287. https://doi.org/10.1016/j.ecosys.2013.09.002
7) Bhagat, S., & Bolton, B. (2019). Corporate governance and firm performance: The sequel. *Journal of Corporate Finance, 58*, 142-168.
8) Danoshana, S., & Ravivathani, T. (2019). The impact of the corporate governance on firm performance: A study on financial institutions in Sri Lanka. *SAARJ Journal on Banking Insurance Research, 8*(1), 62-67.
9) Darvishmotevali, M., Altinay, L., & De Vita, G. (2018). Emotional intelligence and creative performance: Looking through the lens of environmental uncertainty and culturalintelligence. *International Journal of Hospitality Management, 73*, 44-54.
10) Darvishmotevali, M., Altinay, L., & Köseoglu, M. A. (2020). The link between environmental uncertainty, organizational agility, and organizational creativity in the hotel industry. *International Journal of Hospitality Management, 87*, 102499.
11) Esteban-Sanchez, P., de la Cuesta-Gonzalez, M., & Paredes-Gazquez, J. D. (2017). Corporate social performance and its relation with corporate financial performance: International evidence in the banking industry. *Journal of cleaner production, 162*, 1102-1110.
12) Fadhilah, N Dan Sukmana, R. (2017). Pengaruh Sertifikat Bank Indonesia Syariah (Sbis), JakartaIslamic Index (Jii), Tingkat Inflasi, Dan Index Harga Saham Gabungan (Ihsg) TerhadapNilai Tukar: Pendekatan *Autoregressive Distributed Lag* (Ardl), *Jurnal Ekonomi Syariah Teori Dan Terapan*, Vol. 4(1), 833-846
13) Fleming, A., Wise, R. M., Hansen, H., & Sams, L. (2017). The sustainable development goals: Acase study. *Marine Policy, 86*, 94-103.
14) Franco, S., Caroli, M. G., Cappa, F., & Del Chiappa, G. (2020). Are you good enough? CSR, quality management and corporate financial performance in the hospitality industry. *International Journal of Hospitality Management, 88*, 102395.
15) Gasmi, A., Noor, S., Tippairote, T., Dadar, M., Menzel, A., & Bjørklund, G. (2020a). Individual risk management strategy and potential therapeutic options for the COVID-19 pandemic. *Clinical Immunology*, 108409.
16) Gasmi, A., Noor, S., Tippairote, T., Dadar, M., Menzel, A., & Bjørklund, G. (2020b). Individual risk management strategy and potential therapeutic options for the COVID-19 pandemic. *Clinical Immunology*, 108409.
17) Harris, R., & Sollis, R. (2003). *Applied time series modelling and forecasting*. Wiley.
18) Herzer, D. (2012). How does foreign direct investment really affect developing countries' growth?*Review of International Economics*, 20(2), 396–41. https://doi.org/10.1111/j.1467- 9396.2012.01029.
19) Liu, G., Shah, R., & Babakus, E. (2012). When to mass customize: The impact of environmental uncertainty. *Decision Sciences, 43*(5), 851-887.
20) Lonial, S. C., & Raju, P. (2001). The Impact of Environmental Uncertainty on the Market Orientation--Performance Relationship: A Study of the Hospital Industry? *Journal of Economic Social Research, 3*(1).
21) Nilsson, M., Chisholm, E., Griggs, D., Howden-Chapman, P., McCollum, D., Messerli, P., . . . Stafford-Smith, M. (2018). Mapping interactions between the sustainable development goals: lessons learned and ways forward. *Sustainability science, 13*(6), 1489-1503.
22) Pesaran, M. H., Shin, Y., & Smith, R. J. (2001). Bounds testing approaches to the analysis of level relationships. *Journal of Applied Econometrics*, 16(3), 289– 326. https://doi.org/10.1002/jae.616

23) Sabherwal, R., Sabherwal, S., Havakhor, T., & Steelman, Z. (2019). How does strategic alignment affect firm performance? The roles of information technology investment and environmental uncertainty. *MIS Quarterly, 43*(2), 453-474.
24) Weshah, S. R., Dahiyat, A. A., Awwad, M. R. A., & Hajjat, E. S. (2012). The impact of adoptingcorporate social responsibility on corporate financial performance: Evidence from Jordanian banks. *Interdisciplinary Journal of Contemporary Research in Business, 4*(5), 34-44.
25) Willumsen, P., Oehmen, J., Stingl, V., & Geraldi, J. (2019). Value creation through project risk management. *International Journal of Project Management, 37*(5), 731-749.
26) Xie, J., Nozawa, W., Yagi, M., Fujii, H., & Managi, S. (2019). Do environmental, social, and governance activities improve corporate financial performance? *Business Strategy the Environment, 28*(2), 286-300.

There is an Open Access article, distributed under the term of the Creative Commons Attribution – Non Commercial 4.0 International (CC BY-NC 4.0) (https://creativecommons.org/licenses/by-nc/4.0/), which permits remixing, adapting and building upon the work for non-commercial use, provided the original work is properly cited.