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Antecedents and Consequence of Good Corporate Governance

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***Abstract*—The purpose of this study is to examine the antecedents and consequence of good corporate governance (GCG). Antecedent factors considered in this study namely profitability, company size, and leverage, while the consequence of GCG is earnings management. The research data were obtaining from 90 companies listed in the Corporate Governance Perception Index during the period 2013-2016 using purposive sampling method. Hypothesis were testing using multiple regression analysis to determine the effect of antecedent factors of GCG and simple regression analysis to determine the consequence effect of GCG. The results showed that profitability does not influence GCG, company size has a significant positive effect on GCG, and leverage has a significant negative effect on GCG. Moreover, GCG has a significant positive effect on earnings management. Company size and leverage has influence GCG practice and next have impact on earnings management, but the effect of leverage on good corporate governance and its impact on earnings management is not as expected, the direction of influence is reversed even though it is significant. The result had implication that firms performing earnings management could be seen by its size and leverage because both had impact on GCG practice and GCG had an impact on earnings management.**

Keywords—earnings management; good corporate governance; profitability; company size; leverage

I. Introduction

One measure of corporate performance that is often used as a basis for decision making is the profit generated by the company. Besides that, earnings information is also used by investors or other interested parties as an indicator of efficiency in the use of funds embedded in the company which is realized in the rate of return and indicators for increasing prosperity [1]. Profits reported by companies are measured on an accrual basis [2]. The management often manage the company's profit to maximize its interests, so that it can harm investors. This behavior is often referred to as earnings management.

Earnings management is the choice by a manager of accounting policies to achieve some specific objectives [3]. Managers will choose certain accounting policies that are considered to be able to achieve the desired goals, whether it is to increase profits or reduce the level of losses reported.

Earnings management arises because of agency problems, namely the inconsistency of interests between managers and company owners due to information asymmetry. Information asymmetry is a condition where there is an imbalance in the acquisition of information between management and company owners where management has more information than external parties. One mechanism that can be taken to prevent the occurrence of earnings management actions is to implement Good Corporate Governance (GCG). The implementation of the GCG concept is required by the regulator solely to maintain the interests of the company in order to achieve its objectives [4].

Good Corporate Governance is also a principle that directs and controls the company in order to achieve a balance between the strength and authority of the company in providing accountability to its particular shareholders and stakeholders in general. The emergence of the concept of Good Corporate Governance is due to the demands of external parties so that the company does not commit a fraud against the public, namely the information contained in the financial statements can be trusted for decision making.

Research conducted by Putro who uses the CGPI index found that Good Corporate Governance has no significant effect on earnings management [5]. Other studies show different results, Amertha found that Good Corporate Governance has a significant effect on earnings management [6].

The importance of GCG implementation is to reduce the behavior of opportunistic earnings management, giving rise to incentives to test variables that are driving GCG implementation in the company. There are several characteristics of the company that influence the company to implement GCG, which are among others profitability, company size, and leverage. Profitability reflects the company's ability to make a profit [7]. The size of the company is the wealth owned by the company by looking at several things, one of which is the company's assets, and Leverage is how much the company's assets are financed by debt and is an indication of the level of security of the lenders / creditors. The leverage ratio is a debt ratio that can be used to show how much a company uses external debt to finance its operations.

The research conducted by Natalia found that profitability had a negative effect that was not significant, the size of the company had a positive and insignificant effect, and leverage

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had a significant negative effect on corporate governance disclosure [8]. This result contradicts the research of Pamungkas which found that profitability does not have a significant effect, firm size has a significant positive effect, and leverage does not significantly influence the good corporate governance rating [9]. While the research conducted by Irmawatih found that profitability affects good corporate governance, firm size has a significant positive effect on good corporate governance, and leverage has a significant negative effect on good corporate governance [10].

Most previous research only examined the factors that influence GCG. This research besides examining several factors that influence GCG, also examines the impact of GCG implementation on earnings management. Based on the above background, this study would like to test "Antecedents of Good Corporate Governance and their Consequences on Earning Management in Companies Registered in the Corporate Governance Perception Index".

II. Method

This research is a quantitative research that will examine the factors that influence the GCG and the impact of GCG on earnings management. In this study will explain the relationship between variables by analyzing numerical data, using statistical methods through testing hypotheses.

The type of data used in this study is secondary data, where the data comes from sample which derived from population. The population in this study are companies that are included in the CGPI report ranking conducted by the Indonesian Institute for Corporate Governance (IICG) in 2013-2016. The sampling technique uses purposive sampling, with the specified criteria obtained by 90 samples. Table 1 describes the stages of obtaining samples.

TABLE I. SAMPLE SELECTION

Description	2013	2014	2015	2016	Total
Companies listed in CGPI period 2013-2016	42	31	23	30	126
Companies with incomplete data	(7)	(6)	(4)	(3)	(20)
Companies reporting in dollars	(3)	(3)	(0)	(1)	(10)
Companies with negative earnings	(3)	(2)	(2)	(2)	(9)
Total sample	29	20	17	24	**90**

Data obtained from the company's annual report included in the CGPI report ranking issued by The Indonesia Institute for Corporate Governance (IICG) for the 2013-2016 period, the SWA business magazine circulating in the community, and IDX.

Measurement of research variables as follows: Earning Management is proxied by the comparison of working capital accruals and sales [11]. Profitability is a comparison of net income with total assets (ROA) [9]:

$$ROA = \frac{\text{Earning After Tax}}{\text{Total Assets}}$$

Company size is measured using the Natural Log of Total Assets = $LnTA_{it}$ [12].

Leverage is the ratio between total debt and total assets.

$$LEV = \frac{\text{Total Liabilities}}{\text{Total Assets}} \quad [9].$$

Good Corporate Governance is proxied using instruments developed by the Indonesian Institute of Corporate Governance (IICG) in the form of Corporate Governance Perception Index (CGPI) published in SWA magazine. The CGPI assessment includes four stages with value weights: Self-assessment (15%), Company Document Collection (25%), Paper and Presentation Preparation (12%), and Observation to the Company (48%).

Data analysis uses multiple regression models (ordinary least square) with conditions that must be met, passed the normality test and classic assumption test (multicollinearity test, autocorrelation test, and heteroscedasticity test). The test results on the normality test and the classic assumption test show that the regression model passes the four tests.

The research models are as follow [13]:

$$GCG = \alpha + \beta_1 ROA + \beta_2 SIZE + \beta_3 LEV + \varepsilon \quad (1)$$

$$ML = \alpha + \beta_1 GCG + \varepsilon \quad (2)$$

Where:

GCG = CG score according to CGPI index, β1-β8 = regression coefficient of each independent variable, α = constant, ROA = Profitability, SIZE = Company Size, LEV = Leverage, ML = Profit Management, ε = error term.

III. Results and Discussion

Four hypotheses put forward to be tested: H1 = Profitability has a positive effect on good corporate governance [10,14]; H2 = Company size has a positive effect on good corporate governance [9,15]; H3 = Leverage has a positive effect on good corporate governance [16]; and H4 = Good Corporate Governance has a negative effect on earnings management [6].

This research model is illustrated in figure 1.

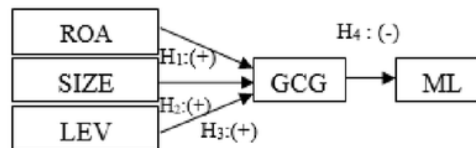

Fig. 1. Research model.

A. Model Testing

Model testing needs to determine the extent to which the model used meets the goodness of fit requirements, so the model can be used to analyze. Model testing is carried out, namely the coefficient of determination, which is indicated by the adjusted R-Square value. Testing of this model can determine the effect of the independent variables used to influence the dependent variable.

The value of R2 adjusted of the first model is 57.1%, which means that the variable Good Corporate Governance is explained by the variable Profitability, Company Size, and Leverage of around 57.1% and the remaining 42.9% is explained by other variables outside this model. So, it can be concluded that the research model is good. The second equation model shows the R Square value of 4.1%, which means that the Earnings Management variable is explained by the Good Corporate Governance variable of about 4.1% and the remaining 95.9% is explained by other variables outside this model. So, it can be concluded that this research model is feasible.

Testing other models is testing the significance value F (F test). This test is to find out whether the regression model meets the requirements of goodness of fit as stated in Ordinary Least Square (OLS). Anova results or F test of model 1 shows that the calculated F value is 40.514 with a significance level of 0.000 far below 0.05, it can be concluded that together the independent variables profitability, firm size, and leverage able to explain variation in the dependent variable that is good corporate governance. Anova results or F test of model 2 shows that the calculated F value is 4.790 with a significance level of 0.031 far below 0.05, then it can be concluded that the independent variable good corporate governance able to explain variation in earnings management.

B. Hypothesis Testing

The results of hypothesis testing by looking at the t test results and significant value on the regression of models 1 and 2. The first hypothesis (H1) was rejected. This shows that the higher the profitability of a company does not affect good corporate governance. The results of this study contrast with the agency theory which states that if the manager as manager and decision maker for the company is able to increase profits and generate good ROA value, it will increase investor confidence in the manager so that he does not hesitate to invest in the company and its corporate governance will be good.

TABLE II. REGRESSION TEST RESULT, EQUATION 1

Model	Beta	t	Sig
Constant	43,732	11,507	0,000
ROA	-1,781	-0,185	0,853
SIZE	2,357	10,891	0,000
LEV	-3,284	-2,117	0,037

Dependent variabel: GCG.

TABLE III. REGRESSION TEST RESULT, EQUATION 2

Model	Beta	t	Sig
Constant	-1,163	-1,884	0,063
GCG	0,016	2,189	0,031

Dependent variable: earning management.

Multiple regression testing results in the following mathematical equations:

$$GCG = 43{,}732 - 1{,}781ROA + 2{,}357SIZE - 3{,}284LEV + e$$

$$ML = -1{,}163 + 0{,}016GCG + e$$

The results of this study are consistent with the research conducted by Pamungkas, Rini and Fitriana which state that profitability does not significantly influence good corporate governance [9,15,17]. But this result contrasts with previous research conducted by Irmawatih found that profitability affects good corporate governance [10].

The second hypothesis (H2) was accepted. This shows that the greater the size of the company the better corporate governance. Agency theory explains the differences in interests between shareholders and management. The greater the size of the company, the role of Good Corporate Governance is increasingly needed to reduce the gap between shareholders and management. The shareholders conduct tighter supervision of the management, resulting in high corporate governance ratings.

The results of this study are consistent with the research conducted by Pamungkas and Irmawatih found that firm size has a significant positive effect on good corporate governance [9,10]. However, these results contrast with previous studies conducted by Natalia, which found that firm size had a significant and non-significant effect on corporate governance disclosure [8]. In contrast to the research conducted by Arif and Dini which found that the size of the company had no significant effect on the extent of corporate governance disclosure [18].

The third hypothesis (H3) was rejected. This finding contrasts with agency theory which states that shareholders as principals certainly expect the return on investment they have made. The higher the company's leverage ratio will cause shareholders to put pressure on management to improve the company's performance so that the leverage ratio decreases. This pressure forces management to implement Good Corporate Governance.

The results of this study are consistent with the research conducted by Irmawatih found that leverage has a significant negative effect on good corporate governance [10]. This result is also contrary to previous research conducted by Pamungkas and Muid which found that leverage does not have a significant effect on good corporate governance [9].

The fourth hypothesis (H4) was rejected. The existence of good corporate governance within the company did not reduce but it actually enhances management actions in conducting opportunistic earnings management. The results of this study are consistent with research conducted by Tarigan who found that good corporate governance has a significant positive effect on earnings management [19]. But this result contrasts with previous research conducted by Putro and Ningsaptiti who

found that good corporate governance does not affect earnings management [5,20].

IV. Conclusion

This study found that profitability does not affect good corporate governance, firm size has a significant positive effect on good corporate governance, leverage has a significant negative effect on good corporate governance, and good corporate governance has a significant positive effect on earnings management. It can be concluded that in the concept of antecedents and consequences, just company size and leverage has influence good corporate governance practice and next have impact on earnings management, meanwhile, the effect of leverage on good corporate governance and its impact on earnings management is not as expected, the direction of influence is reversed even though it is significant.

The difference between hypotheses and empirical results is caused by the existence of two different views regarding the use of debt as a source of funding. On the one hand, it is argued that the existence of debt will increase the company's ability to generate profits and improve supervision to managers because there are outside parties, namely creditors who oversee managers in work. This condition tends to encourage managers to implement good corporate governance better.

On the other hand, there is an opinion stating that the use of debt as a source of funding will increase the financial risk for the company, namely the risk of bankruptcy. This condition tends to encourage managers to pay less attention to the practice of good corporate governance due to the increasing burden of bankruptcy risk. The results of this study indicate that the burden of the risk of bankruptcy actually reduces good corporate governance practices.

Low good corporate governance practices actually reduce earnings management practices. This can happen because managers tend to give a balance to the low practice of good corporate government with low engineering practices on reported earnings.

This study has limitations, the CGPI company sample is very limited, this study does not reveal the mediating effect of antecedent factors and earnings management, and the use of earnings management measures has not captured the influence of each accrual element in explaining earnings management.

For further research it is recommended to add to the research period so that the effects of corporate governance may be felt, test the GCG mediation model, and use a more representative earnings management measurement model.

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