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The Effect of Corporate Governance on Company Financial Performance with Human Capital Investment as a Mediating Variable

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Afifah Wanda Inas Asputri
Management, Faculty of Economics and Business, Diponegoro University, Indonesia
afifahwanda56@gmail.com

Hersugondo Hersugondo
Management, Faculty of Economics and Business, Diponegoro University, Indonesia
hersugondo@lecturer.undip.ac.id

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Abstract:

This study aims to explore the influence of corporate governance on a company's financial performance, with human capital investment serving as a mediating factor. Within this investigation, the company's financial performance is regarded as the dependent variable, while Good Corporate Governance (GCG) is treated as the independent variable. Furthermore, human capital investment is introduced as a mediating variable. A dataset comprising 258 data points was collected from a sample of 43 financial sector companies listed on the Indonesia Stock Exchange between 2015 and 2020. Secondary data was utilized for this study, and the purposive sampling method was employed. The Partial Least Squares-Structural Equation Modeling (PLS-SEM) technique, implemented through the SmartPLS 4.0 program, was utilized to test the research hypotheses. The findings of this study reveal a significant and positive relationship between GCG and company financial performance, both of which exert a notable influence on human capital investment. Moreover, the results suggest that human capital investment acts as a mediator in the relationship between Good Corporate Governance (GCG) and company financial performance. Additionally, it is evident that GCG significantly and positively impacts the company's financial performance.

Keywords: Good Corporate Governance (GCG); Financial Performance; Human Capital Investment; Mediation.

Introduction

Good Corporate Governance (GCG) encompasses a framework of structures, procedures, and mechanisms within an organization that facilitate its direction and control (Azzam Wajeeh & Muneeza, 2012). It plays a pivotal role in averting inaccuracies in financial performance, as inadequate governance can precipitate financial missteps (Arora & Sharma, 2016). Moreover, the adoption of Good Corporate Governance serves additional functions that can be leveraged by investors as a yardstick for evaluating a company's potential for strong performance. This is attributed to the provision of accurate and transparent information by the company's management, thereby mitigating information asymmetry. By adhering to the tenets of Good Corporate Governance, it is anticipated that a company can enhance its corporate worth, particularly through the fulfillment of profit objectives.

The implementation of GCG is intertwined with agency theory, which addresses the potential conflicts between principals and agents. These conflicts necessitate adept management to avert losses for stakeholders with vested interests. The effective implementation of GCG within an organization necessitates the deployment of internal and external mechanisms (Jensen & Meckling, 1976). To mitigate conflicts of interest between principals and agents, the presence of an independent board of commissioners tasked with supervising the actions of agents in steering the company is imperative. Divergent interests or objectives between principals and agents can incite internal conflicts within a company (Maestrini et al., 2018). One such conflict may arise when an agent makes decisions that augment their personal wealth or when there is a disparity in the risks assumed by the principal and the agent (Barros et al., 2020). An agent may potentially exploit company assets to fulfill their personal objectives, thereby engendering conflicts between the principal and the agent (Hessen, 2017).

The internal mechanisms within a company encompass the board of commissioners, board of directors, and board of commissioners. The board of commissioners can be deemed as the linchpin of Corporate Governance, as they bear the responsibility of ensuring the execution of company strategies, supervising company management, and ensuring accountability. Independent commissioners, comprising board members external to the company, exhibit greater objectivity in imposing sanctions when company members experience a decline in performance. Within a company, independent commissioners assume a pivotal role. According to Law No. 40 Article 1 of 2007 concerning Limited Liability Companies, the board of directors, as stipulated in the company's articles of association, is a designated member entrusted with complete authority and accountability to oversee and advance the company's interests, objectives, and purposes. They serve as the company's representatives, both within and outside the court.

In recent years, a multitude of research endeavors have sought to investigate the influence of Good Corporate Governance on companies' financial performance. However, disparities in findings persist across these studies. The conclusions drawn from research conducted by (Abang'a et al., 2021; Iqbal et al., 2019; Widnyana et al., 2020) indicate compelling evidence of a substantial and positive correlation between Good Corporate Governance and company financial performance. Conversely, investigations carried out by (Al-ahdal et al., 2020; Kurniati, 2019) present contrasting results, suggesting the absence of a positive relationship and statistical significance between Good Corporate Governance and company financial performance. Given the divergent outcomes observed in these antecedent studies, the researcher aims to undertake a comparable study integrating additional variables that could potentially mediate the relationship between Good Corporate Governance and company financial performance. In this context, the researcher proposes to employ Human Capital Investment as a mediating variable. The competencies and expertise possessed by employees represent invaluable assets that distinguish a company in producing outputs that confer a competitive edge and yield greater revenue than its counterparts. Augmented value-added and intellectual capital within a company can serve to attract investors, thereby fostering investment in the company. (Penrose, 1959), as the first pioneer of the resource-based theory, states that a manager's experience and other resources within a company can influence the company's image of unique characteristics. A company will achieve a competitive advantage if it can generate greater economic value.

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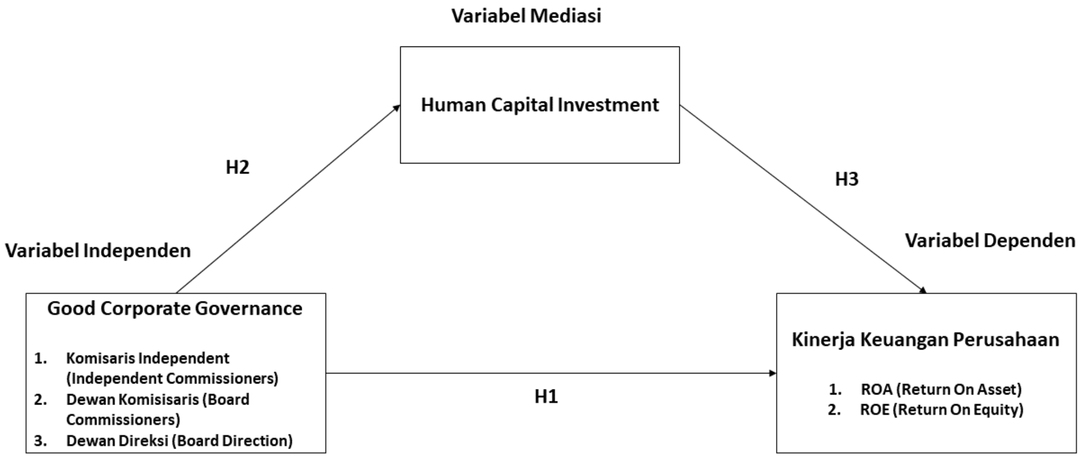

Figure 1: Research Framework of Thought

Source: (Hayes, 2018)

Literature Review

The study by (Al-ahdal et al., 2020) explored the impact of Good Corporate Governance (GCG) on the financial performance of India-listed companies. The research encompassed two variables, each comprising several indicators. The independent variable, GCG, encompassed audit committees, board accountability, and transparency and disclosure, while the company's financial performance, evaluated through ROE (Return on Equity) and Tobin's Q, served as the dependent variable. Analysis of data from non-financial companies in India and non-financial companies in GCG from 2009 to 2016 revealed statistically insignificant effects of board accountability and the influence of audit committees on the financial performance of companies, as assessed by ROE and Tobin's Q. Similarly, transparency and disclosure demonstrated a non-significant negative impact on the financial performance of companies, as measured by Tobin's Q. Furthermore, the results indicated that Indian companies exhibited more effective implementation of Good Corporate Governance (GCG) compared to other countries focusing on GCG.

In a separate study, (Ramia Abriyani et al., 2012) explored the influence of Good Corporate Governance and financial performance on CSR disclosure. The study involved two variables, each with multiple indicators. The independent variables, GCG and financial performance, included managerial ownership, institutional ownership, independent commissioners, board of commissioners, and audit committee size as indicators. Financial performance indicators encompassed company size, profitability, and leverage. Corporate Social Responsibility (CSR) disclosure served as the dependent variable. Regression analysis supported the hypothesis, revealing a positive association between Good Corporate Governance and the financial performance of companies when considering CSR disclosure.

Lastly, the study by (Annisa Hendry & Situmeang, 2020) aimed to scrutinize the impact of Good Corporate Governance (GCG) mechanisms on firm value by examining the role of Human Capital in banking companies situated in Indonesia. The study comprised three variables and several indicators within each variable. The independent variable indicators included managerial ownership, institutional ownership, and foreign ownership, while human capital served as the intervening variable, and firm value proxied by PBV served as the dependent variable. Hypothesis testing indicated a partial influence of Good Corporate Governance (GCG) on human capital, suggesting that effective GCG mechanisms in a company can mitigate risks and lead to more efficient activities, thereby augmenting human capital value. Additionally, the results indicated a relationship between human capital and firm value, signifying that improved empowerment and management of human capital in a company can enhance employee productivity.

The study by (Mukhibad et al., 2020) examined the influence of GCG mechanisms and Human Capital Investment (HCI) on Non-Performance Financing (NPF) and profitability. For this study, a purposive sampling technique was employed to select a sample of 13 commercial banks in Indonesia, covering the period from 2012 to 2016. The variables utilized in this research were profitability measured by ROA and ROE, Human Capital

Investment (salary, recruitment, and education costs), Non-Performance Financing (NPF), the board of directors, and the board of commissioners. The allocation of resources towards human capital development as part of human resources Demonstrated a noteworthy and positive impact on the market value both before and following the financial crisis. Board size and CEO strength exhibited a positive and statistically significant impact, whereas the size of the Sharia Supervisory Board (DPS) had an inverse effect on market performance. Sharia banks that strongly implement Good Corporate Governance tend to invest more in Human Capital.

The study (Mahrani & Soewarno, 2018) aimed to investigate the impact of effective corporate governance mechanisms and Corporate Social Responsibility (CSR) on the financial performance of companies. It also explored the role of earnings management as a mediating variable in this relationship. The study employed secondary data collected from 102 manufacturing companies listed on the Indonesia Stock Exchange (IDX) in the year 2014. The study encompassed three variables, namely the dependent variable, independent variables, and a mediating variable. The independent variables considered in this study were Good Corporate Governance (specifically Institutional Ownership, Independent Commissioners, and Audit Quality) as well as Corporate Social Responsibility (CSR), measured using the Global Reporting Initiative's 91 indexes. The dependent variable in this study was the company's financial performance, which was measured using proxy indicators such as Return on Assets (ROA), Earnings per Share (EPS), and Tobin's Q. Lastly, there was the inclusion of a mediating variable, namely earnings management. The findings of this study revealed a positive relationship between Good Corporate Governance, CSR, and both the financial performance of companies and earnings management. Earnings management has a significant impact on the financial performance of companies. Regarding the mediation analysis, the involvement of earnings management as a mediating variable between Good Corporate Governance and the financial performance of companies yielded partial mediation. However, when considering CSR and financial performance, earnings management acted as a fully mediating variable.

Method

The research will incorporate three variables: the dependent variable, the independent variable, and the mediating variable. The dependent variable in this study refers to the financial performance of the company, while the independent variable focuses on Good Corporate Governance (GCG). The mediating variable under consideration is Human Capital Investment. This study is panel data that combines time series and cross-sectional data. The analysis technique utilized in this study is Structural Equation Modeling (SEM) with the application of the Partial Least Squares (PLS) variant. The analysis process involved Path Analysis using SmartPLS 4.0 software. The data analysis using SmartPLS involves two stages: the Measurement Model (Outer Model) and the Structural Model (Structural Model). The target population for this study includes all companies operating in the financial sector and listed on the Indonesia Stock Exchange (IDX) between 2015 and 2020. The sample for this research was selected through purposive sampling methodology.
This research used path analysis with the following model:

$$Y = a + \beta_1 Board\_Direc + \beta_2 Board\_Com + \beta_3 Ind\_Com + \beta_4 HCI + \varepsilon 1$$

Description:

Y	= Profitability
Board_Direc	= Board of Director
Board_Com	= Board of Commissioner
Ind_Com	= Independent Commissioner
HCI	= Human Capital Investment
α	= Constanta
β1-4	= Beta Coefficient Regression
ε	= Standard Error

Results and Discussion

Descriptive statistical tests are used to obtain a general overview of data distribution, providing values that can be easily understood. These values include standard deviation, mean, maximum, and minimum. The results of these values can clarify the characteristics of each variable in the research. The following is the result of the descriptive statistical table in this study:

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Table 1. Descriptive Statistics

Tranche	N	Minimum	Maximum	Mean	Std. Deviation
Board_Com	258	0,000	10,000	4,477	1,860
Board_Direc	258	0,000	12,000	5,636	2,504
Ind_Com	258	1,000	6,000	2,678	1,008
ROA	258	-0,116	0,098	0,009	0,025
ROE	258	-0,745	0,264	0,043	0,137
HCI	258	68.890	82.500	58.512	12.414

Source: Data processed with SmartPLS, 2022.

Table 2: Hypothesis Testing Results

Alternative Hypothesis (Ha)	Path (Relationship)	*Original Sample*	*T Statistics*	*P Value*	Conclusion
H1	CG -> KP	0,168	2,889	0,004*	Accepted
H2	CG -> HCI	0,535	10,388	0,000*	Accepted
H3	HCI -> KP	0,150	3,324	0,001*	Accepted
H4	CG -> HCI -> KP	0,080	2,772	0,006*	Accepted

Source: Data processed with SmartPLS, 2022.

The following findings present the results of hypothesis testing through path analysis:

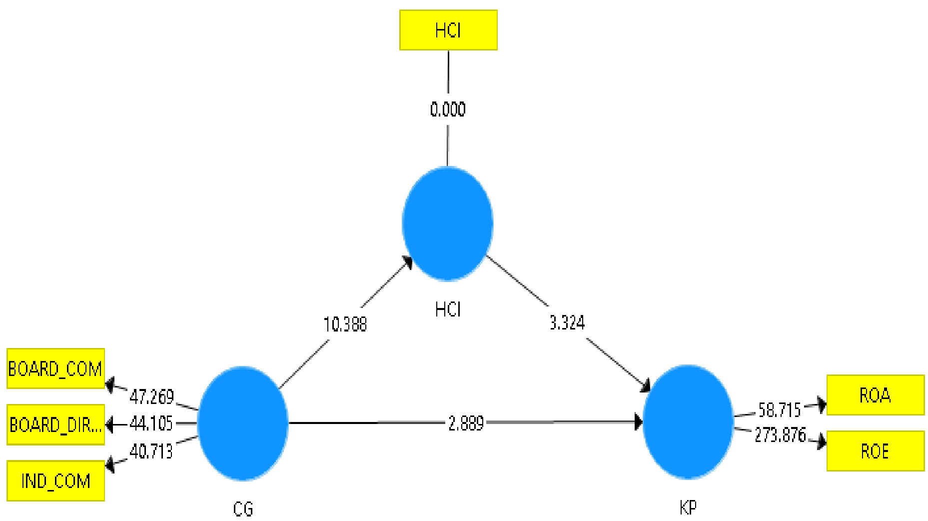

Figure 1. Hypothesis Testing Results
Source: Data processed with SmartPLS, 2022.

The outcome of the first hypothesis test examining the correlation between Corporate Governance (GCG) and the company's Financial Performance reveals a P-value of 0.004, which is below the significance level of 0.05. The T-Statistics value is 2.889, exceeding the critical t-value of 1.96. Moreover, the Path Coefficient is calculated as 0.168, signifying a positive and significant influence (Ghozali & Latan, 2015). Therefore, it can be concluded that GCG has a positive effect on the Financial Performance of the company, supporting hypothesis 1 or accepting the hypothesis. Based on these results, it can be stated that the company has implemented GCG by the established regulations, which can enhance the company's performance and prevent conflicts between principals and agents by monitoring the agents' performance. This study yields similar results to the research conducted by (Abang'a et al., 2021), these results support the assertion that there exists a positive and significant relationship between Corporate Governance (GCG) and the Financial Performance of the company. However, this study contradicts the findings of prior research conducted by (Al-ahdal et al., 2020), which suggests that there is no positive relationship between GCG and the Financial Performance of the company.

The second hypothesis test, which examines the correlation between Corporate Governance (GCG) and Human Capital Investment, reveals a P-value of 0.000, indicating statistical significance at the 0.05 level. The T-Statistics value is 10.388, surpassing the critical t-value of 1.96. Lastly, the Path Coefficient is calculated as 0.535, indicating a positive and significant influence (Ghozali & Latan, 2015). Consequently, we can conclude that GCG has a positive and significant impact on Human Capital Investment, supporting hypothesis 2 or accepting the hypothesis. This study aligns with the research conducted by (Annisa Hendry & Situmeang, 2020), which states that GCG has a positive relationship with Human Capital. Based on these results, it can be stated that when good corporate governance is implemented effectively, it will enhance human capital investment in a company. Increased human capital investment can lead to high-quality human capital due to the knowledge, skills, and experiences possessed by employees, thus enhancing employee productivity. This aligns with the human capital theory, which states that companies are obliged to manage their resources effectively, including providing training to improve human capital among employees, as employees are the main asset in building a company.

The third hypothesis test, examining the relationship between Human Capital Investment and the Financial Performance of the company, reveals a P-value of 0.001, indicating statistical significance at 0.05. The T-Statistics value is 3.324, which is greater than the critical t-value of 1.96. Lastly, the Path Coefficient shows a value of 0.150, indicating a positive and significant influence. As a result, we can conclude that Human Capital Investment has a positive effect on the Financial Performance of the company, thereby supporting hypothesis 3 or accepting the hypothesis. The absence of a negative effect between human capital investment and the financial performance of the company suggests that higher human capital investment conducted by the company can enhance financial performance, or in other words, there is a direct positive relationship between human capital investment and the financial performance of the company. This study is consistent with the research conducted by (Ahesha & Sujani, 2012), which states that Human Capital Investment has a positive and significant relationship with the Financial Performance of the company. The positive impact of Human Capital Investment on the Financial Performance of the company implies that investing in human capital can contribute to enhancing the company's financial performance. In this research, Human Capital Investment is measured based on the training costs for company employees, indicating that the better the training provided to employees, the more skilled and efficient they become in their work. This also implies that increasing the competency of employees through training is directly related to good performance. This is consistent with the human capital theory, which states that human capital's knowledge, skills, and experience can enhance workforce productivity, thereby improving the company's performance and influencing its capabilities.

The results of the fourth hypothesis test, which examines the relationship between Human Capital Investment and the company's Financial Performance, reveal a P-value of 0.006, indicating statistical significance at the 0.05 level. The T-Statistics value is 2.772, surpassing the critical t-value of 1.96. Lastly, the Path Coefficient shows a value of 0.080, indicating a positive and significant influence (Ghozali & Latan, 2015). Thus, we can conclude that Human Capital Investment has a positive impact on the Financial Performance of the company, supporting hypothesis 4 or accepting the hypothesis. The significant and positive impact of Good Corporate Governance on the Financial Performance of the company, mediated by Human Capital Investment, suggests that increased Human Capital Investment in a company can contribute to the enhancement of both Good Corporate Governance and the Financial Performance of the company within that specific organization. Human capital investment in this case successfully mediates the relationship between Good Corporate Governance and the Financial Performance of the company. This aligns with the Human Capital theory, which states that if a company possesses good human capital, the company's performance will increase, resulting in better performance and influencing the company's capabilities. This study aligns with the research conducted by (Hersugondo & Udin, 2019), which states that Human Capital Investment acts as a significant mediating variable between corporate governance and firm value.

Conclusion

The objective of this study is to examine the impact of Good Corporate Governance (GCG) on the Financial Performance of companies operating in the financial sector in Indonesia, with Human Capital Investment serving as a Mediating Variable. The subjects of this study are financial sector companies listed on the Indonesia Stock Exchange (IDX) between 2015 and 2020. The study sample consists of 264 companies from the financial sector. The findings indicate that Good Corporate Governance (GCG) influences the Financial Performance of the company. In the first hypothesis, GCG has a positive and significant influence on the company's Financial Performance, which is supported. This is in line with agency theory, which states that GCG can minimize conflicts by monitoring the performance of agents. The second hypothesis suggests that Good Corporate Governance (GCG) has a positive and significant impact on Human Capital Investment, and the results support this hypothesis. This indicates that the implementation of GCG in companies through monitoring can minimize the risk of conflicts and management actions to maximize value creation, thus leading to efficiency in managing company assets, which in turn enhances human capital.

The results indicate that Human Capital Investment has a positive and significant effect on the Financial Performance of the company, thus confirming the acceptance of the hypothesis. This means that if human capital within a company is well-managed, such as through employee training that enhances productivity and the presence of specialized competencies that give the company a unique advantage, it can outperform competitors in the business competition and achieve greater profits. This outcome can enhance the company's appeal to investors, consequently fostering an enhancement in its financial performance. The positive and significant impact of Good Corporate Governance (GCG) on the Financial Performance of the company, mediated by Human Capital Investment, supports the acceptance of the hypothesis. It implies that when a company invests more in Human Capital, it can positively influence the relationship between GCG and the company's Financial Performance.

The study acknowledges its limitations, including the use of a limited number of indicators to assess Good Corporate Governance and Financial Performance, as well as the relatively short observation period of 6 years, which resulted in a small sample size of companies. To address these limitations, future research is recommended to incorporate additional proxy variables for GCG, such as audit committees, institutional ownership, and others. This expansion of variables could provide a more comprehensive understanding of the relationship between GCG, Human Capital Investment, and Financial Performance. Additionally, extending the observation period and broadening the sample size could further enhance the robustness and generalizability of the findings.

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