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Mediation of Agency Cost on Governance in Company Financial Performance

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Abstract

Financial performance in the perspective of governance with agency cost is the research objective. The study was conducted during the period 2013-2021 on state-owned companies on the Indonesian stock exchange with a purposive sampling method approach. Managerial ownership, leverage and board size as representatives of corporate governance. In measuring financial performance indicators of ROA and firm value are used. SEM-PLS multivariate analysis was used as a data analysis technique. affected by leverage, agency costs and return on assets is significantly Leverage and agency costs have a significant effect on return on assets. leverage and board size have a significant effect on agency costs. Leverage and board size were successfully mediated by agency costs in influencing firm value and ROA.

Keywords
corporate governance; company value; ROA; agency cost

I. Introduction

In general, financial performance is grouped in accounting and market perspectives. Market-based criteria are seen as more objective, but are influenced by a number of factors that are not controlled by management (Gani and Jermias, 2006). According to Rostami et al. (2016) in knowing the relationship between corporate governance and company performance, accounting-based criteria have advantages. Scrimgeour (2010) said that accounting-based earnings measures were criticized because they predominantly reflect on the past and only partially estimate future events in the form of depreciation and amortization. Various considerations of the arguments above form the basis of the accounting and market approach used in the research.

The problem of companies classified as State-Owned Enterprises has become an interesting discussion in recent years. Financial problems can be shown in Figure 1.1 which describes the amount of government revenue as follows:

Table 1. BUMN Performance in 2019

No	Name of Issuer	Profit (Billion Rupiah)	Profit (% YoY)	Earnings per Share (Rp)	Dividend Per Share	DPR
1	Adhi Karya	644	24.98	181.00	36	20
2	Aneka Tambang	874	540.60	36.00	13	35

3	Bank Mandiri	25.015	21.20	536.00	45	4
4	Bank Negara Indonesia	15.015	10.27	805.00	201	25
5	Bank Rakyat Indonesia	32.351	11.57	265.00	131	50
6	Bank Tabungan Negara	2.808	-7.25	265.00	53	20
7	Bukit Asam	5.024	12.23	477.00	358	75
8	Garuda Indonesia	12	-	0.43	0	0
9	Indo farma	-33	-29.28	-11.00	0	0
10	Jasa Marga	2.203	0.11	303.00	46	15
11	Kimia Farma	4.16	27.27	75.00	15	20
12	Krakatau Steel	-1.083	-8.47	-56.00	0	0
13	State Gas Company	4.005	40.48	188.00	57	30
14	PP Tbk	1.502	3.36	242.00	48	20
15	Semen Batu Raja	76	-48.12	8.00	2	24
16	Semen Indonesia	3.079	89.95	519.00	208	40
17	Telekomunikasi Indonesia	18.032	-18.57	182.00	164	90
18	Wijaya Karya Tbk	1,730	43.94	193.00	39	20
19	Waskita Karya	3. 963	2.09	292.00	73	25
20	Timah Tbk	531	5.76	71.00	25	35

One of the biggest scandals in the Indonesian financial market and has become a public discussion is PT Garuda Indonesia (Persero) Tbk.

Table 2. Profit/Loss Statement PT Garuda Indonesia Tbk

Year of	Profit/Loss (US$)	Year of	Profit/Loss (US$)
2012	110.6	2016	8.1
2013	10.8	2017	-216.6
2014	-370.0	2018 (first version)	0.8
2015	76.5	2018 (second version)	-31.14

Garuda Indonesia in 2018 posted a net profit of US$ 0.8 million or US$ 809,846. The presentation of the 2018 financial statements was proven not to be in accordance with the provisions so that the Financial Services Authority (OJK) imposed sanctions on the Garuda Indonesia company in the form of improving and presenting the 2018 annual financial statements (LKT) after the improvement, which is called the new version. surprised the public that the Garuda Indonesia company actually suffered a loss of US$ 31.4 million, a condition that describes a conflict of interest between the agent and principal. Wong (2004) said that most SOEs in developing countries have governance weaknesses such as agency problems that cause high government intervention.

The company 's performance in accounting and market perspective is maximized by implementing corporate governance. Corporate governance is based on professional ethics which aims to create added value to stakeholders. Core et al. (1999) weaker corporate governance describes a larger agency problem. Ionescu (2012) companies can reduce the cost of capital and increase market value when improving corporate governance. Corporate governance reduces agency conflict, improved corporate governance is associated with higher earnings quality and lower earnings management (Balka et al. 2007; Leuz et al. 2003; Vafeas, 2005). Jensen (1986) corporate governance able to reduce agency costs.

II. Review of Literature

In theory, the relationship between board size and company performance is generally not final (Khabiya, Upadhyay, Srivastava, & Anandjiwala, 2014) Agency theory says that a large board can increase managerial costs and therefore adversely affect firm profitability (Yawson, 2006). The increase in the value of the company's shares, the higher the company value, the higher it will be (Katharina, 2021). In the current economic development, manufacturing companies are required to be able to compete in the industrial world (Afiezan, 2020). The existence of the company can grow and be sustainable and the company gets a positive image from the wider community (Saleh, 2019). It can increase board costs such as remuneration, bonuses, travel and other benefits (Vafeas, 1999), which in turn can lead to increased agency costs and lower firm value (Jensen & Meckling, 1976). Small boards were found to be less powerful and effective than large boards in the research conducted by Pearce and Zahra (1992); Singh and Davidson (2003). Florackis and Ozkan (2008); Beiner, Drobetz, Schmid, and Zimmermann (2004); and Eisenberg, Sundgren, and Wells (1998) reveal that board size is negatively correlated with asset turnover. while Xie, Davidson, and DaDalt (2003) find a larger board is associated with less earnings management activity.

Various criteria have been used to evaluate and measure the performance of business units. Market-based criteria in measuring the company's financial performance will be reflected in the market price of its shares (Fama, 1978). Balasubramanian et al., (2008); Al-ahdal, Alsamhi, Tabash, and Farhan (2020) tobin, sq are used as proxies to measure firm value. Fama (1978) the value of the company is reflected in the stock price. Tobin's q has the advantage of profit margin, ROA as a financial indicator based on historical accounting performance because it reflects market expectations so that it is relatively free from the possibility of manipulation by company management. Scrimgeour (2010) asserts that although Tobin's q as a market representation to know the value of the company, it is influenced by various unstable factors, for example, investor psychology, and market forecasts. Company performance from an accounting point of view can be measured by return on assets.

Based on the interpretation and findings of previous research as above, the research hypothesis can be formulated as follows;
H1: Managerial ownership affects firm value
H2: Leverage affects firm value
H3: Board size affects firm value
H4: Managerial ownership affects ROA
H5: Leverage affects ROA
H6: Board size affects ROA
H7: Managerial ownership affects agency cost
H8: Leverage has an effect on agency cost
H9: Board size has an effect on agency cost
H10: Agency cost has an effect on firm value
H11: Agency cost has an effect on ROA
H12: Managerial ownership, leverage and board size affect firm value through agency cost.
H13: Managerial ownership, leverage and board size affect ROA with agency cost.

III. Research Method

Explanatory research based Firm Value (NP), Return On Assets (ROA) and Agency Cost (AC), as endogenous variables are used to describe company performance, while exogenous variables consist of managerial ownership (KM), audit committee (KA), leverage

(Lev), board size (UD) that describes governance. The number of state-owned enterprises (BUMN) in meeting the sample criteria was carried out using a purposive sampling approach resulting in as many as 10 companies listed on the Indonesia Stock Exchange during the period 2013-2021 with a total of 90 observational data. Partial Least Structural Square (SEM-PLS) was used in the t test.

IV. Discussion

The PLS model is evaluated by looking at the Q2^{predictive} relevance measuring how well the observed values are generated by the model and its parameter estimates. Q2 value^{predictive} greater than 0 indicates the model has relevance, if it is less than 0 indicates the model has no predictive relevance. Table 1 describes the test stone-geisser (Q^2) and the goodness of fit (GoF) index test, the results of Q^2 of each endogenous variable in the model have a value of $Q^2 > 0$, meaning the model has predictive relevance. Goodness Of fit (GoF) is used to validate the overall model with the criteria for the GoF value with a normed fit index which is between 0 to 1.

Table 3. Variable Stone-geisser Test and Goodness of Fit

Variable	Q^2	NFI
Value Firm	0.183 (greater than 0)	1,000 (high)
Return on assets	0.095 (greater than 0)	1,000 (high)
Agency cost	0.101 (greater than 0)	1,000 (high)

Source: secondary data after processing

The normed fit index (NFI) value acts as a measure of the suitability of the model on a comparative basis to the baseline model null. The null generally reflects a model which states that every variable contained in the estimated model is not related to each other. The NFI value for the three variables is 1,000, meaning that all models in the study have a good level of 100%.

Table 4. Sub-structure Path Coefficients

Relationship Variables	Original Sample (O)	T Statistics (│O/STDEV│)	P Values
KM->AC	0.098	0.954	0.340
Lev->AC	-0.285	5.307	0.000*
UD ->AC	0.226	2.416	0.016**
KM-> ROA	-0.023	0.394	0.694
Lev ->ROA	-0.562	5.372	0.000*
UD ->ROA	0.033	0.245	0.806
AC-> ROA	-0.354	3.299	0.001*
KM -> NP	-0.107	0.944	0.345
Lev -> NP	-0.209	2.140	0.033* *
UD -> NP	0.145	0.838	0.403
AC -> NP	-0.263	2.595	0.010*
ROA -> NP	0.464	4.276	0.000*

Note:*significant at =1%, **sign at 5%, ***sig at 10 %
Source: SmartPLS processed results

Table 5. Specific Indirect Effects

Relationship with mediation	Original Sample (O)	T Statistics (│O/STDEV│)	P Values
Lev -> AC -> ROA	0.115	2,915	0.005*
UD -> AC -> ROA	-0.125	2,022	0.011**
Lev -> AC -> NP	0.085	2.612	0.009*
UD -> AC -> NP	-0.067	2.477	0.014**

*significant at =1%, **sign at 5%, ***sig at 10%
Source: The processed result of SmartPLS

Leverage measured by debt to equity has a significant effect on agency costs. The research findings confirm that the involvement of funds sourced from creditors encourages agents reduce investment in tangible fixed assets, and increase intangible assets so that the realization of agency cost is detected from the relationship between the two in a negative direction, meaning that it supports the findings of He and Li (2008); Nozari (2016). Leverage has a positive effect on agency costs as stated by Florackis and Ozkan (2008); Khan et al. (2012); Nazir et al., (2012). Alfadhl and Alabdullah (2013) leverage has no effect on agency costs. Board size has a significant positive effect on agency costs, which is a theme in this study, meaning that it accommodates the review of Florackis and Ozkan (2008); Beiner et al. (2004); Eisenberg et al. (1998) disagree with the theme of Pearce and Zahra (1992); Singh and Davidson (2003) who conclude that agency costs are negatively affected. Companies with higher tangible fixed assets can reduce the quality of corporate governance, the decline is meant as an impact of the tendency of directors as company managers to want to increase investment in tangible fixed assets. The low quality of corporate governance can occur as a form of the involvement of directors as owners of the company through managerial share ownership has the same motivation as other owners to increase the value of tangible fixed assets. decisions made by directors as a form of injuring every component applied in corporate governance. Weakening elements of governance as an effect of increasing tangible fixed assets by the board of directors can significantly increase agency costs. Klapper and Love (2004) their findings confirm the truth of the matter.

Agency costs will increase as managerial ownership increases, although this has not occurred significantly as confirmed in the findings. The impact of investment in tangible fixed assets is disclosed by Klapper and Love (2004) that companies with a higher proportion of fixed assets (tangible) have lower governance quality, meaning that agents make decisions that harm principle which causes high agency costs. The amount of investment in tangible fixed assets means that the owner can directly supervise the agent in managing the assets of each tangible fixed asset.

Agency problems can be reduced if the manager has a share ownership in the company, the manager's share ownership is seen as an incentive to increase the value of the company. Wida and Suartana (2014); Mandac and Gumus (2010) support the research findings that managerial ownership has no effect on firm value. The review of the direction of the negative relationship between managerial ownership and firm value is in line with Mandac and Gumus (2010); Wellalage and Locke (2014), and not in line with Fahlenbrach and Stulz (2009); Ruan et al. (2011); Wellalage and Locke (2014); Kamardin (2014) that firm value is significantly and positively affected by managerial ownership.

Leverage has a significant negative effect on firm value as research finding, meaning that it supports Chen et al. (2003); Mandac and Gumus (2010); Chen and Chen (2011); Fosu, Danso, Ahmad, and Coffie (2016), the findings with different directions of the relationship are described by Ross (1977); Jensen and Meckling (1976); Park and Jang (2013) that leverage has a positive effect on firm value. Cheryta et al. (2018). The research findings show that firm value with board size has no effect. The size of the board of directors of more than 10 is considered excessive (Lipton & Lorsch, 1992) causing a decrease in company performance. Mak and Li (2001) state that firm value has a relationship with small board size. The research findings are in line with Kamardin (2014); Al-Sahafi et al. (2015).

The negative relationship of agency cost significantly affects firm value as research findings. Bae et al. (1994); Wright et al. (2009); Wang (2010); Fadah (2013); Khidmat and Rehman (2014) simultaneously reveal that firm value is negatively affected by agency costs, meaning that it supports the research findings. Companies that are able to create profits have an impact on increasing stock prices, meaning that they support the findings of researchers that return on assets has a significant effect on the direction of a positive relationship to firm value. Rosika et al. (2018); Wardani and Hermuningsih (2011); Chen and Chen (2011); Hermuningsih (2013); Chen et al. (2003); Sari and Abundanti (2014); Rasyid, Mahfudnurnajamuddin, Mas'ud, and Su'un (2015); Wijaya and Sedana (2015); Lestari and Armayah (2016); Pramana and Mustanda (2016) strengthen research findings that when ROA increases, the market responds positively, meaning that the perceived value of the company increases.

Return on assets is not influenced by managerial ownership as a research finding as well as supporting the arguments of Mandac and Gumus (2010); Allam (2018). Cui and Mak (2002); Wahba (2013); Wellalage and Locke (2014); Kamardin (2014) reveals that return on assets is positive as the impact of managerial ownership. Ghabayen (2012); Kamardin (2014); Salehi et al. (2018) found no significant relationship between board size and ROA, which means that it supports the research findings. Al-Sahafi et al. (2015) claim board size is significantly positively related to ROA. Agency cost has a significant negative effect on return on assets, meaning that it supports Lachheb and Slim (2017) from a relationship perspective, although not significant.

The position agency cost as a mediation becomes important for several exogenous variables. The research findings identified that leverage and board size directly have a significant effect on agency costs, and agency costs are able to influence significantly in a negative direction on ROA. An interpretation that ROA can leverage and board size through agency be significantlyFrom the perspective of a significant perspective, there is a direct effect of leverage on ROA, if we compare the role of agency cost as a mediation in the influence leverage on ROA, it has a significantly lower level but the relationship is positive, meaning that the direct influence of leverage is stronger than mediation on ROA. The existence of agency costs as mediation can change the direction of the leverage to ROA to be positive. The positive relationship of leverage on ROA with agency cost illustrates that the investment policy of tangible fixed assets decreases in line with the company's use of debt as a source of funding.

Acting as a mediation, agency costs are able to deliver leverage and board size to contribute significantly to firm value. The position agency costs in this study succeeded in mediating the effect of board size on firm value significantly in a negative direction, meaning that an increase agency costs as a contribution from board size could have a negative impact on the value of state-owned enterprises. The effect leverage on firm value through agency costs turns out to produce a significantly smaller value when compared with its direct effect. Agency costs with the company tangible fixed assets in salesTFAOSor tangible fixed assets on sales) are able to position themselves as intervening.

V. Conclusion

Based on the findings and discussion above, it can be concluded as follows;

1. Managerial ownership has no effect on firm value.
2. Leverage has
3. no effect on firm value. Board size has no effect on firm value.
4. Managerial ownership has no effect on ROA.
5. Leverage has an effect on ROA.
6. Board size has no effect on ROA.
7. Managerial ownership has no effect on agency costs.
8. Leverage has an effect on agency costs.
9. Board size has an effect on agency costs.
10. Agency cost has an effect on firm value.
11. Agency cost effect on ROA
12. Leverage and board size has succeeded in influencing firm value with agency cost.
13. Leverage and board size affect ROA with agency cost.

The findings are expected to contribute to state-owned companies in applying every element of governance to the company's performance from a market, accounting and agency perspective. The management of tangible fixed assets is proven as an agency factor and contributes in generating agency costs.

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