BUSINESS STRATEGY AND FINANCIAL PERFORMANCE AS MEDIATION VARIABLES IN THE RELATIONSHIP OF CORPORATE GOVERNANCE TO EARNING QUALITY OF PUBLIC COMPANIES IN ASEAN

Molina[1], Mediaty[2], Asri Usman[3], Bambang Subiyanto[4], Median Wilestari[5]

[1]National University, Jakarta, Indonesia, [2] Hasanuddin University, Makassar, Indonesia, [3] Hasanuddin University, Makassar, Indonesia, [4]National University, Jakarta, Indonesia, [5]As-Syafi'iyah Islamic University, Jakarta, Indonesia

ARTICLEINFO	ABSTRACT
Keywords: Business Strategy, Corporate Governance Mechanisms, ASEAN	This study aimed to analyze the effect of corporate governance mechanisms on earnings quality with business strategy and financial performance as mediating variables. The analysis was carried out using the SEM-Warp PLS 7.0 application with two relationship models; direct and mediation. The first test analyzes the direct effect of corporate governance mechanisms on earnings quality. The corporate governance mechanism is measured by four proxies (number of commissioners, percentage of independent commissioners, percentage of audit committees with financial or accounting education background, and percentage of public ownership); and earnings quality as measured by four proxies (persistence, predictability, variability, and smoothness). The mediating effect of business strategy and financial performance is measured by proxy of intangible asset value and ROA analyzed through the indirect model. The results obtained in this study are different from result of previous studies that show corporate governance mechanisms in public companies in ASEAN have a negative effect on earnings quality. However, business strategy and financial performance partially mediate (competitive mediation) to function as a suppressive or substitute effect. This explain why the overall effect of corporate governance mechanisms on public companies in the ASEAN region has been significantly practised in many previous studies.
Email: [1]molinasuharto@gmail.com, [2]unhasmediaty@gmail.com, [3]asriophu@gmail.com, [4]bambang.subiyanto@civitas.unas.ac.id, [5]medianardian@gmail.com	

1. INTRODUCTION

In recent years, earnings quality in financial reporting has received much attention from stakeholders and researchers. This is understandable as financial statements are the primary source of information for stakeholders, representing important accounting data in decision-making, especially for investors, creditors, and regulators (Menicucci, 2020).

Earnings quality is a broad concept associated with the various determinants that influence it (Eldenburg et al., 2011). High earnings quality is considered reliable information about the company's financial performance description (Dechow et al., 2010). The results of a survey conducted by Dichev et al. (2012) on CEOs regarding their understanding of earnings quality stated that quality earnings information is related to the persistence of sustainable and repeatable earnings. The profit value must be free from dependence on an account (free from one-time items) and reflect long-term trends.

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It is important to consider precise measurement to ensure the value of quality and relevant results. In particular, Menicucci (2020) states that by using time series data from earnings, there are 4 (four) earnings quality measurements that can be analyzed; 1) persistence, to capture the extent to which a given innovation generates consistent revenue in the future; 2) predictability, to explain the ability of earnings in the distribution function for the innovations carried out, 3) variability, to measure the variation in income that occurs from the innovations implemented, and 4) smoothness, to measure the intentional efforts of managers to eliminate fluctuations in earnings that occur.

This study uses multi-dimensional earnings quality measurements as stated by Menicucci (2020) and uses differences in company objects (locations) as research gaps. Menicucci's (2020) research object, which is assumed to be the result of the latest research, is American companies and companies in several European countries. Research data with multi-dimensional earnings quality measurements have not been obtained for developing countries. It is a contribution to this study because the results may differ from the previous research due to the company's different characteristics and organizational culture.

Earnings quality can be improved with a company monitoring or supervision mechanism known as corporate governance. Several studies have faound that corporate governance mechanisms affect earnings quality (Dechow et al., 2010). Furthermore, implementing corporate governance mechanisms ensures that the quality of financial reporting presented by the company can be accounted for (Jiang et al., 2008). Corporate governance represents the role of supervision and monitoring in finance, operations, and strategies carried out by company management.

Larcker, Richardson, and Tuna (2007) stated that good corporate governance is not always relevant to high earnings quality. Many aspects affect the effectiveness of corporate governance, especially the most fundamental ones being management behavior and company performance. From this information, this study develops an analysis by adding variables that are thought to have the potential to mediate the relationship between corporate governance and earnings quality. The mediating variables are the business strategy carried out by management and financial performance, which is often expressed as a representation of the company's characteristics (Xiao, O'Neill and Mattila, 2012; Kanagaretnam)

Contingency Theory is the basis for discussing the relationship between corporate governance mechanisms' effectiveness on earnings quality. Based on the theoretical concept, it is stated that a company's operational performance cannot be discussed separately from the factors that influence it. According to contingency theory, a company's performance results from an agreement and the alignment of various contingent factors such as size, environment, strategy, control, and company ownership structure (Donaldson, 2001).

This study uses cross-country research objects in ASEAN to argue that the ASEAN Capital Market Regulatory Forum (ACMF) has been formed as an economic cooperation and investment company in the Southeast Asian region. This forum consists of 6 countries; Indonesia, Malaysia, Philippines, Thailand, Singapore and Vietnam. ACMF published the ASEAN Corporate Governance Scorecard Country Report and Assessment (ASEAN CG Score card) in 2013 as a rating report and assessment of the corporate governance mechanism of companies in ASEAN countries. It is assumed that there is no significant difference in companies from across ASEAN countries for the measurement of corporate governance variables. Therefore, the results of this study are expected to be a contribution of information to general knowledge about the characteristics of public companies in the ASEAN Region.

2.   METHOD

The research was conducted in the period 2017-2019, with the subject of research being a public company listed on the stock exchanges of ASEAN countries. The analysis was carried out to discuss 4 (four) research hypotheses described above with data analysis using the Structural Equation Modeling Partial Least Square (SEM - PLS) regression method with the WarpPLS 7.0 application. Sholihin & Ratmono (2020) stated that the SEM-PLS method can produce solutions for more complex models and does not require the variables to meet the criteria of parametric analysis. Furthermore, this method can generate parameter estimates for models with formative latent variables and mediating effects, as discussed in this study

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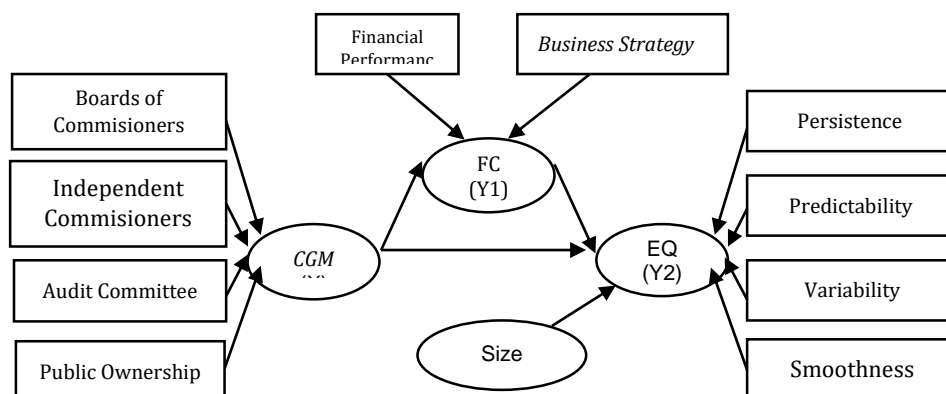
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Figure 1. Path Model of the Effect of Corporate Governance Mechanisms on Earnings Quality
Information:
CGM = Corporate Governance Mechanism
FC = Firm Characteristics
EQ = Earning Quality

The tests carried out in this study are discussed in stages; first, testing the direct influence of corporate governance mechanisms on earnings quality (CGM to EQ). Then, the second stage tests the effect of the mediating variable, namely the company's characteristics (CGM to EQ through FC. The test results from the first and second stages will answer all the questions formulated in the problem and provide information and data that will contribute to the discussion of company performance in ASEAN countries as seen from the implementation of corporate governance and the value of earnings quality presented in the financial statements. A sample of 152 companies was declared to meet the criteria listed in the ASEAN Corporate Score Card (ASEANCGSC).

3. RESULTS DAN DISCUSSION

The following is a table and graph comparison of the average corporate governance mechanisms in public companies in ASEAN from 5 countries:

Table 1. Average Data on Corporate CG Mechanisms in Five ASEAN Countries

Country	Average Value of Corporate Governance Mechanisms			
	Boards of Commissioners (person)	Independent Commissioners (ratio)	Audit Committee (ratio)	Public Ownership (%)
Indonesia	6	0,405	0,625	28,197
Malaysia	9	0,577	0,490	38,835
Philippines	11	0,309	0,288	34,653
Singapore	10	0,651	0,418	45,702
Thailand	12	0,475	0,655	50,900
Average	9	0,484	0,500	39,346
Maximum	12	0,651	0,655	50,900

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	Average Value of Corporate Governance Mechanisms			
Country	**Boards of Commissioners (person)**	**Independent Commissioners (ratio)**	**Audit Committee (ratio)**	**Public Ownership (%)**
Minimum	6	0,309	0,288	28,197
Std Deviation	2	0,135	0,151	8,944

The second data group is the earnings quality variable, whose proxy is measured by value of; persistence, predictability, variability, and smoothness. All these earnings quality proxies are measured using the formula as explained in Menicucci's (2020) study (in the appendix).

Descriptive statistical data for each proxy for measuring earnings quality in each country is explained as follows:

Table 2. Average Earnings Quality Value of Companies in ASEAN Countries

Country	Average Value of Earning Quality Measurements			
	Persistence	*Predictability*	*Variability*	*Smoothness*
Indonesia	31.23	6.44	13.51	1.05
Malaysia	29.69	5.85	11.96	0.91
Philippines	36.50	7.52	15.66	1.03
Singapore	11.56	5.51	0.03	1.38
Thailand	19.47	3.12	6.91	1.00
Average	25.69	5.69	9.61	1.07
Maximum	36.50	7.52	15.66	1.38
Minimum	11.56	3.12	0.03	0.91

The third data group is the mediating variable which is assessed from; the company's innovation strategy (measured by the value of intangible assets) and financial performance (measured by the value of ROA), which are described as follows:

Table 3. Statistical Description of Firm Mediation Variables in ASEAN countries

Country	Average Value of Firm Characteristic Measurements		
	Business Strategy (Intangible Asset)	**Financial Performance (ROA)**	*Size*
Indonesia	10,63	6,68	17,74
Malaysia	11,77	9,32	16,78
Philippines	10,44	5,38	18,77
Singapura	10,74	5,23	16,36

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Country	Average Value of Firm Characteristic Measurements		
	Business Strategy (Intangible Asset)	Financial Performance (ROA)	*Size*
Thailand	6,69	7,82	11,73
Average	10,05	6,90	16,28
Maximum	11,77	9.32	18,77
Minimum	6.69	5.23	11.73

Hypothesis testing was carried out using two (2) models run with the SEM-PLS application with Warp PLS 7.0. The first test is to analyze the direct effect between corporate governance mechanisms on earnings quality by measuring the latent variables (constructs) of the formative model, where the proxy used as a measurement is an indicator which, if changed (one or more), will cause a change in the construct. (Sholihin & Ratmono, 2020).

The next test (second stage) for mediation effect is analyzed through the indirect effect, namely financial performance with ROA proxy and business strategy with intangible asset value proxy. This testing stage (stage 1 and stage 2) is carried out for all companies as an ASEAN cross-country test.

The following describes the test results and discussion of the results:

Information on the feasibility of the model is assessed from the goodness of fit analysis by taking into account the indicators; Average Path Coefficient (APC), Average R-squared (ARS), and Average Full Collinearity VIF (AFVIF). The p-value of APC and ARS must be less than 0.05 (significant), and the AFVIF value must be less than 5 (no multicollinearity) (details in appendix)

From the results of the SEM-PLS analysis with Wrap PLS 7.0, it can be stated that the goodness of fit model criteria has been met, namely with an APC value of 0.606, ARS value of 0.367, and AARS of 0.363 and significant with p-value less than 0.05 (p <0.001). In addition, the AFVIF value of 1,534 also met the criteria. Another model fit indicator is the Tenenhaus GoF value as a data measuring explanatory power, which shows an estimation result of 0.410, which is included in the explanatory power category on a large criterion.

The results of the direct influence of corporate governance mechanisms on earnings quality:

$\beta = -0.61$ (P<.01)
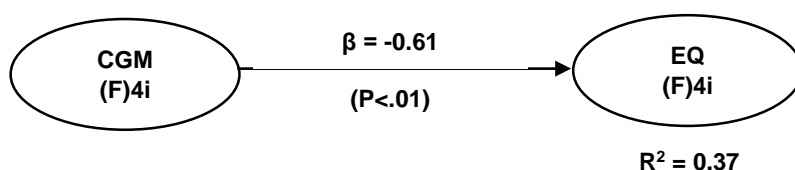
CGM (F)4i → EQ (F)4i

$R^2 = 0.37$

Figure 2. Model Direct Effect of Corporate Governance Mechanisms (CGM) on Earnings Quality

The results of direct influence of corporate governance mechanisms with formative measurement models for all proxies (number of commissioners, independent commissioners, audit committees with accounting and finance education background and public ownership – (F) 4i) on earnings quality (with four proxies: persistence, predictability, variability, and smoothness), resulting in a coefficient of =-0.61 and P=<0.01 (below 0.05). this means that the effect of corporate governance mechanism on earnings quality is significantly negative at stage 1 for public companies in the ASEAN region.

The results of the SEM-PLS analysis with Wrap PLS 7.0 for the fit model and Quality Indices mediation data show that the goodness of fit model criteria has been met, namely with an APC value of 0.279, ARS value of 0.215, and AARS of 0.206 and significant with a p-value. less than 0.05 (p<0.001). AVIF value = 1.138 and

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AFVIP = 1.363. Meanwhile, the value of Go-F = 0.377, which is included in the large category, has also met the criteria (details on the results in the attached data).

The feasibility of indicators and constructs (formative models) in the relationship between variables and their measurements is explained from the results of the indicator weight output. Based on the test results, it can be seen that the model and all indicators of the output indicator weights indicate that all latent variable indicators have met the requirements with p values <0.05 so that they meet the criteria and are suitable for use in this study (data in the appendix).

Tabel 4. *R-Squared, Adjusted R-Square dan Full Collinearity VIF* ASEAN

	MCG	**EQ**	**FC**	**AQ**	**SIZE**
R-Squared		0,419	0,093	0,133	
Adj R-Squared (R^2)		0,403	0,087	0,127	
Full Collinearity VIF	1,573	1,643	1,154	1,283	1,162

The output results in table 4 show an R-Square value of 0.419 which means the ability of all predictor variables (exogenous variables) used is CGM. FC and AQ were able to explain the criterion variable (endogenous variable) EQ by 41.9%, the remaining 58.1% was explained by other variables that were not used in this research model. Meanwhile, the value of full collinearity VIFs, which is the result of complete collinearity testing, which includes vertical and lateral multicollinearity, has met the criteria where all values are below 3.3 (Kock, 2013; Sholihin & Ratmono, 2020) so that the model is free from vertical and lateral multicollinearity interferences.

Although the direction of the relationship is negative, the p-value is significant for direct testing of the effect of corporate governance mechanisms on earnings quality (Figure 4), so that further testing of the effect of mediation (company characteristics and earnings quality) is required, including formative measurement models for all proxies (ROA and intangible assets). For example, the results of testing the mediating effect of firm characteristics with two proxies-(F)2i, on the relationship between corporate governance mechanisms and earnings quality, are explained by the following model image:
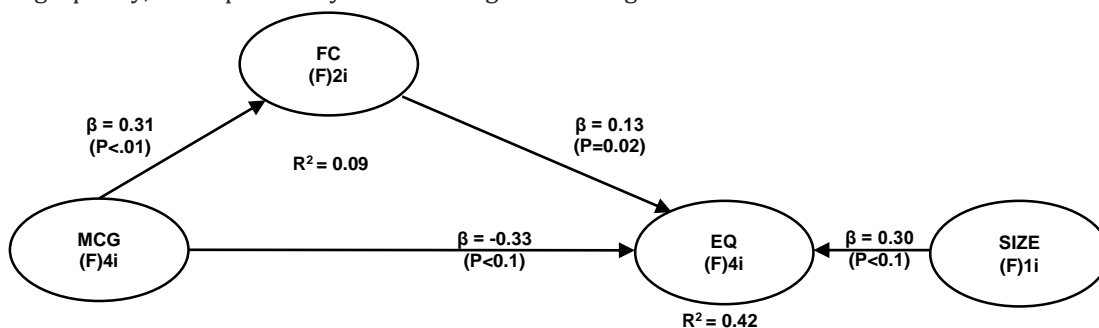

Figure 3. SEM-PLS WrapPLS Model Effect of Corporate Mediation in ASEAN

Based on Figure 3 above, an analysis can be carried out to assess the suitability of the test results with the previously proposed hypothesis as follows:

Table 5. Results of Analysis of Relationships Between Variables and Hypothesis Testing

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No.	Hypothesis	Testing Results	Explanation of Results
Hypothesis 1	Corporate governance mechanism has a positive effect on earnings quality	β (coefficient) = -0.33 p-value <0.01	Corporate governance mechanism has a significant negative effect on earnings quality
Hypothesis 2	Corporate governance mechanism has a positive effect on company characteristics	β = 0.31 p = <0.01	Corporate governance mechanism has a positive and significant effect on company characterisitic
Hypothesis 3	Company characteristics have a positive effect on earnings quality	β = 0.13 p-value = 0,02	Company characteristics have a positive but not significant effect on earnings quality

Table 6. Analysis of the mediating effect for Hypothesis 4

No.	Hypothesis	Testing Results	Explanation of Results
Hypothesis 4	Firm characteristics mediate the relationship between corporate governance and earnings quality:	*direct:* β=-0.33 p=<0.01 (sig) *Indirect:* B=0,04 p2 x p4 = 0,01 (sig)	The direct effect path coefficient stage 1 (path 1. a) is significant (β=-0.61 p<0.01), and the indirect effect path coefficient stage 2 (p2 and p4) is significant (there is mediation) Type of mediation: Partial Mediation (Competitive Mediation) The Direct and Indirect Effects are both significant but in opposite directions. The company's characteristics mediate the suppression of the relationship between corporate governance and earnings quality.

In general, by combining all existing company data from all countries as testing for cross-country, the results of the analysis of the influence of corporate governance mechanisms on earnings quality are different from the empirical evidence presented in the research of Ghofar & Islam (2015), which states that the corporate governance mechanism will strengthen the supervisory function to limit management's expropriation in determining earnings quality. As a result, it positively affects the company's performance results. This study substituted the company performance variable with earnings quality and obtained the results that the corporate governance mechanism had a negative effect on earnings quality. The negative and significant test results indicate that the supervisory function in good corporate governance mechanisms in these companies has not provided optimal results and tends to reduce the value of earnings quality presented in financial reporting. This difference in results strengthens the assumption of previous researchers that the effect of corporate governance mechanisms on earnings quality is still a mixed result. It is mainly due to the difference in the number of measurements used (one role or multi measurement), the methodology used, and the category of research subjects (developing or developed countries).

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Another result that strengthens the conclusion about the negative influence of the corporate governance mechanism above is the value of measuring the quality of earnings of countries in the ASEAN region. Table 3 shows 3 (three) measurements with low-quality indicators, namely persistence, predictability, and variability, recorded by companies in 3 (three) countries. However, the analysis of mediating variables obtained significant results as a partial mediation. Therefore, it can be explained that the negative influence of the corporate governance mechanism can be suppressed by the influence of the corporate strategy and financial performance variables as competitive mediating variables (partial). In general, it can be stated that for companies in the ASEAN region, the role of corporate governance mechanisms in influencing earnings quality can be mediated by increasing profitability and implementing innovation strategies for companies as factors that strengthen the contributing role of corporate governance mechanisms.

Another analysis of the results of the negative influence of corporate governance mechanisms on earnings quality is the uniqueness in the composition of the data used as measurements of corporate governance mechanisms in this study. This data analysis is the result of content analysis which is not visible in the measurement of proxy variables. As discussed for other mechanisms, namely the percentage of independent commissioners, audit committees and public ownership, there is some ambiguity. Of all the existing commissioners, some of them are appointed as independent commissioners. Ideally, independent commissioners are members of the board of commissioners who do not have a direct or special relationship with the company (the company's owner). However, in reality, many Southeast Asia companies appoint independent commissioners who still have a (special) relationship with the company. Likewise, with the appointment of an audit committee, many companies in all countries also serve as independent commissioners or commissioners. There is also similar situation with public ownership analysis. For many companies in the ASEAN region, the most dominant ownership structure is family ownership (La Porta, 2010). The average public ownership is 39% (table 1), so the control function has not been maximized due to the non-majority of voting rights. Decisions, especially for the appointment of commissioners, independent commissioners, and audit committees, tend to prioritize the majority owner (family). This situation certainly provides a limit in optimal supervision

4. CONCLUSION

In general, it can be stated that the analysis of the influence of corporate governance mechanisms on earnings quality in companies in the ASEAN region supports the results of previous studies proposed by Donaldson (2001), Suranta and Merdistusi (2005), and Kousenidis et al., (2013), with implications as follows:

1. This study provides empirical evidence that the measurement of earnings quality recommended by Menicucci (2020) is applicable for measuring the quality of earnings of companies in ASEAN and provides empirical results that are relevant to the uniqueness of public companies in ASEAN countries. In addition, the measurement of earnings quality using multi-measurement provides a complete explanation of the results of the earnings quality assessment compared to the one-role measurement.

2. For research subjects in Southeast Asian countries, the effect of corporate governance mechanisms on earnings quality produces a different effect than research on companies in America and Europe that were the subject of previous research. The variable characteristics of the company as a mediation plays an important role in bridging the relationship between corporate governance mechanisms and earnings quality, either partially or fully.

3. From a theoretical perspective, this study provides a broader understanding of the determinants and effects of corporate governance mechanisms based on contingency theory. For example, if the company has a relatively weak corporate governance, high performance (profitability) and an innovation strategy can substitute factors to strengthen the corporate governance mechanism.

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