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The Moderating Role of Capital Structure on the Relationship Between Corporate Governance and Firm Performance : Evidence from the Manufacturing Sector in Indonesia**Krismi Oftapiani¹, Rita Wijayanti¹**¹Universitas Muhammadiyah Surakarta

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*Email: b200190497@student.ums.ac.id**ABSTRACT**

This study aims to examine the effect of the capital structure moderating variable on the relationship between corporate governance and company performance. This study uses secondary data, namely annual reports of manufacturing companies listed on the Indonesia Stock Exchange for the 2020-2021 period. A total of 96 company samples were obtained by purposive sampling technique, resulting in 192 observations. Multiple regression analysis was performed with the help of the SPSS program. The results showed that corporate governance has a positive effect on firm performance, and capital structure has a negative effect on the relationship between corporate governance and firm performance.

Keywords: corporate governance, firm performance, capital structure, manufacturing sector.

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INTRODUCTION

The capital structure within the company can be one way to increase stakeholder value. The capital structure can be used as funding in a company, it is important to pay attention to its management and supervision (Anggreni and Robiyanto 2021) . Increasingly fierce competition triggers companies to make effective and efficient capital decisions. In carrying out the operational activities of a company requires a very important thing, namely the need for capital. Without capital, the company will find it difficult to achieve its goals (Rafiah Aisyatul and Zuhriyah 2018) .

One strategy that can be used to determine whether a company is good or bad is the capital structure, namely the funding decisions made by company managers. Sources of funding can come from debt and equity, both sources of funding have their own advantages and disadvantages so that the company's managers need the right funding decisions. The parties involved in corporate governance are management, shareholders, the board of directors or other stakeholders.

Diversity in the board of directors is expected to help company decision-making such as capital structure decisions or company funding become an objective and efficient decision and have a better impact on the company. In making decisions, conflicts often occur between managers and shareholders, this conflict is usually referred to as an agency problem. In this case, the effectiveness of the board of directors has a major role in agency problems.

Therefore, a way is needed to create good cooperation between stakeholders, namely by implementing good corporate governance practices (Endrawati and Arfinto 2021) . Currently the implementation of corporate governance is urgently needed to fulfill public and international trust as an absolute requirement for companies to be able to develop better and healthier with the aim of obtaining maximum profits. In general, corporate governance is a system designed to determine policies to increase the success of the company.

Corporate governance (Corporate Governance) is a company's internal control which has the aim of managing risk, through monitoring assets and increasing the value of long-term shareholder investments. Corporate governance includes shareholders, board of directors, management remuneration, corporate governance policies and investors (Dewi et al. 2022) . Good governance will ensure that the business environment is fair and transparent so that companies can be held accountable for their actions. But on the contrary, corruption, misdirection and waste can be caused if corporate governance is weak or not good.

Financial crises can be experienced by a country without good CG practices. In addition, agency theory expects a positive relationship between CG quality and firm performance to reduce conflicts of interest between principals and agencies. Therefore many researchers have focused extensively on investigating the effect of CG quality on firm performance (Mansour et al. 2022) . Currently, research on the effect of CG on company performance is still inconclusive.

This may be caused by differences in sample, sector, period covered, or differences in performance measures used (Mansour et al. 2022) . According to Baron and Kenny, when the relationship between the dependent and independent variables is found to be very inconsistent in the literature, the indirect effect of the moderator variable can explain this inconsistency. Inconsistent empirical results may be caused by several factors, such as the specific characteristics of the company (Mansour et al. 2022) .

In addition to corporate governance, the capital structure in this study is a moderating variable, to find out whether the capital structure of the company will strengthen the role of corporate governance on Return of Equity (ROE) as the dependent variable. The suitability

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Volume 1, Year 2023

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of the Corporate Governance system depends on the key variables that are tied to the company. Previous studies have shown that these mechanisms are interrelated, and companies can choose the optimal combination. Conventionally, researchers have conducted in-depth studies on evidence of a direct relationship between the quality of corporate governance and corporate performance. There is still little research that examines the influence of Corporate Governance on company performance. However, significantly only a few researchers have investigated the effect of moderating variables, in which many researchers in the field of Corporate Governance have urged investigations because of the important role that may be played by intervening factors (Mansour et al. 2022).

This study retrieves data from manufacturing sector companies listed on the Indonesia Stock Exchange (IDX) for the period 2020 to 2021. This sector was chosen because of concentrated ownership of the sample companies aimed at the Annual Report and annual financial reports of the manufacturing sector for the period 2020 to 2020. In this study, it tries to examine the influence of Corporate Governance by developing a Corporate Governance Index (CGI) by referring to previous research. This research investigates the moderating effect of capital structure, which is still a gap in the literature (Mansour et al. 2022).

According to Mansour et al., (2022) many researchers focus on researching the effects of Corporate Governance mechanisms on the performance of developed and developing countries. However, most of the previous research was limited to developed markets, in general, developing countries face different things from developed countries. Traditionally, much research has focused on one or several mechanisms such as board characteristics, board size, board composition, disclosure and transparency, audit committee CEO duality and ownership structure. . The literature has documented that good governance practices can help ensure proper corporate management, increase competitive advantage, attract investment, lower debt costs, and increase trust in financial markets thereby contributing to sustainable economic development (Mansour et al. 2022).

H1: Corporate Governance Index (CGI) has a significant effect on company performance

According to Mansour et al., (2022) Capital structure has developed widely as a core financing strategy by companies in various sectors, including in the non-financial sector. Capital structure can be seen as a mechanism that can contribute to reducing agency problems. In addition, capital structure can be considered as a major factor in determining company performance. The capital structure is a management effort to meet the needs of the company's activities through funding. From previous research, many researchers recommend whether there is a complementary relationship between capital structure, corporate governance and company performance which is expected to have a positive impact on the relationship between corporate governance and company performance. The moderating effect is formed when the moderator variable, namely capital structure, has interacted with the relationship between the explanatory variable and the outcome variable, namely company performance. According to previous studies, capital structure is considered as a governance mechanism because it plays a decisive role in reducing agency costs of free cash flow.

H2: The capital structure as a moderation does not moderate the effect of the quality of corporate governance of the company.

Proceeding Medan International Conference Economics and Business

Volume 1, Year 2023

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METHOD

This research is a qualitative research. The population in this study are manufacturing sector companies listed on the Indonesia Stock Exchange (IDX) for the period 2020 to 2021. Data analysis used multiple linear regression with the help of SPSS 25 software. The sample in this study were 192 manufacturing sector companies during the 2020-2021 period. Samples were taken using purposive sampling with the following criteria.

This study uses ROE as the dependent variable to examine the influence of corporate governance quality and the moderating role of capital structure on the quality of corporate governance relationships. Besides that, there is a Corporate Governance Index (CGI) as an independent variable in this study, while capital structure is a moderating variable which is expected to have a positive influence on corporate governance relationships. In addition, there are several relevant control variables such as sales growth, firm age, and firm size. The model used for the analysis is as follows:

$$\text{ROEt performance} = \beta_0 + \beta_1 \text{CGI}_{t-1} + \beta_2 \text{SIZE}_t + \beta_3 \text{SAGR}_{t-1} + \beta_4 \text{FAGE}_{t-1} + \varepsilon_{i,t}$$

$$\text{ROEt performance} = \beta_0 + \beta_1 \text{CGI}_{t-1} + \beta_2 \text{SIZE}_t + \beta_3 \text{SAGR}_{t-1} + \beta_4 \text{FAGE}_{t-1} + \beta_5 \text{CS}_{t-1} + \varepsilon_{i,t}$$

ROE

Measurement of Return Of Equity (ROE) is carried out by dividing net profit by total equity.

$$\text{ROE} = \frac{\text{Net Income}}{\text{Shareholders Equity}}$$

CGI

The Corporate Governance Index was created to assess the quality of governance practices in a sample of manufacturing sector non-financial companies listed on the Indonesia Stock Exchange (IDX). The index consists of three questions with a total of 32 Corporate Governance Index. Following previous research, each question in the Corporate Governance Index is based on a binary scale (taking a value of one or no;) a value of one indicates presence/compliance with the questions being discussed while zero indicates the absence/non-compliance with the questions being discussed (Mansour et al. 2022)

A	Disclosure and Transparency:
1	The company has a website to disclose information related to annual reports
2	Availability of the company's annual report to the public
3	Company reports comply with International Financial Reporting Standards (IFRS)
4	The company employs one of the well-known Big-4 corporate auditors
5	Companies disclose their annual reports in English
6.	Is the auditor's report complete?
7.	Does the annual report mention potential conflicts of interest such as issues related to related party transactions
8.	The company provides detailed reports on corporate social responsibility
9.	The company discloses the benefits and remuneration of board members
10.	The company discloses the benefits and remuneration of senior executive management
11.	The company discloses senior Executive Management qualifications

Proceeding Medan International Conference Economics and Business

Volume 1, Year 2023

"Entrepreneurship on Global Economics Development in the Era of Society 5.0"

12. Information regarding risk management is available in the annual report
13. The company has a CG report
14. The company provides details regarding credit ratings
15. Availability of details regarding board of directors meetings and attendance

B Board Effectiveness and Composition:

16. The CEO and the Chairman of the board are different people
17. The company has an audit committee
18. The company has a nomination committee and a remuneration committee
19. The company has a majority of non-executive directors
20. The board size is between 5 and 13
21. The company has disclosed the qualifications of board members in its annual report
22. Does the company disclose the shares owned by members of the board of directors?
23. Has the company disclosed the shares held by Senior Executive Management?
24. Do Independent directors make up 1/3 of the total?

C Shareholder Rights :

25. Offers detailed information about shareholders on the company's website or on the IDX website
26. Submit a shareholder meeting report
27. Availability of national and foreign shareholding percentages on company websites or financial market websites
28. Availability of percentage of national and foreign shareholding by foreign shareholders
29. The company allows cumulative voting for director elections
30. The company has a complaint option
31. Dividend declaration available to shareholders
32. The market price of a share is available to shareholders

Capital Structure

In this study the moderating variable uses capital structure to determine the potential role of a moderator of capital structure in the relationship between the quality of Corporate Governance and the performance of manufacturing sector companies. The measurement of the moderating variable is carried out as the ratio of total liabilities to total assets

$$\text{Capital Structure} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

Sales Growth

In this study, sales growth is measured as current sales minus previous year's sales, divided by previous year's sales in the same way as previous research.

$$\text{sales growth} = \frac{\text{Measured as the Ratio of Current Year's sales} - \text{Previous year's sales}}{\text{Previous year's sales}}$$

Firm Size

Company size has been widely used by many studies as a control variable, for example in this study emphasizing that company performance can be varied based on company size. In this study, company size can be measured as the LN of total assets.

Proceeding Medan International Conference Economics and Business

Volume 1, Year 2023

"Entrepreneurship on Global Economics Development in the Era of Society 5.0"

*Firm Size = LN Total Assets**Firm Age*

Mansour et al., (2022) suggests that companies experience financial growth cycles and their capital structure changes with age. Thus the age of the company represents the stage of its development and growth. In this study, the age of the company can be measured by LN from the time period and date of company establishment to the year of analysis.

*Firm Age = LN of the total number of year since a firm was established***DISCUSSION**

In the first table, descriptive statistics are presented to find out the performance indicators on ROE as an independent variable in research on manufacturing sector companies listed on the Indonesia Stock Exchange (IDX) during the 2020-2021 period. In the descriptive analysis, performance indicators show that the manufacturing sector aggregate companies have a low level. This states that manufacturing sector companies on the Indonesia Stock Exchange (IDX) are experiencing difficult conditions. From table 2 it can be seen that CGI as the independent variable in this study has a positive and significant relationship with the ROE indicator as the dependent variable at a significance level of 5% or better. While the control variable in table 2 is firm size, firm age and sales growth has a negative and significant relationship to the ROE variable at a significance level of more than 5%. In addition, the results of the multicollinearity test in table 2 show no serious problems because the tolerance value in the multicollinearity test is more than 0.10 and the VIF is less than 10 which confirms that there is no severe multicollinearity problem among the explanatory variables.

In this study, to run the regression analysis, several multivariate analysis assumptions were made for filtering and data preparation, namely with some extreme data outliers so that they influence each other. To examine the effect of CGI and the role of moderator of capital structure on corporate governance with the relationship between company performance. The multiple regression model is used to enrich indicators in manufacturing sector companies, namely ROE which is expected to be an influence on corporate governance and company performance. The existence of a moderating effect on the capital structure shown in table 3 shows the regression results on the independent variables, namely CGI and other control variables. In table 3 it can be concluded that CGI always has a positive and significant influence on company performance by calculating ROE. Thus good CGI quality can be considered more profitable for companies that use this mechanism to reduce conflict through reducing agency costs of free cash flow that can be obtained by managers. However, capital structure as a moderating variable has a negative and significant effect on company performance which has been stated in the second hypothesis.

IMPLICATIONS

This study aims to explore whether capital structure has a contingent role in the relationship between the quality of Corporate Governance and the performance of companies in the manufacturing sector listed on the Indonesia Stock Exchange (IDX). Before the moderation structure is tested, this study first examines the effect of the quality of Corporate Governance by using the Corporate Governance Index on company performance. The results of this study indicate that the Corporate Governance Index has a positive effect on the related variable, namely ROE as the dependent variable. Evidenced by the t test with a significance of $0.047 < 0.05$. Therefore, the results of this study state that the basic principles of Corporate

Proceeding Medan International Conference Economics and Business

Volume 1, Year 2023

“Entrepreneurship on Global Economics Development in the Era of Society 5.0”

Governance that apply in less developed markets . This study supports the argument that the combined measure of corporate governance greatly improves corporate performance by reducing agency costs and increasing the alignment of the interests of managers and shareholders.

According to the results of the analysis of the moderating effect of capital structure along with the development of capital structure in manufacturing companies towards optimal levels, the Corporate Governance Index has a positive effect on both performance indicators which are getting bigger. However, the results indicated that the combined measure of Corporate Governance and capital structure did not play a role in reducing the conflict of interest between management and shareholders by reducing the agency costs associated with managers. So that it can be interpreted that capital structure as a moderating variable does not affect the relationship between the quality of Corporate Governance and future performance and further states that the interactive effect provides additional information to explain the variability of company performance. According to (Mansour et al. 2022) .

The main implication of this study is that stakeholders must consider the quality of corporate governance and company financial decisions related to capital structure when they make decisions regarding investment in manufacturing sector companies on the Indonesia Stock Exchange (IDX). Thus these results can develop new policies to increase investor confidence and attract more foreign investors. Policy making in developing countries must reform and update recommendations on Corporate Governance to improve company performance and prevent potential company failures. Regarding the implications of this research for manufacturing sector companies listed on the Indonesian Stock Exchange (IDX) and investors who wish to invest, this study shows the results that companies can improve their performance by following good quality CG practices and maintaining a good balance. In addition, the increase in debt financing has not helped the performance of manufacturing sector companies which does not state that companies listed on the Indonesia Stock Exchange in the manufacturing sector should focus on optimizing their capital structure to differentiate themselves in the market.

Like all research, this study also has some limitations. The first is that this research relies on archival data, most of which are obtained from financial reports and annual reports. This data may or may not reflect the fact that the regulatory and institutional framework is perceived as weaker in developing markets than in developed markets. Second, this study only considers companies in the manufacturing sector listed on the Indonesia Stock Exchange (IDX), ii limits the generalizability of the findings. However, apart from these small limitations, this study has a contribution to explain between CGI and company performance.

CONCLUSION

Study aims to analyze the effect of the Corporate Governance Index as an independent variable and the effect of capital structure as a moderating variable in a manufacturing company for the 2020-2021 period. It can be concluded that the Corporate Governance Index has a significant effect on company performance, but capital structure as a moderating variable has no effect or not moderating company performance. These findings specifically support the argument that composite CG measures offer a more accurate measure of CG quality, meaning that companies in the manufacturing sector with higher scores on constructed CGI show superior performance.

Proceeding Medan International Conference Economics and Business

Volume 1, Year 2023

"Entrepreneurship on Global Economics Development in the Era of Society 5.0"

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Proceeding Medan International Conference Economics and Business

Volume 1, Year 2023

"Entrepreneurship on Global Economics Development in the Era of Society 5.0"

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