

IMPACTS OF MANAGERIAL ROLES AND FINANCIAL PERFORMANCES ON GOOD CORPORATE GOVERNANCE

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Abstract

Recently, good corporate governance has become a very crucial issue in the administration of government agencies, especially in the financial management of the government budget. Result orientations in the financial statements contribute to the needs of managerial roles and financial performances to attain optimal budget spending and efficient activities of government agencies. Based on the results of the external auditor of the Republic of Indonesia, there was no financial performance improvement of the agency for monitoring narcotics over the last five years. Therefore, this study aims to investigate the impacts of managerial roles of financial administrator and financial performances on the government internal control system and its impact on the implementation of better corporate governance, using the example of 125 the financial administrators in the agency for monitoring narcotics in the central office, Jakarta, Indonesia by using a survey methodology with purposive sampling methods. Data collection was carried out from November until December 2016. We follow the theoretical framework by Rohman (2007) and Mintzberg (1973) on financial manager role, Rohman (2007) and Kloot (1999) on financial performances, Government regulations No. 60 (2008) on the effectiveness of internal control systems, and Effendi (2009) on the implementation of good corporate governance principles including transparency, accountability, responsibility, independence, and fairness. Employing a Structural Equation Modelling (SEM), we find positive effects of managerial roles and financial performances on the effectiveness of internal control systems with the each construct reliability (CR) value of 2.439 and 2.199. Furthermore, the effectiveness of internal control systems, managerial roles of financial administrators, and financial performances have positive effects on implementations of good corporate governance with the each CR value of 3.003, 3.202, and 2.43. It implies that the agency for monitoring narcotics has been carrying out optimal management and financial accountability in order to support the implementation of good corporate governance.

Keywords: Managerial role, Financial performance, Internal control system, Good corporate governance, Structural equation modelling

1. Introduction

Good Corporate Governance is an important issue in administrative management these days, both in the private, public and charity organizations. One of the goals of good corporate governance is to improve the quality of financial reports so that resource allocation decisions can be made as efficient as possible (Habib & Jiang, 2015). The financial statements provide key information for capital providers about the managers' performance of the organizations (Sloan, 2001). Good corporate governance practices in government agencies have become an interesting issue to be discussed currently especially in term of financial performance. One of the reasons is due to the structures and characteristics of the government agencies are different to the other public organizations. Government agencies are often associated with weak governance, lower performance, lower accountability, and less corporate efficiency compared to public and private organizations (Boardman and Vining, 1989; Borisova et al., 2012; Abdurrouf 2010; Hopper et al., 2016). Moreover, the performance evaluations of government agencies are usually measured by financial performance (Boland & Fowler, 2000). Government agencies in the use of the budget required to provide periodic financial reports which are examined by external auditors. This is consistent with agency theory where government agencies have a contractual relationship between the government as an agent with the people as the principal (Jensen, 2000; Lambert, 2001). Through these financial statements, the people represented by the auditors can measure the performance of government agencies in carrying out its role to create welfare of the people. Prior studies have analyzed the link between financial performance, managerial role, and government internal control system of good corporate governance in public and private organization.

Some of the studies have proven that good corporate governances create a positive impact on financial performance (Lee, 2008; Bonna, 2011; Andreou et al., 2014; Gupta and Sharma, 2014; Rostami, et al., 2015; Liang et al., 2016; Rodriguez-Fernandez, 2016) while Afifah & Azwari (2015) found that government financial performances and internal control systems had positive impacts on good corporate governance. The relationship of the good corporate governance and the managerial role has been demonstrated by Dong & Gou (2010) and Bird, et al. (2015) and the relationship between the internal control system and the good corporate governance (Danescu et al., 2012; Danescu et al., 2015; Mahzan and Yan., 2014).

Most of the studies have analyzed the impacts of good corporate governance against managerial role, financial performance and internal control. However, there is a gap in the relationship instead. Therefore, in this study, we address this gap and analyze the impact of financial manager role, financial performance, and internal control system on the good corporate governance in government agencies. We contribute to the literature by adding a new perspective to the existing body of knowledge on the linkage of managerial roles, financial performance, internal control, and good corporate governance.

Our study focuses on the agency for monitoring narcotics (BNN) in Indonesia. This agency is an interesting example of government agencies that have an obligation to prepare financial statements and audit reports to the external auditor (BPK) of the Republic of Indonesia. According to BPK, for three years in a row of the year 2013 until 2015, BNN received a statement of unqualified (WTP) in paragraph explanation and no increase in the opinion given by BPK. This is presumably because there is still shortcomings of the BNN's internal control system. Or in other words, there is no increase in the financial performance of this agency over the last three years. In order to improve the performance of this agency, it requires the commitment of all parties, including the managerial financial manager who is responsible for the implementation and management of the agencies' financial accountabilities. The rest of this document is as follows. Section 2 discusses the empirical evidence of the effects of good corporate governance on value creation. Section 3 presents the method and the results of testing whether good corporate governance practices payoff for firms. Section 4 explains the method and the results of testing whether a democratic portfolio systematically outperforms an autocratic portfolio. Section 5 is the conclusion.

2. Literature review and hypothesis development

2.1 Internal Control and Managerial Role

The accountability of public money on the government agencies requires a strong commitment to the management of state finances. The commitment must be realized in the form of seriousness and consistency of managing state finances based on the general principles of good financial management. The financial manager roles are very important taken by the competent authorities to motivate and to encourage subordinates to achieve organizational goals (Coralie, 1987).

Mitzberg (1973) explained that there were three managerial roles within an organization, namely: 1) the interpersonal roles consisting of figurehead, leader and liaison roles, 2) the informational roles consisting of a monitor, disseminate, and spokesperson roles, and 3) decision making roles consisting of entrepreneurs, disturbance handles, resource allocators, and negotiator roles. Empirical evidences proven that there was a relationship between the internal control and managerial roles in an organization (Xu and Zhou, 2015). Based on the above arguments, we build the hypothesis:

H1: *There is a positive relationship between financial manager role and internal control system.*

2.2 *Internal Control and Financial Performance*

The performance of government agencies has a multi-dimensional side therefore there is no single indicator which can be used to indicate the level of success in a comprehensive manner. Performance measurement of government agencies can be made through a budget analysis, financial statement analysis, balance score card method and performance audit. Financial performances indicate how the government's financial condition as well as the government's ability to obtain and use the funds for development of the country (Mahsun, 2009).

Kloot (1999) suggested that there were two important issues that must be addressed when measuring the financial performance of government agencies, namely the thing that should be measured and the use of the information generated from the performance measurement system. Indicators used to measure the financial performance of government agencies are: 1) economic indicators, 2) efficiency indicators, and 3) effectiveness indicators. Empirical evidences have proven the relationship between internal control system and financial performance (Köster & Pelster, 2017; Wang & Shi, 2012; Dowdell et al., 2014; Herda et al., 2014). Based on the above arguments, we build the hypothesis:

H2: *There is a positive relationship between financial performance and internal control system.*

2.3 *Internal Control and Good Corporate Governance*

Corporate Governance is the system by which corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the various members of the company, such as the board of directors, management, shareholders and other economic

agents who have an interest or stake in the company. Corporate governance also provides the structure through which company objectives are established, the means to achieve these objectives, and how to monitor their performance. Good corporate governance practices seek to attract capital, to ensure proper company management and administration (mainly for those that issue securities on stock exchanges), to protect investors' and other interest groups' rights, to build confidence in financial markets, and to promote competition (European's Central Bank, 2005).

While internal control is a set of methods, procedures, and policies implemented by the directors, management, and members of other organizations which aims to protect assets and ensure the achievement of organizational goals (Weygan et al., 2010). In practice, The Government Regulation (PP) 60 of 2008 sets the conduct of internal control at the level of central and local government in Indonesia (Afiah & Azwari, 2015). The regulation is based on a framework developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in 1992 in which the internal control system consists of: 1) environmental control, 2) risk assessment, 3) activity control, 4) information and communication, and 5) supervision (Afiah & Azwari, 2015). Prior studies have proven that an effective internal control system will ensure good corporate governance within the organization (Bostan & Grosu, 2010; Mihaela & Lulian, 2012). Based on the above arguments, we build the hypothesis:

H3: *There is a positive relationship between internal control system and good corporate governance.*

2.4 Managerial Role and Good Corporate Governance

The managers' roles can be described in relation to the various roles or organized sets of behaviors identified within a position (Mitzberg, 1973). The relationship between managerial roles and good corporate behaviors have been demonstrated by Hornsby et al. (2009); Papagiannakis & Lioukas (2012); Wang et al. (2015). Based on the above arguments, we build the hypothesis:

H4: *There is a positive relationship between financial manager role and good corporate governance.*

2.5 Financial Performance and Good Corporate Governance

The financial performance of an organization can be determined from the financial statements. Financial statements are a tool to communicate a company's financial information to external parties that covers the resource, acceptance, current cost, and predictive information regarding the company's financial condition in the future (Basley et al., 2007). Empirical evidences proven that there is a relationship between financial performance and good corporate governance (Lee, 2008; Bonna, 2011; Andreou et al., 2014; Gupta and Sharma, 2014; Rostami, et al., 2015; Liang, et al., 2016; Rodriguez-Fernandez, 2016). Based on the above arguments, we build the hypothesis:

H5: *There is a positive relationship between financial performance and good corporate governance*

Based on hypotheses above, we build the conceptual framework of this study, as can be seen in Figure 1 below.

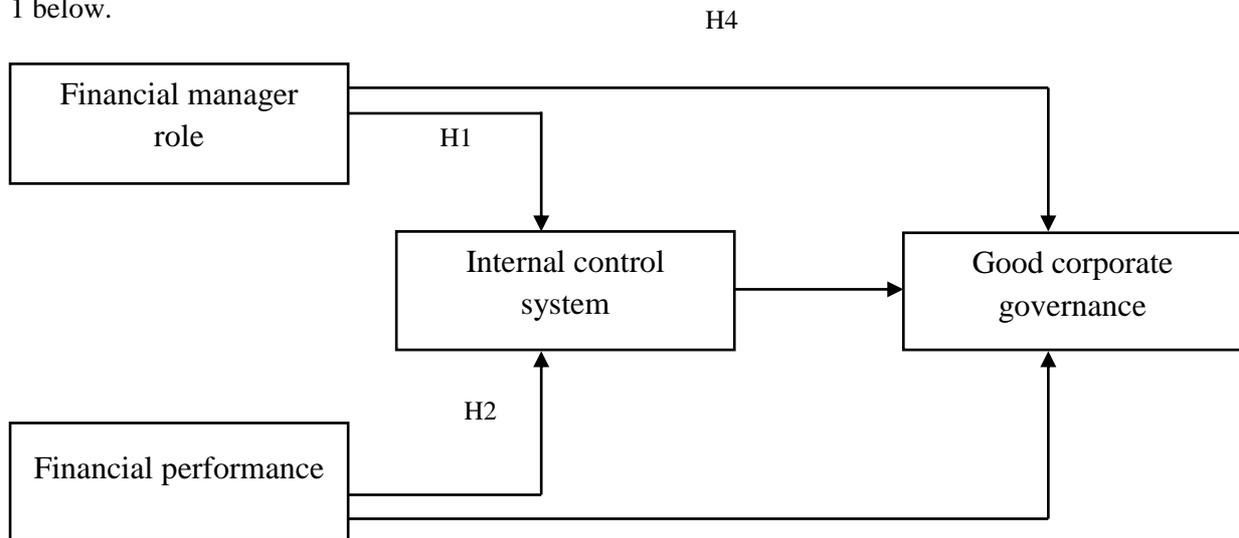


Figure 1. Research conceptual framework

3. Methods

3.1 Measurement Development

In this study, a five-point Likert scale is used to measure the construct where 1 = strongly disagree and 5 = strongly agree. The financial manager role is assessed by using three dimensions developed by Mintzberg (1973), namely interpersonal, informal, and decision roles. The measurement of financial performance relies on the dimensions adapted from Kloot (1999), which consist of

economy, efficiency, and effectiveness. The internal control system is assessed by using PP 60 of 2008 consisting of: 1) environmental control, 2) risk assessment, 3) activity control, 4) information and communication, and 5) supervision. Finally, good corporate governance is built on the model of Effendi (2009) where consists of transparency, accountability, responsibility, independence, and fairness. Moreover, the measurement variables are described in Table 1.

Table 1. Measurement development

Variabels	Indicators	Symbols	Rationales
Financial manager role	An unit leader creates conducive situations to work	MK1	Mintzberg (1973)
	An unit leader leads meetings, ceremonial events and official ceremonies	MK2	
	An unit leader has a good relationship with other unit leaders.	MK3	
	An unit leader actively looks for the latest information and analyze its impact	MK4	
	An unit leader passes the information to the subordinate units effectively.	MK5	
	An unit leader is willing to pass on information and official statements to external parties.	MK6	
	An unit leader becomes the initiator of organizational improvement.	MK7	
	An unit leader overcomes all the crises effectively and efficiently.	MK8	
	An unit leader allocates resources (funds, staff, facilities) effectively.	MK9	
Financial performance	Realization of the budget does not exceed the predetermined budget	KU1	Kloot (1999)
	Monitoring the budget has been done so that the budget does not exceed the predetermined budget	KU2	
	Optimal utilization of the budget	KU3	
	The efficient use of the budget	KU4	
	Determining the amount of funds to be spent on each activity	KU5	
	Determining the desired outcome for each activity	KU6	
	Analysis of the influence of the output to be achieved with the outcome to be generated.	KU7	
	Budgeting improvement in decision making	KU8	
Internal control system	Environmental control	SPI1	Government regulation 60 of 2008
	Risk assessment	SPI2	
	Activity control	SPI3	
	Information and communication	SPI4	
	Supervision	SPI5	
Good Corporate Governance	Transparancy	GG1	Effendi (2009)
	Accountability	GG2	
	Responsibility	GG3	
	Independence	GG4	
	Fairness	GG5	

3.2 Sample and Data Collection

Data were collected from 9 positions of The Agency for Monitoring Narcotics (BNN) in the central office, Jakarta. A total 135 samples were collected using purposive sampling method. The data collection was conducted from November to December 2016.

4. Results

4.1 Overall Model Fit

The data provide chi-squared values of 174.356 were statistically significant at p value = 0.000. To further assess model fit it is necessary to look beyond the chi-squared value and consider a number of additional indices. Thus, with a Root Mean Square Error of Approximation (RMSEA) of .04, Comparative Fit Index (CFI) of .975, *Incremental Fit Index* (IFI) .975, and Tucker Lewis Index (TLI) of .971. Therefore, it can be concluded that these fit indices provide values that support a good model fit for the data sets.

4.2 Reliability and Validity Test

The results from a confirmatory factor analysis (CFA) showed that the standardized loadings for the CFA measurement model ranged from .555 until .907, which are above the acceptable level of 0.50. All critical ratio (CR) values were greater than the acceptable level of .70 and Average variance extracted (AVE) values ranged from .50 to .61, exceeding the critical level of .50, with $p < 0.001$. These results showed that that the entire unit questions of the research variables are reliable. The few units that do not meet the criteria ($> .50$) have been excluded from the research model (financial manager role; MK6, MK7, MK8 and MK9 and financial performance; KU3, KU4, KU5, and KU7. The measurerent of overalls fit model can be seen in Table 3.

Table 2. Confirmatory factor analysis results

Variabels	Indicators	Standardized Loading	Measurment Error	CR ≥ 0,70	AVE ≥ 0,50
Financial manager role	MK1	.787	.381	.89	.61
	MK2	.907	.177		
	MK3	.673	.547		
	MK4	.822	.324		
	MK5	.715	.489		
		3.904	1.918		
Financial performance	KU1	.658	.567	.86	.60
	KU2	.826	.318		
	KU6	.787	.381		
	KU8	.819	.329		
		3.090	1.595		
Internal control system	SPI1	.609	.629	.88	.61
	SPI2	.840	.294		
	SPI3	.769	.409		
	SPI4	.899	.192		
	SPI5	.782	.388		
		3.899	1.912		
Good Corporate Governance	GG1	.738	.456	.81	.50

4.3 Structural Model Fitting Indices and Hypotheses Testing

The fitting indices of the structural path model results are as follows: $\chi^2 = 174.356$, RMR = .104, RMSEA = .040, GFI= .885, RMR= .104, TLI = .971, CFI = .975, IFI = .975, RFI = .843, PNFI = .739, PGFI= .680, AIC =262.356, and CAIC = 430.802. Based on the evaluation of model fit, it can be concluded that all indicators proposed in accordance with the respective criteria.

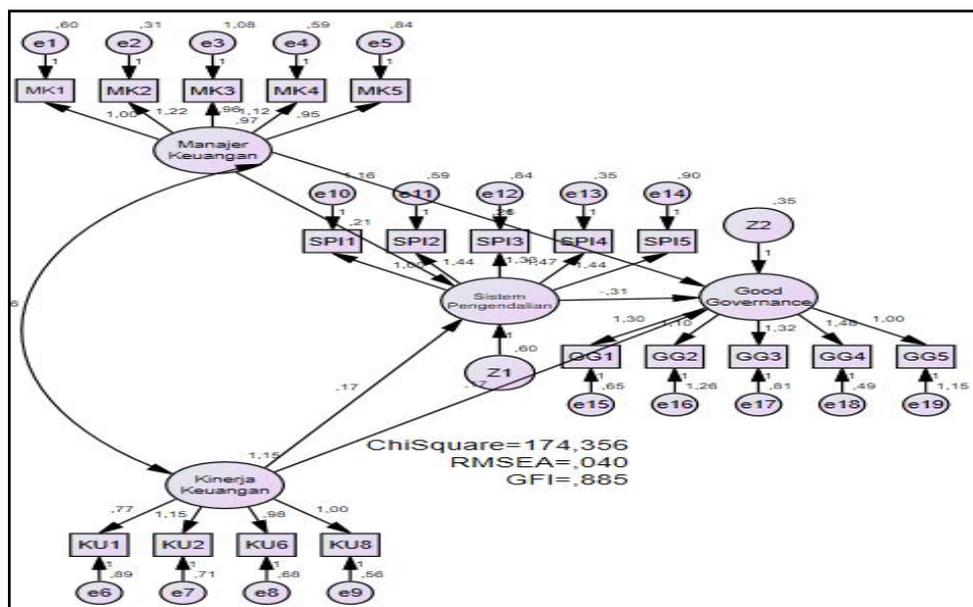


Figure 2. Research output diagram

Based on the interpretation of the model in Table 4 it is found that the financial manager role and financial performance have positive and significant impacts on the effectiveness of internal control systems with each C.R value of 2.439 and 2.199. Financial manager role, financial performance, and effectiveness of internal control system have positive and significant effects on the implementation of good corporate governance with each C.R value of 3.202, 2.430 and 3.202. Therefore, all of the hypothesis is accepted by C.R value ≥ 1.96 and a P value of $0.001 \leq .05$ (Figure 2).

Table 3. The interpretation of research model

Effects between variables			Estimate	S.E.	C.R.	P	R ²
Internal control system	←	Financial manager role	.206	.085	2.439	.015	.127
Internal control system	←	Financial performance	.172	.078	2.199	.028	
Good corporate governance	←	Internal control system	.307	.102	3.003	.003	.250
Good corporate governance	←	Financial manager role	.257	.080	3.202	.001	
Good corporate governance	←	Financial performance	.168	.069	2.431	.015	

$\chi^2 = 174.356$, RMR = .104, RMSEA = .040, GFI = .885, RMR = .104, TLI = .971, CFI = .975, IFI = .975, RFI = .843, PNFI = .739, PGFI = .680, AIC = 262.356, and CAIC = 430.802.

5. Discussions

Financial manager role is essential to attain the effectiveness of the internal control system in government agencies. The successful implementation of the financial manager role in government agencies is caused by the good relationship between superiors and subordinates, where the leader has delivered a division of duties well, so that the process of good communication resulting in the effective job practice due to the clarity of information delivery both from superiors to subordinates and vice versa. As has been stated by Robbins (2004), motivation maintains communication with subordinates by briefing what to do in order to improve performance, to achieve the organization goals, and to attain the effectiveness of internal control systems. Thus, the current study provides additional support to the prior studies (Xu and Zhou, 2015). The success in implementing the accountability of public finance management in terms of realization and utilization of the budget, the supervision system, the

efficiency and effectiveness of the budget distribution have been in accordance with applicable regulations which support the effectiveness of the internal control system (Köster & Pelster, 2017; Wang and Shi, 2012; Dowdell et al., 2014; Herda et al., 2014).

Increasing the effectiveness of the internal control system through effective financial management is one manifestation of good corporate governance in government agencies (Bostan & Grosu, 2010; Mihaela & Lulian, 2012; Afiah & Azwari, 2015). Associated with good corporate governance, one of the factors affecting the successful implementation of the application of this principle is the human factor. The role of human resources in managing the finance function within the organization will affect the successful implementation of the principles of good corporate governance (Hornsby et al., 2009; Papagiannakis & Lioukas, 2012); Wang et al., 2015).

The success of financial management has a direct impact on good corporate governance. This is consistent with previous researches by Lee, 2008; Bonna, 2011; Andreou et al., 2014; Gupta & Sharma, 2014; Rostami, et al., 2015; Liang, et al., 2016; and Rodriguez-Fernandez, 2016. The implementation of planning, implementing, reporting and budgeting accountability of BNN is controlled through the framework of law and the legislation in force.

6. Conclusions, limitations, and future researches

Based on the data analysis, we can conclude the financial manager roles and financial performances have significant positive effects on effectivenesses of internal control systems. In addition, effectivenesses of internal control systems, financial manager roles, and financial performances positively affect the implementation of the good corporate governance principles of BNN. Some other variables that influence the effectiveness of internal controls and good corporate governance may be considered for future research.

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