

THE EFFECT OF GOOD CORPORATE GOVERNANCE ON FINANCIAL PERFORMANCE MEDIATED BY EARNINGS MANAGEMENT

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Abstract

This study examines the impact of Good Corporate Governance on financial performance, considering the role of earnings management as a mediating variable. Good Corporate Governance works to increase transparency and accountability, and reduce information asymmetry, both of which can impact a company's financial performance. This research is expected to add to the literature on the relationship between Good Corporate Governance, earnings management, and financial performance. Quantitative research methods are used in this study. The data used in this study are secondary data taken from the company's annual financial statements. The analytical tool used in this research is Partial Least Squares (PLS). The population in this study is a State-Owned Enterprise company listed on the Indonesian Stock Exchange from 2020 to 2023. The results of this study indicate that Good Corporate Governance affects Financial Performance, but it does not affect earnings management. Conversely, Earnings Management affects Financial Performance, and it does not mediate the effect of Good Corporate Governance on Financial Performance.

Keywords: Financial Performance, Good Corporate Governance, and Earnings Management

INTRODUCTION

Every company sets business goals that are aligned with its vision, mission, and strategy to achieve success. The results of financial statements are used to assess the achievement of business goals and reflect the financial health of the company, indicating its overall financial performance. In line with the findings of Purwanto et al. (2020), which states that financial performance reflects the level of health of a company based on the achievements obtained in a specific period. In this case, transparency and accountability are the primary factors that support healthy financial performance. Transparency ensures that the information provided is clearly understood, while accountability is demonstrated through the company's adherence to applicable regulations in carrying out its activities.

According to Somad et al. (2023), the issue of accountability in financial management in Indonesia is getting more attention. The public demands that companies to be more transparent and accountable. However, manipulation of financial statements is still standard, as reported in www.kabar24.bisnis.com in September 2024 in an article entitled "Ex-Director of Indofarma (INAF) Suspected of Manipulating Financial Statements." The article revealed that PT Indofarma Tbk, a State-Owned Enterprise (SOE), was suspected of manipulating financial statements.

There are still companies that do not present financial reports transparently, such as PT Indofarma Tbk, which is suspected of manipulating reports. This practice occurs due to differences in information between managers and owners. Managers tend to improve reported profits because they are considered key indicators of a company's success. According to Savitri et al. (2020), this phenomenon occurs because profit is often considered the primary indicator of a company's operational success, leading managers to take specific steps to improve reported profits.

Declining company performance is often a key focus for management and stakeholders. Various factors can influence this condition. Several State-Owned Enterprises Listed on the Indonesia Stock Exchange during the 2020-2023 period also experienced a decline in financial performance for three consecutive years, indicating that their financial performance was suboptimal. Several factors can contribute to weakened company performance. The following is a list of State-Owned Enterprises companies listed on the Indonesia Stock Exchange in the 2020-2023 period, and their financial performance has decreased, as measured by Return on Assets (ROA) during the year:

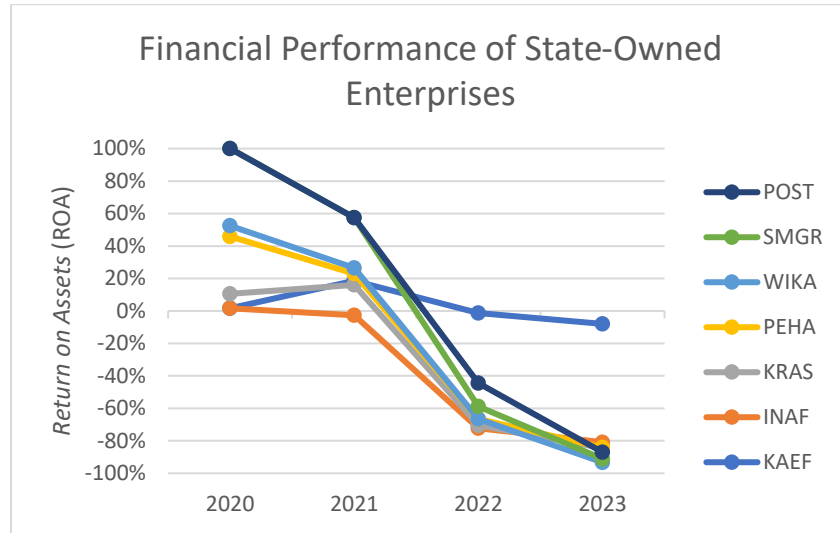


Figure 1.

State-Owned Enterprises Listed on the IDX that Experienced a Decline in Financial Performance

Source: Secondary data processed, 2025

Figure 1 presents data indicating that several State-Owned Enterprise companies have experienced a decline in financial performance, as measured by Return on Assets (ROA) analysis. These companies include PT Pos Indonesia (POST), PT Semen Indonesia (SMGR), PT Wijaya Karya (WIKA), PT Phapros (PEHA), Krakatau Steel (KRAS), PT Indofarma (INAF), and Kimia Farma (KAEF). This decline in financial performance can be attributed to several factors. Therefore, this study aims to identify the factors that influence the company's financial performance. Additionally, this study examines the impact of earnings management practices on the company's financial performance.

The implementation of effective corporate governance has a significant impact on a company's financial performance. Good corporate governance reduces financial risk, increases transparency, and creates an accountable management system, supporting improved economic performance. Good corporate governance ensures that companies operate by the principles of transparency, accountability, responsibility, independence, and fairness, thereby preventing losses for shareholders.

With an effective monitoring and control mechanism, investor and stakeholder confidence can be increased through the implementation of good corporate governance, which has a positive impact on the company's stability and financial performance (Margareth Tijow et al., 2021). Good corporate governance is a system used to organize and manage companies creating value for all stakeholders. This principle is applied in State-Owned Enterprises to ensure transparent and accountable management. Companies with good governance tend to be more resilient to economic changes and have wider access to external funding, increasing long-term growth and business sustainability.

Research by Purwanto et al. (2020) A positive and significant influence of good corporate governance on a company's financial performance is indicated. The application of good governance principles, including transparency and risk management, can enhance financial performance. Conversely, Saputra et al. (2022) found in their research that Good

Corporate Governance does not influence financial performance. This difference in results may be due to various factors such as the less-than-optimal implementation of corporate governance, industry sector variations, or other more influential factors, including macroeconomic conditions, business strategy, and operational efficiency. Overall, the trend suggests that Good Corporate Governance has the potential to improve financial performance, depending on its effective implementation and on going monitoring

Agency theory, proposed by Jensen and Meckling (1976), explains that the existence of differences in interests between management (the agent) and company owners (the principal) can lead to conflicts that affect financial decision-making. In this study, good corporate governance serves as a control mechanism designed to mitigate information asymmetry and reduce the likelihood of opportunistic actions by management. In addition, earnings management practices that act as mediating variables can be utilized by management as a strategy to align their interests with those of company owners. In the end, this strategy can have an influence on the company's financial performance.

Based on the previous phenomena and explanations, a research gap was found in the study of how financial performance is affected by Good Corporate Governance (GCG). The research results are still not finalized, and it has been found that earnings management practices aimed at manipulating financial statements can cause distorted financial information.

REVIEW OF LITERATURE

Agency Theory

Agency theory, proposed by Jensen and Meckling (1976), explains that agents may not always act in the principal's best interest when making decisions. Challenges arise in encouraging agents to act in the principal's interest due to inefficiency and information asymmetry. High information asymmetry increases this risk. The essence of this agency relationship lies in distinguishing between management and operational management, as well as investor ownership (Purba, 2023).

Financial Performance

Financial performance is the result of an organization's financial reporting, as mandated by financial regulations (Pranestianegara & Sari, 2021). Assessing the success of a business depends heavily on its financial performance. It is a measure used to evaluate a company's effectiveness and efficiency in generating profits and managing resources. Several types of ratios can be used to calculate a company's financial performance. One such ratio is Return on Assets (ROA). The company's ability to generate profit from all its assets is measured by Return on Assets (ROA). A high Return on Assets (ROA) indicates good financial performance and efficient asset utilization, while a low ROA suggests a lack of efficiency. Good ROA performance can attract investors to buy company shares (Mevelia et al., 2024).

Good Corporate Governance

Companies are governed through good corporate governance to ensure transparency, accountability, and responsibility. These principles improve the relationship between management and stakeholders. Profitability and operational efficiency are key measures of financial performance, while good governance enhances performance and reduces financial

risk (Fitrianingsih & Asfaro, 2022). Effective corporate governance is crucial for long-term success and offers benefits to both the company and the broader economy. These practices attract investors and build strong relationships with stakeholders.

Earnings Management

To achieve specific goals, financial reports are managed through earnings management, such as increasing or decreasing a company's value (Pratama & Devi, 2021). The numbers in the financial statements are manipulated by management to make them appear more attractive to investors and creditors. In practice, earnings management can take the form of either decreasing profits or increasing profits, depending on the goals to be achieved (Masri & Khairunnisa, 2024). Companies can use appropriate accounting policies to increase profits, for example, by showing stable performance to investors by smoothing out financial fluctuations between periods. The importance of ethics in earnings management is crucial to consider. Management must adhere to correct accounting principles and avoid misleading stakeholders.

RESEARCH METHOD

This research applies a quantitative approach. To research a particular population or sample, research instruments are used to collect data and analyze it quantitatively or statistically. The purpose of this analysis is to test the hypothesis that has been set (Sugiyono, 2022: 16). State-owned enterprises listed on the Indonesia Stock Exchange from 2020 to 2023 are the subject of this research. The sampling was a purposive sampling method, and a sample of 12 companies was obtained, with a 4-year observation period. The data used is a type of secondary data collected from the company's annual financial statements. This research analysis technique uses Partial Least Squares (PLS).

RESULTS AND DISCUSSION

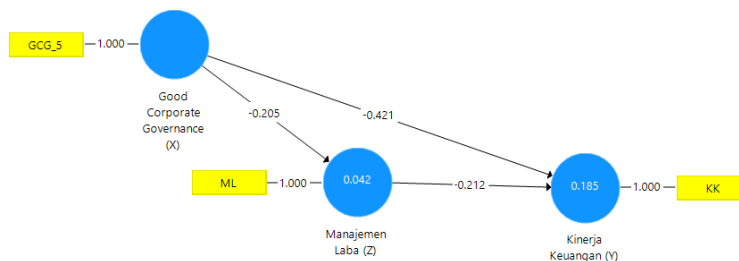


Figure 2.
Measurement Model Scheme (Outer Model)

Source: Secondary data processed, 2025

Convergent validity testing focuses on outer loadings, which explain the relationship between indicators or measurements used against variables. The requirements for convergent validity are that the outer loadings value is greater than 0.7 and the Average Variance Extracted (AVE) is greater than 0.5.

Table 1.
Loading Factor Value

Variable	Loading Factor Value
Good Corporate Governance	1.000
Financial Performance	1.000
Earnings Management	1.000

Source: Secondary data processed, 2025

As shown by the data processing results in Table 1, each indicator used has met the validity and correlation criteria. This is indicated by the outer load value being greater than 0.7.

Table 2.
Average Variance Extracted Value (AVE)

Variable	AVE Value
Good Corporate Governance	1.000
Financial Performance	1.000
Earnings Management	1.000

Source: Secondary data processed, 2025

Based on the results of data processing listed in Table 4.7, it shows that each indicator used has met the established validity and correlation criteria. This is evident from the Average Variance Extracted (AVE) value > 0.5.

Table 3.
Path Coefficient Value (T-Value)

Description	T Statistics
Good Corporate Governance (X) > Financial performance (Y)	3,012
Good Corporate Governance (X) > Earnings Management(Z)	1,390
Manajemen Laba (Z) > Financial performance (Y)	2,452
Good Corporate Governance (X) > Earnings Management (Z) > Financial performance (Y)	1,052

Source: Secondary data processed, 2025

The path coefficient value indicates whether the relationship is significant or not. If the t-value is greater than 1.96 (for a significance level of 5%), the relationship is considered statistically significant. Based on the value of the criteria for determining the significance level of the path coefficient, the following results are obtained:

1. Good Corporate Governance affects Financial Performance
2. Good Corporate Governance does not affect Earnings Management
3. Earnings Management affects Financial Performance
4. Earnings Management does not mediate the effect of Good Corporate Governance on Financial Performance

Table 4.
R-Square Value

Variable	R Square	R Square Adjusted
Kinerja Keuangan (Y)	0,185	0,149
Manajemen Laba (Z)	0,042	0,021

Source: Secondary data processed, 2025

The R-Square value is the coefficient of determination on the independent latent variable. The magnitude of the influence of the independent latent variable on the dependent latent variable is regulated by the coefficient of determination here. Based on Table 4, the R-squared value for financial performance is 0.185, indicating that Good Corporate Governance can influence financial performance by 18%, while other variables affect the remaining 82%.

Table 5.

Hypothesis Test Result

Description	P Values
Good Corporate Governance (X) -> Financial Performance (Y)	0,003
Good Corporate Governance (X) -> Earnings Management (Z)	0,165
Earnings Management (Z) -> Financial Performance (Y)	0,015
Good Corporate Governance (X) -> Earnings Management (Z) -> Financial Performance (Y)	0,293

Source: Secondary data processed, 2025

Path coefficient is the path coefficient or the magnitude of the influence of latent constructs. This test is conducted using a bootstrapping procedure with a two-tailed type I error test. The two-tailed type test itself involves considering the T-statistic and P-value to determine whether to accept or reject the hypothesis. The value that must be met is a P-value of less than 0.05 (Hardisman, 2021). Table 5 shows the results of the research hypothesis test as follows:

1. Good Corporate Governance has a significant effect on Financial Performance, as indicated by a p-value of 0.003. So, the second hypothesis of this study is accepted.
2. Good Corporate Governance does not affect Earnings Management, as indicated by a p-value of 0.165. So, the fifth hypothesis of this study is rejected.
3. Earnings Management affects Financial Performance, as indicated by a p-value of 0.015. So, the third hypothesis of this study is rejected.
4. Earnings Management does not mediate the effect of Good Corporate Governance on Financial Performance as indicated by p-values of 0.293. So, the seventh hypothesis of this study is rejected.

Good Corporate Governance Affects Financial Performance

Financial performance is positively impacted by good corporate governance, as indicated by the results of the hypothesis testing. This is supported by the concept of stakeholder theory, which emphasizes the company's role towards all entities involved. Research conducted by Setiawan and Setiadi (2020) and Lisyanti et al. (2024) indicates that financial performance is enhanced by effective corporate governance. This suggests that implementing effective corporate governance is a crucial strategy for managing company operations and improving business success. Additionally, this approach considers the interests of stakeholders to minimize agency conflicts, enabling the company to achieve its primary objectives. The primary goals of implementing effective corporate governance in a company include enhancing financial performance and profitability for shareholders, improving the effectiveness and efficiency of the board's operations, and strengthening management accountability.

Good Corporate Governance Has No Effect on Earnings Management

The hypothesis test results show that earnings management is not influenced by good corporate governance. This differs from stakeholder theory, which aims to reduce earnings

management practices. This study demonstrates that good corporate governance has no significant effect on earnings management, as even when the principles of good corporate governance are applied, their effectiveness can be weakened without strict regulation and supervision. Companies can formally implement good corporate governance, but still engage in earnings management. The effect also varies depending on the ownership structure and corporate culture. The dominance of controlling shareholders can reduce the effectiveness of good corporate governance in limiting earnings management practices. The results of this study align with the findings of Ryad et al. (2024), who suggest that corporate governance does not significantly impact earnings management. The effectiveness of the corporate governance mechanism in controlling earnings management depends on the specific conditions of a particular company, including applicable regulations, corporate culture, and the level of compliance with governance principles. If the implementation of good corporate governance mechanisms is merely a formality without strict supervision, the impact on earnings management will be minimal.

Earnings Management Affects on Financial Performance

Financial performance is significantly impacted by earnings management, as indicated by the results of the hypothesis testing. This finding aligns with the fundamental assumptions of agency theory, which posits that managers can utilize specific accounting policies to manipulate financial statement numbers, thereby enhancing their attractiveness to investors and other stakeholders. The results of this study align with Faisal & Syafruddin (2020) research, which found that earnings management has an insignificant positive relationship with financial performance. This is because information disclosure and the use of accruals encourage the presentation of detailed financial information. However, Chofifah & Parasetya (2024) stated that earnings management has a significant adverse effect on return on equity. This is due to distortion of financial information, unrealistic investor expectations, decreased operational efficiency, and loss of shareholder confidence. Although earnings management can provide temporary benefits it ultimately harms the company in the long run.

Earnings Management Does Not Mediate the Effect of Good Corporate Governance on Financial Performance

Based on hypothesis testing, it shows that earnings management does not act as a mediator in the relationship between good corporate governance and financial performance. This finding contradicts agency theory, which posits that effective corporate governance should mitigate information asymmetry and prevent opportunistic actions. The main reason earnings management cannot mediate the effect of good corporate governance on financial performance is that the implementation of good governance should limit earnings management practices. With good governance, the opportunity for management to manipulate earnings is reduced. The results of this study are consistent with those of Avilya and Ghozali (2022), which suggest that earnings management does not mediate the relationship between good corporate governance and financial performance. Similar research by Saputra et al. (2022) also shows that financial performance is not significantly affected by good corporate governance through earnings management. Controlling earnings management practices can be more effective if good corporate governance mechanisms are strictly implemented, for example, by strengthening the role of the audit committee, increasing the independence of the board of commissioners, and increasing the transparency

of financial statements. Under these conditions, earnings management can be more directed and serves to stabilize financial performance in the short term.

CONCLUSION

Based on the research results, it was found that Good Corporate Governance (GCG) has a positive influence on financial performance. This demonstrates that the effective implementation of GCG principles can enhance business success, optimize boardroom efficiency, and strengthen management accountability. Thus, GCG is a crucial strategy for enhancing the company's financial performance.

However, this study also reveals that Good Corporate Governance does not affect earnings management. Although in theory, GCG is expected to reduce earnings management practices, its effectiveness still depends on regulation, supervision, ownership structure, and corporate culture. In some cases, companies can still engage in earnings management even after formally implementing GCG principles.

Additionally, the results indicate that earnings management has a significant impact on financial performance. Earnings management can have a positive effect in the short term by enhancing the attractiveness of financial statements to investors. However, this practice also has the potential to be detrimental in the long run due to the distortion of financial information, unrealistic investor expectations, and decreased operational efficiency.

Furthermore, this study concludes that earnings management does not act as a mediator in the relationship between Good Corporate Governance and financial performance. The strict implementation of GCG should limit earnings management practices, thereby preventing this mechanism from mediating improvements in financial performance. Therefore, the effectiveness of GCG in preventing earnings management practices depends on the company's level of compliance with good governance principles, including the role of the audit committee, the independence of the board of commissioners, and the transparency of financial statements.

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