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The Mediating Role of Good Corporate Governance on the Relation between Intellectual Capital and Financial Performance

Akhmad Zainuddin, Nurul Aini*
Wijaya Kusuma University, Jl. Dukuh Kupang XXV No.54, 60225, Surabaya Indonesia
Corresponding Author*: nurulaini@uwks.ac.id

ABSTRACT

Purpose: This study aims to examine the role of good corporate governance (board of directors and board of commissioners) in mediating the bond between intellectual capital and financial performance.

Design/methodology/approach: This study obtains data from 264 manufacturing companies listed on the Indonesia Stock Exchange in the 2015 – 2020 period. This study employs the Warp PLS 7.0 program. The tested research model is the multiple mediator model, with more than one mediating variables, so it requires multiple mediation analysis.

Findings: The results reveal that intellectual capital has no effect on financial performance. Intellectual capital has a significant negative effect on the board of directors and board of commissioners, while the board of directors and board of commissioners have a significant positive effect on financial performance.

Practical implications: Intellectual capital affects financial performance through the board of directors and board of commissioners' as the mediating variables supported by the category of competitive mediation (inconsistent mediation). This competitive mediation provides support for the mediating effect hypothesis.

Paper type: Research paper

Keyword: *Board of Commissioners, Board of Directors, Financial Performance, Intellectual Capital*

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I. INTRODUCTION

Globalization develops business competition among the companies across the globe. The speedy improvement of technology and information generates increasingly intense challenges for companies, creates larger growth opportunities, and constructs a competitive advantage based on the possessed resources.

A contemporary phenomenon, prosperous companies such as Microsoft, Apple, TATA and Infoys have succeeded managing their knowledge and intellectual capital assets. It is essential to conduct a new approach that understands and measures organizational performance from a value creation perspective with business knowledge-based resources (Weqar et.al., 2020).

Based on the resource-based view, company resources yield a sustainable competitive advantage which consists of an asset that is valuable, rare, difficult to imitate, and non substitutable (Barney, 1991). The rapid technological change, globalization, industrial convergence, competitive behavior, and aggressive deregulation cause changes and uncertainty in previously stable environments. To overcome this, companies need to have scarce, incomparable, and heterogeneous resources to develop sustainable sources of competitive advantage (Huang et al., 2015). This type of company resource is called intellectual capital (IC) which is an intangible asset, a strategic asset owned by a company, that produces a sustainable competitive advantage and superior financial performance (Barney, 1991).

The IC components greatly influence productivity outcomes, with tangible capital playing a major role in productivity and profitability (Chowdhury et al., 2018). Sardo et al., (2018) conclude that intellectual capital components provide a positive impact on the financial performance. Human capital and relationship capital are the key elements for the success of hotel management in Portugal. Furthermore, Xu & Liu (2020) discover the

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inconsistent results; the IC component of human capital affects financial performance, but structural capital, innovation capital, and relational capital do not affect financial performance. Forte et al., (2019) state that human capital has a positive effect on financial performance, while structural capital and capital employed have a negative effect. Mehralian et al., (2012) conclude that intellectual capital does not affect market value. Dzenopoljac et al., (2016) find no significant effects of IC and financial performance on the ICT industry in Serbia. According to Weqar et al., (2020) , the inconsistent effect of all components of value-added intellectual capital (VAIC) on productivity indicates that the company does not utilize assets or investments to an optimal level.

Based on the aforementioned studies, the inconsistency of research outcomes in various countries is related to the relationship between intellectual capital and the company's financial performance. This study examines the role of good corporate governance (GCG) as proxied by the board of directors and the board of commissioners as a mediating variable between intellectual capital and the company's financial performance. The definition of GCG according to the World Bank is the structures and processes by which companies are directed and controlled by the rules, standards, and organizations in the economic field that regulate the behavior of company owners, directors, and managers as well as the details and elaboration of duties and authorities and their responsibilities to investors (Hamdani, 2016 : 21). The organs and structure of corporate governance, consisting of the General Meeting of Shareholders, the Board of Commissioners and the Board of Directors, have an important role in the effective implementation of GCG. The management of a limited liability company in Indonesia adheres to the two board system so that the Board of Commissioners and the Board of Directors have clear authority and responsibility in accordance with their respective functions. Those boards have the responsibility to maintain the company's business continuity in the long term (Komite Nasional Kebijakan Governance, 2006). The Board of Commissioners and the Board of Directors have a major role in the business, so these two boards must be occupied by qualified people who have high ability and professionalism. The company business is managed under the direction of a board of directors which is delegated to the CEO and other management staff. The Board of Commissioners and the Board of Directors have various abilities and have certain characteristics that create value of the company. The board of commissioners and the board of directors as leaders in the company must have knowledge of innovation, be able to develop approaches related to market relations, be able to inspire and motivate colleagues, find new market opportunities and product modifications, be able to create value for resources, and be able to set the right goals (Mura et al., 2017). These factors are intellectual resources consisting of knowledge, information, experience, relationships, routines, and procedures that the board can employ to create value of the company. Based on this research, it can be concluded that intellectual capital affects the performance of the boards in managing and supervising the company.

This study aims to analyze the role of GCG in mediating the relationship between intellectual capital and financial performance. IC measurement is based on Pulic (2000) research. This final sample of this research is 264 manufacturing companies listed on the Indonesia Stock Exchange in the 2015 – 2020 period.

A. Theoritical Framework And Hypotheses

1. Resource-Based View Theory

Resource-Based View (RBV) theory states that organizational resources, either tangible or intangible, must be identified, managed, and improved to achieve business goals in order to develop company performance (Wernerfelt, 1995 ; Nwachukwu & Chladkova, 2018). According to Barney (1991) the three types of company resources are; (1) Physical capital resources which consist of the operated physical technology, the plant and equipment, the geographical location, and the access to raw materials, (2) Human capital resources which comprise managers' and staff' work training, experience, consideration, intelligence, relationships and individual insights, (3) Organizational capital resources which involve the company's formal reporting structure, the formal and informal planning, supervision, and coordination systems, as well as, informal relationships of groups within a company and relationships of companies and people in their environment. RBV theory is often associated with research related to intellectual capital and company performance because the resources owned by the company have the potential to increase competitive advantage, profitability, and superior performance (Earnest & Sofian, 2013).

2. Intellectual Capital

Intellectual capital (IC) is an intangible asset and a strategic asset owned by companies that develop sustainable competitive advantages and superior financial performance (Barney, 1991). Intellectual resources such as knowledge, information, experience, relationships, routines, and procedures that the board employ to create value for the firm. The value of IC synergy comes from the interaction between different components, such as human capital (employee talent, skills, and expertise), structural capital (organizational capabilities,

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culture, processes, patents, copyrights, trademarks, and databases), relational capital (creation and maintenance of relationships with stakeholders) (Bontis & Janosevic, 2015 ; Sydler et al., 2014).

3. Good Corporate Governance

GCG is a pattern of associations, systems and processes operated by company organs (board of directors and commissioners) to provide added value for shareholders in the long term, based on applicable laws and norms, taking the interests of other stakeholders into consideration. The organs and structure of corporate governance, consisting of the General Meeting of Shareholders, the Board of Commissioners and the Board of Directors, have a vital role in the effective implementation of GCG. The management of a limited liability company in Indonesia adheres to a two-board system, which means that the Board of Commissioners and the Board of Directors have obvious authority and responsibility in accordance with their respective functions. They hold the responsibility to maintain the company's business continuity in the long term (Komite Nasional Kebijakan Governance, 2006 ; Indriyani et al., 2018).

GCG is used as a system that manages the company's management and minimizes the company's conflict of interest. GCG is a process and structure employed to direct and manage the business accountability. The main goal of GCG is to optimize the company value while still paying attention to the interests of stakeholders (Worokinasih & Zaini, 2020). This study uses the board of directors and commissioners as GCG proxies, because those two boards have vital roles and responsibilities in regulating and managing the company.

4. Financial Performance

Financial performance is a quantitative indicator of how effectively a company can leverage its assets from its main business model and generate revenue. This financial performance is often utilized to measure the overall financial state of an organization over a certain period (Rashid et al., 2020). According to Mensah et al., (2020) financial performance is a combination of tangible and intangible financial and non-financial resources to achieve predetermined organizational goals. Financial performance can be measured using return on equity, return on investment, gross profit margin, net profit, return on assets and others based on the ease of accessing data (Li et al., 2018).

Information on the company's financial performance is vital, especially:

1. To measure the achievements of the company
2. To assess the contribution of an element in achieving the company's overall goals
3. To determine the company's strategy for the future
4. As a basis for decision making and organizational activities
5. As a basis for determining investment policies to improve company efficiency and productivity.

5. Intellectual capital and Financial Performance

Intellectual capital is an intangible asset as a company's strategic asset to enhance company performance. Three constructs presented by IC are human capital, structural capital, and customer capital. When those three constructs are organized well, their performance will increase. IC is a scarce resource, difficult to imitate, and has no substitute, so every company has a distinguishable IC. The previous studies highlighting this hypothesis include Chowdhury et al., (2018), Sardo et al., (2018), and Forte et al., (2019). The proposed hypothessis is:

H1: *Intellectual capital* has a positive effect on financial performance.

6. Intellectual capital and Board of Directors, Board of Commissioners

The board of directors and the board of commissioners are parts of the organs and structures of GCG. The duties and responsibilities of the board of directors and the board of commissioners are heavy. They organize and manage the company to achieve outstanding financial performance. To achieve that, intellectual resources with superior performance are also needed. Intellectual resources such as knowledge, information, experience, relationships, routines, and procedures must be embedded in the board of directors and board of commissioners to create value of the company. Roshayani et al., (2018) and Dalwai & Mohammadi (2020) previously discussed this perspective in their studies. The proposed hypothesis is:

H2a: Intellectual capital has a positive effect on Board of Directors

H2b: Intellectual capital has a positive effect on Board of Commissioners

7. Board of Directors, Board of Commissioners and Financial Performance

GCG is a system that directs and controls the company. The board of directors and the board of commissioners are GCG organs responsible for managing the company. The quality of GCG which consists of the efficacy of internal control monitoring, and the reliability of financial statements will improve the company's performance. The effective board of directors and board of commissioners is important for organizations to help companies achieve their goals by conducting business activities ethically and acceptably. Hence, the company

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remains substantial in the industry and achieve superior business performance. Abbasi et al., (2012), Gill & Obradovich (2012), Nisasmara & Musdolifa (2016) and Rahmawati et al., (2017) obtained this hypothesis in their research. The proposed hypothesis is:

H3a : Board of Directors has a positive effect on Financial Performance

H3b : Board of Commissioners has a positive effect on Financial Performance

8. Intellectual Capital, Board of Directors, Board of Commissioners and Financial Performance

Intellectual resources of a company are rare and difficult to imitate such as knowledge, information, experience, relationships, routines, and procedures. Those resources must be used by the board of directors and the board of commissioners as the parts of the GCG organs and structures. Therefore, they have the ability to regulate and manage the company to achieve superior financial performance. The proposed hypothesis is:

H4a: Intellectual capital has a positive effect on financial performance through the board of directors mediating variable

H4b: Intellectual capital has a positive effect on financial performance through board of commissioners mediating variable

II. METHODS

A. Sample classification

All manufacturing companies in the Indonesia Stock Exchange are the population in this research. Purposive sampling is the sampling technique used for this research. According to Sugiyono (2017:126) purposive sampling is a technique for selecting samples with specific standards. The criteria used in this study are as follows:

1. Manufacturing companies listed on the IDX from 2015 to 2020
2. Manufacturing companies that publish annual reports successively from 2015 to 2020
3. Manufacturing companies using rupiah currency from 2015 to 2020
4. Manufacturing companies that did not suffer losses from 2015 to 2020

B. Research data

This research is a quantitative research using secondary data taken from the Indonesia Stock Exchange. The data analysis test was carried out using the Warp PLS 7.0 program. The research model as follows:

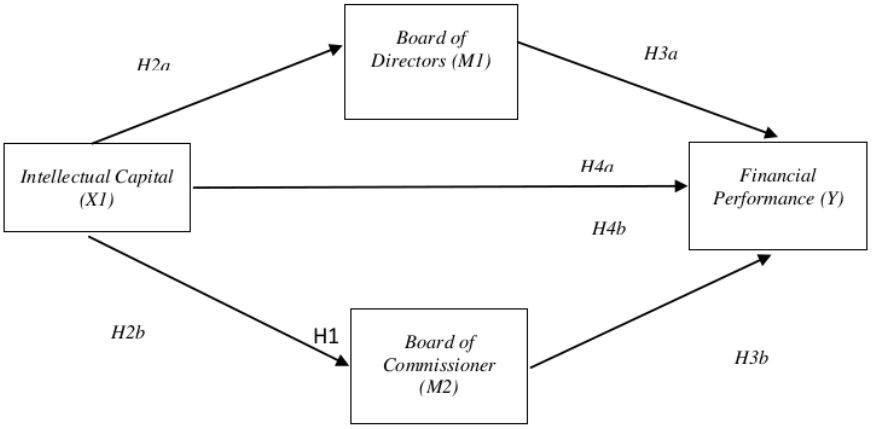

Figure 1. Research Model

The following is a sample selection table:

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Table 1. Sample selection

No.	*Sampel Criteria*	*Total numbers*
1.	*Manufacturing companies listed on the IDX from 2015 to 2020*	*193*
2.	*Manufacturing companies that do not consecutively publish annual reports from 2015to2020*	
	Manufacturing companies that do not use rupiah currency from 2015 to2020	*(43)*
3.	*Manufacturing companies that suffered losses from 2015 to 2020*	*(32)*
	Total number of companies	
4.	*Total number of years of observation*	*(74)*
	Total number of samples (44 x 6)	
		44
		6 years
		264

C. Research variable

1. Dependent Variable (Y)

This study uses financial performance as a proxy for Return On Assets (ROA). ROA reflects business profits and company efficiency in the utilization of total assets (Chen et al., 2005 ; Husna & Satria, 2019). ROA is obtained by comparing the net profit after tax with the company's total assets.

$$\text{ROA} = \frac{\text{Net Income} + \text{interest expense (net of tax)}}{\text{Total Assets}}$$

2. Independent Variable (X)

This study uses the intellectual capital variable which is an intangible asset consisting of human capital, structural capital, and customer capital (Bontis et al., 2000). The employed calculation method is the method developed by Pulic (2000) ; Yustyarani & Yuliana (2020). The steps for calculating Value Added Intellectual Capital (VAIC) are:

1. Calculating *Value Added* (VA)
   VA = OUT – IN
   Description: Output (OUT) = Total revenue
   Input (IN) = all expenses (exclusive of employee costs)

2. Calculating the three components of VAIC model:
   a. Value Added Capital Employed (VACA)

$$\text{VACA} = \frac{\text{VA}}{\text{CE}}$$

   b. Description: CE = Equity and Profit
   Value Added Human Capital Efficiency (VAHU)

$$\text{VAHU} = \frac{\text{VA}}{\text{HC}}$$

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Description: HC = salaries and wages of the staff

d. Structural Capital Value Added (STVA)

$$STVA = \frac{SC}{VA}$$

Description: SC = Structural Capital : VA-HC

Value Added Intellectual Capital (VAIC):

VAIC = VACA + VAHU + STVA

3. Mediating Variable (M)

Mediating variable is a variable that theoretically affects the relationship between the independent and dependent variables. This study employs the board of directors as a mediating variable. The board of directors and the board of commissioners are the GCG organs and structures responsible for the company's operations (Komite Nasional Kebijakan Governance, 2006). The board of directors is measured by counting the number of members of the board of directors in a company (Azeez, 2015). Furthermore, the board of commissioners is measured by counting the number of members of the board of commissioners in a company (Fahrurrozi & Fasieh, 2020).

4. Analysis Tools

This study uses the Warp PLS 7.0 program. The research model to be tested is a multiple mediator model with more than one mediating variables, so it requires multiple mediation analysis (Sholihin & Ratmono, 2021:114).

III. RESULTS AND DISCUSSION

Based on data testing using Warp PLS 7.0, the obtained results are

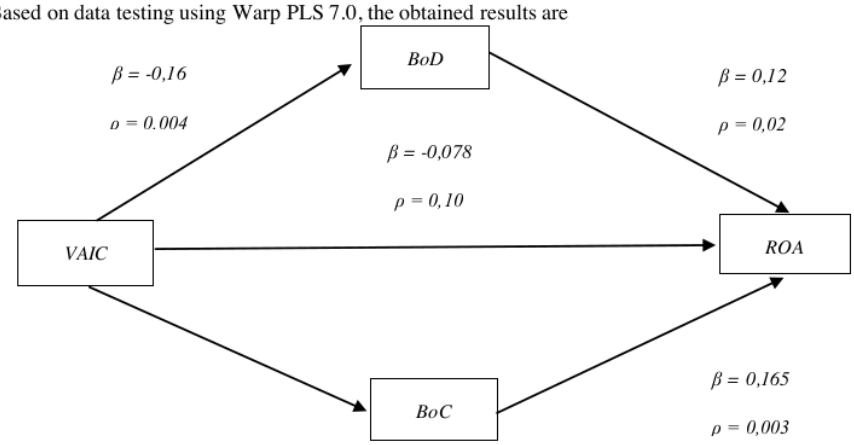

Figure 2. Hypothesis Testing Results

Multiple mediation testing is conducted by inputting all variables and testing them simultaneously as shown in Figure 2 (Sholihin & Ratmono, 2021:114).

Table 2 is the fit and quality indices model criteria showing the fit and weak model results on several criteria. The model suitability analysis has many criteria and of those many criteria, researchers do not have to use all of them to see the suitability of the research model, but it will be better if there are more than one models fit test that met the criteria (Widarjono, 2010). The interpretation of the model fit indicator depends on the purpose of the SEM analysis. If the goal is only to test the hypothesis of the relationship between latent variables, then the model fit indicator becomes less important (Sholihin & Ratmono, 2013:61).

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Table 2. Model Fit and Quality Indices

Indicator fit	*Fit Criteria*	*Value*	*Assesment of Model*
Average Path Coefficient (APC)	*p-value ≤ 0.05*	*0.004*	*Model Fit*
Average R-Squared (ARS)	*p-value ≤ 0.05*	*0.113*	*Weak*
Average Adjusted RSquared (AARS)	*p-value ≤ 0.05*	*0.128*	*Weak*
Average Block VIF (AVIF)	*Acceptable if ≤ 5; Ideally ≤ 3.3*	*1.131*	*Model Fit*
Average Full Collinearity (AFVIF)	*Acceptable if ≤ 5; Ideally ≤ 3.3*	*1.238*	*Model Fit*
Goodness Tenenhaus	*Small ≥ 0.1; Medium ≥ 0.25; Large ≥ 0.36*	*0.214*	*Weak*
Sympson's Paradox Ratio (SPR)	*Acceptable if ≥ 0.7; Ideally = 1*	*1*	*Model Fit*
R-Squared Contribution Ratio (RSCR)	*Acceptable if ≥ 0.9; Ideally = 1*	*1*	*Model Fit*
Statistical Suppression Ratio (SSR)	*Acceptable if ≥ 0.7*	*1*	*Model Fit*
Nonlinear Bivariate Causality Direction Ratio (NLBCDR)	*Acceptable if ≥ 0.7*	*1*	*Model Fit*

A. The effect of intellectual capital on financial performance

Based on the test results in Figure 2, the coefficient value is -0.078 and the significance level is 0.10. This results reveal that the first hypothesis stating that intellectual capital has a positive effect on financial performance is not proven. The use of intangible assets in the sample of manufacturing companies has not been used effectively and efficiently. There are indications of the use of physical and financial assets that still dominate in contributing to the company's financial performance (Andriana, 2014). The results of this study support the researches results of Dzenopoljac et al., (2016) and Mehralian et al., (2012).

B. The effect of intellectual capital on Board of Directors and Board of Commissioners

Based on the test results in Figure 2, the coefficient value is -0.160 and the significance level is 0.004. This shows that hypothesis 2a which states that intellectual capital has a positive effect on the board of directors is not supported. The higher the intellectual capital, the lower the board of directors. According to Peraturan Otoritas Jasa Keuangan Tentang Direksi Dan Komisaris Emiten Atau Perusahaan Publik, (2014), the board of directors is an organ of an Issuer or a Public Company that is fully authorized and responsible for managing the Issuer or Public Company for the interest of and in accordance with the objectives and goals of the Issuer or Public Company, as well as representing the Issuer or Public Company, both inside or outside the court according to its Articles of Association. Board of directors of an Issuer or a Public Company shall at least consists of 2 (two) members. One of the members of board of directors shall be appointed as the president director.

High intellectual capital is not related to the number of the board of directors who are proxies of the board of directors in this study, because the effectiveness of the work of the board of directors is determined by the quality of human resources who become the board of directors. Jensen (1993) stated that keeping the board of

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directors small enhances their performance. When the members of board of directors exceeds seven or eight people, they will likely not function effectively. Conger et al., (1998) also state that to be an "empowered board", the board of directors must be small enough to create a cohesive group. The results of this study are consistent with the research of Nakano & Nguyen (2012) and Azeez (2015).

Furthermore, hypothesis 2b which states that intellectual capital has a positive effect on the board of commissioners, is also not supported. Based on the test results in Figure 2, the coefficient value is -0.206 and the significance level is 0.001. According to Peraturan Otoritas Jasa Keuangan Tentang Direksi Dan Komisaris Emiten Atau Perusahaan Publik (2014), article 6 states that the members of the Board of Commissioners of not more than 3 (three) other Issuers or Public Companies. Intellectual resources such as knowledge, information, experience, relationships, routines, and procedures must be owned by the board so that they can create value for the company. However, the high value of intellectual capital owned by the company does not affect the number of commissioners because their numbers in public companies have been limited by regulations issued by the Financial Services Authority. In addition, the relatively large number of the board of commissioners will interfere with the functions and duties of the board of commissioners (Aini, 2018). The results of this study are consistent with the research of Nugroho (2012), Indah & Handayani (2017).

C. The effect of *Board of Director* and *Board of Commissioners* on Financial Performance

Based on the results in Figure 2, the coefficient value is 0.122 and the significance level is 0.022. This shows that hypothesis 3a which states that the board of directors has a positive effect on financial performance is supported. Hypothesis 3b which states that the board of commissioners has a positive effect on financial performance is also supported, this result is indicated by a coefficient value of 0.165 and a significance level of 0.003. The board of directors has the task of determining the direction of the company's resource policies and strategies, in short and long term. So that the number of the board of directors will determine the effectiveness of the policies and strategies set. Furthermore, these policies and strategies will improve the company's financial performance. The results of this study are in line with research conducted by Nugroho & Raharjo (2014) and Rahmawati et al., (2017). The board of commissioners is responsible for implementing supervision and ensuring that the company has implemented GCG following the applicable regulations. The board of commissioners must carry out its function as a policy supervisor as well as provider of advice to the board of directors in running the company so that management performance will be better and have an impact on improving the company's financial performance. The results of this study are in line with research conducted by Dewi & Widagdo (2012) and Rahmawati et al., (2017).

D. Intellectual capital has a positive effect on Financial Performance through Board of Directors and Board of Commissioners as mediating variables

Sholihin & Ratmono (2021:114) state that multiple mediation testing is conducted by inputting all variables and testing them simultaneously. Based on the test in Figure 2, competitive mediation (inconsistent mediation) is produced. The explanation on the results of hypothesis testing 4a and 4b are :

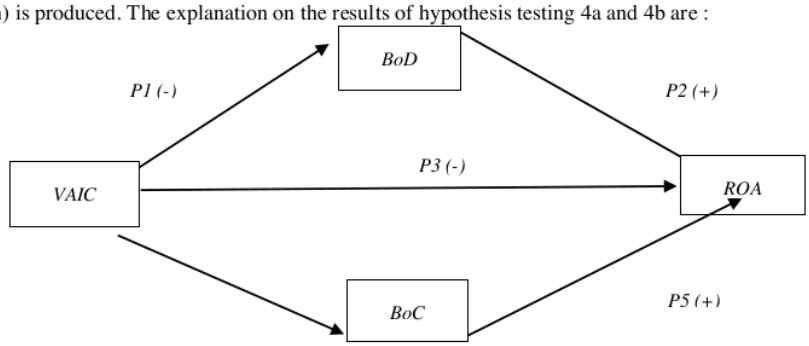

Figure 3. Results of Hypothesis Testing

This competitive mediation occurs because of a direct effect (p3) and one of the indirect effects (p1 or p2) point in opposite directions (MacKinnon et al., 2000). In this study, it is shown in Figure 2 for hypothesis 4a with the analysis of the results as follows:

1. Intellectual capital has a significant negative effect on the board of directors (p1)
2. Board of directors has a significant positive effect on financial performance (p2)
3. Intellectual capital has insignificant negative effect on finance (p3)

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Based on the results of the analysis, hypothesis 4a is stated as a full competitive mediation. Furthermore, hypothesis 4b is also stated as a full competitive mediation by analyzing the results as follows:

1. Intellectual capital has a significant negative effect on the board of commissioners (p4)
2. Board of commissioners has a significant positive effect on financial performance (p5)
3. Intellectual capital has an insignificant negative effect on finance (p3)

In theory, the high intellectual capital possessed by the board of directors and the board of commisioners has an impact on the company's financial performance. Intellectual resources owned by the company are rare and difficult to imitate such as knowledge, information, experience, relationships, routines, and procedures that must be owned by the board of directors and the board of commisioners as part of the GCG organs and structures. Thus, they have the ability to organize and manage the company to achieve superior financial performance. The board of directors and the board of commisioners have various abilities and have certain characteristics that create value for the company. The board of directors and the board of commisioners as leaders in the company must have knowledge of innovation, be able to develop approaches related to market relations, be able to inspire and motivate colleagues, find new market opportunities and product modifications, be able to create value for resources, and be able to set the right goals (Mura et al., 2017).

IV. CONCLUSION

In conclusion, based on hypothesis testing results, intellectual capital has no effect on financial performance (H1). Intellectual capital has a significant negative effect on the board of directors and the board of commissioners (H2a and H2b). The board of directors and the board of commissioners have a positive effect on financial performance (H3a and H3b). Intellectual capital has an effect on financial performance through the mediating variable of the board of directors and board of commissioners with the category of inconsistent mediation (H4a and H4b). This competitive mediation provides support for the mediating effect hypothesis and shows other mediating variables with the same indirect effect as the direct effect.

This study concludes that the intellectual resources of the company are rare and difficult to imitate like knowledge, information, experience, relationships, routines and procedures that must be owned by the board of commissioners and the board of directors who are part of the GCG organ and structure so that they have the ability to organize and manage the company to achieve superior financial performance.

Based on the results of this study, the company's organizational structure, not only the board of commissioners and directors but also the employees, is expected to be able to improve and maintain its intellectual resources,

The limitation of this research is the emergence of inconsistent mediation because the board of directors and board of commissioners as mediating variables act as a suppressor variable which substantially reduces the total effect of X on Y. For further researchers, other mediating variables should be employed to obtain complementary mediation.

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