

Mediating Effect of Financial Engineering Quality on Good Corporate Governance and Firm Performance

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Abstract: *This study aims to analyze and explain the implementation of good corporate governance as an independent variable and financial engineering quality, as a mediating variable on firm performance. This research was conducted at corporate companies in Makassar which consisted of 12 types of industries. This study uses a survey method with the collection of primary data sources. Purposive sampling was used in this study with a total sample of 111 respondents. Data were analyzed using regression analysis with Partial Least Square- SEM techniques.*

The results of the study prove that there has no directly significant effect of good corporate governance on firm performance, good corporate governance has a significant effect on the performance of the company through financial engineering quality; and financial engineering quality has a significant effect on the performance of corporate companies in Makassar

Keyword: *good corporate governance, financial engineering quality, and firm Performance*

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I. Introduction

The need to improve firm performance is one of the big issues in last several decades. Therefore, the demand for the optimization of the practice of good governance structures has become essential, especially in the conditions of the industrial revolution which are strongly influenced by technological aspects. In these conditions the structure of Corporate Governance plays an important role in optimizing the performance of the company that is sustainable in the long term. Thus, several investors, board of directors and government regulators have encouraged companies to emphasize the implementation of good corporate governance in various aspects such as in accounting and finance, economics, law and management. Cadbury (1992) stated that the most important aspect to properly manage the company whether it enters Asia, Europe or the United States is to apply the mechanism of Good Corporate Governance (GCG) to assist businesses in the decision making process.

Therefore, the government including Bank Indonesia has made various efforts to encourage the implementation of GCG in the banking environment. In 2006, Bank Indonesia issued Bank Indonesia Regulation No.8 / 4 / PBI / 2006 dated 30 January 2006 concerning the implementation of GCG for commercial banks. Studies conducted by the Asian Development Bank (ADB) show several factors that contributed to the crisis in Indonesia in 1997-1998. First, high concentration of company ownership; second, the ineffectiveness of the board of commissioner supervisory function, third; inefficiency and low transparency regarding procedures for controlling mergers and acquisitions of companies; fourth, too high reliance on external funding; and fifth, inadequate supervision by creditors.

The weak development of industrial estates in Eastern Indonesia leads the regional economy into a value-added trap. This is evident in the weak ability of the business world to adjust the regulation of restrictions on exports of non-processed commodities. For example, Makassar Industrial Area (Kima), which is oriented towards the largest integrated industrial estate in Eastern Indonesia, is only filled with trade activities. Manufacturing activities in Kima are only limited to producing goods with short value chains. Kima does not have an industry (if there is a small amount) that produces a final product that can be directly used by consumers (end users). Kima also does not focus on developing industrial groups, both natural resource and high-tech industries.

To minimize risk, financial engineering is a tool that is useful for economic planning and is basically a tool for economic transformation. Financial engineering is usually used in securities valuation, and risk management, financial management, insurance, taxation, derivative accounting, commodity trading and other financial decision applications

In general, GCG is a good structure and system for managing companies with the aim of increasing shareholder value and accommodating various parties with interests in the company (stakeholders) such as creditors, suppliers, business associations, consumers, workers, the government and the wider community. This concept is quickly accepted by the wider community and even the performance of a company's stock is now determined by the extent of its seriousness in implementing GCG

Garay& González (2008) conducted a study to examine the relationship between corporate governance, as measured by Corporate Governance Index (CGI), and company value, as measured by Price to Book Value (P / BV) and Tobin'Q, in go public in Venezuela. The results of Garay and González's research showed that an increase of 1% in the CGI resulted in an average increase of 11.3% in dividend payouts, 9.9% in Price to Book Value, and 2.7% in Tobin's q. Garay& González's findings are consistent with the theoretical model of La Porta, et al. (2002) which states that Good Corporate Governance is related to high trust from investors.

Problem Statement

1. Does Good Corporate Governance have a significant effect on firm performance in Makassar?
2. Does good corporate governance have a significant effect on firm performance through financial engineering quality?
3. Does financial engineering quality have a significant effect on firm performance?

Research purposes

1. To prove and analyze the significant influence of good corporate governance on firm performance in Makassar.
2. To prove and analyze the significant influence of good corporate governance on firm performance through financial engineering quality
3. To prove and analyze the significant influence of financial engineering quality on firm performance.

II. Literature Review

2.1 Agency theory

Agency theory is the basis used to understand corporate governance. (Jensen, 1986. Jensen &Meckling (1976) states that agency relations arise when one person or more (principal) employs another person (agent) to provide a service and then delegates decision-making authority to the agent. As agents, managers are responsible for optimizing the profits of the owners (principals), but on the other hand managers also have an interest in maximizing their welfare.

Agency Theory explains how to resolve or reduce conflicts of interest between interested parties in business activities that have a negative impact. To avoid conflict, the basic principles of good company management are needed. Corporate governance, which is a concept based on the Agency Theory, is expected to function as a tool to provide confidence to investors that they will get the same information and complete with those owned by management.

Jensen (1986) explains that the conflict of interest of managers with the interests of shareholders occurs with the assumption that the owners (shareholders) and agents (managers) each want a high return on investment projects but with different interests to risk. The difference to risk is explained by Amihud& Lev (1981) that shareholders have more interest in systematic risk, while managers have more interest in unsystematic risks

2.2 Stakeholder Theory

One of the first theorists who presented Stakeholder Theory inherent in management discipline was Freeman (1984). Freeman also proposed a general theory that applies to companies, which is based on the premise that companies must be accountable to various stakeholders (Solomon & Solomon, 2004). Freeman (1984) defines stakeholders as 'every group or individual who can influence or be influenced by the achievement of company goals'. Thus, stakeholders can include a large group of participants; actually, this applies to anyone who has a direct or indirect stake in this business (Carroll &Buchholtz, 2002). Stakeholders include shareholders, employees, suppliers, customers, creditors and communities around the company's operations (Solomon, 2010)

Wheeler & Sillanpaa (1997), specify stakeholders that must be considered in the governance structure include investors (including banks), managers, employees, customers, business partners (suppliers and subsidiaries), local communities, civil society and the natural environment. Relationships between companies

and their internal stakeholders (such as employees, managers and owners) are framed by formal and informal regulations that have been developed during the relationship. Stakeholders Theory supports the assumption that companies and communities are interdependent and therefore corporations serve social goals that are broader than their responsibilities to shareholders (Kiel & Nicholson, 2003)

Wright et al. (2003) argue that 'stakeholder involvement in corporate governance must depend on a culture of trust, society and consensus rather than individualistic opportunism such as on a shareholders-based system'. Stakeholder theory serves to build good relationships between companies and various internal and external stakeholders in the wider environment, because this is important for the implementation and improvement of effective governance mechanisms and processes (Sarens & Christopher, 2010).

2.3 Good Corporate governance

In order to deal with national economic developments that experience rapid changes, dynamic challenges and increasingly complex and integrated with the international economy, comprehensive and transparent policies are needed. Therefore, the management requirements of the company must be related to the quality and quantity of management as a pillar in creating Good Corporate Governance. In addition, the quality of management needs to be supported by management who are independent of the influence of other parties as well as conflicts of interest that could endanger the sustainability of the Bank's business.

The OECD principles recognize the interests of employees and other stakeholders and their important role in contributing to the company's long-term success and performance. Other factors relevant to the company's decision-making processes, such as environmental, anti-corruption or ethical issues, are considered in principle but are treated more explicitly in a number of other instruments including the OECD Guidelines for Multinational Enterprises, Conventions to Combat Foreign Public Official Bribery in Business Transactions International, United Nations Guiding Principles on Business and Human Rights, and the ILO Declaration on Fundamental Principles and Rights at Work, which are referred to in the Principles.

In this study the author refers to the implementation of the principles of Corporate Governance implemented in Indonesia (IFC, OJK, 2014) which are adopted from OECD principles as indicators and are built with five core values:

1. Justice. In carrying out its activities, companies must always pay attention to the interests of shareholders and other stakeholders based on the principle of fairness and equality
2. Transparency. To maintain objectivity in conducting business, companies must provide material and relevant information in a way that is easily accessible and understood by stakeholders.
3. Accountability. Companies must be able to account for their performance transparently and fairly. For this reason, the company must be managed properly, measured and in accordance with the interests of the company while taking into account the interests of shareholders and other stakeholders. Accountability is a prerequisite needed to achieve sustainable performance.
4. Responsibility. The company must comply with the laws and regulations and carry out responsibility for the community and the environment so that business continuity can be maintained in the long term and receive recognition as a good corporate citizen.
5. Independence. To facilitate the implementation of the GCG principle, companies must be managed independently so that each company organ does not dominate each other and cannot be intervened by other parties

2.4 Financial Engineering Quality

Financial Engineering Quality is a process of innovation in the financial industry that is carried out so that investments in both tangible and intangible are more qualified so as to produce returns as expected and increase the prosperity of shareholders and stakeholders. Financial Engineering is intended to divide the risk component and return of financial products / instruments and offer a combination that best fits the investor's risk return profile (Shah & Serinivasan, 2010).

Shah and Serinivasan (2010) view financial engineering as a technical discipline related to the creation of new and better financial products through innovative design or repackaging of existing financial instruments. They consider financial techniques as pervasive including the overall design of innovative financial instruments, merger agreements, acquisition of financing, corporate restructuring and derivative trading strategies. Financial Engineering and its innovative products have played an important role in expanding financial resources and meeting the requirements of Investors and Issuers.

Financial engineering strategies provide clear direction and focus the efforts of the entire organization on general financial engineering goals (Dharan, 2002). Management needs to develop strategies and communicate the role of financial engineering in a company, decide how to use technology and encourage performance improvement through the use of appropriate performance indicators.

To develop an effective financial engineering process, banking management needs to focus not only on products, technology and processes, but also on organizational culture, norms, values and beliefs (Gunasekaran, 1996). There is a need to develop a climate conducive to creativity (Ahmed 1998), with a strong external focus on many stakeholders (Cagliano, 2001).

2.5 Firm Performance

Performance is the result of all organizational operations and strategies. Accurately measuring financial performance is very important for accounting purposes and remains a major concern for most organizations. Performance measurement systems provide a foundation for developing strategic plans, assessing the completion of organizational goals, and managers (Ittner and Larcker, 1998). Financial performance is very important for the survival of a company in a competitive and uncertain environment

The concept of corporate performance needs to be distinguished from the construction of broader organizational effectiveness. Venkatraman and Ramanujan (1986) offer enlightening figures from three concentric circles that overlap with the effectiveness of the largest organizations. The broadest domain of organizational effectiveness includes intermediate circles that represent business performance, which includes inner circles that represent financial performance. Organizational effectiveness includes other aspects related to organizational functions because of the absence of internal tensions and errors, involvement in legitimate activities, acquisition of resources and achievement of predetermined goals (Cameron, 1986). Business performance, or company performance as we see in this study, is part of the effectiveness of the organization which includes operational and financial results.

Two other aspects to consider when trying to define performance are the time frame and references to distinguish between past and future performance; The superior performance of the past does not guarantee that it will remain superior in the future (Carneiro, 2005). Another problem related to time is the duration of the interval (short, medium or long term) that is considered. References to which performance is measured, eg Industry averages, main competitor results, set targets, or past performance, are also important. Comparisons in relation to targets and past performance show the efficiency and evolution of the company.

In short, much of the company's current performance literature describes corporate objectives such as getting acceptable results and minimizing risks taken (Pont and Shaw, 2003). There is a generally accepted relationship between risk and return, i.e. the higher the risk, the higher the expected rate of return. Therefore, traditional measures of corporate performance have measured risk and returns (Swanson, 1994)

III. Hypotheses and Conceptual Framework

3.1 Good Corporate Governance for Firm Performance

The conceptual framework in this study shows that the role of Corporate Governance Quality as measured by the principles of Good Corporate Governance is important in improving company performance. The advantages of good Corporate Governance are now widely understood because there are many studies and discussions on Corporate Governance by the OECD (Witherell, 2004). Good corporate governance facilitates positive relationships between company management, the board of directors, shareholders and other stakeholders (OECD, 2004). This is reinforced by Freeman (1984), who, as the proponent of Stakeholder theory, argues that a company can run an effective business and achieve its objectives by managing good relationships with stakeholders

Leblanc (2007), provided a comprehensive evaluation of Corporate Governance and Stakeholder Theory in particular, companies that protect the interests of all stakeholders can increase their value in the long run. Mallin (2010) highlighted that stakeholder theory increasingly plays a role when companies are increasingly aware that they cannot operate separately and that, and considering their shareholders, they also need to pay attention to broader stakeholder constituencies. The stakeholder perspective states that the company must consider the interests of each individual or organization that owns shares in the company. Good corporate governance practices are considered as internal management monitoring and effective tools that will help companies achieve higher performance (Ghabayen, 2012)

H1. Corporate governance has a significant effect on firm performance

3.2 Good Corporate Governance to Company Performance through Financial Engineering Quality

Effective corporate governance is very important for functioning financial engineering quality. Good corporate governance shows why and how a company must be managed. Good corporate governance is all about a system that demands integrity, openness, frankness, fairness, timely reporting from company management. It also includes compliance with relevant laws that guide the company's operations. GCG also requires adequate disclosure, reporting, truth in implementing various financial engineering companies.

Financial engineering is a disciplinary technique related to the creation of new and better financial products through innovative design or repackaging of existing financial instruments. They consider financial

engineering as covering all the designs of innovative financial instruments, agreements on fishing mergers and acquisitions, corporate restructuring, derivative trading strategies and others. Financial engineering and innovative products have played an important role in expanding financing sources and meeting investors' Issuer requirements (Osuoha, 2013).

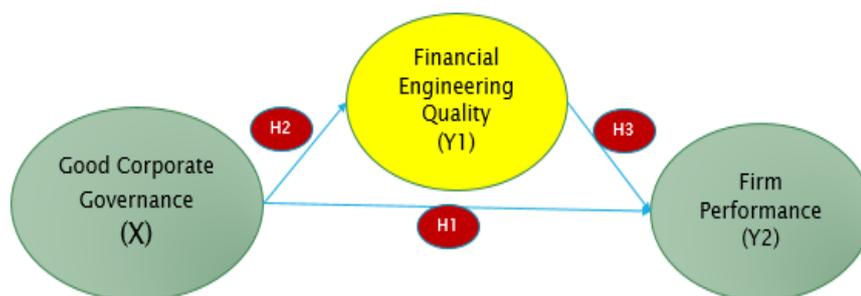
H2 Good Corporate Governance has a significant effect on firm performance through financial engineering quality

3.3 Financial Engineering Quality on Company Performance

There is a lot of empirical evidence that supports the statement and belief that financial development causes economic growth, Levine and Zervos (1998). Financial Engineering and derivatives are products of financial development. The underlying factors of financial development have been identified by Kabiro&Maina (2016) whose findings, his research concluded that there is a supervisory framework that monitors MFIs. Some of the innovations observed by MFIs in mobile banking include partnerships, financial training, branch networks and opening new branches. It was also concluded that innovation can be a source of competitive advantage if the company understands customer needs, competitor actions and technology development and acts accordingly to remain on par with competitors.

H3 Financial engineering quality has a significant effect on company performance

Based on the results of the empirical research that has been put forward, then a model conceptual framework that is integrated or which is the full model of this study can be built:



Figur1: Conceptual Framework

IV. Research Methods

The population of this study was all corporate companies in Makassar with around 51 companies. Based on the established criteria, the number of samples was 37 corporate companies registered in Makassar. Respondents who became the object of research were policy makers in the company with the number of respondents as many as 3 respondents of each company, who were chosen to express their opinions on some of the proposed questionnaires.

This study uses a purposive sampling technique that has been used in previous research on corporate governance in various countries (Mariri&Chipunza, 2011, and Otman 2014) to select companies registered to be sampled. The type of data used in this study is quantitative data and using two data sources namely primary and secondary.

The method of analysis used in this study was statistical test tool, namely variance-based structural equation test, better known as Partial Least Square (PLS) using SmartPLS 3. PLS software is a component model of Structural Equation Modeling (SEM) or variant. According to Ghozali (2006), PLS is an alternative approach that shifts from a covariant-based SEM approach to a variant based.

V. Operational Definition and Research Indicators

5.1 Good Corporate Governance

Good Corporate Governance is the implementation of GCG principles that are applied to every aspect of business and in all levels of the company to achieve business sustainability of the company by paying attention to stakeholders. Principles of Good corporate governance are measured based on the OECD Good Corporate Governance Principles, and all measures of independent variables originate from these principles. This method has been widely used in the existing literature (for example, Li & Tang, 2007; Dao, 2008; Sunityo-Shauki&Siregar, 2007; Kalezić, 2012; Cheung et al., 2011 and Oetman. 2014).

The indicators used were adopted from Syakhrosa (2003), KNKG (2006), the Forum for Corporate Governance in Indonesia taken from the OECD (2014), namely fairness, transparency, accountability, independence, and responsibility.

5.2 Financial Engineering Quality

Financial Engineering Quality is a process of innovation in the financial industry that is carried out so that investments in both tangible and intangible are more qualified so as to produce returns as expected and increase the prosperity of shareholders and stakeholders. The indicators used were adopted from Kariuki (2010), Karani (2015), Kabiro&Maina (2016) are technological innovations, product innovation, market innovation, process innovation and institutional innovation.

5.3 Firm performance

Firm Performance is a result of a company's business process that shows the value of success of a business that can be measured by financial and non-financial information. Company performance is part of organizational effectiveness that includes operational and financial results. The concept of corporate performance is distinguished from the construction of broader organizational effectiveness. The indicators used are adopted from, Cho &Pucik, (2005), Glick et al., (2005), Barney & Clark (2007), Santos and Brito (2012)which comprise from the level of profits, growth rates, the level of sales of the company, the number of new customers and the sustainability of the company.

The research model in full model can be described as follows:

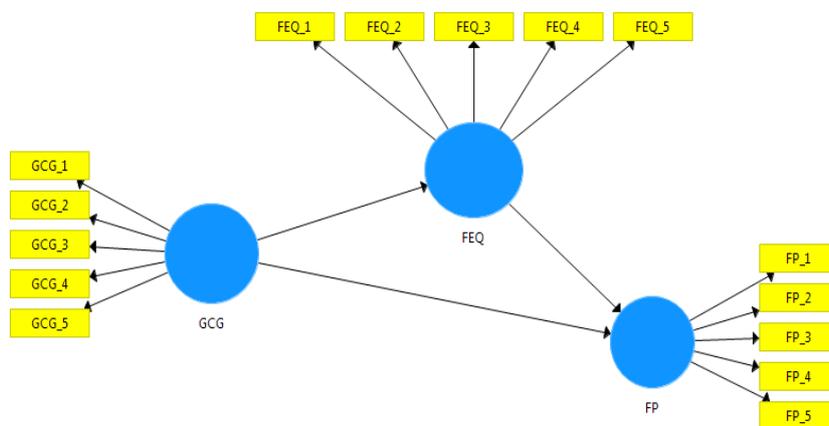


Figure 2. Full Model conceptual framework

VI. Data Analysis

The collected data were analyzed using Smart PLS for the purpose of describing data and testing hypothesized relationships as shown in the following figure:

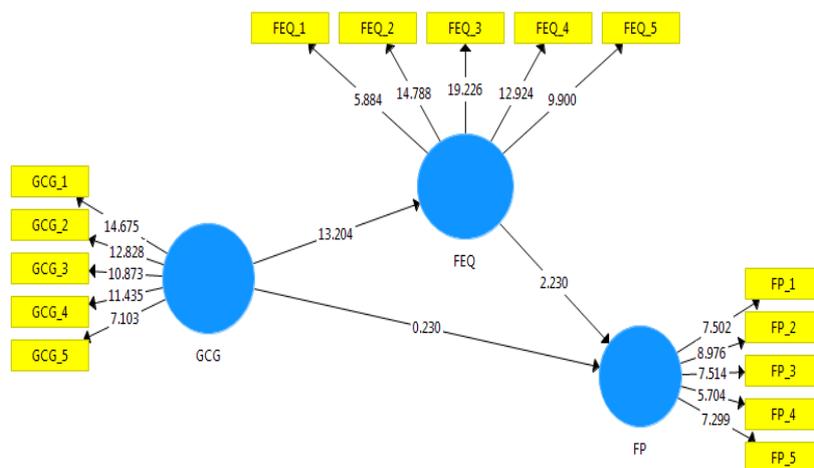


Figure 3. Bootstrapping

5.4 Description of Respondents

In accordance with the purposive sampling technique, there are 37 companies that meet the criteria with 3 people as respondents. After being analyzed and taking into account the completeness of the answers and the suitability of the respondent's criteria, the sample set in this study amounted to 111 people for further processing which means that the number of respondents for each company was 3 people. The details are as follows

No	Type of Corporate	Number of Corporate	Number of Respondent's
1	Food and beverage	8	24
2	Cold storage	11	33
3	Seafood	2	6
4	Ship	1	3
5	Playwood	1	3
6	Constuction	2	6
7	Plastic	1	3
8	Gas	1	3
9	Styrofoam	1	3
10	Botsudan	2	6
11	Bank	2	6
12	Hotel	4	12
13	Car Showroom	1	3
	Total	37	111

5.5 Hypothesis testing

To prove the hypothesis of the influence of independent variables on the dependent variable, a hypothesis is carried out as in the table below:

Path Coefficients

	Original Sampl...	Sample Mean (...)	Standard Devia...	T Statistics (O...	P Values
FEQ -> KP	0.370	0.365	0.164	2.258	0.024
GCG -> FEQ	0.726	0.730	0.057	12.745	0.000
GCG -> KP	0.040	0.060	0.179	0.227	0.821

5.5.1 Effect of Good Corporate Governance on Company Performance

Hypothesis 1 (H1) states that good corporate governance has a positive effect on company performance. This hypothesis statement is proposed by referring to the results of research conducted by Otman (2014) found evidence that the principle of corporate governance has a positive effect on firm performance. From the results of testing the hypothesis 1 (H1) about the effect of good corporate governance on company performance indicated by a coefficient of 0.040 and p-values 0.821, not in the same coefficient as the hypothesis statement, which means an insignificant influence that indicates that good corporate governance does not have a direct influence on company performance. The results of this study indicate that the better / higher the application of good corporate governance in managing the company, the company's performance will decrease. This confirms that the insignificant impact of the implementation of good corporate governance is very strong when managing the company so that it can reduce company performance. Thus, based on the results of empirical testing, the hypothesis 1 (H1) is declared rejected or unacceptable

The results of testing hypothesis 1 (H1) above turned out to be insufficient evidence to accept the results of studies from Cheuang et al (2011), Kalezić (2012), Otman (2014), Abbadi et al (2016) which also found evidence that good corporate governance management had a positive effect on company performance. Furthermore Javed and Iqbal (2007), Tang (2007), Badriah et al (2015), Michelberger (2016), and Buallay at al (2017) together the results of their studies show that there is no significant relationship between good company management and firm performance.

5.5.2 Good corporate governance has a significant effect on company performance through financial engineering quality

Hypothesis 2 (H2) states that Good Corporate Governance influences the Company's performance through Financial Engineering Quality. This hypothesis statement was proposed with reference to the results of

research conducted by Kabiro&Maina (2016) finding evidence that Financial Engineering Quality is positively related to company performance. To prove this hypothesis, hypothesis testing is done as in the table below:

Specific Indirect Effects

	Mean, STDEV, T-Values, P-Va...	Confidence Intervals	Confidence Intervals Bias C...	Samples	Copy
	Original Sampl...	Sample Mean (...)	Standard Devia...	T Statistics (O...	P Values
GCG -> FEQ -> FP	0.269	0.271	0.121	2.213	0.027

The results of testing on hypothesis 2 (H2) about the effect of good corporate governance on company performance through financial engineering quality are indicated by a coefficient of 0.269 and p-values of 0.020, in the direction of the coefficient corresponding to the hypothesis statement, which means a significant effect indicating that good Corporate governance has an indirect influence on company performance through financial engineering quality. The results of this study indicate that indirectly the existence of financial engineering quality is able to act as a mediating variable in the relationship between good corporate governance on company performance. Thus, based on the results of empirical testing, hypothesis 2 (H2) is declared acceptable. The results of this study are in line with research conducted by Mairuri&Nguril (2014) who found evidence that several banks in Kenya have adopted several financial innovations such as credit cards, mobile, internet and banking agents. Financial innovation has a major impact on the bank's financial performance.

5.5.3 Financial Engineering Quality Affects Significance on Company Performance

Hypothesis 3 (H3) states that financial engineering quality influences company performance. This hypothesis statement was proposed with reference to the results of the research conducted by Kabiro&Maina (2016) which found evidence that financial engineering quality is positively related to company performance. As stated in the previous chapter, the results of testing on hypothesis 3 (H3) on the effect of financial engineering quality on company performance are indicated by a coefficient of 0.370 and p-values 0.025, in the same direction as the hypothesis statement, which means a significant influence shows that financial engineering quality has a direct influence on company performance. The results of this study indicate that the better the implementation of financial engineering quality in the management of the company will significantly influence the performance of the company. This confirms that the impact of implementing financial engineering quality is very strong in managing the company so that it can affect the company's performance. Thus based on the results of testing empirically, then hypothesis 3 (H3) is declared accepted. The results of this study are in line with the research conducted by Kabiro&Maina (2016) which found evidence that to improve company performance, microfinancemanagement must focus on company activities that are aligned with updating routines, procedures and processes in innovative ways in the company. This will positively improve the performance of microfinance.

5.6 Determination Coefficient Analysis

R² value states that variations in endogenous constructs can be explained by exogenous constructs that are identical to the magnitude of the contribution of exogenous constructs to endogenous constructs. From the results of data processing, it can be known the value of R² as in the following table:

R Square			
Matrix	R Square	R Square Adjusted	
	R Square	R Square Adjus...	
FEQ	0.526	0.522	
FP	0.161	0.145	

From the table above it can be interpreted that the good corporate governance variable (X1) is able to explain the construct of financial engineering quality as much as R²Y1 value is 0.526 (52.6%) with a P value of 0.000, while other variables not explained in the model are 0.474 (47 , 4%). Furthermore, the company performance variable (Y3) can be explained jointly by the Good corporate governance variable, and financial

engineering quality for the value of R^2Y3 is 0.161 (16.1%) with a P value of 0,000, while the other variables not explained in the model are equal to 0.839 (83.9%).

VII. Conclusion

From several tests that have been done, the conclusion of this study is that from the several hypotheses tested it turns out that there is only one hypothesis that is rejected, namely H1 which states that good corporate governance has no significant effect on company performance while the other two hypotheses are good corporate governance on firm performance (H2) and financial engineering quality on firm performance (H3) have a significant effect on firm performance.

VIII. Limitations and Recommendations

The limitation in this study is because the number of samples used is small (111 samples), this is because many companies are unwilling to accept researchers on busy grounds. For this reason, it is recommended that the next researcher use a larger sample so that the results obtained are more accurate.

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