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Are Gcg Effectıve In Mıtıgatıng Earnıngs Management And Influencıng Csr In Famıly Fırms?

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Abstract
This study aims to examine the effectiveness of the role of corporate governance on corporate social responsibility (CSR) in family firms with earning management as the moderating variable. The data used in this study are secondary data of 120 family firms listed on the Indonesian Stock Exchange for the period 2015 to 2019, analyzed using Smart PLS software. In this study, the corporate governance mechanism is measured with: independent board of commissioners, institutional ownership, the board of director size, managerial ownership, and audit size. CSR is measured using the ISO 26000 standard. Meanwhile, earnings management is measured using discretionary accruals of modified Jones models. The results show that the role of corporate governance positively affects earnings management in family firms. Further analysis shows that corporate governance also influences CSR. This study also provides empirical evidence that earnings management enhances the relationship between corporate governance and CSR.
Keywords:
corporate governance, earnings management, CSR, family firms

Introduction
Corporate governance can be defined as the process that is used by the board of directors to be able to identify the resources that the organization will deploy and resolve conflicts among employees (Das, 2019). It can be used to reduce the agency conflicts between shareholders and manager. Family firms face more agency conflicts than non-controlled family firms and potentially have weaker governance mechanism (Paiva, Lourenço, & Branco, 2016). Consequently, there is a huge potential to exploit minority shareholders for personal benefits (Paiva et al., 2016). Corporations with poor governance mechanisms and legal quality also relationship-specificity relate strongly to get involved in earnings management. In family firms, corporate governance may inflict conflict of interests between the stockholders and managers (Villalonga, Amit, Trujillo, & Guzmán, 2015). The demand for stakeholders' needs mostly affects the managerial to do the earnings management practices without distracting the accounting standard.

Family firms usually focus largely on their self-interests. As a result, many family firms demonstrate lower CSR disclosure level compared with non-family firms (Biswas, Roberts, & Whiting, 2019). According to the law, CSR is regulated as a corporate obligation. CSR is the idea that corporations must stand on the triple bottom line that consists of: financial, social, and environmental. This is because financial conditions are not enough to guarantee the sustainable growth of the corporation. According to the Conference on Corporate Governance and Responsibility: Theory Meets Practice held in 2016 by the National University of Singapore (NUS) Business School and ASEAN CSR Network (ACN), the implementation of CSR by Indonesia's corporations are of lower quality compared to Thailand. The research was conducted by examining 100 companies based in Indonesia, Malaysia, Singapore, and Thailand. It identifies Thailand as the country with the highest quality of CSR implementation with a value of 56.8 out of 100, followed by Singapore who scored 48.8. Indonesia and Malaysia scored 48.4 and 47.7 respectively. A recent study by (Ramadhini, Adhariani, & Djakman, 2020) showed that the concern of external stakeholder on social and environmental issues will encourage companies to disclose CSR matters extensively.

CSR can be signed as one of the main agenda, due to its ability to increase corporate value. The most important decision-makers believe that CSR provides a competitive edge, which ultimately increases the financial strength of the corporation (Mao & Wu, 2019). CSRoriented corporations show off their financial information as a strategy to incentivize managers to be ethical and to establish their reputation in society and to investors. On the other hand, corporations with CSR-oriented practices display high levels of earnings management because managers use these practices to try to cover up the low-quality financial statements (Moratis & van Egmond, 2018).

Agency theory is considered earnings management still occurs. Based on the owners' needs, the company wishes to become healthier and more profitable. Due to the influences of controlling and non-controlling investors, there are differences in interests. However, from the investor's point of view, whether controlling or not, earnings management still needs to be avoided as much as possible. This study aims to provide more literature about corporate governance, earnings management, and CSR in family firms due to the lack of it for this topic.

Public firms tend to focus more on long-term benefits. This is one of the reasons why family firms should implement corporate governance. Independent commissioners can mitigate the agency conflicts. A higher proportion of independent commissioners leads to more monitoring of the separation of interests between board executives and owners. More independent commissioners have a positively impacts on earnings management. Independent commissioners will be able to monitor the management system which reduces the chances of practicing earnings management. However, according to Paminto et al. (2020), independent commissioners less effective to minimizing earnings management due to large of majority ownerships. This might indicate the function of independent commissioners in monitoring earnings management less effective if the majority ownerships were held by family members or firms.

Literature Review

A study by Lemma et al. (2018) evidenced that institutional ownership has a significant positive effect on accrual earnings management, as it heightens earnings management that are based on accruals. This supports the argument that institutional investors typically focus on short-term profits. Therefore, managers tend to be pressured into engaging in earnings management.

Jamaludin et al. (2015) reveal the relationship between earnings management and board of director composition is significant. Generally, it is often found that in family firms, at least one family member serves as one of the board members. The involvement of family members provides the authority to monitor the activities of managers effectively (Teh, Ong, & Ying, 2017). Moreover, leadership by family members can minimize the occurrence of earnings management because of the economic entity principles or separation of interests between personal and entity. However, Teh et al. (2017) also argued that there is a huge potential for family board members to engage in earnings management to cover up the firm's bad performance.

Stewardship theory suggests that a closer relationship of the manager with the family enhances positive benefits to the firm. Giving the manager share ownership and an influential position will impact the firm positively. Due to an increased stake in the firm, managers tend to work longer periods and avoid actions that will negatively impact the firms. Furthermore, the audit committee reflects the good implementation of corporate governance. An audit committee that is more active tend to reduce the level of discretionary accruals (Mardjono & Chen, 2020). From these discussions, the following hypothesis is developed:

H1: Corporate governance influences earnings management negatively.

Oh, Chang, & Jung (2019) found that how effective a board is at improving CSR depends on some common attributes of the firm. For example, it is not effective if family members dominate the boards. Independent commissioners significantly impact corporations because they are more likely to consent to CSR implementation. Saraswati, Azzahra, & Sagitaputri (2020) found that independent commissioners can extensive the voluntary disclosure. Saraswati et al. (2020) argued this caused by the ability of independent commissioners can mitigate the conflict of interest. On the contrary, (Itan & Lestari, 2015) found out the independent commissioners are not really independent enough to play serious monitoring role. The independent commissioners sit to fulfill the requirements of the Indonesian Capital Market Regulation, decree number Kep-315/BEJ/06-2000 concerning code for good corporate governance that requires listed companies to have independent commissioners of at least 30 percent in the of board of commissioners, but who might not be able to exercise their power. A study by (Adnan, Hay, & van Staden, 2018) found that institutional ownership influences CSR implementation positively.

The board of directors in a family firm usually consists of at least one family member who is oriented towards long-term goals. Hence board size may increase the firm's social involvement because it benefits stakeholders and enhances goodwill. The board may lead to the disclosure of CSR. However, a

study by (Oh et al., 2019) claimed that the board is ineffective in disclosing CSR practices if the family is strongly involved in the firm.

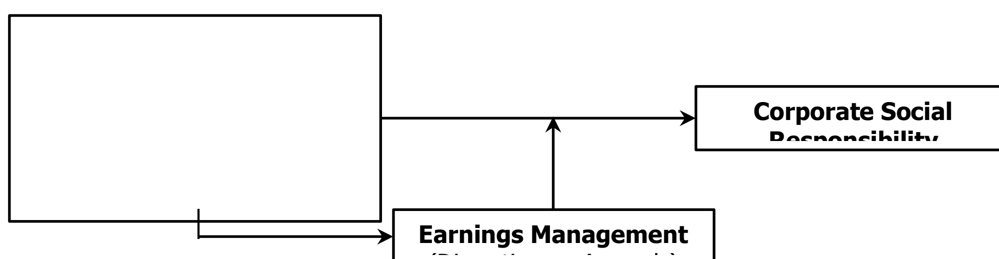
According to (Biswas et al., 2019), the presence of audit committee in family firms can enhance CSR disclosure. The purpose of the audit committee is to control and supervise operational activities within the firm, but this function tends to be ineffective due to its character and composition. Therefore, based on the above facts, this study hypothesizes that:

H2: Corporate governance influences CSR positively. With corporate governance, the manager will seek any advantage as a tool to organize the CSR.

With corporate governance, the manager will seek any advantage as a tool to organize the CSR. Based on the pyramid of CSR by (Carrol, 1991), a firm needs to be profitable as part of its economic responsibility, obey the law as part of legal responsibility, be ethical as part of ethical responsibility, and be a good corporate citizen as the part of the responsibility. Therefore, corporate governance is an integral part of CSR. A well-known CSR related company compels the public to focus on what is inside that company. In order to handle public attention, corporate governance is needed to preserve the health of the firm and direct the public attention towards their CSR activities. Consequently, the earnings management behaviors performed in the firm will be covered up by CSR activities and protected because of the firm's good public image.

To cover up earnings management actions, managers will actively disclose CSR activities to manipulate stakeholders. Companies that invest in CSR tend to show higher levels of earnings management since managers cover up the firm's bad financial statements by signaling their good CSR (Moratis & van Egmond, 2018). Managers proactively enhance their public exposure through CSR activities to control earnings management. Therefore, it can be hypothesized that:

H3: Earnings management moderates the relationship relating corporate governance and CSR.



Corporate Governance:
- Independent Board of Commissioners
- Institutional Ownership
- Board of Director Size
- Managerial Ownership
- Audit Committee Size

Control:
- *Firm Size*
- *Firm Age*

Figure 1. Theoretical framework

The theoretical foundation of this analysis is the agency theory, which emphasizes the separation of ownership and control. Figure 1 shows the theoretical framework that elaborates how corporate governance mechanisms in family firms influences CSR with the moderating role of earning management.

Research Methods

The data used in this study are secondary data from the Indonesia Stock Exchange (IDX) from 2015 to 2019. CSR disclosures are determined using ISO 26000 guidelines. To determine CSR, ISO 26000 focuses on 7 main factors, which consist of: corporate governance, human rights, labor practices, environment, fair operating practices, consumer issues, and community involvement and development. Family firms are analyzed in this study to emphasize voluntary activities in family businesses. This study defines a family firm as a firm, where an individual, or group of family members, holds more than 20% of the firm's shares.

Based on the above criteria, 120 firms were selected as the sample for this study. Using the observation year from 2015 to 2019, a total of 600 data were determined for the study. The outlier test was conducted to find data that had sufficient deviation from the average to affect the data spread abnormally. Studentized Deleted Residual (SDR) was run to identify the most extreme high and low values. The recommended limits in SDR for outliers are value greater than 1.96 and smaller than -1.96. After the outlier test, the final dataset was 596 observations. Table 1 presents the operationalization of variables and measurement:

Table 1. Observation Variable

Variable	Measurement
Corporate Governance:	
- Independent board of commissioners	$BCIND = \frac{Number\ of\ Independent\ Board\ Members}{Number\ of\ Board\ of\ Commissioners}$
- Institutional ownership	$INSTOWN = \frac{Number\ of\ shares\ owned\ by\ institutions}{Outstanding\ shares}$
- Board of director's size	$BOD = Total\ number\ of\ board\ of\ directors$
- Managerial ownership	$MNOWN = \frac{Number\ of\ shares\ owned\ by\ executive\ board}{Outstanding\ share}$
- Audit committee Size	$ACMS = Total\ number\ of\ audit\ committee\ members$
Control Variable:	
- Firm Size	$Size = Natural\ log\ log\ of\ total\ assets$
- Firm Age	$Age = Number\ of\ years\ since\ listed\ on\ the\ public$
Earnings Management:	
Discretionary accruals	$DA_{it} = TA_{it} - NDA_{it}$ (Modified Jones Model)
Corporate Social Responsibility:	$CSR = \frac{Sum\ of\ diclosed\ index}{Number\ of\ total\ indicators}$

Source : Proceed Data, 2020

This study uses structural equation modeling (SEM) based on Partial Least Square (PLS) to assess the hypothesis in this study. The first latent construct to describe corporate governance was using a formative perspective. A formative perspective is used to describe corporate governance because it can better predict relevance and amount of variances (Thompson, Higgins, & Howell, 1994). The corporate governance construct (ξ) is reflected as:

$$\square = \square_{\square 1}\square 1 + \square_{\square 2}\square 2 + \square_{\square 3}\square 3 + \square_{\square 4}\square 4 + \square_{\square 5}\square 5 + \gamma_{\square 6}\square 6 + \square_{\square 7}\square 7 + \square$$

Earnings management and CSR are considered as a single construct, hence H1 and H2 can be determined using the following formula:

$$\eta 1 = \beta_1 \xi_1 + \zeta \quad (H1)$$
$$\eta 2 = \beta_1 \xi_1 + \zeta \quad (H2)$$

Notes:

ξ : Corporate governance
η_1 : EM
η_2 : CSR
γ_{x1} : BCIND
γ_{x2} : INSTOWN
γ_{x3} : BOD
γ_{x4} : MNOWN
γ_{x5} : ACMS
γ_{x6} : SIZE
γ_{x7} : AGE
ζ : Random disturbance term

Earnings management plays a role as a moderating effect between corporate governance and CSR. A two-stage approach is used to determine this connection which is applicable in the formative perspective model. This study explains the results in two stages: measurement model and structural model. Validity and reliability test are used to measure the model, while the significance of constructs (β), coefficient of determination (R^2), and predictive power value (Q^2) are used to estimate the structural model.

Results and Discussion

Table 2 shows the descriptive statistic test that includes the minimum value, maximum value, mean, and standard deviation. From the results below, the average independent board of commissioners is 41,59% implying that the number of outsider board members in family firms is quite high. The range of 14,29% to 80% indicates that family businesses are still concerned about the role of outsider board members in their management. Institutional ownership in Indonesia is mixed but based on the average value of 64,83%, it shows that the ownership of family firms is mostly held in the form of institutions. However, not all companies are owned by institutional shares, evidenced by the minimum value of 0%. The average number of board of directors is 5 with a range of 2 to 16. Meanwhile, the managerial ownership in Indonesia's family firms tends to be low, with a mean value of only 4.77%. Audit committee size has an average value of 3 members. Most companies are merely following the policy that each company must have at least 3 audit committees according to Financial Service Authority Regulation (POJK) No.55/POJK.04/2015.

Table 2. Descriptive statistics

	N	Min	Max	Mean	Std. Dev
BCIND	596	0.14286	0.80000	0.41592	0.10984

INSTOWN	596	0.00000	0.99711	0.64834	0.22709
BOD	596	2.00000	16.00000	4.80000	2.27700
MNOWN	596	0.00000	0.77781	0.04766	0.12945
ACMS	596	2.00000	5.00000	3.02349	0.28893
EM	596	-0.59853	0.66213	-0.02953	0.10159
CSR	596	0.151909	0.86364	0.43215	0.14477
SIZE (in billions)	596	48	126,723	8,076	16,123
AGE	596	0.00000	38.00000	18.93289	7.64015
Valid N (listwise)	596				

Source : Proceed Data, 2020

Furthermore, earnings management has an average value of -2.95%, showing that family firms only fulfill the requirements of accounting standards and focus on long-term benefits. While the mean value of CSR disclosure in family firms is 43,22%. It is highly advised that the measurement model should be assessed first before determining the model, to ensure the robustness of the tests conducted. This study assesses bootstrapping using 2000 test resamples in smart PLS to get valid individual indicators. To test the second-order construct, this study uses two measurements: validity and reliability tests. To verify the reliability of the model, this study uses VIF to check if any collinearity exists. According to Hair et al. (2014), there is no collinearity if the VIF value is less than 5. On the other hand, the bootstrapping technique is used to test the validity of indicators. This approach gives statistical weights for each indicator and its influence through the t-value.

Table 3 shows the result of the validity tests. A multicollinearity test was passed, shown by the VIF values all indicators that remain under 5 (Hair et al., 2014). The results show that no collinearity exists in this study. Meanwhile, the validity test using bootstrapping methods shows that not all indicators were significant (t-value<1.96). Corporate governance variables (i.e., BCIND, INSTOWN, BOD, MNOWN, and ACMS) suggest that only board size (BOD) indicators have significant effects. This was an issue to omit or retain the indicators in the model. Some studies only observed the multicollinearity of each indicator to test the validity of a formative perspective. This study did not find any collinearity problem, so the next step is to test the hypothesis with structural model analysis.

Table 3. Measurement model test

Variables	Outer Weight	t-value	VIF
Corporate Governance:			
BCIND	0.02453	0.18971	1.03406
INSTOWN	0.12414	0.99273	1.21230
BOD	0.81861***	9.35236	1.04359
MNOWN	0.18848	1.24698	1.27572
ACMS	-0.10034	0.87438	1.02291
SIZE	0.39267***	3.40696	1.00923
AGE	0.24528**	2.18007	1.09003
EM*CG		Single item construct	
EM		Single item construct	
CSRD		Single item construct	

Notes: *** p<0.01; ** p<0.05

Source : Proceed Data, 2020

This section explains the result of the hypothesis test using model structural analysis. To determine the statistical significance of path coefficients (β), a bootstrapping technique with 2000 resamples was applied using Smart PLS. Table 4 represents the results of path coefficients. Corporate governance is shown to have a positive influence to earnings management (β=0.183, t-value = 4.332, p-value = 0.00). These findings are not in line with the first hypothesis which expects a negative correlation between corporate governance and earnings management. The coefficient with less than 1% significance indicates corporate governance strongly influences family firms to manipulate their earnings. This suggests that corporate governance in family firms does not adequately mitigate earnings management behaviors.

Table 4. Path Coefficients

Path	Expected sign	Path Coefficient	t-value	p-value
CG→EM	+	0.18274***	4.33160	0.00002
CG→CSR	+	0.27507***	5.79934	0.00000
EM*CG →CSR	+	0.13800***	2.80919	0.00501
EM→CSR	-	-0.02418	0.68950	0.49059
Indirect effect: GCG→EM→CSR	+	0.01428	1.60132	0.10946

Notes: *** p<0.01; ** p<0.05

Source : Proceed Data, 2020

On the other hand, corporate governance shows strong effects on CSR (β=0.275, t-value = 5.80, p-value = 0.00), which verifies H2. This strengthens the conjecture that corporate governance and CSR are related in a causal effect. As with H2, the moderate effect of earnings management also strengthens corporate governance in relation to CSR. Moderate effect demonstrates a significance at 1% level (β=0.138, t-value = 2.809, p-value = 0.005) which proves H3. However, earnings management as individuals does not affect CSR, as shown by the t-value (0.69 < 1.96). The indirect effect from bootstrapping results confirms that corporate governance does not have an indirect influence on CSR through earnings management. (β=0.138, t-value = 1.601, p-value = 0.11).

Then the overall model fit is measured using the coefficient of determination (R^2) and predictive power value (Q^2). R^2 is used to calculate the variance identified by independent latent constructs in the dependent latent construct. Table 5 shows that earnings management represents 3.34% of the overall model, while CSR was 10.16% of the overall model. The R^2 value can be categorized as small (10%), medium (25%), and large (36%). The earnings management latent construct was categorized as a small value while CSR latent construct is in the medium range. The latent construct of CSR above 10% means it was adequate and worth reporting.

Table 5. Overall Statistical Model

Dependent	R^2	t-value	Q^2	Criterion
EM	0.03339	2.03042**		
CSR	0.10160	3.74057***		

Q^2 Predictive Relevance	0.13160	>0.000

Notes: *** p<0.01; ** p<0.05
Source : Proceed Data, 2020

Thus, to test the predictive relevance of the overall model, the Stone-Geisser Q^2 was performed for dependent latent constructs. The predictive power value should be greater than zero (Hair et al., 2014) to validate its redundancy. However, the predictive power value of the results of this study is more than its cutoff point (Q^2=13.16%), indicating that this study's predictive power is to fulfill the threshold recommendation. This explains the model of this study is able to contribute 13.16%, while the remaining is explained by other factors that are not included in this analysis.

Table 6 shows the regression results to test the hypotheses. The value of path coefficient (β) should be at least 0.2 and ideally higher than 0.3. This study suggest that H2 has a strong connection while the remainder was lesser than 0.2 (β1 = 0.183, β2 = 0.275, β3 = 0.138). Overall, all of the hypotheses show significant results (p<0.01).

Table 6. Hypothesis Testing

	Hypothesis	Suggested Effect	Path Coefficient	p-value	Confirmed
H1	Corporate governance influence earnings management negatively	-	0.18274	0.00002***	No
H2	Corporate governance influence CSR positively	+	0.27507	0.00000***	Yes
H3	Earnings management moderates the relationship relating corporate governance and CSR	+	0.13800	0.00501***	Yes

Notes: *** p<0.01; ** p<0.05
Source : Proceed Data, 2020

The link between corporate governance and earnings management shows significant positive results and is likely to have a weaker effect (β < 0.2). This is contrary to H1 which expects both to have negative relationships. This result proves that applying corporate governance in family firms may be less effective in mitigating earnings management and manipulative behaviors. It also reveals that corporate governance can be inefficient and may also incentives high earnings management in family firms.

Corporate governance was proved to have a strong impact on CSR in family firms (β > 0.2, p<0.01) and have a positive influence on CSR disclosures in family firms. Many studies also found high CSR disclosure to be beneficial, including to provide good feedback and impacts. However, as mentioned before, corporate governance is an integral part of CSR based on the pyramid of CSR (Carrol, 1991). H3 also shows significant results but seems to have a weaker effect compared to H2 (β < 0.2). Earnings management plays a greater role in corporate governance to disclose social activities and be able to strengthen the relationship between corporate governance and CSR. Managers who are involved in earnings management are more likely to engage in CSR to cover up their earnings management practices. However, this study found that the indirect effects of earnings management have no impact on CSR.

Conclusions

This study found that the implementation of corporate governance cannot reduce earnings management behaviors. This study also shows all corporate governance variables

affect earnings management positively. We conclude that family firms are more likely to be engaged in earnings management practices. The results indicate that corporate governance is ineffective to mitigate earnings management. As a result, family firms tend to act in their interest to achieve their family objectives. In contrast to CSR, corporate governance was found to be more aggressive to disclose firm reporting. This suggests that firms engage in voluntary activities to protect the reputation of the family and business. Therefore, in line with H2, managers are willing to be involved in social disclosure for their long-term benefit. For both family and non-family controlling firms, CSR leads to high disclosure to obtain goodwill and a good public image.

The literature on family businesses suggests both support and conflict of interests between stakeholders and family members. Only a few studies have examined the relationship between corporate governance, earnings management, and CSR in family firms. Moreover, the linear relationship between these variables is not conclusive and produces mixed results on whether family firms' CSR disclosure is higher than nonfamily firms and whether family firms engage more in managing earnings, or vice versa. This study found that family firms might prevent earnings management behaviors and focus more on long-term interests by carrying out their social responsibility. However, this study also has limitations; the result of the study will vary with the type of businesses examined, the data and variables observed, the social responsibility measurements, and also will be affected by the world's financial and environmental conditions. Moreover, the sample selection was based on a predetermined criterion. These variations identified will lead to differing analyses for every study and provide various significant policies.

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