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THE ROLE OF CORPORATE SOCIAL RESPONSIBILITY AS MEDIATION IN INDONESIA

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Abstract

This study examines the direct and indirect relationships between the quality of corporate governance and company performance with CSR as mediation. A better quality of corporate governance means the more fulfilled of stakeholder's interest so that it will give positive impact on the company performance.

Data of corporate governance quality and CSR were obtained by carrying out a content analysis on the company's annual report for 2016. The analysis was done based on a template developed by the Forum for Corporate Governance in Indonesia (FCGI) and GRI Index. The results show that companies that disclose information about CSR activities have better performance than those that do not perform it. Such information is considered as a sign that the company has fulfilled all stakeholders' interests. Furthermore, the results also show that corporate governance quality does not affect the level of company performance. Nevertheless, this research cannot prove the indirect relationship of CSR on the interaction between corporate governance and company performance in Indonesia.

Keywords: Quality of Corporate Governance, CSR, Company Performance

Introduction

Basically, corporate social responsibility or CSR is viewed as the form of company's non-financial accountability to all parties that affect and are affected by the company. In Indonesia, the concept of CSR has been initially acknowledged by the government and public in general. It is evidenced by the issuance of several laws and regulations concerning with CSR, including Law No. 40 of 2007 on Limited Liability Companies *jo*. the Government Regulation No. 47 of 2012 on Social and Environmental Responsibilities of Limited Liability Companies, and Law No. 25 of 2007 on Capital Investment. Nevertheless, previous studies have shown that the implementation of CSR in Indonesia is still inferior compared to other Asian countries, e.g., Singapore and Thailand (Suastha, 2016).

Corporate governance established a system of control over management actions/behavior; corporate governance controls the behavior of management to act in accordance with the interests of the company. The better the quality of a corporate governance system, the lower the issue of differences in interests between management and owner (Brown & Caylor, 2009).

Stakeholder theory emphasizes the importance of building up good relations between the company and all stakeholders that affect or be affected by the company (Hill & Jones, 1992). Such good relations are possible only if there is trust between the involved parties. *Legitimacy theory* also highlights an organization's obligation for not only paying attention to the shareholders' interests but also to the public interest in order to gain legitimacy for its continuity (Deegan &

Rankin, 1997). Furthermore, trust can be obtained when the interests of the parties that influence and are influenced by the company are fulfilled. The quality of corporate governance mechanisms plays a role in building and maintaining the trust of all parties. Interest and trust are crucial in accelerating the company performance. In this context, CSR becomes an effort to fulfill the interests and eventually to gain trust. Based on this theory, there is a positive correlation between the quality of corporate governance and CSR, as well as between the quality of corporate governance and company performance. A good corporate governance system will insist company (manager) for not only focusing on the interests of company owner (shareholders), but also on the interests of all parties that affect and are affected by the company (e.g., creditors, employees, society, particular communities, and customers) (Spitzeck, 2009). Moreover, corporate governance aims to create an added-value for all parties that affect and are affected by the company. Effective corporate governance is expected to increase the company's value (Rustiarini, 2010).

Agency theory explains the separation of the role of principal (owner) and agent (management) will lead to agency problems due to the conflicts of interests between those two parties (Jensen & Meckling, 1976). The greater the difference in interests, the greater the problems that occur in the company, and the more significant it will affect the company performance. Potential agency problems urge the presence of effective control mechanism to balance the interests between owners and management. Corporate governance controls the behavior of management to act in accordance with the interests of the owner. Good corporate governance will protect the interests of owners by minimizing agency problems and improving company performance at once (Riyanto & Toolseman, 2007).

Jo and Harjoto (2012) investigated the relationship between corporate governance, CSR, and company value in the U.S. The study found that company with good corporate governance will disclose CSR information voluntarily, and will obtain a greater value. It shows that CSR mediates the relationship between corporate governance and company performance. Therefore, the present study attempts to test this relationship in a developing country, i.e., Indonesia. According to Tsamenyi, Enninful-Adu, and Onumah (2007), the disparities in characteristics between the developed and developing countries potentially lead to different models of corporate governance relations. Ainy (2016) has examined the relationship between corporate governance, environmental responsibility, and company value in Indonesia, but the findings do not find any relationship between corporate governance, environmental responsibility, and company value. The study, however, did not entail corporate governance in a whole. Instead, it only focused on concentrated ownership and audit quality as the measures of corporate governance, and on environmental accountability. The preset study attempts to fill the gap by examining both the direct and indirect relationships of CG, CSR, and company performance using measurements of the quality of corporate governance and CSR in overall.

Relationship between the Quality of Corporate Governance and CSR

Stakeholder theory emphasizes the importance of building up good relations between the company and all stakeholders that affect or be affected by the company (Hill & Jones, 1992). Stakeholders are, in fact, important since they influence the goal and operational activities. The underlying aspect of *stakeholder theory* is the need for companies to manage relationships with all parties that affect and are affected by the achievement of company's goals (Donaldson & Preston, 1995; Jones, 1995). Meanwhile, *legitimacy theory* describes the relationship between the company and the parties that affect and are affected by the company. *Legitimacy theory* affirms that the inseparable link between company and social context; the company has a social contract with the environment and its surroundings (Holder-Webb, Cohen, Nath, & Wood, 2009). A good relationship between the company and all parties is resulted from the trust between them. Trust can be created when the interests of all parties and the company's social contract with the surrounding environment are fulfilled. In this process, corporate governance (CG) has a vital role. Good CG will likely build and maintain the trust of those who affect and are affected by the company by ensuring that the company fulfills its obligations to them (Stuebs & Sun, 2015).

CSR is an effort of a company to gain trust; CSR is a form of fulfillment of social contract and the interests of all parties that affect and are affected by the company. Stuebs and Sun (2015) provided evidence about the positive interaction between CG and CSR. The study found that companies owning good corporate governance also had better CSR performance. Another study revealed that CG affected the disclosure of information. The more effective of the CG, the more likely the company to disclose information, both mandatory and voluntary, including CSR information (Bokpin & Isshaq, 2009; Lakhal, 2005; Rao, Tilt, & Lester 2012).

H_1: The quality of corporate governance positively affects the corporate social responsibility.

The Relationship between the Quality of Corporate Governance and Company Performance

Agency theory explains the separation of the role of principal (owner) and agent (management) will lead to agency problems due to the conflicts of interests between those two parties (Jensen & Meckling, 1976). The greater the difference in interests, the greater the problems that occur in the company, and the more significant it will affect the value of the company. Due to the potential of agency problems, a quality control mechanism is required to balance the interests of owners and management. Good corporate governance will protect the interests of shareholders (owners) by minimizing agency problems and enhancing company value (Riyanto & Toolseman, 2007). Good CG will establish a control system for management actions/behaviors thereby minimizing agency problems and enhancing trust. Briefly, a qualified CG structure will help reduce agency conflicts that may occur (Dey, 2008).

Siallagan and Machfoedz (2006) suggest the implementation of good CG as the mechanism to control agency costs and increase company value. Several studies have discussed the role of CG on company performance. Brown and Caylor (2009) and Klapper and Love (2002) have claimed that CG improves company performance. In addition, Silveira and Barros (2009) also revealed the influence of CG on the market value of the company.

H_2: The quality of corporate governance positively affects the company value.

The Relationship between CSR and Company Performance

According to the *stakeholder theory*, companies have to provide benefits for shareholders as company owners, and also for parties that affect and are affected by the company. CSR is the effort carried out by the company to fulfill those benefits (Freeman & Phillips, 2002). Meanwhile, *legitimacy theory* emphasizes the company's social contract to the community and the surrounding environment. The company must fulfill it in order to obtain legitimacy or social support. This support means that the trust achieved by the company. CSR is a form of corporate responsibility for social contracts to gain support and public trust, so that it can have an impact on company performance.

Essentially, company performance is an economic measurement that reflects the overall business value allocated to shareholders and bondholders (Malik, 2014). Previous studies reveal that companies that disclose CSR information voluntarily have greater company value than those that do not (Al-Tuwajiri, Christensen, & Hughes, 2004; Jo & Harjoto, 2011/2012). A meta-analysis of the relationship between CSR and company value has been carried out by Moser and Martin (2012). The study concluded that CSR had a positive effect on company value.

H_3: CSR positively affects company performance.

The Relationship between the Quality of CG, CSR, and Company Performance

Agency theory underlines corporate governance as an effective mechanism to reduce agency problems so that it can have an impact on increasing the value of the company. Jo and Harjoto (2012) reaffirmed the stakeholder theory by showing corporate CSR as an extension of effective (good) corporate governance that secures the sustainability of the company with accountable and transparent business practices, and meets the interests of all parties that affect and are affected by the company. It indicates that CSR is able to mitigate the conflicts of interest within the company; it is a device for resolving internal conflicts of interest (stakeholder-theory-based conflict resolution explanation) (Jo & Harjoto, 2012). CSR is also viewed as the company's effort to provide benefits to all parties and fulfillment of social contracts to gain trust. The positive relationship between the quality of CG and CSR has an impact on improving company performance. A good CG is likely to support CSR (Rao et al., 2012), reducing the conflicts of interest within the company (Shleifer & Vishny, 1997) and improving the value of the company (Tsamenyi et al., 2007).

H_4: CSR mediates the quality of corporate governance on company performance.

Methodology

The population of the present study was all companies listed on the 2016 Indonesia Stock Exchange (IDX). The samples were the top 100 manufacturing companies in 2016 listed on the Indonesian Stock Exchange. The sampling technique was purposive sampling with the criteria as follows:

1. Samples are listed as issuers on the 2016 IDX manufacturing sector.
2. Samples provide an annual report by the end of December 2016.
3. Samples are included in the top 100 companies in manufacturing sector.

The secondary data were also involved for the analysis. They covered the data of CG, CSR, and company value from manufacturing companies listed on the 2016 Indonesia Stock Exchange (IDX). The data were in the form of quantitative data obtained from the samples' annual report and Indonesia Capital Market Directory (ICMD) for 2017 period.

The present study examines the direct and indirect relationship between the quality of CG, CSR, and company performance. Indirect effects is predicted from the effect of independent variable (the quality of CG) on the dependent variable (company performance) mediated by CSR as the mediator (Preacher, Rucker, & Hayes, 2007). The causal steps method developed by Baron and Kenny (1986) is used to test the mediation effect hence three regression equations are established and then tested with multiple regression analysis using *Eviews* statistical analysis tools. The equations are as follows:

$$CSR=i_1+a\ CG+\varepsilon_1 \quad (1)$$
$$P=i_2+c\ CG+\varepsilon_2 \quad (2)$$
$$P=i_3+c'\ CG+b\ CSR+\varepsilon_3 \quad (3)$$

CSR Corporate social responsibility, which is measured by using indicators from the Global Reporting Initiative (GRI) G4 guideline. The disclosure of each item in CSR on the company's annual report, and/or ongoing reports, and/or website is scored 1, while the non-disclosure is scored 0. The score of each item will be added to obtain the total score.

CG The quality of corporate governance, which is measured by using indicators from FCGI. The implementation of each item of CG is scored 1 while it is scored 0 if it is not implemented.

P The company performance measured using ROA.

Resuls and Discussion

Descriptive statistics provide an overview of the distribution of data in the tested variables. The samples were the top 100 manufacturing companies listed on the 201 Indonesia Stock Exchange (IDX). The descriptive statistics of variables is presented in Table 1.

Table 1. Descriptive Statistics

Var	N	Min	Max	Mean	Std. Dev
CG	100	.569	.928	804	.083
CSR	100	.088	.495	.250	.089
P	100	-17.4	29.5	4.21	8.242

The results of the descriptive statistics indicate that the values of CG and CSR of the samples are relatively diverse. It possibly occurs due to the absence of CG and CSR standards in Indonesia.

Table 2. Result of Regression Analysis H_1

Variable	*Predicted Sign*	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
C		.217	.095	2.289	0.012**
CG	+	.142	.107	1.322	0.095*
Control Variable					
DEBT		-.098	0.044	-2.244	0.014**
LIQUIDITY		-.025	0.012	-2.075	0.020**
N	100				
R-squared	.076				
Adjusted R-squared	.048				
F-statistic	2.647				
Prob(F-statistic)	.054*				

CG is the quality of corporate governance assessed based on FCGI, score 1 for each "yes" and 0 for each "no" response. DEBT is a ratio that shows the amount of debt compared to total equity. LIQUIDITY is a ratio that shows the company's ability to fulfill its short-term obligations.
*** significance level of 0.01
** significance level of 0.05
* significance level of 0.1.

H_1 supported if the coefficient of CG is positive and significant. The output of the regression analysis in Table 2 shows that CG has a positive and significant effect on the disclosure of CSR. The implementation of effective (good) CG in a company encourages the company to fulfill the interests of all parties that affect and are affected by the company, including to disclose CSR information voluntarily. The result confirms Stuebs and Sun (2015) in which the CSR of a company is better when the company has better corporate governance.

Table 3. Result of Regression Analysis H_2

Variable	*Predicted Sign*	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
C		13.618	7.859	1.732	0.043**
CG	+	-8.346	8.877	-.940	0.174
Control Variable					
DEBT		-9.994	3.619	-2.761	0.003***
LIQUIDITY		1.912	.992	1.928	0.028**
N	100				
R-squared	.256				
Adjusted R-squared	.233				
F-statistic	11.034				
Prob(F-statistic)	.000***				

CG is the quality of corporate governance assessed based on FCGI, score 1 for each "yes" and 0 for each "no" response. DEBT is a ratio that shows the amount of debt compared to total equity. LIQUIDITY is a ratio that shows the company's ability to fulfill its short-term obligations.
*** significance level of 0.01
** significance level of 0.05
* significance level of 0.1.

H_2 is supported if the coefficient of CG is positive and significant. The result indicates the CG insignificantly affects the company performance. This finding opposes both *stakeholder theory* and *agency theories that emphasize* the implementation of good corporate governance will ensure the establishment of good relations and maintain the trust of all parties that affect and are affected by the company. It is possibly caused by the inappropriate assessment of the quality of corporate governance carried out in this study. In Indonesia, there are several official institutions that develop measurement for the corporate governance index, including the Indonesian Institute for Corporate Governance (IICG) with its Corporate Governance Perception Index (CGPI), and the International Finance Corporation (IFC) in collaboration with the OJK with its Indonesia Corporate Governance Manual published in 2014.

The Corporate Governance Roadmap (OJK, 2014) explains that the assessment of the implementation of corporate governance in Indonesia has been carried out by three international institutions. The World Bank and the International Monetary Fund (IMF) assess the implementation of the principles of corporate governance in Indonesia compiled by the Organization for Economic Co-operation and Development (OECD). The second institution is the Credit Lyonnais Securities Asia (CLSA) in collaboration with the Asian Corporate Governance Association (ACGA), which periodically conducts a survey of corporate governance practices in Asia (including Indonesia) and publishes the results in the Corporate Governance Watch. The last is the ASEAN Capital Market Forum (ACMF) that publishes the ASEAN Corporate Governance Scorecard (ASEAN CG Scorecard)—which aims to measure and improve the effectiveness of the implementation of the corporate governance principles.

Several indices that can be used to assess the implementation of corporate governance in Indonesia accompanied by the absence of regulation to apply a particular index are the reason for the insignificant effect of CG on company performance. It can be a consideration for further studies for using another measurement index.

Table 4. Result of Regression Analysis H_3

Variable	*Predicted Sign*	Coefficient	Std. Error	t-Statistic	Prob.
C		9.987	7.946	1.257	.106
CG	+	-10.716	8.819	-1.215	.114
CSR	+	16.689	8.309	2.008	.023**
Control Variable					
DEBT		-8.355	3.655	-2.286	.012**
LIQUIDITY		2.328	.998	2.331	.011**
N	100				
R-squared	.287				
Adjusted R-squared	.257				
F-statistic	9.546				
Prob(F-statistic)	.000***				

CG is the quality of corporate governance assessed based on FCGI, score 1 for each "yes" and score 0 for each "no" response. CSR is the score of corporate social responsibility measured based on GRI index, score 1 for a disclosed information and score 0 for non-disclosed information. DEBT is a ratio that shows the amount of debt compared to total equity. LIQUIDITY is a ratio that shows the company's ability to fulfill its short-term obligations.

*** significance level of 0.01

** significance level of 0.05

* significance level of 0.1.

H_3 is supported if the coefficient of CSR is positive and significant. The results show that CSR variables have a positive and significant effect on company performance, H_3 is supported. The result of this study reaffirms previous studies in which the companies that disclose CSR information are inclined to have better value and performance (Jo & Harjoto, 2011/ 2012). The increased company value is a result of the high public trust. It is in accordance with the *legitimacy theory*: companies must have legitimacy from the market (society) in order to maintain their operational activities.

The indirect relationship between the quality of CG and company performance (H4) has not been tested since the quality of CG has insignificant effect on company performance (H4 is not supported).

Conclusion, Recomendation, and Research Limitation

The findings of this study indicate the effect of the disclosure of corporate social and environmental responsibility (CSR) on company performance. A company is motivated to disclose CSR information due to its willingness to fulfill the interests of all parties that affect and are affected by the company. The disclosure of CSR is a positive signal for the market that the company has fulfilled the interests of all parties. It also shows effective or good corporate governance encourages companies to both compulsory and voluntary, disclose information.

Nevertheless, his study has not been able to prove the effect of corporate governance on company performance. In Indonesia, there are several organizations that develop the measurement of effective corporate governance. It is the possible reason for the insignificant effect of corporate governance on the company performance. However, the absence of the effect of corporate governance on the company performance means that this study has not been able to prove the role of CSR as a mediator in the relationship.

The role of CSR has not been identified due to the lack of uniform CSR reporting standards. Despite the government has issued regulations related to CSR activities for companies listed on the Indonesia Stock Exchange (IDX), yet there is no basic and uniform standard for disclosing CSR activities. Nevertheless, this study can be valuable for policy-makers in considering the importance of CSR reporting standard.

Furthermore, this study has several limitations. *First*, it merely includes a single reporting period as a research sample. *Second*, this study merely uses the FCGI template to assess the quality of corporate governance and the ROA to assess the company performance. It is recommended for subsequent studies to involve more samples as well as other variable measurements.

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