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Does Corporate Social Responsibility Shape the Relationship between Corporate Governance and Financial Performance?

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Abstract: The correlation between theoretical and empirical of corporate governance (CG) and corporate financial performance (CFP) is not there without controversy. This paper aims to determine the moderating effects of corporate social responsibility (CSR), on the relationship between corporate governance and corporate financial performance. The sample of this research are banking companies that are listed on Indonesia Stock Exchange between the period of 2010-2014, taken by using purposive sampling method. Moderated Regression Analysis (MRA) analysis was used in this study. The results of this study indicate that corporate governance affects the company's financial performance positively. Aspects of corporate governance such as audit committees and number of board meetings have a positive relationship with financial performance, but there is no relationship from the aspect of independent board of commissioners. Furthermore, CSR can only strengthen the positive relationship between the number of board of commissioners' meetings and the financial performance of the company. The frequency intensity of board of commissioners' meetings can increasingly address corporate governance reforms by improving and realizing social responsibility as part of sustainability innovation by optimizing media and CSR reporting methods.

Keywords: corporate social responsibility, corporate financial performance, corporate governance, Indonesia.

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Introduction

A company's financial performance is heavily affected by how serious the company incorporating good corporate governance (GCG). Corporate governance (CG) has been a popular topic of discussion within the developed and developing countries. CG, as defined by Claessens & Yurtoglu (2013), is a set of mechanism which designed and adopted to control the decisions and management activities to improve company's performance, its market value and its resources in a positive way.

Company adopts CG to ensure corporate accountability to shareholders and to improve the transparency of its financial statements (Tariq & Abbas, 2013). According to Wahyudin & Solikhah (2017) stated that after the crisis in mid-1997 in Asian countries, including in Indonesia, awareness of the importance of corporate governance has been increasing.

Referring to the agency theory which is the basis for corporate governance, there is a conflict of interest between principal and agent (Jensen & Meckling, 1976). In implementing good corporate governance, it is necessary to meet the trust of the community and the international world as an absolute requirement for the company to be able to have a good and healthy growth to achieve the ultimate goal, which is to improve financial performance.

According to Outa & Waweru (2016) adherence to the CG Index, which covers all of all CG guidelines, positively and significantly related to firm performance. The findings indicate that CG guidelines are related to the company's financial performance. Siagian et al. (2013) in one of their studies reported the companies implemented better CG, had higher scores. Subramanyam & Dasaraju (2014) also supported the theoretical argument that the CG disclosure improve corporate financial performance (CFP).

Study Malik & Makhdoom (2016) found a strong positive relationship between corporate governance and company performance. Findings on Bhatt & Bhatt (2017) shows that company performance is positively and significantly related to corporate governance. Abdallah & Ismail (2017) shows a positive relationship between governance and performance. Empirical research by Kusmayadi (2012) shows that partially good corporate governance has a positive and significant effect on performance. This means that good corporate governance is the main instrument of an entity in achieving good performance.

Results from the study by Ghosh (2017) shows that even though corporate governance reform itself is not very effective, the impact on profitability can be felt when some characteristics of corporate governance are added to the consideration. Whilst Caesari et al. (2016) found CG and CFP has a negative relationship. This means that the implementation of CG resulted in a decrease in the company's financial performance.

Some studies showed there is no relationship between corporate governance and corporate financial performance, take research conducted by Siahaan (2013) as an example, it says that the implementation of GCG has no effect on Return On Assets (ROA). The most recent study conducted by Shahwan (2015) did not find a significant relationship between CG investigative practices and company performance.

The relationship between corporate governance and corporate performance are always measured using one or more variables of corporate governance mechanisms. Different researchers have used different variables to explain corporate governance settings.

One of the problems in the implementation of corporate governance is allegedly the existence of a CEO that has greater strength than the board of commissioners. With independent commissioners, it is expected that executives will act in the interest of the owner (Honggowati et al., 2017). Research on the impact of the independence of the board of commissioners on the performance of the company is done by Bhagat & Bolton (2013) using independent commissioner as a key mechanism for evaluating the relationship of corporate governance and company performance. In a more recent paper, Liu et al. (2015); Black et al. (2015) reported a positive correlation between board independence and improved business performance. While Nguyen et al. (2017) found that the percentage of independent directors on the board was significantly and negatively related to firm performance measured by ROA. Empirical research by Widhianningrum & Amah (2012) also shows that partially independent commissioners variables have a negative effect on the company's financial performance. Meanwhile, analysis by Borlea et al. (2017) failed to show any statistically significant relationship between the independence of the directors and the performance shown by ROA.

Independent commissioners establish audit committees in carrying out supervisory functions on the performance of the company, hence it is expected that the supervisory function will be more optimal (Rahmawati et al., 2017). Establishing an audit committee is a way to solve agency problems. Previous studies have found mixed results in the relationship between audit committees and financial performance. Audit

Committee is a supervisory mechanism that can improve the financial performance of banking companies (Suteja & Gunardi, 2016). Results from paper by Salloum et al. (2014) is an added value to corporate governance in banking companies and demonstrates the importance of the audit committee's impact on financial performance. Audit committee size found Al-Matari et al. (2012) to have a significant relationship with the performance of the company, but it went against what expected. The activities of the audit committee also show a significant relationship with the company's performance in a nonlinear manner (Sarpal, 2017). On the other hand, audit committee size is found to have no effect on financial performance (Herdjiono & Sari, 2017). Results from paper by Borlea et al. (2017) concluded that having an audit committee to assist board activities does not necessarily imply significant performance improvements.

This study also estimates the impact of board of commissioners' meetings frequency, as measured by the frequency of meetings each year on the company's financial performance. The academicians found to have both positive and negative opinion regarding the frequency of meetings and the presence of board of commissioners. They agreed on the importance of frequent board meetings as a proxy of corporate governance mechanisms (Karamanou & Vafeas, 2005); (Ntim & Osei, 2011). Findings from the research by Al-Daoud et al. (2016) showed that there are positive correlation between frequency of board meetings and company performance. The more frequent the director’s meetings represent the higher ability to monitor their engagement and larger discussions lead to better decisions that improve performance. Conversely, study conducted by Malik & Makhdoom (2016) concluded that the frequency of board meetings is inversely proportional to firm performance. Mardiyati (2016) also found the frequency of board meetings to have a negative and significant impact on the performance of the company.

Furthermore, part of the sustainability innovation in corporate governance (CG) reform around the world is improving and supporting in the realization of social responsibility (CSR). The relationship between CSR and CFP is still debatable (Chen & Wang, 2011). Whether CSR can increase, decrease, or even not related at all to the value of the company (Jo & Harjoto, 2011). Jo & Harjoto (2011) who conducted research to prove the relationship between CSR and CFP concluded that CSR activities can improve the company's performance as long as the company does not over-invest in CSR activities. Research done by Caesari et al. (2016) found otherwise, that the disclosure of CSR has an effect on decreasing the company's financial performance. This can be because CSR is not allocated appropriately, or is wrong in choosing media and reporting methods.

In general, a well-known reporting standard for implementing CSR is the Global Reporting Initiative (GRI). In recent years, GRI has outlined guidelines for preparing social reports or sustainability (Asmeri et al., 2017); (Gunardi et al., 2016). GRI develops reporting guidelines using a global consensus search process that involves both the company as the reported organization, and also the user of the report such as employees and investors (Galani et al., 2012).

Choosing the banking system as a framework for the research cannot done arbitrarily. The banking industry in Indonesia is currently growing quite rapidly (Suteja et al., 2016), coupled with CSR practice disclosure issues have become increasingly prominent in social accounting and corporate governance. The activities of banking companies, such as lending and investment policies, can be considered equally environmentally sensitive when compared to the direct impact of firms in polluting industries. According to Branco & Rodrigues (2006) banks can report what they do to ensure that their lending and investment policies do not facilitate industrial activities that are harmful to the environment. On the other hand, financial institutions consume large amounts of resources, such as paper and energy, and create waste (Rokhmawati et al., 2017). Therefore, policies on how they contribute to energy management and natural resources and recycling activities are important aspects of their social responsibility activities (Khoiruman & Haryanto, 2017); (Rokhmawati & Gunardi, 2017).

The purpose of this study is to obtain empirical evidence that CG affect the financial performance of the company and CSR is a moderating variable between CG and corporate financial performance. The results of this study are expected to contribute to the development of theory, particularly on corporate governance, CSR, and its consequences to the financial performance of the company. The findings of this study are also expected to provide benefits in providing input to users of financial statements, sustainability reports, and corporate managers in understanding the relationship between corporate governance, CSR, to improve corporate financial performance.

Methods

The population in this study are all banking companies listed on the Indonesia Stock Exchange (BEI). Samples in this research are gathered using nonprobability sampling technique with purposive sampling method. The criteria used to determine the sample are: 1) The banking company listed on the BEI and publish the audited financial statements from 2010-2014 consistently and completely. 2) The period of financial statements ends on 31 December. 3) The company includes CSR disclosures in annual reports as well as sustainability reports from 2010-2014. Based on these criteria, 15 banking companies are chosen.

The dependent variable in this research is the company's financial performance. Management can measure the company's financial performance and assess its operational performance in utilizing the company's resources by considering the issue of asset financing using the Return on Assets. The measurement of the firm's financial performance with ROA shows the capability of the invested capital in its total assets to generate profit (Borlea et al., 2017).

The moderating variable used in this research is Corporate Social Responsibility. The CSR is measured by the proxy of the Corporate Social Responsibility Index (CSRI) based on the Global Reporting Initiative indicator. The Corporate Social Responsibility Index is assessed by comparing the number of disclosures made by the company with the amount of disclosures required in GRI G3.1 covering 79 disclosure items. GRI is divided into several categories of disclosure covering environmental, human rights, labor practices and decent work, society, product responsibility, and economic. The CSRI measurement uses the content analysis method, which is a method of codifying text from the same characteristics to be written in different groups (categories) depending on certain criteria (Galani et al., 2012).

Based on the understanding of previous researches, we have looked at corporate governance from a various perspectives of independent variable. Refining the previous studies, variable measurement proxies were added. To assess corporate governance, researchers added independent proxy commissioners, audit committees, and number of board meetings. The current study will use a percentage of independent commissioners compared to the total number of commissioners as independent commissioners' proxy (Widhianningrum & Amah, 2012). The current study will use the number of audit committees the company has as a measure of the audit committee (Herdjiono & Sari, 2017). The frequency of meetings of the board of commissioners is measured by the number of meetings of the board of commissioners held during the calendar year (Mardiyati, 2016).

To test the relationship between research variables Moderated Regression Analysis (MRA) model is used. MRA is a regression model by testing interaction between variables. This regression model is a specialized application of multiple linear regression which in the regression equation contains an element of interaction (multiplication of two or more independent variables). This research model consists of 2 (two) equations, that are.

$ROA = \alpha 0 + \beta 1 INDEP + \beta 2 AUDIT + \beta 3 FREQ + \varepsilon$ … (Model 1)

$ROA = \alpha 0 + \beta 1 INDEP + \beta 2 AUDIT + \beta 3 FREQ + \beta 4 CSRI + \beta 5 INDEP*CSRI + \beta 6 AUDIT*CSRI + \beta 7 FREQ*CSRI + \varepsilon$ … (Model 2)

Gloss:

ROA	=	Return on Assets
α	=	Constant
β1-β7	=	Regression Coefficient
INDEP	=	Independent Commissioner
AUDIT	=	Audit Committee
FREQ	=	Frequency of Meetings of the Board of Commissioners
CSRI	=	Corporate Social Responsibility Index
INDEP*CSRI	=	Interaction between INDEP and CSRI
AUDIT*CSRI	=	Interaction between AUDIT and CSRI
FREQ*CSRI	=	Interaction between FREQ and CSRI
ε	=	standard error

Results and Discussion

The classical assumption test is performed before the MRA model is feasible to use. There are four assumptions that must be met, which are assumption of normality, multicollinearity, heteroscedasticity, and autocorrelation. Based on the test results can be concluded that all these classical assumptions have been met and no serious problems.

The results of the test from the first model (Table 1), the F test were used to simultaneously test INDEP, AUDIT, and FREQ meanings of ROA. Based on Table 1 we can see the value of Sig. F is less than 0.01, which means INDEP, AUDIT, and FREQ simultaneously affect the ROA. The t test is used to determine INDEP, AUDIT, and FREQ effects individually on ROA. Based on the results in Table 1 can be seen how much influence INDEP, AUDIT, and FREQ to ROA. Effect of INDEP on ROA, it can be seen that the t value at INDEP is 0.317 and has a significance level of 0.752 greater than alpha 0.01. This means INDEP has no positive effect on ROA. The effect of AUDIT on ROA, can be seen t AUDIT value of 3.696 and has a significant level of 0.000, which is less than alpha 0.01. This means that AUDIT has a positive effect on ROA. The effect of FREQ on ROA, can be seen t FREQ value of 6.493 and has a significance level 0.000 less than alpha 0.01. This means that FREQ has a positive effect on ROA. Results from the first model test (Table 1) showed that the R square has the value of 0.509 or 50.9%. This means that 50.9% of the ROA variance can be explained by INDEP, AUDIT, and FREQ. While the remaining 49.1% is explained by other variables not included in the model.

Based on Table 1 in this second model can be seen that the value of Sig. F is less than 0.01, which means INDEP, AUDIT, FREQ, and CSRI as moderators simultaneously affect ROA. The t test on the second model in this research is used to find out about the influence of CSRI in moderating INDEP, AUDIT, FREQ influence on ROA. Based on the results in Table 1 it can be seen that CSRI cannot moderate the effect of INDEP on ROA. This means that CSRI within a company does not have an impact on INDEP's influence on ROA. CSRI cannot moderate AUDIT influence on ROA. This means that CSRI within a company does not affect the effect of AUDIT on ROA. CSRI can moderate the effect of FREQ on ROA. This means that CSRI within a company gives impact to the influence of FREQ on ROA.

Table 1 also shows the R-Square value of the results of the second model test, i.e. 0.540 or 54.0% which means that 54.0% ROA variance can be explained by INDEP, AUDIT, FREQ, and CSRI as moderators. While the remaining 46.0% is explained by other variables not included in the model. The value of R-Square in model 2, after the inclusion of CSR as a moderator increased contribution.

Table 1 Results Moderated Regression Analysis (Dependent Variable: ROA)

Variable	Model 1			Model 2		
	Coefficient	t	Sig.	Coefficient	t	Sig.
(Constant)	-0.130	-0.314	0.755	-4.484	-2.407	0.019
INDEP	0.048	0.317	0.752	-0.171	-0.137	0.892
AUDIT	0.308	3.696	0.000*	1.848	1.822	0.073***
FREQ	0.043	6.493	0.000*	1.203	3.070	0.003*
CSRI				-1.885	-1.509	0.136
INDEP*CSRI				0.125	0.177	0.860
AUDIT*CSRI				0.383	0.593	0.555
FREQ*CSRI				0.602	2.064	0.043**
R	0.714			0.735		
R square	0.509			0.540		
F	24.581			15.604		
Sig.	0.000*			0.000*		

* significant at level 1%, ** significant at level 5%, *** significant at level 10%

The results of the first model testing showed no evidence of INDEP positive effect on ROA. The results of this study support the research by Borlea et al. (2017) that INDEP has no effect on ROA. This study proved that independent commissioners can have positive and insignificant effect on ROA, because the existence of independent commissioner in company is just a matter of formality and just to fulfill regulation. Therefore, the existence of independent commissioner has no meaningful part in running good monitoring function and do not use its independence to oversee the policies of the board of directors that ultimately have no effect on performance.

AUDIT has a positive influence on ROA in line with research by Suteja & Gunardi (2016) and Salloum et al. (2014). Audit Committee is a supervisory mechanism that can improve the financial performance of banking companies. The audit committee is also a plus for corporate governance in banking companies and demonstrates the importance of the audit committee's impact on financial performance. Thus, the existence of an audit committee within the company as a controlling mechanism in the preparation of financial statements has affected on the improvement of the company's financial performance can be justified.

The positive effect on ROA occurs when the company has agreed on the importance of the frequency of meetings of the board of commissioners. These results are consistent with Karamanou & Vafeas (2005); Ntim & Osei (2011); Al-Daoud et al. (2016) shows that a positive relationship between the frequency of meetings of the board of directors and the performance of the company. With more meetings demonstrating the ability of higher board of commissioners to monitor their involvement and larger discussions leads to better decisions, thereby improving performance. This is in line with agency theory which suggests that regular board meetings help create solid monitoring and solidarity activities to advise and monitor management and improve better performance.

Based on the results of research the second model can be found not all CG mechanisms can have a significant effect on financial performance after moderated by CSRI. CSRI cannot moderate INDEP and AUDIT influence on company performance. Only the frequency of meetings of the board of commissioners can strengthen the positive and significant impact on financial performance.

This means that CSRI within a company can only reinforce the impact on the frequency of meetings of the board of commissioners on the performance of the company. These results support the research (Jo & Harjoto, 2011). The frequency intensity of board of commissioners' meetings can increasingly address corporate governance reforms by improving and realizing social responsibility as part of sustainability innovation (Jones et al., 2017) by optimizing media and CSR reporting methods.

Banks can report what they are doing to ensure that their lending and investment policies do not facilitate industrial activities that are hazardous to the environment and waste pollution, thereby strengthening the occurrence of an increase in ROA (Branco & Rodrigues, 2006).

Conclusion

CG and CFP have a positive and significant influence on financial performance when there is AUDIT and FREQ. This means that the implementation of CG resulted in the improvement of financial performance of banking companies. However, in this study the size of the CG application is measured only in terms of quantity, not measuring in terms of quality. For example, a large independent commissioner does not indicate a better CG implementation. This is because independent commissioners adjust the size and complexity of the company.

In addition, CSR activities should also be reported with appropriate media and methods. For that reason, companies should make careful planning in the implementation of CSR to ensure that their lending and investment policies do not facilitate industrial activities that are harmful to the environment and waste pollution. Increased corporate financial performance is also not seen because of the influence of CG and CSR alone. There are still many other factors to watch out for. Therefore, if the company wants to improve its financial performance, the company must implement other strategies such as sustainability innovation and continuous improvement.

Based on the research that has been done, this research has some suggestions for the next research, namely: 1) It is recommended that the analysis is taken the addition of new periods to provide more reliable results. 2) It is advisable to extend the sample variety, not only limited to companies grouped as banking companies, and included companies from other developing countries in ASEAN to obtain similarities and differences. 3) It is recommended to update corporate social responsibility disclosure items by using corporate social responsibility index based on GRI Sustainability Reporting Standards 2016.

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