CORPORATE SOCIAL RESPONSIBILITY MEDIATES CORPORATE GOVERNANCE INDEX AND FINANCIAL PERFORMANCE IN INDONESIA

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ABSTRACT

The aim of this study is to investigate the impact in Indonesia between: (a) the Indonesian Index of Corporate Governance, (b) corporate social responsibility, and (c) financial performance. The sample is companies in the Indonesia Institute for Corporate Governance (IICG). This study uses secondary data from the annual reports from 2014 to 2016. Our first result shows a significant impact between corporate governance and financial performance. Our second result shows that corporate governance has a significant effect on corporate social responsibility. However, our final result shows that corporate social responsibility does not significantly affect financial performance. Regulation by the government, namely the Indonesian Index of Corporate Governance (IICG), which is currently voluntary, in the future may become compulsory. There are two limitations of this study. The first limitation is that not all companies joined Indonesian Institution for Corporate Governance (IICG). The second limitation is that corporate social responsibility apparently does not mediate between index of corporate governance and financial performance.

Keywords: Indonesia Index of Corporate Governance, Corporate Social Responsibility, Financial Performance.

INTRODUCTION

In Indonesia, there is a Forum for Corporate Governance in Indonesia (FCGI), and also the Indonesian Institution for Corporate Governance (IICG). Companies in Indonesian Institution for Corporate Governance include private companies, state-owned enterprises, and banks. The index of corporate governance results are published nationally and internationally in the SWA magazine[1] and the IICG website[2]. This study used Indonesian Index of Corporate Governance data.

In recent years, research on corporate governance has been increasing in various countries. Corporate governance has become an interesting research topic (Al Mutairi et al., 2012). Previous studies link corporate governance with corporate social responsibility (Khan et al., 2013; Chang et al., 2015; Kabir & Thai, 2017; El-bassiouny & El-bassiouny, 2018; ElGammal et al., 2018; Jouini & Ajina, 2018). Corporate governance has impact corporate social responsibility in Bangladesh (Khan et al., 2013). Corporae governane has significant impact corporate social responsibility from Small Medium Enterprises (SMEs) in the Middle East and North Africa (MENA) countries (ElGammal et al., 2018). El-bassiouny & El-bassiouny (2018) show corporate governance has a positive and significant impact corporate social responsibility from surveyed

203 employees companies of family owned in Lebanon. Corporate governance has relationship with corporate social responsibility from 65 firms in French listed on SBF 120 index for 2010-2014 (Jouini & Ajina, 2018). This topic research is world-wide: Europe (Dam & Scholtens, 2012); United States (Boulouta, 2013); Bangladesh (Khan et al., 2013); Korea (Chang et al., 2015); France (Jouini & Ajina, 2018); Lebanon (El-bassiouny & El-bassiouny, 2018); the Middle East and North Africa (MENA) countries (ElGammal et al., 2018).

The impact between corporate social responsibility and financial performance is positive (Mcwilliams & Siegel, 2000; Soana, 2009; Belu & Manescu, 2013; Ntim & Soobaroyen, 2013; Erhemjamts et al., 2013; Elouidani & Zoubir, 2015; Boonnual et al., 2017; Galant & Cadez, 2017). Sample from 291 non-financial companies from Johannesburg Stock Exchange (South African the period 2002 to 2009 showed the positive impact between corporate social responsibility and financial performance (Ntim & Soobaroyen, 2013). Boonnual, Prasertsri, & Panmanee (2017) the data from 394 companies in Thailand Stock Exchange on 2014, showed that corporate social responsibility related to firm performance (Return on Assets). Galant & Cadez (2017) showed the influence between corporate social responsibility and financial performance. However, corporate social responsibility does not impact financial performance (Mcwilliams & Siegel, 2000; Soana, 2009). Belu & Manescu (2013); Elouidani & Zoubir (2015) showed a negative impact between corporate social responsibility and financial performance.

Studies on the impact between corporate governance and financial performance include (Bhatt & Bhatt, 2017; Wahyudin & Solikhah, 2017). Bhatt & Bhatt, 2017; showed Malaysia Corporate Governance Index has a positive impact financial performance, sample from 113 listed firms in Malaysia. Wahyudin & Solikhah (2017) showed corporate governance index has a positive and significant impact financial performance, the data period 2008-2012 in Indonesia.

This study focuses on investigating the impact between corporate social responsibility, the Indonesian Index of Corporate Governance, and financial performance in Indonesia. Thus increasing growth can be maintained continuously so companies need to implement strategies in accordance with conditions to improve company performance, one of them is financial performance. The principles of corporate governance have a goal to provide an increase in the performance of a company so that the company can survive in a long period of time. It is important to investigate the role of corporate governance index especially impact on corporate social responsibility and also the financial performance for those companies.

LITERATURE REVIEW

Index of Corporate Governance

Ratings by the Indonesian Institution for Corporate Governance (IICG) improve voluntary disclosure among firms. The iinstitution itself was established on 2nd June 2000 by the Transparency Society of Indonesia and community leaders to promote good Corporate Governance (GCG) concepts, practices, and benefits (Tables 1 & 2). The institution is one of Indonesia's many steps towards a reliable, ethical and dignified business atmosphere (Wahyudin & Solikhah, 2017).

Table 1
LEVEL AND SIZE OF CORPORATE GOVERNANCE INDEX AWARDS

Level	Size (%)
Self-Assessment	17

Table 1
LEVEL AND SIZE OF CORPORATE GOVERNANCE INDEX AWARDS

Document Evaluation	35
Paper reviews	13
Company observation by visit	35
Total	**100**

Table 2
ASSESSMENT CATEGORY OF CORPORATE GOVERNANCE INDEX AWARDS

Score	Category
55 to 69.99	Just Trusted
70 to 84.99	Trusted
85 to 100	Most trusted

Development of Hypotheses

Corporate governance index and corporate social responsibility

Freeman (1983) on stakeholder theory states that companies should use corporate social responsibility as an extension of effective governance to solve conflicts between managers and non-investment stakeholders. Previous research positively links governance and social responsibility (Dam & Scholtens, 2012; Boulouta, 2013; Hafsi & Turgut, 2013; Khan et al., 2013; Chang et al., 2015; Kabir & Thai, 2017; El-bassiouny & El-bassiouny, 2018; ElGammal et al., 2018; Jouini & Ajina, 2018). Governance hinges on the board's, and the owners', gender, experience, and hidden (or overt) prejudice. The studies cited above show the index's effect on corporate social responsibility (Arora & Dharwadkar, 2011; Harjoto & Jo, 2011; Jo & Harjoto, 2012). The first hypothesis is that:

H1: The corporate governance index affects corporate social responsibility.

Corporate Governance index and financial performance

The agency problem in the relation between the agent and the principal may arise in the form of a moral hazard; this is on agency theory (Jensen & Meckling, 1976). In addition, Wahyudin & Solikhah (2017) find that GCG maintains the credibility of the company. Thus, as GCG increases, so does financial performance.

Bhatt & Bhatt (2017) in Malaysia and Wahyudin & Solikhah (2017) in Indonesia show that the corporate governance index affects performance. Studies on the impact between corporate governance and financial performance include (Bhatt & Bhatt, 2017; Wahyudin & Solikhah, 2017). Thus, the hypothesis is formulated as follows:

H2: The corporate governance index affects financial performance.

Corporate social responsibility and financial performance

Based on the stakeholder theory, the perspective from agents related to Corporate Social Responsibility argues that if there is no strong control by shareholders, then managers pursue goals that increase their own benefits and decrease shareholder benefits Freeman (1983).

The impact between corporate social responsibility and financial performance is positive (Mcwilliams & Siegel, 2000; Soana, 2009; Belu & Manescu, 2013; Ntim & Soobaroyen, 2013; Erhemjamts et al., 2013; Elouidani & Zoubir, 2015; Boonnual et al., 2017; Galant & Cadez, 2017). The data from Johannesburg (South African) Stock Exchange the period 2002 to 2009 showed the positive impact between corporate social responsibility and financial performance (Ntim & Soobaroyen, 2013). The sample from 394 companies in Thailand Stock Exchange on 2014,showed that corporate social responsibility related to firm performance or Return on Assets (Boonnual et al., 2017). Galant & Cadez (2017) showed the influence between corporate social responsibility and financial performance. However, corporate social responsibility does not impact financial performance (Mcwilliams & Siegel, 2000; Soana, 2009). Belu & Manescu (2013); Elouidani & Zoubir (2015) showed a negative impact between corporate social responsibility and financial performance. Thus, the hypothesis is formulated as follows:

H3: Corporate social responsibility affects financial performance.

RESEARCH METHODS

Research Design

Joining the Corporate Governance Index is voluntary, therefore, only a small number of companies participate. Our data comes from Indonesian Institution for Corporate Governance (IICG). Twenty-four companies are observed from 2014 to 2016.

Secondary Data

We use secondary data from the Indonesian Institution for Corporate Governance (IICG) report, and company financial statements obtained from their official websites.

Definition of Operational Variables

Independent variable

The independent variable of this research is the Indonesian Index of Corporate Governance (IICG). It is based on the Institution on Corporate Governance in Indonesia (Wahyudin & Solikhah, 2017). Wahyudin & Solikhah (2017) used this variable in their research.

Intervening variable

Corporate social responsibility as an intervening variable is measured by the corporate social responsibility index (Haniffa & Cooke, 2005).

Dependent variable

The dependent variable is as in the following (Jouini & Ajina, 2018):

$$ROA = \frac{Net\,\mathrm{Pr}\,ofitAfterTax}{TotalAssets}$$

Analysis Method

The data is analysed by using panel data regression with SPSS software In addition, to investigate the relations between corporate social responsibility, Corporate Governance index and performance, we implemented the following two models.

$$\text{Model 1} \quad CSR = \beta_0 + \beta_1 CG + \varepsilon$$

$$\text{Model 2} \quad FP = \beta_0 + \beta_1 CG + \beta_2 CSR + \varepsilon$$

Where,
CSR=Corporate Social Responsibility.
CG=Corporate governance index.
FP=Financial Performance.

RESULTS AND DISCUSSION

The results of normality testing with the One Sample Kolmogorov Smirnov Test showed the results of Asymp. Sig (2-tailed) of 0.833 which is higher than 0.05 so that the data is normally distributed. The results of calculating tolerance values indicate that all independent variables have a tolerance value of more than 0.10. The results of the calculation of the VIF value also shows that all independent variables have a VIF value<10, so it can be concluded that there are no symptoms of multicollinearity between independent variables. Similarly, the result of a heteroscedasticity test shows that all variables are not significant at 0.01 so it can be concluded that heteroscedasticity does not occur.

The results of regression of the research variable test states that the model summary shows the adjusted R^2 amount of 0.808. This means that 80.8% of the ROA variables can be explained by the variation of the two independent variables namely Corporate Social Responsibility, Corporate Governance Index (100%-80.8%=19.2%) is explained by other causes outside the model (Table 3).

Tabel 3
MODEL SUMMARY

Model 1	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.791[a]	0.625	0.620	0.101
a. Dependent Variable: Corporate Social Responsibility				
Model 2				
1	0.902[a]	0.814	0.808	2.265
a. Dependent Variable: Financial Performance (Return on Asset)				

Based on the test results in Table 4 below, the t value of corporate governance index 10.800 and 10.429 with the probability of both being 0.000. Thus the probability is <0.005 which means there is a significant influence on the first and second hypotheses. However, corporate social responsibility shows a value of 0.248 and a probability of 0.805. This indicates an insignificant influence because the probability value is>0.005.

Table 4
COEFFICIENTS

Model 1		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-1.838	0.220		-8.363	0.000
	CGPI	0.026	0.002	0.791	10.800	0.000
Model 2		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-61.277	6.945		-8.823	0.000
	CGPI	0.929	0.089	0.885	10.429	0.000
	CSR	0.663	2.672	0.021	0.248	0.805

Hypothesis 1: states that the corporate governance index affects corporate social responsibility. This hypothesis is statistically supported by the resulting research, and is accepted. Corporate governance has a significant influence on corporate social responsibility. The finding is consistent with previous research (Arora & Dharwadkar, 2011; Harjoto & Jo, 2011; Jo & Harjoto, 2012).

Hypothesis 2: states that the corporate governance index affects financial performance. This hypothesis is statistically supported by the resulting research, and is accepted. Corporate governance improves financial performance. The finding is consistent and supports the previous research (Bhatt & Bhatt, 2017; Wahyudin & Solikhah, 2017).

Hypothesis 3 states that the corporate social responsibility affects financial performance. The result of the research shows that hypothesis 3 is not statistically supported, so hypothesis 3 is rejected. The result does not support previous findings (Belu & Manescu, 2013; Ntim & Soobaroyen, 2013; Erhemjamts et al., 2013; Elouidani & Zoubir, 2015; Boonnual et al., 2017; Galant & Cadez, 2017), which argue that the corporate social responsibility influence on financial performance. However, this result relevance with (Mcwilliams & Siegel, 2000; Soana, 2009) showed did not significant impact between corporate social responsibility and financial performance

CONCLUSIONS

Good corporate governance affects business competitivity and increases the trust of investors, shareholders and other stakeholders. Corporate social responsibility does not, however, mediate between the corporate governance index and financial performance for companies in Indonesia. Corporate governance affects social responsibility. Corporate governance affects financial performance. However, corporate social responsibility and financial performance do not significantly impact.

This study has theoretical and practical implications. Companies in Indonesian Institution for Corporate Governance (IICG) have policies regarding corporate governance. The government in future can oblige all companies to join Indonesian Institution for Corporate Governance (IICG). With clear rules, all companies can follow and produce a good corporate governance index for their company.

There are two limitations of this study. The first limitation is that not all companies joined Indonesian Institution for Corporate Governance (IICG). The second limitation is that corporate social responsibility apparently does not mediate between index of corporate governance and financial performance. Based on the second limitation is that the framework needs other variables, for instance intellectual capital, profitability, earning management and firm value.

ENDNOTE

[1] A biweekly business magazine based in Jakarta
[2] *https://iicg.org/*

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