The Impact of Corporate Governance on Corporate Social Responsibility Disclosure: Evidence from Indonesia

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Abstract

This research examines the level of Corporate Social Responsibility (CSR) Disclosure in order to provide information to the interested parties. This research tries to find evidence regarding the potential effects of Corporate Governance characteristics on CSR reporting in Indonesia.

The samples were selected from LQ- 45 index in Indonesia Stock Exchange on August 2010 to January 2011 period. The descriptive statistics include the process of organizing, summarizing, and presenting data in informative way that presented the analysis formally to give the reader an overall sense of being analyzed. This statistical method is used to summarize the elements of the data in the research which presents the collection of the main features data in quantitative terms.

The analysis determined whether there is any association between corporate governance characteristics and CSR disclosure. The research result found that approximately, 41 per cent of Indonesian companies reported theirs CSR in their annual report. However, this study found that there is no evidence of statically significant correlation between corporate governance and corporate social responsibility.

Keywords: Corporate social responsibility, Corporate governance, Disclosure, Indonesia stock exchange.

1. Introduction

In agency theory which was developed by Jansen and Meckling in 1976, described that an agency relationship arise where there is a contract under which one party (the principal) engages another party (the agent) to perform some services on the principal's behalf. Under the contract, the principal delegates some decision-making authority to agent. Furthermore, Jansen and Meckling also explained there are several conflict occurs in agency theory, because in such a situation where both of the principal and the agent have their own interest. The agent has decision making authority so he or she could transfer wealth in certain manner from the principal to the agent if the principal intervene and the managers, as the agents of shareholders, could act in their own business. In reality these agency problems, sometimes occurs when the shareholders has interest to maximize the firm's value, but the managers have more knowledge, understanding and information about the company than the

shareholders. This asymmetry information practice, encourages managers to whether disclosed certain information in company's report or not disclosed related to their conflict with the shareholders. Corporate Social Responsibility or CSR is a phenomenon where companies concern not only to their profit but also to society related issues. CSR information consider one of crucial for company profitability and long term existence and the corporate governance is one of the ways to monitor the company's activity *"CG is concerned with holding the balance the between economic and social goals and between individual and communal goals"* (Khan, 2010). This paper is motivated by this curiosity about the impact of corporate governance on corporate social responsibility disclosure in Indonesian companies.

2. Theoritical Framework

Godfrey et al. (2006) stated "The agency problem that arises is the problem of inducing an agent to behave as if he or she were maximizing the principal's welfare." Splitting the control and ownership means managers could act in their own interest but inverse with agents' interest of the shareholders, this problem as recognized by Adam smith on 1776 in to *The Wealth of Nations.* Based on Godfrey et al (2006) in their text book "Accounting Theory" the differences in managers' and shareholders' incentives according firm policies cause several problems

By occurrences several conflicts causes from agency problem, CSR disclosure in certain firm become confusing whether disclosed or not disclosed which actually CSR is vital to their companies' profitability. Based on Harwood (1992) and Roberts (2011) Corporate social responsibility is rapidly gaining importance for businesses all over the word to ensuring the long term continued existence, *"greater social responsibility lower risk"* (Herremans et al, 1993). Different company different strategy their use whether the CSR become part of their cost or their assets. Several past studies indicated that CSR should be include to their asset related CSR activities more likely investment for company. Porter and Kramer (2006) stated *"Corporation were to analyse their prospects for social responsibility using the same frameworks that guide their core business choices they would discover that CSR can be much more than cost, a constraint, or a charitable deed-it can be a source of opportunity, innovation, and competitive advantages".* They also added that corporate social responsibility can become a source of tremendous social progress, as the business applies its considerable resources, expertise, and insights to activities that benefits society. And Corporate Governance seems to be one of factor to maintain and monitoring the agency conflicts and CSR disclosure which is crucial for companies. According to Cadbury (1992), Dahya et al. (1996), Belgian Banking and Finance Commission (1998), Maier (2005) and Berk & DeMarzo (2007) define Corporate Governance as the way of companies controlled and governed with several principles based on the OECD principles of Corporate Governance (1999).

3. Hypotheses Development

For the hypotheses development authors take from past research that conducted in Bangladesh from Md. Habib-Uz-Zaman Khan, the empirical studied using 30 private commercial banks of Bangladesh. The four hypotheses consist of:

a) First Hypothesis
Tricker (1984) illustrated that CSR reporting endeavor can be viewed as a strategy heading towards closing a perceived legitimacy gap between management and shareholders especially foreign shareholders via non-executive directors. Non executive directors are seen as check and balance mechanism to owners, stakeholders and public so they would generally interested in satisfying the social responsibilities of the company because that might improve their social prestige. Fama and Jensen (1983) explained that non-executives directors are regarded as a dependable method equipped of spread the agency problems between managers and owners. From the discussion, the non-executive directors have an essential role to play. Therefore, board represent by non-executive directors are believed to have more pressure on CSR reporting. Thus the first hypothesis of this study is:

H1: The higher proportion of non-executive directors on the board, the greater the degree of CSR reporting information.

b) Second Hypothesis

Equal opportunity is concerned with the achievement of fair treatment of group facing discrimination. It involves combating discrimination due to race, gender, disability, age, class, religion, sexual orientation, etc. Branco and Rodrigues (2008) mentioned the theme of board diversity correctly match into the structure of stakeholder theory. Carter *et al.* (2003) revealed empirical evidence of a significant positive relationship between board diversity, defined as percentage of women, African American, Asians and Hispanics on board of directors and firm value. Adams and Ferreira (2004) suggest that boards with a higher proportion of women directors tend to make the more board meetings possible and special attendance patterns at boards. Therefore the second hypothesis of this study is:

H2: The higher proportion of women directors on the board, the greater the degree of CSR reporting information.

c) Third Hypothesis

Besides the proportion of non-executive directors and women directors on the board, it is possible that proportion of foreign nationals may also have influence on disclosure practice. Branco and Rodrigues (2008) explained the involvement between the proportions of foreign nationals and reporting might lead to raise the issue causality. Thus based on discussed literature, Khan (2010) assumed that board diversity measured as percentage of foreign national. Non-Indonesia nationality on the board of directors may have power on CSR reporting. Hence the following hypothesis is examined:

H3: The higher proportion of foreign nationals on the board, the greater the degree of CSR reporting information.

d) Control Variables

Khan (2010) studied consider size, profitability and gearing as the control variables based on his prior research there were positive relationship between CSR reporting and company size, profitability and gearing. For the relationship, larger company assume more activities and have greater impact to community, larger company also have bigger pressure to report their responsibility to society. Also about the profitability, more profitable company needs to show their social information. Highly geared companies disclose more information to give guarantee to the creditors. Thus, the hypothesis is:

H4: The extent of CSR reporting is greater for; larger firms; highly profitable firms; and firms having highly gearing ratio.

4. Methodology

The author uses purposive sampling method to obtain the samples period 2010 as of august 2010 until January 2011. The population of companies consists of 45 companies that include in LQ-45. For the research aim, collecting and codifying the data from content analysis based on chosen criteria.

- **CSR Categorization**

1. Community Involvement

2. Environmental

3. Employee Information

4. Product or Service Information

5. Value-Added Information

Based on all company's information disclosure, it would be measure include under each category.

- **CSR reporting index (CSRRI)**

CSRRI = ∑*di* 43/nj

Where "1" coded for disclosed and "0" for not disclosed, *di* is the 1 or 0. *Nj* is the maximum number of items for *jth* firms < 60. To get company's score, the scores for each item is added and the total is divided by the maximum likely scores, that are multiplied by 100 to gather percentage scores. The past study Haniffa & Cooked (2005) discovers 43 items in CSR disclosures. The average score is calculated by divided the number of companies. The numbers of words in every sentence relating to each CSR measure using similar mechanism.

Table-1. Independent Variables Table

Independent Variables	Measurement
Composition of non-executive (COMPNED)	% of non-executive directors to total directors
Composition of women directors (COMPWD)	% of women directors to total directors
Composition of non-Indonesian directors (FOROWN)	% of non Indonesian directors to total directors
Size (STA)	Total assets
Profitability (ROE)	Return on equity
Gearing (DTE)	Debt to total equity

- **Multiple Regression**

$$CSRRI = \beta_0 + \beta_1 COMPNED + \beta_2 COMPWD + \beta_3 FOROWN + \beta_4 STA + \beta_5 ROE + \beta_6 DTE + e_t$$

Regression analysis was used to test relationship between the various independent variables and the measures the overall CSR reporting. Where CSRRI is the corporate social responsibility index, COMPNED is the percentage of independent directors to total Directors on the board, COMPWD is the percentage of women directors to total Directors on the board, FOROWN is percentage of foreign directors to total Directors on the board, STA is the size on the basis of total assets, ROE is the profitability on the basis of return on equity, DTE is gearing on basis of Debt to equity ratio, e is the disturbance term, and B is beta coefficient.

- **Descriptive analysis**

The descriptive statistics include the process of organizing, summarizing, and presenting data in informative way that presented the analysis formally to give the reader an overall sense of being analyzed. This statistical method is used to summarize the elements of the data in the research which presents the collection of the main features data in quantitative terms.

5. Finding and Discussion

In this section, the author conducts descriptive statistic to show the general ideas regarding the analyzed samples. This study is about Corporate Social Responsibility (CSR) which used Indonesian companies as a sample consider 43 CSR reporting items, the CSR scoring is measured by conducting the code of CSR items from company's Annual Report into CSSRI index which originally based on earlier study that have been taken in Malaysia by Haniffa & Cooked (2005). Hence the company who earns zero point, when there is missing information in the annual report that considered as deficiencies in the related parameters. For company who has insufficient information about CSR practice on annual report, may cause the company to have a zero point on some parameters, which in turn earns the low score of Corporate Social Responsibility. The detailed results of those items are shown in table

appendix The result indicates that although CSR disclosure is voluntary in Indonesia, the items of Indonesian companies disclosed is quite vary, most of all firms in LQ-45 index include their CSR activity in their annual report, on average is 41% and contributing in the different sectors.

The highest CSR disclosure was reported by Bakrieland Development Tbk. (IDX:ELTY) by a huge percentage of 65%. Half of the firms (50 per cent) reported CSR information on such items as general philanthropy, community program, environment, employee benefits, products and all the firms reported value added statement. In those certain of the items company fulfilling their commitment to the society. In the community involvement section, 97.78 per cent of the companies disclose general philanthropy in terms of building cooperation to local community and donation to orphanage. And 91.11 per cent of firms reported their CSR disclosure in terms of community programs for instance education programs and build facilities for local (school, hospital). Most of the companies in LQ-45 index also disclosed their CSR in environmental issues, there are 38 companies report environmental programmed for example tree plantations and 34 firms reported support for public/ private action designed to protect the environment and to victims because of natural disasters for instance flood. Also in section 3 and 4 about employee and products/service of the company, in those section companies disclose certain items for instance employee bonuses, profit sharing, training and improving quality services to value added their annual report. Nevertheless, it seems that company's commitment towards their long term impact issues are fairly unsatisfactory, because none of them disclosed the information about their long term impact from their business and the way how they responsible to their impact directly depend on their business area, for example cigarette firms who responsible with building the lungs clinic instead of tree plantation. Overall reporting score of 41 Per cent evidences that CSR of Indonesian companies disclose in the annual report are not as low as expected, but compared to others country for instance Malaysia, Indonesia still at low level.

Table 2 shows the results of the descriptive analysis of CSR reporting in each broad category of reporting items to measure the company keenness of reporting items. It also shows the extent of disclosure as measured by the word count to total words for all disclosures in the sample population and the means of disclosure based on the number of words reported under each category Table 2 shows that surveyed banks reported fewer words in community involvement issues than employees related product and service and statement information, even though most of the companies disclose information about community involvement especially for the local community but did not support with the numbers of words, different with community involvement words, wording related employee and products consistent with earlier findings shows large number of words discuss about those two. A total of 261689 words of CSR reporting were provided in the annual reports for the 45 surveyed companies examined, representing an average of 5815 words per annual report.

Table-2. Descriptive Analysis (Word)

Categories	Reporting	Percentage	No of words reported	Percentage of reported words	Mean
Community involvement	38	84	26748	10.22	594.4
Environmental	40	88	45593	17.42	1013.17
Employee	44	97	51273	19.59	1139.4
Product or service	36	80	64109	24.50	1424.64
Value added	45	100	73966	28.26	1643.64
Total:			261689	100	
Note: Total surveyed Indonesian companies = 45					

In terms of CSR reporting items, Bakrieland Development Tbk. Has received a top position by disclosing 65 per cent out of 43 items. The in-depth investigation of this company activity showed that as a responsible corporate body, this company had became the pioneering role in implementing several social and philanthropic programs to help disadvantages people and protect the environment. Bringing out diverse social and philanthropic activities and such areas as education with a million book program, healthcare with health examination, human resources development with training and

internship, conservation to nature with 10000 trees program and utilization of idle land, rehabilitation with high school empowerment program and other programs to helping other people not only enlighten company's image to the society but also bring many local and international awards, Bakrieland achieved several awards such as Best Indonesian Green CSR Award held by business and CSR magazines and also two Bakrieland's property also awarded the best Indonesia Green Hotel Awardfor Pan Pacific Nirwana Bali Resort and Best Indonesia Green Real Estate Award for Rasuna Epicentrum. In addition, at the 2010 cityscape Awards Real Estate Asia, Bakrieland was awarded with highly commended Best Developer CSR for Bakrieland Goes Green program. Indeed, those awards distinguish company's excellent loyalty to social activities and interest to environmental issues. However, with regards to ranking, this is followed by International Nickel Indonesia Tbk, Bakrie & Brothers Tbk, Bumi Resources Tbk, Kalbe Farma Tbk, Timah (Persero) Tbk, Indocement Tunggal Prakasa Tbk, and so on. Bank Tabungan Negara (Persero) Tbk and Bank Central Asia Tbk obrtained the lowest rank from 45 companies samples due to the least CSR reporting items. No matter what CSR project, the level and varieties of reporting is addresses for substantiating organizational caring to society, unfortunately the bottom line is still financial reporting, that has been said that there are rare investor look at to sustainable report.

Table 3 provides descriptive statistics of the continuous independent variables. It is noticeable that the Board composition that is measured by the proportion of non executive directors which is in Indonesia called "Dewan Komisaris" with a mean 48 percent indicates that financial institution are mostly dominated by executive directors. The mean value of women representation is only 7 per cent with the highest percentage of women representation on firms board is over 40 per cent. Compared to the other developed and developing countries practice (Thomas, 2001; Burgess and Tharenou, 2002) on Khan (2010) journal stated that women representation on board seems rather healthier. The ratio of foreign directors on companies' boards is approximately 11 per cent.

Table-3. Descriptive Analysis (Independent Variables)

Variables	Mean	Std Dev.	Min	Max
COMPNED	0.488	0.139	0.40	0.60
COMPWD	0.079	0.064	0.00	0.40
FOROWN	0.110	0,181	0.00	0.60
STA (ln)	20.635	4.605	15.12	31.81
ROE	0.203	0.247	-0.71	0.84
DTE	0.647	0.472	0.00	2.21

Notes: COMPNED = Percentage of non executive directors on the board; COMPWD = Percentage of women directors to total directors on board; FOROWN = Percentage of non-Indonesian directors to total directors on the board; STA = size on the basis of total assets; ROE = profitability on the basis of Return on equity and DTE = gearing on the basis of Debt to equity ratio

Regression analysis was used to test the relationship between the various independent variables and measures of overall CSR reporting.

Table 4 shows the results of multiple regressions. As can be seen from that table, the regression indicates weak relationship between independent variables and dependant variables as presented in the equation. The adjusted R squared statistics or adjusted coefficient determination for degree of freedom is 0.061. It shows only explained 6 per cent (F = 1.477) of the CSR reporting variance of the independent variables in regression model. This finding did not support the several hypotheses.

6. Concluding Remarks

From the research that already conducted the level of CSR items that Indonesian companies LQ-45 report on their annual report quiet vary. The research reveals that on average of 41 per cent of Indonesian companies disclose CSR in their annual report. The varieties of the CSR items also impressive from community involvement, environment, employee, products and value added.

The multiple regressions are conducted to answer the research question within independent variables which are the Corporate Governance characteristics and dependent variable which is Corporate Social Responsibility disclosure. The result shows F-test of p-value indicates weak relationship between variables. The CSR and Corporate Governance shows statically insignificant

relationship thus, the corporate governance has no relationship with Corporate Social Responsibility reporting.

Table-4. Multiple Regression Table

Result of Multiple Regression Analysis			
Independent Variables	Coefficient	p-value	VIF
COMPNED	0.206	0.202	1.177
COMPWD	-0.170	0.277	1.109
FOROWN	0.175	0.284	1.212
STA (ln)	-0.093	0.571	1.248
ROE	-0.152	0.311	1.033
DTE	0.080	0.628	1.262
N = 45			
F-test (p-value) = 1.477 (0.212)			
R squared = 0.189			
Adjusted R squared = 0.061			

Insignificant relationship Corporate Governance and CSR result of the study, Generally, the information regarding CSR of company listed in Indonesia Stock Exchange (IDX) is limited. Public and investor find difficulties to asses the practice and quality of CSR that reflected by Corporate Governance characteristics.

The result of the study shows well developed of CSR but the perception of the investors regarding CSR is still low and the influence of corporate governance that consider could bring certain pressure to CSR reporting for this Indonesian case not proven. CSR practice may be seen by the companies just a formal requirement with low benefits.

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APPENDIX 1
Result of CSR Disclosure in Annual Report

No	Items	Number of Companies reported	Percentage (%)
	COMMUNITY INVOLVEMENT		
1	General philanthropy	44	97.78
2	Participation in government social campaigns	23	51.11
3	Community programs (health & education)	41	91.11
	ENVIROMENTAL		
1	Environmental policies	23	51.11
2	Raw materials conservation & recycling	17	37.78
3	Environmental protection programmed	38	84.44
4	Awards for environmental protection	8	17.78
5	Support for public/private action designed to protect the environmental and natural disaster victims	34	75.56
	EMPLOYEE INFORMATION		
1	Employees appreciation	23	51.11
2	Recruitment problems	11	24.44
3	Discussion of ways to overcome problems (evaluation)	10	22.22
4	Employee welfare	2	4.44
5	Employee benefits, bonuses	21	46.67
6	Profit sharing schemes policy	4	8.89
7	Number of employee	21	46.67
8	Breakdown of employee by line of business (career development, rotation, cross assignment)	21	46.67
9	Breakdown of employee by geographic area	4	8.89
10	Categories of employee by functions	20	44.44
11	Categories of employee by race	18	40
12	Categories of employee by age	18	40
13	Numbers of employees for 2 or more years	2	4.44
14	Reason for changes in employee number	3	6.67
15	General redundancy/ retrenchment information	5	11.11
16	Information on accidents	3	6.67
17	Cost of safety measures	17	37.78
18	Health & safety standards	23	51.11

19	Corporate policy	21	46.67
20	Nature of training	27	60
21	Number of employees trained	11	24.44
22	Amount spent on employees training	9	20
23	Categories of employee trained	13	28.89
	PRODUCT OR SERVICE INFORMATION		
1	Discussion of major types of products	36	80
2	Pictures of major types of products	21	46.67
3	Improvement in product quality	38	84.44
4	Improvement in customer services	29	64.44
5	Distribution of marketing network for products domestic market	16	35.56
6	Distribution of marketing network for products foreign market	7	15.56
7	Customer awards/ratings received	19	42.22
	VALUE-ADDED INFORMATION		
1	Value-added statement	45	100
2	Qualitative value-added statement	19	42.22
3	Value-added data/ratios	27	60