The Influence of Good Corporate Governance Mechanisms to Financial Performance with Corporate Social Responsibility as an Intervening Variable

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Abstract - The purpose of this study is to analyze the effect of good corporate governance mechanisms to financial performance with corporate social responsibility (CSR) as an intervening variable. The hypothesis testing using descriptive analysis, multiple regression, and path analysis. The empirical results indicate that partially managerial ownership and independent commissioner is significant influence on the financial performance and CSR disclosure but institutional ownership is not significant influence to financial performance and CSR disclosure. CSR is not an intervening variable in the influence of corporate governance mechanisms to financial performance.

Keywords - Financial Performance, Corporate Social Responsibility, Mechanisms Good Corporate Governance, Managerial Ownership

I. INTRODUCTION

Mechanism of Good Corporate Governance (GCG) is one key element in improving economic efficiency and quality of performance that includes a series of relationships among the company's management, board of commissioners, the shareholders, and other stakeholders so that banks can grow and develop in a healthy and efficient way [15]. The five principles of GCG mechanism are openness, accountability, responsibility, fairness, and independence. The main idea of GCG mechanisms is corporate social responsibility (CSR). The Performers of CSR should not separate CSR activities with GCG. Both are a single entity and not a unification of several integral parts [9].

Several cases of financial scandals such as Enron Corp., Worldcom, Xerox, and others in the United States involve the company's top executives. This illustrates the failure to apply the principles of good corporate governance. Examples of cases in Indonesia are PT. Lippo Tbk, and PT. Kimia Farma Tbk [11]. The other cases is Bank Century (now Bank Mutiara) that occurred in the 2008 also involves the manipulation of financial statements that are detected.

The cases of environmental responsibility in Indonesia like the PT. Freeport in Papua and Lapindo Brantas in Sidoharjo, East Java, and in Papua by PT. Freeport-McMoRan have been damaging to the environment. The cases
show the importance of CSR as a form of corporate responsibility to the environment. Responsibility not only done after a problem but is also responsible for detecting and preventing problems. These cases may indicate that the implementation of good corporate governance and CSR in Indonesia is still very weak. Of the cases that occur, the government's attention to this problem is realized with the establishment of the National Committee on Governance (NCG) at the end of 2004 [14].

Implementation of good corporate governance mechanisms is indispensable in meeting the public trust and internationally as an essential condition for the world economy to develop well and healthy. Therefore, the Bank for International Settlement (BIS) as an institution that continuously examines the precautionary principle should be adopted by banks, has also issued Guidelines for the Implementation of Good Corporate Governance for the banking sector internationally.

II. LITERATURE REVIEW

Agency theory developed by Jensen and Meckling as in [3] considers that the management of the company as "agents" for the shareholders, will act with full awareness of their own, not as the wise and prudent and fair to shareholders. Perspective agency relationship is the basis used to understand the mechanisms of good corporate governance. Reference [3] states that an agency relationship is a contract between the manager (agent) with the investor (principal). Conflicts of interest between the owner and the agent happen because of possible agents do not always act in accordance with the interests of the principal, thus triggering the agency cost.

Agency theory is used to explain the basis of good corporate governance mechanisms. Mechanism of good corporate governance is a concept that is based on agency theory, is expected to serve as a tool to provide confidence to investors that they would receive a return on the funds they have invested. Mechanism of good corporate governance is concerned with how investors believe that managers will benefit them, confident that the manager will not darken or invest in projects that do not benefit associated with funds or capital that has been invested by investor, and relates to how the investors control managers [13]. In other words, good corporate governance mechanisms is expected to function to suppress or lower the cost of agency (agency cost).

Performance is the achievement of the goal of an activity or a particular job in realizing the goals, objectives, vision, and mission of the organization. Corporate performance assessment aims to determine the effectiveness of the company's operations [7]. Financial performance of the company is a certain size that is used by the entity to measure success in generating profits. Company's financial performance can be measured from the financial statements issued by the company within a certain period [4]. Financial performance is a tool to measure the financial performance of the company through its capital structure. Assessment should be known to the company's financial performance output and input. The output is the result of an employee's performance, while the input is the result of a skill that is used to obtain these results. Financial performance is one factor that shows the effectiveness and efficiency of an organization in order to achieve its objectives [5].

Shareholders as the holder of constraints within an enterprise are key factors in Good Corporate Governance. Commissioner Board is also the core of good corporate governance. With the ownership of shares by the managers and institutions are expected to support the company in improving CSR disclosure. High level of ownership should be led to greater scrutiny of business by the investors so as to deter opportunistic behavior of managers. When linked with social responsibility disclosure, monitoring activities undertaken by
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in institutional investors can force the management to disclose social information. Because institutional investors have a strong motivation to exercise closer scrutiny over the activities that occur within the company. The hypotheses are:

H1: Institutional ownership effect on Corporate Social Responsibility
H2: Managerial Ownership effect on Corporate Social Responsibility
H3: Independent Commissioner influence on Corporate Social Responsibility

Shareholders and managers (Independent Commissioner) to be in control of a company is a major factor in good corporate governance. GCG arise from agency problems. Agency theory states that in the event of separation of owners and managers of the company, agency conflicts will arise. With the GCG, it is expected that the company will conduct financial performance improvement. The Hypotheses are:

H4: Institutional ownership effect on financial performance
H5: Managerial ownership effect on financial performance
H6: Independent Commissioner influence on Financial Performance

Companies that disclose more CSR the company's financial performance is likely to increase due to CSR programs to benefit the community. The Company is currently required to carry out the principles of Good Corporate Governance. Companies should care about the interests of social and environmental. Good Corporate Governance is a determining factor implementation of Corporate Social Responsibility are expected to contribute to the improvement of social and community environment. One of the key principles of Good Corporate Governance is accountability that leads not only to shareholders but also to stakeholders. The hypotheses are:

H7: Corporate Social Responsibility influence on Financial Performance
H8: Institutional ownership effect on financial performance through Corporate Social Responsibility
H9: Managerial ownership affects financial performance through Corporate Social Responsibility
H10: Independent Commissioner affect financial performance through Corporate Social Responsibility

III. RESEARCH METHODOLOGY

The study population was banking companies listed on the Indonesia Stock Exchange. Sampling was conducted with a purposive method in order to get 20 banking companies. This study used secondary data from annual report banking by the method of documentation. Data were analyzed using descriptive statistics, multiple regression, and path analysis.

IV. RESULTS AND ANALYSIS

The results of this study showed that of ten hypotheses, there are five hypotheses are accepted (H2, H3, H5, H6, H7) and the others are rejected (H1, H4, H8, H9, H10). Institutional ownership has no effect on CSR disclosure, because in Indonesia is not yet considering CSR as one criterion in making investment, so there is no pressure on the management of CSR disclosure [10]. The results of this study showed a negative relationship between institutional shareholding with CSR disclosure means that the higher level of stock ownership by institutions that will reduce the level of CSR disclosure by the company. The more shares company owned by the institution, so the institutions will have ability to intervene in the operating of the company.

Managerial ownership effect on CSR disclosure. Manager of the company will disclose social information in order to improve the image of the company, although the company has to sacrifice resources to
undertake CSR activities. Reference [3] states that the higher the managerial ownership, the greater the motivation of companies to make disclosure of corporate activity. Managerial stock ownership can help unify the interests between shareholders and managers. Both of which want to benefit by enhancing and developing CSR programs to the public on a large scale.

Independent Commissioner influence on CSR disclosure. The results of this study support the theory of agency and managed in accordance with the opinion of Coller and Gregory, as in [1] which states that the greater the number of commissioners, the easier it shall be controlled and monitored by the CEO; thus making it more effective.

Institutional ownership has no effect on financial performance. Reference [8] stated institutional ownership does not affect the company's financial performance. The majority of institutional investors not to supervise the management of the company but rather an optimal compromise or side with the management and ignore the interests of minority shareholders. Changes in income now can affect investors' institutional decision. If unfavorable changes perceived by the investor, then the investor can withdraw their shares. Since institutional investors hold shares with a large amount. If they withdraw their shares, it will affect the value of the stock as a whole. This means that institutional ownership has not been able to be a mechanism to improve financial performance. Besides the institutional shareholdings that are too large it will make the manager feel bound by the desire of investors to meet targets and increase in corporate profits, so supposedly the manager remains inclined to manipulate earnings.

Managerial ownership effect on the financial performance. Based on agency theory, the difference between the interests of managers and shareholders has resulted in conflict commonly called agency conflict. Managerial stock ownership can help pooling of interests between shareholders and managers. The increasing proportion of managerial stock ownership, the performance of the company is also getting better. Reference [6] shows that in order to minimize losses in the event of a decision of the manager is to increase managerial ownership in the company.

Independent directors influence on the financial performance. These results are consistent with [2] that the board of commissioners who come from outside the company or outside director may reduce the opportunistic actions of management, so that if the commissioners from outside improving control measures will relate to the lower the deviant behavior by management.

Corporate Social Responsibility effect on financial performance. The existence of corporate social responsibility disclosure will positively responded by many investors who invest in the company that led to increase performance that reveals company’s information. Companies with more corporate social responsibility have better financial performance than companies that disclose less information [12]. Through its corporate social responsibility report, the public can monitor the social activities that the company has done. Companies that disclose more CSR so the company's financial performance is likely to increase.

This study shows that the direct effect of corporate governance mechanisms are represented by the variable institutional ownership, managerial ownership, and independent directors on the financial performance is greater than the indirect effect of corporate governance mechanisms on financial performance through CSR. Company Law No. 40 year 2007 is indicative of CSR disclosure is not a moderating variable, because the law states that the company deals with nature must implement CSR, therefore investors feel no need to look at CSR disclosure made by the company, because the company must implement CSR otherwise they
will get sanctions.

Companies that implement corporate social responsibility should provide sufficient funds. The more corporate social responsibility activities, the more expenditure of the companies in support of these activities. This large expenditure that might change the company’s objectives, of which aims to improve the financial performance of CSR but in fact be one of the factors that can reduce the level of financial performance.

V. CONCLUSIONS

The results of this study indicate that institutional ownership has no effect on CSR and financial performance, managerial ownership and independent directors influence on disclosure of CSR and financial performance. CSR is not an intervening variable in the influence of corporate governance mechanisms on financial performance. Limitations of this study is on the previous research had been investigated regarding CSR as intervening and the result was rejected. So, further research is recommended to replace or add other intervening variable in this study because CSR is rejected as an intervening variable.

REFERENCES

(Arranged in the order of citation in the same fashion as the case of Footnotes.)


