

MEDIATION OF CSR AND PROFITABILITY ON THE INFLUENCES OF GCG MECHANISMS TO THE FIRM VALUE

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ABSTRACT

Keywords:
Corporate Social Responsibility, financial performance, firm value, Good Corporate Governance mechanism

JEL Classification:
G32, G34

The purpose of this research was to determine the causal relationship among GCG mechanism, financial performance, CSR and firm's value. The model of the research was constructed by using financial performance and CSR as intervening variables on the effect of GCG mechanism to firm's value. This research was accomplished on companies listed in Jakarta Islamic Index (JII) in Indonesia Stock Exchange for the period of 2007-2013. The result showed that GCG mechanism tended to reject every CSR financing. CSR was positively affected by Return on Investment (ROI). GCG mechanism represented by institutional ownership (INWN) had a positive effect to ROI. ROI had a positive effect to return on equity (ROE), and ROE had a positive effect to firm's value. This study proved that ROI was mediating significantly the effect of INWN to CSR, and ROE was mediating significantly the effect of ROI to firm's value.

ABSTRAK

Kata kunci:
Corporate Social Responsibility, kinerja keuangan, nilai perusahaan, mekanisme Good Corporate Governance

Tujuan penelitian ini adalah untuk menguji hubungan kausalitas antara mekanisme GCG, kinerja keuangan, CSR dan nilai perusahaan. Model penelitian dibangun dengan menempatkan kinerja keuangan dan CSR sebagai variabel intervening pada pengaruh mekanisme GCG terhadap nilai perusahaan. Penelitian dilakukan pada perusahaan Jakarta Islamic Index (JII) di Bursa Efek Indonesia untuk periode tahun 2007- 2013. Hasil penelitian menunjukkan bahwa mekanisme GCG cenderung menolak berbagai pembiayaan CSR. CSR dipengaruhi positif Return on Investment (ROI). Mekanisme GCG yang diproksi Institutional Ownership (INWN) berpengaruh positif terhadap ROI. ROI berpengaruh positif terhadap Return on Equity (ROE), dan ROE berpengaruh positif terhadap nilai perusahaan. Penelitian ini membuktikan bahwa ROI memediasi secara signifikan pengaruh INWN terhadap CSR, dan ROE memediasi secara signifikan pengaruh ROI terhadap nilai perusahaan.

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Corporate Social Responsibility (CSR) has become an integral part of business practice for the last few decades. Many companies have dedicated parts of their annual reports and website pages to reveal CSR activities. It describes how important companies attach such activities (Servaes & Tamayo 2013). CSR in Indonesia develops in the background of the issuance of CSR practice and disclosure regulation through Limited Company Law. No.40 of 2007 articles 66 and 74 and the Investment Law No.25 of 2007 which regulates every investment to participate in implementing CSR. The financial literature explains that the purpose of company management is to maximize the company/ firm value. Therefore, it is necessary to examine whether CSR increases shareholder value or focuses too much on other stakeholders, thereby lowering firm value (Servaes & Tamayo, 2013).

Epstein & Freedman (1994) reveal that CSR is currently believed to provide competitive advantage as investors in making decisions do no longer just look at the company's financial performance. Investors are more interested in the CSR information disclosed in the company's annual report, and the growing importance of CSR for businesses has resulted in much research on CSR. Various studies on CSR and the relation to firm value show inconsistent results.

Nguyen (2015) and Adeneye (2015) prove that CSR has positive effect on the firm value, but Reddy & Gordon (2010) and Cui, *et al.* (2012) find the negative relationship. Other results are shown by Sabbaghi & Xu (2013) who do not find a significant relationship between CSR and achievements of the firm value. Servaes & Tamayo (2013) prove that CSR and firm value positively relates to firms with high customer awareness. For the companies with a low customer awareness, the relationship will be negative or insignificant.

Servaes & Tamayo (2013) explain that the vagueness of the relationship between CSR and firm value is due to methodological problems, especially the error in the specification of the research model built, and the lack of understanding of through which channels CSR affects the firm value. This is because most of the theoretical models constructed assume the relationship between CSR and firm value is direct. Utama (2007) explains that the practices and disclosure of CSR is a logical consequence on the implementation of Good Corporate Governance (GCG). Meanwhile, the principles of good corporate governance include that the company must consider the interest and make active cooperation with stakeholders for the survival of the company itself.

The relationship of GCG, CSR and firm value has not been extensively studied in the groups of sharia category companies. This research was conducted at Jakarta Islamic Index (JII) in Indonesia Stock Exchange. The purpose of this study was to know and analyze: (1) the influence of GCG on financial performance; (2) the impact of GCG and financial performance on CSR; (3) the influence of GCG, financial performance, and CSR on firm value; (4) mediation of financial performance on the influence of GCG on CSR; 5) CSR mediation on the influence of GCG on corporate value.

GCG mechanism is proxy by variables of Institutional Ownership (INWN); Board Independent (BIND); and Board Size (BSIZE) (Mai, 2015). Financial performance is proxy by variables of Return On Investment (ROI) and Return on Equity (ROE) (see Bhattacharya, 2009; Widyanti, 2014). CSR is proxy by variable of Corporate Social Responsibility Disclosure Index (CSR-DI) (Haniffa & Cooke, 2005). Firm value is proxy by Price to Book Value (PBV) (Garay & González, 2008).

HYPOTHESES DEVELOPMENT

Effect of Institutional Ownership and Board Independent on Return on Investment

Wiranata & Nugrahanti (2013) proved institutional ownership does not affect the firm performance. Abbasi et al (2012) proved institutional ownership positively affects the return on investment. Romano et al . Romano et al. (2012) stated that board independent has no effect on profitability. Darwis (2009) revealed that the presence of independent board is a formality and only to meet the regulations, so that its presence is not to carry out monitoring of the directors board policy. Abbasi et al . Abbasi et al. (2012) proved that board independent has positive effect on return on investment.

H₁ : institutional ownership has a positive effect on Return on Investment.

H₂ : board independent has a positive effect on Return on Investment.

Effect of Board Independent and Board Size on Return on Equity

Ramdani & Witteloostuijn (2010) prove that firms with larger independent commissioner proportions have higher return on equity. Bayrakdaroglu et al. (2012) state the size of the commissioner board has no effect on profitability. Wulandari (2006) describes the optimal *board size* depends on the conditions of each company. Velnampy (2013) proves that board size negatively affects profitability as fewer members of the commissioner board will create better communication, more effective coordination, and faster action to solve problems.

H₃ : board independent has positive effect on Return on Equity.

H₄ : board size has negative effect on Return on Equity.

Effect of Return on Investment on Return on Equity

Return on Investment (ROI) is the ratio that measures a company's ability to generate net income using total assets (Shamsuddin, 2009). Return on Equity (ROE) is a measure of income available to owners of companies on capital invested (Syafri 2008). High ROE will attract investors to increase their capital (Mandala & Prathama 2004). Companies which are able to manage the total capital including debt can produce a higher *return* than the interest rate, so the increase of ROI will have positive impact on ROE.

H₅: return on investment has positive effect on Return on Equity.

Effect of Institutional Ownership, Board Independent and Board Size on Corporate Social Responsibility

The research finding of Rawi & Muchlis (2010) and Wakidi & Siregar (2011) prove that institutional ownership does not affect the extent of CSR disclosure. Matoussi & Chakroun (2008) state that institutional ownership has a power and experience and it is responsible in implementing GCG principles in order to protect the rights and interests of shareholders. They require companies to communicate transparently. Nussy (2013) proves institutional ownership positively affects CSR.

Said et al. (2009) prove that independent board does not affect CSR. Huafang & Jianguo (2007) stated that independent board has a positive effect on CSR. Beasley (1996) describes independent board can improve the effectiveness of board in overseeing management in order to prevent fraud in the financial statements. Collier & Gregory (1999) suggest the greater the board size is the easier to control CEO and monitoring can be run more effective, so it can provide a stronger pressure on the management to run and disclose

H₆ : institutional ownership has a positive effect on

H₇ : board independent has a positive effect on Corporate Social Responsibility

H₈ : board size has a positive effect on Corporate Social Responsibility

Effect of Financial Performance on Corporate Social Responsibility

Susanto (2003) explains that the company should have a high profitability for implementing CSR program because without an adequate profitability CSR program will not be realized. Tsoutsoura's research (2004) proves the existence of a positive relationship between CSR and financial performance.

H₉ : Return on Investment has a positive effect on Corporate Social Responsibility

H₁₀ : Return on Equity has a positive effect on Corporate Social Responsibility

Effect of Institutional Ownership on Price to Book Value

Shahid (2003) proves institutional ownership does not affect the performance of the company. Zouari & Boulila (2014) find a negative relationship between institutional ownership and performance of Islamic banks. Arouri et al. (2014) proves a positive relationship between institutional ownership and bank performance. Thanatawee (2014) proves institutional investors provide oversight role effectively, thereby improving corporate governance and firm value.

H₁₁ : institutional ownership has a positive effect on Price to Book Value.

Effect of Board Size on Price to Book Value

Belkhir (2009) proves there is a positive relationship between board size and firm perfor-

mance due to the board size identical to the firm size. Big assets ownership shows that the company has reached maturity. Companies at this maturity stage have advantages in financial stability, the prospect of a better distribution of dividends, thus attracting investors to invest (Fatemi & Bildik, 2013; El Essa et al., 2012).

H₁₂ : Board size has a positive effect on the Price to Book Value.

Effect of Financial Performance on Price to Book Value

Research of Mursalim et al. (2015) proves that the achievement of financial performance has a positive effect on firm value. Investors will be motivated to invest in a company if the level of profit earned in the current year and forecast for the years ahead is high.

H₁₃ : Return on Investment has a positive effect on Price to Book Value.

H₁₄ : Return on Equity has a positive effect on Price to Book Value.

Effect of Corporate Social Responsibility on Price to Book Value

Sarvaes & Tamayo (2012) prove that CSR's activity and disclosure can add value to the company because CSR provides a good image so that loyal customers buy products produced by the company. Adeneye (2015) and Nguyen (2015) prove that CSR's disclosure and activity influence positively on firm value.

H₁₅ : Corporate social responsibility has a positive effect on price to book value.

Based on the relationship inter variables described in the development of the hypothesis, it can be put forward that empirical research model is as follows (Figure 1)

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METHOD

The population of this study was all companies that entered the category of JII in Indonesia Stock Exchange, period 2007-2013. Sampling method used purposive sampling with company criterion: (1) having financial report; (2) publishing annual report; and (3) having an independent commissioner board member.

This study used path analysis with pooled regression model approach. The definition of operation for all variables was described as follows: First, corporate social responsibility disclosure index (CSR-DI) used dichotomy approach, namely every item of CSR rated 1 if it was disclosed, and rated 0 if it was not (Haniffa & Cooke, 2005). The following is formula for getting the variable value of CSR-DI.

$$CSR - DI_j = \frac{\sum x_{ij}}{n_j}$$

Where:

CSR-DI_j = Corporate Social Disclosure Index of company j;

X_{ij} = 1= if item i is disclosed; 0 = if item i is not disclosed;

N_j = number of items for company j, n_j = 79. Thus, 0 <CSRI_j> 1

Furthermore the indicators (proxies) and measurement for other variables used in this research are described using Table 1.

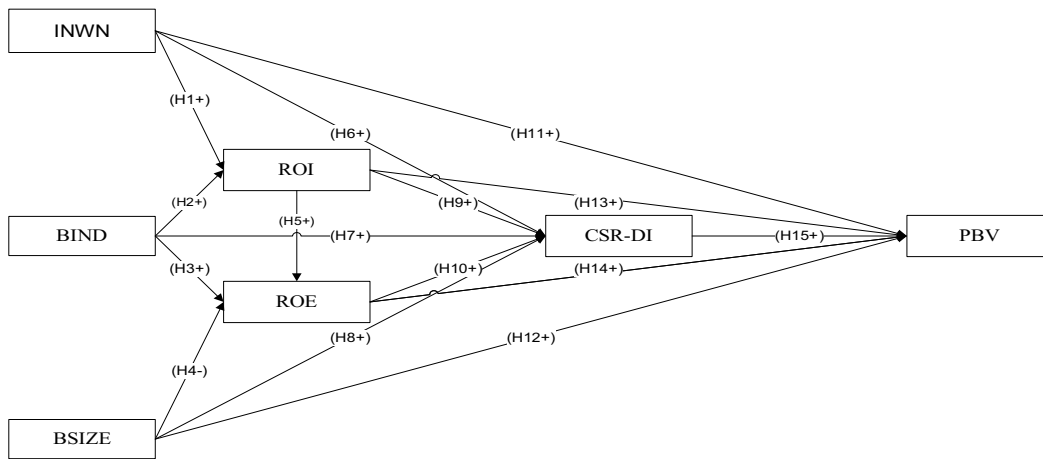


Figure 1: Empirical Research Model

Table 1. Variable Indicators and Measurements

Variable	Indicator (Proxy)	Measurement
INWN	Institutional Ownership	Number of shares owned by another institution / Total number of shares circulating
BIND	Independent Board	Number of independent commissioner board members / Number of all commissioner board members
BSIZE	Board Size	Number of all commissioner board members owned by the company
ROI	Return on Investment	Earnings after interest and tax / Total assets
ROE	Return on Equity	Earnings after interest and tax / Total equity
PBV	Price to Book Value	Market price per share / book value per share

RESULTS

Data collection result obtained 210 pairs of enterprise data, and to obtain *multivariate* normality data, 25 pairs of data were eliminated.

Assessment of normality result was 1.985, which meant that the data in multivariate normality criteria could be met. Furthermore, the goodness of fit condition for the empirical research model is presented in Table 3.

The results of data analysis showed that the empirical research model built was very feasible to test all the hypotheses that had been formulated. Furthermore, the result of Path analysis is presented in Figure 2.

Table 4 below presents the magnitude of regression coefficient, the direction of influence or regression, and the effects significance level among the variables analyzed.

Based on Table 4 , four structural equations are further developed, which can be put forward as follows:

$$\begin{aligned}
 \text{ROI} &= 17,341\text{INWN} + 0,393 \text{ BIND} + \varepsilon_1 \\
 &\dots\dots\dots(1) \\
 &\text{sig-t (0,000) (0,949) Sig-t (0.000) (0.949)} \\
 \text{ROE} &= 0,68\text{BIND} - 0,22\text{BSIZE}+1,22\text{ROI}+ \varepsilon_2 \\
 &\dots\dots\dots(2) \\
 &\text{sig-t (0,830) (0,210) (0,000) Sig-t (0.830)} \\
 &\text{(0.210) (0.000)}
 \end{aligned}$$

Table 2. Assessment of Normality

Variable	MIN	MAX	SKEW	C.R.	CURTOSIS	CR
BSIZE	2,000	12.000	0.710	3.941	0.979	2.719
BIND	0.140	0.750	0.736	4.088	2.326	6.458
INWN	0.110	0.950	-0.796	-4.419	0.747	2.074
ROI	-3,490	36.800	0.671	3.724	-0.055	-0.153
ROE	-0.670	53,130	0.455	2.526	0.093	0.258
CSR-DI	0.367	0.797	0.831	4.612	1.692	4.697
PBV	0.250	9.880	0.859	4.769	0.642	1.782
Multivariate					3.277	1.985

Table 3. Summary of Goodness of Fit Evaluation Result

Goodness of fit Index	Cut-off Value	Model Result	Information
Absolute Measures			
χ^2 - Chi-Square	Expected smaller	3.810	Very fit because χ^2 on α 0,05 and df. 3 = 7.81.
Probability	≥ 0.05	0.283	Very fit
CMIN / DF	≤ 2.00	1.270	Very fit
RMSEA	≤ 0.08	0.038	Very fit
GFI	≥ 0.90	0.994	Very fit
Incremental Fit Measures			
AGFI	≥ 0.90	0.946	Very fit
TLI	≥ 0.95	0.988	Very fit
CFI	≥ 0.95	0.998	Very fit
NFI	≥ 0.90	0.992	Very fit

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$$\begin{aligned} \text{CSR-DI} = & -0,047\text{INWN} -0,058\text{BIND}+0,001\text{BSIZE}+ & \text{PBV} = & 0,442\text{INWN} -0,096\text{BSIZE}+0,025\text{ROI}+ \\ & 0,004\text{ROI} - 0,002\text{ROE} + \varepsilon_3 \dots\dots\dots(3) & & 0,080\text{ROE} -2,074\text{CSR-DI}+ \varepsilon_4 \dots\dots\dots(4) \\ \text{sig-t} & (0,245) (0,292) (0,611) (0,010) & & \text{sig-t} (0,582) (0,116) (0,477) (0,002) (0,193) \\ & (0,141) \text{Sig-t} (0.245) (0.292) (0.611) & & \text{Sig-t} (0.582) (0.116) (0.477) (0.002) (0.193) \\ & (0.010) (0.141) & & \end{aligned}$$

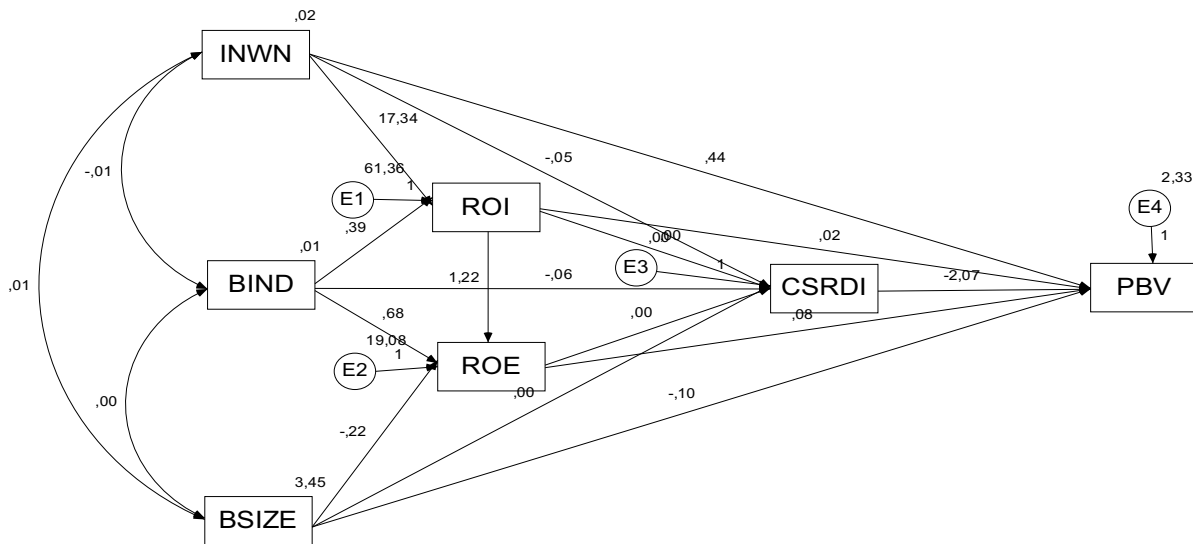


Figure 2. Path Analysis Result

Table 4. Casuality Relationship among Variables

Dependent Variable	Independent Variable	Estimate	SE	C.R.	P	Information	Testing Hypothesis
ROI	<--- INWN	17.341	4.265	4.066	***	Significant	Be accepted
ROI	<--- BIND	0.393	6.168	0.064	0.949	Not Significant	Rejected
ROE	<--- BSIZE	-0.218	0.174	-1.253	0.210	Not Significant	Rejected
ROE	<--- BIND	0.681	3.178	0.214	0.830	Not Significant	Rejected
ROE	<--- ROI	1.218	0.039	30.882	***	Significant	Be accepted
CSR-DI	<--- INWN	-0.047	0.040	-1.162	0.245	Not Significant	Rejected
CSR-DI	<--- ROI	0.005	0.002	2.561	0.010	Significant	Accepted
CSR-DI	<--- BSIZE	-0.001	0.003	-0.509	0.611	Not Significant	Rejected
CSR-DI	<--- BIND	-0.058	0.055	-1.053	0.292	Not Significant	Rejected
CSR-DI	<--- ROE	-0.002	0.001	-1.473	0.141	Not Significant	Rejected
PBV	<--- ROI	0.025	0.035	0.712	0.477	Not Significant	Rejected
PBV	<--- INWN	0.442	0.803	0.551	0.582	Not Significant	Rejected
PBV	<--- CSR-DI	-2.074	1.595	-1.301	0.193	Not Significant	Rejected
PBV	<--- BSIZE	-0.096	0.061	-1.573	0.116	Not Significant	Rejected
PBV	<--- ROE	0.080	0.026	3.071	0.002	Significant	Accepted

Identification and Testing of Mediation

Variables

Mediation of ROI on the influence of INWN on CSR-DI: (a) The direct effect of INWN on CSR-DI was -0.047, not significant; (b) the effect of INWN on ROI was 17.341, significant; (c) the effect of ROI on CSRI was 0.005, significant; (d) the effect of INWN on CSRI through ROI was $17.341 \times 0.005 = 0.087$, proven. Testing the significance of ROI mediation on INWN influence on CSR-DI was conducted by using Sobel test (Ghozali, 2009), as follows:

Calculating the standard error of the coefficient of indirect effect ($S_{p_2p_3}$) used formula:

$$S_{p_2p_3} = \sqrt{p_3^2 Sp_2^2 + p_2^2 Sp_3^2 + Sp_2^2 Sp_3^2}$$

$S_{p_2p_3}$ = standard error of the indirect effect coefficient

p_2 = 17.341 (unstandardized coefficient of INWN influence on ROI).

p_3 = 0.004 (unstandardized coefficient of ROI influence on CSR-DI).

S_{p_2} = 4.265 (unstandardized standard error of INWN influence on the ROI).

S_{p_3} = 0.002 (unstandardized standard error of ROI influence on CSR-DI)

$$S_{p_2p_3} = \sqrt{(0.004)^2 (4.265)^2 + (17.341)^2 (0.002)^2 + (4.265)^2 (0.002)^2}$$

$$S_{p_2p_3} = \sqrt{0.00045 + 0.0012 + 0.000073} = 0.0415$$

Calculating t value of statistics used the formula:

$$t = \frac{p_2 p_3}{Sp_2p_3} = \frac{(17.341)(0.0050)}{0.0415} = \frac{0.0867}{0.04015} = 2.0892$$

t value of table at $\alpha = 0.05$ was 1.960, and t value of arithmetic was 2.0892. It meant ROI mediated significantly on the influence of INWN on CSR-DI.

ROE mediation on the influence of ROI on PBV: (a) direct influence of ROI on PBV was 0.025 not significant; (b) Effect of ROI on ROE = 1.218, significant; (c) the effect of ROE on PBV was 0.080, significant; (d) the effect of ROI on PBV through ROE was proven, $1.218 \times 0.080 = 0.097$. The result of Sobel test for ROE mediation on ROI effect on PBV showed t value of table was 1.960, and t arithmetic was 3.0738, so ROE mediated significantly the influence of ROI on PBV.

CSR-DI did not mediate the influence of GCG mechanisms on PBV because: (a) GCG mechanisms did not effect on PBV; (b) GCG mechanism did not effect on CSR-DI; and (c) CSR-DI did no affect on PBV.

DISCUSSION

Institutional ownership influence on ROI, so the first hypothesis was accepted. The research result supported Abbasi et al. (2012), but unlike Hapsoro (2008) who conclude institutional ownership did not have effect on financial performance.

Independent board did not effect on ROI, so hypothesis 2 was rejected. This finding supported Romano et al. (2012) who stated independent commissioner board did not affect the profitability, but it was in contrary to research conducted by Abbasi et al. (2012), who indicated the presence of independent board had a positive effect on profitability.

Independent board did not effect on ROE, so hypothesis 3 was rejected. This finding supported Abdillah et al. (2015), but it was different from Ramdani & Witteloostuijn (2010), who proved the company which had larger independent commissioner had a higher ROE.

Board size did not effect on ROE, so hypothesis 4 was rejected. This finding supported Romano et al. (2012) and Bayrakdaroglu et al. (2012) who stated that the size of the number of commissioners did not effect the company's financial perfor-

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mance. The result of this study was different from Gill & Obradovich (2012) who found the board size affected the company's financial performance.

ROI influence on ROE, so hypothesis 5 was accepted. The results of this study showed that the company had managed its total assets productively so as to contribute positively to the return rate of capital invested by the owner.

Institutional ownership did not effect on CSRI, so hypothesis 6 was rejected. The results supported Wakidi & Siregar (2011) who proved institutional ownership did not affect the disclosure of CSR. However, it was contrary to research conducted by Matoussi & Chakroun (2008) who stated that institutional ownership affected the CSR disclosure.

Independent board did not effect on CSRI, so hypothesis 7 was rejected. The results supported Said et al. (2009) who proved the independent commissioner had no effect on CSR. However, it was in contrary to research conducted by Huafang & Jianguo (2007) who showed independent commissioner had effect on CSR.

Board size did not effect on CSRI, so hypothesis 8 was rejected. The results of this study rejected the findings of Sembiring (2005) and Mutia et al. (2011) who proved the number of commissioner board members had positive influence on CSR disclosure.

ROI influence on CSRI, so hypothesis 9 was accepted. The results of this study supported the findings of Tsoutsoura (2004) and Lindrawati & Budianto (2008), but they were different from Fauzi (2004) who stated that ROI had a negative effect on CSR.

ROE did not effect on CSRI, so hypothesis 10 was rejected. This study supported Lindrawati & Budianto (2008) who proved that ROE had no effect on CSR disclosure, but it was strongly influenced by ROI.

Institutional ownership did not affect on PBV, so hypothesis 11 was rejected. This finding supported Shahid (2003), but it was in contrary to research conducted by Arouri et al. (2014) and Thanatawee (2014), who proved that institutional ownership had positive effect on the firm value.

Board size did not affect on PBV, so the hypothesis 12 was rejected. The results of this study were different from Belkhir (2009) and El Essa et al. (2012), who proved the positive relationship between board size and firm performance.

ROI did not affect on PBV, so the hypothesis 13 was rejected. These findings supported Gusaptono (2010), but refused Mursalim et al. (2015) that proved ROI had a positive effect on firm value.

ROE influence on PBV, so hypothesis 14 was accepted. These findings supported Mardiaty et al. (2012) but in contrary to research conducted by Arafat et al. (2012) who proved return on equity did not affect the firm value.

CSR did not effect on PBV, so hypothesis 15 was rejected. These findings supported Suhartati et al. (2011) and Widyanti (2014), who proved that the area of CSR disclosure did not affect the firm value. These findings rejected Sarvaes & Tamayo (2012), Adeneye (2015) and Nguyen (2015), who proved the positive impact of CSR on firm value.

CONCLUSION AND SUGGESTION

Conclusion

The GCG mechanism that is proxy by institutional ownership is able to encourage companies to increase their ROI, and ROI can increase CSR activity and disclosure. However, CSR cannot increase firm value. ROI significantly mediates the influence of GCG mechanisms on CSR. GCG mechanism (institutional ownership) is able to encourage companies to increase ROI, and ROI

has a positive effect on ROE. Furthermore, ROE has a positive effect on firm value. ROE mediates significantly the impact of ROI on firm value.

Another finding is that the GCG mechanism has no effect on CSR, and as the representation of company owners. GCG mechanisms tend to reject various CSR financing. The impartiality of the company owners to CSR is reinforced by the negative effect of ROE on CSR. ROE is net income which becomes the rights of the company owner. CSR is positively influenced by ROI, where ROI is the rate of return of all investments including external capital (debt). It refers to Servaes & Tamayo (2013) who revealed CSR and firm value are positively related to the company with the high awareness of customers (investors). Conversely, companies with low awareness of investors have the negative or insignificant relationship.

Suggestion

For management, it should increase profitability because the firm value is determined by ROE and ROI, improve the implementation of GCG mechanism because the increase of ROI is determined by institutional ownership. For investors, they should invest aimed at profitable JII companies. The presence of institutional ownership is considered because it plays a role in increasing profitability and they should appreciate high values for CSR programs.

Limitations of this study, among others, are only done at JII company in BEI period 2007-2013, using internal GCG mechanism, variables for predicting CSR and firm values other than GCG mechanisms only use firm fundamental factors, analysis of panel data only uses pool regression models. Suggestion for further research is that it should include all industry sectors, macroeconomic variables and investor behavior, add external GCG mechanism, use time effect model and random effect model.

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