THE IMPACT OF CORPORATE GOVERNANCE ON THE TENDENCY OF SUSTAINABILITY REPORTING

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Abstract

This study aims to investigate the association between corporate governance and sustainability reports. We use binary logistic analysis in service industry companies listed on the IDX in 2018 to observe the relations between probability of the sustainability reporting and various factors related to corporate governance, including the capacity of the directors, the capacity of the commissioner, the capacity of the audit committees, and the independence of the directors. The result shows that there were significant differences between some of the corporate governance factors and the probability of reporting the sustainability report. Particularly in the capacity of the directors, where companies with higher number of board members and the frequency of board meetings have a higher probability of reporting sustainability reports. Then, the capacity of the audit committee, where companies with higher frequency of committee meetings have a higher probability to report sustainability reporting. This study adds information about corporate governance and sustainability reports. In addition, this study also provides empirical evidence and also provides suggestions that can be used by regulators in Indonesia on how the probability to report the sustainability reporting can be improved by enhancing the quality of corporate governance in the companies.

Keywords: *sustainability report, corporate governance, probability of the reporting*

Abstrak

Penelitian ini bertujuan untuk menginvestigasi korelasi corporate governance dan pelaporan *sustainability report*. Analisis *logistic binary* digunakan pada perusahaan industri jasa yang terdaftar di BEI pada tahun 2018 untuk mengamati hubungan probabilitas pelaporan *sustainability report* dan berbagai faktor yang berhubungan dengan *corporate governance*, termasuk kapasitas direksi, kapasitas komisaris, kapasitas komite audit, dan independensi direksi. Hasil penelitian menunjukkan ada beberapa hubungan signifikan antara *corporate governance* dan probabilitas pelaporan *sustainability report*. Utamanya ada pada kapasitas direksi, dimana perusahaan dengan jumlah anggota direksi dan frekuensi rapat direksi yang lebih tinggi memiliki probabilitas yang lebih tinggi untuk melaporkan *sustainability report*. Lalu pada kapasitas komite audit, dimana perusahaan dengan frekuensi rapat komite audit yang lebih tinggi memiliki probabilitas yang lebih tinggi untuk melaporkan *sustainability report*. Penelitian ini menambahkan informasi mengenai *corporate governance* dan *sustainability report*. Selain itu, penelitian ini juga menyediakan bukti empiris dan saran yang dapat digunakan oleh pembuat regulasi di Indonesia mengenai bagaimana probabilitas pelaporan *sustainability report* dapat ditingkatkan melalui peningkatan kualitas *corporate governance* suatu perusahaan.

Kata Kunci: *sustainability report*, *corporate governance*, probabilitas pelaporan

INTRODUCTION

The awareness of sustainability has grown significantly among the stakeholders over the last few decades, especially after environmental disasters. This awareness is believed to increase the quality of information for management to make decisions (Burritt, R.L., 2010). According to Agency Theory, companies can reduce information asymmetry through voluntary disclosure, so it can protect stakeholder's interest with lower agency cost (Cormier, D., 2005).

Nowadays, the method of sustainability disclosure is through voluntary disclosure and according to the standard Global Reporting Index (GRI). However, reporting is not fully explored, it is seen from the newest reporting GRI standard 2017. The current evolution and form of reporting has been based on CSR and environment reporting. Kolk, A. (2004) said that sustainability reporting has been significantly increasing and seen by the world. For example, even though there are slight changes, in Indonesia, they have another standard authorized by the Financial Services Authority (FSA) which is the Financial Services Authority Regulation Number 51/POJK.03/2017.

If we look at management performance, one of the main focus is Corporate Governance (CG). CG is a collection of rules in which companies are controlled and operated, including the relation between stakeholders. That's why Good Corporate Governance plays an important role in going concern. Without CG, companies can't grow and compete with competitors. CG can also increase the company's value in the eyes of investors. Companies' goals not only make profit, but also the ability to survive and increase investor trust in the company. That's why Corporate Governance is very important.

In this case, corporate leadership, especially company directors, have an important role in disclosing economic, social, and governance information through sustainability reporting. Given the main role of the boards in influencing the company's disclosure, we would like to conduct a cross-sectional study to test the relation between corporate governance and the observed variations in sustainability reporting among companies listed in Indonesia. This study focuses on two aspects of corporate governance, which are board capacity and board independence. It will give a comprehensive understanding between boards, which is the most important part of corporate governance and sustainability reporting in Indonesia perspective.

According to Indonesia's Legislations Number. 40 Year 2007 of the LLC, Board of Directors is the company's organ that is authorized and responsible for the management of the company for the company's interest be it from the inside or outside of the court in consistent with the clauses determined in the company's charter.

According to the Financial Services Authority Regulation Number 33/POJK.04/2014 Article 2, the member of a company's Board of Directors should at least be two people, where one of the Board members is appointed as Head of Director or President Director. Members of the Board of Directors are appointed and also discharged by the General Meeting of

Shareholders, where they can be appointed for a certain period and also be reappointed. The working period of the member of Board of Directors is at most, five years or until the closing of the General Meeting of Shareholders of the aforementioned end of one working period.

According to the Financial Services Authority Regulation Number 33/POJK.04/2014 Article 16, members of the Board of Directors are obligated to hold a meeting at least once a month and the attendance of the members must be disclosed in the issuer or public company yearly report. According to the Agency Theory, more members of the board will lessen the board’s control, therefore a larger board size would usually be deemed more effective in avoiding conflict of interest. The Board of Directors is also an important asset for the company by being skilled labour and for their association with the company’s external environment.

According to Indonesia’s Legislations Number 40 Year 2007 of the LLC, the Board of Commissioner is the company's organ that has a duty to conduct general or special supervision and provide advice to the directors. Also, to direct and supervise the board of commissioners in managing and representing the company.

According to Sembiring (2005), the size of the Board of Commissioner is the total number of the Commissioner in the company that supervises the Directors that run the company. According to the Financial Services Authority Regulation Number 33/POJK.04/2014 Article 20 the member of a company’s Board of Commissioner is at least two people. where one of the Board members is appointed as Head of Commissioner and the other as a member. The Board the Commissioner consists of more than two members. The Independent Commissioner must be at least 30% of the total members of the Board of Commissioner. Whereas, one of the members are appointed as the President Commissioner.

Board Meetings are the number of official board meetings that are held in order to fulfil the responsibilities as the supervisory board. It is to be expected with the more frequent the meetings, the board shall be able to increase the surveillance over the management and decrease the agency problem. According to the Financial Services Authority Regulation Number 33/POJK.04/2014 Article 31, The Board of the Commissioner is obligated to hold a meeting at least once or twice in four months and the attendance of the members must be disclosed in the issuer or public company yearly report.

According to the Financial Services Authority Regulation Number 55/POJK.O4/2015 about the Formation and Guidelines for the Implementation of Audit Committee Work, Audit Committee is a committee that formed by and responsible to the Board of Commissioners in helping to carry out the duties and functions of the Board of Commissioners. An Audit Committee must be independent, not involved in management tasks, and have experience in order to carry out supervisory duties effectively. In serving as a member, the Audit Committee may not be longer than the term of office of the Board of Commissioners and can be re-elected for only one subsequent period.

Good Corporate Governance (GCG) states that the board of commissioners must form an audit committee that consists of at least one or more members of the board of commissioners (Sutedi, 2011: 150). This is why the audit committee is responsible to the Board of Commissioners. The more members of the Audit Committee of a company, the more recommendations from the Audit Committee to the Board of Commissioners to disclose information that is useful for disclosure in the responsibility reports. Based on the Financial Services Authority Regulation Number 55 / POJK.04 / 2015, the Audit Committee in the company consists of at least three members from Independent Commissioners and parties outside the Issuer or public company, and is chaired by the Board of Commissioners.

According to the decision of the Capital Market and Financial Institution Supervisory Agency Number Kep-24 / PM / 2004, the Audit Committee meeting is held at least the same as the minimum provisions of the board of commissioners' meeting. The more frequently the Audit

Committee holds meetings, the better the coordination of the Audit Committee, with the hope that it can carry out supervision of management more effectively and can support the company in improving the publication of social and environmental information.

According to the New York Stock Exchange Section 303A.02(a) (i) (2009), a Director shall be independent only if the Board determines that the Director does not have any material relationships with the listed company, either directly or as a partner, shareholder or officer of an organization that has a relationship with the company. According to the Agency Theory, the main responsibility of the Board of Directors is to reduce the agency cost by overseeing the management activities to meet the interest of the shareholders. Compared to non-independent directors, independent directors are more wary and effective in the oversight function, and also more tolerant of shareholder costs. Companies that have a larger composition of independent directors are expected to exhibit a higher level of accountability and transparency.

METHODS

According to Sugiyono (2015:135), population can be defined as “a generalized area consisting of: objects or subjects with specific quantities and characteristics determined by the researcher to study and later, concluded.” As such, based on the aforementioned definition, we determined that all of the companies listed in the Bursa Efek Indonesia (BEI) are the population of this study.

According to Sugiyono (2015: 116), samples can be defined as “part of amount and characteristics owned by the population. If there is a large population, and the researcher is unable to conduct a study of all of the population, for example because of limited funds, energy, and time, then the researcher can use samples taken from the population.

The sampling technique used to determine the sample used by the researcher is the Non-Probability Sampling with Purposive Sampling approach. According to Sugiyono (2015:84), Purposive Sampling is a sample determination technique with certain considerations. This technique is used because not all samples have a matching criterion with what have been initially determined by us. As such, the researchers determined several criteria for sampling purposes, which are companies included in the recording board main category that are listed in the BEI in 2018, companies with financial statements ending on December 31st. This is to avoid partial time differences in the variable measurement, and companies that published their financial statements in Rupiah. This is to avoid translation differences caused by foreign exchange fluctuations.

We constructed the following model to examine the hypotheses in regards to the impact of board governance to sustainability reporting tendencies:

$$\mathbf{SR = \alpha0 + \beta1NOD + \beta2NOC + \beta3NOAC + \beta4NODM + \beta5NOCM + \beta6NOACM + \beta7DIN + \beta8LOGA + \beta9DER + \beta10ROA + e}$$

Where SR is sustainability report, NOD is no. of directors, NOC is no. of commissioners, NOAC is number of audit committee members, NODM is number of director meetings, NOCM is number of commissioner meetings, NOACM is number of audit committee meeting, DIN is percentage of independent directors, LOGA is company size, DER is the company’s leverage, and lastly, ROA is company’s productivity.

This model is used to research the relationship between corporate governance and the tendency of a company to publish a sustainability report. The dependent variable, sustainability report (SR), is a dummy variable. If the company reported sustainability for the year, it equals 1, and it equals 0 if the company did not report sustainability for the year.

The independent variable consisted of seven corporate governance, i.e., NOD, NOC, NOAC, NODM, NOCM, NOACM, and DIN, and three control variables, i.e., LOGA, DER, and ROA. Director capacity is measured by number of directors on board (NOD) and number of meetings conducted by the board of directors (NODM). Commissioner capacity is measured by number of commissioners on board (NOC) and number of meetings conducted by the board of commissioners (NOCM). Audit committee capacity is measured by number of audit committee in the company (NOAC) and number of meetings conducted by the audit committee (NOACM). DIN is measured by the number of independent directors divided by the total number of directors on the board. Based on previous studies, we used log of total asset, debt to equity ratio, and return on asset to control for company size (LOGA), leverage (DER), and profitability (ROA), respectively.

FINDINGS AND DISCUSSION

A. Description of Research Results

Table 1. Descriptive Variable Results

	N	*Min*	*Max*	Mean	*Std. Dev*
SR	333	0	1	.08	.269
NOD	333	1	12	4.56	1.957
NOC	333	1	15	3.93	1.905
NOAC	333	0	8	3.13	.727
NODM	333	0	188	16.48	16.409
NOCM	333	0	66	6.83	6.153
NOACM	333	0	36	5.68	5.462
DIN	333	0.00%	75.00%	20.10%	15.56%
LOGA	333	5.67	16.48	12.32	1.28
DER	333	-4308.60%	4315.00%	164.64%	418.58%
ROA	333	-543.0%	1076.0%	3.714%	77.26%
***Valid* N (*listwise*)**	333				

Based on the established criteria of samples we have explained earlier, we have gathered 333 data. Table 1 shows the results regarding descriptive statistics on the variables used. The mean of the dummy variable is 0.08, which means that 8% of the companies (26 of 333) reported SR in 2018. On average, companies in the service industry have five board members, undertook sixteen meetings in a year, and 20% of the members are independent. Furthermore, companies in the service industry have four commissioners, with a frequency of seven meetings in a year. And lastly, on average, companies in the service industry have three members of the audit committee, with a frequency of six meetings a year.

We used several hypotheses testing methods, the Nagelkerke R^2 test (Nagelkerke, 1991), Hosmer and Lemeshow test (Hosmer & Lemeshow, 2000), Classification Table, and Variable Significance Test.

Table 2. Model Summary

Step	***-2 Log likelihood***	***Cox & Snell R^2***	***Nagelkerke R^2***
1	98.257[a]	.224	.530

The results on table 2 of the Nagelkerke is 0.530. it shows that in general, the independent variables are capable of explaining 53% of the dependent variables.

Table 3. Hosmer and Lemeshow

Step	***Chi-square***	***df***	***Sig.***
1	1.731	8	.988

The results on table 3 of Hosmer and Lemeshow test shows 1.731 and with a significance of 0.988. As the significance is above 0.05, it shows how the model is capable of predicting its observational data. Which means, the model is fit for use.

Table 4. Classification Table

Observed			***Predicted***		
			SR		***Percentage Correct***
			0	**1**	
***Step* 1**	**SR**	**0**	304	3	99.0
		1	15	11	42.3
	Overall %				94.6

The results on table 4 of the clarification table shows how the accuracy of the model in reality is 11/26 or 42.3%. The better the model is, the closer the accuracy would be to 100%.

Table 5. Variables in Equation

		B	**S. E**	***Wald***	**df**	**Sig.**	***Exp* (B)**
***Step* 1[a]**	**NOD**	.432	.164	6,919	1	.009	1.540
	NOC	.164	.152	1.163	1	.281	1.178
	NOAC	.511	.340	2.261	1	.133	1.667
	NODM	.038	.019	3.822	1	.051	1.038
	NOCM	-.029	.058	.248	1	.618	.971
	NOACM	.148	.048	9.745	1	.002	1.160
	DIN	.010	.022	.216	1	.642	1.010
	LOGA	-.342	.229	2.225	1	.136	.710
	DER	.000	.001	.013	1	.909	1.000
	ROA	-.002	.010	.061	1	.806	.998
	Constant	-5.155	2.661	3.754	1	.053	.006

The results on table 5 of the variable significance test shows that independent variables NOD, NODM, and NOACM is significant of 0.008, 0.051, and 0.02 while the other independent variables (NOC, NOAC, NOCM, and DIN) is deemed insignificant. In conclusion, according to the logistic regression above, the tendency of a company to do sustainability reporting is positively correlated to the number of directors on board, the board's frequency of meeting, and the audit committee's frequency of meeting in a company.

B. Discussion

The results shown by the models and results in the findings section shows several consistencies with past studies regarding corporate governance and tendency of a sustainability report being published by a company. In terms of board capacity. In terms of board capacity, companies with a larger amount of board members and more meeting frequency are more likely to practice sustainability reporting. This is consistent with prior studies (Hu, M. 2018). For board independence, no significant effect is found between proportions of independent directors and the tendency of practicing sustainability reporting. For commissioner capacity, there seems to be no significant relations between the amount of commissioner members and meetings to that of the tendency of sustainability reporting. Lastly, for audit committee capacity, there does not seem to be significant influence caused by the size of the audit committee, this might be caused by the low variability in the independent variable, making it hard for the model to detect significant outcome. But a higher frequency of audit committee meetings might increase the tendency of sustainability reporting.

CONCLUSION

This study investigates the impact of corporate governance and the tendency of sustainability reports being published, specifically for companies in the service industry registered in BEI in 2018. We found that Board Capacity, which is the amount of board members and board meeting frequency, and also some of the Audit Committee Capacity, which is the frequency of Audit Committee meetings have a substantial relation with the tendency of sustainability reporting. Hence, our study suggests that the tendency can be increased by increasing the number of board members. Increasing the frequency of board meetings, and lastly increasing the frequency of audit committee meetings.

However, there are certain limitations to this study. First, the regression result depended on information gathered from annual reports published by companies, and therefore the information can only be as accurate as the level of disclosure that the company's practices. Furthermore, significant relationship that is identified in the study does not imply causation, which means that there is no certainty that significant relationship implies that the dependent variable is indeed caused by the existing independent variables. Lastly, the study does not explore other industries as the sample was taken exclusively from the service industry.

For future research, first, there are other corporate governance variables that can be further investigated. This study only uses seven of them (NOD, NOC, NOAC, NODM, NOCM, NOACM, DIN) and there are plenty of other factors that can still be further analysed, such as Commissioner Independency. Second, the sample was only taken from the service industry, therefore future research could analyse the industry as a whole, particularly for corporations registered in BEI, to further show the true conditions in Indonesia regarding corporate governance and SR reporting.

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