

THE EFFECT OF CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE TO THE QUALITY OF CORPORATE SUSTAINABILITY REPORTS

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ABSTRACT

The focus of this research is to examine how CG affects sustainability report quality using financial performance as a mediator. Companies listed on the Indonesia Stock Exchange for the years 2018 through 2021 made up the study's population. In total, 44 companies made up the study's sample. According to this study's findings, 1) CG has no direct impact on the quality of sustainability reports, 2) CG affects financial performance, 3) financial performance affects the quality of sustainability reports, and 4) CG has an indirect impact on the quality of sustainability reports through the use of financial performance.

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1. INTRODUCTION

The latest report was prepared with due regard to corporate social responsibility so that stakeholders get quality information [1]. To determine the quality of regularity reports, there are several principles, namely balance, comparability, accuracy, timeliness, clarity, and statement [2]. The purpose of producing quality reports is to communicate commitments, economic, environmental and social performance to stakeholders and the wider community in a transparent, structured and quality manner [1], [3], [4]. Through this report, stakeholders and the public are able to get a more open picture of all the sustainable development activities that have been carried out by the company. The quality of the signing report is very important to win the process of exploration, construction, modification, negotiation with stakeholders. A report is said to be of high quality if it has value for its readers [5], [6].

The quality of the sustainability report is corporate governance. CG can explain the relationship between various parties within a company and, consequently, determine the direction in which performance of the company is directed. [4]. Businesses with strong CG will be able to achieve strong corporate performance [7]–[9]. CG will give the company a positive image and boost investor confidence in it [10]. The business considers CG adoption to be another another way to uphold work ethics and business ethics, which has long been a company commitment. [10], [11].

Research on the quality of sustainability reports began to develop with mixed results. Handajani, Subroto, Sutrisno, & Saraswati (2014) found a positive influence between board effectiveness and disclosure of social responsibility [12]. According to research by Janggu et al. (2014), CG as defined by board size, professionalism, and appointments has a significant impact on sustainability disclosure, while neither board independence nor board ownership do [3]. In addition, the research by Nawawi, Agustia, Lusnadi, & Fauzi (2020) also provides results where the CG mechanism as measured by board size, board proportions, audit committee size, and managerial ownership has no significant effect on sustainability report disclosure [13].

Numerous research' findings indicate that other factors may have an impact on the sustainability report. Financial performance can be one of them [13]. Profitability is often the focus of stakeholders in assessing financial performance. Companies with the ability to generate high profits will have strong financial performance so they have the ability to disclose social and environmental responsibility [14], [15]. Profitability is an indicator that must be disclosed in a sustainability report. Therefore, companies with a high level of profitability tend to disclose sustainability reports. Research by Mishra & Mohanty (2014) and Ramli & Ramli (2016) proves that CG significantly influences financial performance [16], [17].

With financial performance as a mediator, the purpose of this research is to examine how CG affects the quality of sustainability reports. Companies listed on the Indonesia Stock Exchange for the years 2018 through 2021 make up the study's population. This is due to the fact that, despite a rise in companies

reporting sustainability in 2021, there are not many businesses in Indonesia using sustainability practices as documented in sustainability reports. Only 20% of the 154 companies listed on the Indonesian Stock Exchange have published sustainability reports [18].

2. LITERATURE REVIEW

Quality of Sustainability Report

A strategy for communicating company information to stakeholders, the sustainability report combines financial, social, environmental, and corporate governance reporting in one package [19]. The company's operating activities are limited by a social contract (licence to operate) in which the company agrees to take a number of actions expected by stakeholders in return for their agreement to achieve company goals [15]. The social contract is a tacit, unspoken agreement between a business and its constituents. Through credible sustainability reports, the company strives to draw attention to its compliance with the contract [3], [14], [20].

The quality of sustainability reports made by companies depends on corporate social responsibility information [1]. Measuring the quality of a report begins with determining user needs and identifying the attributes and qualitative characteristics of those needs [21]. The purpose of producing quality reports is to communicate commitments, economic, environmental and social performance to stakeholders and the wider community in a transparent, structured and quality manner. Through this report, stakeholders and the public are able to get a more open picture of all the sustainable development activities that have been carried out by the company.

Corporate Governance

In general, corporate governance is a system (input, process, output) and a collection of guidelines that regulate interactions among diverse stakeholders to achieve company goals [22], [23]. All business operations are directed and managed by the CG system. The company must be managed properly, measurably, and in accordance with the company's interests while also taking into account the interests of stakeholders because the company must be able to account for its performance in a transparent and fair manner. Accountability is another principle of CG. It requires that the company provide material and relevant information in a way that is easily accessible and understood by stakeholders. A company's management must be independent in order for one to not control the other and for third parties to be unable to intervene. And also, companies must always consider stakeholders in their operations based on the values of justice and equality. [2].

Financial performance

Financial performance is a measure of an organization's efficacy and efficiency in achieving its objectives. [24], [25]. To estimate prospective changes in economic resources that might be managed in the future and to forecast the production capacity of present resources, information on financial performance is required. [26], [27]. Companies with good financial performance will usually be better known by the public because financial performance is one of the parameters that can be used to measure a company's ability to earn profits [24], [28]. However, high financial performance cannot be used as a reference that the company is responsible for the business activities carried out. Therefore, management must be able to explain to its stakeholders how these benefits are obtained. The decision to disclose social information will be followed by expenses that can reduce income [29]. With strong financial performance, the company will be able to fulfill stakeholders' wishes to make broader disclosures through sustainability reports [4].

Hypothesis

Corporate Governance affects the Quality of Sustainability Report

Disclosure of sustainability reports can attract the attention of investors and help companies to obtain capital [30]. CG plays a role in encouraging companies to disclose sustainability reports [30]. Sustainability reports translate ecological, economic, and social facts to help decision makers and stakeholders [31]. In this situation, CG's responsibility is to make sure that the information provided is in line with stakeholders' interests, is transparent, pertinent, and reliable in order to eliminate information asymmetry through the efficiency of current monitoring mechanisms [20], [31]. The results of research Handajani et al. (2014) and Janggu et al. (2014) prove that there is an influence of CG on the quality of sustainability reports [3], [12]. This shows that the implementation of CG serves to ensure whether management behaves according to its social contract.

H1: CG affects the quality of the Sustainability Report

Corporate Governance affects Financial Performance

CG is a company steering and management system, which has a major influence in determining company goals, achieving optimal business performance, and controlling risk [32]. The application of CG is intended to minimize agency conflicts through the existence of a structure of supervision and management of the company that provides alignment of the company's interests with stakeholders. The application of CG is also intended to convince stakeholders, especially investors, that the company is not committing fraud against funds that have been invested in the company. Research Mishra & Mohanty (2014) and Abdallah & Ismail (2016) shows that there is an influence of CG on financial performance [16], [33].

H2: CG has an effect on financial performance

Financial performance affects the quality of the Sustainability Report

Companies that perform well financially tend to release more information because they want to demonstrate to the public and other stakeholders that they are performing better than other companies in the same industry [3], [14], [31]. To support this, it is necessary to have disclosures that are more in line with the needs of each user, namely through the media of disclosure of sustainability reports. Companies with strong financial performance have more ability to collect, classify, and process information to make it more useful and can make more comprehensive sustainability report disclosures [34].

H3: Financial Performance affects the quality of the Sustainability Report.

Financial Performance Mediates the influence of Corporate Governance on the quality of the Sustainability Report

Apart from CG, disclosure of sustainability reports can also be influenced by the company's financial performance [3], [14], [20], [31]. Companies with good financial management are able to create high profits from existing capital and will understand the importance of disclosing the company's social, environmental and economic activities, which will eventually be disclosed in a sustainability report (Fatemi et al., 2016). Companies with good financial performance have freedom and flexibility for management to disclose social responsibility to shareholders [35]. This means that the better the company's performance, the greater the disclosure of social information. In line with that, financial performance can mediate the influence of CG on sustainability reports. CG will directly encourage managers to work efficiently and effectively to improve financial performance by maximizing their capital [3], [4]. When a company has good financial performance, the company will be encouraged to carry out quality sustainability reports in order to improve the company's reputation and corporate image in society [3].

H4: Financial Performance Mediates the influence of CG on the Quality of Sustainability Reports

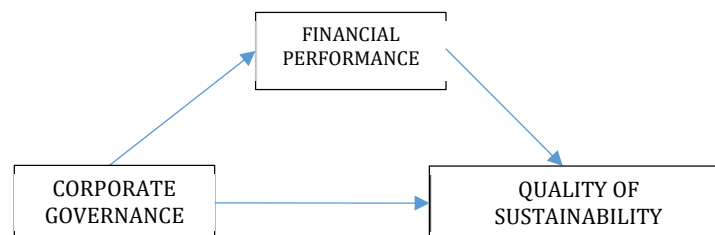


Figure 1. Conceptual Framework

3. METHOD

This is a quantitative study. Companies listed on the IDX make up both the sample and the population of this study, which covers the years 2018 through 2021. Based on the purposive sample methodology, data from 44 companies may be examined. Annual reports and sustainability reports served as the study's data sources, which were subsequently subjected to route analysis. GRI Standard is used to measure the quality of sustainability reports, ROA is used to measure financial performance, and SE OJK No. 32/SEOJK/04/2015 concerning Guidelines for Public Company Governance is used to measure corporate governance.

4. RESULT AND DISCUSSION

Result

Table 1 shows the results of the direct influence between variables. First, CG has an effect on FP with a standard deviation of 0.124, t statistic 4.492, and significant at 0.000. Second, CG has no effect on QSR

with a standard deviation of 0.091, a t statistic of 1.731, and a p value of 0.083. Third, FP has an effect on QSR with a standard deviation of 0.101, t statistic 7.116, and significant at 0.000.

Table 1. Path Coefficients

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistic (O/STDEV)	P Values
CG -> FP	0.557	0.555	0.124	4.492	0.000
CG -> QSR	0.158	0.165	0.091	1.731	0.083
FP -> QSR	0.716	0.709	0.101	7.116	0.000

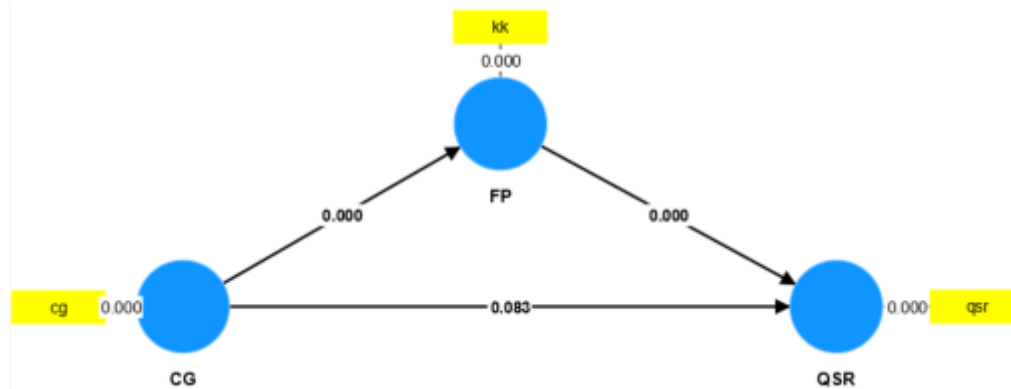


Figure 2. Path Coefficients

Table 2 shows the results of the indirect influence of CG on QSR through the mediating variable FP. This model has a standard deviation of 0.087, a t statistic of 4.599, and is significant at 0.000. These results indicate that there is an indirect effect of CG on QSR through FP.

Table 2. Indirect effect

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistic (O/STDEV)	P Values
CG -> FP -> QSR	0.399	0.389	0.087	4.599	0.000

Table 3 shows that the FP in this research model has an adjusted R-square value of 0.294. This shows that the FP variable is influenced by the independent variable by 29.4%. Furthermore, the QSR has an adjusted R-square value of 0.646. This shows that the QSR is influenced by the independent variable in this model by 64.6%.

Table 3. R-square

	R-square	R-square adjusted
FP	0.311	0.294
QSR	0.663	0.646

Discussion

Corporate Governance Has No Effect on the Quality of Sustainability Reports

The goal with a sustainability report should be to encourage responsible company action towards stakeholders rather than preventing wrongdoing [3], [20]. So that companies can monitor company activities, CG practices are needed. However, based on the results of this study, for companies in Indonesia, the implementation of CG has not been able to influence companies to produce quality sustainability reports. This is due to the company's supervisory board is more focused on financial performance. In addition, corporate sustainability reporting in Indonesia is voluntary so that its application is not maximized [36]. Sometimes companies disclose sustainability reports to meet the requirements of stakeholders without paying attention to quality so that they are only limited to reporting.

Corporate Governance Influences Financial Performance

The application of CG can reduce agency conflicts between principals and agents [37]. Principal is not able to handle the business directly. They provide managers control and accountability for running the business so that they can act on their behalf and for their own gain. Managers are motivated to make strategic, tactical, and operational decisions that will benefit themselves as a result of this transfer of responsibility [32], [37]. CG can boost a business's financial performance [25], [38]. Stakeholders will get a positive perception of companies that are managed with high accountability and responsibility so that they feel safe to invest [16]. The application of CG will minimize the risks arising from the company's activities so that it can reduce potential losses and achieve optimal profits. Better implementation of CG shows better company performance [39]. The decision-making process will take place better, because it is based on balance and accountability, so that it will produce decisions that are profitable for the company, such as increasing efficiency, creating a healthier work culture.

Financial Performance Influences the Quality of Sustainability Report

Financial performance plays an important role in non-financial activities such as corporate social responsibility [29]. This is a result of the belief that a company's capacity to satisfy societal needs is equivalent to that capacity to generate profits. In addition, the level of profitability can show how well the management of the company is managed. Companies that have high profitability will tend to spread good news [31]. Therefore, a company's high ROA reflects greater financial resources so that they will present other disclosures than those required to stakeholders, namely by presenting a sustainability report [4], [31]. Companies with the ability to generate high profits will have strong financial performance. So that companies have more ability to collect, classify, and process information to make it more useful and can disclose a more comprehensive sustainability report [14], [40], [41]. Therefore, the higher the company's profit, the higher the disclosure level of the sustainability report.

Corporate Governance Influences the Quality of Sustainability Reports Through Financial Performance

Corporate governance is crucial for enhancing overall business performance and implementing moral behavior throughout the entire organizational structure [20]. When there is a separation of ownership between the owner and/or shareholder (principal) and the manager (agent), the shareholder cannot be involved in management. By implementing CG, businesses may make sure that their managers are using their resources to maximize shareholder value. This is carried out to facilitate managerial effectiveness, to check compliance with the law, and to guard against improper and illegal behavior. The creation of effective CG aims to safeguard the interests of numerous stakeholders [3], [20], [35], [42].

The quality of sustainability reports made by companies depends on corporate social responsibility information [1]. The quality of sustainability reports is influenced by the existence of good CG to motivate companies disclose their performance, both financial and non-financial performance in order to produce quality sustainability reports [1], [3]. The application of CG is expected to increase the wider disclosure of sustainability reports, because the possibility for managers to hide information can be reduced. This shows that the CG function in overseeing management performance is going well so that the disclosure of sustainability reports made by the company will be wider. The application of CG alone is not enough to improve the quality of sustainability reports. Other things are needed such as good financial performance to improve the quality of sustainability reports.

Companies that have good and strong financial performance are more flexible in carrying out their business activities [41]. The company has an obligation to report all of its business activities in the sustainability report. Stakeholders need quality reports [1]. The CG function as supervisor and director is able to encourage companies to disclose company performance according to stakeholder needs [3]. Companies with good CG and financial performance will disclose their performance more broadly so that stakeholders get quality sustainability reports.

5. CONCLUSION

The findings of this study demonstrate that CG has an indirect impact on financial performance, a direct impact on financial performance, and a direct impact on sustainability report quality. Although CG cannot directly improve sustainability report quality, it can have an indirect impact through financial performance. It is anticipated that the adoption of CG will lead to a larger disclosure of sustainability reports. The standard of sustainability reports cannot be raised merely

by applying CG. To increase the caliber of sustainability reports, other factors are required, such as strong financial performance.

The recommendation from this study is that companies, especially supervisory boards, can focus more on disclosing non-financial performance, such as sustainability reports. This can be used as a bridge between the company and stakeholders to better communicate the goals and performance of the company as a whole. In addition, with a sustainability report the company can establish good relations with the surrounding community and avoid social conflicts that might occur.

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