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The Effect of Corporate Governance, Political Connection, and Executive Power on Corporate Social Responsibility Performance

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ABSTRACT

CSR is a form of sustainability activity that must be a concern for the company because it poses a risk to existence. This study aims to determine the effect of governance, political connections, and executive power on CSR performance. The research uses a quantitative approach with a positivism paradigm. The research population is all issuers of the manufacturing sector listed on the Indonesia Stock Exchange during the 2017-2021 period. The research sample was 89 companies with 445 observations. Data were analyzed using multiple regression. The results show that corporate governance has a positive effect on CSR performance, whereas executive power has a negative effect on CSR performance. The political connection does not affect CSR performance. This research confirms stakeholder theory, legitimacy theory, and agency theory. The study results are also useful for investors/creditors in making investment decisions in companies, and top management can adopt CSR strategies that affect sustainability. This study uses a more comprehensive measurement variable.

INTRODUCTION

Financial performance is no longer considered the only measure of the company's optimal performance. Social accounting believes that the company's optimal performance can also be measured from environmental and social aspects (Deegan, 344: 2014). Companies with good environmental and social performance will gain legitimacy and a positive response from the public (Triyani et al., 2020). Therefore, there is a shift in the focus of accounting reporting. The previous focus of accounting reporting was only limited to reporting on economic performance; through a triple bottom line perspective, reporting was expanded to incorporate social and environmental performance.

Activities related to social and environmental performance are known as Corporate Social Responsibility (CSR). CSR is a problem that must be a company's attention because it poses a risk to its existence. The case that occurred in Indonesia in the case of PT. Lapindo Brantas lost its existence because it was only profit-oriented. PT Lapindo Brantas carried out drilling that crossed the

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specified limits, which resulted in flooded residential, agricultural and industrial areas and affected economic activity in East Java (Intakhiya et al., 2021). This makes PT. Lapindo had to make compensation and went bankrupt. There is also the case of PT Indominco, a subsidiary of PT Indo Tambang Raya Megah Tbk. which is found guilty of dumping waste without a permit into the river and is subject to a fine of Rp. 2 billion (Kontan.co.id, 2018).

These cases prove that the existence of companies can be threatened not only because of economic problems but also by social and environmental problems. Therefore, companies must also focus on their CSR performance. One of the factors that can improve CSR performance is Good Corporate Governance. The study results show that governance proxied by the proportion of the board of commissioners can improve CSR performance because of supervision from an independent party (Hu & Loh, 2018; Nguyen & Nguyen, 2020; Ong & Djajadikerta, 2018). The opposite result shows that the proportion of the board of commissioners is not able to improve CSR performance because not all members of the board of commissioners are independent, so there is a lack of supervision, and the independent board of commissioners has not considered it necessary regarding the presence or absence of CSR disclosure (Ikhsan et al., 2021; Liana, 2019; Sulistyawati & Qadriatin, 2018; Suprobo & Setiadarma, 2017). One of the reasons for inconsistent study results is that Good Corporate Governance is still being tested individually (proxy). Therefore, this study will test Good Corporate Governance with the KNKG index, which refers to Surat Edaran Otoritas Jasa Keuangan (SE OJK) Number No.32/SEOJK.04/2015 concerning Guidelines for Public Company Governance. SE OJK is believed to be perfect because it has been guided by international practices, considering the industrial sector, size, and complexity of public companies. The measurement of governance using the KNKG index is also a novelty in this research.

Political connections are also proven to influence CSR performance. Companies with political connections with politicians or the government are more likely to disclose CSR (Muliwati & Hariyati, 2021; Rahman & Ismail, 2016; Sulistyowati & Prabowo, 2020). This is because the company will try to improve and create value for all its stakeholders, which will impact business sustainability (Muliwati & Hariyati, 2021). The opposite result shows that companies with political connections will reduce CSR disclosure (Hung et al., 2018; Muttakin & Khan, 2014; Saraswati et al., 2020). This is because having political connections through directors or commissioners will be easier for companies to obtain litigation protection to reduce CSR costs (Saraswati et al., 2020). Inconsistent study results are caused because most studies measure political connections with the proportion of government share ownership. This study will re-examine political connections by using measurements based on government structural positions with the status of Civil Servants (PNS) concerning the research of Supatmi et al. (2019). The novelty is believed to present more comprehensive results regarding the condition of companies with political connections in Indonesia.

The Chief Executive Officer (CEO) has an essential role in decisions regarding disclosure reporting (Rashid et al., 2020). The study results show that CEO power will have a negative impact on sustainability performance (Rachmawati et al., 2021; Rashid et al., 2020). This is because the CEO only focuses on the company's short-term economic benefits. At the same time, sustainability requires high costs, and the prospects for long-term profits are uncertain, so the CEO will consider it a waste (Martínez & Gallego-Álvarez, 2021). CEOs also consider financial issues more important than CSR issues (Rachmawati et al., 2021). The opposite result shows that the greater the power of the CEO, the higher the CSR disclosure (Ikhsan et al., 2021). CEOs will invest in CSR to balance the interests of all stakeholders and create a competitive advantage (Rashid et al., 2020). CSR activities can also reduce conflicts of interest (Jo & Harjoto, 2011). The results of previous studies were inconsistent because the CEO power measurement was still using CEO Status (Muttakin et al., 2018). According to the study this study will examine CEO power based on the annual compensation of the executive board of directors and commissioners (Maharani & Utami, 2019). Measurement of CEO power with compensation is believed to provide more precise results about CEO power.

MATERIALS AND METHODS

MATERIALS

Legitimacy theory

Legitimacy theory believes in a social contract between the organization and the organisation's environment. The social contract is challenging to define explicitly but can be thought of as a concept that presents implicit and explicit public expectations regarding how organizations should operate. The public expects that a successful company will think about the impact on humans, the environment and other social consequences of the company's activities. The public also expects that the company will overcome and prevent damage to the environment and ensure the safety and health of consumers, employees, and the people in the product manufacturing and waste disposal environment. The consequence is that companies that show poor social and environmental performance will find it challenging to get resources and operational sustainability support from people who want environmental cleanliness.

The community will allow the organization to continue its operations when the company's operations meet the community's expectations and not just meet the interests of investors. Suppose the organization or company fails to meet community expectations. In that case, the community will impose sanctions in the form of filing lawsuits and limiting resources and reducing demand for these products. If it is associated with a social contract, then a company that does not operate to public expectations, the community can revoke the company's sustainability “contract”.

Changes in people's expectations must be adapted and followed by the company. This means that when public expectations about performance change, the company must show that what the company does is also changing. Organizations can use disclosure of information to the public in the annual report to implement several strategies to meet these expectations. Companies, through annual reports, can eliminate terrible news that will have a negative impact when published or highlight the company's advantages by displaying environmental awards won or company security implementations.

Stakeholder Theory

Stakeholder theory has several parts, namely ethical (moral) or normative and positive (managerial). The moral and normative perspective of stakeholder theory argues that all stakeholders have the right to be treated fairly by the organization. Stakeholders are divided into two, namely primary and secondary stakeholders. Primary stakeholders are parties whose participation impacts the sustainability of the company's operations. Meanwhile, secondary stakeholders are parties that influence or are influenced by the company but are not involved in the company's transactions and have no effect on the company's survival. The perspective of ethics and norms more broadly assumes that all stakeholders have fulfilled rights, rights that should not be violated and the right to obtain organizational information.

The managerial perspective of stakeholder theory explains that company management tends to meet the expectations of specific stakeholders (who have power). Stakeholders are identified based on the company's interests. The more essential stakeholders are to the company, the more effort management will put into the relationship. Organizations cannot respond to all stakeholders in the same proportion but will tend to pay more attention to stakeholders who have an impact on the organization. Gomes (2006) stated that the higher the hierarchy of stakeholder groups, the stronger their influence and the more complex the requests to be made.

Based on the managerial perspective of stakeholder theory, information (including financial information and organizational social performance) is the main element that can be arranged (or manipulated) by the organization to stakeholders to gain support and acceptance or reduce stakeholder resistance and resistance. Taghian et al. (2015) states that developing the reputation of a socially responsible company through the performance and disclosure of social responsibility activities is part of a strategy for managing organizational relationships with stakeholders.

Agency Theory

Agency theory explains that there is a contract between one or more parties (the principal) which involves another party (the agent) performing some services on behalf of the principal and delegating some decision-making authority to the agent (Jensen & Meckling, 1976). Agency theory is a branch of game theory that studies contract design to motivate rational agents to act on behalf of the principal when there is a possible conflict of interest between the agent and the principal (Scott, 2015). Agency conflict in the company arises because of information asymmetry. Namely, the agent has more relevant information than the principal, so the principal cannot assess the agent's performance by the contract or not. To ensure the performance of agents, principals will increase supervision, which causes an increase in agency costs (Armour et al., 2009).

Agency conflict is divided into the first, second, and third types of agency conflict. The second type of agency conflict occurs between the majority shareholder (principal) and minority shareholder (agent). This conflict arises because the majority party has stronger control to influence the outcome of decision making than the minority party. The second type of agency conflict can also occur between common and preferred shareholders and senior and junior creditors. The third type of agency conflict occurs between internal companies (agents) and external companies involved in contracts (principals), such as creditors, employees and consumers. This conflict explains the difficulties in ensuring that companies do not act opportunistically and harm external parties, such as defrauding creditors, exploiting employees and misleading consumers (Armour et al., 2009).

Research Hypotheses

Effect of GCG on CSR Performance

CSR activities are a form of political cost due to conflicts of interest and information asymmetry between principals and agents. Principals want maximum CSR performance, while agents consider costs and benefits when making decisions to do CSR (Yip et al., 2011). One of the efforts to minimize agency conflicts within the company is implementing good corporate governance. The implementation of corporate governance is expected to improve the company's supervisory mechanism from internal, external, and government parties (Kim et al., 2010), encouraging more optimal CSR performance.

Optimal implementation of supervision through corporate governance is considered to improve CSR performance carried out by companies (Giannarakis et al., 2020; Hu & Loh, 2018; Nguyen & Nguyen, 2020; Ong & Djajadikerta, 2018). This is because corporate governance requires the creation of a fair distribution of rights and responsibilities carried out by companies and stakeholders (OECD, 2015). Disclosure of optimal social and environmental performance can also minimize agency costs (Giannarakis et al., 2020). In accordance with these reviews, the hypotheses that can be formulated are:

H1: GCG has a positive effect on CSR performance

Effect of Political Connections on CSR Performance

CSR is now becoming an integral part of business, especially in large-scale companies (Porter & Kramer, 2006; Sahut et al., 2019). CSR activities certainly require no small amount of money. Therefore, companies will take advantage of their political connections to gain stakeholder legitimacy apart from CSR activities. Having relationships with politicians or government officials can help companies obtain less CSR oversight (Muttakin & Khan, 2014).

The study results show that the presence of politically connected board members in companies will reduce CSR disclosure (Hung et al., 2018; Muttakin & Khan, 2014; Saraswati et al., 2020). This is because political connections facilitate companies to obtain funding/capital more easily, reduce public pressure, and reduce litigation risk (Saraswati et al., 2020). Therefore, environmental and social activities will reduce the need to gain legitimacy. Based on the description above, the hypotheses that can be formulated are:

H2: Political Connections have a negative effect on CSR Performance

Effect of CEO Power on CSR Performance

Stakeholder theory states that stakeholders are parties with interest in the company who can influence or can be influenced by the company's activities. The CEO can control the company's operational activities, including CSR performance. The company's activities include how the company flexibility in increasing company profits. CEOs with high power can create conflicts between managers and shareholders, leading to agency problems.

The results of the study show that the greater the power of the CEO, the higher the CSR disclosure (Ikhsan et al., 2021). High compensation is expected to reduce conflicts of interest (Jo & Harjoto, 2011). CEOs with high compensation are believed to be no longer oriented towards personal wealth but will carry out their responsibilities as best they can. Therefore, CEOs with high compensation will maximize CSR performance to stakeholder expectations.

H3: CEO Power has a positive effect on CSR Performance

METHODS

Population and Sample

The population of this study is all issuers of the manufacturing sector listed on the Indonesia Stock Exchange during the 2017-2021 period. The population list is accessed in the statistical report through the website www.idx.co.id. Samples were selected using the purposive sampling method. The criteria for selecting the sample are as follows:

1. The company is consecutively listed on the Indonesia Stock Exchange from 2017 to 2021.
2. The company reports CSR activities in the annual report from 2017 to 2021.
3. The company publishes an annual report successively from 2017 to 2021.

Data and Data Sources

The data used is secondary data obtained from the annual report on the www.idx.co.id website and the websites of each company.

Research Variabel and Measurement

CSR Performance (Y)

CSR performance is part of sustainability activities. CSR performance is the company's performance in terms of economic, social and environmental sustainability (Deegan, 2014). CSR reports are useful as a fulfilment of responsibilities to stakeholders to provide information related to the company's interactions with the physical and social environment as well as information related to company support to employees, local communities, foreign communities, safety records and the use of natural resources (Deegan, 2014).

Setiani & Sinaga (2021) formulated as follows: CSR performance assessment is based on the G4 sustainability report guidelines issued by the Global Reporting Initiative, which consists of several indicators from economic, environmental, and social categories. The company's CSR index is assessed by giving a score of 1 if there are disclosures according to the GRI indicators and a score of 0 if there are no disclosures or disclosures that are not by the GRI indicators (Merkusiwati & Damayanthi, 2019).

$$\mathrm{CSRDIj} = \frac{\sum \mathrm{Xij}}{\mathrm{n}}$$

Ket:
CSRDIj = Corporate Social Responsibility Disclosure Index
$\sum$Xij = The number of disclosures disclosed by the company
n = CSRDI disclosure items, ≤ 77 item.

Corporate Governance/CG (X1)

CG is defined as an effort to create a trusted, transparent and accountable corporate environment needed to encourage long-term investment, financial stability and business integrity to support the growth of stronger companies and more inclusive society (OECD, 2015). CG in this study will be assessed using an indexing mechanism using recommendations for good corporate governance based on the Surat Edaran Otoritas Jasa Keuangan No.32/SEOJK.04/2015 concerning Guidelines for Public Company Governance. Public Company Governance Guidelines cover 5 aspects, 8 principles of good corporate governance and 25 recommendations for the implementation of aspects and principles of good corporate governance. The use of the KNKG index in the study refers to Setyastrini et al. (2021), calculation which is formulated as follows:

$$\mathrm{KNKG} = \frac{\text{Number of Items Revealed}}{\text{Total Overall Indicator Items}}$$

Political Connection (X2)

Companies classified as politically connected companies are companies in which one of the major shareholders or the board of commissioners or the board of directors of the company is: (a) a member of parliament, (b) a minister or head of a regional government or (c) has a relationship close to politicians or political parties (Habib et al., 2017). This study uses the following criteria for companies that have political connections:

1. There is at least one block shareholder (ownership above 20%) or majority shareholder currently or has served as a government official, military or police official, and a political party figure.
2. At least one of the company's top executives (board of commissioners, board of directors and company secretary) currently or has served as a government official, military or police officer and a political party figure.
3. Political connections through family members, namely parents, spouse, children and siblings who are relatives of the president or former president, vice president or former vice president, become one of the blocks or majority shareholders or are currently occupying the company's top executive ranks.

The political connections in the company will be scored according to their position or position and status. The scoring in this study refers to Supatmi et al. (2019) research. The scoring will be distinguished between the political connections of those who are (still) in office during the research period and those who are no longer in office (former). A higher score will be given to companies with political connections that are (still) in office. This is based on the consideration that the level of connection provided by the party that is (still) in the office is higher than the party that has finished serving. Scores for political connections who are still in office are given a score of 2 (lowest level) to 9 (highest level). Politically connected parties who are no longer active (former) will be given a score of 1 (lowest level) to 8 (highest level). Companies with no political connections will be given a score of 0.

The political connection index (IKP) owned by the company will be calculated by the natural logarithm of the total political connection score in the company plus one point or can be formulated as Ln(IKP)= Ln(1+IKP). This calculation is based on consideration of the tendency of the index of political connections and the existence of companies that do not have political connections (Sutrisno et al., 2019; Tao et al., 2017).

CEO Power (X3)

CEO is a position for the highest executive ranks in a company or can also be called company executive (Rachmawati et al., 2021). CEOs in Indonesia usually consist of a board of commissioners and a board of directors (Maharani & Utami, 2019). CEO power in this study was measured using the natural logarithm of the total value of compensation received by the board of commissioners and the board of directors for one year reported in the annual report according to the study (Maharani & Utami, 2019).

CEO Power = Ln(Total Executive Compensation)

RESULTS AND DISCUSSION

Descriptive Statistics

The following is a table of descriptive statistics generated in the following research:

Table 1. Descriptive Statistics

	N	MIN	MAX	MEAN	STD. DEV
CSR PERFORMANCE	**445**	**0,00**	**0,96**	**0,2521**	**0,10877**
GCG	**445**	**0,24**	**1,00**	**0,7138**	**0,24704**
KONEKSI POLITIK	**445**	**0,00**	**3,78**	**1,3594**	**1,23810**
CEO POWER	**445**	**0,04**	**1,19**	**0,4941**	**0,20369**

Based on table 1 the average value of CSR Performance is 0.2521 with a standard deviation of 0.10877. The mean value greater than the standard deviation indicates that the minimum and maximum values have small variations or gaps during the observation period. GCG is assessed by measuring how many companies have implemented recommendations by Surat Edaran Otoritas Jasa Keuangan No.32/SEOJK.04/2015. Based on table 1, the sample companies, on average, have a recommendation application value of 0.7138 or have implemented 17 to 18 recommendations based on the SE OJK. The standard deviation value of 0.234704 is smaller than the average value indicating the low variation between the minimum and maximum values during the observation period. CEO power has an average value of 0.4941 and a standard deviation of 0.20369. This value indicates that the minimum and maximum values during the observation period have small variations or gaps.

Hypothesis Testing

Table 2. Regression Test Results

Variable	Coefficient	T value	Sig.	Sig. two tailed	Decision
Corporate Governance	0,046	2,207	0,028	0,014	H1 Accepted
Political Connection	-0,001	-0,157	0,876	0,438	H2 Rejected
CEO Power	-0,059	-2,322	0,021	0,0105	H3 Rejected
F	3,337				
Sig F.	0,019				
Adj *R2*	0,016				

The data from this research is analyzed by utilizing the multiple linear regression analysis. The regression model in this research has fulfilled the classical assumption test namely normality test, heteroscedasticity as well as multicollinearity. The regression result of this research is presented in Table 2. Based on Table 2, this research has the value of adjusted *R2* amounting to 0,016. Such a number means that th variable in the model could affect the tax aggressiveness amounting to 1,6% as well as for the rest, they are influenced by other variables that are not included in the research model. Test F aims to examine the model conformity as well as to observe whether there is an independent variable or not that influences the dependent variables. Test F of this research has the value of sig ANOVA α < 0,05 (0,016) with the F value amounting to 3,337. This means that there is at least one influential independent variable namely corporate governance, political connection, CEO Power. Table 2 shows that the corporate governance variable has a significant value of significance amounting to 0,014 < 0.05. This result indicates that the corporate variable does affect CSR peformance.

Based on the result, it could be concluded that H1 is supported. The variable of political connection has a value of significance amounting to 0,438 > 0,05. This result indicates that that the variable of political connection doesn’t affect CSR peformance. Based on such a result, it could be concluded that H2 is not supported. CEO power has a value of significance amounting to 0,0105 < 0,05 with the coefficient marked as negative. This result indicates that the variable of CEO power has a negative effect on CSR peformance. The negative coefficient towards CSR performance means the decrease of CSR acitivity. Based on such a result, it could be concluded that H3 is not supported.

DISCUSSION

Corporate Governance and CSR Peformance

Based on the results of the hypothesis testing, corporate governance influence CSR peformace. This finding is different from the finding of Castillo-Merino & Rodríguez-Pérez (2021) dan Wardah & Nugrahaningsih (2020), that corporate governance is able to minimize CSR peformance, but is consistent with the finding of (Fajriyanti et al., 2021), that corporate governance is able to maximize CSR peformance. Further, the results of this study do support the application of corporate governance to increase control from the perspective of stakeholder theory. Corporate governance regulates the relationship between stakeholders and internal and external companies in fulfilling the interests of each party which can create an increase in CSR performance in manufacturing company. Based on the results of the descriptive statistics in Table 2, the sample companies have shown the implementation of good corporate governance with the mean value of 0,7138 or 71.,38%. The good application of corporate governance is believed to be as an effort to maximize CSR performance and sustainability of business

Political Connection and CSR Peformance

Based on table 2, it is known that political connections do not affect CSR performance. The results of the study are consistent with Hung et al. (2018); Saraswati et al. (2020); and Wardah & Nugrahaningsih (2020). Companies with political connections will reduce CSR. Having political connections in executive positions will make it easier for companies to obtain law (Saraswati et al., 2020).

CEO Power and CSR Peformance

The hypothesis test results found that the CEO Power variable has a significance value of 0.021 with a negative coefficient. The amount of annual compensation received by the CEO (executive) will reduce the company's CSR activities. CEOs prefer to maximize short-term economic profits. CSR requires high costs, and long-term profit prospects are uncertain and considered a waste. The results follow the research of Rachmawati et al. (2021) and Rashid et al. (2020).

CONCLUSIONS AND SUGGESTION

This study examines the effect of Good Corporate Governance (GCG), political connections, and CEO power on CSR performance. The hypothesis test results prove that the implementation of GCG affects the company's CSR performance. Corporate governance can control and manage the relationships of all stakeholders to fulfill their respective interests, including CSR performance. Companies with political connections tend to reduce CSR activities. CEOs with high compensation will reduce CSR activities because they are more oriented to short-term profits.

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