

# THE RELATIONSHIP BETWEEN GOVERNANCE ON SUSTAINABILITY AND PERFORMANCE

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## ABSTRACT

*This study examine the indirectly effect between good corporate governance (GCG) and performance, using sustainability disclosure as mediating variable. Based on the data from rating of IICG (Indonesian Institute for Corporate Governance) 2007-2009, the findings show that sustainability disclosure influence to performance whereas GCG doesn't influence to sustainability disclosure. The findings also indicate that sustainability disclosure doesn't have mediation role on the relationship between GCG and performance. This prediction doesn't consistent that governance is expected can improve corporate sustainability disclosure which is reflected in sustainability report. Through sustainability, it should be implementation of governance will be increasing corporate performance.*

Keywords : governance, sustainability, performance, information disclosure

## I. INTRODUCTION

Agency problems often have arisen because of interest conflict between principal and agent that cause agency cost (Jensen Meckling, 1997; Eisenhardt, 1989; Scott, 2009). Agency theory try to explain about formulating contract efficiently, but it is not enough to solve agency problems.

Corporate governance is one of way to answer the limitation of agency theory. Governance issue was rise when business scandal in England in 1950 and to be continued until 1980. Issue of corporate governance in Indonesia start at 1995, when Indonesia government issue regulation of UU No.1 / 1995 and revised with UU No.40/2007 about Perseroan Terbatas. Kamal (2008) state that expectation of Indonesia government to realized GCG is never reached.

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The effort to improve public trust to public company in Indonesia is done by fulfill minimal requirements in composition of commissioner board. One of commissioner duties is reviewing and giving approval to annual report so that it will be valuable for users. Corporation have to provide the information which it will be basic on decision making by users.

The crucial point which have noted in the interim report of Forum GCG Japan in 1997 was the rise of principles that corporation should not only disclose information which compromise with shareholder interest, but also to all stakeholders and they have to up grade quality of information. Then implementation of GCG is expected to reduce information asymetry between principal and agent as a consequences of agency relationship.

Prior study about the relationship between implementation of GCG to information disclosure in Indonesia have done by Sabeni (2002) and khomsiyah (2003) which use sample of corporation in IICG (Indonesian Institute for Corporate Governance) ranking show that there are relationship between corporate disclosure index and level of disclosure. Hastuti (2005) examine the relationship of corporete governanace and ownership to organisational performance. Corporate governance are measured by accountability and transparancy. Information disclosure focuses on financial disclosure. The findings show that there aren't relationship between ownership and accountability to corporate governance. Conversely that there are the influence of transparency and performance.

The study about direct influence of governance to perfomance have done by Brown and Cyler (2004) which examine the influence of gov-score (director bord, charter/bylaw, director education, ownership, progressive practice, and state of corporation) to organisational performance. The findings show that there is negative influence between governance and performance. This is consistent with Bauer, et al (2003). Study of Jog explain that there isn't influence of GCG mechanism and performance. This indicated that there is indirect influence between GCG and performance. This study purpose to examine the indirect influence between GCG and performance using sustainability disclosure as a mediating variable.

## **II. RELATED RESEARCH AND HYPOTHESIS DEVELOPMENT**

### **The influence of GCG to Sustainability Disclosure**

Agency cost and information asymetry as part of problems that rised as a consequences of agency theory. For this reason, the company should provide information to users transparently as basis for decision making. One of mechanism to minimise information asymetry is by implementing good corporate governance (GCG) which it could influence the information disclosure. Bier et al (2002) examine the role of ownership and competition to explain practice of voluntary disclosure USA's companies. The results show that ownership (more than 20%) tend to disclose more voluntary information, as well as the company in higher competition. Lang and Lundholm (1993) explain that higher rate of information disclosure are done by companies whose lower symetry information. There is positive influence between GCG and disclosure index. (Sabeni, 2002; Khomsiyh, 2003).

Based on the assumption above, companies which doing GCG (good corporate governance) will disclose more information to decrease information asymmetry, so the formulation of hypothesis is :

*H1 : GCG influence to sustainability disclosure*

### **The influence of Sustainability Disclosure to Organisational Performance**

Jenkin (1994) report the study of AICPA committee about nature and scope of information which should be prepared by management to fulfill users's need. The result recommend that companies should prepare amount of additional disclosure including segmental information, non financial and forwardlooking information. The recommendation have inspired researchers to look the benefit of information broad scope. Botosan (1997) and Sengupta (1998) find that information broad scope can decrease cost of capital and increase liquidity (Diamond and Verrechia, 1991) and increasing stock return (Healy, et al, 1999). Widiastuti (2002) find that voluntry disclosure have effect positively to earnings response coefficient (ERC). Murni (2003) result that there are relation between voluntary disclosure, asymmetry information and cost of equity. So that hypothesis formulation as below :

*H2 : Sustainability disclosure influence to performance*

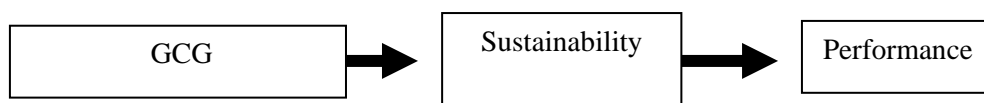
### **The Relationship Between GCG, Sustainability Disclosure and Performance**

Prior research examine the relationship between GCG, sustainability disclosure and performance directly. Implementation of GCG will influence performance effectively if there is supporting in information disclosure feasibility. So that information disclosure in this case sustainability mediate the relation between GCG and performance. Arifin (2003) examine that GCG influence to performance, the result show that high level of GCG will increase performance because the companies provide information more accurate and complete. Kusumawati and Riyanto (2005) find that level of transparancy in governance influence to market value positively.

Contradictory findings (Midiastuti and Machfoedz, 2003) show that ownership doesn't influence to value of the firms. Ferguson , et al (2002) find that pressure to implement GCG in public company will increase level of information disclosure in this case strategies, financial and non financial information. Landier, et al (2005) and Trangadisaikul find that governance will increasing performance. So the formulation of hypothesis as below

*H3 : sustainability disclosure mediate the relationship between GCG and performance.*

### **Model**



### III. SAMPLE AND METHODOLOGY

#### Sample Description

Sample in this study are companies which listed in Indonesia Stock Exchange (IDX) and including in rating IICG (The Indonesian Institute for Corporate Governance) for 2007-2009. Total of 45 annual report we examine in this study which we collect from website every companies.

#### Empirical Models and Variable Definitions

To test H1 and H2, I use empirical model that is Spearman Correlation to examine whether GCG influence to sustainability disclosure and then Sustainability disclosure influence to performance.

To test H3, which to show the mediating effect of sustainability disclosure on GCG and performance, I use empirical model below :

$$Y = b_0 + b_1 X_1 + e \quad \dots\dots\dots (1)$$

$$Y = b_0 + b_1 X_1 + b_2 Z_1 + e \quad \dots\dots\dots (2)$$

Where :

Y = performance

b = regression coefficient

X<sub>1</sub> = GCG

Z<sub>1</sub> = sustainability disclosure

Decision criteria for mediating effect as below:

- 1) b<sub>1</sub>, for equation 1 is significant
- 2) b<sub>2</sub>, for equation 2 is significant
- 3) adjusted R<sup>2</sup> for equation 2 more than equation 1
- 4) level of significance b<sub>1</sub> in equation 2 less than equation 1.

This study examine three variables, they are GCG, sustainability disclosure, and performance. GCG is measured by CGPI (corporate governance perception index) which issued by IICG. CGPI componnets consist of corporate governance priciples which developed by 7sMcKinsey including 10 aspects : commmitment, transparancy, accountability, responsibility, independency, justice, competency of management and controller, mission statements, leadership of top management, and collaboration between staf and management. This index use interval scale 1 – 100.

Sustainability disclosure is measured by environmental disclosure in annual report. Weighted score using Indonesian Environmental Reporting (IER) which reflect the need of stakeholders.

Table 1 : Indonesian Environmental Reporting (IER) Index

<i>No.</i>	<i>IER Items</i>	<i>IER Index (Weighted)</i>
1	Impact of Using Water	3.25
2	Incidents and Fines	3.05
3	Program for Protection	2.27
4	Waste by Type	1.99
5	Impacts of Activities	1.91
6	Materials by Type	1.84
7	Environmental Expense	1.63
8	Discharges Water	1.58
9	Other Air Emissions	1.54
10	Withdrawals of Ground Water	1.44
11	Land Information	1.43
12	Volume of Water Use	1.41
13	Energy Consumption	1.29
14	Performance of Supplier	1.25
15	Impact of Discharges Water	1.05
16	Impact of Transportation	1.05
17	Impact of Products	0.95
18	Land for Extraction	0.84
19	Spills of Chemicals	0.76
20	Indirect Energy	0.67
21	Renewable Initiatives	0.59
22	Habitat Changes	0.42
23	Other Indirect Energy	0.41
24	Recycling Water	0.37
25	Hazardous Water	0.36
26	Impermeable Surface	0.30
27	Affected Red List Species	0.30
28	Impact of Activities on Protected Areas	0.28
29	Waste of Material	0.20
30	Direct Energy	0.19
31	Greenhouse Gas Emissions (GGEs)	0.14
32	Recycling Materials	0.10
33	Emissions of Ozone Depleting Substance	0.08
34	Other Indirect GGEs	0.02
35	Operations in Protected Areas	0.02
	<b>Mean</b>	1.00

*Source : Subardjanto, Tower dan Brown (2007)*

Organisational performance is measured with market to book ratio that reflect market price of stock in the end of the year.

#### IV. RESULTS

Table. 2 provide spearman correlation test. The correlation value (2-tailed) = 0.282 more than probablity value 0.05 which prove that GCG doesn't influence sustainability disclosure. So that H1 is not supported. This findings contradiction with previous studies (Sabeni, 2002 ; Khomsiyah, 2003).

The correlation value 0.023 between GCG and performance which is less than 0.05 shows that GCG influences performance. So that H2 is supported based on statistical analysis.

Table 2. Test of Spearman Correlation

			GCG	Pengungkapan Informasi	Kinerja
Spearman's rho	GCG	Correlation Coefficient	1.000	-.164	-.116
		Sig. (2-tailed)	.	.282	.449
		N	45	45	45
	Pengungkapan Informasi	Correlation Coefficient	-.164	1.000	-.338*
		Sig. (2-tailed)	.282	.	.023
		N	45	45	45
	Kinerja	Correlation Coefficient	-.116	-.338*	1.000
		Sig. (2-tailed)	.449	.023	.
		N	45	45	45

\*. Correlation is significant at the 0.05 level (2-tailed).

To see the effect of mediating variable, I develop two model regression: linear regression and multiple regression as look at table 3 and table 4 and then see the mediating criteria.

Table 3. Linear Regression

		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
Model		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	.689	2.390		.288	.775		
	GCG	-.521	1.259	-.063	-.414	.681	1.000	1.000

a. Dependent Variable: Kinerja

Model Summary<sup>b</sup>

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.063 <sup>a</sup>	.004	-.019	.3494770	1.336

a. Predictors: (Constant), GCG

b. Dependent Variable: Kinerja

ANOVA<sup>b</sup>

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.021	1	.021	.171	.681 <sup>a</sup>
	Residual	5.252	43	.122		
	Total	5.273	44			

a. Predictors: (Constant), GCG

b. Dependent Variable: Kinerja

Table 4. Multiple Regression

**Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.348 <sup>a</sup>	.121	.079	.3321429	.121	2.898	2	42	.066

a. Predictors: (Constant), Pengungkapan Informasi, GCG

b. Dependent Variable: Kinerja

**Coefficients**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.108	2.350		.897	.375
	GCG	-.938	1.209	-.113	-.775	.443
	Pengungkapan Informasi	-.581	.245	-.346	-2.368	.023

a. Dependent Variable: Kinerja

**ANOVA**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.639	2	.320	2.898	.066 <sup>a</sup>
	Residual	4.633	42	.110		
	Total	5.273	44			

a. Predictors: (Constant), Pengungkapan Informasi, GCG

b. Dependent Variable: Kinerja

Table 3 Anova F test = 0.681 morethan 0.05 show that all of the model is not significant, it means that GCG doesn't influence performance. We can see that coefficient beta 0.681 which morethan 0.05. The value R square = 0.004 which show that only 4% GCG can explain performance and 0.96% is influenced by another factors.

Table 4 Anova F test = 0.066 morethan 0.05 show that all of the model is not significant, it means that GCG and sustainability disclosure don't influence performance. If we use level of confidence alpha = 0.1 we can decide that the model is significant.

Further to see mediating effect we have to fulfill the decsion criteria as below :

$$Y = 0.288 - 0.414X_1 + e \quad \dots\dots\dots \text{equation (1)}$$

$$Y = 2.108 - 0.938X_1 - 0.581Z_1 + e \quad \dots\dots\dots \text{equation (2)}$$

Criteria :

1. b1 for equation 1 is not significant
2. b2 for equation 2 significant
3. adjusted R<sup>2</sup> for equation 2 (= 0.121) morethan equation 1 (R<sup>2</sup> = 0.004)
4. level of signficancy b1 equation 2 (= 0.443) lessthan equation 1 (=0.063)

Some of decision criteria especially number 1 and 4 are not fulfilled, so we conclude that sustainability disclosure doesn't have role as mediating variable in the relationship between GCG and performance. So we can't support H3.

## V. SUMMARY AND CONCLUSION

This study purpose to examine the relationship between sustainability disclosure on GCG and performance using sample of 45 annual reports for period 2007 -2009. The list of companies which practice governance are collected from IICG (*Indonesian Institute for Corporate Governance*).

The findings of this study are GCG doesn't influence to sustainability disclosure an, and we don't support H1. Test of Spearman correlation show that value = 0.282 morethan significancy alpha = 0.05. And value = 0.023 for the relation between sustainability disclosure and performance show that significancy alpha lessthan 0.05 so that we can conclude that sustainability disclosure influence to performace and support H2. The effect mediation in this study which formulated in H3 is not supported, because only two of four decision criterias for mediating variable fulfilled. So we can conclude that sustainability disclosure doesn't mediate the relationship between GCG and performance.

This study have limitation as follow : 1) that sustainability disclosure just base on environmental aspect, as we know that dimension of sustainability including economic, social and environmental aspects 2) performance organisational is only measured by financial indicator, in this case market to book ratio while in this study we try to look at effect sustainability which it is not only depend on financial but also non financial 3) periode for data collecting limited on 2007 – 2009 so that only about 45 item data can be analysed for this reason.

We suggest for the further research that they should measure another aspect such as economic and social for sustainability disclosure variable. To balance the measurement so that performance organisational also extended with non financial aspect. For the next research are recommended to add period of research.

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