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CSR Disclosure, Corporate Fundamental Factors, Corporate Governance and Profitability of Banks in Indonesia

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Abstract: This research is aimed at gaining empirical evidence regarding the influence of CSR disclosure, corporate fundamental factors and corporate governance on firm's profitability. This research sample is banks listed in Indonesia Stock Exchange (IDX) in 2010-2014 which reported CSR disclosure. Data are collected through purposive sampling method. The statistical method used is multiple regression. The independent variables in this research are CSR disclosure as revealed by Global Reporting Initiative (GRI), corporate fundamental factors which are proxied by leverage, firm size and public ownership. While the governance is proxied by the size of the board of commissioner and audit committee. To measure profitability, ROE is used as the dependent variable. The result of this research shows that CSR disclosure, firm size, leverage, public ownership, board size of commissioner and audit committee significantly influence profitability of the banks.

Key words: CSR disclosure, corporate fundamental factors, leverage, firm size, corporate governance, public ownership, board size of commissioner, audit committee, profitability

INTRODUCTION

A Company is an organization performing activities using its resources to achieve the intended purposes. To be sustainable, profit-oriented companies will certainly keep using their resources optimally to gain profit. Likewise for banking companies, profit is the main objective to be achieved when performing their banking businesses. Bank's capital will increase which in turn will enhance their ability to conduct their operations (Suteja and Ginting, 2014).

Company's profit is a fundamental factor for investors in their investment decision-making process. One of the analysis tools is profitability ratio, i.e. the ratio that measures a company's ability to generate profit. As a business entity, a company gains a favorable condition or profit in order to survive and be sustainable. Corporate sustainability is a reporting process of information about the organization's non-financial performance. The sustainability of company is a combination between Corporate Social Responsibility (CSR) and the triple bottom line (Daizy and Das, 2014). The concept of triple bottom line consists of profit, people and planet. These three things guide companies to contribute to the welfare of social life (people) as well as ensure the sustainability of environment (planet) in a long term (Velasquez, 2012).

The concept of CSR guides companies to not only seek for profit which is the short-term goal but also to maintain a strong sustainability in a long-term (Munoz *et al*., 2015). Therefore, CSR is not a new concept for companies but in the current economic situation, there has been the best solution for integrating triple bottom line in their business activities.

The relationship between CSR and profitability has been much discussed in previous studies. But this results in mixed results. Chen and Wang (2011) find that CSR activities can increase profitability of the current year and have a significant effect on profitability next year. The fact saying positive influence of CSR on future profitability is also found by Inoue and Lee (2011). These results may encourage companies to disclose their CSR activities because there seems to be a positive influence on future profitability. Oeyono *et al.* (2011) in Indonesia find that CSR as measured by GRI is positively associated with profitability. Most of literature reviews also conclude that there is a positive relationship between CSR rating and profitability (Rajput *et al.* 2012).

While the research results of Purnomo and Widianingsih (2012) show that CSR disclosure is not able to strengthen the influence of environmental performance on financial performance. Aras *et al.* (2010) in their study do not find significant relationship between corporate social responsibility and financial performance (profitability). Furthermore, Makni *et al.* (2009) find a significant negative impact of environmental dimensions of Corporate Social Performance (CSP) on Financial Performance (FP). Negative synergy states that companies which are socially responsible experience

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lower profits and lower shareholder value which in turn limit the socially responsible investment. These various results are probably because CSR is still not enough to improve company's profitability. Company's strategy should also be viewed in terms of management policy. This policy includes management decision in obtaining company's funding associated with leverage ratio. Leverage refers to the extent to which the company utilizes debt financing to increase profitability and it is measured by long-term liabilities on equity.

The level of leverage may have positive or negative impact on profitability of the company. Singapurwoko and El-Wahid (2011) suggest that good corporate governance shows the performance of companies in using debt to increase their profits. Abdul and Adelabu (2015) in their study conclude that companies should make more debt to improve profitability while Dogan (2013) suggests that the level of leverage shows a negative relationship with profitability.

When studies about the relationship between firm size and profitability are reviewed, the results found are varied. The influence of firm size on profitability shows positive direction as discovered by Kaya. He finds that firm size is one of company's specific factors that affects company's profitability. Other empirical results show a positive relationship between firm size and company's profitability (Dogan, 2013; Kosmidou 2008; Altunbas *et al*., 2001). Conversely, Salawu *et al*. (2012) and Becker *et al*. (2010) find a negative relationship between firm size and profitability. Furthermore, Niresh and Thirunavukkarasu (2014) show that firm size does not have significant influence on company's profitability.

Several studies have shown that bank ownership may be an important variable in explaining bank profitability. The results of the previous studies have explored a positive relationship between public ownership and the company's profitability. The increasing public ownership has a positive influence on profitability (Bonin *et al*., 2005; Molyneux and Thornton, 1992). Conversely, La Porta *et al*. (2002) say that in developing countries, public banks have a detrimental effect on growth. According Dhouibi (2015) and Short (1979), there is a negative relationship between public ownership and bank's performance.

The findings show that companies with larger corporate governance perform well financially (Yasser *et al*., 2011). In general, studies show that there is a positive relationship between good governance practices and profitability (Fauzi and Locke, 2012). Another important finding is that board size improves bank performance (profitability), indicating that good corporate governance standards are important for any bank, investors and other stakeholders (Oner *et al*., 2015; Amarneh, 2014). On the contrary, Mnasri (2015) finds that board size is negatively related with performance, confirming that the smaller board size is more efficient. Gill and Mathur (2011) also find a negative influence of board size on profitability.

Another control is through the audit committee. Audit committees play a role in the oversight. Accountability of board of directors is generally inadequate to perform inspection or investigation considered necessary regarding the performance of directors in managing the company and carrying out important tasks related to financial reporting system. Yasser *et al*. (2011) and Aryan (2015) show that there is significant positive relationship between audit committee and ROE. Instead, the audit committee members observed negatively relate to profitability (Narwal and Jindal, 2015).

Based on above description, it is known that there is inconsistence of results in previous studies. This indicates that there is phenomenon or research gap that needs to be investigated further. Therefore, this study is aimed at examining the effect of Corporate Social Responsibility Disclosure (CSRD), the company's fundamentals and Corporate Governance (CG) on profitability of the banking companies. The company's fundamentals are proxied by firm size, leverage and public ownership while corporate governance is composed of board size of commissioner and audit committee.

MATERIALS AND METHODS

This study is conducted to determine the relationship of corporate social responsibility disclosure, company's fundamentals and corporate governance on profitability. The study population is all banks listed in the Indonesia Stock Exchange (IDX) in 2010-2014. The sampling technique used in this research is purposive sampling method. The first criterion is, the company must have financial year ends on 31 December and publish its annual report. The second criterion is the company must report its CSR activities. The third criteria is the company must show the data of leverage, firm size, public ownership, board size and the audit committee. Based on those criteria, there are 15 companies taken as sample as shown in Table 1.

This research uses seven variables consisting of CSR disclosure, leverage, firm size, public ownership, board size, audit committee and profitability. CSR disclosure is measured by using a content analysis sourced from secondary data using guidance based on Global Reporting Initiative (GRI). Guideline used is GRI G3.1 covering six aspects, i.e., environmental, human rights,

Table 1: List of banks taken as sample

Name of bank	Ticker
Bank Capital Indonesia	BACA
Bank Ekonomi Raharja	BAEK
Bank Central Asia	BBCA
Bank Negara Indonesia	BBNI
Bank Rakyat Indonesia	BBRI
Bank Danamon Indonesia	BDMN
Bank Jabar dan Banten	BJBR
Bank QNB Indonesia	BKSW
Bank Mandiri	BMRI
Bank CIMB Niaga	BNGA
Bank Internasional Indonesia	BNII
Bank Artha Graha Internasional	INPC
Bank Mega	MEGA
Bank OCBC NISP	NISP
Bank Pan Indonesia	PNBN

labor practices and decent work, society, product responsibility and economic (GRI, 2006). The calculation is done by giving score 1 if an item is disclosed and score 0 if it is not disclosed. It is then summed to get the overall score for each firm.

Leverage is obtained from debt to equity ratio which is the total debt divided by total equity. Firm size is measured by using the proxy of the natural logarithm of total assets owned by the company. Public ownership is measured by the number of company's shares owned by the outsider (public/community) of the total shares outstanding. Board size is measured by the number of board of directors of each company. The audit committee is measured by the number of each company's audit committee. Measurement of profitability uses return on equity which is the net profit after tax divided by total equity. Furthermore, this study uses multiple regression model. The following is the equation model:

$$PROFIT = \beta_0 + \beta_1 CSRD + \beta_2 LEV + \beta_3 SIZE + \beta_4 PO + \beta_5 BOC + \beta_6 AC + \varepsilon$$

Where:

PROFIT = Profitability
CSRD = Corporate social responsibility disclosure
LEV = Leverage
SIZE = Firm size
PO = public ownership
BOC = Board size
AC = audit committee
β_0 = Intercept
$\beta_1,\ldots,\beta_6$ = Coefficient
ε = Error

RESULTS AND DISCUSSION

R^2 value (Table 2) obtained is 0.606 or 60.6%. This indicates that the CSRD, leverage, firm size, public ownership, board size and audit committees used in regression equation simultaneously explain the variability of profitability by 60.6%. While the remaining 39.4% is explained by other variables not examined in this study. The test result of simultaneous influence through F test (Table 2) shows that significance value is 0.000. This is smaller than β = 0.05. Thus, it can be concluded that the CSRD, leverage, firm size, public ownership, board size and audit committee simultaneously influence profitability.

Table 2: Multiple regression results for predictive variables

Variables	Hypotheses	Coefficient	t-statistics	p-values
Intercept	-	-12.326	-	-
CSRD	+	44.725	4.372	0.000*
LEV	+	1.047	2.625	0.011*
SIZE	+	-0.937	-3.310	0.001*
PO	+	0.172	3.199	0.002*
BOC	+	1.708	2.759	0.007*
AC	+	2.365	3.256	0.002*

R = 0.779; R^2 = 0.606; F-statistics = 17.442; p-value (F-statistics) = 0.000*

The research result proves that CSRD has a positive influence on profitability. The higher level of CSRD is the greater the profit will be. This result is consistent with study of Chen and Wang (2011) who show that there is the relationship of CSRD with profitability. As stated by Chen and Wang (2011), corporate social responsibility can improve financial performance of company in the current year. CSRD has a significant influence on financial performance next year and vice versa. Variation of CSR and financial performance can also significantly affect one another. This is supported by the argument that when a company has a high level of CSRD, the company's financial performance will improve. Companies which have more sales and profits spend more on CSR (Rajput *et al*., 2012).

Leverage positively influences profitability. This result is consistent with the finding of Singapurwoko and El-Wahid (2011) who find that the ability of the company's management to increase profits by using the debt indicates the quality of corporate governance. A good corporate governance shows the performance of companies in using debt to increase profits. Companies that have a huge amount of debt tend to gain a lot of profit. This argument is supported by Abdul and Adelabu (2015) concluding that the company should take more debt to increase profitability; that the level of leverage influences profitability.

This study proves that the firm size has a negative influence on profitability. Negative coefficient indicates that larger banks are more likely to earn lower profits. This finding is consistent with research result of Salawu *et al.* (2012) and Becker *et al.* (2010). They find a negative relationship between firm size and profitability. Yet, this is not line with research of Dogan (2013), Kosmidou (2008) and Altunbas *et al.* (2001) finding the positive influence

between firm size and profitability. The size of the bank is generally used for capturing economical or diseconomical scale in banking. The empirical results indicate that the increasing size of company may not always lead to higher profit because of diseconomical scale. It reveals that reliance on one major asset can cause a significant decline in profitability. The test result proves that public ownership has a positive influence on profitability. It is consistent with the study of Moussa (2014), Bonin *et al.* (2005), Molyneux and Thornton (1992), proving that the increasing public ownership has a positive influence on bank's profitability. Thus, the higher number of shares held by public will increase profitability. Public intervention can motivate companies to improve profitability.

The result proves that the board size positively influences profitability. This finding supports the study of Oner *et al.* (2015) and Amarneh (2014) saying that the board size improves bank performance (profitability). This indicates that good corporate governance standards are important for any bank, investors and other stakeholders. The larger the board size means the greater opportunities and resources for better financial performance. The presence of commissioners can supervise and encourage management to improve profitability.

Based on the research finding, the audit committee has a positive influence on profitability. The result of this study is consistent with the research of Yasser *et al.* (2011) and Aryan (2015) showing that there is significant positive relationship between audit committee and ROE. Thus, the committee is an oversight mechanism to improve financial performance of the company. This result will be beneficial for the company in conducting corporate governance especially in playing supervisory role.

CONCLUSION

Profitability is positively influenced by CSRD, leverage, public ownership, board size and audit committee. Conversely, profitability is negatively influenced by firm size. The empirical results show that CSRD plays an important role in profitability. Company should seek to improve profitability as much as possible by making various policies including performing CSRD. CSRD is able to improve profitability of the company. Bank gives an important role because it can provide a socially responsible investment. By implementing various CSR policies related to human resources and involvement in community activities, banks can make profit. So, the activity of corporate social responsibility can improve financial performance in the current year. This indicates that there is positive relationship between CSR and profitability. The company issuing CSR does not only get benefit of sustainable development over the long term but also enjoys increasing profitability.

A company is described as leveraged if it is financed partly by debt and partly by equity. A company cannot survive without significant liquidity with the use of debt. Debt is used by many companies to increase capital and profit. However, to increase assets to generate more profits, company may use leverage. The increasing size of firm may not always lead to higher profits because of diseconomies scale. It reveals that reliance on one major asset can cause a significant decline in profitability. Meanwhile, the large number of shares owned by public will increase profitability. Public intervention can motivate companies to improve profitability. Board size and supervision by the audit committee in corporate governance mechanisms are able to play an important role in increasing company's profitability of banks in Indonesia.

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