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The Impact of Corporate Social Responsibility and Corporate Governance on Firm Performance: A Study of ESG Quality 45 IDX-KEHATI

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Abstract: The KEHATI-listed companies have displayed commendable SRI performance across financial metrics and transactional liquidity. Among these firms, PT Danone Indonesia faced a Corporate Social Responsibility (CSR) issue in 2012 due to the uneven distribution of benefits, which prompted community protests and undermined the company's efficacy, ultimately impacting its performance. The overarching objective of this study is to explore and comprehend the relationship between CSR, corporate governance, and their potential impact on the performance of ESG QUALITY 45 IDX KEHATI listed on the Indonesia Stock Exchange (IDX). The study utilized panel regression analysis to analyze data collected over five years (2017-2021) from IDX. The research implies that there is no substantial relationship between corporate governance and performance. However, the findings evidence implies that there is a strong negative relationship between CSR and ROE, while ROA remains unaffected. In terms of control variables, the study found no significant correlation between firm size and ROA and ROE, while leverage had shown a substantial negative influence on both financial performance measures. This research sheds light on the connection between CSR, corporate governance, and business performance.
Keywords: Corporate Governance; Corporate Social Responsibility; Firm Performance

INTRODUCTION

Public establishments in both developed and developing nations, including Indonesia, constitute a significant portion of registered companies. As of now, the Indonesia Stock Exchange (IDX) lists 759 public companies operating across various sectors, such as manufacturing and finance. The IDX categorizes companies into two primary segments: LQ45 and Kehati. LQ45 firms are distinguished by their high liquidity, while Kehati comprises firms that prioritize Sustainable Responsible Investment (SRI). The Kehati category consists of 45 companies that have demonstrated good SRI performance based on financial and liquidity measurements. The goal of the Kehati category is to provide investors with more options to select and evaluate companies based on their future performance.

A company's aptitude to deliver positive growth is a key indicator of good performance. Investors commonly use performance as a benchmark to evaluate investment options and gauge the company's success (Matei et al., 2021). Conducting an assessment of a company's performance is necessary to gain a current understanding of its situation (Tania & Hesniati, 2022). Indicators of profitability, such as Return on Asset (ROA) and Return on Equity (ROE), can be utilized as a performance metric. ROA evaluates the skillfulness of management in producing profits, while ROE assesses the company's performance and management's capacity to deliver benefits to its shareholders (Darmawan, 2020).

Evaluating a company's performance involves assessing its CSR and corporate governance, which directly impacts public trust (Sisca et al., 2022). CSR is essential for meeting social obligations towards employees, the government, consumers, the environment, and society. Neglecting CSR impedes growth, making it a mandatory requirement for efficient operations. The journey toward CSR can significantly influence a company's performance. Siregar & Safitri (2019) outlined three principles for CSR

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disclosure, namely sustainability, corporate responsibility, and transparent reporting that accurately reflects the company's actions.

Companies worldwide are expected to implement CSR as a way of ensuring a direct positive impact on the business environment. PT Danone Indonesia encountered a CSR problem in 2012, with residents of the Polanharjo subdistrict protesting against the uneven distribution of benefits. The head of the village expressed concern about unequal distribution, and the company only distributed CSR to nearby villages, Wangen and Kebonharjo. This was due to cost limitations and a lack of community education about their operations, leading to a perception of unfairness among nearby communities adversely affected by water shortages for farming and transportation.

The establishment of a company directly affects the activities of the surrounding community. PT Danone Indonesia faced a lawsuit for violating local government demands, leading to the implementation of new regulations and a CSR program to improve their management experience in sustainable development programs. The program had low acceptance in the 18 Polanharjo Klaten villages, but a meeting was held with village leaders the latter offered feedback and opinions as representatives of the village residents. According to Sindhutumo (2018), the program aims to introduce social practices that facilitate communication between the company and nearby communities, enhancing social interaction.

Effective corporate governance, which encompasses processes, tools, systems, and regulations governing responsibilities, rights, authorities, and influences within a company, can positively impact its performance. Organizations must ensure good management in corporate governance, as it is responsible for investigating and evaluating financial reports that affect company performance (Syofyan, 2021). Measuring Board Size (BS) and BI (Board Independence) is essential for evaluating corporate governance. BS is an indicator of the number of individuals serving as directors on a company's board, which can affect its performance because directors play a critical role in overseeing the company's activities. Additionally, board independence, which comprises board members with no affiliation with the company, is essential to enhance the quality of financial reports and enhance company performance.

The governance structure of a company is comprised of several committees, with one such committee being the Nomination and Remuneration Committee (NRC). The committee is responsible for ensuring fair policies for compensation and nominations and advising the company. It is regulated by The Financial Services Authority Regulations (POJK) and is believed to positively impact company performance. The PT Bank Negara Indonesia (BNI) case emphasizes aligning the committee with the company's vision for optimal performance, aiming to be an independent and professional board that adheres to transparent policies (Cintya, 2020). It is essential to conduct extensive research to examine and comprehend the complex interplay between CSR and corporate governance, as well as their potential impacts on the performance of ESG QUALITY 45 IDX KEHATI listed on the IDX.

CSR is crucial for companies as it impacts public perception and a company's responsibility toward society, which ultimately affects its performance (Sisca et al., 2022). Indonesian law requires all companies to engage in CSR activities as outlined in UU No. 19 of 2003. State-owned enterprises play a pivotal role in overseeing social responsibilities, while small businesses in the state-owned enterprise partner program must also follow their social responsibilities as per Regulation No. PER-05/MBU/2007. CSR is mandatory and can impact performance measurement. Companies must consider their social responsibilities, including the local community's values, culture, and environment, as outlined in UU No. 25/2007 when investing capital. Research

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conducted by Gonçalves et al. (2021); Kuo et al. (2021); Okafor et al. (2021); Singh et al. (2021); and Thuy et al. (2021), collectively demonstrate that CSR positively influences company performance, making it an essential aspect of business growth, performance measurement, and mandatory for all companies engaged in any activity.

Ahmed et al. (2019) and Kyere & Ausloos (2021) highlight that board size (BS) significantly positively impacts a company’s performance. BS denotes the board size of a company, which refers to the number of individuals serving on it, which is typically disclosed in the notes to the financial statements. The board of directors plays a crucial role in influencing the company's success by ensuring that the company complies with relevant laws and regulations, as well as by prohibiting directors who have been declared bankrupt from causing financial harm to the company due to potential criminal penalties.

The study conducted by Uyar et al. (2021) revealed a direct correlation between BI and the performance of the company. Board independence pertains to members of the board of commissioners who have no prior association or involvement with the organization. Meanwhile, directors with shares in the company align their interests with shareholders to raise the level of performance for the company. The primary function of board independence is to manage and enhance the quality of financial reporting, resulting in relevant values and enhanced company performance. Therefore, board independence has an impact on the company's performance (Fourati & Dammak, 2021).

The academic research completed by Harymawan et al. (2020) and Hidayat et al. (2022) demonstrates that the NRC has a notable influence on company performance. This committee provides oversight and advice in the establishment of fair policies and rules for decision-making when implementing new policies. The committee's operations are governed by rules set out in POJK Number 24/POJK.04/2014, and it is believed that these regulations enable the committee to positively influence company performance.

METHODS

The study was carried out on companies that were enlisted on the IDX, ESG QUALITY, with a total of 45 companies being selected. The purposive sampling technique was employed in the research, whereby the predetermined criteria were outlined in Table 1, and served as a guide for the researchers in selecting the most relevant and appropriate companies to include in the study.

Table 1. Criteria for Research Sample

Information	Amount
Listed companies in IDX (2017-2021)	843
Companies selected as samples	45
Research period of 5 years	5
Total of samples	225
Number of outlier samples	(20)
Total number of samples after outlier	205 sample

Source: Processed Data (2023)

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This research employs secondary data, which refers to data that has already been analyzed and made publicly available by other researchers (Qadri et al., 2022). However, it is essential to ensure that the data are reliable, relevant, and appropriate for the research being investigated. Thus, this study used data from annual and sustainability reports of selected companies from 2017 to 2021, which are commonly used sources of data in studies related to CSR and corporate governance and can be found on the IDX website.

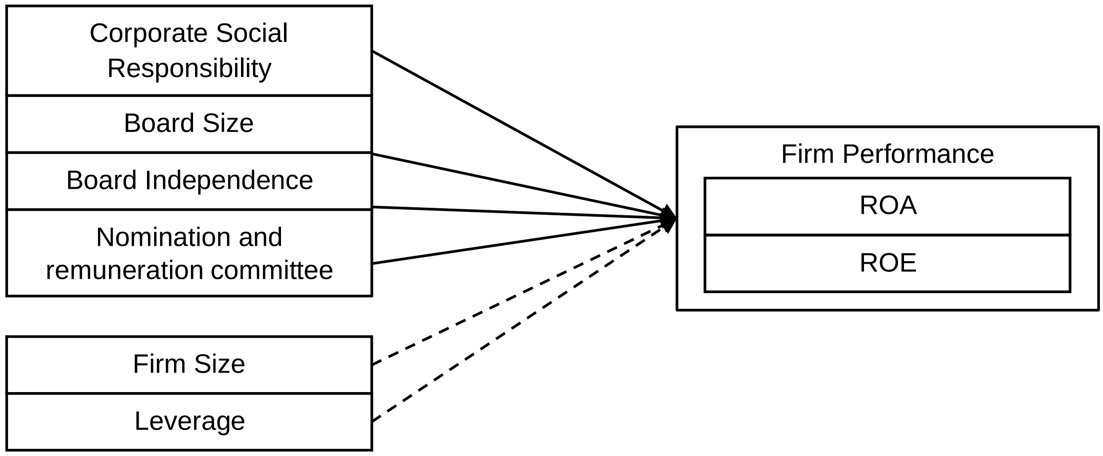

Figure 1. Schematic Framework
Source: Processed Data (2023)

Based on the theoretical framework presented in Figure 1, the hypothesis for the study was formulated as follows:
H_1: Corporate social responsibility significantly impacts firm performance.
H_2: Board size significantly impacts firm performance.
H_3: Board independence significantly impacts firm performance.
H_4: Nomination and remuneration committee significantly impacts firm performance.

The research methodology used in this study is causal-comparative, which is intended to identify the underlying reasons and causes behind the studied variables (Ghozali, 2018). This study is focused on evaluating the direct linkages between CSR, corporate governance, and firm performance. Table 2 outlines the variables utilized in this research, along with the corresponding formulas applied as part of the analysis.

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Table 2. Measurement of the Variables

Variable Type	Variable Name	Formula	Source
Dependent Variable	Return on Asset Ratio	$\frac{\text{Net Profit}}{\text{Total Asset}}$	Kyere & Ausloos (2021)
	Return on Equity Ratio	$\frac{\text{Net Profit}}{\text{Total Equity}}$	Tunio et al. (2020)
Independent Variable	CSR	$\frac{\text{Number of Items Disclosed}}{91}$	Rahmi & Sukma Wijaya (2019)
	Board Size	Number of board members	Kyere & Ausloos (2021)
	Board Independence	Number of independent board members	Masitoh & Hidayah (2018)
	Nomination & Remuneration Committee	Number of members of the NR committee	Priyandani & Rohman (2019)
Control Variable	Firm Size	Ln Total Asset	Haryanto (2022)
	Leverage	$\frac{\text{Total Debt}}{\text{Total Asset}}$	Priyandani & Rohman (2019)

Source: Processed Data (2023)

The data gathered for this research is classified as panel data, as it comprises both cross-sectional and time-series data. Therefore, the E-Views software will be utilized to test and analyze the hypotheses. The following equation model was utilized in this study:

$$Y = \alpha + \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \beta_4 X_{4it} + \beta_5 Z_{1it} + \beta_6 Z_{2it} + \varepsilon$$

Denotes:
Y = Dependent variable
X = Independent variable
Z = Control variable
α = Constanta
β = Coefficient beta
ε = Error term
i = Cross-section item
t = Time series item

RESULTS AND DISCUSSION

The descriptive statistical analysis conducted on the sample data presents crucial insights into its distribution and variability. The results of this analysis, including minimum and maximum values, average values, and standard deviation values, provide valuable information on the degree of deviation from the mean. The data has undergone an outlier test, and the descriptive statistical test was conducted on the remaining data points, resulting in a sample size of 205.

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Table 3. Descriptive Statistical Test Result

Variable	Descriptive Statistic			
	Min	**Max**	**Mean**	**Std. Dev**
CSR	0,19800	0,80200	0,50823	0,12252
BS	4	12	6,57561	1,94795
BI	0	3	0,58537	0,76619
NRC	1	7	3,39024	1,09540
ROA	-0,13358	0,24263	0,05390	0,05507
ROE	-0,19104	0,29724	0,10783	0,07802
FS	28,78102	34,74444	31,20492	1,42900
LEV	0,08306	0,88972	0,50941	0,23717

Source: Processed Data (2023)

Table 3 presents various outcomes derived from the sample data. Firstly, it reveals that the CSR variable has a narrow distribution with a standard deviation of 0,12252. The values range from 0,19800 to 0,80200, with an average of 0,50823. The BS variable exhibits limited variability, evidenced by its small standard deviation of 1,94795, and an average of 6,57561, with values ranging from 4,00000 to 12,00000. The BI variable, on the other hand, shows a high degree of variability, as indicated by the standard deviation of 0,76619. The average value of BI is 0,58537, with a minimum value of 0,00000 and a maximum value of 3,00000. In addition, the NR variable exhibits low variability, with a small standard deviation of 1,09540, and an average of 3,39024. Its values range from 1,00000 to 7,00000. The variable of FS, which serves as a control in the study, demonstrates a maximum value of 34,74444 and a minimum value of 28,78102. The relatively low standard deviation of 1,42900 implies that the selected companies possess assets of relatively small average sizes. Likewise, the leverage control variable has a standard deviation of 0.23717, with a maximum and minimum value of 0.88972 and 0.08306, respectively, indicating homogeneity or less variability of data around the mean value. Table 3 also shows that the sampled Kehati companies have an average ROA of 0,05390 or 5.39% and an average ROE of 0,10783 or 10.783%. These average values of ROA and ROE indicate that Kehati companies are moderately profitable, with a relatively stable financial performance.

However, it is crucial to carry out several tests such as the Hausman tests and Chow tests to ascertain the optimal model that corresponds to the research data, and to ensure the accuracy and inclusiveness of research findings.

Table 4. Chow Test

Dependent Variable: Firm Performance (ROA) Independent Variables: CSR and Corporate Governance			
Effect Test	**Statistic**	**d.f.**	**Prob**
Cross-section F	8,44557	(41,157)	0,0000
Cross-section Chi-Square	238,7999	41	0,0000
Dependent Variable: Firm Performance (ROE) Independent Variable: CSR and Corporate Governance			
Effect Test	**Statistic**	**d.f.**	**Prob**
Cross-section F	6,273135	(41,157)	0,0000
Cross-section Chi-Square	198,8704	41	0,0000

Source: Processed Data (2023)

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Table 4 displays the outcomes of the redundant fixed effect test that explores the effects of the variables analyzed in the study. The objective of this test was to identify the regression model that most effectively explains the connection between the common effect model (CEM) and the fixed effect model (FEM). The results show that the probabilities associated with the interrelation between CSR and corporate governance on ROA and ROE are statistically significant because the probability is 0.0000, which is below the significance level α (α = 0.05). The next table, Table 5, will feature the results of the Hausman test.

Table 5. Hausman Test

Dependent Variable: Firm Performance (ROA) Independent Variables: CSR and Corporate Governance			
Test Summary	**Chi-Sq Statistic**	**Chi-Sq. d.f.**	**Prob.**
Cross-section random	5,195641	6	0,519
Dependent Variable: Firm Performance (ROE) Independent Variables: CSR and Corporate Governance			
Test Summary	**Chi-Sq Statistic**	**Chi-Sq. d.f.**	**Prob.**
Cross-section random	5,96288	6	0,427

Source: Processed Data (2023)

The results of the Hausman test, as shown in Table 5, suggest that the probabilities associated with the impact of CSR and corporate governance on ROA (0,519) and ROE (0,427) exceed the significance level α (α = 0.05). As all probability values displayed in Table 5 are greater than α (α = 0.05), the random effect model (REM) has been deemed the more favorable model. Therefore, to determine which model is more effective between the CEM and REM, the Lagrange multiplier test will be displayed in Table 6.

Table 6. Lagrange Multiplier Test

Dependent Variable: Firm Performance (ROA) Independent Variables: CSR and Corporate Governance			
		Test Hypothesis	
	Cross-section	**Time**	**Both**
Breusch-Pagan	101,7328 (0,0000)	1,2045 (-0,2724)	102,9283 (0,0000)
Dependent Variable: Firm Performance (ROE) Independent Variable: CSR and Corporate Governance			
		Test Hypothesis	
	Cross-section	**Time**	**Both**
Breusch-Pagan	57,79033 (0,0000)	0,35825 (-0,54950)	58,14858 (0,0000)

Source: Processed Data (2023)

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Table 6 features the results of the Lagrange Multiplier test, which can be utilized to establish whether the CEM or REM is more suitable for the study. If the cross-section value of Breusch-Pagan exceeds α (α = 0.05), then CEM can be considered. Conversely, if the value falls below α (α = 0.05), REM may be more suitable. Since all values in Table 6 are below α (α = 0.05), REM is the preferred model to use. The findings of the regression test employing REM are shown in Table 7.

Table 7. Regression Test Results

Dependent Variable: Firm Performance (ROA)				
Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
C	0,128598	0,163779	0,785188	0,4333
CSR	-0,05844	0,048349	-1,20876	0,2282
BS	0,002325	0,002993	0,776851	0,4382
BI	0,00745	0,004971	1,498704	0,1355
NRC	0,000664	0,003934	0,168678	0,8662
FS	0,000446	0,005748	0,077579	0,9382
LEV	-0,15775	0,027773	-5,67989	0,0000
Dependent Variable: Firm Performance (ROE)				
Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
C	0,279592	0,25844	1,081848	0,2806
CSR	-0,20559	0,073807	-2,78551	0,0059
BS	0,007021	0,004975	1,411194	0,1598
BI	0,015023	0,008272	1,816051	0,0709
NRC	0,006539	0,006522	1,002595	0,3173
FS	-0,00283	0,009169	-0,30879	0,7578
LEV	-0,10854	0,04333	-2,50487	0,0131

Source: Processed Data (2023)

The outcomes of the regression analysis in Table 7 indicate that CSR has a significantly adverse impact on firm performance, as measured by ROE. This is supported by the probability value of 0,0059, which is below 0,05, and a coefficient of -2,78551. In contrast, the effect of CSR on firm performance, as measured by ROA, was found to be not statistically significant as it has a probability value greater than 0,05, specifically 0,2282, and a coefficient of -1,20876. The study's results demonstrate that there is no significant relationship between corporate governance, as measured by BS, BI, and NRC, and firm performance, as measured by both ROA and ROE. Furthermore, the study demonstrates that including FS, as a control variable does not have a statistically significant effect on firm performance, as measured by ROA or ROE, as evidenced by its probability values of 0,9382 and 0,7578, respectively, both exceeding 0,05. Conversely, the second control variable, leverage, has a significant negative correlation on ROA, with a probability value of 0,000 and a coefficient of -5,67989, while not affecting ROE.

Hypothesis Testing (H_1)

The research on the amidst between CSR and company performance, as gauged by ROA was found to be insignificant. This means that the use of ROA as a gauge of company performance is not affected by CSR. This scenario implies that the

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implementation of CSR can be costly and divert funds from other business purposes, resulting in short-term negative effects on financial performance. Additionally, CSR programs are seen as a social responsibility rather than a direct driver of financial performance. This finding aligns with the study conducted by Benali et al. (2021), Matei et al. (2021), and Nzuki & Opuodho (2022). Conversely, the firm's performance measured by ROE can be negatively influenced by CSR. The higher costs associated with CSR implementation, which can surpass regular operational expenses, can lead to a decline in the company's performance, indicating that CSR has an adverse effect on company performance. This study supports the findings of previous research conducted by Lee and Yang (2021), Ratajczak (2021), and Zhou et al. (2021) but contradicts the study by Sharma et al. (2021).

Hypothesis Testing (H_2)

Based on the examination, it can be concluded that there is no notable association between the BS variable and company performance, as measured by the ROA and ROE indicators. Hence, this hypothesis is proven to be rejected. The board size refers to the number of members serving on the board of directors of a company. The notes to the financial statements generally include the necessary information, specifically regarding the composition of the board of directors at the end of the fiscal year. Each member of the board has a distinct role to play in the company's operations. However, the board of directors only plays a minor role in determining the company's overall performance in a company but does not influence the company's performance. This study aligns with the study Chaudhry et al. (2020) and Cherian et al. (2019).

Hypothesis Testing (H_3)

The data gathered and analyzed for the third hypothesis indicate that the performance of the firm is not significantly influenced by BI, leading to the rejection of the hypothesis. BI is primarily tasked with ensuring the quality of financial reports and controlling the performance of the company's activities. Nonetheless, it is not directly related to the financial performance of the company because BI does not have any control over the actual operations of the company. Instead, its role is to oversee the company's financial reporting and ensure that the interests of shareholders are taken into account. Thus, while important for corporate governance, BI is not a significant determinant of a company's financial performance. This finding is in agreement with the study by Ramirez et al. (2020).

Hypothesis Testing (H_4)

The regression test conducted by the study indicates that NRC has no considerable outcome on the company's performance based on ROA and ROE measurements, leading to the rejection of the fourth hypothesis. The NRC is accountable for supporting the Board of Commissioners in their tasks and providing assistance in the nomination and remuneration process of the Board of Commissioners and directors. However, the role of NRC in determining performance is insignificant as the board of commissioners' role is limited to overseeing and providing advice, rather than directly establishing rules affecting the company's performance. The appointment of NRC members should be transparently regulated, as stated in POJK Regulation No. 34/POJK.04/2014 published on December 8th, 2014. These results are consistent with prior research conducted by Dasgupta (2022) and Zakaria (2018).

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CONCLUSION

Based on the evidence presented in this study indicates that the corporate governance components of board size, board independence, and nomination and remuneration do not have a considerable significance for the financial performance of a company, as gauged by ROA and ROE. However, one key finding of this study is that while there is no significant correlation between CSR and ROA, a significant negative relationship exists between CSR and ROE, suggesting that CSR can have an impact on a company's financial performance as measured by these indicators. In terms of control variables, the study found no significant association between firm size on ROA and ROE, while leverage is significantly and negatively associated with the financial performance of a company, as measured by both ROA and ROE. These results underscore the potential influence of CSR and corporate governance on a company's performance.

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