Ownership Structure and Corporate Social Responsibility Disclosure

Maya INDRIASTUTI[1], Anis CHARIRI[2]

[1]Universitas Islam Sultan Agung; Universitas Diponegoro, Semarang, Indonesia, maya@unissula.ac.id

[2]Universitas Diponegoro, Semarang, Indonesia, anis_chariri@live.undip.ac.id

Abstract

Corporate social responsibility disclosure (CSRD) has become one of the business practices in the current era. The companies have recognized the effect of social pressure on their operations and behavior that is more responsible for all stakeholders. They are subject to intensive supervision from the public, not only from shareholders and creditors. The ownership structure is expected to affect CSRD. This study examined the ownership structure of CSRD with a target sample of LQ 45 companies listed on the Indonesia Stock Exchange in 2010-2019. This research contributes to the literature on CSRD practices by looking at the extent to which LQ 45 companies listed on the Indonesia Stock Exchange take their social role seriously.

Keywords: Ownership structure, corporate social responsibility disclosure, LQ 45 companies

Introduction

Corporate social responsibility (CSR) is still evolving and attracting researchers and practitioners around the world. Most of them strongly opposed that companies should not only be judged based on successful economic performance and financial performance but also social behavior. It implies that companies need to balance their financial and non-financial goals to act in the best interest of society, the natural environment, their employees and their customers. CSR has become one of the standard business practices in today's era, where companies have recognized the effect of social pressure on their activities and operations. Companies also recognize that CSR makes their behavior more accountable to stakeholders and is subject to intense scrutiny from the public, not just shareholders and creditors. Reporting on CSR activities is increasingly essential for businesses to demonstrate their commitment to environmental and social issues (Adams, 2004; Brammer & Pavelin, 2008).

CSRD is a disclosure made by companies in fulfilling their responsibilities in the economic, environmental and social fields without putting aside the interests of investors in earning profit (Deegan, 2004; Cormier et al., 2011). CSRD can continue to develop through ownership structures that include institutional, managerial, government and foreign ownership. Concentrated ownership is a mechanism by which owners can control and influence the director to protect their interests at the expense of others (Shleifer and Vishny, 1986; Coffee, 1991). Conflicts of interest between majority and minority shareholders are central to modern corporate analysis, where the majority shareholder tries to control the director by providing less quality information (Shleifer and Vishny, 1997; La Porta et al., 2000).

Companies with a high percentage of ownership concentration, block holders try to engage and direct the company management. It results in reduced access to information for other shareholders. Meanwhile, companies with a dispersed ownership environment provide greater information disclosure to minimize agency costs and information asymmetry. Several studies have discussed the relationship between ownership structure and voluntary disclosure (Abu & Suwaidan, 2019; Al-Janadi et al., 2016; Laidroo, 2009; Mohd Ghazali & Weetman, 2006; Xiao and Juan, 2007).

This research contributes to the literature on CSR practice and disclosure in different ways. First, it shows the extent to which LQ 45 companies registered in Indonesia and took their social role seriously. Second, the study adds to the existing literature on the potential impact of financial performance on firm value. Finally, this study is anticipated to give feedback to regulators at the Indonesia Stock Exchange regarding the adequacy of social disclosure requirements for companies in Indonesia.

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Problem Formulation

Agency issues are different from country to country, depending on the system of ownership structure in a country and whether the country is developed or developing. Agency problems arise in Latin America and some Asian countries because of the mismatch of interests between minority and majority shareholders. Claessens et al., (2000) found that agency problems in East Asian countries arise from conflicts of interest between majority and minority shareholders. These results are consistent with La Porta et al., (2000). They defined agency problems as conflicts of interest between controlling shareholders and outside minority shareholders. In this type of conflict, the controlling shareholder can influence management decisions in determining company policy. Therefore, the majority shareholder is the actual controller instead of management. It makes them behave in opportunistic ways, such as diverting corporate wealth for their benefit (Shleifer and Vishny, 1997), deciding dividend policy (Gugler & Yurtoglu, 2003), and providing low levels of disclosure (Watts, 1977).

In India, Muttakin & Subramaniam (2015) observed that CSR disclosure is positively related to foreign ownership and government ownership. In China, Dam & Scholtens (2012) pointed that different owners have different CSR effects. Companies that the government controls are more likely to disclose CSR information. Their CSR reports quality is better than other companies. Moreover, companies with more shares held by mutual funds, foreign investors or other companies are significantly better at CSR disclosure. In another study, Saudia, Habbash (2016) suggested that government and family ownership are positively related to the level of CSR disclosure. However, institutional ownership has an insignificant effect on the level of CSR disclosure. Based on the background and reviews above, the problem formulations of this study are as follows:

1. Does institutional ownership have a positive effect on corporate social responsibility disclosure?
2. Does foreign ownership have a positive effect on corporate social responsibility disclosure?
3. Does government ownership have a positive effect on corporate social responsibility disclosure?

Literature Review and Model Development

Agency Theory

Agency theory describes that concentrated ownership in the hands of shareholders can lead to information asymmetry with other shareholders (Jensen & Meckling, 1976). Majority shareholders, such as the government, try to control the company by not sharing useful information with minority shareholders (Shleifer and Vishny, 1997). Therefore, these controls may affect the reporting of certain information not only to minority shareholders but also to other users of the information. Information asymmetry arises from various sources, such as concentration of ownership in several shareholders, weakness or absence of high levels of regulation, poor managerial performance, and irresponsible managers (Dallas, 2004; Mehran, 1992).

Legitimacy Theory

Deegan (2002) asserted that legitimacy theory is an idea that describes that there is a "social contract" between an organization and the environment in which the organization operates. Social and environmental reporting disclosure is a way companies can achieve good performance for the public and investors. The disclosure helps the company to get a good image and recognition. It will also attract domestic and foreign investment or investors.

Institutional Ownership

Abdel (2003); Cox et al., (2004); Graves & Waddock (1993); Johnson & Greening (1999) explained institutional ownership as the proportion of shares owned by the institution (non-individual ownership) on the total outstanding shares. Institutional investors are driven by investor recognition of the low-cost diversification value. It is also driven by favorable tax regulation and treatment. Tonello & Rabimov (2010) added that the amount of ownership by institutional investors is to hold more than 50% of the company's outstanding equity. It results in every institutional investor can have a significant position in many publicly traded companies.

Foreign Ownership

Foreign ownership is the percentage of company share ownership by foreign investors (Barkemeyer, 2007). Multinational companies or foreign ownership mark legitimacy benefits from their stakeholders, typically based on a home market (the market in which they operate) that can provide high long-term existence.

Government Ownership

Government ownership is when the government owns shares in a company (Borisova et al., 2012). Government ownership helps pool interests between managers and shareholders because in carrying out their duties, the government already has precise mechanisms and rules. Thus, the government can be an effective and efficient means to monitor the management performance (Al-Janadi et al., 2016). It will ultimately have an impact on increasing the number of CSR disclosures of a company.

Corporate Social Responsibility Disclosure

The World Business Council for Sustainable Development (WBCSD) suggested that CSR is an ongoing commitment by the business world to act ethically. It also contributes to the economic development of the local community or the broader community by improving the standard of living of workers and their entire families at the same time. Kotler & Lee (2005) emphasized that companies would be encouraged to carry out CSR practices and disclosures because they obtain several benefits. The benefits are increased sales and market share, strengthening brand positioning, improving company image, reducing operating costs, and expanding the company's attractiveness in the eyes of investors and financial analyst.

Empirical Research Model

The empirical model of this study is developed from a combination of studies on institutional ownership, foreign ownership, government ownership, and corporate social responsibility disclosure.

The following is the Resilience development of Fintech and Digital-Based in Improving the Businesses Sustainability:

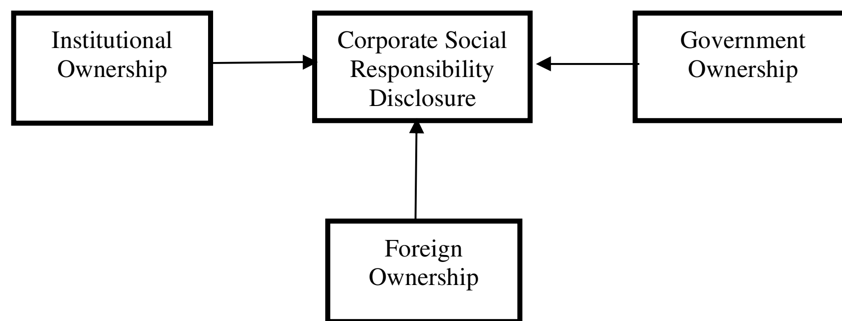

Figure 1: Empirical Research Model

Hypothesis Development

The Effect of Institutional Ownership on Corporate Social Responsibility Disclosure

Institutional ownership is a group of special shareholders with larger shares and voting rights (Chang and Zhang, 2015; Schnatterly et al., 2007). This group does not only look at the short-term returns in the companies but also concern the company's long-term performance. A way to increase is through good management practices such as CSR actions. Therefore, institutional investors will fully support the CSR initiative (Mahoney & Roberts, 2007). Empirical evidence from previous research shows positive results. Additionally, Abdel (2003); Cox et al., (2004); Graves & Waddock (1993); Johnson & Greening (1999); Oh et al., (2011); Soliman et al., (2013) found a positive relationship between institutional ownership and the level of CSR disclosure.

H1: There is a positive effect between institutional ownership and the level of CSR disclosure in the annual reports of manufacturing companies listed on the Indonesia Stock Exchange.

The Effect of Foreign Ownership on Corporate Social Responsibility Disclosure

Greater foreign ownership is generally associated with a stronger foreign influence (Oh et al., 2011). Many foreign investors, including multinational businesses, tend to undertake CSR with a different value and broader knowledge related to their foreign market exposure. Besides, foreign investors are warier of social responsibility (Muttakin & Subramaniam, 2015). Geographical separation between management and owners lead to the disclosure, including CSR disclosure (Haniffa & Cooke, 2005). In addition, foreign directors selected to represent foreign owners on the board can add value and diversity to the experience because of their different backgrounds and cultures. They are expected to support CSR

initiatives and disclosures.

Another point is that investing abroad has uncertainty due to increased information asymmetry (Gehrig, 1993). Siegel & Vitaliano (2007) proposed that investing in socially responsible companies is a way to reduce the risk for foreign investors because CSR can be seen as a signal of reputable companies to potential investors. Empirical evidence provided by Muttakin & Subramaniam (2015); Oh et al., (2011); Soliman et al., (2013) showed a significant positive relationship between foreign ownership and CSR disclosure.

H2: There is a positive effect between foreign ownership and the level of CSR disclosure in the annual reports of manufacturing companies listed on the Indonesia Stock Exchange

The Effect of Government Ownership on Corporate Social Responsibility Disclosure

Government ownership is when the government owns shares in a company (Borisova et al., 2012). Government ownership positively affects adequate information disclosure. A high percentage of government ownership can lead to more excellent monitoring and improved governance due to the government's monopoly on coercive power. The government's unique role as a strong and coercive owner provides opportunities for enhanced governance through extensive monitoring and direct enforcement. In 1999, the Asia Development Bank (ADB) reported that concentrated ownership affects the effectiveness of participation mechanisms among shareholders when voting on the board of directors. It involves transparency and corporate social disclosure and is reflected in shareholder protection.

A high percentage of government ownership will lead to conflicts of interest between the majority and minority shareholders. It is consistent with agency theory that government ownership tries to control management and is involved in management activities; It leads to limited access to information for other shareholders. Agency theory also suggests that when shares are widely held, managers can voluntarily disclose information to reduce agency conflicts with owners. Studies by Baek et al., (2009); Craswell & Taylor (1992); Eng & Mak (2003); Makhija & Patton (2004); Watts (1977) found that concentrated ownership structures have a positive effect on the level of social information disclosure for monitoring purposes. These results indicate that organizational blockholders perform high disclosure because the organization has more experience in monitoring managers, which is reflected in higher quality information.

H3: There is positive effect between government ownership and the level of CSR disclosure in the annual reports of manufacturing companies listed on the Indonesia Stock Exchange

Method and Procedure

Population and Sample

Population

The population consisted of objects or subjects with specific qualities and characteristics determined by the researcher to be studied and drawn conclusions. The population in this study comprised all LQ 45 companies listed on the Indonesia Stock Exchange in 2010-2019. The company LQ 45 was chosen because LQ 45 shares are one of the active stocks, so they can constantly experience price changes.

Sample

The sample is part of the population whose characteristics will be investigated and are considered to be representative of the population. The samples were determined using the purposive sampling method. It used specific considerations which aim to make the data obtained later can be more representative. The characteristics of sample selection in this study are as follows:

1. LQ 45 companies listed on the Indonesian Stock Exchange in 2010-2019.
2. LQ 45 companies that present financial statements during the study period
3. LQ 45 companies that have complete data and information during the observation period.
4. LQ 45 companies that have foreign ownership > 5%.

Research Setting

This research belongs to causality research which tests hypotheses related to the causality relationship between one or more variables with one or more other variables. The research model developed is expected to explain the causality relationship between the variables analyzed and make research implications for the development of science, methods, and techniques for solving problems. This study focuses on empirical testing of a model developed based on a fundamental

theoretical model. Identifying and integrating the determinant variables of CSRD involves the ownership structure.

Measurement Method

The problem in this research is formulated into a simultaneous model. This model is formed by the dependent variable, which is explained by one or more independent variables. The dependent variable in this study is CSRD, proxied by the CSRD score. The independent variable in this study is the ownership structure (institutional ownership, foreign ownership and government ownership).

Corporate Social Responsibility

Corporate social responsibility disclosure uses indicators or standards from the Global Reporting Initiative (GRI-G4) (http://www.globalreporting.org). Global Reporting Initiative is a reporting framework used to make sustainability reporting with 141 disclosure items covering the theme: economic, environment, labor practices, human rights, society, and product responsibility (Roger & Hsun, 2017).

Institutional Ownership

Abdel (2003); Cox et al., (2004); Graves & Waddock (1993); Johnson & Greening (1999) demonstrated that institutional ownership is the proportion of shares owned by the institution (non-individual ownership) to the total outstanding shares.

$$\text{Institutional Ownership} = \frac{\text{Number of Shares owned by the Institution}}{\text{Number of Outstanding Shares}} \times 100\%$$

Foreign Ownership

Foreign ownership is the percentage of company stock ownership by foreign investors (Barkemeyer, 2007). Foreign ownership is measured by a formula:

$$\text{Foreign Ownership} = \frac{\text{Number of Shares by Foreign Parties}}{\text{Number of Outstanding Shares}} \times 100\%$$

Government Ownership

Government ownership is when the government owns shares in a company (Borisova et al., 2012). Government ownership is measured by a formula:

$$\text{Government Ownership} = \frac{\text{Total Government Shares}}{\text{Number of Outstanding Shares}} \times 100\%$$

Data Collecting Plan

The type of data used in this study is secondary data sourced from www.idx.co.id. The secondary data is in annual reports from companies listed on the Indonesia Stock Exchange from 2010 to 2019.

Data Analysis Plan

The data analysis technique of this study is SEM-PLS (Structural Equation Modeling based on Partial Least Square) with a regression equation:

a. Outer Model Equation
   - Exogenous latent variable 1
     $$\mathbf{X1 = \lambda X1\xi 1 + \delta 1} \quad \textbf{(1)}$$
   - Exogenous latent variable 2
     $$\mathbf{X2 = \lambda X2\xi 2 + \delta 2} \quad \textbf{(2)}$$
   - Exogenous latent variable 3
     $$\mathbf{X3 = \lambda X3\xi 3 + \delta 3} \quad \textbf{(3)}$$

- Endogenous latent variable 1

  $$\mathbf{Y1 = \lambda Y1\eta 1 + \varepsilon 1} \quad \mathbf{(4)}$$

b. Inner Model Equation

$$\mathbf{\eta 1 = \gamma 1\xi 1 + \gamma 2\xi 2 + \gamma 3\xi 3 + \varsigma 1} \quad \mathbf{(5)}$$

Information:

X_1 : Institutional Ownership
X_2 : Foreign Ownership
X_3 : Government Ownership
λX_1 : Outer Loading Institutional Ownership
λX_2 : Outer Loading Foreign Ownership
λX_3 : Outer Loading Government Ownership
Y_1 : Corporate Social Responsibility Disclosure
$\lambda Y1$: Outer Loading Corporate Social Responsibility Disclosure
$\xi 1$: Institutional Ownership
$\xi 2$: Foreign Ownership
$\xi 3$: Government Ownership
δ : Exogenous Latent Noise Variable
ε : Endogenous Latent Noise Variable
ς : Residual Value
$\eta 1$: Corporate Social Responsibility Disclosure
$\gamma 1$: The Coefficient from Institutional Ownership on Corporate Social Responsibility Disclosure
$\gamma 2$: The Coefficient from Foreign Ownership on Corporate Social Responsibility Disclosure
$\gamma 3$: The Coefficient from Government Ownership on Corporate Social Responsibility Disclosure

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