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Can Corporate Social Responsibility Disclosure and Independence of the Board of Commissioners Improve Earnings Quality and Investor Reactions?

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This study aims to examine the effect of Corporate Social Responsibility (CSR) disclosure and the independence of the board of commissioners (BOC) on investor reaction through the earnings quality as a mediating variable. The population of this study are all companies listed on the Indonesia Stock Exchange that selected using the purposive sampling method. Data analysis uses path analysis. The results show that: CSR disclosure has a positive and significant effect on earnings quality, but no effect of CSR disclosure was found on investor reactions, Independence board of commissioners on earnings quality, independence of the board of commissioners on investor reactions, and earnings quality on investor reactions. The results of this study also indicate that there is no mediating role in the earnings quality variable that links the CSR disclosure and the independence of the board of commissioners with the investor reaction variable.

Key words: *Corporate social responsibility disclosure, independence of the board of commissioners, earnings quality, investor reaction.*

Introduction

The capital market acts as an intermediary body between those who have surplus funds (investors) and those who need funds, facilitates of buying and selling activities and other related activities in the capital market. One of the financial instruments most traded on the capital market is stock. Investment in stock is considered to have a greater level of risk compared to other investment alternatives due to expected return on investment in stock is uncertain and highly dependent on market conditions. This situation will affect the behaviour and psychology of investors to deal with risk. Thus, the investor's preference for the risks contained in each type of stock will affect the price of the relevant stock.

The greater risk level of investment in stocks, also promises a large return as well. As a popular investment doctrine, namely high risk-high return (Asnawi and Wijaya, 2005). Every investor who invests in shares has the same goal, which is to get a capital gain that is a positive difference between the selling price and the purchase price of the stock, and dividends received from the profit (Samsul, 2006).

Due to the existence of a large level of risk in investing in shares, then investors must conduct an analysis of what factors are affect the condition of the issuer company. This analysis pursues to minimize losses that might arise from fluctuations in the growth and development of the issuer concerned.

Belkaoui (1986) and Patten (1990) research results show that the decision-making process in the investment companies include variables related to social issues and environmental sustainability. Investors are more inclined to invest their capital in companies that have concerns of social and environmental issues. Beltratti (2005) states that socially responsible companies are the most respected and profitable companies. Socially responsible companies try to maximize profits but at the same time try to improve the welfare of other stakeholders.

The research results of Nuzula and Kato's (2011) show that financial markets in general have reacted positively to the publication of CSR reports in Japan. In the similar vein, the results of research by Liu et al. (2013) conducted on companies listed on the Chinese stock market also show that CSR disclosures play the same role as financial disclosures in promoting stock market transparency and influencing investor behaviour. In contrast to previous studies, the results of Zareian's (2012) study of companies listed on the Tehran Stock Exchange (TSE), the period 2004 to 2008, could not confirm the existence of a significant relationship between disclosure quality and stock returns.

CSR disclosure by the company and supported by the practice of Good Corporate Governance (GCG) will further strengthen the company in increasing the value of the company. Beltratti (2005) states that CSR and Corporate Governance (CG) complement each other in shaping the function of objectives and constraints faced by the company. In line with Beltratti (2005), Harjoto and Jo (2011) research found that CSR choices are positively related to CG characteristics and CSR involvement positively influences operating performance and firm value. This is in line with what Sedarmayanti (2012) stated that the application of GCG can increase company value, improve financial performance, reduce the risk that may be carried out by the board with decisions that benefit themselves, and generally CG can increase investor confidence.

Although several studies have shown a direct relationship between CSR disclosure and investor reaction and between the independence of the BOC on investor reaction, there is a lack of consistency in this relationship. The existence of the lack of consistency of the relationship gave rise to a mediating variable. This study suspects earnings quality mediating this relationship.

Healy and Palepu (2001) state that financial reporting and disclosure are important potential tools for management to communicate performance and governance to outside investors. The quality of financial information is an important information in making economic and investment decisions. In the basic framework of the preparation and presentation of financial statements, it is stated that the purpose of financial reporting is to provide useful information in economic decision making. To be useful, financial statements have to meet the requirement of a qualified financial report.

This study emphasizes the importance of investors considering earnings quality in making investment decisions on shares, in addition to CSR disclosure and the independence of the BOC. This study uses earnings quality measured by earnings persistence as a mediating variable to analyze CSR disclosures and the independence of the BOC in stimulating investor reaction. This research is a follow-up study conducted by Nurdin et al. (2016) that empirically examines the CSR disclosure as a mechanism to increase the earnings persistence and stock return in Indonesia. The difference between this research and the previous research, this study examines the effect of CSR disclosure and the independence of the BOC on investor reactions as measured by using cumulative abnormal returns, with earnings quality as a mediating variable.

Based on the description above, the following research questions can be formulated: (1) Does CSR disclosure affect investor reactions through earnings quality, directly or indirectly? (2) Does the independence of the BOC affect the reaction of investors through the quality of earnings, directly or indirectly?

The objectives of this study are: (1). to analyze the direct and indirect effects of disclosure of CSR to investors' reactions through earnings quality at companies listed on the Indonesia Stock Exchange; (2). to analyze the direct and indirect effects of the independence of the BOC on investor reaction through earnings quality at companies listed on the Indonesia Stock Exchange.

Literature Review

CSR Disclosures

CSR disclosure often referred as social disclosure, corporate social reporting, social accounting (Mathews 1995). The disclosure recommends providing information that is beneficial not only to community members relating to environmental matters, but also to investors who are interested in assessing and potential future obligations based on reported problems and progress.

In the World Business Council for Sustainable Development it is stated that the Global Reporting Initiative (GRI) report is a standard for sustainability reports that is widely accepted. The Sustainability Report Guidelines by the GRI states that the Sustainability Report is a practice of measuring, disclosing and accountability for organizational performance in achieving sustainable development goals to stakeholders both internal and external. “Sustainability Report” is a general term that is considered synonymous with other terms to describe reports on economic, environmental and social impacts (for example, triple bottom line, corporate responsibility report, etc.).

The GRI Guidelines state that companies must explain the impact of the company's activities on the economy, environment and social aspects of the disclosure standard. From the three dimensions, it was expanded into 6 dimensions, namely: economy, environment, labor practices, human rights, society, and product responsibility. Of the six dimensions there are 34 constructs and the total of all disclosure items according to GRI is 79 disclosure items.

Independence of the BOC

In managing the company according to general GCG principles, the role of an Independent Commissioner is very much needed. The BOC is a major element of CG because it is responsible for monitoring the quality and integrity of the company's financial statements and overseeing top management, as delegated by shareholders (Fama and Jensen: 1983). One important factor affecting the board's ability to monitor company managers is the composition and percentage of independent commissioners. Based on agency theory, one of the mechanisms designed to reduce agency problems is the appointment of an independent commissioner on the company board.

The BOC may consist of commissioners who are not affiliated parties known as independent commissioners and affiliated commissioners. Affiliated is a party that has a business and family relationship with the controlling shareholder, members of the board of directors and other commissioners, as well as within the company itself. Former affiliated members of the Board of Directors and BOC and company employees, for a certain period of time, are included in the affiliated category (KNKG, 2006).

Earnings quality

Earnings quality is a multidimensional concept that can be seen from various viewpoints. In the Statement of Financial Accounting Standards requires that financial information must have several qualities, namely: (1) understandable; (2) relevant; (3) reliable; and (4) comparable. Relevant information has predictive value, feedback value, and timeliness. In addition to relevance, accounting information needs to have reliability, namely: verifiable, honest presentation and neutrality.

The better the earnings quality, the more useful the decision maker. Earnings and metrics derived from them are generally used in the preparation of compensation and credit purposes. Contractual decisions based on low quality or defective earnings will result in the undesired transfer of wealth. (Bandi, 2007; Chen, Chang & Chang 2017). A number of research results have not identified a uniform method for measuring the concept of earnings quality. This study uses earnings persistence in measuring earnings quality.

Investor Reaction

Testing of market reaction through stock price indicators is more associated with testing of the market efficiency hypothesis. Husnan (2005) states that an efficient capital market is defined as a capital market whose security prices reflect all relevant information. The faster the new information is reflected in the price of the security, the more efficient the capital market will be. If market participants (investors) consider good information (good news) then there will be investor reaction which is reflected through an increase in stock prices and trading volume of shares.

Beaver (1968) states that price changes reflect changes in the average market beliefs as a whole, while trading volume shows the sum of all trades or actions of individual investors. This is consistent with the research of Bamber and Cheon (1995) states that, conceptually there is a difference between price and volume. An important difference between price and volume testing is that prices reflect changes in overall market expectations, while volumes reflect changes in individual investor expectations. This study uses stock price indicators in looking at investor reactions, where researchers focus on changes in the average market beliefs.

If all announcements are informative, it is expected that the market will react immediately when the announcement is received by the market and can be seen from changes in stock prices measured by using abnormal returns. Abnormal returns are generally the focus in the study of events that observe price reactions or market efficiency. This research uses Cumulative Abnormal Return (CAR). Husnan (2005) states that CAR is the sum of AR from period to period, to see the development of AR over several periods.

The hypothesis used in this study as follows:

1. CSR disclosure affects the investor's reaction through earnings quality both directly and indirectly.
2. The independence of the BOC affects the investor reaction through the earnings quality both directly and indirectly.

Research Method

The observational objects of this study are: (1) Data on CSR disclosure contained in annual reports and / or sustainability reports for the period of 2013; (2) Data relating to the calculation of earnings quality, which is contained in the annual financial statements for the period of 2012, 2013; and (3) closing price for 3 days, which is 1 day before the date of publication of the annual report, at the time of publication and 1 day after the date of publication of the annual report for the period of 2013.

The study population are all companies listed on the IDX in 2013. The number of companies listed on the IDX in 2013 was 492 companies. The sample in this study are companies that selected based on the purposive sampling method by determining the sample on the basis of conformity, characteristics and certain criteria. The sample selection criteria are as follows: (1) Companies that are included in the high profile category listed on the Indonesia Stock Exchange for the period of 2013 (2) The company has issued a complete financial statement as of December 31, 2013; (3) Companies that disclose CSR information on annual reports and / or sustainability reports listed on the IDX for the period of 2013; (4) Companies that consistently use the rupiah (Rp.) In presenting financial statements. In accordance with the sample selection criteria, 125 companies were eligible to be used as the sample in this study.

The variables in this study can be described as follows:

1. CSR Disclosure (X1)
CSR disclosure is the level of fulfillment of the extent and complete disclosure of economic, environmental and social information made by companies that make CSR reports that are listed on the Indonesia Stock Exchange (IDX). To calculate the total disclosure index (TI), which is the ratio that companies actually disclose divided by the number of items expected to be disclosed, as follows (Aljifri, 2008; Touf, 2011; Popova, 2013):

$$TI = \frac{TD}{M} = \frac{\sum_{1}^{m} d_i}{\sum_{1}^{n} d_i} \qquad \text{....................} (1)$$

Where:
TI = Total Disclosure index
TD = Total disclosure score
M = Maximum disclosure score of each company.
di = Disclosure item i, with a score of one or zero.
m = Actual number of relevant disclosure items (m≤ n)
n = Number of items expected to be disclosed.

The list of disclosures used is a list of CSR disclosure items based on the sustainability report guidelines set by GRI, which consists of economic, social and environmental performance.

2. Independence of the Board of Commissioners (X2)
The independence of the board of independent commissioners, is the total membership of the independent commissioners to the total number of members of the BOC. as follows:

$$\text{Independence of the BOC} = \frac{\text{Number of Independent Commissioners}}{\text{Total Number of Members of the BOC}} \qquad \text{..........................} (2)$$

3. Earnings quality (Y)
Earnings quality in this study is measured using earnings persistence. To calculate earnings persistence, using estimates from each company:

$$E_{i,t} = \mu_{0,i} + \mu_{1,i} E_{i,t-1} + v_{i,t} \qquad \text{..........................} (3)$$

Where:

Ei, t: Net Income before Extraordinary items of company i in year t divided by the average number of shares outstanding during year t.
Based on equation (3), it then measures earnings persistence from the estimated regression slope coefficient.

$$PERS_i = -\mu_{1,I} \qquad \text{..........................} (4)$$

4. Investor reaction (Z)

The investor reaction that examined in this study is the stock price measured using Cumulative abnormal return (CAR). Abnormal Return (AR) is an abnormal return indicated by the difference between realized returns and expected returns. Following is the formula for calculating AR:

$$AR_{i,t} = R_{i,t} - E[R_{i,t}]$$

$$R_{i,t} = \frac{P_{i,t} - P_{i,t-1}}{P}$$

Where:

ARi, t: Abnormal return for company i on the t-day
Ri, t: Daily return for company i on the t-day
E [Ri, t]: Return of the market index on the t-day
Pi, t: Index of company's individual stock prices i at time t
Pi, t-1: Index of individual company stock price i at time t-1
E [Pi, t]: Composite Stock Price Index at time t
E [Pi, t-1]: Composite Stock Price Index at time t-1

The window period used to calculate AR is 3 days, 1 day before the date of publication of the annual report, at the time of publication and 1 day after the date of publication of the 2013 annual report.

To be able to test AR values for 3 days, the AR will be accumulated. Calculation of Cumulative Abnormal Return (CAR) for each company is an accumulation of the average AR over the 3-day window period ending at t2, using the following formula:

$$CAR_{it} = \sum_{a=t1}^{3} AR_{i,a}$$

Where:

CARit: Cumulative Abnormal Return of company i at time t

To find out the magnitude of the role of earnings quality as a mediator of CSR disclosure and independence of the BOC in stimulating investor reactions used path analysis with the help of the SPSS software version 21.

Results and Discussion

After testing the assumptions of the Goodness-of-Fit Model of 125 samples, there are 122 samples selected and tested using path analysis. Testing of hypotheses using regression models in path analysis to predict the relationship between exogenous and endogenous variables. To test the hypothesis, a structural equation is made:

1) The effect of CSR disclosure and independence of the BOC on earnings quality with the following equation:

$$Y = \rho_{YX1}X_1 + \rho_{YX2}X_2 + \rho_{Y\varepsilon1}\varepsilon_1$$

2) The effects of CSR disclosure, independence of the BOC and earnings quality on investor reaction with the following equation:

$$Z = \rho_{ZX1}X_1 + \rho_{ZX2}X_2 + \rho_{ZY}Y_1 + \rho_{Z\varepsilon2}\varepsilon_2$$

The results of the calculation of the regression analysis can be seen in table 1 and table 2 below:

Table 1: Results of calculation of the coefficient of regression equation analysis 1

Coefficients[a]						
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	1,526	,390		3,910	,000
	CSR_Disc	,296	,088	,293	3,359	,001
	Ind_BOC	-,075	,087	-,075	-,854	,395

a. Dependent Variable: EQ

Table 2: Results of calculation of the coefficient of regression equation analysis 2

Coefficients[a]						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	,108	,251		,430	,668
	CSR_Disc	,053	,056	,090	,942	,348
	Ind_BOC	-,037	,053	-,063	-,693	,490
	EQ	,027	,055	,046	,480	,632

a. Dependent Variable: Investor_Reaction

Calculation of Significance Value of the Effect of Mediation (Sobel Test)

To find out the significance value of the role of mediating variables or indirect effects, a Sobel test is used. Table 3 below shows the result of calculating the role of mediating variables from this research model.

Table 3: Results of Calculation of Significance Value of Indirect Testing (Sobel Test)

Variable Combination			Estimated Value	*Standard Error*	*P value of Sobel Test*
CSR_Discl	--->	Investor_Reaction *via* Earnings _Quality	0,296; 0,027	0,088;0,055	0,627
Ind_BOC	--->	Investor_Reaction *via* Earnings _Quality	-0,075; 0,027	0,087;0,055	0,669

Source: Calculations with the help of the program statistics calculator ver. 3.0 BETA, http://www.danielsoper.com/statcalc3/calc.aspx?id=31

The Sobel test calculation results in table 3, show the following:

1. The indirect effect of CSR disclosure on investors' reaction has a Sobel Test p-value (two-tailed probability) of 0.627> alpha 0.05.
2. The indirect effect of the independence of the BOC on the investor's reaction has a p-value (two-tailed probability) Sobel Test of 0.669> alpha 0.05.

Based on the above calculation, it can be concluded that the variables of CSR disclosure and the independence of the BOC do not have an indirect effect on investor reaction.

Hypothesis Testing

Direct Effect of CSR Disclosure on Earnings Quality and Investor Reaction

The path analysis results presented in Table 1, the standardized beta coefficient value of the direct influence of CSR disclosure on earnings quality as measured by earnings persistence are 0.296 with a p-value of 0.001 <alpha 0.05. This shows that CSR disclosure has a positive and significant effect on earnings quality. The results of this study are in line with research conducted by Calegary et al., (2010) who found that CSR describe a corporate culture that positively improves the earnings quality reporting. This indicates that the more CSR activities are carried out and disclosed in the annual report and / or the sustainability report, the tendency of the resulting earnings to be more qualified.

The standardized beta coefficient value of the direct effect of CSR disclosure on investor reaction is 0.053 with a p-value of 0.348> alpha 0.05. This shows that CSR disclosure has no significant effect on investor reaction. The results of this study indicate that the disclosure of CSR has not been responded well by investors in making investment decisions in sample companies listed on the Stock Exchange. The results of this study are in line with research conducted by Zareian (2012) conducted on companies listed on the Tehran Stock Exchange (TSE), the period 2004 to 2008, could not confirm the existence of a significant relationship between disclosure quality and stock returns.

Direct Effect of Independence of the BOC on Earnings Quality and Investor Reaction

The path analysis results presented in Table 1, the standardized beta coefficient value of the independence of the BOC on earnings quality as measured by earnings persistence is -0.075 with a p-value of 0.395> alpha 0.05. This shows that the independence of the BOC does not have a significant influence on earnings quality. The results of this study are not in line with Lee (2013) who found that independent directors can improve earnings quality. Likewise, Alves's research (2014) which shows that independent board members is a positive step in improving earnings quality. The results of this study indicate that the supervisory role of the independent BOC has not been well implemented in the sample companies listed on the IDX. As stated in the Limited Liability Company Law, independent commissioners have at least an oversight function and an advisory function.

The standardized beta coefficient influences the independence of the BOC on investor reaction is -0.037 with a p-value of 0.490> alpha 0.05. This shows that the independence of the BOC does not have a significant influence on investor reaction. The results of this study are not in line with Ifada and Suhendi (2014) who found that to predict market reactions, companies can entrust the existence of independent commissioners and audit committees owned by the company. The results of this study indicate that the supervisory role of the independent BOC has not been responded well by investors in making stock investment decisions in sample companies listed on the IDX. This can be caused by the investor's opinion that the function of the independent BOC has not been effective. Independent commissioners are part of the BOC who have the same tasks as the BOC in general, namely performing the supervisory and advisory functions. However, in practice many commissioners neglect their duties to provide oversight of the directors' policies in running the company.

Furthermore, the standardized beta coefficient influences the quality of earnings on investor reaction is 0.027 with a p-value of 0.632> alpha 0.05. This shows that earnings quality does not have a significant effect on investor reaction. The results of this study are not in line with Chan et al., (2016) who found that earnings quality has the power to predict stock prices. The results of this study indicate that investors do not use aggregate earnings quality information when analyzing quality earnings in their stock investment decision making.

The Role of Mediating Earnings Quality on Investor Reactions

Calculation of the significance of the sobel test for the indirect effect of CSR disclosure on investor reaction in table 3, the Sobel test p-value of 0.627> alpha 0.05. This shows that CSR disclosure has no indirect effect on investor reaction. In this case earnings quality measured by earnings persistence fails to mediate the effect of CSR disclosure on investor reaction. Furthermore, the calculation of the significance value of the sobel test for the indirect effect of the independence of the BOC on investor reaction in Table 3, obtained the Sobel test p-value of 0.668> alpha 0.05. This shows that the independence of the BOC does not have an indirect effect on investor reaction. In this case earnings quality fails to mediate the effect of the independence of the BOC on investor reaction.

The results of this study find that the earnings quality variable measured by earnings persistence did not mediate between the CSR disclosure variables and the independence of the BOC with the investor reaction variable. Earnings quality measured by earnings persistence in this study failed to become a mediating variable that links the CSR disclosure variable and the independence of the BOC to investors' reactions to companies listed on the IDX. This can be caused because investors tend to use external information in addition to internal information, in this case the quality of corporate earnings in making investment decisions. External information is related to Indonesia's macroeconomic conditions, domestic political turmoil, security, or the condition of the Indonesian capital market.

Conclusion

This study aims to examine the effect of CSR disclosure and the independence of the BOC on investor reaction, with earnings quality measured by earnings persistence as a mediating variable. The sample used in this study amounted to 122 companies listed on the Stock Exchange that have passed various testing processes, this study concludes the following (1) CSR disclosure has a positive and significant effect on earnings quality; (2) CSR disclosure has no effect on investor reaction; (3) Independence of the BOC does not have an influence on earnings quality; (4) Independence of the BOC does not have an influence on investor reaction; (5) Earnings quality has no influence on investor reactions; (6) The results of this study indicate that there is no mediating role in the earnings quality variable that links between CSR disclosure and BOC independence with investor reaction.

This study has limitations that can be used as a reference for further research in order to obtain better results. The limitations of this study are as follows: (1) The use of a checklist to measure CSR disclosure makes it difficult to distinguish the quality of disclosure between one company and another. This can also lead to the subjectivity of researchers in measuring CSR disclosure indexes; (2) GCG mechanism in this study only uses the independence of the BOC variables. (3) This study still uses annual reports to look at CSR disclosures in addition to sustainability reports because of the limitations of companies that make CSR reports separate from annual reports on sample companies.

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