Corporate Governance, Corporate Social Responsibility and Firm Value: Economic Value Added as the Intervening Variable

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Abstract

This research study is aimed to find out whether Economic Value Added (EVA) mediates the relationship between Good Corporate Governance (GCG) and firm value, and mediate the relationship between Corporate Social Responsibility (CSR) and firm value. The sample used in this research is mining sector companies listed on the Indonesia Stock Exchange during the period 2013-2017. The statistical method used is multiple linear regression with path analysis to solve the mediate variable. The research findings revealed that EVA does not mediate the relationship between GCG and firm value, and does not mediate the relationship between CSR dan firm value. Although EVA does not serve as the mediator, it influences firm value.

Keywords: GCG, CSR, EVA, firm value, mining companies.

Introduction

Firm value is how investors perceive the success level of a company. Investors usually use it as the benchmark in trading decision-making. The firm value of publicly-traded companies can be observed through the movements of share prices. Therefore, the topic of firm value receives a lot of interest regarding fluctuations in share prices. In Indonesia, the composite index fell 8.75% during the first half of 2018. It is the index weakening at its worst level compared to other stock exchanges in Asia: Shanghai index dropped 13.9%, SET index (Stock Exchange of Thailand) dropped 9.02%, KLCI Index (Kuala Lumpur Composite Index) declined 5.86%, Kospi index fell 5.73%, Strait Times index fell 3.94%, Hang Seng index dropped 2.22%, and the Nikkei index dropped 2.02% (Kevin, 2018)

Given that the importance of firm value, the efforts to maximize the value of a company are carried out by improving the company's financial performance. In the process of maximizing firm value, a conflict of interest between managers and shareholders sometimes occur. Managers may have their interests and goals which differ from the company's main goals and ignore the shareholders' interests. Delegating authority from shareholders to agents may give rise to information asymmetry between principals (shareholders) and agents (management). This problem can be anticipated if the company has good governance (Taufik, *et al.*, 2018).

Corporate Governance is a process by which a company is organized and controlled to reach business success while taking into account the interests of shareholders and reduced agency conflicts for achieving the company's goals (Rimardhani, *et al.* 2016). The purpose of corporate governance is to improve added value, prosperity, and impact positively the company's financial performance or supervision. Another way that a firm may use to improve its value which in turn be able to attract potential investors is Corporate Social Responsibility (CSR) – a strategy that aims to earn legitimacy in society. It is expected that heightened investor attention to the company may boost the company's value.

This research study is aimed to corroborate the research by Taufik, *et al.* (2018) by adding CSR as the independent variable and using Economic Value Added (EVA) as the intervening variable. EVA is considered to be able more to represent the actual economic profit of a company compared to other profit measures (Mardiyanto, 2013).

Literature Review

Good Corporate Governance

Agency problems often give rise to a conflict of interest between managers and shareholders, and it may harm profitability which in turn affect the firm value. Therefore, Good Corporate Governance (GCG) is of great importance. In general, the term Corporate Governance is associated with consequences of interest separation between ownership and control over an effective modern corporation. In other words, the agency problem between the firm owners and the management, minority versus majority owners, and between the owners and other stakeholders encourage the need for effective governance control mechanism (Lukviarman, 2016). As such, Good Corporate Governance has five main principles for its implementation - transparency, accountability, responsibility, independence, and fairness, which will enhance company performance, improve the quality of financial statements, and inhibit manipulation of financial statements. Thus, when good corporate governance is practiced, it will likely result in higher firm value (Lukviarman, 2016). Istighfarin & Wirawati (2015) proved it in their research that GCG has a positive effect on profitability. It is corroborated by Sarafina and Saifi (2017) who found that all components of GCG have a positive effect on firm value. Hypotheses are proposed as follows based on the theoretical review:
H1: Good corporate governance has a positive effect on Economic Value Added
H2: Good corporate governance has a positive effect on firm value

Corporate Social Responsibility (CSR)

Legitimacy theory suggests that organizations are continually looking for ways to ensure that their operations are within the restrictions and norms that apply in society. According to the legitimacy theory perspective, a firm is required to disclose its activities if the firm perceives that communities expect the disclosure. In this regard, the firm is considered to have "a social contract" between the firm and the society where the firm operates (Rokhlinasari, 2012). Therefore, CSR is one of the ways to attract and earn legitimacy in society. If a company earns public attention, it will be likely to attract investors so that the demand for the company's stock is increasing. As a result, the stock price will rise which directly affect the company's value. In addition to attracting investors, public attention also will be likely to attract more consumers, which, in turn, enhance the company's profitability.

Prior studies regarding CSR show that CSR has a positive effect on firm value (Arianti, *et al*, 2018). CSR also has positive effect on profitability (Almar, *et al*, 2012). Thus, two hypotheses are proposed as follows:
H3: Corporate social responsibility has a positive effect on Economic Value Added
H4: Corporate social responsibility has a positive effect on firm value

Economic Value Added

Economic Value added (EVA) offers an objective parameter as it deducts profit by the cost of capital which reflects the risk level of a company. Cost of capital represents the level of return expected by investors for the money invested into the business. So, a positive EVA indicates higher return level than the level of capital cost (Mardiyanto, 2013).

Basically, EVA is a measure of company performance which is directly linked with shareholders' wealth over time. The increased profitability is expected to attract investor attention so that it will raise the firm value. Thus, EVA will be more likely to increase by the implementations of GCG and CSR, which, in turn, the firm value will also rise.

Previous study regarding EVA revealed that EVA has a positive and significant effect on firm value (Wedayanthi dan Darmayanti (2016). Ayuningrum and Saputra (2017) included profitability as an intervening variable among the relations of GCG. Panjaitan (2015) found that

CSR has a significant effect on firm value with profitability as the intervening variable. Thus, three hypotheses are proposed as follows:
H5: Economic Value Added has a positive effect on firm value
H6: Economic Value Added mediates the effect of corporate governance on firm value
H7: Economic Value Added mediates the effect of corporate social responsibility on firm value

Research Sample

The population in this research study is mining companies listed on the Indonesian Stock Exchange (IDX). Purposive sampling method is used to select research sample based on the following criteria:

1. Mining companies listed on the Indonesian Stock Exchange (IDX) during the period 2015 - 2017.
2. The data of audited financial statements and audited annual reports are available consecutively during the period 2015-2017.
3. The companies published financial statements in Rupiah.

Dependent Variable

Stock price represents firm value. Firm value is measured by Price to Book Value (PBV), that is by comparing stock price per share to book value per share which is expressed in the following equation:

Firm Value (PBV) = stock price/book value per share

The book value calculated referred to the company's book value on December 31st in the year of investigation, that is 2013-2017, while the stock price referred to the price on March 31st in the previous year.

Independent Variable

Good Corporate Governance (GCG) is a set of systems which organize and control a company to create value added for stakeholders, as it can encourage the management's work patterns that are clean, transparent and professional (Effendi, 2009). The following is how to measure GCG

GGDI = The number of items disclosed/42

Corporate Social Responsibility (CSR) is an act based on a company's ethical considerations to promote the economy of the company, the employees' wellbeing as well as their families, and to improve the wellbeing of the community and civil society in general (Arianti & Putra, 2018). Calculation of CSR is conducted by giving a score on each CSR disclosure.

CSRI = The number of items disclosed/91

Intervening Variable

Economic Value Added (EVA) is the nominal obtained by subtracting capital charge from net operating profit. The capital charge is derived from multiplying between the amount of assets used and tariff level (Anthony & Govindarajan, 2007).

Economic Value Added (EVA) = NOPAT – Cost of Capital

Information:
NOPAT: Net Operating Profit After Tax

Data Analysis Method

This research study makes use of regression analysis with the following equation:
Calculation Structure 1: $Z = \alpha_3 + \beta_3 X_1 + \beta_3 X_2 + \varepsilon_3$
Calculation Structure 2: $Y = \alpha_4 + \beta_4 X_1 + \beta_4 X_2 + \beta_4 Z + \varepsilon_4$
Information:
Z = Economic Value Added (EVA)
Y = Firm value
X_1 = Corporate Governance
X_2 = Corporate Social Responsibility
$\beta_1, \beta_2, \beta_3, \beta_4$ = Coefficient
$\alpha_1, \alpha_2, \alpha_3, \alpha_4$ = Constanta
$\varepsilon_1, \varepsilon_2, \varepsilon_3, \varepsilon_4$ = Residual error

Results and Discussions

Description of the Research Sample

Results of the descriptive statistical analysis are shown in table 1 below:

Table 1. Results of Descriptive Statistical Analysis

	N	Minimum	Maximum	Mean	Std. Deviation
GCG	40	.31	.86	.5524	.14866
CSRI	40	.01	.90	.1731	.21623
EVA	40	-628202387324.74	768453584367.83	79869448176.8313	211676535738.71152
PBV	40	.16	3.15	1.1125	.69778

Table 1 displays that Good Corporate Governance has an average of 0.5524. It indicates that the average of the sampled companies revealed a GCG index of 55.24% out of the total index of 42, which amounts to 23 indicators. PT Citatah Tbk earned the GCG minimum value, which is 0.31, while the GCG maximum value is 0.86 earned by PT Aneka Tambang Tbk.

The table also shows that Corporate Social Responsibility has an average of 0.1731. It indicates that the average of the sampled companies revealed a CSRI index of 17.31% out of the total index of 91, that amounts to 16 indicators. The CSRI minimum value is 0.01 earned by PT Citatah Tbk, while the maximum value 0.90 earned by PT Timah Tbk.

Furthermore, Economic Value Added (EVA) has an average of 79,869,448,176. 8313. Such average has a positive value, which means most of the sampled companies can produce a comparable rate of return (profit) to cover the risks and investment costs invested by the capital owners. The EVA minimum value is -628,202,387,324.74 that PT Aneka Tambang Tbk earned in 2013. The negative value indicates the rate of return (profit) is not equivalent to the risks and investment costs. Meanwhile, the EVA maximum value is 768,453,584,367.83 0.21 that PT Aneka Tambang Tbk earned in 2015. The positive value indicates the rate of return (profit) is equivalent to the risks and investment costs.

The last one is PBV. The firm value proxied by PBV has an average of 1.1125. This indicates that the average firm value of the sampled companies is 1.1125. The PBV value which is close to 1 reflects the sampled companies on average are considered to be an attractive investment for investors. The PBV minimum value is 0.16 earned by PT Citatah Tbk. PBV value which is below 1 indicates that the share price of PT Citatah Tbk is cheaper than its fair share price. Meanwhile, the PBV maximum value is 3.15 earned by PT Cita Mineral Investindo Tbk. Such value (3.15) indicates that the share price of PT Cita Mineral Investindo Tbk is considered too expensive, as it is 3.15 times its fair price.

Results of Hypothesis Testing

The results of regression equation model 1 and 2 employed to prove hypotheses 1,2,3,4 are shown below:

Results of Regression Analysis Model 1

Model		Unstandardized Coefficients		Standardized Coefficients	Sig.
		B	Std. Error	Beta	
1	(Constant)	2.542	.559		.000
	GCG	1.909	.919	.333	.045
	CSRI	.455	.217	.336	.043

Dependent Variable: EVA

Results of regression Analysis Model 2

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.697	.312		2.231	.032
	GCG	.887	.435	.270	2.041	.049
	CSRI	.212	.103	.273	2.060	.047
	EVA	.228	.074	.398	3.102	.004

Dependent Variable: Firm Value

This research study proposes the first hypothesis stating that GCG has a positive effect on EVA. The table shows that the regression value is 1.909 and significance value is 0.045. At the level of α = 5%, it can be concluded that GCG has a positive and significant effect on EVA, thus H1 is supported. This result supports the theory which explains different goals between agents (managers) and owners. To straighten out the goals between the two parties, Good Corporate Governance is one of the ways. EVA will encourage managers to take prudent measures as it measures a company's profitability not only from the profits earned but also from risks and investment costs. This research finding is in line with the research by Istighfarin & Wirawati (2015) that found the positive and significant effect of GCG on a company's profitability.

The second hypothesis proposed in this research study states that GCG has a positive effect on firm value. The table above demonstrates that the regression value is 0.887 and the significance value is 0.049. At the level of α = 5%, such values indicate that GCG has a significant effect and its regression coefficient directs to positive, thus H2 is supported. The more the GCG indicators are disclosed, it will be likely to enhance firm value. Otherwise, the less the GCG indicators are disclosed, it will be likely to lower firm value. This research finding has proven that GCG has a positive and significant effect on firm value. It has also proven agency theory; Good Corporate Governance can minimize agency problems which possibly impact firm value. Thus, the implementation of good corporate governance is of great importance in order that management can act in positive ways, according to the company's goals. If the management is aligned with the company's goals, the company's profitability will rise as corporate governance gets better. This research finding supports the research by Sarafina and Saifi (2017), and Retno and Priantinah (2012) that found Corporate Governance has a positive effect on firm value.

The third hypothesis in this research study states that CSR has a positive effect on EVA. The table above displays that the regression value is 0.455 and the significance value is 0.043, which means CSR has a positive and significant effect, thus H3 is supported. The more the CSR indicators are disclosed, it will likely boost EVA of a company or the less the CSR indicators are disclosed, it will likely lower EVA. This research study supports legitimacy theory, that a company needs to publicize its activities if it is perceived the community expects it. Nevertheless, implementing CSR and publicizing its activities are the ones that society expect. Once CSR is implemented and publicized, it will increase stakeholder attention which in turn enable improve a company's profitability. This research finding corroborates the research by Almar, Rachmawati, and Murni (2012) which revealed that CSR has a positive and significant effect on a company's profitability.

The fourth hypothesis states that CSR has a positive effect on firm value. It can be seen from the table that the regression value is 0.212 and the significance value is 0.047. At the level of α = 5%, CSR has a positive and significant effect on, thus H4 is supported. The more the CSR indicators are disclosed, it will likely enhance firm value or the less the CSR indicators are disclosed, it will likely degrade firm value. This research finding supports legitimacy theory stating that a company needs to publicize its corporate activities. The theory is an impetus for a company to earn public recognition. Once the company has earned public recognition, it will build investor awareness of the company's existence, so that the demand for the company's stock rises, which in turn affects the company's value. This research finding conforms to the research by Arianti, *et al* (2018) revealing that CSR has a positive effect on firm value.

The fifth hypothesis states that EVA has a positive effect on firm value. The table shows that the regression value is 0.228 and the significance value is 0.004. At the level of α = 5%, EVA has a positive significant effect, thus H5 is supported. The larger the EVA value, it will enhance the value of a company, or the less the EVA value, it will reduce the company's value. Economic Value Added is a measure of financial performance which enables to capture the true economic profit of a company than any other measures. Once profitability increases, investors will be attracted to invest in the company, thus increasing firm value.

Testing the sixth and seventh hypothesis was done utilizing the following flowchart:

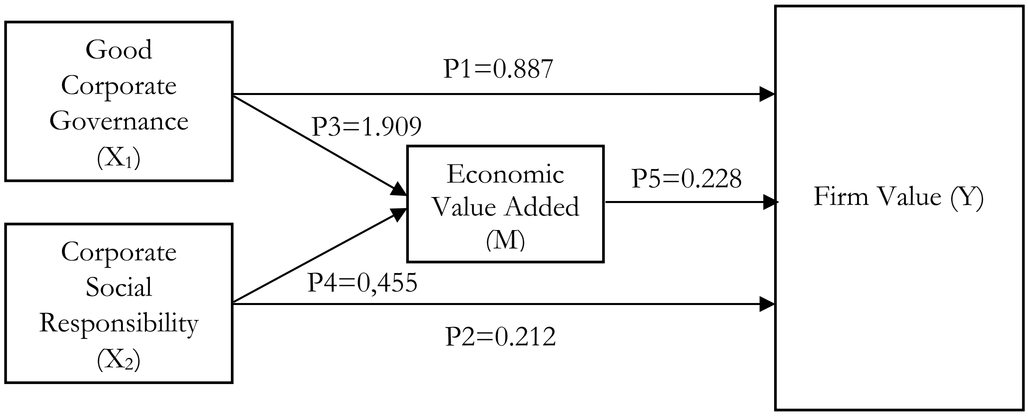

Figure 2: Flowchart Result

Testing the sixth hypothesis was conducted by examining the direct or indirect influence of GCG on firm value via EVA. P6 value is a direct coefficient value, that is 0.887, while indirect coefficient consists of P3 (1.909) and P5 (0.228). To find out the value of the indirect effect, the calculation was done by multiplying its indirect coefficient of 1.909 x 0.228 = 0.435. The result indicates the direct effect is larger than the indirect one so that EVA does not mediate GCG on firm value. Thus, H6 was rejected. Such a result indicates that the GCG mechanism implemented by the company is probably not focused on improving the company's profitability. To put it another way, the company that discloses GCG information aims to attract investors and simply carries out the responsibility of disclosing GCG information, not to optimize profits. It can be seen when GCG can affect firm value positively and significantly, but unable to mediate the relationship between GCG and firm value. This research finding is in line with the research by Taufik, *et al* (2018) revealing that EVA is unable to mediate the relationship between GCG and firm value.

Testing the seventh hypothesis was conducted by examining the direct and indirect effects of CSR on firm value via EVA. Value of P2 represents the direct coefficient value, that is 0.212, while the indirect coefficient comprises P4 (0.455) and P5 (0.228). To find out the value of indirect effect, the calculation was done by multiplying its indirect coefficient of 0.455 x 0.228 =

0.103. The finding reveals that the value of the direct coefficient relationship is larger than the indirect one so that EVA does not mediate the influence of CSR on firm value. Therefore, H7 was rejected. Such a result indicates that CSR which is considered obligatory by the companies engaged in the field of natural resources is not aimed to enhance profitability. This research finding is aligned with the research by Arianti, *et al* (2018) who found that yang profitability is unable to mediate the relationship between CSR and firm value.

Conclusions

This research study has proven the hypotheses proposed. GCG has a positive and significant effect on firm value. CSR has a positive and significant effect on firm value. GCG has a positive and significant effect on EVA. CSR has a positive and significant effect on EVA. EVA has a positive and significant effect on firm value. Meanwhile, EVA is unable to mediate the relationship between GCG and firm value. EVA is also unable to mediate the relationship between CSR and firm value. Given such research findings, companies need to take into account GCG and CSR, because these have been proven to affect firm value and performance.

Nevertheless, the research findings must be interpreted with caution and some limitations should be borne in mind. The primary limitation of this research study is the researcher's subjectivity in interpreting CSR disclosure of the sampled companies because not all of them issued a sustainability report in their annual reports. For possible future research, it is recommended that future studies enlarge sample size in other sectors (not restricted to mining sector) and extend the research period to be more representative of a large population.

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