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Corporate governance, corporate social responsibility and corporate risk: evidence on Indonesia

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Abstract
This research aims to test the influence of corporate governance and disclosure of social responsibility on corporate risk. The research was conducted on primary and secondary industrial companies listed on the Indonesia Stock Exchange (IDX) using data from 2014 to 2020. Data analysis will be done by quantitative data analysis with regression analysis using panel data. The results show that corporate governance and corporate social responsibility have a significant effect on company risk. The results are expected to be an additional reference to academics and researchers, about governance, disclosure of corporate social responsibility and its relationship to corporate risk, as well as an additional reference for capital market supervisors and regulators around corporate management.
Keywords: Corporate social responsibility, Earning management, Corporate governance, Indonesia Stock Exchange.

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1. Introduction

Risk is the final event that will be considered from the beginning in designing planning within the company (Hatane et al., 2019). CRMS *(*Center for Risk Management Studies*)* is the platform for the largest risk management training in Indonesia that has a vision to help develop risk management capabilities for practitioners and organizations in Indonesia. According to (CRMS Indonesia, 2019) the risk of being cultivated becomes the foundation in creating *value* and maintaining the company's value to be in line with the goals to be achieved. The small risk depends on the information obtained from the company's internals. The more information obtained, the clearer the risks that will be faced.

According to (Ott, 2020) confirmed that risk reporting in recent decades has both had an increasing discussion in developed and developing markets. (Khandelwal et al., 2020) Explaining that the importance of corporate risk is mitigated by each company. Corporate risk attracts researchers to research it so much research in discussing corporate risk (Zhang et al., 2018) Risk taking becomes the foundation for a company in running a business.

Every company has risks (Hatane et al., 2019). In the process of movement of companies or organizations has become a natural and absolute thing in risk taking. However, these risks must be able to be managed and overcome by the company. Risk management can be done through corporate governance mechanisms (Hatane et al., 2019). This mechanism can be used as a tool to discipline managers and comply with agreed contracts. Management should strive to find the right balance between the growth of the company and the risks it faces. Furthermore, the company's risk can be suppressed through corporate governance because it minimizes opportunities among managers in cheating (Asghar et al., 2020).

Another thing that affects corporate risk is corporate social responsibility. The implementation of corporate social responsibility disclosure can improve the company with increasing reputation and competitiveness so as to manage the company's risks properly. Social responsibility involvement is believed to lower a company's risk according to research by Rehman et al., (2020) and Cui *et al.* (2017). Meanwhile, the relationship of social responsibility disclosure and idiosyncratic risk has been studied by Ozdemir et al. (2020).

This research aims to examine the relationship between corporate governance, corporate social responsibility and corporate risk. The sample in this study are companies in primary and secondary sector industries (agriculture, basic and chemical industries, consumer goods industry, mining, and other industries) listed on the Indonesia Stock Exchange in 2014-2020. This study is different from previous research that uses idiosyncratic risk measurement to measure corporate risk and the ASEAN CG Scorecard to look at the implementation of corporate governance. This research contributes to the development of financial accounting literature, especially on the topic of corporate risk. In addition, research has pre-pragmatic implications in the form of consideration materials by various stakeholders such as investors, managers and regulators. The next part of the study is part 2 literature review, part 3 Methodology, 4 Results and Discussion and 5 Conclusions.

2. Literature Review and Hypotheses Development

2.1. Agency Theory

Agency theory was first initiated by Jensen and Meckling (1976). From the point of view of agency theory, this is found in the agency relationship between the agent and the principal. Agency theory observes the emergence of company managers can use the opportunity to maximize profits that will be achieved personally that can harm the owner of the company massively. In return, an agent gets bonuses, premiums, compensation, and so on for personal gain, instead the principal as the owner of the company as well as the provider of company

funds (Hatane et al., 2019) Therefore, the absence of the concept of successful governance internally or externally, with example implementing investments that damage value, not remembering investments that create value, or abusing financial returns as a way to maximize personal profits (Almaskati et al., 2020).
According to Khandelwal *et al.* (2020a) , well-regulated companies are bound to signal their quality to investors through highly informative and permanent corporate risk disclosure that eliminates investor concerns about the company's risk as well as results in lower cost of the company structured capital for the company which in turn will increase the company's valuation. Internal corporate governance mechanisms are expected to reduce agency costs. The company's board is obliged to ensure the information in the financial statements in the fulfillment of the conditions that have been determined (Hatane et al., 2019). Directors as responsible parties in running the company have the vulnerability to optimize its interests at every opportunity by abusing the company's resources, at the expense of shareholders or so-called *agency costs* (Hatane et al., 2019).
The agency's theory controls that conflicts of interest between managers and shareholders lead to less than optimal risk-taking (Chakraborty et al., 2019). Agency theory holds that managers take less than optimal risks for two main reasons. First, managers avoid risk and avoid investing in investments that are risky but increase in value. Second, unlike fully diversified shareholders, managers are not well diversified because most of their human capital and financial wealth is linked to their companies (Chakraborty et al., 2019).

2.2. Corporate Governance and Risk

The corporate governance component that influences corporate risk, it seems, that the internal governance mechanisms associated with the board are more relevant (Hatane et al., 2019). In increasing managing corporate risk is used as a reference for good corporate governance so that it is a symbol of corporate governance (Zhang et al., 2018) Corporate governance is needed to maintain the stability of the company (Napitupulu et al., 2020). The board is more relevant in the process of managing the company well because it is more internally processed (Archbold, 2016).
In line with research (Hatane et al., 2019) proves that the components of corporate governance mechanisms have an insignificant effect on corporate risk. This is because risk can come from internally or externally, therefore the company must understand the different types of risks facing the company. (Chakraborty et al., 2019) also said that corporate governance has a negative impact on corporate risk. (Zhang et al., 2018) found that the governance significantly exerts influence on increasing corporate risk.
In contrast to research (Khandelwal et al., 2020) said the company's risk is positively affected by corporate governance mechanisms. (Archbold, 2016) reveals board diversity negatively affects relationships with corporate risk. According to the description above, it attracted the attention of researchers to test.
H1: Corporate governance affects corporate risk

2.3. Corporate social responsibility and corporate risk

CSR is related to the maximum for social welfare for the sustainability of a company's life. Involvement in CSR activities improves the organization's image as a socially responsible organization which may be useful especially during economic downturns and adverse scandals when the organization needs the support of its stakeholders (Rehman, 2020). This shows that companies with high CSR practices are less likely to hide bad news about the company to shareholders, thus minimizing the company's risk with transparency from a company.

CSR activities are believed to be an effective strategy for the company's cash turnover. Cash turnover stability has involvement with corporate CSR. involvement in CSR activities helps reduce financial risk and improve credit rating thereby lowering capital costs (Rehman, 2020). The majority of research over the past few years provides growing evidence of a negative relationship between CSR and corporate risk. Ozdemir *et al*, (2020) aims to examine the interrelationship between corporate social responsibility (CSR) and idiosyncratic risks in the restaurant industry. The result of this study is that CSR involvement reduces special risks and risk reduction which means CSR provides a negative link to corporate risk.
H2: *Corporate social responsibility* affects corporate risk.

3. Methodology

3.1. Population and sample

This research was conducted on primary and secondary sector companies listed on the Indonesia Stock Exchange (IDX) from 2014-2020. Using purposive sampling techniques, the final sample of the study amounted to 130 companies with a total of 910 observations. The type of data in this study is quantitative data. The data was obtained from the company's annual report published on the Indonesia Stock Exchange.

3.2. Regression model

Regression analysis of this study uses panel data. To test the effect of corporate governance and CSR on corporate risk, this study uses the following regression model.

$$IR_{it} = \beta_0 + \beta_1 CG + \beta_2 CSR + \beta_3 ROA_{it} + \beta_4 LEV_{it} + \beta_5 SIZE_{it} + \beta_6 AGE_{it} + \beta_7 YEAR_{it} + \varepsilon$$

Information:
IR: Idiosyncratic risks for companies
CG: Corporate governance score
CSR: CSR Disclosure
ROA: Return on Asset
LEV: Debt to Equity ratio
SIZE: The Company's size of the number of company asset logs
AGE: The age of the company from the number of years since the company was founded
YEAR: Year of data used
ε: Error term, error rate of presumption in research

3.3. Variable Operationalization

Independent Variables
Independent variables are usually symbolized by x. The variables in this study are the factors that affect the company's risk. These factors are corporate governance and disclosure of corporate social responsibility.

Corporate Governance
In this study corporate governance using the ASEAN CG scorecard 2014 measurement, there are 2 levels in the following assessment categories

Level 1
The level 1 assessment contains five main aspects that refer to OECD principles and each aspect has 179 items used as guidelines. These five aspects, namely:
a) Protection of the rights *of shareholders*;

b) Equal treatment of *shareholders (the equitable treatment of shareholders*);
c) Stakeholder role (*the role of stakeholders in corporate governance*);
d) Disclosure and *transparency*;
e) Responsibilities *of the Board of* Commissioners and Board.
How to calculate a level 1 score as follows:

$$\boldsymbol{Score} = \frac{\boldsymbol{No. of\ Item\ scored\ by\ PLC}}{\boldsymbol{Total\ no. of\ question}} \ \mathbf{x}\ \boldsymbol{Maximum\ Attainable\ score\ of\ part}\ (\boldsymbol{in\ points})$$

Level 2
Level 2 contains bonuses and penalty with a composition of 11 bonus items and 21 penalty items. The total level 2 score is calculated by adding a bonus score and penalty score.

Table 1. Structure and Composition of Level 2 ASC

Level 2	Number of Questions	Maximum Score (point)
Bonus	11	28
Pinalty	21	(50)

Source: ASEAN CG Scorecard Assessment (2014)

Determining the number of scores is:

TOTAL SCORE = Total level score 1 + Total level 2 score

Corporate social responsibility
This study *uses corporate social responsibility* as a dependent variable. *Corporate social responsibility* is assessed based on indicators in the Global Reporting Initiatives G4 Guidelines Scoring. The assessment guidelines are gri g4 guidelines, the criteria for giving the score are as follows:
0 = if the item is not disclosed
1 = if the item is disclosed but not comprehensive
2 = if the item is comprehensively disclosed but does not conform to the GRI G4 Guidelines criteria
3 = if the item is comprehensively disclosed and in accordance with the GRI G4 Guidelines criteria

Control Variables
This research uses control variables, namely profitability projected by ROA, leverage, company size, company age and year effects.

4. Results and Discussion

4.1. Results of Descriptive Statistical Analysis

Table 2 draws each variable used in this study, through mean values, standard deviations, minimums and maximums.

Table 2. Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
BETASAHAM	910	.732	.359	.11	2
GCG	910	38.922	12.917	4.286	82.113
CSR	910	.302	.145	0	1
ROA	910	3.009	8.946	-56.73	71.6

Variable	Obs	Mean	Std. Dev.	Min	Max
LEV	910	8.343	34.648	-244.22	357.4
SIZE	910	21.963	1.584	17.134	26.587
AGE	910	37.395	20.15	5	119

Based on the table above, it is known that the disclosure of the implementation of good corporate governance has begun to reach a good level, then, for CSR implementation also the average company is already very concerned, this is seen from there are companies that have revealed in full.

4.2. Results of Hypothesis Testing and Discussion

Table 3. Regression Analysis Results

BETASAHAM	Coef.	St.Err.	t-value	p-value	[95% Conf	Interval]	Sig
GCG	.007	.001	8.06	0	.005	.009	***
CSR	.326	.069	4.74	0	.191	.461	***
ROA	.001	.001	1.23	.219	-.001	.003	
LEV	.001	0	2.73	.006	0	.001	***
SIZE	.098	.006	15.06	0	.085	.11	***
AGE	.001	0	1.50	.134	0	.002	
Constant	-1.773	.135	-13.09	0	-2.038	-1.507	***
Mean dependent var	0.732		Prob > F		0.000		
Number of obs	910		R-squared		0.126		
Prob > chi2	1.000		Akaike crit. (AIC)		314.079		
*p<.01, **p<.05, *p<.1*							

The results of this study show that corporate governance is based on corporate risk, H1 is accepted. These results support the agency's theory that conflicts of interest between agents and principals can be suppressed by a system that oversees each other. Corporate governance is needed to maintain the stability of the company (Napitupulu et al., 2020). The board is more relevant in the process of managing the company well because it is more internally processed (Archbold, 2016).

This finding is in line with Zhang et al., (2018) which found that corporate governance significantly affects the disclosure of corporate risks. Then (Hatane et al., 2019) proved that the components of corporate governance mechanisms have no significant effect on corporate risk. This is because risk can come from internally or externally, therefore the company must understand the different types of risks facing the company. (Chakraborty et al., 2019) also said that corporate governance has a negative impact on corporate risk.

Then, this study also showed that *corporate social responsibility* is responsible for the company's risk, H2 is accepted. The findings also confirm the agency's theory that there is a conflict of interest occurring between the agent and the principal. This finding can be interpreted that there is awareness on the part of the agency (management) to carry out corporate social responsibility. With the implementation of CSR is ultimately able to reduce the risk of the company.

CSR is related to the maximum for social welfare for the sustainability of a company's life. Involvement in CSR activities improves the organization's image as a socially responsible organization which may be useful especially during economic downturns and adverse scandals when the organization needs the support of its stakeholders (Rehman, 2020). This shows that

companies with high CSR practices are less likely to hide bad news about the company to shareholders, thus minimizing the company's risk with transparency from a company.
These findings are in line with the study (Rehman, 2020). CSR activities are believed to be an effective strategy for the company's cash turnover. Cash turnover stability has involvement with corporate CSR. Involvement in CSR activities helps reduce financial risk and improve credit ratings thereby lowering capital costs. Then reconfirmed by ozdemir *et al* research, (2020) aims to test the linkage between corporate social responsibility (CSR) and idiosyncratic risks in the restaurant industry. The result of this study is that CSR involvement reduces special risks and risk reduction which means CSR provides a negative link to corporate risk. Furthermore, research (Cui et al., 2017) found corporate risks have a negative impact on corporate social responsibility disclosure.

5. Conclusion

Based on hypothesis testing, the study found CG and CSR had an effect on corporate risk. The results of this study contribute to the development of science, especially accounting and finance. Then, this research has social implications such as being a consideration for the government in making regulations in order to form a good economic and investment climate and have sustainability. In addition, companies and stakeholders can also be guided by this research in determining policies and decisions for the company.
This research certainly has limitations. This study still considers the direct effect between CG and CSR on corporate risk. So that further research can develop a research model by including other variables that allow to have a mediation effect on this research model. Then, the study is still analyzing in one country only, so the results cannot be generalized in other developing countries. For that, further research is recommended to conduct research with cross-country so that the results are wider.

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