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The Effect of Corporate Social Responsibility on Management Compensation: Do Corporate Governance and Performance Matter?

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Abstract—This study aims to examine the indirect effect of corporate social responsibility (CSR) on management compensation. Tests were conducted with moderated mediation models to banking companies listed on the Indonesia Stock Exchange in 2016. The results show that corporate governance (CG) moderates the influence of CSR on corporate performance. However, instead of having indirect effect, the results reveal that CSR has direct positive effect on management compensation. It means that market appreciates CSR carried out by those companies even though it does not necessarily serve as the basis for determining management compensation.

Keywords—Corporate Social Responsibility, Corporate Governance, Corporate Performance, Indirect Effect, Management Compensation.

I. INTRODUCTION

In banking, management compensation has sparked off controversy among stakeholders in both the legislature and the economic sector since 1930s (Ghozali, 2015). There are more than 300 studies investigating factors influencing management compensation (Gomez-Mejia and Wiseman, 1997). Furthermore, in the last two decades the number of studies on management compensation have increased along with a rise in executives' salaries. Those studies were conducted in developed countries, particularly in the United States of America (USA) and the United Kingdom (Murphy, 1999).

A policy should be established to stipulate compensation distribution and its clear objectives as good compensation will result in justice, i.e. the management receives compensation based on their respective duty, function, position, and work achievement (Notoatmodjo, 2010 in Ritawati, 2015). In the last few years, a company's purposes do not only center on management and customer satisfaction or company profit, but also on natural environment and society carrying capacities with regard to financial or economic, social, and environmental aspects known as the triple bottom line. Therefore, to obtain carrying capacities the company needs to conduct responsible activities that integrate those aspects. Such responsibility is known as Corporate Social Responsibility (CSR).

CSR and management compensation can be crucial issues because they may lead to a question such as what motivates CEO to get involved in CSR activities? Does the company management appeal to get involved in CSR activities in the company's interest or in their own interest? According to Jensen and Mecklin (1976), and Jensen and Murphy (1990) in Miles and Miles (2013), compensation is arranged in a certain way in order to harmonize the interests of shareholders. In this case, shareholders tend to be an alignment of interests among stakeholders because CSR improves utility of the shareholders and on the other side, the company appreciates the management's performance by rewarding them with compensation.

Numerous studies have been conducted to assess the effect of CSR on management compensation. Of those studies, some revealed that CSR had positive effect on management compensation (Mahoney et al., 2006) and some found out that CSR had negative effect upon management compensation (Rekker et al., 2014; Cai, Jo, and Pan, 2011).

However, unlike in other countries, there are only a few studies into CSR and compensation in the banking sector in Indonesia. The researcher only found one study on the correlation between CSR and compensation, which was conducted by Natalia. In developing countries, especially in Asia, such scarcity results from limited data (Kato et al., 2006). With little literature on research into the effect of CSR on management compensation, especially in the Indonesian banking sector, then first, generous but competitive management compensation is expected to promote sustainable business productivity, profit, and growth as a result of increased corporate performance, putting the company in the spotlight among shareholders (Sari & Harto, 2014). Second, Bank Indonesia Regulation No. 8/4/PBI/2006 concerning GCG implementation stipulates that commercial banks have to disclose remuneration and any facilities received on their GCG report.

Third, the CG structure adopted in Indonesia is different from that of America. The first adopts a two-tier system, namely each public company should have two groups of top-level management, i.e. a Board of Directors as functional management and a Board of Commissioners as supervisory function (Law No. 40 of 2007). Meanwhile, the latter implements a one-tier system consisting of only a Board of Directors that serve the same function as the Board of Commissioners in Indonesia, i.e. to supervise the management. The term *board of directors* in Indonesia refers to managerial function tasked with management and operation of a company in America (Wardhani, 2007).

Therefore, in terms of role, the function and position of CEOs (directors) in Indonesia differ from those of managers in America. Furthermore, in this study the researcher added corporate performance mediation and corporate governance as moderating variables. The researcher added corporate performance because disclosure of CSR information was used to evaluate corporate performance through market share transaction, while on the other hand, Kristanto (2018) stated that better corporate performance results in a higher amount of compensation. Hence, the researcher considered that compensation exercises indirect effect and such effect is affected by CSR activity. Moreover, the researcher added moderating variables because according to Jensen & Meckling (1976) and Barnea & Rubin (2010) in Cai at el. (2011), CSR initiatives do not maximize corporate value, waste precious resources and proposition, and may ruin corporate value. Thus, it is necessary to implement good governance, which surely enables a company to formulate a precise management compensation package.

Based on the foregoing, the main issue under study centers on whether corporate performance indirectly affects compensation because of the company's involvement in CSR in good governance. It is expected that the results of this study will confirm the argument in the agency and stakeholder theory that CSR activities can be used to harmonize the interests of the agent and the principal in compensation payouts.

II. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

A. The effect of CSR on management compensation

Despite numerous literature on CSR and management compensation, no theory explains their correlation. In the agency and stakeholder theory, Jensen & Meckling (1976) and Barnea & Rubin (2010) considered involvement in CSR as main agent correlation between the manager and shareholders. They argue that people who affiliate are interested in deeper investment in CSR if it gives personal benefit in developing social reputation as good citizens even though it might sacrifice shareholders.

According to Milbourn (2003), when their reputation increases, CEOs will enjoy better career opportunities outside and greater bargaining power, which eventually will increase their ability to negotiate higher compensation levels. If CEOs tend to invest more in CSR to build their reputation, CSR and management compensation presumably have a positive relationship.

Second, the stakeholder theory shows that companies conduct CSR not only to generate profits and comply with regulations, but also to be ethical and get social support (Carroll, 1999). If managers have the flexibility to offer stakeholder protection, then, sometimes, they can become entrenched by building strong relationships with non-investment stakeholders and social activists, leading to poor financial performance.

The result of previous research such as the ones conducted by Rekker et al. (2014), Miles et al. (2013), and Cai et al. (2011) showed that a company's higher involvement in CSR activities tended to result in lower management compensation. Besides, higher compensation could have negative effect on the company.

Cespa and Cestone (2007) state that when the company involved in CSR, it could explicitly offer protection to stakeholders to prevent bad managerial performance when developing alliance with stakeholders. This statement is consistent with the research into the effect of management compensation on companies' involvement in CSR, which showed a significant positive correlation. It means that a compensation structure can be used as an effective tool to encourage managers to conduct socially responsible activities, which eventually will result in responsible companies. Based on the previous elaboration, the researcher proposes the following hypothesis:

H1: CSR has positive effect on management compensation.

B. The effect of CSR on corporate performance with corporate governance as moderating variable

Agency problems arise if managers give priority to their own goals and well-being. On the other hand, based on stakeholder theory, companies are not an entity that operates based on their own interests. Rather, they must provide benefits to stakeholders. It is expected that disclosure of information about a company's activities can be used as evaluation materials to improve corporate performance.

According to Dahlia and Siregar (2008), there is a significant positive relationship between a company's CSR and its market performance because companies with good environmental performance will gain acceptance from investors through increased stock price fluctuations from year to year. This result concurs with findings of the research conducted by Pramana and Yadnyana (2016) that companies carrying out CSR disclosures would be responded positively by the market. In addition, corporate performance is determined by the extent to which companies implement corporate governance seriously.

Companies believe that corporate governance implementation can maximize their corporate value. It means that CSR activities are certainly not a type of activity that wastes their valuable resources and propositions, and potentially ruin their corporate value. Rather, they are another form of business and work ethics enforcement that have long become companies' commitment. In relation to the company management, corporate governance is also part of efforts to promote CSR activities (Irawan & Farahmita, 2012). Hence, the existence of corporate governance will strengthen the influence of CSR on corporate performance. Based on the description above, the researcher proposes the following hypothesis:

H2: Good corporate governance will strengthen CSR's positive effect on corporate performance.

C. *The effect of corporate performance on management compensation*

Corporate performance can also affect compensation because according to agency theory assumptions by Jensen and Meckling (1976), each individual acts on his own interests. The principal wants a return of profitable investment while the agent expects high rewards for performance fulfilling the demands of the principal. The management's satisfaction with the amount of compensation they receive contributes to achievement of a company's goals. Satisfaction will trigger the management to continue improving their performance, thus both the company's goals and the management's needs can be achieved together (Muljani, 2002).

According to the study conducted by Conyon and He (2011), the amount of compensation can improve corporate performance because a company can change its management if their poor performance affects corporate performance. Moreover, according to Irawan & Farahmita (2012), corporate performance affects the amount of compensation because the management are obliged to utilize company resources effectively and efficiently. This statement accords with Wicaksono's research, (2017) that corporate performance influences the amount of compensation. Based on the description above, the researcher proposes the following hypothesis:

H3: Corporate performance has positive effect on management compensation.

D. *The effect of CSR on management compensation with corporate performance as moderating variable*

Companies disclose CSR activities to the public in order to enhance their image. Lindawati and Puspita (2015) argue that disclosure of social information is a way a company build its reputation. This reputation is expected to be responded positively by market players, particularly by increasing the company's share value. A positive response that indicates an increase in corporate performance is expected to benefit the management when it is associated with compensation. This means that CSR will indirectly increase compensation when the market responds to CSR positively. Based on the description above, the researcher proposes the following hypothesis:

H4: CSR has indirect positive effect on management compensation with corporate performance as moderating variable.

III. RESEARCH METHODS

A. *Data gathering*

The sample in this study was comprised of banking companies listed on IDX in 2016. Data were gained from their annual reports and financial statements. From a total of 43 companies, 31 met the testing criteria.

B. *Research variables and measurement method*

There were five research variables in this study. The first one is **the dependent variable** *management compensation (Comp)*, which was measured using the natural logarithm of directors' total compensation. Second, **the independent variable** *corporate social responsibility (CSR)*, which was measured using the standard GRI index 4 (91 items). Then, **moderating variables** were comprised of Corporate Governance (CG) and corporate performance (Ret). The first was measured using dummy variables from results of the indicators for the implementation of Corporate Governance guidelines compiled by the National Committee on Governance Policy (KNKG). The latter was measured based on annual return (the current year's investment price minus the previous year's investment price deflated by the previous year's investment price). Lastly, **the control variable** was company size. Bigger companies may have bigger agency problems because they are more difficult to monitor. Generally, company size is proxied by the natural logarithm of total assets.

C. *Data Analysis and Discussion*

TABLE 1. CLASSICAL ASSUMPTION TEST

	Auto Correlation (*Durbin-Watson*)		**Normality *Asymp Sig. (2-tailed)***
	1.965		0.137
	Multicollinearity		**Heterosce-dasticity**
	Tolerance	***VIF***	**(*Sig.*)**
Corporate Social Responbility	0.930	1.075	0.000
Corporate Governance	0.818	1.298	0.815
Corporate Performance	0.062	16.330	0.30
Size	0.818	1.075	0.888
Int_CSR*CGd	0.062	20.330	0.086

Results of the classical assumption test reveal multicollinearity among moderating variables and the variables resulting from the testing model. The researcher ignores this multicollinearity since according to Nugroho (2015) it can be ignored when the coefficient of determination is quite high and does not make the regression estimator biased (Gujarati, 2003).

D. *Testing Results of Hypothesis 1*

TABLE 2. THE EFFECT OF CSR ON COMPENSATION

	coeff	**se**	**p-val**
constant	19.9256	0.4724	0.0000
Ret	-0.0781	0.2805	0.7828
CSR	0.2309	0.0227	0.0000
Size	0.0216	0.1928	0.9115

Outcome: Comp

Testing results of the first hypothesis (H1) suggest that CSR has positive effect (0.2309) on CEOs' compensation and it is significant at a p-value of 0.0000. The results of this study indicate that companies' involvement in CSR activities affects the amount of management compensation.

Those results accord with findings of the research conducted by Mahoney and Thorn (2006) that compensation structure could be used as an effective instrument to persuade managers to conduct a socially responsible activity which transforms a company into a social responsible one.

A study conducted by Conyon et al. (2013) elaborated that stakeholders tried to design an optimal compensation package to give the executives incentive in order to harmonize their common interests. Results of that study reveal that companies designing the most interesting and efficient compensation package managed tomaintain and motivate their management. Moreover, the compensation package given could also motivate the management to maximize corporate value through CSR activities.

Therefore, this result does not support the study conducted by Rekker et al. (2014), which suggests that CSR has negative effect on management compensation because what motivates the management to conduct CSR activities is their own interest as part of short-term performance to gain higher compensation.

E. Testing Results of Hypothesis 2

TABLE 3. SIMULTANEOUS EFFECT OF CSR AND CORPORATE GOVERNANCE ON PERFORMANCE

	coeff	se	p-val
constant	-0.9532	0.2296	-0.0003
CSR	0.0627	0.0157	0.0005
CG	1.1113	0.5170	0.0407
int_1	-0.0597	0.0265	0.0325

Outcome: Ret

The second hypothesis (H_2) reading "good corporate governance will strengthen CSR's positive effect on corporate performance" does not prove true in this study as shown by the interaction effect (int_1) in Table 3 that has a negatif coefficient (-0.0597) with a p-value of 0.0325. The result of this study indicates that corporate governance implementation across a company weakens CSR's effect on corporate performance. It is probably because the market took time to respond to corporate governance implementation.

The result of this study conflict with findings of the research conducted by Dahlia and Siregar (2008), which showed that CSR activities have positive effect on corporate performance. It is assumed that good corporate governance implementation remains vulnerable due to the absence of awareness of value and practice in running a business. Results of the Asian Corporate Governance Association (ACGA) survey showed that Indonesia is still in the lowest rank after China and Korea.

F. Testing Results of Hypothesis 3

Based on Table 3, corporate performance does not have positive effect on management compensation (p-value = 0.7828), meaning that the third hypothesis (H_3) is rejected. It indicates that an improvement in corporate performance does not influence the amount of compensation received by the management.

The result of this study was inconsistent with that of the research conducted by Wicaksono (2017) stating that if the management was able to improve corporate performance, the company could determine the amount of compensation given to the management.

G. Testing Results of Hypothesis 4

TABLE 4. INDEX OF MODERATED MEDIATION MODEL

	Index	BootLLCI	BootULCI
Ret	.0047	-.0261	.0491

Testing results fail to prove that CSR has indirect positive effect on management compensation through corporate performance, as shown by an insignificant index value (0.0047). It means that the fourth hypothesis (H_4) is rejected. The result of this study indicates that involvement in CSR activities does not have positive effect on companies improved corporate performance, thus affecting the amount of management compensation. Besides, the market perceives social responsibility activities carried out by banking companies as part of their obligation and compliance with regulations, rather than as a determinant of corporate performance. Another reason, in the researcher's view, is that the market does appreciate CSR activities, but it does not always serve as a basis for determining management compensation.

IV. CONCLUSION, LIMITATIONS, AND SUGGESTIONS

This study aims to provide better understanding of the effect of CSR on management compensation. The correlation between CSR and management compensation becomes a challenge since whether the management conducts CSR activity in the company's interests or in their own interests remains a matter for debate. The results of this study show that first, CSR has positive effect on management compensation among companies listed on the Indonesia Stock Exchange. It means that compensation structure can be used as an effective instrument to encourage managers to conduct a socially responsible activity which results in a socially responsible company (Mahoney & Thorn, 2006). Second, good corporate governance implemented by a company reduces CSR's positive effect on corporate performance, which allegedly results from the market's slow response to the implementation of corporate governance. Third, corporate performance does not affect management compensation among banking companies listed on the Indonesia Stock Exchange, meaning that better improvement of corporate performance does not influence the amount of compensation received by the management. Fourth, CSR has no indirect effect on management compensation through corporate performance among banking companies listed on the Indonesia Stock Exchange. It is probably because the companies involved in their CSR activities were not responded positively by an improvement in their corporate performance, which in turn affects the amount of

management compensation. Besides, the market perceives CSR activity conducted by banking companies as part of their compliance with the regulation, rather than a determinant of corporate performance. Another reason is that the market appreciates CSR activities more even though it does not always serve as the basis for determining management compensation.

However, this study has some limitations. First, the variable *CSR* used in this study were GRI indicators so that the data obtained were not good enough since those indicators were not implemented by banking companies. Therefore, the researcher suggests using indicators from National Governance Policy Committee (KNKG) or 2 raters. Second, the sample used in this study was comprised of commercial banks listed on the Indonesia Stock Exchange (IDX). Future studies had better use non-banking data, especially companies that have an impact on the environment such as mining companies. Third, this study neither analyzed determinants of management compensation nor involved compensation in the forms of share option due to limited information revealed by the sample companies during the observation period. Thus, the researcher suggests disclosing types of compensation in detail, if the sample companies disclose the types of compensation given in detail.

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