



## The Effect of Sustainability Report on Firm Value with Corporate Governance as a Moderating Variable

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### ABSTRACT

This study aims to analyze the effect of sustainability reports on firm value with Corporate Governance (CG) as a moderating variable. The population in this study are all companies listed on the Indonesia Stock Exchange (IDX), with a CGPI score from 2014-2021, and companies that publish sustainability reports from 2014-2021. This study used purposive sampling with a sample of 64 observations. The Moderating Regression Analysis (MRA) was applied to test the hypotheses. The results of this study indicate that the sustainability report has a significant positive effect on firm value (H1). CG positively and significantly affects firm value (H2). CG weakens the relationship between sustainability reports and firm value (H3).

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## INTRODUCTION

A company builds a business intending to get maximum profits. Improving the welfare of stakeholders by increasing firm value is one of the company's missions. Companies will use various methods to achieve this goal, such as abusing natural and human resources excessively. The Ministry of Environment and Forestry (KLHK) noted that oil and gas and mining companies were indicated to have committed the pollution during 2017-2018.

Companies can carry out several activities for the community, namely opening up employment opportunities, offering cooperation with local regional organizations, and donating to village development around the company. Environmental sustainability must always be considered from time to time. Several activities can be done to preserve the environment, such as AMDAL (Environmental Impact Analysis) and reforestation. The company publishes the Triple-P Bottom Line through a sustainability report. Then, the public can learn about the firm's performance in implementing sustainability reports (Fatchan & Trisnawati, 2018).

A sustainability report is an activity that measures and discloses company activities as a responsibility to both internal and external stakeholders related to the development of company activities in realizing planned development. The sustainability report contains economic disclosures, social disclosures, and environmental disclosures. The purpose of the sustainability report is to openly convey the organization's economic, social, and environmental commitment and performance to stakeholders and society. Companies carrying out sustainability reporting are regulated in Law No. 40 Limited Liability Company of 2007, article 66, paragraph 2, Law No. 32 of 2009 concerning management and protection of life article 22. Financial Services Authority (OJK) issued regulation no. 51/POJK.03/2017 in 2017 concerning Financial Implementation, which requires companies to make sustainability reports

The value of the firms reflects the wealth of firm assets linked to share prices. The firm value can be reflected in the stock market price. Investors can use stock market price movements as a medium to use as a reference for observing a company's performance. Companies can survive and continue to develop if they are willing to carry out social commitments with society and position these two elements as part of the implemented system. Increasing firm value positively impacts implementing a sustainability report (Susanti & Handayani, 2022). Firm value is essential to research because it reflects company management's performance.

Corporate governance (CG) is a factor that can influence firm value and sustainability reports. Firm value can be increased by monitoring management performance and responsibility towards stakeholders. By monitoring management performance and responsibility toward stakeholders, firm value can be increased. CG is a rule that contains the management of relationships between investors, company management, and any other stakeholders relating to the company's rights and obligations (Susanti & Handayani, 2022). The implementation of CG can run well and grow sustainably if the company is

aware of the responsibility of preserving the environment and surrounding communities.

This research reexamines the moderating effect of CG in the relationship between Sustainability Reports (SR) and firm value. This research is interesting to retest because previous research showed inconsistent results. Research conducted by Jawas and Sulfitri (2022), Puspita and Jasman (2022), and Atahau and Kausar (2022) shows there is a positive effect between SR and firm value.

The differences in results were found by research conducted by Novia and Halmawati (2022), Ningrum et al. (2021), and Pratami and Jamil (2021), which shows the results that sustainability reports do not affect firm value. From the results of these different studies, other variables may influence the relationship between sustainability reports and firm value, namely corporate governance. This is based on the theory that CG is a system that regulates and controls companies, which can increase the company's value for investors.

## **THEORETICAL REVIEW**

### **Sustainability Report**

A sustainability report (SR) is an annual report published by a company to convey corporate social responsibility activities and results. The value of the sustainability reporting mechanism is to ensure that companies consider the impact of sustainability issues and make companies more open about the risks and opportunities they face. Sustainability reporting has become essential for every company (Nuraisah & Laily, 2022). The Global Reporting Initiative (GRI) is an international organization whose primary activities prioritize achieving transparency and corporate reporting by developing sustainability report disclosure standards and guidelines.

### **The value of the firm**

Firm value describes how the firm's performance can influence investors' thoughts about the company. Firm value is generally linked to share prices. Therefore, managers must make the right decisions and be able to decide regarding net working capital to create value for the company (Novia & Halmawati, 2022). Firm value is essential to research because it has a relatively significant role; high firm value will be followed by high shareholder prosperity. The higher the share price, the higher the firm value. A high share value is the desire of investors because a high share value reflects the prosperity of shareholders.

### **Corporate Governance**

Corporate governance is the rules, elements, and legal systems that regulate company activities. Corporate governance aims to control and direct a company so activities run according to stakeholder plans and provide more value to interested parties. Implementing corporate governance is a form of ethics in the world of work, and enforcing business ethics is an organization's commitment. Implementing good corporate governance will increase investor confidence and increase firm value.

## **Hypothesis**

### **The Impact of Sustainability Reports on Firm Value**

The Global Reporting Initiative (GRI) states that sustainability reports can be a medium for companies to disclose economic, social, and environmental reports (Nuraisah & Laily, 2022). The company's goal in disclosing its sustainability report is to gain the trust of stakeholders. Pujiningsih (2020) research shows that sustainability reports positively affect firm value. This is because sustainability reports can help demonstrate how to increase firm value related to social and environmental issues. In other research conducted by Jawas and Sulfitri (2022), the results showed that sustainability reports positively affected firm value because of the high book prices resulting from share prices relative to their book value. Based on the description above, the following hypothesis can be formulated:

H1: Sustainability Reports Positively Impact Firm Value.

### **The Impact of CG on Firm Value**

CG is aimed at actions taken by company executives not to harm stakeholders because they are related to morality, work ethics, and sound work principles. Good corporate governance can create efficient, transparent, consistent market conditions following applicable laws. According to research conducted by Nuraisah and Laily (2022), the results showed that corporate governance influences firm value. Implementing good corporate governance will improve financial performance and increase firm value. In line with research conducted by Lestari and Ghani (2020), corporate governance influences firm value. Based on the description above, the following hypothesis can be formulated:

H2: CG Positively Impacts Firm Value

### **Corporate Governance, Sustainability Report, and Firm Value**

The implementation of CG can run and grow sustainably if it is carried out consistently. This can become the foundation for company competition and increase firm value. This shows a relationship between CG, SR, and firm value (Susanti & Handayani, 2022). The research results by Pujiningsih (2020) prove that corporate governance positively affects firm value. The result shows that implementing appropriate corporate governance can improve the quality of company sustainability reports, and it is hypothesized as follows.

H3: CG Strengthens the Relationship Between SR and Firm Value.

## **METHODOLOGY**

### **Population and Sample**

The population is companies registered on the IDX for 2014-2021, totaling 237 companies. Purposive sampling is implemented in sample selection based on the following criteria: Registered on the BEI for the 2014-2021 period, Registered with the CGPI organized by IICG in collaboration with SWA magazine from 2014-2021, companies that report sustainability reports for 2014-2021, companies that publish financial reports for the 2014-2021 period. Based on these criteria, 64 sample companies were obtained that could be studied.

## Variables and Operational Definitions of Variables

### Independent Variable (IV)

The IV is the sustainability report index. An SR is a form of report a company prepares to become accountable to its stakeholders for achieving sustainable company goals. SR is measured using the Sustainability Report Disclosure Index (SRDI) ratio by giving a score to the social responsibility disclosure items disclosed by the company.

The formula for calculating the sustainability report index is as follows:

$$SRDI = V/M \dots\dots\dots(1)$$

Where:

SRDI: Sustainability Report Disclosure Index

V : Number of items disclosed

M: Maximum score

### Dependent Variable (DV)

The DV is firm value. Firm value is the value of profits obtained and expected in the future, which are calculated by considering the appropriate level of risk and interest rate. Firm value was chosen as the dependent variable because firm value can be used as a reference for stock market price performance. Tobin's Q. Tobin's Q can measure firm value, showing that asset investment produces profits that provide a higher value than investment expenditure. Tobin's Q value can be calculated with the following equation:

$$\text{Tobin's Q} = (\text{MVE} + \text{DEBT}) / \text{TA} \dots\dots\dots(2)$$

Where:

MVE : (Closing share price) x (Number of outstanding shares)

DEBT: Total company debt

TA: Total assets

### Moderating Variable (MV)

The MV in this research is the CGPI published by the IICG. The CGPI scores achieved by participating companies result from assessing Corporate Governance indicators, namely aspects of CG structure.

### Data

The documentation method is carried out by collecting data that the company has compiled in the form of annual reports, financial reports, CGPI data, and sustainability reports published through ([www.idx.co.id](http://www.idx.co.id)) and the official website of each company. The company reporting period in this research is 2014-2021. Based on the data obtained, the population in this study amounted to 237 reports. After determining the sample using purposive sampling with the specified criteria, a sample of 64 observations was obtained.

### Analysis method

This study implemented a classic assumption test, which includes normality and heteroscedasticity tests. The normality test uses the Jarque-Bera method, while the heteroscedasticity test uses Breusch-Pagan-Godfrey. The third test uses a panel data regression test, which combines time series data with cross-sectional data. In panel data tests, there are the Chow test, Hausman test, and Lagrange multiplier test. The fourth test is hypothesis testing. This hypothesis

test examines the effect of sustainability reports on firm value with corporate governance as a moderating variable. The t-test aims to determine the influence of independent variables in explaining the dependent variable. The hypotheses are tested based on the following regression model.

$$\text{Tobins'Q} = \alpha + \beta_1\text{SRI} + \beta_2\text{CG} + \beta_3\text{SRI*CG} + e \dots \dots \dots (3)$$

**RESULTS**

**Normality and Heteroscedasticity Test**

The probability value of the normality test is 0.3399, greater than 0.05, so it can be stated that the data in this study is normally distributed. The heteroscedasticity test shows that the Chi-Square probability value in Obs\*R-Square is 0.6744, greater than 0.05, so heteroscedasticity does not occur.

**Panel Data Regression Test**

Table 1. presents the panel data regression results and some tests described in the following section.

**Chow Test**

The results of the Chow test show that the Cross Section Chi-Square prob. value is  $0.0000 < 0.05$ , so the common effect model is rejected, and the fixed effect model is accepted. The model chosen is fixed effect, so next, a Hausman test will be carried out to determine the model used between fixed effect and random effect models.

Table 1. Panel data regression results.

| Variable                        | Coef.     | t-Stat. | Prob.  |
|---------------------------------|-----------|---------|--------|
| Constant                        | 1.761     | 3.364   | 0.0013 |
| SRI                             | 7.219     | 3.634   | 0.0006 |
| CG                              | 1.773     | 3.366   | 0.0013 |
| SRI*CG                          | -0.776    | -3.419  | 0.0011 |
| F-statistic                     | 16.698    |         | 0.0000 |
| <b>Chow Test</b>                |           |         |        |
| <i>Cross-section F</i>          | 5.710823  |         | 0.0001 |
| <i>Cross-section Chi-square</i> | 35.459381 |         | 0.0000 |
| <b>Hausman Test</b>             |           |         |        |
| Chi-Sq.Statistik                | 1.789     |         | 0.4089 |
| R <sup>2</sup>                  | 0.455     |         |        |
| <i>Adjusted R<sup>2</sup></i>   | 0.428     |         |        |

**Hausman test**

The Hausman test shows that the probability cross-section value of 0.2229 is greater than 0.05, so the fixed effect model is rejected, and the random effect model is accepted. Then, the random effect model is chosen.

**Lagrange multiplier test**

The Lagrange multiplier test shows that the Breunsch-Pagan cross-section value is  $0.0000 < 0.05$ , so the random effect model is accepted, and the common effect

model is rejected. The best estimation model chosen in this research is the random effect model.

### **Hypothesis testing**

#### **Hypothesis 1: Sustainability Reports Positively Impact Firm Value**

Table 1 shows that the prob. value of SRI is 0.0006, less than 0.05, and has a t value of 3.633963, so it can be said that the SR positively impacts firm value, so H1 is accepted.

#### **Hypothesis 2: CG Positively impacts firm value**

The prob. value of CG is 0.0013, less than 0.05, and has a t-value of 3.36565, so it can be stated that CG positively impacts firm value, so H2 is accepted.

#### **Hypothesis 3: CG Strengthens the Relationship Between SR and Firm Value.**

The t value of the moderating variable (SRI\*CG) was -3.419 with a probability value of  $0.001 < 0.05$ , so it can be stated that the corporate governance variable weakens the relationship between sustainability reports and firm value, so H3 is rejected.

## **DISCUSSION**

### **The Effect of Sustainability Reports on Firm Value**

Hypothesis 1 is that Sustainability Reports Positively Impact Firm Value. In this research, a probability value of  $0.0006 < 0.05$  was obtained, so it can be stated that the sustainability report has a significant positive effect on firm value, so H1 is accepted. This is consistent with legitimacy theory, which states that the right company will adequately express its responsibilities to stakeholders and society to gain legitimacy and positively impact the company's quality, one of which is firm value. The results of this research are in line with Pujiningsih (2020), Jawas and Sulfitri (2022), and Puspita and Jasman (2022), who stated the results that sustainability reports have a positive effect on firm value. Companies that carry out sustainability reports can generate positive signals for investors. So, this research illustrates that increasing the quality of sustainability report disclosures will help companies maximize firm value.

### **The Effect of Corporate Governance on Firm Value**

Hypothesis 2 is that CG Positively impacts firm value. CG is shown in the actions taken by company executives so as not to harm stakeholders. Based on the hypothesis test results, the probability value obtained is  $0.0013 < 0.05$ , so it can be stated that CG has a significant positive influence on firm value, so H2 is accepted. This is related to legitimacy theory, where the theory is on the side of stakeholders regarding how companies are responsible and organize systems in company activities to get good firm value and positive responses from stakeholders. The results of this research are in line with those of Nuraisah and Laily (2022), Lestari and Ghani (2020), and Leni (2019), who stated that corporate governance influences firm value. Good corporate governance will improve financial performance, increase firm value, and attract investors to invest their capital.

### **Corporate Governance Strengthens the Relationship between Sustainability Reports and Firm Value.**

The regression results of the moderating variable (SRI\*CG) have a t-value of -3.419, with a probability value of  $0.001 < 0.05$ . So, it can be stated that the corporate governance variable has a significant adverse effect on the relationship between sustainability reports and firm value, so the third hypothesis, CG Strengthens the Relationship Between SR and Firm Value.; is rejected. Excessive regulatory systems or governance processes are considered unimportant for investors; most investors will focus more on company profits; this causes the influence of corporate governance to weaken the relationship between sustainability reports and firm value. In this case, legitimacy theory is less related to the moderating variable, namely corporate governance, because legitimacy theory focuses on disclosing corporate responsibility in the economic, social, and environmental fields rather than focusing on the company's regulatory system. This research is in line with Pujiningsih (2020), Wardhani and Titisari (2021), and Fatchan and Trisnawati (2018), who stated the results that corporate governance variables weaken the relationship between sustainability reports and firm value.

## **CONCLUSIONS**

The research conclusion is as follows: disclosure of sustainability reports significantly influences firm value (H1 is accepted). Increasing the quality of sustainability report disclosures can help companies maximize firm value. CG has a significant influence on firm value (H2 is accepted). Implementing good corporate governance will improve financial performance and increase firm value. Corporate governance weakens the relationship between sustainability reports and firm value (H3 is rejected). Excessive regulatory systems or governance processes are considered unimportant to investors.

## **FURTHER STUDY**

Several suggestions can be given for future researchers, namely that future researchers are expected to increase the number of independent variables in predicting firm value, such as profitability and financial performance. It is hoped that future researchers can extend the observation period so that more samples are obtained so that they can reflect good research. Future researchers should consider the company sample selection criteria, such as year and data source.

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