Sustainability Disclosure And Firm Performance: The Role Of CEO Power As Moderation

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Abstract. The issue of sustainability has become a critical and very important issue to be discussed because of the increase in environmental damage, unethical corporate behaviour, exploitation of child labour and other economic, social and environmental challenges. Companies that implement sustainability practices publish their sustainability activities in sustainability reports, considered an integral part of the communication process between business enterprises and various stakeholders. The activities are summarised in a separate sustainability report, which is then audited before being presented to stakeholders. This study aims to examine the effect of sustainability disclosure on firm performance, as well as to examine the effect of CEO Power as a moderator between the relationship between sustainability disclosure and company performance. Sustainability disclosure is measured using the GRI index, CEO Power is measured by the number of years of experience as CEO, and accounting performance is measured by ROA, while market performance is measured by Tobin's Q. This study uses panel data analysis with Generalised Least Square (GLS) technique with a sample of primary and secondary sector companies listed on the Indonesia Stock Exchange (IDX) in the observation period 2014-2020. The results show that sustainability disclosure has a significant effect on company performance, both accounting-based and market-based performance. However, the presence of CEOs with work experience as CEOs in previous companies cannot have a significant effect on the relationship between sustainability disclosure and firm performance. These results have implications for strengthening the focus of companies to start presenting more comprehensive non-financial information such as sustainability reports that have an impact on improving company performance, especially market performance.

Keywords: Sustainability Disclosure, Performance, CEO, Indonesia

1 Introduction

Following the occurrence of the financial crisis in the years 2008-2009, regulatory bodies across the globe implemented a series of changes aimed at enhancing corporate governance and sustainability disclosure, with particular emphasis on publicly traded corporations[48]. The concept of sustainability in business, as discussed[10], involves a decision-making process that considers economic, environmental, and social aspects in a balanced manner. This approach emphasizes the equal integration of these aspects into stakeholder management, as highlighted [46,36,47]. The underlying principle of this notion is rooted in the triple bottom line framework, which serves as a solution to address challenges within the traditional business model. The

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traditional business model entails that managers are solely responsible for pursuing profitability and maximizing the welfare of shareholders. Moreover, this model also perceives activities or investments in social and environmental elements as the responsibility of the firm.

Moreover, the topic of sustainability has emerged as a crucial and significant subject for deliberation due to the escalating levels of environmental degradation, unscrupulous corporate practices, the exploitation of child labor, and various economic, social, and environmental complexities[33]. The United Nations (UN) member countries have responded significantly to this matter, urging firms to adopt sustainable development practices. It is crucial for corporations to enhance their emphasis on corporate responsibility, which includes taking into account social and environmental factors, alongside their pursuit of profits. The objective of this method is to effectively tackle and resolve concerns such as violations of human rights, the phenomenon of climate change, discrimination against vulnerable communities, and the exploitation of minors. According to the studies conducted[47,51,26].

Nevertheless, as per the "Asia and the Pacific SDG Progress Report 2020" published by the United Nations, the region of Asia-Pacific exhibits the least favorable performance in terms of environmental conservation and sustainable development. The data reveals that the global usage of renewable energy stands at a mere 16%, which is the lowest among all nations. Furthermore, it is noteworthy that greenhouse gas emissions have experienced a twofold increase since the year 2000. Moreover, it has been observed that the Asia-Pacific region is perceived to be deviating from the desired trajectory [50]. Moreover, it is imperative that the Asia-Pacific area expeditiously adopts sustainable development practices, as emphasized [3,32].

Following this, it is common for firms that embrace sustainable practices to communicate their sustainability efforts through the use of sustainability reports. These reports are widely recognized as an essential means of communication between corporate entities and various stakeholders. The actions are consolidated and delineated in a separate sustainability report, which is subjected to an audit procedure before being disseminated to stakeholders [12]. The purpose of this report is to provide a comprehensive account of the company's economic, social, and environmental activities through the disclosure of relevant facts. Moreover, this research expounds upon the organization's long-term and short-term vision and mission, as examined [11,16,5,46] asserts that the adoption of sustainable disclosure strategies has the potential to reduce information asymmetry and bolster the competitive advantage of the company.

Indonesia has enacted specific legislation regarding the publication of sustainability information. Companies listed on the Indonesia Stock Exchange are required to include sustainability reports inside their annual reports, however, there is no compulsion to publish them as separate entities. The aforementioned regulation provides enterprises in Indonesia with the opportunity to voluntarily submit a separate sustainability report. Therefore, as stated [39], the level of sustainability report submissions in Indonesia is limited. Moreover, shareholders are consistently granted the utmost level of importance among all the stakeholders concerned. There are at least two rationales that exist. First and foremost, it is crucial to recognize that shareholders occupy a position of utmost importance as stakeholders inside a company. The principal aim is to maximize shareholder profit, while simultaneously taking into account the concerns and needs of other stakeholders. Moreover, it is important to highlight that the reactions of shareholders to information carry substantial influence, owing to their financial interest in the firm, and these responses are appropriately reflected in the financial markets [38]. Hence, the potential for inequity and prejudice may manifest during the reporting procedure.

Furthermore, the matter of sustainability disclosure in Indonesia is apparent in the study conducted [29], wherein it is revealed that Indonesia trails behind other Asian countries in terms of the magnitude of sustainability disclosure.

The number of research subjects investigating the relationship between sustainability and company performance is on the rise, as evidenced by the studies conducted [48,32,27,29]. Nevertheless, the results vary among studies. Previous studies have established a positive correlation between sustainability disclosure and corporate performance [25, 29]. Have examined the potential for presenting data that are favorable, negative, or inconsequential, as well as exploring other causal connections [23,48].

The performance of a corporation is of considerable significance in relation to its overall success and long-term viability. The performance of a corporation can be defined as the extent to which it is able to achieve its economic goals. The assessment of a company's performance is of considerable significance for potential investors in the context of the investment procedure [48] Investors tend to allocate their investments exclusively to companies that display positive performance or offer robust prospects for future development. The assessment of financial performance can be carried out by employing accounting-based and market-based indicators [21,35,48]. The assessment of market-based corporate performance can be carried out by employing two primary indicators, Tobin's q (TBQ) and Market to Book Value (MBV). Within the realm of accounting, the assessment of company performance can be carried out by employing two primary indicators, specifically Return On Asset (ROA) and Return On Equity (ROE).

The relationship between sustainability and corporate performance continues to produce diverse results. This discovery implies that there exist additional variables that exert a moderating influence on the relationship between the two variables. This study proposes that the Chief Executive Officer (CEO) have the power to exert impact on the relationship between sustainability and company performance. The achievement of favorable performance and effective implementation of sustainability policies within a corporation are dependent on its governance structure, particularly its corporate governance (CG). Furthermore, it is imperative to emphasize the significance of implementing effective governance procedures in order to maintain stakeholders' trust in the organization and improve its operational effectiveness [4,22,1]. The role of the chief executive officer (CEO) is of considerable importance in this context.

The investigation of CEO characteristics, namely CEO Power, is justified given the substantial impact that CEOs exert on both sustainability and financial strategy, as indicated by prior research [15,48]. When examining the upper echelons of corporate management, there is a hypothesis suggesting that the influence wielded by chief executive officers (CEOs) will enhance the positive effects of sustainability disclosure on the financial performance of firms. According to the upper echelons theory, the influence of senior management on a corporation's strategic direction and operational procedures is significant [47]. As stated [8], the Chief Executive Officer (CEO) occupies a prominent role on the company's board and wields considerable power in shaping strategic decision-making procedures. This comprises both the financial and non-financial strategies utilized by the firm. Enhanced organizational performance is more probable when a firm is under the leadership of a Chief Executive Officer (CEO) who enjoys a higher degree of power.

The objective of this study is to examine the moderating influence of CEO Power on the association between sustainability disclosure and business performance. Although the investigation of this study model remains limited, a total of three investigations have been identified thus far that have endeavored to examine it. These studies were conducted in the United Kingdom [31,24,47]. Therefore, this research represents the inaugural examination of the model within the context of Indonesia. In contrast to prior research endeavors, the nation of Indonesia possesses a distinctive contextual backdrop. Indonesia, as a nation in the process of development, exhibits considerable economic potential on a global scale. Indonesia is a constituent nation of the G20, as evidenced by research conducted in Pakistan [24]. Indeed, there exist discernible distinctions. Pakistan does not possess the status of a member country within the G20. In a study conducted [31] in the United Kingdom, it was observed that the primary distinction is in the mandatory implementation of a one-tier system for business governance in the UK, whereas in Indonesia, a two-tier system is employed by companies. The disparity in this arrangement will inevitably impact the CEO's position inside the organization. The phenomenon of CEO duality is prevalent within the one-tier structure when the CEO concurrently assumes the role of chairman of the business board. This arrangement has the potential to augment the authority wielded by the CEO. In contrast to Germany, a high-income nation, Indonesia is regarded as a developing country with a relatively lower to moderate average income. Therefore, this study aims to address several research gaps. This research contributes to developing literature, especially on sustainability and corporate performance.

This paper is the first analysis of this concept within the context of Indonesia. Furthermore, this research will comprehensively examine the performance of firms by investigating the moderating influence that enhances the positive association between sustainability and company performance, which is further categorized into market performance and accounting performance. This study provides practical insights for firms seeking to enhance their strategic decision-making processes, with a particular focus on boosting corporate performance through heightened awareness of sustainability concerns. Furthermore, the findings of this study hold potential implications for governmental decision-making, particularly with regard to the formulation of rules pertaining to sustainability practices inside Indonesian enterprises.

2 Literature Review & Hypotheses Development

2.1 Upper Echelon Theory

According to several scholarly sources [47,48,14], this idea suggests that the strategic direction and operational methods of an organization are mostly influenced by its senior executives. This study emphasizes the influential role of the Chief Executive Officer (CEO) in shaping the strategic decisions of the organization [2,14,48]. According to [6], the success of an organization is contingent upon the skill, trust, and experience possessed by its CEO. Several prior studies have utilized age, ethnicity, experience, and education as indicators of top leader traits [47]. This study primarily focuses on the psychological state of the CEO as a representative measure. According to this theoretical framework, an individual's psychological state will influence their perspective when analyzing and choosing the necessary actions to address the challenges encountered by the organization.

2.2 Stakeholder Theory

This idea posits that corporations are integral components of society and are interconnected with many stakeholders. According to the theoretical framework proposed [42], the attainment of long-term success is contingent upon the alignment of the diverse requirements and interests of stakeholders and the organization. Moreover, as previously said, the corporation is an integral component of society, thereby contributing to the creation of public value through the fulfillment of sustainability objectives. Nevertheless, it is imperative for firm executives to effectively address the conflicts of interest that emerge as a result of the diverse range of stakeholders' interests [13]. One strategy employed to address the issue involves the dissemination of information regarding sustainable practices [19]. The establishment of a positive relationship between a company and the community it serves can lead to enhanced legitimacy and reputation, contributing to the overall improvement of the company's performance [48,20].

2.3 Sustainability Disclosure and Firm Performance

According to stakeholder theory, a company that successfully meets the expectations and requirements of its stakeholders is likely to receive support from the surrounding community. One component of community needs and expectations is to the requirement for corporations to demonstrate sensitivity towards sustainability concerns. This entails companies not only prioritizing their financial interests but also devoting attention to environmental and community considerations [48]. Nevertheless, prior studies have yielded inconclusive findings and conflicting outcomes. Nevertheless, several studies indicate that the implementation of sustainable practices by a company might lead to an enhancement in its overall performance. The study conducted [25] provides empirical evidence supporting the notion that engagement in sustainability initiatives has a favorable impact on a company's financial performance. Similarly, organizations that effectively include financial and non-financial reports as a means of engaging with stakeholders are likely to achieve favorable financial outcomes [28,48]. Thus the hypothesis we propose is as follows:

H1. Sustainability disclosure has a positive effect on company performance.

2.4 CEO Power, Sustainability Disclosure, and Firm Performance

The Upper Echelons Theory posits that the actions and decisions of a chief executive officer (CEO) who possesses significant influence and power will have a pervasive impact on the whole operations of the organization. Moreover, the operational strategies of a corporation are significantly influenced by the proclivities of its Chief Executive Officer (CEO), particularly in relation to sustainability initiatives. Both the criteria connected to the board and the pivotal position of the CEO can significantly influence the development of an optimal sustainability strategy. Subsequently, an increased level of authority can be advantageous if the Chief Executive Officer (CEO) demonstrates motivation to establish stakeholder management practices that enhance corporate reputation, sustainability disclosure, and financial success [24,31]. Hence, the influence wielded by chief executive officers (CEOs) is likely to incentivize companies to adopt sustainability disclosures and enhance their overall organizational performance. The proposed hypothesis is:

H2. CEO Power enhances the positive effect of sustainability disclosure on firm performance.

3 Research Method

3.1 Sample & Data

This research was conducted on primary and secondary sector companies (agriculture, mining, basic industry, and chemical sectors, miscellaneous industry sectors, and consumer goods industry sectors) listed on the Indonesia Stock Exchange (IDX) and published annual reports and sustainability reports from 2014-2020. The year 2014 was chosen as the initial year of observation in the study because, in that year, sustainability reports were introduced which contained information on the company's sustainability activities from the economic, social, and environmental segments. Sustainability reports published by listed companies in 2014 have used GRI-4, which was later changed to GRI Standard. The observation period interval from 2014-2020 is expected to show a more consistent interaction trend between variables.

3.2 Variables & Measurement

Dependent Variable

The dependent variable in this study is corporate performance. The evaluation of company performance can be categorized into two main approaches: accounting-based assessment, which utilizes Return on Asset (ROA) as a proxy, and market-based performance, which employs Tobin's Q (TBQ) as a proxy. The following is each measurement:

$$ROA = \frac{Net\ Income}{Total\ Asset} \quad (1)$$

$$\text{TBQ} = \frac{\text{Amount of total debt and total market capitalization}}{\text{total asset}} \quad (2)$$

Independent Variable

This study uses the quality of sustainability disclosure (CSRD) as the dependent variable. Sustainability disclosure is measured using indicators in the Global Reporting Initiative (GRI) adjusted for the year of data analyzed. The scoring criteria are as follows:

0 = If the object is not revealed or made known.

1 = If the item is disclosed yet lacks comprehensiveness.

2 = If the item is provided in a comprehensive manner but does not adhere to the Global Reporting Initiative (GRI) requirements.

3 = If the material is disclosed in a complete manner and adheres to the specified standards.

3.3 Moderated Variable

This study uses CEO Power (WE_CEO) as a moderating variable. WE_CEO is measured by counting work experience as CEO in units of years.

WE_CEO = Number of years of experience as CEO

Control Variables

The control variables used in this study are leverage (LEV), company age (FAGE), company size (FSIZE), and regulation (REG).

- LEV $= \frac{\text{Total Liabilities}}{\text{Total Asset}}$
- FSIZE = Ln (Total Asset)
- FAGE = Company age since the establishment
- REG = Regulation, 1 for primary companies, 0 otherwise.

Research Model

The model used is a modification of the model used in previous studies. The following is the model used in this study:

$$ROA_{it} = \beta_0 + \beta_1 SD_{it} + \beta_2\ CEOP_{it} + \beta_3 SD{*}CEOP_{it}\ \beta_5 LEV_{it} + \beta_6 FAGE_t + \beta_7 FSIZE_{it} + \beta_8 REG + \varepsilon \qquad \text{.....(3)}$$

$$TBQ_{it} = \beta_0 + \beta_1 SD_{it} + \beta_2\ CEOP_{it} + \beta_3 SD{*}CEOP_{it}\ \beta_5 LEV_{it} + \beta_6 FAGE_t + \beta_7 FSIZE_{it} + \beta_8 REG + \varepsilon \qquad \text{.....(4)}$$

Keterangan:

ROA	: *Return on Asset*
TBQ	: Tobin's Q
SD	: Sustainability disclosure
WE_CEO	: CEO Power
LEV	: *Debt to Equity ratio*.
FAGE	: Company age.
FSIZE	: Firm Size.
REG	: Regulation
ε	: *Error term*, the error rate of the estimator in the study

Result & Discussion

Table 1. Descriptive Statistic

Variable	Obs	Mean	Std. Dev.	Min	Max
TBQ	711	1.046	1.742	.042	13.967
ROA	711	.036	.101	-.531	.527
CSRD	711	.181	.098	.053	.522
WE CEO	610	3.687	2.949	1	16
SIZE	711	21.997	1.535	18.667	25.818
LEV	711	1.345	2.256	-3.038	22.015
AGE	711	38.627	19.441	8	119
REG	711	.252	.434	0	1

Table 1 presents pertinent information pertaining to the state of the variables under observation. Table 1 presents the mean values of TBQ and ROA. The average TBQ value is 1.046, indicating that the observed companies' average stock capitalization value exceeds their total assets by a factor of one. Additionally, the mean ROA value is 0.036, indicating that the average net profit earned by the companies is equivalent to 3% of their total assets. The average value of CSRD is 0.181, indicating that the mean disclosure of sustainability reports corresponds to 18% of the total score on the Global Reporting Initiative (GRI). Similarly, the mean value of CEO Power is 3.68, signifying that the average tenure of CEOs in the examined organizations is 3.6 years. Table 1 presents the statistical summary of the control variables employed in the present investigation. The average value of firm size is LN 21.997 or equivalent to IDR 17,561,941,802,000. This indicates that the observed companies possess an average total asset amount of IDR 17,561,941,802,000. The calculated mean leverage value is 1.345, indicating that the observed companies had an average total debt-to-equity ratio of 1.34.

Table 2. Pearson Correlations Matrix

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
(1) TBQ	1.000							
(2) ROA	0.479*	1.000						
(3) CSRD	0.084	0.084	1.000					
(4) WE_CEO	0.061	0.057	0.026	1.000				
(5) SIZE	0.112*	0.129*	0.180*	0.192*	1.000			
(6) LEV	-0.067	-0.134*	0.001	-0.032	0.039	1.000		
(7) AGE	0.141*	0.071	0.028	-0.002	-0.002	-0.026	1.000	
(8) REG	-0.100*	-0.001	0.024	0.125*	0.163*	0.124*	-0.191*	1.000

**** p<0.01, ** p<0.05, * p<0.1*

Table 2 shows that the correlation coefficient between the two variables does not exceed 0.8, so it is said that the research model does not have multicollinearity.

Table 3. Hypotheses Test

	(1) TBQ	(2) TBQ	(3) TBQ	(4) ROA	(5) ROA	(6) ROA
Intercept	-1.003	-1.189	-1.396	-0.080	-0.125**	-0.134**
	(-1.293)	(-1.394)	(-1.552)	(-1.329)	(-2.001)	(-2.079)
CSRD	1.527**	1.690**	2.547***	0.060*	0.040	0.078
	(2.300)	(2.355)	(2.625)	(1.648)	(1.063)	(1.293)
SIZE	0.075**	0.082**	0.083**	0.006**	0.008***	0.008***
	(2.235)	(2.267)	(2.295)	(2.502)	(3.264)	(3.282)
LEV	-0.040**	-0.040**	-0.040**	-0.006***	-0.005***	-0.005***
	(-2.378)	(-2.411)	(-2.367)	(-3.815)	(-3.005)	(-3.000)
AGE	0.012**	0.008	0.008	0.001*	0.000	0.000
	(2.051)	(1.416)	(1.446)	(1.688)	(0.745)	(0.775)
REG	-0.305**	-0.334***	-0.315**	-0.016	-0.012	-0.011
	(-2.497)	(-2.629)	(-2.380)	(-1.284)	(-0.897)	(-0.829)
WE_CEO		0.032	0.072*		0.001	0.003
		(1.489)	(1.841)		(0.761)	(0.921)
CSRD*WE_CEO			-0.225			-0.010
			(-1.099)			(-0.822)
Adj.R2	0.12	0.11	0.11	0.06	0.05	0.05
N	711	610	610	711	610	610
F-stat	7.357	6.105	5.752	5.505	4.094	3.955

t statistics in parentheses
* p<0.10, ** p<0.05, *** p<0.01

According to the data presented in Panel 1 of Table 4.3, the p-value associated with the relationship between CSRD and TBQ is less than 0.01. Additionally, the coefficient of the impact is reported to be 1.527. In Panel 4, it is observed that the p-value associated with the relationship between corporate social responsibility disclosure (CSRD) and return on assets

(ROA) is less than 0.1. Additionally, the coefficient estimate for this relationship is 0.060. These findings provide support for the alternative hypothesis (H1) posited in the present study. The findings of this study suggest that there is a notable favorable impact of the level of sustainability report disclosure on both market-based and accounting-based firm performance. The observed outcome can be attributed to the correlation between sustainability initiatives, as reported in the company's sustainability report, and the subsequent enhancement of the company's image and reputation. This, in turn, leads to an elevated evaluation of the company's business ethics by investors, potentially resulting in an increase in the market value of the company's stocks. This aligns with the principles of stakeholder theory, which posits that a company's operational and non-operational endeavors should prioritize the interests of shareholders while also considering the needs of other stakeholders, such as potential investors and the local community in which these activities take place. This phenomenon undeniably influences the augmentation of trust among these stakeholders, hence leading to a potential enhancement in the company's stock market valuation.

Conversely, the findings of this study also indicate that there exists a positive correlation between the caliber of a company's sustainability disclosures and its level of profitability. The positive response from consumers towards the company's business ethics, as evidenced by the quality of sustainability report disclosures, has resulted in increased sales of the company's products and enhanced reputation. Despite the fact that the implementation of sustainability initiatives and the production of sustainability reports incur additional costs for the company, the subsequent increase in sales can sufficiently offset these expenses. This finding aligns with the descriptive statistical analysis, which reveals that the average return on assets (ROA) for the observed companies remains positive at a significance level of 3%. The findings of this investigation are consistent with those of other prior studies [7,9,34,37].

Panel 3 shows that CEO power measured by experience as CEO cannot moderate the effect of CSRD on market-based firm performance. This can be identified from the p-value > 0.1. In line with this, panel 6 shows that CEO experience also does not moderate the effect of CSRD on accounting-based firm performance. This is identified from the p-value, which is >0.1. This result concludes that H2 is rejected. Each company, even in the same industry, has its characteristics and culture, so one’s experience as CEO in another company cannot necessarily make the CEO quickly adjust to the character and culture of the company. Hancock (2010) found that all major actions decided by the CEO only occurred within two years of his tenure. In addition, this result confirms that the company’s reputation is prioritized, even though the impact on the company’s expenses increases. So, for this reason, work experience as a CEO that aims to improve company performance, especially on the profitability side, cannot influence the selection of sustainability-oriented corporate strategies. This result also aligns with several previous studies [18,30,49].

4 Conclusion

The findings of this study suggest that there is a positive relationship between the extent of sustainability report disclosure and corporate success, encompassing both market-based and accounting-based measures. The enhancement of corporate reputation resulting from the adoption of ethical business practices has a consequential effect on bolstering the trust of prospective investors and consumers. The suggestion is that there exists a correlation between the rise in trust from possible investors and the market price of the company's shares, as well as an increase in the company's sales due to the favorable perception of consumers towards its products. Another finding that may be inferred is that the presence of a seasoned CEO does not influence the company's inclination to prioritize reputation management, while simultaneously implementing corporate strategies aligned with social responsibility.

Theoretically, this study develops the literature on the relationship of the quality of corporate sustainability disclosures to firm performance and the impact of the presence of an experienced CEO. This study strengthens stakeholder theory which explains that corporate activities are aimed at the interests of shareholders and will also impact other stakeholders. Practically, this study contributes that increased disclosure in sustainability reports will increase investor and consumer confidence, which can increase the company’s stock market price and sales of the company’s products.

This research is only limited to primary and secondary sector companies using secondary data, so the results of this study could be different if conducted in other sectors and using primary data. Therefore, future research suggestions can conduct similar research using other sectors and primary data, such as surveys or interviews.

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