

THE UNIVERSITY OF HULL

Corporate Governance Mechanisms, Corporate Sustainability Concerns and Company Financial Performance: Evidence from Public Listed Indonesian Commercial Banking Companies

being a Thesis submitted for the Degree of Doctor of Philosophy
in the University of Hull

by

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September 2016

Dedication

This thesis is especially dedicated to my parents, *Minarsih* and *Suherwan*, my wife, *Yane*, and my children, *Grani* and *Kinkin*, who have always loved and supported me during the hardship of completing this study; I wish them peace and a great life in the future.

Acknowledgments

Bismillāhi r-raḥmāni r-raḥīm

First and foremost, In the name of Allah, The Most Gracious and the Most Merciful, all my praise and thanks to Almighty God, the Lord of mankind, the one who always gave me the strength, ability and guidance to complete my study.

I would like to express my great gratitude to my mother *Minarsih*, and my father *Suherwan Kartadjumena* for unconditional love in their prayers and undivided support during the journey of my study. I am blessed to have you as my parents and I can never thank you enough. You are my strength and I owe you for every success and happiness in my life.

I owe my deepest appreciation to my wife, *Yane*, who has always been with me during my poor and bad times; and always encouraged me to accomplish of study. To my lovely son and daughter, *Grani* and *Kinkin*, both of you always make me proud and I am blessed for being your dad.

I acknowledge the consistent support of my first supervisor, *Professor Waymond Rodgers*. Without his encouragement to believe in my ability, this doctoral thesis could not have been formulated and finished. I would like to thank *Professor Steve Johnson*, my second supervisor who gave me many positive feedbacks and comments for my thesis proposal.

This journey of study would not have been possible without support from outside the University of Hull. I acknowledge generous financial support from the Indonesian Government through the Directorate General of Higher Education (DGHE /Dikti) Scholarship from the Ministry of Research Technology and Higher Education for giving me the chance to study for a doctoral degree abroad.

Additionally, I acknowledge consistent support from Widyatama University and Widyatama Foundation, Bandung, Indonesia. In particular, I want to thank the Former Rector of Widyatama University, *Dr. Mame S. Soetoko, Ir*,

DEA, Former Dean of the Economic Faculty (now Rector), *Dr. Islahuzzaman, Ak, CA* and the late Chairman of Widyatama Foundation, *Toto Ontowiryo, MBA*, who trusted, encouraged and supported me to take opportunity to study for doctoral degree in England.

A Special gratitude goes to my caring sister, brother and brother in law, *Holliana, Rubiana* and *Sardjono*, who supported me despite our physical distance. I deeply thank them for always being there

Finally, my inmost appreciation goes to all my friends, colleagues and members of my family who patiently bore my absence. Thank you for all the moral support and encouragement that helped me to overcome many obstacles during my journey of study. I apologies for not mentioning every single one.

Abstract

This thesis investigates the relationship between corporate governance mechanisms, corporate sustainability concerns and company financial performance for public listed of Indonesian commercial banking companies throughout the period 2007-2014. Corporate governance mechanisms are defined by the construct of the board of commissioners' (BoCs) role, executive compensation and ownership structure. Meanwhile, corporate sustainability concerns are defined by the corporate social responsibility activities, which are disclosed in the bank's published reports (i.e., annual report or sustainability report). This thesis also employs the combination of two different measures of company financial performance: company financial health and market value, measured by the Altman's Z-Score Revision Model and Tobin's Q, respectively.

The thesis employs a decision-making model framework, the Throughput Model, which is developed by Rodgers (1997) to describe the relationship among those constructs by adopting the shareholder and stakeholders perspectives. Data is presented from 252 firm-year observations as an unbalanced data panel of 39 commercial banking companies publicly listed on the Indonesia Stock Exchange throughout 2007-2014. Then, Partial Least Square-Structural Equation Modelling (PLS-SEM) is used to analyse data and provide results about potential influences among those aforementioned constructs.

The thesis contains seven chapters, including three chapters of empirical findings, which are presented in chapters four, five and six. For each chapter of empirical findings, the study built and tested the potential influences among the constructs in four different research models: a simultaneous and separate current period analysis, a year time-lagged analysis, a moderation effect analysis and a reverse (changing) direction of framework analysis.

The first empirical finding is presented in chapter four. It addresses the issue of whether mandatory internal corporate governance mechanisms, particularly the role of board of commissioners as the board supervision function, could influence corporate sustainability concerns as the construct of corporate responsibility disclosure. Further, this study examines whether there is an extended impact of the relationship of corporate sustainability concern on financial performance, in terms of both financial health and market value performance. This study provides evidence that the board of commissioners could be an important control mechanism to encourage the company to be more concerned with corporate sustainability with respect to economic, environment, and social activities. Further, viewed from the shareholder perspective, the positive influence brought by the board of commissioners on corporate sustainability concerns may dampen the firm's market value. On the other hand, according to the stakeholder perspective, the positive influence of the board of commissioners on corporate sustainability concern will improve company market value performance through its financial health performance. Moreover, this study also reveals that the motive of Indonesian banking companies in engaging in corporate sustainability initiatives tends to be altruistic. Indonesian commercial banking companies conduct corporate social responsibility activities only for their own sake, which influences the reduction of the company's financial performance, both financial health and market value performance.

The second empirical finding is provided in chapter five. It explores the potential influence of executive compensation on corporate sustainability concerns and company financial performance. Interestingly, by investigating the pay-for-performance relationship, this study finds that executive compensation has a direct significant positive impact on corporate sustainability concerns and both company financial health and market value performance. Meanwhile, by adopting a shareholder perspective, this study reveals that higher executive compensation can encourage managers to adopt more corporate sustainability concerns for the shareholders' and/or managers' benefits; however, this will reduce

the firm's value. However, a counter-balance mechanism occurs when employs the stakeholders' perspective is employed. High executive compensation motivates managers to implement more corporate sustainability concerns to serve all stakeholders' interests, which may to increase the firm's market value through company financial health.

The third empirical finding is described in chapter six. It investigates whether the BoCs' role simultaneously with executive compensation could shape the motivation of the top management or executives to achieve company goals of higher company financial performance in a concentrated ownership dominant context. This study discovers that both the BoCs' role and ownership structure have a direct significant positive influence on executive compensation. This study reveals that the BoCs' role and ownership structure in two-tiered corporate governance systems promote higher payment of executive compensation and better company financial performance. Thus, there is a substitution and complementarity effect among the constructs and indicators of corporate governance mechanisms in determining company financial performance. This study also finds that concentrated ownership strengthens the positive relationship between the role of board of commissioners and executive compensation in order to increase company financial health and market value performance.

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Chapter 1. Introduction

This chapter introduces the research by discussing in section 1.1 the background of the interrelationship between corporate governance and corporate sustainability concerns with their impact on the company financial performance. Meanwhile, in sections 1.2 and 1.3, the research objectives and the reasons why Indonesian commercial banking was chosen for this study are currently explained. Then, section 1.4 outlines the thesis structure and findings.

1.1. Research Background

Corporate sustainability (CS) issues throughout the world remain strong since the worldwide financial crisis, multi-national corporation scandals, frauds, crimes and irresponsible actions, which led to sudden corporate collapse and massive stakeholders' problems. Hence, simultaneously with global competition, technological change, and the serious economic downturn, stakeholders' pressures to secure and maintain continuing operation of corporations have increased significantly (Accenture, 2010). The stakeholders encourage and pursue corporations to practise four principles of corporate governance, which are transparency, accountability, responsibility and fairness, that can be highly influential on sustainability of business operations, to maintain and enhance firm performance. Hence, companies need to identify how to improve their strategy in applying these principles.

One of the company strategies that can be applied is adopting corporate governance principles interrelated with corporate social responsibility (CSR) (Aras and Crowther, 2008; Jamali et al., 2008) to maintain firm performance and treat those as two sides of the same coin¹ (Bhimani and Soonawalla, 2005). The interrelations between corporate governance and sustainability concerns through corporate social responsibility² are reflected as a corporation's commitment to align its own interests in economic, environmental and social initiatives with its stakeholders' interests in large communities in order to make the best decision for a company's sustainability (Jamali et al., 2008; Freeman, 2010). In this context, corporate governance must develop control mechanisms that can balance between

1. Bhimani and Soonawalla (2005) argue that corporate governance and corporate social responsibility cannot be completely separated, even though reporting standards and issues of accountability have developed independently. Corporate governance with the operational codes of practice emphasise protection of the interests of company shareholders. However, corporate social responsibility relates to company conformance over stakeholder value creation. Therefore, corporate conformance and performance are linked in the same continuum with different endpoints for independent companies.

2. In the past, sustainability referred to the environment aspect only and CSR was related to social aspects. However, this thesis considers the terms of the CS and CSR as synonyms. Hence, this thesis defines CS and CSR as "company activities – voluntary by definition – demonstrating the inclusion of social and environmental concerns in business operations and in interactions with stakeholders" (Van Marrewijk, M. 2003).

economic, environment and social goals of the company by implementing a strategy of efficiency of resources and accountability for the business's power and behaviour on the social environment, in order to increase both shareholders' value and the satisfaction of other stakeholders (Aras and Crowther, 2008).

Moreover, this interrelation also allows and induces transparency of the company reports, whether mandatory or voluntary, to adopt a more comprehensive and integrated approach in considering company disclosure issues as part of corporate responsibilities. These tend to shift the paradigm of business operations of large financial and non-financial corporations around the world, from business morality expressed as company generosity in environmental and social aspect, to a strategic business action approach within the core of business to reach higher business performance (Accenture, 2010, 2013; KPMG, 2011). Companies and business scholars believe that good performance on sustainability concerns, in terms of economic, environmental and social aspects are an effect of the implementation of good corporate governance and its control mechanism with further impact on good business overall, which can be reflected in higher company financial performance (Orlitzky et al., 2003).

These interrelationships leads management to be actively involved in collaborative activities with stakeholders to legitimise company behaviours, educate stakeholders and change their perceptions and expectations (Gray et al., 1995b; Adams and Larrinaga-González, 2007; Adams and McNicholas, 2007), reduce agency problems and enhance corporate value (Beltratti, 2005), as well as

minimise significant negative external effects from potential prosecutions and business closure on sanction by the government (Jizi et al., 2013; Marley and Weber, 2012). It also would be useful to overcome company risks and stakeholders' uncertainties from investors, consumers, and regulators in the decision-making process (Gill, 2008; Accenture, 2010).

Stakeholders' uncertainties are reflected in the effort to create corporate value through sustainable and responsible products and services, which can be seen as a factor in failing performance in investors' valuation models, unclear signals as driving factor to increase the purchasing behaviour of customers and the need greater clarity for future regulation for government decisions (Accenture, 2010). Moreover, stakeholders expect the companies to be more socially responsible by disclosing their corporate social responsibility activities, such as part of sustainability efforts (Bayoud et al., 2012; Lee and Faff, 2009). Companies that demonstrate a commitment to a broad range of stakeholders are likely to show better management skills and increase in accountability can maximise sustainable wealth creation.

Whilst corporate sustainability concerns with economic, environmental and social participation have been extensively discussed in the literature and attracted the attention of many worldwide scholars and practitioners (Baird et al., 2012; Andersen and Olsen, 2011; Orlitzky et al., 2003; Griffin and Mahon, 1997; Orlitzky and Benjamin, 2001; McWilliams and Siegel, 2000; Margolis and Walsh, 2003), the potential relationship between corporate governance - corporate

sustainability - financial performance as a single study has gained little attention in the empirical literature. Most of the literature on corporate governance, corporate sustainability concerns through corporate social responsibility and company financial performance treats them as independently and separately studied topics across disciplines. However, several prior studies have investigated their integration, mostly in developed country settings, such in the United States (US), United Kingdom (UK) and European countries, with mixed and inconclusive results. Such studies focused on how the increased quality of corporate governance may be used to communicate and provide transparent and credible information of corporate social responsibility activities to stakeholders (Michelon and Parbonetti, 2010; Jizi et al., 2013; Michelin and Parbonetti, 2012; Young and Thyl, 2013; Jamali et al., 2008).

This study focused on investigating those relationships in Indonesian capital market context as the world's 10th largest economy in terms of purchasing power parity, the largest economy in Southeast Asia countries with gross national income per capita has steadily risen, from \$560 in the year 2000 to \$3,374 in 2015 as well as substantial growth rate and high capital formation from foreign investors (www.worldbank.org). Moreover, the Indonesian companies, typically of Asian countries, have a two-tiered corporate governance system with highly concentrated ownership structured from family, individual, business group and institutional investors (Claessens and Fan, 2002; Claessens et al., 2000). This can lead to a "unique" agency problem, known as principal-principal (PP) conflict, as well as principal-agent (PA) conflict. PP conflict is a conflict between large

owners as controlling shareholders and minority shareholders, whenever one or more groups of stakeholders coordinate their actions in order to increase their benefit at the expense of other stakeholders' benefit (Dharwadkar et al., 2000; Morck et al., 2005; Shleifer and Vishny, 1997; Young et al., 2008).

In the Indonesian corporate governance context, the board of commissioners' ineffectiveness in supervising managerial functions and the lack of company transparency have been identified as factors that increased company's vulnerability to negative impacts of Indonesia's financial crisis (Kameyama et al., 2006). This statement is supported by the Worldwide Governance Indicators (WGI) survey in 2014, which shows that Indonesia is categorised as a weak country in six dimensions of governance: voice and accountability, political stability and the absence of violence, government effectiveness, regulatory quality, rule of law, and corruption control (www.govindicators.org). Moreover, during 2006-2014, the corruption perception index for Indonesia has ranged from 24 to 34 with the highest country rank in 107 from 175 countries for the year 2014 (www.transparency.org).

Particularly, during 2011-2014, at least 11 massive management scandals and crimes occurred in the Indonesian banking environment, as well as other small scandals in government-owned banks (www.infobank.com). These cases imply that several Indonesian banking companies have not always fully complied with corporate governance regulations and have failed to be socially responsible. However, the banking sector, as the centre of the financial sector with a financial

intermediary function, should be credible and trustworthy for its customers and affiliations.

Moreover, prior literature to examining the relationship between those topics as a single study in developing countries, such as in the Indonesian banking companies' context, is practically non-existent. Indeed, some previous studies from the Indonesian context only showed empirical results on the topic of corporate governance and corporate sustainability or corporate social responsibility independently or separately in manufacturing or natural resources companies. However, they do not provide specific empirical results from commercial banking companies (Darmawati and Khomsiyah, 2005; Gunawan et al., 2009; Gunawan, 2007). Research by Etty (2009) has investigated the relationship between corporate governance, corporate social responsibility and financial performance as one continuum by using path analysis; however, it only provided evidence from all public listed Indonesian companies, not banking companies.

This study notes that the rationale behind company decision makers to the interrelationship between corporate governance and corporate sustainability concern through corporate social responsibility activities has not been universally agreed among the previous literature. However, this study considers employing two perspectives to explain this relationship: the shareholder and the stakeholders' perspectives. That is because investigating both these perspectives, which are relevant to the typical condition of corporate governance systems in the

Indonesian context, could provide broader benefit and a clear justification for decision makers of why they need to interrelate those topics as a business strategy.

According to the shareholder perspective, the relationship between corporate governance and corporate sustainability concern through corporate social responsibility activities refers to agency problems known as principal-agent (PA) conflict, when expropriation happens between shareholders/principals and managers/agents (Jensen and Meckling, 1976; Berle and Means, 1932). This shareholder perspective widely appears in dispersed ownership situations predominant in developed countries. In this perspective, the decision makers (i.e., managers and or principals) conduct corporate social responsibility activities for their own purposes to create a good social reputation in the society, which could impose cost on shareholders without positive influence to maximise the company value (Barnea and Rubin, 2010).

Hence, corporate governance includes internal and external mechanisms designed to minimise divergences that arise from separation of ownership and decision control by ensuring that managers act in the best interests of shareholders (principals) to maximise the shareholders' interest in the company value (Denis, 2001; Fama, 1980). It deals with the ways that corporate governance through several mechanisms can act as the shareholders' control to mitigate and reduce the managers' moral hazard in taking opportunistic actions for their own interests in corporate social responsibility activities that can be expected to maximise the shareholders' interests in the company value.

In contrast, the stakeholder perspective indicates that the relationship between corporate governance and corporate sustainability concerns through corporate social responsibility activities in the company has the purposes not only of generating profits and complying with the law or regulations but also is required for the firm's responsibility towards its stakeholders by implementing transparency and accountability principles (Carroll, 1991; Carroll and Buchholtz, 2014). Stakeholders can be defined as groups and individuals who can affect or are affected by the organisation's purpose (Freeman, 1984). Moreover, stakeholders also include individuals and constituencies who are potential beneficiaries and/or risk bearers by contributing either voluntarily or involuntarily in creating wealth, capacities and activities within organisations (Post et al., 2002)

This perspective has wider implications than the shareholders' perspective in the company decision makers' view (i.e., managers and principals or shareholders). Their managerial decisions will not only affect shareholders, but also exert externalities for different groups of company stakeholders (Tirole, 2001). So thus, implementing corporate responsibility activities will be part of transparency and accountability representation to maximise and distribute welfare in the interest of multiple parties of the companies (Ayuso and Argandoña, 2009; Hess, 2007). In this stakeholders' perspective, corporate governance can play an effective role to serve company's management, its board and different stakeholders' interests from the rising pressures of public, customers and investors, rather than protecting only the shareholders' interest (Donaldson and Preston, 1995; OECD, 2004). In this perspective, corporate governance can be

defined as an institutional device with the aim of inducing the management to internalize welfare maximization of a broader range of stakeholders, both internally (i.e. controlling shareholders and employees) and externally (i.e. customers, suppliers, regulators, societies, investors, minority shareholders, etc) (Tirole, 2001). Moreover, it provides a framework of effective monitoring for balancing ownership and control and proper incentives for the board and management to pursue objectives in line with the interests of the company and its shareholders, as well as equitable treatment of shareholders and other stakeholders (Monks et al., 2004; OECD, 2004).

In the Indonesian banking context, decision makers tend not only consider to concern the controlling shareholders but are also accountable to the depositors or customers (Kameyama et al., 2006), which is supported by the wider concept of the stakeholders' perspective. Decision-makers seem to have additional crucial responsibilities in balancing the interests of shareholders and other stakeholders, such as creditors and depositors regarding the boards' decision-making practices and strategic aims. The company's success in serving shareholders' interests is likely to be affected by how a company treats and to some degree satisfies other stakeholders' needs (Jamali, 2008).

This study employs a decision-making model framework, the Throughput Model, which is developed by Rodgers (1997) to describe the relationship between corporate governance mechanisms, corporate sustainability and company financial performance by adopting the shareholder and stakeholders perspectives.

The Throughput Model was implemented because it allows to study of organisational cognitive structures (i.e., strategic perception and judgment) to determines a decision in different decision pathways (Narayanan et al., 2011). This model posits that four major concepts of perception, information, and judgment are implemented in a certain sequence before a decision choice.

The Throughput Model involves multiple latent constructs with multiple indicators, hence, it can be analysed by using a second generation multivariate methods such as Structural Equation Modelling (SEM), especially Partial Least Square (PLS). PLS is a soft modelling approach to SEM with no assumptions about data distribution and emphasises the prediction objective using analysis of variance (Vinzi et al., 2010). In this study, PLS is focused on predicting and explaining the variance of the endogenous construct (i.e., firm's market value) by estimating partial model relationship in an iterative sequence of OLS regression from different exogenous constructs (i.e., corporate governance mechanisms and sustainability concerns, etc) in Indonesian commercial banking companies. PLS is advance statistical technique that allows simultaneous analysis to understand overall relation among the constructs in the complex and comprehensive model instead of separately and "piecemeal" approach like in the normal regression method (Chin, 1998).

Moreover, PLS-SEM is essentially able to conduct path analysis with latent variables (Chin, 1998), whereas each variable in a path model is measured through multiple indicators (e.g., multiple questions referring to the same

construct in a questionnaire). Particularly, PLS-SEM in this study can handle with relatively small of the sample size (e.g., 39 banking companies), formative measures and non-normal data occurs (i.e., highly skewed); when the covariance based (CB)-SEM as well as normal multiple regression analysis cannot provide the best questionable results. PLS-SEM also can handle mediating or intervening construct very well, which has a different meaning to moderating construct. However, like all statistical methods, “PLS-SEM requires several choices that, if not made correctly, can lead to improper findings, interpretations, and conclusions.” (Hair et al., 2012). Hence, the accurate formation of the conceptual model become the key foundation to develop the structural model, such to determine a reflective or formative construct measures that should be clarified clearly.

1.2. Research Objectives

The purpose of this thesis is fourfold. *First*, it aims to provide recent insights on the potential influence of corporate governance mechanisms, in particular on the role of board of commissioners and executive compensation, in affecting both corporate sustainability concerns through disclosure and corporate financial performance, according to the shareholder and the stakeholders' perspectives, by employing the Throughput Model, a decision-making model developed by Rodgers (1997). *Second*, it presents a recent picture of the implementation of corporate governance mechanisms, with particular reference to the board of commissioners, executive compensation and ownership structure in

publicly listed Indonesian commercial banks following the implementation of mandatory regulation of corporate governance for all Indonesian commercial banking companies, which was enacted in 2006. *Third*, it also demonstrates the implementation and practice of corporate sustainability concerns through corporate social responsibility activities and disclosure after the law related to the mandatory implementation of corporate social responsibility for public listed companies in Indonesia was published in 2007. *Fourth*, this study aims to enrich the literature and enhance understanding of the relationship of those topics in Indonesian commercial banking companies, representing South East Asian emerging countries, which have a two-tiered corporate governance system. This study departs from many previous studies, which have generally focused on one-tiered systems like the United States (US) and United Kingdom (UK) and other two-tiered corporate governance systems in European and Asian countries.

1.3. Research Motivations

Discourse and topic research in the banking and financial sector is always interesting and attracts attention among practitioners and scholars. It happens because the banking and financial sector is vital, quite unique and distinctive from the other nonfinancial sectors (Alexander, 2003). Unlike firms in the nonfinancial sector, operations in the banking sector have an extensive risk, and failure in handling the operation of banks can cause banks and other companies to face serious negative consequences. This may lead to collapse and failure of broader national economic obligations and macro-financial stability. That is

because the banks fail to provide liquidity and fulfil obligations to other financial institutions and sectors of the country economy. However, in the context of banks, governance problems are relatively similar and do not differ greatly from other organisations (Andres and Vallelado, 2008). In fact, there are similar empirical governance findings on banks' operations when they use the same corporate monitoring mechanisms as non-financial companies (Laeven and Levine, 2009).

This study explores publicly listed Indonesian commercial banking companies throughout the period 2007-2014 for several reasons. ***First, academic motivation.*** The interrelationship among the aforementioned topics is very rarely published compared to research in other industries, for instance in manufacturing or the mining industry. Hence, this study can potentially fill an important gap over a given time period and create deeper understanding of the different impacts that occur among the constructs, as well as extend the potential of other explanatory factors in the literature.

Second, industry motivation. Commercial banking companies, such as Indonesian banks, being central in financial sector, play a very important role in modern economic systems to ensure stability for the economy of the country. This is reflected in their opportunity to be actively involved in society by practising sustainable development through several different responsible actions in various business relations with both customers and other firms in an era of global industry, such as providing customers with security, access and liquidity. Moreover, the banks serve as financial intermediaries by facilitating cash flow

between lenders and borrowers in which they may use public resources more than other industries. The cash may mainly come from stakeholders (i.e. depositors and lenders) rather than shareholders. Hence, banks have to adopt corporate social responsibility practices and perform highly reliable, complying with relevant legal framework/s and responsible behaviour, effectively and efficiently using resources, to be healthy banks that can create external benefit for society and the environment. They also must gain profit in their short and long term business activities, and comply with relevant legal framework/s to maintain their company financial performance as profitable organisations for stakeholders' (include shareholders') interests. Especially, public-listed banks should be more pro-active in adopting and promoting high-profile corporate sustainability initiatives in economic, environmental and social activities.

Therefore, as a result of this study, I expect that Indonesian banks will be more aware of using their public resources and should form an intention to give back to their stakeholders through corporate social responsibility initiatives. Moreover, the banks must also be transparent and accountable to their stakeholders by integrating and disclosing corporate social responsibility activities in their annual reports or additional separate reports, such as the sustainability report or CSR report.

Third, the regulator motivation; this research takes the opportunity to see how the Indonesian commercial banks focus on implementation of corporate governance and corporate social responsibility activities after the regulators (i.e.,

Bank Indonesia and the Indonesian government) enacted the new regulation and law regarding mandatory corporate governance and corporate social responsibility initiatives. The Bank Indonesia (BI) has launched a new regulation (i.e., PBI number 8/4/2006 amendment PBI number 8/14/2006) regarding mandatory implementation of corporate governance for all Indonesian commercial banking companies. Moreover, the Indonesia Government also has enacted two Laws that regulate corporate social responsibility and environmental activities, namely, Investment Law number 25/2007 article 15.b and Limited Liability Company Law number 40/2007 article 66.c. These laws were first effectively mandatorily applied in 2007, requiring listed companies to disclose their corporate social responsibility and environment initiatives in their annual report or other additional reports.

This new regulation and laws have motivated this thesis to promote a better understanding of recent development and the implementation of corporate governance and corporate social responsibility activities in the publicly listed Indonesian commercial banking companies, especially regarding the role of the board of commissioners, executive compensation and ownership structure. Hence, this research might encourage initiatives by Bank Indonesia and the Indonesia Financial Service Authority to motivate societal demands and expectations on CG and CSR issues as a part of business operation, in the form of organising seminars, press releases, or in award programmes and other initiatives.

Finally, investor motivation; since the worldwide financial crisis of 1997 and 2008 occurred, banks are being called upon to operate in a more ethically responsible manner. In the Indonesian context, integration corporate social responsibility and corporate governance may create benefit for minority shareholders and foreign investors. Foreign investors that enter emerging markets need to develop early effective corporate strategies to manage risk and to find the way to arrange activities in a complex business environment, which has a different set of characteristics from those employed in developed markets. They will avoid banks with poor sustained performance, whose pay interest rates will be more expensive, rather than ‘the sustainable’ bank, which reduces the shareholders' or investors' return. Hence, this study will provide information on investors and other stakeholders' reaction regarding the decision making process for their investment continuity when the banks determine the corporate sustainability concern to integrate with the bank governance.

1.4. Thesis Structure and Findings

This thesis contains six chapters beyond this introduction. *Chapter two* contains two sections and attempts to present a comprehensive firms level picture of the implementation of corporate governance mechanisms and corporate sustainability concerns through corporate social responsibility disclosure in Indonesian commercial banking companies over the period of study 2007-2014. *Chapter three* contains five sections and describes the research design and methodology. It explains how the data are collected, analysed and measured based

on its constructs and indicators. *Chapter four, five and six* are separate self-contained documents, each reflecting a typical empirical findings paper (i.e. each chapter contains seven sections: introduction, research background, theoretical review, hypothesis development, results, discussion and conclusion). Each chapter, reports the building and testing of four different research models to explain different impacts and relationships of the aforementioned constructs. *Chapter seven* presents the thesis conclusions and contains five sections, that explain the thesis findings, limitations, contributions, implications and avenues for future research.

Chapter 2. Corporate Governance Mechanisms and Corporate Sustainability Concerns in Indonesian Commercial Banking Companies

2.1. Introduction

This chapter aims to provide a comprehensive firms level description for the publicly listed Indonesian commercial banking companies of the implementation of corporate governance mechanisms, with particular reference to the board of commissioners' role, executive compensation and ownership structure, as well as the recent development of corporate sustainability concerns through corporate social responsibility disclosure for the period 2007-2014.

2.2. Corporate Governance in the Indonesian Context

Indonesia has learned that weak implementation of corporate governance practices was one of the causes of the financial crisis of 1997 and the global crisis of 2008. Hence, comprehensive efforts through independent or government bodies to improve good governance practices and regulations in Indonesian companies have been to pursued until today. One recent development in corporate governance in the financial sector of Indonesia is the establishment of the Financial Services Authority (Otoritas Jasa Keuangan/OJK) through Law No. 21 of 2011 concerning the Financial Services Authority.

The OJK serves as an independent regulatory and supervisory organisation with the aim of making Indonesia's financial system sustainable,

stable and capable of protecting the interests of consumers and the public by ensuring all activities in the financial services sector are held on a regular basis, fair, transparent and accountable. This FSA/OJK was established by combining two financial services regulatory agencies in Indonesia, namely, the capital market and non-bank financial industry authority (Bapepam-LK) and the banking authority (Bank Indonesia/BI). FSA/OJK has taken over as the regulatory and supervisory authority for all activities in the capital market, insurance, pension funds, and other financial services institutions since 31 December 2012, while responsibility for the banking industry was transferred to OJK on 31 December 2013.

However, the discourse of good corporate governance practices in Indonesian companies started to receive special attention when it was hard hit by the financial crisis of 1997, along with three other Asian countries, the Republic of Korea, Malaysia and Thailand. This crisis led to various initiatives and provided significant momentum to urge reforms of corporate governance, especially in banking institutions, in order to strengthen the national economy and regional cooperation. The crisis encouraged the Indonesian government as the policy maker to addresses the issue of corporate governance of Indonesian companies concerning accountability and transparency, to achieve economic recovery with some recovery programme. Issues of corporate governance have become a major concern for the shareholders (investors), customers, depositors, creditors, society as well as policymakers.

The Indonesian government started to reform corporate governance by establishing the National Committee for Corporate Governance/NCCG (Komite Nasional Kebijakan Corporate Governance/KNKCG) in 1999 by a Decree of the Coordinator Ministry for the Economy, Finance and Industry of Indonesia. The Committee had a task to provide recommendations for publishing national corporate governance principles. Then, the Committee issued a Code of Good Corporate Governance (Code of GCG) in 1999, revised twice in 2001 and 2006, which is believed to reflect the best common practice for Indonesian companies. Furthermore, in the attempt to extend coverage to public company and sector governance, the NCCG/KNKCG was converted into the National Committee on Governance/NCG (Komite Nasional Kebijakan Governance/KNKG) by Decree of the Coordinator Ministry of Economic in 2004. The NCG/KNKG published several company general codes, sector codes and a manual for the application of corporate governance in the Indonesian context (see in Figure 2.1).

Figure 2.1 shows the sequence of implementation of corporate governance codes in Indonesian companies, which can be divided into three different aspects:

1. The General Code, which consists of three codes:

- 1. Good Corporate Governance**
- 2. Good Public Governance**
- 3. Sharia Business Good Governance**

2. The Sectoral Codes, which consists of four codes:

1. Banking Companies
 2. Insurance and Reinsurance Companies
 3. Actuarial Consultant Companies
 4. Insurance and Reinsurance Broker Companies
3. The Manual of Good Corporate Governance, which consists of four books:
1. Business Ethics
 2. Whistle Blowing Systems
 3. Audit Committee
 4. Risk Management

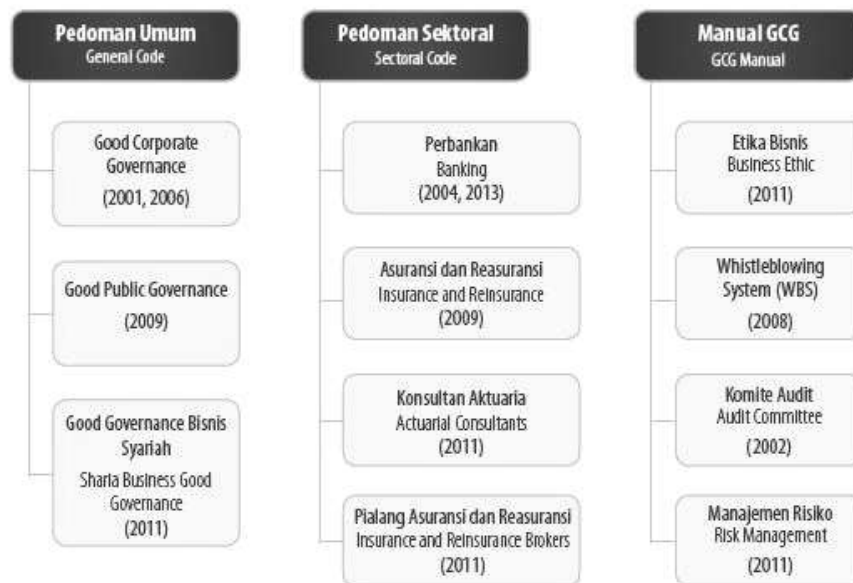


Figure 2.1 : Series of General, Sector and Manual of Indonesian Corporate Governance (source: NCG)

Although the Indonesian regulator seems to have adequate codes and a manual of corporate governance for companies, in fact, many previous attempts of governance improvements have not succeeded as expected, because most of the improvement efforts were done partially and sporadically. Simply issuing a

regulation will not automatically improve the implementation of corporate governance in companies. The implementation of good corporate governance in companies requires continuous comprehensive efforts, such as socialization, education and training, a conducive environment as well as incentives or rewards to encourage the adoption of corporate governance.

Indeed, several private organisations have launched initiatives and are actively involved in promoting governance awareness by organising seminars, helping companies to conduct self-assessment, providing education and training programme, assessing governance practices, as well as providing a governance perception index on an annual basis. Examples include: The Indonesian Institute for Corporate Directorship (IICD), the Indonesian Institute for Corporate Governance (IICG), Forum for Corporate Governance in Indonesia (FCGI), the Indonesian Institute of Audit Committee (IKAI) and the Indonesian Institute of Commissioners and Directors (LKDI), etc.

Moreover, the Indonesian corporate governance codes do not have a binding legal force; hence, implementation cannot be enforced, at either corporation or regulatory levels. Nevertheless, the regulators and companies can use the Codes as an important reference to develop regulations; prepare systems, structures, and guidelines relevant to corporate governance for themselves and other companies. As the result, the Indonesian government also has published Law number 40 of 2007 concerning Limited Liability Companies and replaced the previous Law number 1 of 1995.

This new law is a major legal product for companies in the form of a limited liability company (PT), including public listed companies in the capital market. This new law is more comprehensive than the previous law; it accommodates and describes how to implement the governance principles and other elements in a limited liability company, including the regulation about the equality of company organs, such as the General Meeting of Shareholders (GMS), and the role of Board of Commissioners (BoCs) and Board of Directors (BoDs). Currently, the BoCs and BoD are required to be more accountable in carrying out fiduciary duties.

Importantly, this new law also states the obligation to implement good corporate governance practices and corporate social responsibility in limited liability companies (in Article 66 paragraph 2). Hence, in this context corporate governance with specific reference to corporate responsibility actions can be defined as the ‘system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all of their stakeholders and act in a socially responsible way in all areas of their business activity’ (Solomon and Solomon, 2004). The company must be able to interact in an equal, fair and transparent way with all stakeholders, which demonstrates a better commitment of management to a broad range of stakeholders to increase accountability by disclosing their activities in the form of the annual report, as well as maximising sustainable wealth creation.

2.2.1. Overview of Corporate Governance in Indonesian Commercial Banking Companies

Following the 1997-1998 financial crisis, company stakeholders in Asian countries demanded to implementation of good corporate governance for all business levels and sectors, including the Indonesian banking sector. The issues in corporate governance concerning accountability and transparency have become a major concern for the shareholders (investors), depositors, creditors as well as policymakers. The weakness of the Indonesian fundamental economy and failure to implement prudent internal corporate governance have been identified as major sources of corporate collapse and shutdown of business operations (Kameyama et al., 2006). Some factors, including ineffective supervision by the board of commissioners, lack of transparency and accountability procedures and control, and high concentration of company ownership, have contributed to exacerbating the impact of the financial crisis on Indonesian companies.

Hence, the Indonesia government and regulatory bodies (i.e. Bank Indonesia and Financial Service Agency) issued several strict regulations and took intervention actions in order to avoid the further impact of a financial crisis that could lead to instability of the financial sector (i.e. banking), excessive risk-taking by investors and consumers and unavailability of credit. Bank Indonesia (BI) launched the new regulation (PBI Number 8/4/2006 amendment PBI number 8/14/2006) regarding mandatory implementation of corporate governance for all Indonesian commercial banking companies. This regulation is among the efforts to strengthen the internal condition of national banks pursuant to the Indonesian

Banking Architecture (IBA). According to Levine (2004), a strong, prudent and safe internal condition of banks, as well as a healthy banking system, is a the key to maintaining prosperity to create external benefits to society and the environment, as well as playing an important role in macroeconomic growth and development.

The new regulation, which is mandatory for Indonesian commercial banking companies, consists of 11 mechanisms, which are:

1. Duties and responsibilities of the Board of Commissioners;
2. Duties and responsibilities of the Board of Directors;
3. Completion and implementation of the Task Committee;
 1. Audit Committee,
 2. Risk Policy Committee,
 3. Remuneration and Nomination Committee.
4. Handling conflicts of interest;
5. Compliance function;
6. Internal audit function;
7. External audit function;
8. Risk management and internal control systems;
9. Provision of funds to related parties and large exposures;
10. Transparency regarding the bank's condition;
11. Strategic plan.

Table 2.1 exhibits a list of the Indonesia commercial banks' names, the bank's codes and the date of their first sale of common stock to the public or Initial Public Offering (IPO) in the Indonesia Stock Exchange. There are 40 banking companies listed on the market at the end of 2014.

Table 2.1 : The Public Listed Indonesian Commercial Banks for period 2007-2014

NO	CODE	BANK NAME	INITIAL PUBLIC OFFERING (IPO)
1	PNBN	Bank Pan Indonesia Tbk	29 December 1982
2	BNII	Bank BII Maybank Tbk (previously Bank Internasional Indonesia Tbk)	21 November 1989
3	BNGA	Bank CIMB Niaga Tbk (previously Bank Niaga Tbk)	29 November 1989
4	BDMN	Bank Danamon Indonesia Tbk	6 December 1989
5	BNLI	Bank Permata Tbk (previously Bank Bali)	15 January 1990
6	INPC	Bank Artha Graha International Tbk (previously Bank Interpacific Tbk)	29 August 1990
7	NISP	Bank OCBC NISP Tbk (previously Bank NISP Tbk)	20 October 1994
8	BBNI	Bank Negara Indonesia Tbk	25 November 1996
9	BCIC	Bank Mutiara Tbk (previously bank Century Tbk)	25 June 1997
10	MAYA	Bank Mayapada Internasional Tbk	29 August 1997
11	BVIC	Bank Victoria International Tbk	30 June 1999
12	BNBA	Bank Bumi Arta Tbk	31 December 1999
13	MEGA	Bank Mega Tbk	17 April 2000
14	BBCA	Bank Central Asia Tbk	31 May 2000
15	BBNP	Bank Nusantara Parahyangan Tbk	10 January 2001
16	BEKS	Bank Pundi Indonesia Tbk (previously Bank Eksekutif International Tbk)	13 July 2001
17	BSWD	Bank of India Indonesia Tbk (previously Bank Swadesi Tbk)	1 May 2002
18	BABP	Bank MNC International Tbk (previously Bank ICB Bumiputera Tbk)	15 July 2002
19	BKSW	Bank QNB Kesawan Tbk (previously Bank Kesawan Tbk)	21 November 2002
20	BMRI	Bank Mandiri (Persero) Tbk	14 July 2003
21	AGRO	Bank Rakyat Indonesia Agroniaga Tbk (previously Bank Agroniaga Tbk)	8 August 2003

Table 2.1 : The Public Listed Indonesian Commercial Banks for period 2007-2014 (continue)

NO	CODE	BANK NAME	INITIAL PUBLIC OFFERING (IPO)
22	BBRI	Bank Rakyat Indonesia (Persero) Tbk	10 November 2003
23	BBKP	Bank Bukopin Tbk	10 July 2006
24	SDRA	Bank Woori Saudara Indonesia 1906 Tbk (previously Bank Himpunan Saudara 1906 Tbk)	15 December 2006
25	MCOR	Bank Windu Kentjana International Tbk (previously Bank Multicor International Tbk)	3 July 2007
26	BACA	Bank Capital Indonesia Tbk	4 October 2007
27	BAEK	Bank Ekonomi Raharja Tbk	8 January 2008
28	BTPN	Bank Tabungan Pensiunan Nasional Tbk	12 March 2008
29	BBTN	Bank Tabungan Negara (Persero) Tbk	17 December 2009
30	BJBR	Bank Pembangunan Daerah Jawa Barat dan Banten Tbk	8 July 2010
31	BSIM	Bank Sinarmas Tbk (previously Bank Shinta Indonesia)	13 December 2010
32	BJTM	Bank Pembangunan Daerah Jawa Timur Tbk	12 July 2012
33	NOBU	PT Bank National Nobu Tbk (previously Bank Alfindo Sejahtera)	20 May 2013
34	BBMD	PT Bank Mestika Dharma Tbk.	8 July 2013
35	NAGA	PT Bank Mitraniaga Tbk.	9 July 2013
36	BMAS	PT Bank Maspion Indonesia Tbk.	11 July 2013
37	PNBS	PT Bank Panin Syariah Tbk (previously Bank Harfa)	15 January 2014
38	BINA	Bank Ina Perdana	16 January 14
39	DNAR	Bank Dinar Indonesia	11 July 2014
40*	AGRS	Bank Agris	22 December 2014

Source: Indonesia Stock Exchange Various Indonesia Stock Exchange Annual Reports

Notes: * The bank is excluded as unit observation due to incomplete data (missing data) on the data collection period

2.2.2. The Role of the Board of Commissioners

The board of directors in banks differs slightly from those in industrial companies. They are typically larger, more independent and have more authority (Core et al., 1999). Moreover, they often tend to have more committees (Mehran

et al., 2011) and seem to have a lower disciplinary role (Ozkan, 2007). The banks are more regulated and have some specific features, such as regulation, supervision, capital structure, risk, trust relationships, property and deposit insurance (Levine, 2004; Macey and O'hara, 2003). Jensen (1993) argues that the board of directors is crucial to effective internal control, as a dysfunctional corporate internal control system will lead to ultimate consequences of corporate failure.

The board of directors in the Indonesian context is commonly known as the board of commissioners, it is a supervisory board, which has the tasks of overseeing and providing advice for the management or executives. The board of commissioners' role in Indonesian commercial banks is regulated by Bank Indonesia (BI) regulation 8/4/PBI/2006 amended in 8/14/PBI/2016 concerning mandatory implementation of corporate governance at all company levels for Indonesian commercial banking companies. The board of commissioners' role is described in this regulation in terms of their size, composition, and requirements in dealing with task and responsibilities, which are explained in parts one and two of articles 4 to 18. For example:

1. The board of commissioners' member should consist of at least three persons and the size is not allowed to exceed the size of the board of directors (top executive or managers),
2. The board of commissioners shall consist of commissioners and independent commissioners with a minimum proportion of independent commissioners fifty (50) per cent,

3. All the member of the board of commissioners are appointed in the general meeting of shareholders based on a recommendation from the Remuneration and Nomination Committee after passing the fit and proper test of Bank Indonesia.
4. The board of commissioners is required to held four meetings a year and the members must physically attend the meeting no less than two times a year.
5. Board of commissioners' members must disclose their share ownership, financial and family relationship at the banks and other domestic and foreign banks or companies.
6. The majority of the board of commissioners' members shall refrain from having family relationship up to the second degree with other members of the Board of Commissioners and /or members the Board of Directors.

The candidates of the board of commissioners' members are approved and appointed by the company's general meeting of shareholders. However, the candidates prohibited to perform duties and responsibilities in their position before they obtain an approval from the Bank Indonesia as a legal supervisory body for Indonesian commercial banking companies. The approval is released after the candidates passing the fit and proper test pursuant to the Bank Indonesia to meet the requirement of integrity, competence and financial reputation. The mechanism in conducting the fit and proper test is regulated on the Bank Indonesia regulation number 12/3/PBI/2010 that is implemented by an administrative investigation and direct interview with the candidates.

The candidates must satisfy and fulfil the requirement of integrity, which are related to having a good character and morals, never been convicted of a specific crime for the last of twenty years, have a commitment to comply with the applicable laws and regulations, and they must commit to developing of the bank operations. Further, the candidates also fulfil the requirements of competences regarding the adequacy and relevance of the banking knowledge and experiences. Then, they meet to requirements of financial reputation which do not have any record regarding non-performing loan, the bankrupt declaration or have convicted guilty in causing of company's bankrupt within five years of prior nomination.

This study provides recent insight of implementation on the firm level of the board of commissioners of publicly listed of Indonesian commercial banks through its indicators in the period study 2007-2014. This study defines the construct of the board of commissioners' role by using several formative indicators such as the proportion of independent commissioners, number of meetings of the board of commissioners, the size of the board of commissioners, the board of commissioners' compensation, number of joint meetings between the board of commissioners and board of directors, and the board of commissioners' ownership.

Table 2.2 shows a list of the role of the board of commissioners' indicators for Indonesian commercial banking companies during this period. The grand average of the proportion of independent commissioners on the board was 59.1 per cent, which is somewhat above the 50 per cent mandatory minimum

requirement for the proportion of independent commissioners on the board, which is equal to an average of three independent commissioners on the board. It can be concluded that most of the Indonesian commercial banks have followed the regulation about the mandatory minimum 50 per cent proportion of independent commissioners on the board. Moreover, PT Bank ICB Bumiputera Tbk and PT Bank QNB Kesawan Tbk have the highest average proportion of independent commissioners with 75.42 and 75 per cent, which is equal to an average of three persons as independent commissioners.

Table 2.2 : The Average Indicators of the Role of Board of Commissioners in Indonesian Commercial Banking during period 2007 - 2014

No	BANK NAME	Independent Commissioners		Board of Commissioners Size		Board of Commissioners Meetings			Board of Commissioners Compensation			
		PICOB (%)	ICOB	Exc Size (%)	BoC Size	Excess Meet (%)	Number Meet	Joint Meet	Own (%)	MVOWN (%)	Rem BoC	Average RemBoC
1	Bank Rakyat Indonesia Agroniaga Tbk	58.88	2	120.86	4	284.38	15	12	0.00	27	1,831	519
2	Bank ICB Bumiputera Tbk	75.42	3	150.00	4	262.50	15	4	0.00	0	1,687	408
3	Bank Capital Indonesia Tbk	66.75	2	112.50	3	243.75	14	5	10.37	60,704	894	262
4	Bank Ekonomi Raharja Tbk	63.10	2	114.29	3	117.86	9	4	0.54	32,080	4,089	1,277
5	Bank Central Asia Tbk	60.00	3	166.69	5	1215.63	53	13	0.05	124,656	47,781	9,555
6	Bank Bukopin Tbk	57.14	3	183.34	5	900.00	40	12	0.00	59	14,902	2,761
7	PT Bank Mestika Dharma Tbk.	50.00	2	133.33	4	100.00	8	3	0.01	648	3,513	878
8	Bank Negara Indonesia Tbk	54.46	4	237.48	7	1125.00	49	12	0.01	8,721	28,288	3,935
9	Bank Nusantara Parahyangan Tbk	53.75	3	162.51	5	118.75	9	5	2.14	13,564	1,759	377
10	Bank Rakyat Indonesia (Persero) Tbk	54.76	4	237.50	7	906.25	40	16	0.00	0	32,595	4,361
11	Bank Tabungan Negara (Persero) Tbk	50.00	3	188.89	6	1020.83	45	18	0.00	0	14,414	2,506
12	Bank Mutiara Tbk	51.04	2	116.67	4	296.88	16	13	0.00	0	3,389	1,040
13	Bank Danamon Indonesia Tbk	52.68	4	245.83	7	156.25	10	6	0.00	399	18,537	2,539
14	Bank Pundi Indonesia Tbk	61.46	2	137.50	3	231.25	13	6	19.31	10,542	2,000	592

Table 2.2: The Average Indicators of the Role of Board of Commissioners in Indonesia Commercial Banking during period 2007 - 2014 (continue)

No	BANK NAME	Independent Commissioners		Board of Commissioners Size		Board of Commissioners Meetings			Board of Commissioners Compensation			
		PICOB (%)	ICOB	Exc Size (%)	Numb BoC	Excess Meet (%)	Number Meet	Joint Meet	BoC Own (%)	MV BoCOWN	Rem BoC	Average RemBoC
15	Bank Pembangunan Daerah Jawa Barat dan Banten Tbk	62.10	4	193.33	6	1045.00	46	12	0.01	1,238	17,317	2,996
16	Bank Pembangunan Daerah Jawa Timur Tbk	50.00	2	133.33	4	150.00	10	11	0.00	0	11,183	2,796
17	Bank QNB Kesawan Tbk	75.00	3	141.67	4	115.63	9	5	0.00	0	2,041	510
18	PT Bank Maspion Indonesia Tbk.	66.67	2	100.00	3	100.00	8	4	0.00	0	5,619	1,873
19	Bank Mandiri (Persero) Tbk	61.31	4	225.00	7	365.63	19	9	0.00	0	38,281	5,624
20	Bank Bumi Arta Tbk	68.75	2	104.17	3	150	10	3	5.47	19,754	1,285	458
21	Bank CIMB Niaga Tbk	51.25	4	237.50	7	343.75	18	12	0.00	0	15,378	2,238
22	Bank Internasional Indonesia Tbk	52.68	4	220.83	7	307.29	16	10	0.00	0	11,645	1,776
23	Bank Permata Tbk	51.25	4	270.83	8	262.50	15	11	0.00	0	10,614	1,288
24	Bank Sinarmas Tbk	63.33	2	93.33	3	610.00	28	28	0.00	0	1,846	664
25	Bank of India Indonesia Tbk	60.21	3	162.50	5	100.00	8	4	1.61	10,520	872	171
26	Bank Tabungan Pensiunan Nasional Tbk	48.57	3	195.24	6	132.14	9	5	0.00	319	17,794	3,012
27	Bank Victoria International Tbk	69.79	3	125.00	4	240.63	14	11	10.71	74,527	1,952	520
28	Bank Artha Graha	53.75	3	187.50	6	318.75	17	11	52.25	429,146	14,881	2,672

Table 2.2: The Average Indicators of the Role of Board of Commissioners in Indonesian Commercial Banking during period 2007 - 2014 (continue)

No	BANK NAME	Independent Commissioners		Board of Commissioners Size		Board of Commissioners Meetings			Board of Commissioners Compensation			
		PICOB (%)	ICOB	Exc Size (%)	BoC Size	Excess Meet (%)	Number Meet	Joint Meet	BoC Own (%)	MV BoCOWN	Rem BoC	Average RemBoC
29	Bank Mayapada Internasional Tbk	52.50	3	150.00	5	100.00	8	4	3.81	240,381	10,089	2,293
30	Bank Windu Kentjana International Tbk	45.83	2	112.50	3	225.00	13	8	4.51	26,164	1,106	323
31	Bank Mega Tbk	62.50	2	108.33	3	485.71	23	15	50.27	4,860,255	13,329	4,118
32	PT Bank Mitraniaga Tbk.	66.67	2	100.00	3	287.50	16	4	72.07	207,802	458	153
33	Bank OCBC NISP Tbk	50.89	4	262.50	8	100.00	8	4	0.00	28	13,885	1,767
34	PT Bank Nationalnobu Tbk.	70.83	3	116.67	4	150.00	10	4	0.00	0	743	217
35	Bank Pan Indonesia Tbk	51.25	2	133.33	4	323.96	17	10	0.00	0	2,753	667
36	Bank Himpunan Saudara 1906 Tbk	63.54	2	104.17	3	259.38	14	11	0.07	1,138	1,359	455
37	Bank Panin Syariah	66.67	2	100.00	3	225.00	13	9	0.00	0	1,029	343
38	Bank Ina Indonesia	66.67	2	100.00	3	125.00	9	5	0.00	0	1,162	387
39	Bank Dinar	66.67	2	100.00	3	100.00	8	8	21.15	92,320	2,484	828
GRAND AVERAGE		59.18	3	156.03	5	348	18	9	6.52	159,359	9,610	1,773

Notes: **PICOB** : proportion of independent commissioners on the board; **ICOB** : number of independent of commissioners on the board, **Exc Size** : percentage of excess minimum number of board of commissioners (at least three persons); **BoC Size** : number of board of commissioners; **Excess Meet** : percentage of excess of minimum meeting in a year (four times a year); **Number Meet** : Number of meeting in a year; **Joint Meet** : Number of joint meeting between board of commissioners and board of directors in a years; **BoCOwn** : percentage of board of commissioners Shareholders ownership; **MV BoCOWN**: market value of board of commissioners shareholders ownership (in million Indonesian Rupiahs); **RemBoC** : total board of commissioners cash compensation in a year (in million Indonesian Rupiahs); and **Average RemBoC** : average of board of commissioners cash compensation per person.

Additionally, this table shows that the grand average excess of the board of commissioners' size is 156 per cent, which is equal to five persons for the average number of board of commissioners. It means most of the banks have fulfilled the minimum of three persons as the board of commissioners' members. PT Bank OCBC NISP Tbk and PT Bank Permata Tbk have the highest average number of board of commissioners' members, with eight members in the board, with 262.50 per cent and 270.83 per cent, respectively. Further, this study finds the grand average number of meetings the board of commissioners is 18 times a year. It means most of the board of commissioners in Indonesia commercial banking have fulfilled obligation to held minimum 4 times meetings per year. PT Bank Central Asia Tbk has the highest average number of board of commissioners meetings per year with 53 meetings per year.

Moreover, this study shows that the grand of average number of joint meeting between the board of commissioners and board of directors is nine times a year, which PT Bank Sinarmas Tbk has the highest average joint meeting between the board of commissioner and board of directors (managers) with 28 times a year. In addition, the grand average the board of commissioner compensation a year was IDR 9,610 million with the average of compensation received by each individual of commissioners per year was IDR 1,773 million. The highest average of the board of commissioners compensation per year was paid by PT Bank Central Asia Tbk with IDR 47,781 million, which is individual of commissioners can receive with IDR 9,555 million per year. This study notes that the grand average of the board of commissioners ownership was 6.52 per cent

with the average market value of the board of commissioners ownership was IDR 159,359 million. The highest average of the board of commissioner ownership hold by PT Bank Mitraniaga Tbk with 72.07%; however, the highest average of market value the board of commissioner ownership hold by PT Bank Mega with IDR 4,860,255 million.

2.2.3. Executive Compensation

The topic of executive compensation in the developing economies such as in the South East Asia region is much less documented (Cheng and Firth, 2005), since unavailability of detail or low quality of public data, including in Indonesia banking companies. The Indonesian banking companies mandates to disclose general information about total payment of their executive compensation and structure for both the board of commissioners and board of directors; however, they do not mandate to disclose payment for each individual executive and its compensation structure.

Table 2.3 provides the result of a grand average of total cash of executive compensation (REMBOD) per year in Indonesian commercial banks is IDR Rp. 32,416 million with the highest average of total cash of executive compensation is paid by PT Bank Central Asia with amount IDR Rp. 154,971 million and the lowest average of total executive compensation is paid by PT Bank Mitraniaga Tbk with amount IDR Rp. 1,871 million. This study reveals a high difference (gap) of the average of total cash of executive compensation (i.e. salary and bonus) per year between banking companies with the highest and the lowest

payment. I notice only 13 out of 39 Indonesian commercial banks have average total cash of executive compensation per year above the grand average of total cash of executive compensation per year among Indonesian commercial banks (i.e. > IDR Rp. 32,416 million per year).

Table 2.3 : The Average Indicators of Executive Compensation for each Indonesian Commercial Bank during period 2007 - 2014

No	BANK NAME	EXECUTIVE COMPENSATION (in IDR Rp million)		
		REM BoD	AveREM BoD	MV BODOWN
1	Bank Rakyat Indonesia Agroniaga Tbk	4,026	965	287
2	Bank ICB Bumiputera Tbk	8,612	1,596	10
3	Bank Capital Indonesia Tbk	3,286	843	0
4	Bank Ekonomi Raharja Tbk	26,665	5,018	18,756
5	Bank Central Asia Tbk	154,971	16,505	373,428
6	Bank Bukopin Tbk	35,981	5,325	8,293
7	PT Bank Mestika Dharma Tbk.	10,422	2,084	648
8	Bank Negara Indonesia Tbk	92,073	9,253	85,251
9	Bank Nusantara Parahyangan Tbk	9,619	1,835	0
10	Bank Rakyat Indonesia (Persero) Tbk	98,693	9,228	32,891
11	Bank Tabungan Negara (Persero) Tbk	38,382	6,397	5,640
12	Bank Mutiara Tbk	8,603	1,867	0
13	Bank Danamon Indonesia Tbk	91,118	9,839	70,914
14	Bank Pundi Indonesia Tbk	4,987	973	82
15	Bank Pembangunan Daerah Jawa Barat dan Banten Tbk	45,089	7,606	5,501
16	Bank Pembangunan Daerah Jawa Timur Tbk	19,809	3,962	144
17	Bank QNB Kesawan Tbk	10,986	1,895	19,880
18	PT Bank Maspion Indonesia Tbk.	6,310	1,577	0
19	Bank Mandiri (Persero) Tbk	121,303	11,126	160,572
20	Bank Bumi Arta Tbk	3,241	1,080	34,650
21	Bank CIMB Niaga Tbk	102,935	9,828	0

Table 2.3 : The Average Indicators of Executive Compensation for each Indonesian Commercial Bank during period 2007 - 2014 (continue)

No	BANK NAME	EXECUTIVE COMPENSATION (in IDR Rp million)		
		REM BoD	AveREM BoD	MV BODOWN
22	Bank Internasional Indonesia Tbk	43,758	4,945	9
23	Bank Permata Tbk	57,853	6,640	0
24	Bank Sinarmas Tbk	6,345	958	742
25	Bank of India Indonesia Tbk	2,764	563	0
26	Bank Tabungan Pensiunan Nasional Tbk	62,961	6,855	140,090
27	Bank Victoria International Tbk	5,747	1,142	0
28	Bank Artha Graha	13,938	2,323	0
29	Bank Mayapada Internasional Tbk	27,798	4,458	9,548
30	Bank Windu Kentjana International Tbk	7,724	1,608	9
31	Bank Mega Tbk	28,902	4,005	0
32	PT Bank Mitraniaga Tbk.	1,871	456	0
33	Bank OCBC NISP Tbk	57,569	5,890	4,615
34	PT Bank Nationalnobu Tbk.	2,030	452	0
35	Bank Pan Indonesia Tbk	32,260	2,971	0
36	Bank Himpunan Saudara 1906 Tbk	4,986	1,411	3,290
37	Bank Panin Syariah	4,951	1,238	0
38	Bank Ina Indonesia	2,737	912	0
39	Bank Dinar	2,905	968	0
GRAND AVERAGE		32,416	4,015	25,006

Notes: One U.S. dollar equals to approximately IDR Rp.13,514 (in 2014)

REM BoD : Total Board of directors cash compensation in a year; **AveREM BoD :** Average of board of director compensation per person in a year; and **MV BoDOWN :** market value Board of Directors shareholders ownership.

Table 2.3 shows the grand average of total cash of executive compensation per individual per year (AVERemBoD) was IDR Rp. 4,015 million with the highest and the lowest average of total cash of executive compensation per individual per year are paid by PT Bank Central Asia Tbk and PT Bank

National Nobu Tbk with amount IDR Rp. 16,505 million and IDR Rp. 452 million respectively. I found only 14 out of 39 banking companies, which are in above the grand average of total cash of executive compensation per individual per year among Indonesian commercial banks (i.e. > IDR Rp. 4,015 million per individual per year). Moreover, this study finds the grand average of market value board of directors' ownership is IDR Rp 25,006 million with the highest of the average of market value board of directors' ownership is received by PT Bank Central Asia Tbk for the amount of IDR Rp. 373,428 million.

Furthermore, table 2.4 exhibits indicators of executive compensation in Indonesia Commercial Banks for each year of period study 2007 - 2014. In general the trend was dramatic increase over the period for three reflective indicators of executive compensation, such as total cash payment of executive compensation per year, total cash of executive compensation per individual per year and the market value of the board of directors' ownership, with particular reference on the aspects of maximum (the highest) and the mean (average) values. The evidence reveals that the highest of average total cash payment of executive compensation per year rose more than 300 per cent from IDR Rp 69,962 million in 2007 to become IDR Rp 254,915 million in 2014. I notices that PT Bank Central Asia, Tbk, as the highest of average cash payment of executive compensation per year from 2009 - 2014 (six years). Moreover, the table also documented that the trend of grand average cash payment of executive compensation per year was Rp. 19,3254 million to Rp 49,422 million. It was a significant increase for more than 240 per cent in eight years from 2007 to 2014.

Table 2.4 : The Trend of Average Indicators Executive Compensation in Indonesia Commercial Banks for period study 2007 - 2014

Indicators		2007	2008	2009	2010	2011	2012	2013	2014
REMBOD	Max / Bank	69,962 BDMN	100,542 BNGA	106,598 BBCA	149,164 BBCA	164,940 BBCA	194,342 BBCA	211,778 BBCA	254,915 BBCA
	Min / Bank	867 BEKS	953 BEKS	899 BEKS	1612 BEKS	2,556 BSWD	3,086 BNBA	1,725 NAGA	1,820 NOBU
	Mean	19,324	26,762	26,317	32,718	39,773	46,273	50,711	49,422
	SD	20,772	30,382	28,282	34,830	42,568	49,757	60,154	66,483
AVEReMBoD	Max / Bank	9,706 BBCA	15,414 BDMN	11,844 BBCA	16,574 BBCA	16,511 BBCA	19,454 BBCA	21,199 BBCA	25,492 BBCA
	Min / Bank	289 BEKS	318 BEKS	300 BEKS	461 BSWD	511 BSWD	885 BACA	448 NOBU	336 NAGA
	Mean	2,631	3,504	3,267	4,101	4,602	5,304	5,845	5,696
	SD	2,650	3,783	2,812	3,650	3,775	4,353	5,545	6,161
MVBODOWN	Max / Bank	295,874 BBCA	261,317 BBCA	413,600 BBCA	452,219 BBCA	311,875 BBCA	356,083 BBCA	378,701 BBCA	517,755 BCA
	Min	0	0	0	0	0	0	0	0
	Mean	24,856	20,800	29,295	32,842	31,104	36,561	30,134	33,161
	SD	66,415	56,221	89,000	86,497	71,972	84,202	76,636	96,374

Notes : **REM BoD** : Total Board of directors cash compensation in a year; **AveREM BoD** : Average of board of director compensation per person in a year; and **MV BoDOWN** : market value Board of Directors shareholders ownership

Similarly, the table 2.4 shows that the highest of average total cash of executive compensation per individual per year increase dramatically more than 200 per cent from IDR Rp 9,706 million in 2007 to become IDR Rp 25,492 in 2014. PT Bank Central Asia, Tbk also as the highest of average cash of executive compensation per individual per year since 2009 - 2014. I also found the grand average total cash of executive compensation per individual per year has increased sharply for more than 200 per cent from IDR Rp. 2,361 million in 2007 to IDR Rp 5,696 million in 2014. Furthermore, the table 2.4 presents the highest of average market value of the board of directors' ownership with the range from IDR Rp. 295,874 million to IDR Rp. 517,755 million that hold by PT Bank Central Asia, Tbk since 2007 to 2014. The facts show that the grand average of market value of the board of directors' ownership increased significantly from IDR Rp. 24,856 million to IDR Rp. 33,161 million.

2.2.4. Ownership Structure

Discussion on the banking ownership issue generally focuses on special attention of two important issues, namely: ownership concentration and owner's identity or ownership type. In Indonesia, a public banking company typically control by shareholder concentration and is owned by the government or a family or business group from foreign investors (World Bank, 2010). In this case, it can lead to different of the agency problems, which may have a tendency of controlling shareholders to make a decision in favour of their interests and may be harmful to the interests of non-controlling shareholders. Besides, the problem

equality in similar treatment among the same order or class of shareholders ownership, the issues on ownership structure in listed Indonesian banking companies also have implications in the distinct amount of company payment for their executive (i.e. directors and top management) compensation as well as the firm's business environment. Ownership structure can influence the company's monitoring mechanism and can intensively determine the objective and the shareholder's wealth (Porter, 1990; Jensen, 2001).

There have been major changes as part of banking reconstruction after Asian crisis in 1997-1998 severely hit the Indonesia financial and macroeconomics (Enoch et al., 2001; Enoch, 2000). Several banks' restructuring agenda as Indonesian banks governance reforms has been launch under the International Monetary Fund (IMF) conditionality. The aim of the Indonesian banking reforms not only to prevent the banking sectors collapsed but also establish the banking sector would be more prudent and healthier. Moreover, to accelerates the macroeconomic development and allows participation of the private sector as well as reduces government interference, Indonesian has adopted a privatisation programme for the financial market. The government enacted regulation number 29/1999 that initiated privatising, internationalizing and inviting capital inflow from the private and foreign investors. The regulation also allows the foreign investors to own up to 99% equity of shareholders in Indonesian companies, including banking companies. Moreover, the changes in ownership also occurred in the domestic private banks and most of happened because of the impact of liquidity problem from the crisis. The regulation

attracted the foreign banks, financial institutions and many domestic private banks to deal with privatizing the shares ownership by new investors.

This study finds that the Indonesian commercial banking tends to have concentration ownership. All the commercial banking companies reveals can be characterised by the presence of strong, large shareholders with the three main categories being family, or business group shareholders from local and foreign investors, and government, or state investors. Several government or states ownership banks have started to sell their shares and privatised to public in order to increased transparency and minimised the political interventions as well as official involvement. However, the government, or states still keep their own majority controlling shares in several banks.

Table 2.5 provide a list of the average of ownership structure in Indonesian commercial banking that listed on the Indonesia Stock Exchange during period 2007 – 2014. The grand average of foreign ownership in Indonesian commercial banking companies is displayed by 30.4% with the highest average of foreign ownership is 93.9% hold by PT Bank International Indonesia Tbk. There are at least 14 of Indonesian commercial banking companies consider as the banks that are under-controlled of foreign ownership due to they tend to have the average of foreign ownership exceed the grand average of foreign ownership (i.e. 30.4%).

Table 2.5 : The Average of Indicators of Ownership Structure for each of Indonesian Commercial Banks during period study 2007-2014

No	BANK NAME	OWNERSHIP STRUCTURE				
		Domestic Own	Public Own	Foreign Own	Ultimate Own	Govern Own
1	Bank Rakyat Indonesia Agroniaga Tbk	100.0%	3.8%	0.0%	88.2%	40.6%
2	Bank ICB Bumiputera Tbk	36.1%	26.2%	63.9%	65.1%	0.0%
3	Bank Capital Indonesia Tbk	63.3%	31.8%	36.7%	54.3%	0.0%
4	Bank Ekonomi Raharja Tbk	15.2%	1.5%	84.8%	95.9%	0.0%
5	Bank Central Asia Tbk	50.3%	47.7%	49.7%	49.7%	0.0%
6	Bank Bukopin Tbk	100.0%	29.0%	0.0%	35.1%	15.1%
7	PT Bank Mestika Dharma Tbk.	100.0%	10.5%	0.0%	89.4%	0.0%
8	Bank Negara Indonesia Tbk	82.8%	33.9%	17.2%	66.1%	66.1%
9	Bank Nusantara Parahyangan Tbk	24.4%	11.2%	75.6%	61.3%	0.0%
10	Bank Rakyat Indonesia (Persero) Tbk	64.2%	43.2%	35.8%	56.8%	56.8%
11	Bank Tabungan Negara (Persero) Tbk	80.3%	32.0%	19.7%	66.6%	66.6%
12	Bank Mutiara Tbk	84.8%	6.9%	15.2%	91.3%	75.1%
13	Bank Danamon Indonesia Tbk	29.2%	29.1%	70.8%	67.6%	0.0%
14	Bank Pundi Indonesia Tbk	82.7%	11.3%	17.3%	61.1%	0.0%
15	Bank Pembangunan Daerah Jawa Barat dan Banten Tbk	87.7%	25.0%	12.3%	75.0%	75.0%
16	Bank Pembangunan Daerah Jawa Timur Tbk	60.2%	13.3%	6.5%	86.7%	86.7%
17	Bank QNB Kesawan Tbk	63.6%	25.9%	36.4%	65.3%	0.0%
18	PT Bank Maspion Indonesia Tbk.	100.0%	12.8%	0.0%	67.7%	0.0%

Table 2.5 The Average of Indicators of Ownership Structure for each of Indonesian Commercial Banks during period 2007 - 2014 (continue)

No	BANK NAME	OWNERSHIP STRUCTURE				
		Domestic Own	Public Own	Foreign Own	Ultimate Own	Govern Own
19	Bank Mandiri (Persero) Tbk	72.7%	36.5%	27.3%	63.5%	63.5%
20	Bank Bumi Arta Tbk	100.0%	9.1%	0.0%	45.5%	0.0%
21	Bank CIMB Niaga Tbk	8.1%	8.1%	91.9%	87.7%	0.0%
22	Bank Internasional Indonesia Tbk	6.1%	6.1%	93.9%	93.9%	0.0%
23	Bank Permata Tbk	55.5%	10.7%	44.5%	44.5%	0.2%
24	Bank Sinarmas Tbk	98.7%	35.9%	1.3%	59.3%	0.0%
25	Bank of India Indonesia Tbk	22.4%	5.3%	77.6%	76.4%	0.0%
26	Bank Tabungan Pensiunan Nasional Tbk	80.1%	33.4%	19.9%	57.4%	0.0%
27	Bank Victoria International Tbk	92.1%	34.0%	7.9%	37.0%	0.0%
28	Bank Artha Graha	82.1%	47.7%	17.9%	52.3%	0.0%
29	Bank Mayapada Internasional Tbk	40.2%	12.9%	59.8%	27.6%	0.0%
30	Bank Windu Kentjana International Tbk	100.0%	15.4%	0.0%	51.4%	0.0%
31	Bank Mega Tbk	100.0%	42.5%	0.0%	57.5%	0.0%
32	PT Bank Mitraniaga Tbk.	100.0%	9.9%	0.0%	72.1%	0.0%
33	Bank OCBC NISP Tbk	17.0%	16.5%	83.0%	79.6%	0.0%
34	PT Bank Nationalnobu Tbk.	90.1%	47.8%	9.9%	23.7%	0.0%
35	Bank Pan Indonesia Tbk	63.4%	17.9%	36.6%	45.5%	0.0%
36	Bank Himpunan Saudara 1906 Tbk	91.7%	33.1%	8.3%	64.3%	0.0%

Table 2.5: The Average of Indicators of Ownership Structure for each of Indonesian Commercial Banks during period 2007 - 2014 (continue)

No	BANK NAME	OWNERSHIP STRUCTURES (%)				
		Domestic Own	Public Own	Foreign Own	Ultimate Own	Govern Own
37	Bank Panin Syariah	75.3%	23.2%	24.7%	51.1%	0.0%
38	Bank Ina Indonesia	62.4%	38.4%	37.6%	20.0%	0.0%
39	Bank Dinar	100.0%	21.4%	0.0%	34.5%	0.0%
GRAND AVERAGE		68.8%	23.1%	30.4%	61.2%	14%

Notes : **Domestic Own** : percentage of share owned by domestic or local institutions and individual; **Public Own**: percentage of share owned by public; **Foreign Own** : percentage of share owned by foreigner institution and individual; **Ultimate Own**: percentage of share owned by ultimate shareholders (controlling shareholder) and **Govern Own**: percentage of share owned by government.

Moreover, the grand average of government or states ownership is 14% with PT Bank Pembangunan Daerah Jawa Timur Tbk as the highest of states ownership by 86.7% and PT Bank Tabungan Negara Tbk as the highest average of government ownership by 66.6%. There are eight of Indonesian commercial banks are under the control of government or states ownership, which they have an average of shareholders ownership hold by government or states above the grand average of government ownership (i.e. 14%). Additionally, the grand average of ultimate (block holder) institutional ownership is 61.2% with the PT Bank Internasional Indonesia Tbk as the highest average ultimate-controlling ownership by 93.9 per cent. All the Indonesian banking companies consider as the banks with ultimate (controlling) ownership.

2.3. Corporate Sustainability Concerns in the Indonesian Context

2.3.1. The Terminology of Corporate Sustainability

The concept of corporate sustainability has become a worldwide interesting topic in economic and society field since the Rio Declaration of the United Nations in 1992. However, corporate sustainability is still a controversial topic because there are many definitions that can mean differently for different people in many different ways among scholars (Aras and Crowther, 2008). There is no standard definition that emerges as companies' consensus. However, most of the definitions are stemmed from the term "*sustainable development*", which may close to be best defined by the World Commission on Environment and Development in Our Common Future from The Brundtland Report: "*development*

that meets the needs of the present without compromising the ability of future generations to meet their own needs"(WCED, 1987).

Hence, corporate sustainability can be seen as a transfer of the overall idea of sustainable development to business level. This view implies that corporate activities should not concentrate on short-term improvements of a single dimension, but should strive for middle to long-term balance between all three dimensions. Moreover, the term "sustainability" can also be referred to Triple Bottom Line (TBL) or Corporate Social Responsibility (CSR). Elkington (2006) defined TBL as companies', or other organisations' concept of creating value to maintain their long term success by emphasising on all three dimensions, such as in economic, social, and environmental dimensions with cooperation and partnerships among industry, governments, and non-governmental organisations. Meanwhile, Jamali and Mirshak (2007) described corporate social responsibility as how companies manage their business processes to produce an overall positive impact on the society by serving people, communities, and the environment in ways that go above and beyond what is legally and financially required from them. However, the World Business Council for Sustainable Development (WBCSD) defined corporate social responsibility as "the commitment of business to contribute to sustainable economic development, working with employees, their families and the local communities" (WBCSD, 2002).

In practice, the term "corporate sustainability" is commonly related to business entity dealing with corporate social responsibility issue in which it

operates by addressing the sensitivity and the awareness of economic, environmental and social issues to provide benefits for societies and communities (Jackson and Parsa, 2009). Moreover, it should not only concentrate on temporary improvements in one dimension, but should also attempt to balance all three dimensions for middle to long-term improvements purposes. Hence, this study uses the terms corporate sustainability and corporate social responsibility synonymously as two sides of a coin, which refers to a wide range of business processes that voluntarily deal with triple bottom line performance (i.e. profit, people, and planet) in order to remain fundamentally sustainable in long-term value creation according voluntarily company activities, that demonstrate the involvement of social and environmental concerns in business operations and in interactions with stakeholders (Van Marrewijk and Werre, 2003).

2.3.2. Overview of Corporate Sustainability Concern in Indonesian Commercial Banking

In Indonesian context, for many decades, the term "corporate sustainability" through corporate social responsibility initiatives has not been an important issue for banking companies or other industries. However, it could noticed that corporate social responsibility movement was initiated after the economic crisis in 1997 through the establishment of the Indonesia Business Links (IBL) in 1999. IBL aims to contribute to the creation of sound and ethical business practices and to support corporate social responsibility practices in the operations of Indonesian companies through seminars, discussions, conferences

and research. The financial crisis forced the Indonesian government as well as corporations to implement good corporate governance.

Recently, there are two government laws that regulate corporate social responsibility and environmental activities, namely:

1. Investment Law number 25/2007 article 15.b that states obliges every investors to implement corporate social responsibility. This law defines corporate social responsibility as the responsibility attached to every investment company to keep fostering relationship harmonious, balanced and fit relationship with for the local community's neighborhood, values, norms, and culture.
2. Company Law number 40/2007 article 66.c and article 74 point 1 and 3 that defines corporate social and environment responsibility as the company's commitment to participate in sustainable economic development to improve the quality of life and environment that benefits the company itself, the local community, and the society in general (article 1 point 3). Article 66 states that company's annual report of the company should contain corporate social responsibility and environment initiatives. Meanwhile, article 74 point 1 and 3 states that the obligation to implement corporate social responsibility is only for companies that are environmentally sensitive and conduct business operations related to natural resource usage; and those who do not implement it would receive sanctions in accordance with the provisions of the laws and regulations.

Both laws show that the Indonesian government tries to regulate the obligations corporate social responsibility activities for companies or investors that would have positive impact on the societies and the communities as well as on the company. However, the positive impact will depend on the motivation and the capacity of institutions or organisations in conducting corporate social responsibility activities. The implementation and reporting of corporate social responsibility activities are mostly driven by company's internal forces and corporate values and belief that it should be a part of the environment and the community (Sammur and De Marco, 2013). Furthermore, they stated that the companies' believe that their activities will have impact on corporate behaviour, image, brand reputation, retaining stakeholders' good impression and employee interest, and will reduce uncertainty or skepticism. The statement is supported by argument in several previous studies that companies could create competitive advantages, brand and reputation through the communication of voluntary social and environmental disclosures with certain ethic elements (O'Dwyer, 2002; Erlandsson and Tillman, 2009; PriceWaterhouseCooper, 2010)

Moreover, in practice, the need to disclose corporate social responsibility activities in the annual report of Indonesian companies is based on the Statement of Financial Accounting Standards (SFAS) number 1/2009 (revised) amended 2013 (revised) paragraph 12. It states that "Company may also present additional statements such as statements regarding the environment and value added statement, especially for industries that consider the environmental and the employee's factors as a factor or a group of users report plays an important role".

Hence, corporate social responsibility reporting, or sustainability reporting has been broadly extended the traditional model of financial reporting that emphasises company's economic prosperity, to incorporate social and environmental dimensions (Elkington, 1999).

Despite many efforts to introduce and to implement corporate sustainability initiatives through corporate social responsibility activities in Indonesia, lack of understanding of the benefits and limited quantity and quality of corporate social responsibility activities due to cost avoidance behaviour are still found among Indonesian companies (Djajadikerta and Trireksani, 2012; Gunawan et al., 2009). Furthermore, recent studies showed that there is a weak positive impact of corporate social responsibility on both profitability and firm value among the listed Indonesian companies (Nina Karina et al., 2013; Oeyono et al., 2011), on determinant factors of corporate social responsibility disclosure (Gunawan, 2013), on stakeholders' influence and corporate social disclosure motives (Gunawan, 2015), and on corporate social performance (Fauzi et al., 2007). However, a study on the effect and other factors affecting in corporate sustainability concern through the implementation of corporate social responsibility in Indonesian commercial banking context is practically non-existent.

This chapter provides the firm's level of development and implementation on corporate sustainability concerns through corporate social responsibility disclosure among publicly listed Indonesian commercial banking.

Table 2.6 shows the list of the average level of every Indonesian commercial bank's corporate sustainability concerns during the period of study 2007-2014 through corporate sustainability performance disclosure, such as economic (EC), environmental (EN), and social (SOC), which consists of society (SO), product responsibility (PR), labour (LA) and human rights (HR) performance indicators. In general, the average level of corporate sustainability disclosure in Indonesian commercial banks in 2007-2014 was 19.54 per cent, with 50.35 per cent as the highest and 7.52 per cent as lowest held by PT Bank Negara Indonesia Tbk and PT Bank of India Tbk, respectively. There are only 13 from 39 (a third) listed Indonesian commercial banks, that score above the grand average level of corporate sustainability disclosure (i.e.19.54 per cent).

Table 2.6 : The Average Corporate Sustainability Concerns Indicators of Indonesian Commercial Banks for period 2007 - 2014

No	BANK NAME	CORPORATE SUSTAINABILITY CONCERNS							
		CSD	SOC	SO	PR	LA	HR	EN	EC
1	Bank Rakyat Indonesia Agroniaga Tbk	12.50%	14.87%	23.22%	27.50%	11.93%	0.00%	5.47%	17.36%
2	Bank ICB Bumiputera Tbk	16.09%	22.84%	39.29%	33.75%	17.05%	5.21%	4.30%	15.28%
3	Bank Capital Indonesia Tbk	11.81%	27.37%	26.79%	30.00%	18.18%	0.00%	0.00%	11.11%
4	Bank Ekonomi Raharja Tbk	11.64%	16.01%	21.43%	28.57%	15.58%	0.00%	4.02%	11.11%
5	Bank Central Asia Tbk	28.36%	32.33%	53.57%	40.00%	27.84%	9.37%	10.94%	33.33%
6	Bank Bukopin Tbk	17.37%	23.92%	35.71%	26.25%	25.57%	5.21%	5.47%	17.36%
7	PT Bank Mestika Dharma Tbk.	20.83%	29.31%	42.86%	10.00%	31.82%	25.00%	7.81%	16.67%
8	Bank Negara Indonesia Tbk	50.35%	50.00%	54.47%	58.75%	57.95%	21.87%	43.36%	63.89%
9	Bank Nusantara Parahyangan Tbk	11.00%	14.65%	43.75%	0.00%	9.09%	1.04%	1.17%	16.67%
10	Bank Rakyat Indonesia (Persero) Tbk	42.83%	48.71%	57.14%	56.25%	52.84%	27.08%	29.25%	47.92%
11	Bank Tabungan Negara (Persero) Tbk	28.68%	33.62%	34.53%	45.00%	41.67%	8.34%	8.85%	46.29%
12	Bank Mutiara Tbk	14.47%	18.97%	35.72%	32.50%	9.66%	5.21%	3.13%	20.14%
13	Bank Danamon Indonesia Tbk	42.13%	46.77%	57.14%	62.50%	44.89%	25.00%	31.64%	45.83%
14	Bank Pundi Indonesia Tbk	11.58%	17.69%	28.57%	30.00%	14.20%	1.04%	0.39%	11.81%
15	Bank Pembangunan Daerah Jawa Barat dan Banten Tbk	41.85%	47.86%	44.29%	44.00%	55.45%	30.00%	28.75%	52.22%
16	Bank Pembangunan Daerah Jawa Timur Tbk	10.49%	16.09%	30.95%	16.67%	15.15%	0.00%	0.00%	11.11%
17	Bank QNB Kesawan Tbk	12.38%	17.89%	34.82%	11.25%	18.75%	2.08%	3.13%	11.11%

Table 2.6: The Average Corporate Sustainability Concerns Indicators of Indonesian Commercial Banks for period 2007 - 2014 (continue)

No	BANK NAME	CORPORATE SUSTAINABILITY CONCERNS							
		CSD	SOC	SO	PR	LA	HR	EN	EC
18	PT Bank Maspion Indonesia Tbk.	14.82%	22.41%	35.71%	30.00%	18.18%	8.33%	0.00%	16.67%
19	Bank Mandiri (Persero) Tbk	25.23%	25.43%	38.39%	37.50%	22.16%	6.25%	16.02%	40.97%
20	Bank Bumi Arta Tbk	8.22%	11.85%	24.11%	11.25%	10.23%	1.04%	0.00%	11.11%
21	Bank CIMB Niaga Tbk	27.66%	36.21%	52.68%	35.00%	53.98%	6.25%	13.28%	25.69%
22	Bank Internasional Indonesia Tbk	26.27%	30.17%	48.22%	32.50%	28.41%	10.41%	14.84%	34.03%
23	Bank Permata Tbk	29.98%	37.72%	64.29%	57.50%	25.57%	11.46%	20.59%	20.14%
24	Bank Sinarmas Tbk	15.37%	19.31%	45.71%	14.00%	10.00%	8.33%	6.25%	18.89%
25	Bank of India Indonesia Tbk	7.52%	10.56%	22.32%	13.75%	7.39%	0.00%	0.00%	11.11%
26	Bank Tabungan Pensiunan Nasional Tbk	18.65%	27.09%	50.00%	10.00%	30.61%	8.33%	1.34%	22.22%
27	Bank Victoria International Tbk	13.75%	20.48%	39.29%	23.75%	14.77%	6.25%	1.95%	13.19%
28	Bank Artha Graha, Tbk	18.06%	21.82%	42.86%	6.25%	28.41%	0.00%	9.38%	20.13%
29	Bank Mayapada Internasional Tbk	9.60%	14.37%	33.03%	13.75%	9.09%	3.12%	0.00%	11.11%
30	Bank Windu Kentjana International Tbk	11.59%	17.46%	42.86%	10.00%	13.07%	2.08%	0.78%	11.81%
31	Bank Mega Tbk	14.13%	22.85%	53.03%	27.50%	15.34%	0.00%	0.00%	11.11%
32	PT Bank Mitraniaga Tbk.	9.24%	13.80%	39.29%	0.00%	11.36%	0.00%	0.00%	11.11%
33	Bank OCBC NISP Tbk	43.75%	49.35%	62.50%	50.00%	46.59%	38.54%	32.42%	45.83%
34	PT Bank National Nobu Tbk.	9.74%	14.66%	39.29%	10.00%	9.09%	0.00%	0.00%	11.11%

Table 2.6 : The Average Corporate Sustainability Concerns Indicators of Indonesian Commercial Banks for period 2007 - 2014 (continue)

No	BANK NAME	CORPORATE SUSTAINABILITY CONCERNS							
		CSD	SOC	SO	PR	LA	HR	EN	EC
35	Bank Pan Indonesia Tbk	19.71%	21.25%	33.93%	33.75%	14.20%	11.46%	12.89%	24.31%
36	Bank Himpunan Saudara 1906 Tbk	12.50%	18.75%	40.18%	23.75%	13.07%	0.00%	1.95%	11.11%
37	Bank Panin Syariah, Tbk	13.39%	21.67%	42.86%	20.00%	22.73%	0.00%	0.00%	11.10%
38	Bank Ina Indonesia, Tbk	13.89%	18.97%	42.86%	20.00%	13.64%	0.00%	3.13%	16.67%
39	Bank Dinar, Tbk	14.82%	20.69%	50.00%	10.00%	13.64%	8.33%	3.13%	16.67%
GRAND AVERAGE		19.54%	25.02%	41.22%	26.75%	23.05%	7.61%	8.35%	22.19%

Notes: **CSD** : total corporate sustainability concerns; **SOC**: disclosure of corporate social activities concern; **SO**: disclosure of corporate society activities concern; **PR**: disclosure of corporate product responsibility activities concern; **LA** : disclosure of corporate labour practices concern; **HR**: disclosure of corporate human right activities concern; **EN**: disclosure of corporate environmental activities concern; and **EC**: disclosure of corporate economic activities concern.

Furthermore, among six corporate sustainability performance disclosures, the listed Indonesia commercial banks are more concern on disclosing social performance (SOC), especially society performance (SO) with the average levels of disclosure of 25.02 per cent and 41.22 per cent, respectively. PT Bank Negara Indonesia Tbk indicated the highest average level of social performance (SOC) disclosure (50 per cent), whereas PT Bank OCBC NISP Tbk showed the highest average level of society performance (SO) disclosure (62.5 per cent). Moreover, at the firm's level, the highest average level of economic performance (EC) and environmental (EN) disclosures was held by PT Bank Negara Indonesia Tbk with 63.89 per cent and 43.36 per cent, respectively.

Generally, Indonesian commercial banks shown in low attention and seemed to neglect both human rights (HR) and environmental (EN) performance as their average disclosure levels are only 7.61 per cent and 8.35 per cent, respectively. It was noticed that there are six publicly listed Indonesian banks that shows the lowest concern on human rights (HR) and environmental (EN) performance with 0 per cent disclosure level, namely: PT Bank Capital Indonesia Tbk, PT Bank Pembangunan Daerah Jawa Timur Tbk, PT Bank of India Indonesia Tbk, PT Bank Mega Tbk, PT Bank Mitraniaga Tbk and PT Bank Panin Syariah, Tbk.

In terms of product responsibility (PR) and labour (LA) performance disclosures, the grand average levels are 26.75% and 23.05%, respectively. PT Bank Danamon Indonesia, Tbk and PT Bank Negara Indonesia, Tbk was

indicated to have the highest average of product responsibility (PR) and labour (LA) performance disclosures by 62.5 per cent and 57.95 per cent, respectively. Moreover, two listed Indonesian commercial banks have been noticed to never disclose information related to product responsibility (PR) performance, namely: PT Bank Nusantara Parahyangan, Tbk and PT Bank Mitraniaga, Tbk. Additionally, PT Bank of India, Tbk was indicated to have the lowest average of labour (LA) performance disclosure with 7.39 per cent.

Based on those results, it can be considered that most of the public listed Indonesian commercial banks are not really concerned and aware on sustainability practices through corporate responsibility activities implementation. This is represented by two-thirds of public listed Indonesian commercial banking that have a very low grand average value of corporate sustainability concerns (i.e. less than 19.54 per cent). Additionally, there are five out of eight Indonesia commercial banks that are owned by the government or the states among the thirteen listed Indonesia commercial banks that score above the grand average value of corporate sustainability concerns. It can be concluded that generally, Indonesian commercial banks owned by the government or states are relatively more concerned on and aware of corporate sustainability practices implementation. Meanwhile, only one of the public listed Indonesia commercial banks scores above 50 per cent on the grand average of corporate sustainability concerns (i.e. PT Bank Negara Indonesia, Tbk with 50.35 per cent). This finding supports the previous finding in the same context by Gunawan (2007), (2015) and

Gunawan et al. (2009) who stated that Indonesian companies tend to have limited and low level of corporate social responsibility disclosure and to pay attention to community or society initiatives, while the companies owned by the government are more aware about corporate social responsibility issues. This indicates that corporate social responsibility practise in Indonesian companies is essentially targeted to protect business operations by evading any prosecution and law or regulation sanction in their relationships with the government and the society.

Furthermore, Table 2.7 presents the trend of corporate sustainability concerns indicators in Indonesian commercial banks from 2007 to 2014. The trend shows a steady increase, ranging from 11.3 per cent to 28.7 per cent. PT Bank Negara Indonesia Tbk was found to be consistent to have the highest average value of corporate sustainability disclosure in 2009 - 2014 (six years) with the range of 36.1 per cent to 78.7 per cent. Previously, from 2007 to 2009, PT Bank OCBC NISP Tbk had the highest average value of corporate sustainability disclosure with 23.15 per cent. In contrast, PT Bank of India Indonesia, Tbk had the lowest average value of corporate sustainability disclosure in 2007 to 2014 with the range of 5.6 per cent to 9.3 per cent (for eight years). This proves that Indonesian commercial banking industry is still not aware and not concerned on corporate social responsibility activities as there has been only low average level of corporate social responsibility sustainability disclosure.

Table 2.7 : The Trend of Corporate Sustainability Concerns Indicators in Indonesia Commercial Banks for each year of period study 2007 - 2014

Indicators		2007	2008	2009	2010	2011	2012	2013	2014
Corporate Sustainability Concerns									
CSD	Max / Bank	0.2315 NISP	0.2315 NISP	0.361 BBNI	0.463 BBNI	0.574 BBNI	0.713 BBNI	0.769 BBNI	0.787 BBNI
	Min / Bank	0.056 BSWD	0.056 BSWD	0.065 BSWD	0.083 BSWD	0.083 BSWD	0.083 BSWD	0.083 BSWD	0.093 BSWD
	Mean	0.113	0.124	0.144	0.170	0.193	0.257	0.288	0.287
	SD	0.049	0.049	0.068	0.084	0.107	0.184	0.218	0.206
SOC	Max / Bank	0.328 NISP	0.328 NISP	0.328 NISP	0.414 BBRI	0.552 BBNI	0.776 BDMN	0.793 BDMN	0.81 NISP
	Min / Bank	0.069 BSWD	0.069 BSWD	0.086 BSWD	0.121 BSWD	0.121 BSWD	0.121 BSWD	0.121 BSWD	0.138 BSWD
	Mean	0.150	0.169	0.188	0.217	0.244	0.312	0.344	0.349
	SD	0.064	0.064	0.071	0.082	0.107	0.180	0.206	0.196
SO	Max / Bank	0.571 BNLI	0.571 BNLI	0.643 BNLI	0.643 BNLI	0.643 BBNI	0.929 BDMN	0.929 BDMN	0.929 BDMN
	Min / Bank	0.143 BACA	0.143 BEKS	0.143 BEKS	0.214 BEKS	0.214 BEKS	0.214 BEKS,	0.214 BEKS	0.214 BEKS
	Mean	0.328	0.342	0.357	0.387	0.412	0.453	0.478	0.489
	SD	0.124	0.117	0.125	0.122	0.127	0.152	0.159	0.152

Notes: **CSD** : total corporate sustainability concerns; **SOC** : disclosure of corporate social activities concern; **SO** : disclosure of corporate society activities concern;

Table 2.7 : The Trend of Corporate Sustainability Concerns Indicators in Indonesia Commercial Banks for each year of period study 2007 - 2014 (continue)

Indicators		2007	2008	2009	2010	2011	2012	2013	2014
Corporate Sustainability Concerns									
PR	Max	0.4 NISP	0.6 BBNI	0.6 BBNI/ BNLI	0.6 BBNI, BDMN, BNLI	0.7 BDMN, BNLI	0.8 BBRI	0.8 BBRI BDMN BJBR	0.8 BBRI BJBR NISP
	Min	0	0 MCOR BSWD INPC	0 MCOR BBNP INPC	0 BBNP, INPC MCOR	0 BBNP INPC	0 BBNP	0 BBNP	0 NAGA BBNP
	Mean	0.158	0.207	0.238	0.277	0.294	0.334	0.372	0.379
	SD	0.124	0.151	0.163	0.165	0.181	0.204	0.231	0.252
LA	Max / Bank	0.273 BBNI/BB RI	0.273 BBNI/ BBRI	0.318 BTPN	0.727 CIMB	0.727 CIMB	0.901 BBRI	0.901 BBRI	0.955 BBNI
	Min / Bank	0 BSWD	0.045 BSWD	0.045 BSWD	0.045 BVIC, BSIM	0.045 BSIM	0.091 BBNP,B SWD,BJTM MAYA	0.091 BBNP	0.091 MAYA
	Mean	0.114	0.128	0.150	0.195	0.233	0.310	0.345	0.351
	SD	0.075	0.067	0.080	0.142	0.167	0.243	0.270	0.257

Notes: PR : disclosure of corporate product responsibility activities concern; LA : disclosure of corporate labour practices concern

Table 2.7: The Trend of Corporate Sustainability Concerns Indicators in Indonesia Commercial Banks for each year of period study 2007 - 2014 (continue)

Indicators		2007	2008	2009	2010	2011	2012	2013	2014
Corporate Sustainability Concerns									
HR	Max / Bank	0.167 NISP	0.167 NISP	0.167 NISP	0.25 BBRI	0.25 BBRI	0.583 BDMN, NISP	0.917 BJBR	0.917 NISP
	Min / Bank	0	0	0	0	0	0	0	0
	Mean	0.013	0.015	0.020	0.040	0.054	0.115	0.162	0.154
	SD	0.039	0.040	0.048	0.060	0.076	0.159	0.223	0.196
EN	Max / Bank	0.273 BBNI/ BBRI	0.273 BBNI/ BBRI	0.375 BBNI	0.5 BBNI	0.531 BBNI	0.688 NISP	0.719 BBNI	0.75 BBNI
	Min / Bank	0	0	0	0	0	0	0	0
	Mean	0.026	0.027	0.047	0.066	0.080	0.134	0.164	0.162
	SD	0.039	0.039	0.079	0.100	0.109	0.194	0.224	0.218
EC	Max / Bank	0.333 BMRI	0.333 BMRI	0.444 BBNI	0.555 BBNI	0.722 BBNI	0.944 BBNI	0.944 BBNI	0.944 BBNI
	Min / Bank	0.0056 BEKS	0.0056 BEKS	0.111	0.111	0.111	0.111	0.111	0.111
	Mean	0.145	0.153	0.174	0.201	0.222	0.288	0.316	0.308
	SD	0.063	0.065	0.090	0.110	0.146	0.228	0.273	0.247

Notes: **HR** : disclosure of corporate human right activities concern; **EN** : disclosure of corporate environmental activities concern; and **EC** : disclosure of corporate economic activities concern.

Furthermore, among three corporate sustainability concerns indicators (i.e., economic, environmental and social), the economic performance indicator was found to have the highest value, with 94.4 per cent held by PT Bank Negara Indonesia Tbk in 2014, followed by social indicator held by PT Bank NISP Tbk with 81 per cent, and economic performance indicator held by PT Bank Negara Indonesia Tbk with 75 per cent.

However, the average value of corporate sustainability concerns indicators was different each year of study, I noticed that social performance has the highest average value of corporate sustainability concerns indicators, ranging from 15 per cent to 34.9 per cent. Meanwhile, environmental concern has the lowest average value of corporate sustainability concerns indicators for every year, with the range of 2.6 per cent to 16.2 per cent. It can be concluded that most of the Indonesian commercial banking companies are more aware of social activities rather than environmental for their corporate sustainability concerns.

Chapter 3. Research Design and Methodology

3.1. Introduction

This chapter describes the research design and methodology that has been used in this study to examine the relationship among the constructs of corporate governance mechanisms, corporate sustainability concerns and company financial performance in public listed Indonesian commercial banking companies. In sections 2 and 3, it explains how data were collected and analysed.

3.2. Data Collection and Sampling

This study used a data sample from 39 commercial banking companies publicly listed on the Indonesia Stock Exchange from the period 2007 to 2014 (see Table 3.1 and Table 3.2). All the data regarding governance mechanisms, corporate sustainability concerns through company disclosure, bank's financial ratios (capital, assets, management, earning and liquidity, or CAMEL) and company financial performance (i.e. company financial health and market value performance) were hand-extracted from secondary data.

The secondary data were primarily the mandatory and voluntary reports for the Indonesian Securities Commission and the Bank Indonesia (BI), such as the banks' annual reports, the banks' financial statement, the banks' corporate responsibility report or corporate sustainability report and the bank's corporate governance report. The secondary data were collected from the 39 banks'

websites, website of the Indonesia Stock Exchange (IDX) (www.idx.co.id), website of the Bank Indonesia (www.bi.go.id), and Datastream.

The rationale for choosing 2007 as the beginning of the study period is that it was the first year of Indonesian banking CG reform after the implementation of the mandatory Bank Indonesia (BI) regulation number 8/4/PBI/2006 with amended number 8/14/PBI/2006 for daily operational banking. The year 2014 was chosen as the end of the study period as it was the latest financial year for which all companies published annual reports, which were available at the time when data collection started.

Table 3.1 : Number Population and Sample of Indonesian Commercial Banks that Listed on Indonesia Stock Exchange during the period of study 2007-2014

Year	Population	Samples (Observations)	Sample (%)
2007	26	26	100
2008	28	28	100
2009	29	29	100
2010	31	31	100
2011	31	31	100
2012	32	32	100
2013	36	36	100
2014	40	39	97.5
Grand Total		252	99.7

Table 3.1 provides a list of the sample of 39 Indonesian commercial bank companies that were publicly listed on Indonesian Stock Exchange for the period 2007-2014. I found the population of Indonesian commercial banks consists of 40

banks. The number of Indonesian commercial banks listed on the market before 2007 was 26 and another 13 banking companies were listed on IDX after 2007, and were included as samples for the next seven in consecutive years until 2014. One commercial bank (i.e. PT Bank Agris, Tbk) was excluded from the sample because much data was missing or unavailable to the public. Hence, the final data set was an unbalanced data panel, a combination of time series and cross-sectional data, with a total of 252 firm-year observations from 39 Indonesian commercial banking companies, instead of 312 firm-years of observation (details of the bank names and the number of firm- year observations are provided in Table 3.2).

Table 3.2 displays a list of the Indonesia commercial banks' names, the bank's code, the date of their first sale of common stock to the public or Initial Public Offering (IPO) in the Indonesia Stock Exchange and the number of years of observation. There are 26 banking companies listed on the market, which have a full eight years of observations, and 13 banks listed after 2007, that including two banks have with seven and five years of observation, one bank has six and three years of observation, four banks with two years of observation and three banks with only one year of observation.

3.3. Data Analysis

This study analyses the relationships between the constructs using three different research frameworks and provides the results in three empirical chapters (see chapters 4, 5, and 6).

Table 3.2 : The Indonesian Commercial Bank Names, the Bank Codes, the Initial Public Offering (IPO) and the Year of Observation during the period of study 2007-2014

NO	CODE	BANK NAME	AVERAGE OF TOTAL ASSETS (in IDR million)	YEARS
1	PNBN	Bank Pan Indonesia Tbk	109,252,449	8
2	BNII	Bank BII Maybank Tbk (previously Bank Internasional Indonesia Tbk)	88,283,985	8
3	BNGA	Bank CIMB Niaga Tbk (previously Bank Niaga Tbk)	150,252,317	8
4	BDMN	Bank Danamon Indonesia Tbk	135,930,043	8
5	BNLI	Bank Permata Tbk (previously Bank Bali)	100,897,949	8
6	INPC	Bank Artha Graha International Tbk (previously Bank Interpacific Tbk)	17,626,204	8
7	NISP	Bank OCBC NISP Tbk (previously Bank NISP Tbk)	61,254,114	8
8	BBNI	Bank Negara Indonesia Tbk	287,093,796	8
9	BCIC	Bank Mutiara Tbk (previously bank Century Tbk)	12,871,002	8
10	MAYA	Bank Mayapada Internasional Tbk	14,753,338	8
11	BVIC	Bank Victoria International Tbk	11,394,114	8
12	BNBA	Bank Bumi Arta Tbk	3,088,540	8
13	MEGA	Bank Mega Tbk	52,855,946	8
14	BBCA	Bank Central Asia Tbk	363,480,210	8
15	BBNP	Bank Nusantara Parahyangan Tbk	6,360,542	8
16	BEKS	Bank Pundi Indonesia Tbk (previously Bank Eksekutif International Tbk)	4,694,029	8
17	BSWD	Bank of India Indonesia Tbk (previously Bank Swadesi Tbk)	2,382,126	8
18	BABP	Bank MNC International Tbk (previously Bank ICB Bumiputera Tbk)	7,577,680	8
19	BKSW	Bank QNB Kesawan Tbk (previously Bank Kesawan Tbk)	6,176,204	8
20	BMRI	Bank Mandiri (Persero) Tbk	537,195,659	8
21	AGRO	Bank Rakyat Indonesia Agroniaga Tbk (previously Bank Agroniaga Tbk)	3,827,193	8
22	BBRI	Bank Rakyat Indonesia (Persero) Tbk	449,560,160	8
23	BBKP	Bank Bukopin Tbk	51,440,393	8

Table 3.2: The Indonesian Commercial Bank Names, the Bank Codes, the Initial Public Offering (IPO) and the Year of Observation during the period of study 2007-2014 (continue)

NO	CODE	BANK NAME	AVERAGE OF TOTAL ASSETS (in IDR million)	YEARS
24	SDRA	Bank Woori Saudara Indonesia 1906 Tbk (previously Bank Himpunan Saudara 1906 Tbk)	5,807,543	8
25	MCOR	Bank Windu Kentjana International Tbk (previously Bank Multicor International Tbk)	5,236,351	8
26	BACA	Bank Capital Indonesia Tbk	4,689,746	8
27	BAEK	Bank Ekonomi Rakyat Tbk	23,120,769	7
28	BTPN	Bank Tabungan Pensiunan Nasional Tbk	41,436,651	7
29	BBTN	Bank Tabungan Negara (Persero) Tbk	85,650,345	6
30	BJBR	Bank Pembangunan Daerah Jawa Barat dan Banten Tbk	49,647,315	5
31	BSIM	Bank Sinarmas Tbk (previously Bank Shinta Indonesia)	12,664,852	5
32	BJTM	Bank Pembangunan Daerah Jawa Timur Tbk	24,305,669	3
33	NOBU	PT Bank National Nobu Tbk (previously Bank Alfindo Sejahtera)	1,449,767	2
34	BBMD	PT Bank Mestika Dharma Tbk.	6,439,507	2
35	NAGA	PT Bank Mitraniaga Tbk.	820,477	2
36	BMAS	PT Bank Maspion Indonesia Tbk.	2,965,895	2
37	PNBS	PT Bank Panin Syariah Tbk (previously Bank Harfa)	2,035,264	1
38	BINA	Bank Ina Perdana	1,951,587	1
39	DNAR	Bank Dinar Indonesia	1,641,451	1

Source: Indonesia Stock Exchange Various Indonesia Stock Exchange Annual Reports

Each empirical chapter describes a different research framework, latent variables or constructs (i.e., variables that are not directly measured) and types of indicator measurement, such as formative and reflective indicators (these will be explained in the methodology section in this chapter).

The data characteristics of the study, which contains a latent variable with formative measures, the relatively small size of the sample (i.e., 252 firm-year observations) and apparently non-normal distribution (see Table 3.3 for Skewness and Kurtosis values) led to the use of a PLS-SEM approach. Table 3.3 shows the range skewness values of all indicators are from -1.82 to 12.86, while, the range of kurtosis values is from -1.19 to 188.26. The data distribution is considered to be skewed when the value is greater than +1 or lower than -1 and the distribution to be too peaked when the value reached more than +1 or too flat when the value less than -1.

This study uses the structural equation modelling (SEM) technique in particular partial least square-structural equation modelling (PLS-SEM) to examine the complex or multiple relationships among latent variables or constructs of the bank's governance mechanisms, sustainability concerns, financial ratios information and company financial performance (i.e., financial health and firm value). This study investigates four different research models for each research framework, in order to gather new and complete empirical knowledge concerning the relationship between the constructs of the bank's governance mechanisms, sustainability concerns, financial ratios information and company financial performance. These research models consist of a simultaneous and separate current period analysis, a year time-lagged analysis, a moderation effect analysis and a reverse (changing) direction of research framework analysis.

Table 3.3 : The Statistic Descriptive

Indicators	Minimum	Maximum	Mean	Std. Deviation	Skewness		Kurtosis	
					Statistic	Std. Error	Statistic	Std. Error
PICOB	0.25	1.00	0.58	0.12	1.25	0.15	3.55	0.31
ExcBoCSIZE	0.67	4.00	1.65	0.62	0.43	0.15	-0.43	0.31
BOCOWN	0.00	0.72	.058	0.15	2.89	0.15	7.04	0.31
REMBOD	324	81967	10870.75	13666.56	2.38	0.15	6.79	0.31
BOCMEET	0.75	16.00	3.74	3.58	1.69	0.15	1.85	0.31
JointMeet	1.00	53.00	9.19	6.46	2.86	0.15	13.70	0.31
FOROWN	0.00	0.99	0.35	0.34	0.50	0.15	-1.19	0.31
ULTOWN	0.20	1.00	0.62	0.20	0.18	0.15	-0.44	0.31
GOVOWN	0.00	1.00	0.14	0.29	1.75	0.15	1.47	0.31
PUBOWN	0.00	0.86	0.23	0.16	0.39	0.15	-0.46	0.31
REMBOD	867	254915	37682.45	46845.24	2.06	0.15	4.54	0.31
AVEREMBOD	289	25492	4497.48	4474.76	1.78	0.15	3.63	0.31
MVBODOWN	0.00	517755	30192.58	79356.70	3.54	0.15	13.68	0.31
CAR	-2.38	9.94	1.15	0.98	3.85	0.15	28.42	0.31
NPL	0.00	0.18	0.01	0.02	4.12	0.15	23.71	0.31
NOP	-0.02	1.32	.032	0.09	12.86	0.15	188.26	0.31
NIM	0.00	0.17	0.06	0.02	1.28	0.15	3.13	0.31
LDR	0.09	1.13	0.78	0.15	-0.839	0.15	1.24	0.31
ZSCORE	-2.91	3.45	1.15	0.69	-1.82	0.15	9.92	0.31
TOBINS	0.87	1.61	1.09	0.13	1.40	0.15	1.94	0.31
Valid N (listwise) 252								

Notes: **PICOB** : proportion of independent commissioners on the board; **ExcBoC Size** : percentage of excess minimum number of board of commissioners (at least three persons); **BoCOwn** : percentage of board of commissioners Shareholders ownership; **Rem BoC** : total board of commissioners cash compensation in a year (in million Indonesian Rupiahs); **BoC Meet** : percentage of excess of minimum meeting in a year (four times a year); **Joint Meet** : Number of joint meeting between board of commissioners and board of directors in a years; **PubOwn**: percentage of share owned by public; **ForOwn** : percentage of share owned by foreigner institution and individual; **UltOwn**: percentage of share owned by ultimate shareholders (controlling shareholder) and **GovOwn**: percentage of share owned by government. **REM BoD** : Total Board of directors cash compensation in a year; **AveREMBOD** : Average of board of director compensation per person in a year; **MV BoDOWN** : market value Board of Directors shareholders ownership; **CAR** : Capital Adequacy Ratio; **NPL**: Non-Performing Loan; **NOP** : Net Open Position; **NIM** : Net Interest Margin; **LDR** : Loan to Debt Ratio; **Z Score**: Revision Altman's Z score for financial health mesrument and **TOBINS**: Tobin's Q for firm market value performance.

A time-lagged analysis will mitigate potential simultaneity issues and allow the effect of any time changes in corporate governance mechanisms (i.e. the board of commissioners' role, executive compensation and ownership structure) and bank financial ratio to show up in corporate sustainability concerns and both measures of corporate financial performance. Moreover, this can provide strong evidence to support the hypothesis that the prior period's corporate governance mechanisms can affect management decisions in improving current corporate sustainability concerns and both measures of corporate financial performance.

3.4. Measurement of Constructs and Indicators

Definitions of the constructs and indicators in this study are provided in systematic arrangement below.

3.4.1. The Role of the Board of Commissioners

The construct of the board of commissioners' role is measured as a formative construct by referring to the mandatory board of commissioners' requirements according to the BI regulation number 8/4/PBI/2006, amended by number 8/14/PBI/2006. This construct consists of six indicators, which are defined in systematic arrangement below:

1. the proportion of independent commissioners on the board (PICOB) is the ratio of the number of independent commissioners to the total number of the board of commissioners (Jensen, 1993; Zajac and Westphal, 1994; Core et al., 1999; Ayadi and Boujèlbène, 2013; Conyon and He,

2011; Htay et al., 2013; OECD, 2004; Jizi et al., 2013; Janggu et al., 2014),

2. the size of the board of commissioners (BoCSize) is the ratio of the total members of the board of commissioners over the minimum number of members of the board of commissioners (i.e. at least three persons) (Dalton et al., 1999; Ayadi and Boujèlbène, 2013; Htay et al., 2013; Core et al., 1999; Jensen, 1993)
3. the number of board of commissioners meetings per year (BoCMeet) is the ratio of number of board of commissioners meetings over the minimum meetings per year (i.e. at least four times per year) (Ayadi and Boujèlbène, 2013; Andres and Vallelado, 2008)
4. board of commissioners ownership (BoCOWN) is the ratio of outstanding common stocks held by the board of commissioners (Janggu et al., 2014; Core et al., 1999; Zou et al., 2015; Brick et al., 2006; Htay et al., 2013)
5. the number of board of commissioners joint meetings with managers/executives in a year (JointMeet) is the number of joint meetings between the board of commissioners with the board of directors per year; and
6. total board of commissioners compensation per year (RemBoC) is the board of commissioners' cash compensation, measured by aggregate total cash of salary, bonus and other benefits received by the board of commissioners per year.

3.4.2. Corporate Sustainability Concerns

To the best of my knowledge, there are no universally accepted sustainability standards, or methodologies for measuring, assessing and/or monitoring a company's progress towards sustainability. Various methods can be identified to measure corporate sustainability, such as following standards/codes benchmarking, third parties' awards, external assurance, indices and other non-quantifiable criteria. This study measures corporate sustainability concerns through the company's disclosure of responsibility activities by following Standard Disclosure of Global Reporting Initiative (GRI) 3.1 guideline (www.globalreporting.org).

GRI was founded in Boston in 1997 by a US non-profit organisation that called the Coalition for Environmentally Responsible Economies (CERES) and the Tellus Institute. The GRI is an international, independent organisation that helps businesses, governments and other organisations understand and communicate the impact of business on critical sustainability issues such as climate change, human rights, corruption and many others. The GRI aims to produce the world's most trusted and widely used standards or guidelines for sustainability reporting. The GRI Guidelines enable organisations to measure and understand their most critical impacts on the environment, society and the economy. Nowadays, 9,524 organisations (including the world's 250 largest corporations) from over 90 countries have adopted the GRI's Standards for their sustainability reporting.

The first GRI Guidelines were issued in 2006 and called the GRI G3 Guidelines. These G3 Guidelines focused on sustainability disclosures that organisations can adopt flexibly and incrementally, enabling them to be transparent about their performance in key sustainability areas. Then, in 2011, the G3.1 Guidelines were released by completely updating the G3 Guidelines and expanding guidance on local community impacts, human rights and gender. They also introduced the Technical Protocol – Applying the Report Content Principles, offering process guidance on how to define the content of a sustainability report. The most recent GRI Guidelines is G4, the fourth generation of the Guidelines, launched in May 2013. The G4 was issued after two years of extensive stakeholder consultation and dialogue with hundreds of experts from across the world from a wide variety of sectors, including companies, civil society, labour organisations, academia, and finance. The G4 aims to help organisations to recognize the importance of sustainability reports, and make robust and purposeful sustainability reporting standard practice.

GRI guidelines have been chosen since this guideline the most prominent and widely accepted framework among scholar and practitioners (Oeyono et al., 2011) and it can support companies to ensure transparency and completeness of corporate social responsibility information in their sustainability reporting (Menichini and Rosati, 2014). Moreover, GRI is the leading internationally recognised standard in reporting corporations' social responsibility. In addition, almost all companies in Indonesia are following this guideline in preparing their

sustainability reports. The GRI 3.1 guideline consists of three main areas of performance, namely (see Table 3.4):

1. Economic Dimension Performance (EC)

The economic dimension of corporate sustainability concerns consists of nine formative indicators and describes the organisation's impact on the economic conditions of its stakeholders as well as the influence of the organisation's activities on local, national and global levels of economic systems. The economic indicators illustrate the flow of capital among different stakeholders; and the ultimate economic impacts of the organisation throughout society.

2. Environmental Dimension Performance (EN)

The environmental dimension of sustainability concerns, which consists of 16 formative indicators, describes an organisation's impacts on living and non-living natural systems, including ecosystems, land, air, and water. These indicators disclose the inputs (e.g. material, energy and water) and outputs (e.g., emissions, effluents, waste) used and produced by the organisation. This dimension also covers biodiversity, environmental compliance, and information regarding environmental expenditure and the impacts of products and services.

3. Social Dimension Performance (SOC)

The social dimension of performance of sustainability concerns describes the organisation's impact on the social system within which it operates, which consist of a four-part performance evaluation:

1. Human rights performance (**HR**), which discloses the organisation's processes have been implemented on incidents of human rights violations and on changes in the stakeholders' ability to enjoy and exercise their human rights. It consists of six formative indicators.
2. Labour practices and decent work performance (**LA**), which describes the labour practices in the organisation, such as employment, training and education, diversity and equal opportunity; and equal remuneration for women and men, which consists of 11 formative indicators;
3. Product responsibility performance (**PR**), which describes the impacts of the organisation's products and services that directly affect customers, namely, health and safety, information and labeling, marketing, and privacy. These aspects consist of five formative indicators; and
4. Society performance (**SO**), which describes the organisation's impacts and risks that may arise from interactions in the local communities and other social institutions in which it operates is managed and mediated (e.g. bribery and corruption). It consists of seven formative indicators.

This study develops a measurement of the construct of corporate sustainability concerns from corporate responsibility disclosure by adopting a manual quantitative content analysis method. It was carried out by converting qualitative information in those reports into quantitative scores with a range of three weighted scores from 0 (zero), 1 (one) and 2 (two) for each indicator, based on a modification of the Standard Disclosure of GRI 3.1 Guideline launched in 2011.

Table 3.4 : The Global Reporting Initiatives (GRI) 3.1 Disclosure Indicators

CORPORATE SUSTAINABILITY CONCERNS PERFORMANCE		Max Score
ECONOMIC PERFORMANCE INDICATORS		
EC1	Direct economic value generated and distributed, including revenues, operating costs, employee compensation, donations and other community investments, retained earnings, and payments to capital providers and governments.	18
EC2	Financial implications and other risks and opportunities for the organization’s activities due to climate change.	
EC3	Coverage of the organization’s defined benefit plan obligations.	
EC4	Significant financial assistance received from government.	
EC5	Range of ratios of standard entry level wage compared to local minimum wage at significant locations of operation.	
EC6	Policy, practices, and proportion of spending on locally-based suppliers at significant locations of operation.	
EC7	Procedures for local hiring and proportion of senior management hired from the local community at significant locations of operation.	
EC8	Development and impact of infrastructure investments and services provided primarily for public benefit through commercial, in-kind, or pro bono engagement.	
EC9	Understanding and describing significant indirect economic impacts, including the extent of impacts.	
ENVIRONMENT PERFORMANCE INDICATORS		
EN1	Materials used by weight or volume.	32
EN2	Percentage of materials used that are recycled input materials	
EN3	Direct energy consumption by primary energy source.	
EN4	Indirect energy consumption by primary source.	
EN5	Energy saved due to conservation and efficiency improvements.	
EN6	Initiatives to provide energy-efficient or renewable energy-based products and services, and reductions in energy requirements as a result of these initiatives.	
EN7	Initiatives to reduce indirect energy consumption and reductions achieved.	
EN8	Total water withdrawal by source.	
EN9	Water sources significantly affected by withdrawal of water.	
EN10	Percentage and total volume of water recycled and reused.	
EN11	Strategies, current actions, and future plans for managing impacts on biodiversity.	
EN12	Total water discharge by quality and destination.	
EN13	Total weight of waste by type and disposal method.	
EN14	Initiatives to mitigate environmental impacts of products and services, and extent of impact mitigation.	
EN15	Significant environmental impacts of transporting products and other goods and materials used for the organization’s operations, and transporting members of the workforce.	
EN16	Total environmental protection expenditures and investments by type.	

Table 3.4: The Global Reporting Initiatives (GRI) 3.1 Disclosure Indicators (continue)

CORPORATE SUSTAINABILITY CONCERNS PERFORMANCE		Max Score
SOCIAL PERFORMANCE INDICATORS		58
HUMAN RIGHT PERFORMANCE INDICATORS		
HR1	Percentage and total number of significant investment agreements that include human rights clauses or that have undergone human rights screening.	12
HR2	Percentage of significant suppliers and contractors that have undergone screening on human rights and actions taken.	
HR3	Total hours of employee training on policies and procedures concerning aspects of human rights that are relevant to operations, including the percentage of employees trained.	
HR4	Total number of incidents of discrimination and actions taken.	
HR5	Operations identified in which the right to exercise freedom of association and collective bargaining may be at significant risk, and actions taken to support these rights.	
HR6	Percentage of security personnel trained in the organization’s policies or procedures concerning aspects of human rights that are relevant to operations.	
LABOR PRACTICES and DECENT WORK PERFORMANCE INDICATORS		
LA1	Total workforce by employment type, employment contract, and region.	22
LA2	Total number and rate of employee turnover by age group, gender, and region.	
LA3	Benefits provided to full-time employees that are not provided to temporary or part-time employees, by major operations.	
LA4	Percentage of employees covered by collective bargaining agreements.	
LA5	Rates of injury, occupational diseases, lost days, and absenteeism, and total number of work-related fatalities by region.	
LA6	Health and safety topics covered in formal agreements with trade unions.Health and safety topics covered in formal agreements with trade unions.	
LA7	Average hours of training per year per employee by employee category.	
LA8	Programs for skills management and lifelong learning that support the continued employability of employees and assist them in managing career endings.	
LA9	Percentage of employees receiving regular performance and career development reviews.	
LA10	Ratio of basic salary of men to women by employee category.	
LA11	Return to work and parental leave, by gender	
PRODUCT RESPONSIBILITY PERFORMANCE INDICATORS		
PR1	Practices related to customer satisfaction, including results of surveys measuring customer satisfaction.	10
PR2	Programs for adherence to laws, standards, and voluntary codes related to marketing communications, including advertising, promotion, and sponsorship.	
PR3	Total number of incidents of non-compliance with regulations and voluntary codes concerning marketing communications, including advertising, promotion, and sponsorship, by type of outcomes.	

Table 3.4: The Global Reporting Initiatives (GRI) 3.1 Disclosure Indicators (continue)

CORPORATE SUSTAINABILITY CONCERNS PERFORMANCE		Max Score
PR4	Total number of substantiated complaints regarding breaches of customer privacy and losses of customer data.	
PR5	Monetary value of significant fines for non-compliance with laws and regulations concerning the provision and use of products and services	
SOCIETY PERFORMANCE INDICATORS		
SO1	Nature, scope, and effectiveness of any programs and practices that assess and manage the impacts of operations on communities, including entering, operating, and exiting.	14
SO2	Percentage of employees trained in organization’s anti-corruption policies and procedures.	
SO3	Actions taken in response to incidents of corruption.	
SO4	Total value of financial and in-kind contributions to political parties, politicians, and related institutions by country.	
SO5	Monetary value of significant fines and total number of non-monetary sanctions for noncompliance with laws and regulations	
SO6	Operations with significant potential or actual negative impacts on local communities.	
SO7	Prevention and mitigation measures implemented in operations with significant potential or actual negative impacts on local communities	
Maximum Score		108

Many prior studies have used a content analysis method, which is considered as an appropriate technique in the analysis of corporate social responsibility disclosure (Al-Tuwaijri et al., 2004; Beattie and Thomson, 2007; Gray et al., 1995a). However, this technique has been criticized for "subjectivity", which is related to reliability and validity issues. Hence, as part of efforts to minimise the subjectivity of the researcher, this study has analysed disclosure of corporate responsibility activities by strictly following the information that should be disclosed in the company's reporting according to Standard Disclosure of GRI 3.1 Guideline and awarded the information disclosed a simple score using three weighted scores (i.e., score of zero, one and two). A set

of 54 indicator of corporate sustainability concern are developed with description from each sustainability performance indicator adoptedg in the GRI 3.1 Guideline, such as EC, EN, HR, LA, PR and SO.

To quantify of disclosure in the reports, I strictly followed the narratives in the reports according to the description of each indicator in GRI 3.1 Guideline. I read all the statements in the reports, indicated each statement and quantified the score for each specific indicator. I awarded scores based on "how much" the company discloses on specific or individual information related to the performance indicators of the GRI 3.1 guideline with a three range of weighted scores 'zero', 'one' and 'two', as follows:

1. Score 'zero' when the company does not discloses any information related to the main sustainability performance indicators of GRI 3.1.
2. Score 'one' when the company partially discloses some information related to the main sustainability performance indicators of GRI 3.1.
3. Score 'two' when the company fully disclosed any information related to main sustainability performance indicators of GRI 3.1.

After the individual main sustainability performance indicators (i.e. EC, EN, HR, LA, PR and SO) are quantified, I determine the aggregate score for each company, which is then divided by the maximum score of each valuation of the main areas of sustainability performance (see Table 3.4). It is contended that quantitative disclosure by using this content analysis technique is more objective

and informative than qualitative analysis to provide information for the stakeholders' interests.

3.4.3. Executive Compensation,

The indicator of executive compensation in this study consists of three reflective indicators, namely:

1. RemBoD is the executive (BoD) cash compensation, measured by aggregate total cash of salary, bonus and other benefits received by the executive per year (Unite et al., 2008; Brick et al., 2006; Core et al., 1999; Conyon, 1997),
2. AveRemBoD is the average cash compensation received by executives, per head, measured as the total cash executive compensation divided by the total number of executives. (Unite et al., 2008)
3. MVBoDOWn is the market value of stock held by executives as compensation measured by total amount of stock outstanding held by executives multiplied by market value of stock (Brick et al., 2006)

3.4.4. Ownership Structure

The construct of ownership structure consists of three reflective indicators:

1. FOROWN is the ratio of shares held by foreign investors in a firm's total outstanding shares (Colpan and Yoshikawa, 2012; Lipsey and Sjöholm, 2001, 2003; Yoshikawa et al., 2010; Firth et al., 2007)

2. GOVOWN is the ratio of government/state ownership in company (Conyon and He, 2011)
3. PUBOWN is the ratio of shares held by the public in the capital market

3.4.5. Company Financial Health,

This study employs the Altman Revision Z-Score Model (Altman et al., 1995) as the measure of company financial health (Pradhan, 2014). This Altman Revision Z-Score model has been used to assess financial health for non-US corporations, especially for non-manufacturing corporations in emerging market countries. Hence, this Revision Z-Score model is more appropriate than is the original Altman Z-Score (Altman, 1968).

This Revised Z-score model provides a score that indicates a distressed company condition for a non-manufacturing company in the emerging countries, with the formula:

$$Z'' = 6.56 (X1) + 3.26 (X2) + 6.72 (X3) + 1.05 (X4)$$

Notes:

X1 = working capital/total assets, **X2** = retained earnings/total assets, **X3** = earnings before interest and taxes/total assets, and **X4** = market value equity/book value of total liabilities.

To calculate the value of X1 that is working capital relative to the size of the assets used in the business. This study calculated the working capital in the banking company as total amount of minimum capital adequacy after calculating

the market and credit risk that should be available in the company according Basel 1 formula, which consists of the total amount of Tier 1 and Tier II of capital in the banking company (Thalassinos and Liapis, 2011). Tier 1 is equity capital plus disclosed reserves minus goodwill. Tier 1 capital ought to constitute at least 50 per cent of the total capital base. Thus, Tier 2 is asset revaluation reserves, undisclosed reserves, general loan loss reserves, hybrid capital instrument and subordinated term debt. Subordinated debt, with a minimum fixed term to maturity of five years, available in the event of liquidation but not available to participate in the losses of a bank which continues trading is limited to a maximum of 50 per cent of Tier 1. Then, this amount is divided by the total asset of the bank to measure X1.

The revision of Altman Z-Score model suggests that the safe zone a financial company that can achieve the score for more than 2.6. Then, a financial company that is unable to secure the score of 1.1, it can be assumed in distress zone and it is more prone to bankruptcy. The value of Z-score is in between 1.1 and 2.6, it should be treated in the grey zone.

3.4.6. Company Market Value

This study used Tobin's Q to measure the construct of company financial performance. Tobin Q ratio is the ratio of the market value of equity and the book value of liabilities, scaled by the book value of assets

3.4.7. Banks' Financial Information

The banks' financial ratios consist of five constructs with one reflective indicator each:

1. Capital Adequacy Ratio (CAR) is "the ratio between capital in excess of regulatory requirements over the minimum capital requirements" (Shehzad et al., 2010).
2. Net Open Position (NOP) is "the net sum of all foreign currency assets and liabilities of a bank or financial institution inclusive of all of its spots and forward transactions and off-balance sheet items in that foreign currency".
3. Non-Performing Loan (NPL) is "a sum of borrowed money upon which the debtor has not made his or her scheduled payments for at least 90 days. A nonperforming loan is either in default or close to being in default" (Shehzad et al., 2010).
4. Net Interest Margin (NIM) is "the ratio of the difference of investment return with interest expenses divided by average earning assets".
5. Loan Debt Ratio (LDR) is "a loan to debt ratio is the ratio of bank liquidity to cover unforeseen fund requirements".

3.5. Methodology

3.5.1. The Partial Least Square-Structural Equation Model (PLS-SEM)

Partial Least Squares-Structural Equation Modelling (PLS-SEM) is part of second-generation statistical techniques that referred to as structural equation modelling (SEM) that is used to assess the reliability and validity of the model

measures. PLS-SEM enable to incorporate unobservable or latent variables or constructs measured indirectly by a set of indicators or manifest variables that serve as proxy variables (Hair et al., 2014). Edwards and Bagozzi, 2000 defines the construct as “a conceptual term used to describe a phenomenon of theoretical interest”.

PLS-SEM is applied as an iterative algorithm that consists of two steps of measurement: outer (measurement) and inner (structural) models. PLS-SEM emphasizes the prediction objectives by assessing latent variables (constructs) from separate indicators in the blocks of the measurement model (outer model) and then, testing the relationship between latent variables (constructs) by providing path coefficients estimation in the structural model (inner model). PLS-SEM can simultaneously examine relationships in the research model between indicators or manifest variables, and their corresponding constructs or latent variables, as well as the relationship between the constructs, by focusing on explaining the variance in the dependent variables.

In PLS-SEM, each indicator represents a single separate aspect of an unobservable variable or construct, which can facilitate reduction of measurement error arising from poorly worded questions on a survey, mis-understanding of the scaling approach, and incorrect application of a statistical method to observed variables or indicators (Chin, 1998). PLS-SEM enables to the combination of aspects of regression and factor analysis to develop theories in exploratory research that can best explain the residual variance of constructs as well as

indicators in the model, even when there is no or only little prior knowledge on how the variables are related. The PLS regression analysis is useful to test established theories and concepts by providing prediction or estimation, where a large set of independent variables are statistically significant as predictors of the set of dependent variables (Vinzi et al., 2010; Hair et al., 2014). Then, factor analysis can be used to identify which additional independent variables serve as better predictors of the dependent variable. In other words, factor analysis is applied to the research model to assess the relationships among a large number of variables by reducing them to a smaller set of composite factors (i.e. combinations of variables) (Chin, 1998).

PLS-SEM is a principal-component or variance-based estimation approach, which is different from the covariance-based-SEM (CB-SEM) or LISREL-type approach. CB-SEM estimates model parameters by minimising the discrepancy between the estimated and sample covariance matrix. In contrast, PLS-SEM estimates partial model relationships in an iterative sequence of ordinary least squares (OLS) regressions by maximising the explained variance of the dependent (endogenous) latent variables and will not reproduce a covariance matrix sample (Vinzi et al., 2010). Hence, PLS-SEM is considered as a soft modelling approach which relaxes the strict assumptions typically needed in CB-SEM usage; hence, it has several advantages for examining the overall relationships, namely (Hair et al., 2014; Chin, 1998):

1. It is very flexible to assess relationships in very complex causal modeling that may consist dozens of constructs and hundreds of indicators.

2. It can easily and almost unrestrictedly handle equally well reflective, formative and single-item measures.
3. It is practically a non-parametric statistic technique, which can handle extremely non-normal data and have no assumption about probability distributions.
4. It is not constrained by identification concerns and has minimum requirements regarding sample size and scale measurement.
5. It creates more robust estimation in dynamic change inference than cross-sectional data and generally can reach high levels of statistical power.

A formative construct appears as a manifestation or "effect" of its indicators, in which causality flows from the manifest variables (indicators) to the unobservable variable (construct). It means the indicators are assumed to be causing or "forming" the construct. Consequently, the arrowheads that represent their relationships are drawn from indicators to construct in the model. The indicators are used to minimize residuals in the structural relationship (Rodgers and Guiral, 2011). Formative indicators are not assumed to be correlated; they do not covary and do not measure the same underlying phenomenon, where variations at the indicators level imply variations in the construct and those are measured directly (emergent). The indicators also are not exchangeable, therefore, dropping or adding an indicator may provoke a change in the meaning of the construct (Hair et al., 2014).

In contrast, reflective constructs assume that the manifest variables (indicators) are seen as manifestations of unobservable variable (construct) and "reflect" changes in the latent variable (construct). Variations in the constructs are directly reflected in indicators responses, where the arrowhead comes from the construct to the indicators or the arrows point from construct to indicators. Reflective indicators should share a common theme, so indicators covary by definition; they are correlated and interchangeable, such that any of them can be safely removed or added without changing the conceptual construct (Rodgers and Guiral, 2011; Hair et al., 2014). Moreover, *a single-items measure* has been chosen sometimes by the researcher to create a construct. It has the advantages of practical ease of application and brevity, promoting higher response rates because the questions can be easily and quickly answered by respondents.

These studies have two formative measures, two reflective measures and seven single-item measures, which are:

1. Formative measures:
 1. The role of board of commissioners (ROLEBOC)
 2. Corporate sustainability concerns (SUSTAINABILITY CONCERNS)
2. Reflective measures:
 1. Executive compensation (EXECOMPEN)
 2. Ownership structures (OWNSTRUC)
3. Single-item measures:
 1. Company financial health (FINHEALTH)
 2. Company financial performance (MARKET VALUE)

3. Capital information ratio (CAPITAL)
4. Assets information ratio (ASSETS)
5. Management information ratio (MANAGEMENT)
6. Earning information ratio (EARNING)
7. Liquidity information ratio (LIQUIDITY)

Then, PLS-SEM analyses relationships among constructs and indicators using two sets of linear assessment, namely: the measurement (outer) model and the structural (inner) model. (Hair et al., 2014; Henseler et al., 2009).

1. The Measurement (Outer) Model Assessment

This focuses on assessment of the relationships between a latent variable or construct and its indicators. The outer model assessment plays a vital role in PLS-SEM analysis by providing an examination of how accurate (i.e., reliable) the individual indicators are, the reliabilities for each construct's component measures (i.e., internal consistency reliability), as well as the measures' convergent and discriminant validities. However, there are differences of approach between reflective and formative measures, when determining the reliability and validity of constructs and indicators measures. Assessment of reflective measures involves determining indicator reliability (*squared standardized outer loadings* ≥ 0.700), internal consistency reliability (*composite reliability*, $CR \geq 0.700$), convergent validity (*average variance extracted*, $AVE \geq 0.500$), and discriminant validity (*Fornell-Larcker criterion*, or *cross-loadings*, or *heterotrait-monotrait ratio of correlations*, $HTMT \leq 0.900$) (Hair et al.,

2014; Henseler et al., 2009; Henseler et al., 2015). Lack of reliability and validity measures can lead to the structural (inner) model assessment may be substantially biased, leading researchers to overlook relationships that could be significant.

Reliability assessment of formative measures is not appropriate and meaningful to evaluate in the same way as reflective measurement, since there is no assumption that formative indicators will covary and both indicators have different epistemic relationships with their construct (Chin, 1998; Hair et al., 2014). Hence, for formative measure model does not need to analyse indicator reliability, internal consistency reliability, or discriminant validity because the formative indicators are not highly correlated together. Instead, the primary statistic to evaluate the quality of formative measures is the factor weight, convergent validity, and collinearity of indicators.

The factor weight represents the partial effect of the indicator on its construct, controlling for the effect of all other indicators of that construct. It should include a resampling procedure using blindfolding or bootstrapping to determine significance value (Hair et al., 2014). The rule of thumbs to examine the indicators reliability states if an indicator's factor weight is insignificant but its outer loading is high (i.e., above 0.50), the indicator should be interpreted as absolutely important but not as relatively important and all the indicator could be retained.

However, in the situation an indicator has an insignificant weight and the outer loading is below 0.50, the indicator should be kept in the formative outer

model when the theoretical relevance and possibility the content overlap with other indicators of the same construct strongly supports to retain the indicator. Otherwise, the indicator strongly should be removed when the outer loading is low, insignificant, and there is no empirical support for the indicator's relevance to provide the indicator as the formative index.

Moreover, the validity of designated set of formative measures (convergent validity) can be examined by employing the redundancy analysis. This analysis examines the correlation between the formative measure construct and a reflective measure of the same construct with expected result is the correlation values > 0.80 (Chin, 1998). This involves the use of an existing formative latent variable as an exogenous latent variable to predict an endogenous latent variable operationalized through one or more reflectively measured indicators.

Further, to avoid potentially unstable indicator weights, it may occur the indicators are highly correlated to each other. Hence, this study also measures multicollinearity between indicators, which involves primarily using tolerance > 0.1 or variance inflation factor ($VIF < 10$) as criteria there is no collinearity problem. in assessing formative measurement.

2. The Structural (Inner) Model Assessment

This focuses on evaluation of the relationship between exogenous (independent) and endogenous (dependent) latent variables (constructs) is using variance-based, non-parametric evaluation quality criteria by the model in

question. (Chin, 1998; Hair et al., 2014; Chin, 2010). The primary criterion for inner model assessment is the coefficient of determination (R^2), which represents the amount of explained variance of each endogenous (dependent) latent variable or construct. Moreover, standardized path coefficients are common use to provide evidence of the inner model's quality, and their significance should be assessed using resampling procedures, such as blindfolding or bootstrapping procedures (use individual sign change option with 5,000 bootstrap sample equal to a number of valid observations cases).

3.6. The Throughput Model

The study uses a process thinking or a decision-making model called the Throughput Model, which allows the capture of different pathways and stages that can affect a decision at the individual or organisational level in several sequential arguments (Rodgers, 1997; Rodgers et al., 2009; Foss and Rodgers, 2011). The Throughput model alert decision-makers to identify the impact on various stages in the decision-making process and inform how the use of a particular pathway will affect a decision. It provides benefit for decision-makers, who can follow the pathways to improve and modify the decision by searching, observing and choosing any information, biases and strategies employed in rendering a decision. Thus, if a certain pathway dominates and is chosen by decision makers, it will have a different weight or impact from other pathways.

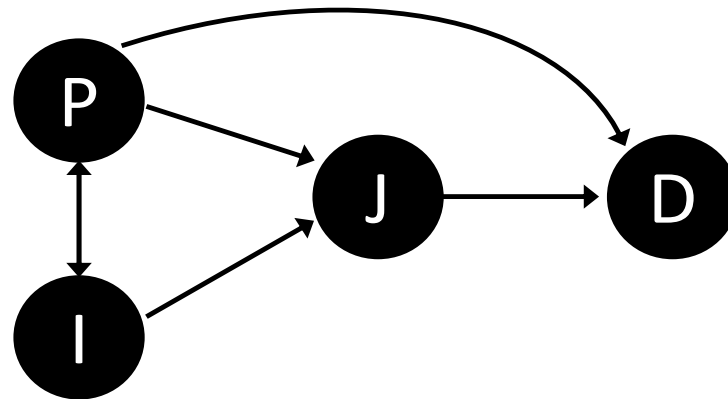


Figure 3.1 : The Throughput Model

This model incorporates four major concepts: perception (**P**), information (**I**), judgment (**J**), and decision choice (**D**) (see Figure 3. 1). ***Perception*** refers to the way decision makers frame problem solving by using pre-formatted knowledge from their own expertise to guide and direct the search and confirm or reject incoming information for the problem-solving or decision-making process. ***Information*** includes the set of reliable and relevant available data sources for a decision maker, for problem-solving or decision-making purposes. The ***judgment*** stage contains the decision maker's process to analysing available information, *and the influences from the problem framing (perception) function in order to* compare alternatives or the criteria across the alternatives. Finally, in the ***decision*** choice stage an action is taken or not taken. In this model, the perception and information are interdependent, which is represented by a double-ended arrow connecting each other. That because information can influence how the decision-maker frames a problem (perception) or how he/she select the evidence

(information) to be used in later decision-making stages (judgment and choice) (Rodgers, 1997; Rodgers et al., 2009).

This study uses the Throughput Model to analyse how the potential effect of decision makers' *perceptions* a dealing with banks' governance codes (i.e. the board of commissioners' role, executive compensation and ownership structure) and sustainability concerns with or without a set of bank's financial ratio *information* can influence their *judgment* of financial health, to determine **decision** choice on the firm's market value performance.

Further, the interaction between those four concepts provides and guides decision makers with six different pathways and stages that may influence decision choice and can be established (Rodgers, 1997; Rodgers et al., 2009; Foss and Rodgers, 2011):

1. **P → D** agency theoretic position (or ethical egoism)
2. **P → J → D** rule-based (or deontology)
3. **I → J → D** principle-based (or utilitarian)
4. **I → P → D** relativist-based (or revisionist)
5. **P → I → J → D** value-driven based (virtue ethics)
6. **I → P → J → D** stakeholders' perspective position (or ethics of care)

The model can be explained in two phases. The first phase involves framing of the bank decision makers' as *perception* ("P") based upon experience, heuristics and many informational sources in dealing with corporate governance mechanisms and sustainability concerns that can influence directly company

market value performance *decisions* ("D"). Then, in the second phase, the banking financial ratios *information* ("I") that consists of capital, assets, management, earning and liquidity are interdependently with *perceptions* ("P") to influence *the judgment* of company's financial health ("J") to make a *decision* choice ("D") on the company market value.

This study only adopts two pathways of the Throughput Model: (1) the agency theoretic position and (2) stakeholders' perspective pathways. The models suggest that a decision can be influenced by individuals' ethical beliefs; hence, not all the four major concepts are necessary for each of the six pathways. The two pathways highlight the importance of how two different philosophical perspectives of individuals' or decision makers' morality and ethical reasoning processes may be used by decision makers in arriving at a decision (Rodgers and Gago, 2001), which are the shareholder and the stakeholders perspectives. By adopting only two pathways, it does not prescribe any one philosophy or process as best or most ethical. The Throughput Model has aim only to understand how decision-makers' current values and convictions are implemented in their actions.

First, the agency theoretic position pathway, or ethical egoism (P→D); it represents the decision makers with a certain level of expertise framing the problem and directly making a decision. This pathway can be related to *the shareholder perspective*, as decision makers' morality and ethical beliefs, which assumes that decision makers will maximise their self-interest as an egoist viewpoint when making decisions. That is, each person is best suited to know his

or her best interests. The tenets of this position rest on the rational choice perspective, in that the behaviour of decision makers is fundamentally described as outcomes established by the maximization of individuals' objective functions, such as decision makers' interests (i.e. the shareholders' and managers').

The agency theoretic pathway does not rely on a set of bank financial ratio information, since the information may not be reliable and relevant or the decision makers are faced with time limitation pressure to make decisions. In this study, the decision makers' framing of the governance mechanisms together with corporate sustainability concerns leads them to make decisions on the firm market value without any judgment on the financial health (i.e., downplaying or ignoring "J"), as well as disregarding all of the bank's information (i.e., downplaying or ignoring "I").

Secondly, *the stakeholders or ethic of care position pathway (I→P→J→D)*; it represents the decision makers' perception expanded to search patterns and strategies that are influenced by a set available information, which affect the analysis (judgment) to make decision choices. Decision-makers can use accounting information to help improve their judgments and choices. This pathway is symbolising the ethics of care position, which is focused on an eagerness of the decision makers to learn and observe a wider distinct and previously unacknowledged perspectives. This focus of stakeholder position is on responsiveness to need, empathetic understanding, and the interrelatedness of people, rather than on individual rationality or universal moral rules. It

emphasizes relations between people rather than the preferences or dispositions of individuals; it entails thoughtful relations that are thought to have primary value.

This pathway depicts a process of thinking about the decision starting from a set of "information" sources that influences the decision makers' "perception", which leads to "judgment" and is followed by the "decision" choice. This pathway, which considers the availability of accounting information, will help decision makers' perception to improve, modify, and enhance their judgments and decision choices. However, the decision makers may face time pressure problems when they adopt this pathway. Hence, it may take a longer amount of time to revise the perception and occurs irrelevance of the information set can occur instability of the environment.

The stakeholder perspective position pathway assumes that decision makers' perception of corporate governance mechanisms and sustainability concerns can act as stakeholders' protectors, which have a consensus to be a standing bodyguard for different stakeholders' interests in the company (i.e., employees, suppliers, customers, and the community) – not merely shareholders' interests. Stakeholders can be defined as groups and individuals who can affect or are affected by the organisation's purpose (Freeman, 1984). Moreover, stakeholders are also individuals and constituencies who are potential beneficiaries and/or risk bearers by contributing either voluntarily or involuntarily in creating wealth, capacities and activities within organisations (Post et al., 2002). In this context, the corporate governance mechanisms (i.e., the board of

commissioners and executive compensation) are responsible for setting up the standards or the value within organisations through the decision makers' choice of strategy, incentives or internal control systems, which commit to corporate social responsibility and seek to serve the diverse interests of stakeholders.

Chapter 4. The Board of Commissioners, Corporate Sustainability Concerns and Company Financial Performance

4.1. Introduction

This chapter examines whether mandatory internal corporate governance mechanisms, particularly the role of the board of commissioners as the board supervision function, could influence corporate sustainability concerns as the construct of corporate responsibility disclosure. Further, this study investigates whether there is an extended impact of the relationship of corporate sustainability concern on financial performance, both on financial health and market value performance.

4.2. Research Background

Over the last two decades, worldwide fraud scandals and financial crises with their impact on corporations' operation collapse and performance failure have stimulated regulators and lawmakers around the world to develop and to pursue strict regulation regarding accountability and transparency issues at the company level. For instance, in Asian developing countries, specifically in the Indonesian context, corporate scandals and failures as well as unethical business practices have brought the attention of the government and academic scholars to the need is modify and embed corporate governance codes with ethical standards through mandatory corporate social responsibility (CSR) practices for corporate

sustainability (CS) purposes. It is represented by enacted the new Corporation Law number 40 regarding the limited liability company (LLC), which is stated in one of the articles about the obligation to implement corporate governance and corporate social responsibility practices in every corporation.

Moreover, in the business practice context, companies also receive more attention and exert more effort in order to remain sustainable in their operation and maintain higher financial performance by engaging in corporate sustainability initiatives with an emphasis on the board of directors' role. Corporate sustainability initiatives include empowering societies, protecting human rights, preventing corruption and bribery and addressing environmental concerns on climate change (Elkington, 2006) and they are disclosed by being integrated into the annual report, or separately in corporate sustainability reporting. The board of directors' role in sustainability initiatives represents one key aspect of corporate governance mechanisms in order to improve economic efficiency, business growth and investor confidence (OECD, 2004).

Governance and sustainability concerns through corporate social responsibility are interrelated, reflecting an organization's commitment to their stakeholders, including the community at large (Jamali et al., 2008). The integration of corporate social responsibility into corporate governance is important and can be linked to behaviours, reputation, risk, and transparency related to the economic environment, national governance system, regulation and soft law, shareholders, national culture and industry impact (Young and Thyl, 2004).

2013) to minimise potential significant negative external effects on society (Jizi et al., 2013). Moreover, the complementarities between the two could reduce agency problems and enhance corporate value (Beltratti, 2005).

The complementary effects may lead the company management (i.e. the board and managers) to provide and disclose any information (i.e. financial, and non-financial) in order to align and fulfil not only stakeholders' requirements, but also their own interests to make the best decision for a company's sustainability (Freeman, 2010). These behaviours integrate the interests of all stakeholders, including those shareholders. In this sense, corporate social responsibility can be defined as a set control mechanisms, practices, policies and standards with the aims of creating sustainable value for all stakeholders (i.e. customer, suppliers, regulators, societies, investors, shareholders, etc.) and preventing negative effects of managers' moral hazard behaviour on the company's business environment and society as well as maintain good corporate reputation (Gantenbein and Volonté, 2012).

The literature of corporate governance, corporate sustainability through corporate social responsibility disclosure and company financial performance reveals that this is a well-studied topic across disciplines. However, very limited empirical studies have treated these topics as in a single study (Michelon and Parbonetti, 2012), especially in the banking industry context (Jizi et al., 2013). In particular, some studies in the banking context only focused independently on the board of directors' role (Andres and Vallelado, 2008), corporate social

responsibility practices and motives in international banking (Scholtens, 2009; Wu and Shen, 2013; Weber, 2005; Viganò and Nicolai, 2009), or sustainability disclosure and motives (Wu and Shen, 2013; Jizi et al., 2013; Weber, 2005), and implementation of corporate governance in the financial crisis (Kameyama et al., 2006; Mehran et al., 2011).

Indeed, prior studies on the linkage of the board of directors' role and corporate sustainability have been done mostly in well-developed countries with one-tier corporate governance systems, such as the United States (Jizi et al., 2013), United Kingdom (Aguilera et al., 2006) and other European countries (Gantenbein and Volonté, 2012; Michelon and Parbonetti, 2010; Michelon and Parbonetti, 2012). These led to the conclusion that attention to these topics in the context of the banking industry for developing countries with a two-tiered governance structure in the South East Asia region is practically non-existent (Arora and Dharwadkar, 2011; Jo and Harjoto, 2011). In Indonesian context, the “owner-manager control” is conducted by the Board of Commissioners (BoC) by referring to the Board of Directors (BoD), which commonly act as the supervisory board function in the Anglo-American one-tiered CG system. Henceforward, to avoid confusion and foul-up, this study uses the term of the board of commissioners and the board of directors is interchangeable in the same meaning.

This study uses the terms corporate sustainability and corporate social responsibility synonymously, which refers to a wide range of business processes in order to remain fundamentally sustainable in long-term value creation, which is

included voluntarily activities deal with triple bottom line performance (i.e. profit, people, and planet) and demonstrate the involvement of social and environmental concerns into their business operations and in interactions with stakeholders (Van Marrewijk and Werre, 2003)

In this framework, the board of directors' role is central pertaining to overseeing corporate governance codes, assessing and shaping company policies and practices on a wide range of corporate responsibility practices (i.e. financial, social and environmental) (Lucy and Utter, 2004; Aras and Crowther, 2008; Beltratti, 2005). To date, voluntary codes have emerged as corporate responsibility practices with a new role of the board of directors in balancing all stakeholders' interests. These voluntary codes assist boards of directors in their roles of monitoring and advising managers, in order to prevent pitfalls in corporate responsibility practices and company financial performance.

According to agency theory, the board of directors' role was originally to act as a protector for the shareholders' interests with remedial responsibilities for principal-agent conflict (Fama, 1980; Jensen and Meckling, 1976). However, the board of directors' role is argued that they can also effective in encouraging serving a wide range of stakeholders' interests in the light of increasing pressures from public, customers and investors. For this part, it is related to stakeholders' perspective, which the board of directors should preserve a consensus of various interests party in the company (Donaldson and Preston, 1995).

Hence, by incorporating corporate responsibility practices into governance mechanisms, companies seem to have extended from the shareholder perspective to the stakeholders perspective in their view of the board of directors role (Ayuso and Argandoña, 2009). The board of directors should direct the company (including the managers) to be more concerned with different groups of stakeholders' interests and disclose corporate responsibility activities as part of accountability representation and stakeholder engagement (Hess, 2007). Under this perspective, the board's role shifts from the shareholders' view model to the stakeholders' view model, which aims to ensure effective negotiations, coordination, cooperation and conflict resolution in order to maximize and distribute welfare for multiple parties of the company interests (Ayuso and Argandoña, 2009).

This study argues that employing the stakeholders' view rather than the shareholders' perspective on the linkage of the board of directors' role, corporate sustainability concern and company financial performance is important and requires further empirical investigation in two-tiered Indonesian corporate governance systems. The board has multiple tasks to monitor and advise on managers' actions based on the shareholders' interests as well as the stakeholders' concerns. Theoretically, the motivation of the board's role employs the stakeholders' view, as the shareholders' view should assist the facilitation of all the stakeholders in accessing company information and other resources for making their strategic decisions. Hence, by examining perspectives, this study attempts to answer two important questions: (1) how is the board of directors role

related to corporate sustainability concerns toward corporate responsibility initiatives in order to maintain company financial performance? and (2) what is the motive for engagement in corporate sustainability concerns in the Indonesia banking context?. Practically, in Indonesia companies with external competitive markets, corporate and CEOs control are still underdeveloped, and the expropriation may occur not only between shareholders and managers (i.e. principal-agent conflict), but also between large ownership as “strong” controlling shareholders and “weak” minority shareholders (i.e. principal-principal conflict) (Lukviarman, 2004).

This study fills a gap in the literature by examining and explaining the impact of corporate governance, with particular reference to the role of the board of directors on corporate sustainability concerns and financial performance in a two-tiered board structure of Indonesian listed commercial banking companies. Therefore, this can be perceived be a fruitful area for study by following the business system theory, which holds that the result from one business system cannot always be generalised to a different business system (Whitley, 1992) and need to explores the impact of this relationship in different governance systems and types of industry (Young and Thyl, 2013).

This study encapsulates three areas of research by examining the shareholder and stakeholder perspectives in a single empirical study. This study utilises a new unbalanced data panel of 252 firm-year observations from a population of 39 Indonesian listed commercial banking firms during the period of

2007-2014, and tests the relationship among constructs using four different research models, drawing on both shareholder and stakeholders' perspectives. It does so by utilising on a decision-making model framework, the Throughput Model (Rodgers, 1997; Rodgers and Guiral, 2011), which allows identification of the impact of various steps in the decision-making process.

This study adds to the academic literature in three ways. First, it adds to theory by providing empirical tests of both of shareholder and stakeholder perspectives, to investigate how the board of commissioners' role can influence corporate sustainability concerns and financial performance for the banking industry in developing countries with a two-tiered corporate governance system. This study found that banking companies that follow the mandatory new regulation of the board of commissioners' role are more likely to be better governed and able to pursue more corporate responsibility activities in order to maintain company financial performance. Second, the study contributes empirically to methodology as it uses a quantitative method and claims to be the first study to employs partial least square - structural equation modelling (PLS-SEM) to analyse shareholder and stakeholder perspectives on both independent and interdependent impacts of the board of commissioners - corporate sustainability - company financial performance in a single model.

Moreover, this study contributes by checking the robustness of the findings with several estimation methods to control for unobserved heterogeneity, simultaneity and reverse causality. This study found that in Indonesian banking,

corporate sustainability concern is a partial mediator of the relationship between the role of the board of commissioners as part of the internal corporate governance mechanism and company financial performance, according to the shareholder and stakeholder perspectives. In addition, this study can identify the motivation behind corporate sustainability initiatives in Indonesian banking companies as the altruistic motive. The corporate responsibility activities seem to be window-dressing practices, which the company undertakes for their own sake in order to create a positive image for stakeholders. Moreover, these activities can be categorized as responsive corporate responsibility with companies being good corporate citizens addressing social norms as related to business operations (Porter and Kramer, 2006).

Third, this study adopts a decision-making model, the Throughput Model, which is able in practically to look inside and explain in the decision-making process by utilising both shareholder and stakeholder perspectives. These are embedded into two different pathways of the decision-making process, as the agency theoretic and stakeholders (ethics of care) pathways position, in looking at the impact of the boards' role in corporate sustainability concerns and financial performance. The model illuminates into two different perspectives (i.e. shareholders and stakeholders) how the perception of the board of commissioners' role (as the principal's representative) jointly with corporate sustainability concern (as managers' initiatives) affect both company financial performance in terms of the judgment of financial health (as an intermediary outcome) and firm market value (as the final stage of decision choice). Further, by employing the agency

theoretic pathway from the Throughput Model, it seems that the shareholders' perspective of the board of commissioners' roles has a positive influence on corporate sustainability concerns; however, as a further impact it may dampen the banks' market value. On the other hand, according to the stakeholder pathway position, the positive influence of the board of commissioners on corporate sustainability concerns will improve banks' market value performance.

4.3. Theoretical Review

4.3.1. Theories of The Relationship Between Corporate Governance and Corporate Sustainability

Despite, the topic of corporate governance has been a well-researched area of study in the last decade, there is still no universally accepted definition of corporate governance among practitioners and scholars. According to Nerantzidis et al. (2012), the definition of corporate governance can be divided into six dimensions: institutional, shareholder, governance, control, performance and stakeholder, which is referred to practitioners and scholars' interpretation. Thus, at least 22 various definitions of corporate governance that have been produced by 33 researchers in recent years.

However, one definition considers to be the most generally use among scholars, which defines corporate governance is “the system by which companies are directed and controlled, the corporate governance structure specifies the distribution of the right and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders”

(OECD, 2004). Also La Porta et al. (2002) defines corporate governance as “a set of mechanisms through which outside investors protect themselves against expropriation by the insiders (i.e. both managers and controlling shareholders)”. Moreover, the definition of corporate governance from Nerantzidis et al. (2012) provides in a comprehensive and concise manner as “the plethora of mechanisms, both internal and external, that gives at least the fair value in shareholders and in parallel protects the interests of all stakeholders”.

Dimensions	The definition is coded to the dimension if it refers to	Example phrases
The institutional dimension	Institutional and organizational mechanisms or A nexus of contracts	“set of mechanisms” “mechanisms by which corporations” “structures, processes, cultures and systems”
The shareholder dimension	Shareholders or shareholder group	“the interest of shareholders” “the benefit of investors” “suppliers of finance”
The governance dimension	The Board of Directors (including managers as well)	“company’s management” “exercise of power over corporate entities” “companies are strategically directed, integratively managed”
The control dimension	The function of audit/ control	“companies controlled” “holistically controlled” “controlled”
The performance dimension	Investor’s performance	“of getting a return on their investment” “performance” “distribution of firm value”
The stakeholder dimension	Stakeholders or stakeholder groups	“rights and wishes of stakeholders” “stakeholders”

Figure 4.1 : The Distinction of Corporate Governance Dimensions with Their Description along with Example Phrases
(source: Nerantzidis, 2012)

Variation in the adoption of theoretical perspectives regarding the relationship between corporate governance and corporate sustainability through corporate social responsibility is related to the use of different empirical justifications among researchers, the absence of single conceptual framework, and insufficient specified theory (Belkaoui and Karpik, 1989; Deegan, 2002; Gray et

al., 2001). However, this study relies on two notable theories that are more relevant to explain the integration between those topics in Indonesian context (Gunawan et al., 2009), namely: *legitimacy theory* (Dowling and Pfeffer, 1975; Magness, 2006) and *stakeholder theory* (Freeman, 1984, 2010).

The *basis of legitimacy theory* relies on the notion of social contract as a strategy to narrower the perceived legitimacy gap between an organisation or a company and the society (Magness, 2006; Kolk and Pinkse, 2010). An organisation or a company exists and gains permission to use community resources in its operation ("license to operate") as the community considers that the organisation or the company is legitimate (Dowling and Pfeffer, 1975). However, if the community assumes that the organisation or the company has been doing illegitimate behaviour, they will response by withdrawing or suspending the continuity of its operational contract.

This means that organisations or companies will still be legitimate and have earned their right to exist when their system of values are always in line and harmonious with the larger social system (i.e., societies or communities); otherwise, they would be threatened and face problem when potential conflict appears between those two (Ashforth and Gibbs, 1990; Suchman, 1995). Hence, in order to minimise potential conflict between the society's expectations or perceptions and the organisations' value of systems and to strengthen the organisation's license to operate, the organisations' or companies' managements have to implement four principles of corporate governance and to conduct and

disclose corporate social responsibility agendas (i.e., economic, environmental and social) in their operation and reporting (Cormier and Gordon, 2001; Gray et al., 2001).

However, according to *the stakeholder theory*, companies will be successfully served shareholder's interests when they can treat and satisfy other stakeholders' needs (Jamali, 2008; Freeman, 1984). Freeman (1984) defined stakeholder as “any group or individual who can affect or be affected by the achievement of an organization’s objective”. The stakeholder theory helps re-conceptualising and re-thinking company's responsibility, which does not always attend on the shareholders' interests. It argues that direct profit maximisation as shareholders' primary concern cannot be met without being affected by the success of serving other stakeholders' concerns. The foundation of this theory relies on the assumption that companies are getting bigger and grow their assets and activities. It will increase the complexity of business relations and many operations, which makes societies and other parties pervasive in bonding together. Hence, the companies have to be accountable, not only for the shareholders, but also for various parties and societies. It means that companies and their actions should focus on internal and external stakeholders to provide resourcefull support and to fulfil their demands.

Companies could not just concentrate on their responsibility for activities and operations that will bring-their-own economic benefits. They must also they must contribute to deliver environment and social benefits for their

stakeholders. Therefore, appealing corporate sustainability concerns through corporate social responsibility disclosure in their corporate governance could help organisations (i.e., companies) increasing their moral and relationship with various powerful stakeholders through fair harmonisation of various conflicting difficulties (Freeman, 1984). According to Hoskisson et al. (2009), company, through its manager, does not only have primary accountability on wealth and treasures for its shareholders, but also has the responsibility for the investment of employees, suppliers, customers, and society, which is an equally prominent aspect. Furthermore, extensive corporate governance conception is not only needed to emphasize that every business that wants to survive, to be competitive, and to successful must be responsible for providing all necessary resources for the stakeholders (MacMillan et al., 2004), but must also direct and align all constraints in managerial action and stockholder's rights with the entire stakeholders' interest (Jamali et al., 2008)

4.3.2. Corporate Governance and Corporate Sustainability Concerns in the Indonesia Banking Context

Nowadays, the central debates on corporate governance issues in corporate practise are related to how to solve perceived deviation on company fraud, managerial power abuse and corporate social irresponsibility practices (Letza et al., 2004). The attention among scholars and practitioners to response this issue refer to develop an effective governance mechanism and measurement, and to narrower between current social expectations and the shareholder expectations with the manager's expectations. Several prior studies have been

published with mixed and distinctive results on the topic of corporate governance mechanisms in Indonesian context (Alijoyo et al., 2004; Lipsey and Sjöholm, 2001, 2003; Darmadi, 2011a, b; Sato, 2004), and especially investigated in Indonesian commercial banks with focused independently on the impact of corporate governance mechanisms before and after crisis (Kameyama et al., 2006), managerial stock ownership (Junarsin and Ismiyanti, 2009), ownership concentration and board of commissioners power (Hanafi and Santi, 2013), the relationship corporate governance and remuneration (Endraswati, 2014; Suherman et al., 2011).

The company structure in the Indonesian market context is different from the one-tiered corporate governance system applied in developed countries, such as the United Kingdom (UK), United States (US), and European countries, and/or other Asian countries. All entities of Indonesian companies apply a two-tiered board model in management organisation for the limited companies (referring to the Corporation Law number 1/1995 amended number 40/2007). Moreover, the “owner-manager control” is conducted by the Board of Commissioners (BoC) by referring to the Board of Directors (BoD) as the supervisory board that plays the control mechanism role within the corporate governance structure framework in stock companies as seen in the Anglo-American one-tiered CG system. Hence, this study suggests that the definition of BoC in Indonesia is the same as that of the BoD in other Anglo-American countries. The second component of this model refers to the executive or the management board with president director or CEO as the leader of company management.

Importantly, in the Indonesian commercial banking setting, a type of business that relies heavily on public trust and tight regulation, the banks are required to be more transparent by disclosing more information regarding major strategic decisions for shareholder and stakeholder interests. Hence, corporate governance is focussed on the setting the business operation direction through over-sighting management activities with the aim to protect all of the stakeholders interests. To that end, corporate governance plays an important role in ensuring that capital markets and banks are managed based on the principles of fairness, transparency, accountability, responsibility and independence in order to gain investor confidence.

The Bank Indonesia (BI), as the supreme banking regulator and supervisor, released a mandate for the implementation of eleven corporate governance aspects in all commercial banks in Indonesia through BI regulation number 8/4/PBI/2006 of 30 January 2006, amended by BI regulation number 8/14/PBI/2006 of 5 October 2006. According to this regulation, the board of commissioners is the core internal mechanism in banking operations. They responsible for setting up and control the internal governance system, while the external governance mechanisms for market control are remain underdeveloped. The board of commissioner has the basic task of continuously monitoring all aspects of the company operation and activity. They can examine and review all company documents, reports and explanations from management, employees, and auditor. Moreover, they also can encompass appointment and recall of

management board members, review annual reports, and monitor the planned performance.

This regulation mandates the board of commissioners to have at least three persons, of whom at least 50% are independent commissioners. Additionally, the board of commissioners should hold at least four meetings a year and each member must attend at least two of these meetings. All board of commissioner members (including top management) is appointed by the shareholders at the general meeting of shareholders and they must disclose share ownership if the amount exceeds 5%. This regulation with its requirements represents the public interest, including the stakeholders' concerns (i.e. controlling shareholders, depositors, creditors, government, societies, and other shareholders). The supervisory and authority institution (i.e. Bank Indonesia) via its regulation seems to be attempting to ensure the bank's adherence to regulatory and legal responsibilities. Hence, Indonesia banking companies need to shift from shareholders' perspective through their board of commissioners' role to focus on the stakeholders' interests, in order to alleviate any potential "unique" agency conflict not only between shareholders and management, but also among stakeholders.

Survey findings from Kameyama et al. (2006) show that the board members of Indonesian banks not only to be concern on the large shareholders but also accountable to the depositors or customers. This implies demand for the concern with stakeholders' interests by the board of commissioners, whereby they

are expected to be more active and to be independent of management, as well as more accurately reflect a broad range of constituents (i.e. stakeholders and shareholders) to mitigate negative external effects of the company's operations. Internal corporate governance mechanisms (i.e. the board of commissioners' role) have become more important to mitigate the agency conflict among stakeholders (Young et al., 2008).

The "unique" agency conflict in Indonesia seems likely to occur in the context of other Asia countries, which are characterised by a highly concentrated ownership structure controlled by family, individual, business group, or institutional investors, external governance mechanisms, such as competitive markets for corporate control and for CEOs, are still underdeveloped and offer limited protection of minority ownership interests (Dharwadkar et al., 2000; Lukviarman, 2004). Moreover, the unique agency problem in the Indonesia context has become a crucial issue and seems to lead La Porta et al. (2000) to extend the corporate governance definition to multifaceted issues, and defining it as a set of mechanisms through which outside investors protect themselves against expropriation by the insiders (i.e. the managers and controlling shareholders).

However, the board of commissioners' ineffectiveness in supervising managerial functions and the lack of company transparency have been identified as factors that increased company's vulnerability to negative impacts of Indonesia's financial crisis (Kameyama et al., 2006). Further, this statement is supported by the Worldwide Governance Indicators (WGI) survey in 2014, which

shows that Indonesia is categorised as a weak country in six dimensions of governance: voice and accountability, political stability and the absence of violence, government effectiveness, regulatory quality, rule of law, and corruption control (www.govindicators.org). Moreover, during 2011-2014, at least 11 massive management scandals and crimes occurred in the Indonesian banking environment, as well as other small scandals in government-owned banks (www.infobank.com). These cases imply that several Indonesian banking companies have not always fully complied with corporate governance regulations and have failed to be socially responsible. However, the banking sector, as the centre of the financial sector with a financial intermediary function, should be credible and trustworthy for its customers and affiliations.

Further, in regard to corporate responsibility concerns, the Indonesian government released Article 74 of Limited Liability Company Law number 40/2007 and article 15 of Investments Law number 25/2007 in 2007 regarding the obligation to implement corporate social responsibility for listed investors, or companies that have core business operations related to non-renewable natural resources. Hence, the implementation of corporate responsibility activities and disclosure of such activities in the annual report, or a sustainability report, in Indonesian banking companies is considered in the early stage. Moreover, research on the compliance of companies with this regulation has not been well documented yet. Therefore, following this regulation, investigation of the linkage of the board of directors - corporate sustainability concerns - company financial

performance in the Indonesian banking context would be an interesting topic to enrich the literature.

4.3.3. The Shareholders and Stakeholders Perspectives on the Role of the Board of Directors and Corporate Sustainability Concerns

Both shareholder and stakeholder perspectives are derived from the same root, which is the agency theory (Jensen and Meckling, 1976), which tends to follow the institutional classic issue on the separation of companies' ownership and control (Berle and Means, 1932). Most of the corporate governance literature on the shareholder perspective has been done in systems where dispersed ownership is predominant (i.e. Anglo-American style) and the focus is mainly on ensuring that shareholder rights are safeguarded. The three aspects of hierarchical corporate governance structures (i.e. the shareholders' general meeting, the board of directors and the managers) are designed to protect shareholders' interest.

In this sense, the board of directors' role is to mitigate faulty managerial behaviour that counters shareholders' interests because of principal-agent problems. They are responsible for mitigating the moral hazard of managers and other organization members who want to satisfy their own interest and are assumed to be willing to neglect shareholders' return or profit maximization (Gantenbein and Volonté, 2012; Jensen and Meckling, 1976). Hence, in the shareholder perspective, the board of directors is assumed to pay only a little attention to corporate sustainability concerns toward corporate responsibility activities because those tend to absorb the company's resources (i.e. money) and

to oppose shareholders' wealth maximization purposes (i.e. profit and share prices). In other words, the board will only pay more attention to managers' efforts and company activities, which are expected have the influence to increase of shareholders' wealth.

However, in a contrasting view is the stakeholder perspective, which is mostly adopted in less dispersed, or predominantly concentrated contexts (i.e. Continental European-Asia style). This perspective views the corporation as a locus in relation to wider external stakeholders' interests rather than merely shareholders' wealth. According to the stakeholder perspective, corporate governance (i.e. the board of directors) is an institutional device which is responsible for corporate strategic decisions with the aim of inducing the management to internalize welfare maximization of a broader range of stakeholders, both internally (i.e. controlling shareholders and employees) and externally (i.e. customer, suppliers, regulators, societies, investors, minority shareholders, etc.) (Tirole, 2001).

Therefore, this study expects the stakeholders' perspective of the board of directors' role on sustainability concerns will represent on company ethically responsible operation for the stakeholders' interest with the impact on the increase or maintain higher company financial performance. That means the stakeholders' perspective on the board of commissioners' role in overseeing and motivating managers' function can be more engaged in sustainability concerns through

corporate responsibility activities with potential implications to improve company financial performance.

4.3.4. The Throughput Model Framework on the Relationship the Board of Commissioners' Role and Corporate Sustainability Concerns.

This study employs and adopts two of six possible pathways from the Throughput Model that are selected carefully to the best capture: (1) *the agency theoretic position pathway* ($P \rightarrow D$), and (2) *the stakeholders position pathway* ($I \rightarrow P \rightarrow J \rightarrow D$) (Rodgers et al., 2009; Rodgers, 1997). By implementing the Throughput Model, this study argues that a full explanation of the relationships among the constructs can be illuminated. It will describe the relationship between the role of the board of commissioners, sustainability concerns toward corporate responsibility activities, and company financial performance (see Figure 4.2). Moreover, this model provides details about the board of commissioners' process approach to determine whether company's sustainability concern influences both the intermediary outcome (company's financial health represented by revised Altman Z" Score) and the final stage (investors' decision as represented by Tobin's Q) of company financial performance.

Decision makers through their perception of the role of the board of commissioners and corporate sustainability concern when they neglect of using the content of the bank information in assessing company market value, as the first-stage evaluation. Then, the decision makers' perception together with a set of bank financial information is used in the second stage evaluation, to measure the

company's performance, assessing both financial health and market value performance. That is, decision makers will make a judgment on financial health as measured by the revised Altman Z" score to make a final decision regarding the firm's market value.

This study depicts "perception" in the framework model that contains two formative constructs such as the board of commissioners' role and corporate sustainability concerns. The board of commissioners' role construct has been formed or "created" of six indicators, namely: the presence of independent commissioners, board of commissioner size, board of commissioners' ownership, number of meeting the board of commissioners per year, number of joint meeting the board of commissioners with the board of directors, and the board of commissioners' compensation.

Meanwhile, the corporate sustainability concerns as an effect from corporate responsibility disclosure of six sustainability performances, such as economic (EC), environmental (EN), society (SOC), labour practices (LA), human right (HR) and product responsibility (PR) based on GRI 3.1 guideline disclosure. A set of information is gathered from bank's financial ratios that consist of a single-item construct capital, assets, management, earning and liquidity (CAMEL) in analysing company financial health according to Revised Altman's Z-Score as judgment stage to determine a decision choice on firm's marker value performance according to Tobin's Q.

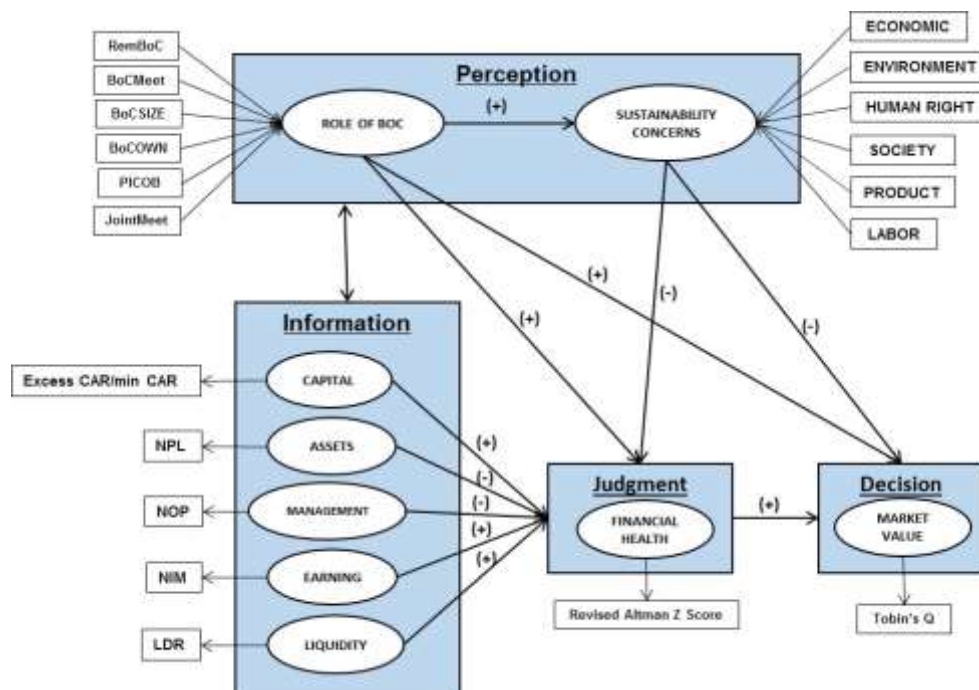


Figure 4.2 : Research Framework the Board of Commissioners' Role on Corporate Sustainability Concerns

The agency theoretic pathway refers to the relationship between two concepts: "**P→D**". It represents the ethical egoism pathway, whereby an individual relying upon knowledge (i.e. from experience, training and education) makes a decision instantly, due to time pressures, by neglecting information. The decision makers are assumed to have an egoistic perspective to maximise their interests and need not be concerned about others' welfare to serve the common good. Moreover, they will concern about others only such concern has a means or benefit to achieve their own self interest (Rodgers and Gago, 2003).

This pathway depicts the shareholders' view, where the role of the board of commissioners and corporate responsibility disclosure are seen as the decision makers (i.e. investors or managers) "perception" in the decision-making model.

The decision makers evaluate and create their "perception" based on the influences between the role of the board of commissioner and corporate responsibility disclosure, to determine the direct outcome of the "decision" on firm market value by disregarding all of the bank's accounting "information" and "judgment" on its financial health.

According to the agency theory, the role of the board of commissioners is as an oversight mechanism, not only to look specifically after shareholders' interests, but also to resolve conflicts related to management interests, including preventing top management's opportunistic behaviour, as well as monitoring and supervising all management activities (Fama and Jensen, 1983a; Eisenhardt, 1989). In this context, company, whose implement the mandatory requirement of the board of commissioners expect to motivate the managers to disclose and more concern regarding corporate responsibility activities and promote maximising firm's market value.

The second one, **the stakeholder pathway position**, depict the relationship between the four concepts: "**I→P→J→D**". This pathway relies on the stakeholder perspective, which assumes company need built solidarity and carry out its accountability to the stakeholders (i.e. employees, suppliers, customers, and the community). It also represents ethics of care, which focuses on a willingness to concern with distinct and different interests among stakeholders and not just merely for the shareholders' interests. The company has obligation to deliver information and its actions must focus on internal and external

stakeholders to providing resources support and fulfilling company stakeholders' demand.

The decision makers' perception emphasises a systematic approach in the decision-making process. In this context, decision makers (i.e. investors and managers) evaluate the role of the board of commissioners to identify its influence with the extent of corporate sustainability concern measured through corporate social responsibility disclosure in economic, environment and social activities based on GRI 3.1 guidelines. This stakeholder perspective indicates how decision makers should consider outside party influence and follow the guidelines in verified information through their analysis (i.e., judgment) and then make a decision choice on potential success in the future.

For this part, the decision maker assumes that the perception of the board of commissioners' role and corporate sustainability concern can serve as a standing bodyguard that should strive towards a consensus to protect the interests of diverse company stakeholders (i.e. employees, suppliers, customers, shareholders, and the community) – not merely shareholders' interests (Donaldson and Preston, 1995). Freeman (1984) defines stakeholder as “any group or individual who can affect or be affected by the achievement of an organization’s objective”.

By utilising this pathway, all information is collected on short-term bank performance (CAMEL ratio) will influence how the board of commissioners' role and corporate sustainability concern are perceived them. Specifically, this

pathway allows the decision makers' concern about the utility of the bank's information, in order to establish their judgments about its financial health and determine the firm's value decision.

4.4. Hypothesis Development

4.4.1. The Relationship between the Board of Directors, Corporate Sustainability and Company Performance

Recently, there has been growing interests in discussion of the impact of corporate governance mechanisms on corporate sustainability, in particular the board of directors role, which can serve as a key device control in relation to the triple bottom line performance, that is, financial (Cho and Kim, 2007; Jo and Harjoto, 2011), social (Johnson and Greening, 1999; Ntim and Soobaroyen, 2013; Ntim et al., 2015) and environmental (de Villiers et al., 2011; Zou et al., 2015). Moreover, with the role as a supervisory board, the board of directors are expected to monitor and facilitate the management operations so that they fulfil legal compliance and avoid unlawful and improper behavior (Beltratti, 2005).

Most of those studies define in whose interests and how companies should be run in shaping the fundamental business purpose in corporate sustainability as well as focus on accountability and transparency issues. Moreover, sustainability disclosure policies emanate from the board of directors through its functions or roles from their attributes (i.e., composition, structure and leadership) that have been identified as determinant factors of company's disclosure (Michelon and Parbonetti, 2010; Haniffa and Cooke, 2005; Gul and

Leung, 2004). They articulate an increased pressure on the board's role in the new level of transparency, accountability, and governance responsibilities from stakeholders around sustainability issues.

Jensen (1993) argues that the board of directors is crucial to effective internal control, as a dysfunctional corporate internal control system will lead to ultimate consequences of corporate failure. The board of directors' task is to ensure that the company's business activities are well operated in the right direction, and free of fraud, scandals and management misconduct, that could affect shareholders' and stakeholders' interests. Theoretically, in this setting, the board of directors' role is even more complex and it refers to relationships between a company's management, its board, its shareholders, and other stakeholders. Directors have a responsibility to determine the strategic decisions of the corporate organisation and act on behalf of the stakeholders' interests. They have the ultimate power to determine the direction the company will take and how the objectives can be achieved. Directors also have a responsibility not only to supervise the result of the organization, but also to promote the stakeholders' interests concerning long-term vision, growth, and strategies in financial and non-financial objectives (Daily et al., 2003).

Hence, the board responsible for financial or non-financial reporting integrity, corporate ethical standards and social concerns (Rose, 2007). They need to urge the companies to contribute to the well-being of their communities, environment, and societies, related to the stakeholders' concerns as part of the

company's sustainability performance. Thus, the Board has power and authority to determine the company's direction and its operations in order to improve the company's sustainability. Moreover, the board of directors is supposed to have a responsibility to decide the contribution of the company's financial, and, or non-financial objectives to improvement of the community, environment, and society, as part of its sustainability concerns.

The board of directors, as the stakeholders' representation in the company, oversees essential internal control mechanisms with three important functions (Hillman and Dalziel, 2003; Beltratti, 2005):

1. Monitoring and advising the managers by ensuring their acts in line with the shareholder's interests,
2. Facilitating the access to information and other resources for all stakeholders, and
3. Asserting to fulfill legal compliance and avoiding unlawful or improper behavior.

This study defines the construct of the board of commissioners' role by using several formative indicators such as the proportion of independent commissioners, number of meetings of the board of commissioners, the size of the board of commissioners, the board of commissioners' compensation, number of joint meetings between the board of commissioners and board of directors, and the board of commissioners' ownership. Aims that only focus on shareholder wealth maximization have been hostile to the stakeholder perspective, so that

empirical results to support the stakeholders' view are mixed (Donaldson and Preston, 1995; Callan and Thomas, 2014; Hillman et al., 2001).

Empirically, research from Jizi et al. (2013) examined the board's role in relation to its independence and sizes in the large US banking sector, and found a positive influence on CSR disclosure. They state that an effective board of directors' role will improve business sustainability by engaging and providing corporate social responsibility activities. The aim is not only to appease managers' personal moral concerns, but also to support commitment to societal concerns by maintaining positive relationships with the key stakeholders (Porter and Kramer, 2006). This finding supports Fama (1980) argument that internal corporate governance mechanisms are effective to promote shareholders' interest and to encourage management to serve a wide range of stakeholders.

In addition, research from Huang (2010) found that independent board members who have specific ownership characteristics have a significant positive impact on both financial performance and social performance. Recently, Shrivastava and Addas (2014) found that board meeting attendance and independent directors are important predictors of both scores sustainability performance and disclosure. Boards meeting these criteria are more likely to discipline the management for better sustainability performance and GRI compliance, in such matters as climate change and environmental supply-chain management policies in the company. Moreover, the board's role in regard to the advisory, supervisory and controlling functions over managers' operations can be

achieved through their meeting activities (Ayadi and Boujèlbène, 2013). Thus, when the board has more frequent meetings, it can be assumed to be a way to seek strategic decisions to improve the company value and avoid poor results. However, research by Jangu et al. (2014) failed to find that board independence and board ownership are able to motivate managers to disclose sustainability activities.

This study argues that in a two-tiered corporate governance system where concentrated ownership is predominant, the shifting of the corporate governance aim to the stakeholders' interests would be more appropriate than shareholder' interests in order to help in establishing company objectives and strategies, working to achieve them, and monitoring performance. Companies need to implement well-designed corporate governance systems and describe the rights and responsibilities of the board of directors to align different stakeholders' interests that include managers, shareholders, customers, societies and others. Hence, this study develop hypothesis:

Hypothesis 1: The role of the board of commissioners has a significantly positive influence on company sustainability concern.

Moreover, this study expects the result from effective implementation of corporate governance through the board of commissioners' role and sustainability concerns to represent company ethically responsible operation. It should be able to place a greater impact on increasing and maintaining higher company financial performance. The board of commissioners' role in overseeing and motivating

managers' function can be more engaged in sustainability concerns through corporate responsibility activities with potential implications to improve company financial performance. It seems that the new broader corporate governance concept from the the agency theory to stakeholders theory, which includes not only the board of directors' role in ensuring that investments are aligned to the owners' (investors') wishes in higher financial performance through company's strategic vision to increase corporate responsibility practices in society, as stakeholder engagement. It can expected to assist and attract stakeholder bonding for by exerting the best effort for the company's benefit; such as improving corporate image, improving internal decision-making, retaining the good workers and improving financial returns. Hence, the second hypothesis is represented as follow:

Hypothesis 2: The role of the board of commissioners has a significantly positive influence on company financial performance by mediating company sustainability concern.

4.4.2. The Relationship between Corporate Sustainability and Company Financial Performance

The direct relationship between corporate sustainability and financial performance has emerged and been examined as a key area in many scholars' research over the last two decades. However, the results seem to be inconclusive, inconsistent, and contradictory. The link between those topics in business practices continues to be highly debated and problematic, as it is often perceived that one is disadvantageous to the other and companies are presumed always to

have the aim of generating shareholder wealth (Aras et al., 2010). Hence, the question remains whether corporate sustainability initiatives toward corporate responsibility practices are beneficial to enhance company value, while some scholar finds a negative linkage or insignificant effect on financial performance.

Regardless of the continuing debates, a survey from Accenture (2010) revealed that 98 per cent of banks' CEOs worldwide and 93 per cent of companies' CEOs believe that corporate sustainability concern through CSR activities is one of the important keywords in modern business activities and future business success. A further Accenture (2013) survey states that 76 per cent of companies' CEOs believes that embedding corporate sustainability into core business will drive revenue growth and new opportunities. Those results are in line with Garriga and Melé (2004) argument that CSR activities have been identified as a key factor to attain economic goals and generate company wealth. However, it is increasingly apparent that most CEOs are constrained by market expectations, and struggling to quantify and capture the business value of sustainability (Accenture, 2013).

Some scholars argue that inconsistent findings might be related to several direct or indirect determinant factors as well as company motives behind conducting corporate sustainability concerns, which lead to spurious and imprecise relationships (Saeidi et al., 2015; Wu and Shen, 2013; Baron, 2001). For instance, Michelon et al. (2013) found corporate sustainability initiatives have a more positive effect on financial performance when it is linked to organizational

strategy. Thus, the positive effect of CSR activities on firm performance exists due to the mediation factors of higher company reputation and competitive advantage (Saeidi et al., 2015). Moreover, it is necessary for academic scholars to assess company financial performance by measuring both company financial accounting and market-based measures rather than only focusing on one single measure of performance (Rodgers et al., 2013; Barnett and Salomon, 2006). These considerations drive the stance of the present study, which focuses on the practice of corporate sustainability initiatives in a different business environment using two type of financial performance, financial health as an accounting performance measures and Tobin's Q as a measure of firms' market value. The remaining question which needs to be answered in this study is about the actual situation of those financial performance indicators concerning the impact and motivation in the banking industry of conducting corporate sustainability concerns in a developing countries context.

Empirically, a prior study from Margolis and Walsh (2003) reviewed and documented 127 studies from 1972 to 2002 and reported that 54 studies found a positive relationship, 20 studies showed mixed results; and 28 and 7 studies showed insignificant and negative relationships respectively. In addition, a study by Wu and Shen (2013) of 162 banking companies in 22 countries in 2003-2009 found that CSR is positively associated with accounting financial performance measured by ROA, ROE, and net interest income; and negatively associated with non-performing loans. They suggested that strategic choice is the primary motive of banking industries to engage in CSR.

Moreover, Rodgers et al. (2013) found that a firm's CSR reputation has a positive correlation to firm's value and will increase the firm's financial health and market value. They also found that the customer dimension of CSR has a significant impact on both accounting and market-based financial performance. Meanwhile, the employee or community relations dimensions only affect a specific performance and/or a specific group of firms. Brammer and Millington (2008) states that the positive relationship between CSR and CFP reflects an assumption that financial benefits are not subject to diminishing returns.

In contrast, the previous research which found the negative association between company sustainability concerns and CFP reflects the assumption that there are no financial payoffs to good social performance (Brammer and Millington, 2008). The authors argue that socially unresponsive firms incur fewer direct costs and, *ceteris paribus*, reap higher profits than socially responsive ones. In that sense, the companies that increase their sustainability concern would be competitively disadvantaged without managerial benefits. Companies incur significant expense in using firms' resources that could lower returns for their shareholders from sources of alternative investment projects. Prior research from Orlitzky et al. (2003) and Michelin et al. (2013) supported the argument that company participation in social issues will reduce the company's performance output, such as intangible asset, capital expenditure, and EBITDA in spite of their beneficial and positive effect on the stakeholders and the shareholders.

Moreover, in other developing countries, such in Turkey (Aras et al., 2010) and India (Aggarwal, 2013) research also failed to find an effect of corporate social responsibility and overall sustainability rating on financial performance. Further, in the Indonesian companies' context, a study based on 383 companies failed to find a significant relationship between CSP and CFP using the model of slack resources theory and good management theory (Fauzi et al., 2007). However, it was found that the company's size can be a significant positive moderating variable on the relationship between CSP and CFP. Moreover, research Oeyono et al. (2011) reveals a weak positive relationship between level of CSR and profitability among top 50 Indonesian listed companies.

Additionally, research Gunawan (2015) has shown that the motivation of most Indonesian public companies to engage and disclose corporate sustainability tends to be only to fulfil legal obligation and the demands of communities as well as legitimising the business operations. This motivation tends to follow an altruism motive, which is conducting corporate sustainability for its own sake rather than its being integrated strategically into each company's decision-making process (Baron, 2001). Therefore, this study posits that in the Indonesian banking industry, as an emerging country context, companies with higher sustainability concern may have lower financial health and market value in the short-term period.

Hypothesis 3: Company sustainability concern have a negative influence on both company financial health and market value.

4.5. Results

4.5.1. The Statistic Descriptive

Table 4.1 contains a statistical description of the indicators of the impact of the board of commissioners' role on company financial performance through its sustainability concerns. Overall, this study shows that the indicators of the board of commissioners' role in Indonesian banking companies has followed the corporate governance reforms regulation by fulfilling the mandate to have at least 50 per cent independent (outside) commissioners, to have a minimum of three commissioners on the board and to hold a minimum of four meetings per year.

The table 4.1 shows that the average proportion of independent commissioners on the board (PICOB) is 58 per cent (maximum = 100 per cent and minimum = 25 per cent), the average board of commissioners size is 165 per cent which equals 5 (five) commissioners on the board (maximum = 400 per cent and minimum = 67 per cent), and the average number of board of commissioners meetings per year is 374 percent which equals to 15 times per year (maximum = 1600 per cent and minimum = 75 per cent). This study also found that the average number of joint meetings between board of commissioners and the management is nine times per year (maximum = 53 times/year and minimum = 1 time/year and the average board of commissioners compensation is IDR 10,870 Million/year (maximum = IDR 81,967 Million and minimum = IDR 324 Million). One U.S. dollar equals approximately IDR 13,514. However, the Bank of Indonesia as the regulator should give more attention to the board of commissioners' ownership

because the average of its ownership in Indonesian commercial banks slightly exceeds 5 per cent as the maximum ownership regulation, at 5.8 percent (maximum = 72 percent and minimum=0 percent).

Table 4.1 : The Statistic Descriptive

Indicators	Min	Max	Mean	Std. Dev	VIF
Tobins	0.87	1.61	1.09	0.13	1.00
Z Score	-2.91	3.45	1.15	0.69	1.00
CAR	-2.38	9.94	1.15	0.98	1.00
NPL	0.00	0.18	0.017	0.02	1.00
NOP	-0.02	1.32	0.03	0.09	1.00
NIM	0.00	0.17	0.06	0.02	1.00
LDR	0.09	1.13	0.78	0.15	1.00
PICOB	0.25	1.00	0.58	0.12	1.25
ExcBoCSize	0.67	4.00	1.65	0.62	1.61
BoCMeet	0.75	16.00	3.74	3.58	1.96
JointMeet	1.00	53	9.23	6.45	1.58
BoCOwn	0.00	0.72	0.058	0.15	1.05
REMBoc	324	81,967	10,870.75	13,666.56	1.79
SO	0.14	0.93	0.41	0.15	1.89
PR	0.00	0.80	0.29	0.21	2.32
LA	0.00	0.96	0.24	0.21	4.40
HR	0.00	0.92	0.08	0.15	4.08
EN	0.00	0.75	0.09	0.16	6.34
EC	0.06	0.94	0.23	0.19	6.20
Valid N (listwise)	252				

Notes: **PICOB** : proportion of independent commissioners on the board; **ExcBoC Size** : percentage of excess minimum number of board of commissioners (at least three persons); **BoCOwn** : percentage of board of commissioners Shareholders ownership; **Rem BoC** : total board of commissioners cash compensation in a year (in million Indonesian Rupiahs); **BoC Meet** : percentage of excess of minimum meeting in a year (four times a year); **Joint Meet** : Number of joint meeting between board of commissioners and board of directors in a years; **CAR** : Capital Adequacy Ratio; **NPL**: Non-Performing Loan; **NOP** : Net Open Position; **NIM** : Net Interest Margin; **LDR** : Loan to Debt Ratio; **Z Score**: Revision Altman's Z score for financial health mesrument and **TOBINS**: Tobin's Q for firm market value performance; **SO**: disclosure of corporate society activities concern; **PR**: disclosure of corporate product responsibility activities concern; **LA** : disclosure of corporate labour practices concern; **HR**: disclosure of corporate human right activities concern; **EN**: disclosure of corporate environmental activities concern; and **EC**: disclosure of corporate economic activities concern

Moreover, this study shows that corporate sustainability concerns in Indonesian commercial banking companies is still in the early stage with, poor and patchy implementation depending on their disclosure. Overall, the six indicators of corporate sustainability concerns reveal that the average level of disclosure on economic, environment, and social aspects, which consist of product responsibility, labour, human rights and society are below 50 per cent. The highest average on sustainability concerns was found in society performance disclosure, with 41 per cent (maximum = 91 per cent and minimum = 14 per cent); and the lowest sustainability concern was found in environmental performance disclosure with nine per cent (maximum = 75 per cent and minimum = 0 per cent). This study noticed that most of the Indonesian commercial banks are healthy companies as the average Z-score is 1.15 (maximum = 3.45 and minimum = -2.91). It is slightly above the cut-off limit score of 1.1 as a non-distressed company; however, this is still in the grey area as it is below the level for a safe company. Thus, the average company's market value is 109 per cent (maximum = 161 per cent and minimum = 87 per cent), which mean that the banking company's market value was over-valued.

Furthermore, this study conducted a correlation analysis to examine the potential of substitution or complementary effect among indicators in the board of commissioners' role as an internal corporate governance mechanism. In Table 4.2, we found the substitution effect shown through significant negative association between proportion of independent commissioners and the board of commissioners' size, the board of commissioners' compensation and the board of

commissioners' joint meetings ($r = -0.46$, $r = -0.29$; $\rho < 0.01$ and $r = -0.14$; $\rho < 0.05$). Further, there is also significant negative association between board of commissioners' ownership and the board of commissioners' size, the board of commissioners' meetings, board of commissioners' joint meetings and the board of commissioners' compensation ($r = -0.17$, $r = -0.17$; $\rho < 0.01$ and $r = -0.16$, $r = -0.13$; $\rho < 0.05$).

Moreover, I also notices a complementarity effect, which can be shown by the significant positive association between board of commissioners' compensation and the board of commissioners' size, the board of commissioners' meetings and the board of commissioners' joint meetings ($r = 0.66$, $r = 0.39$ and $r = 0.39$; $\rho < 0.01$). Thus, a significant positive association is found between board of commissioners' joint meeting and the board of commissioners' size and the board of commissioners' meetings ($r = 0.17$, $r = 0.67$; $\rho < 0.01$); and between the board of commissioners' size and the board of commissioners' meetings ($r = 0.21$; $\rho < 0.01$).

Table 4.2 : The Indicators Correlation Matrix

Indicators	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)
Tobin's Q (1)	1.00	.																	
ZScore (2)	0.52**	1.00																	
CAR (3)	0.12	0.60**	1.00																
NPL (4)	-0.14*	-0.48**	-0.33**	1.00															
NOP (5)	-0.05	-0.210**	-0.19**	0.17**	1.00														
NIM (6)	0.28**	0.36**	0.05	-0.12	-0.02	1.00													
LDR (7)	-0.01	0.13*	-0.05	0.08	-0.09	0.29**	1.00												
PICOB (8)	-0.13*	-0.09	-0.04	-0.04	-0.03	-0.09	-0.26**	1.00											
BoC Size (9)	0.15*	0.17**	-0.11	-0.12	0.08	0.23**	0.31**	-0.46**	1.00										
BoC Meet (10)	-0.07	-0.24**	-0.24**	0.08	0.16*	0.07	-0.08	-0.02	0.21**	1.00									
Joint Meet (11)	-0.09	-0.21**	-0.22**	0.15*	0.11	-0.00	0.09	-0.14*	0.17**	0.67**	1.00								
BoCOwn (12)	-0.19**	0.02	0.08	-0.11	-0.14*	-0.07	-0.21**	0.13*	-0.17**	-0.17**	-0.16*	1.00							
REMBoc (13)	0.26**	0.21**	-0.14*	-0.19**	-0.01	0.31**	0.21**	-0.29**	0.66**	0.39**	0.39**	-0.13*	1.00						
SO (14)	0.10	0.11	-0.14*	-0.19**	0.02	0.17**	0.20**	-0.19**	0.45**	0.19**	0.31**	-0.00	0.56**	1.00					
PR (15)	0.03	0.02	-0.17**	-0.01	0.14*	0.14*	0.21**	-0.04	0.40**	0.34**	0.30**	-0.30**	0.47**	0.40**	1.00				
LA (16)	0.05	0.17**	0.02	-0.14*	-0.02	0.18**	0.33**	-0.16*	0.54**	0.29**	0.22**	-0.13*	0.65**	0.57**	0.61**	1.00			
HR (17)	0.05	0.20**	0.03	-0.15*	-0.07	0.08	0.26**	-0.15*	0.41**	0.13*	0.19**	-0.13*	0.49**	0.57**	0.56**	0.63**	1.00		
EN (18)	0.06	0.13*	-0.06	-0.06	0.08	0.06	0.33**	-0.23**	0.57**	0.37**	0.34**	-0.27**	0.61**	0.47**	0.65**	0.70**	0.67**	1.00	
EC (19)	0.09	0.14*	-0.05	-0.07	0.04	0.17**	0.23**	-0.21**	0.56**	0.39**	0.34**	-0.25**	0.68**	0.51**	0.61**	0.69**	0.68**	0.78**	1.00

Notes: *. Correlation is significant at the 0.05 level (2-tailed). **. Correlation is significant at the 0.01 level (2-tailed).

PICOB : proportion of independent commissioners on the board; **ExcBoC Size** : percentage of excess minimum number of board of commissioners (at least three persons); **BoCOwn** : percentage of board of commissioners Shareholders ownership; **Rem BoC** : total board of commissioners cash compensation in a year (in million Indonesian Rupiahs); **BoC Meet** : percentage of excess of minimum meeting in a year (four times a year); **Joint Meet** : Number of joint meeting between board of commissioners and board of directors in a years; **CAR** : Capital Adequacy Ratio; **NPL**: Non-Performing Loan; **NOP** : Net Open Position; **NIM** : Net Interest Margin; **LDR** : Loan to Debt Ratio; **Z Score**: Revision Altman's Z score for financial health mesrument and **TOBINS**: Tobin's Q for firm market value performance; **SO**: disclosure of corporate society activities concern; **PR**: disclosure of corporate product responsibility activities concern; **LA** : disclosure of corporate labour practices concern; **HR**: disclosure of corporate human right activities concern; **EN**: disclosure of corporate environmental activities concern; and **EC**: disclosure of corporate economic activities concern

Table 4.3 : The Construct Correlations Matrix

Constructs	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Role BoC (1)	1.00								
Sustainability Concerns (2)	0.75***	1.00							
Capital (3)	-0.15***	-0.16***	1.00						
Asset (4)	-0.28***	-0.20***	-0.24***	1.00					
Management (5)	-0.06	-0.05	-0.09	0.23***	1.00				
Earning (6)	0.26***	0.14**	-0.00	-0.03	-0.15***	1.00			
Liquidity (7)	0.15***	0.21***	-0.18***	0.03	-0.04	0.28***	1.00		
Financial Health (8)	0.25***	-0.10*	0.46***	-0.48***	-0.45***	0.37***	0.10*	1.00	
Market Value (9)	0.29***	-0.07	0.23***	-0.121*	-0.03	0.25***	0.02	0.47***	1.00

Note: *. Correlation is significant at the 0.1 level (2-tailed). ***. Correlation is significant at the 0.01 level (2-tailed).

In addition, Table 4.3 shows that the inter-correlation between the constructs of the role of the board of commissioners as part of internal corporate governance mechanisms and corporate sustainability concerns is strongly positive in order to maintain corporate financial performance ($r = 0.75$; $p < 0.01$). Further, I found a statistically significant correlation between constructs the role of board of commissioners and the company sustainability concerns (“P”) with financial information sources (“I”) of capital, asset, earning and liquidity ($r = -0.15$, $r = -0.29$, $r = 0.26$, $r = 0.15$; and $r = -0.16$, $r = -0.20$, $r = 0.14$, $r = 0.21$; $p < 0.01$).

4.5.2. Measurement (Outer) Model Assessment

This study analysed the measurement (outer) model by examining individual item reliability, internal consistency or construct reliability, average variance extracted analysis, and discriminant validity. This study described nine constructs in the research framework by using two different types of indicators, namely: reflective and formative indicators. In this study, the reflective measures consist of seven constructs with a single indicator, which are CAPITAL, ASSET, MANAGEMENT, EARNING, LIQUIDITY, FINANCIAL HEALTH and MARKET VALUE. While, for formative measures consists of two constructs, which are ROLE OF BOC and SUSTAINABILITY CONCERNS.

In PLS, to assess individual indicator reliability for reflective measures by observing the loadings value or simple correlation of the indicators with their respective construct. Table 4.4 shows all of the seven reflective indicators have the maximum level, 1.00, which is above a widely acceptable indicator reliability

at 0.707 (Chin, 1998). It indicates that each reflective indicator as constituent of a manifest variable or construct. Moreover, table 4.4 also exhibits all the composite reliability (CR) values above 0.700 to measure the construct reliability, which means that all reflective indicators have variance at least 50% in common with the latent variable.

This study also conducted convergent validity to measure the amount of variance that a reflective construct captures from its manifest variables or indicators and discriminant validity to ensure that the reflective construct has the strongest relationships with its own indicators. I noticed that all the average variance extracted (AVE) values are above 0.50, which means that 50% or more of the indicator variance should be accounted for. Moreover, by employing the heterotrait-monotrait ratio of correlations (HTMT) criterion from Henseler et al. (2015), I found all reflective constructs' HTMT values are below 0.90, which means that the discriminant validity between pairs of reflective constructs has been established. According to Hair et al. (2014), HTMT criterion is superior to assess discriminant validity, instead of the Fornell-Larcker and cross-loadings criterion.

Nonetheless, to assess individual indicator reliability for a construct with formative measures is not appropriate and illogical to use the same technique as reflective measures, which can lead to misleading because intraset correlation to obtain construct are never taken in the estimation process. All indicators for a formative construct might be completely uncorrelated (independent) across two or

more components; therefore, it should use weight factors (Chin, 1998). The weight factors represents canonical correlations analysis, which is the value meaning very different in terms of reliability measures. The weight factors provide information to understand how each indicator create or contribute to latent variable (construct).

Table 4.4 exhibits the weight factors and the level of significance for twelve indicators associated with two formative constructs, which are ROLE OF BOC and SUSTAINABILITY CONCERNS. It indicates twelve indicators that cause the formation of two constructs. Further, PLS could not use the traditional parametric procedure to determine coefficient significance level for estimating the factor loading, or weight magnitude and path coefficients. Hence, this study includes non-parametric of resampling procedure using bootstrapping method due to the data is assumed as non-normal distribution. Then, to avoid systematically biased on the results of significance test, this study examined the factor loading, or weight magnitude and path coefficients by using 5,000 bootstrap samples with no sign change option for 1% significance level ($\alpha = 0.01$; one-tailed test) as recommendation by Chin (1998) and Hair et al. (2014). When the results show for each “t” value above 2.33, 1.97 and 1.67, which means that the loading, or weight and path coefficients represent significantly different from zero at 1%, 5%, and 10% significance levels respectively.

Table 4.4 : The Measurement (Outer) Model Result

Constructs	Loadings	Weights	Observed <i>t</i> -value	CR	AVE	Signi.- level 1- tail
Role of Board of Commissioner (Formative) :						
PICOB	-0.272	0.00	0.02			0.49
BoC SIZE	0.724	0.322	3.54			0.00
BoCOWN	-0.273	0.162	2.66			0.00
BoCMeet	0.518	0.061	0.53			0.30
JointMeet	0.241	-0.039	0.53			0.30
RemBoC	0.935	0.750	7.95			0.00
Company Sustainability Concerns (Formative)						
EC	0.944	0.745	3.41			0.00
EN	0.864	0.166	0.71			0.24
HR	0.708	0.477	2.48			0.01
LA	0.874	0.153	0.98			0.16
PR	0.772	0.139	1.05			0.15
SO	0.753	0.304	3.29			0.00
Capital						
CAR	1.00	1.00		1.00	1.00	0.00
Asset						
NOP	1.00	1.00		1.00	1.00	0.00
Management						
NPL	1.00	1.00		1.00	1.00	0.00
Earning						
NIM	1.00	1.00		1.00	1.00	0.00
Liquidity						
LDR	1.00	1.00		1.00	1.00	0.00
Financial Health						
Revised Altman Z Score	1.00	1.00		1.00	1.00	0.00
Market Value						
Tobin's Q	1.00	1.00		1.00	1.00	0.00

Notes: **PICOB** : proportion of independent commissioners on the board; **ExcBoC Size** : percentage of excess minimum number of board of commissioners (at least three persons); **BoCOWN** : percentage of board of commissioners Shareholders ownership; **Rem BoC** : total board of commissioners cash compensation in a year (in million Indonesian Rupiahs); **BoC Meet** : percentage of excess of minimum meeting in a year (four times a year); **Joint Meet** : Number of joint meeting between board of commissioners and board of directors in a years; **CAR** : Capital Adequacy Ratio; **NPL**: Non-Performing Loan; **NOP** : Net Open Position; **NIM** : Net Interest Margin; **LDR** : Loan to Debt Ratio; **Z Score**: Revision Altman's Z score for financial health mesrument and **TOBINS**: Tobin's Q for firm market value performance; **SO**: disclosure of corporate society activities concern; **PR**: disclosure of corporate product responsibility activities concern; **LA** : disclosure of corporate labour practices concern; **HR**: disclosure of corporate human right activities concern; **EN**: disclosure of corporate environmental activities concern; and **EC**: disclosure of corporate economic activities concern

This study found that three formative indicators of ROLE OF BOC (BoC Size, BoCOWN, and RemBoC) and SUSTAINABILITY CONCERNS (EC, HR and SO), as well as all seven reflective indicators of the bank information and company financial performance have significant values at the 1% level, while the six remaining indicators do not have significant values. This empirically suggests that the construct of the board of commissioners' role is primarily formed by the board of commissioners' size, the board of commissioners' ownership and the board of commissioners' compensation. Meanwhile, for the construct of corporate sustainability concern is primarily formed by corporate responsibility activities that relate to economic, human right and society performances.

However, by employing formative measures might be deals with the multicollinearity problem among the indicators. This could generate unstable estimates and make it difficult to identify separate different effect between indicators to the respective construct. This study found that all indicators in formative constructs have variance inflation factors (VIF) ranging between 1.05 and 6.34 (see Table 4.1). The highest VIF value was 6.34 for environment indicators. It is somewhat above 5, as the rule of thumb, but still below 10, implying that all indicators do not have a multicollinearity problem and are independent of one another (Hair et al., 2014).

4.5.3. The Structural (Inner) Model Assessment

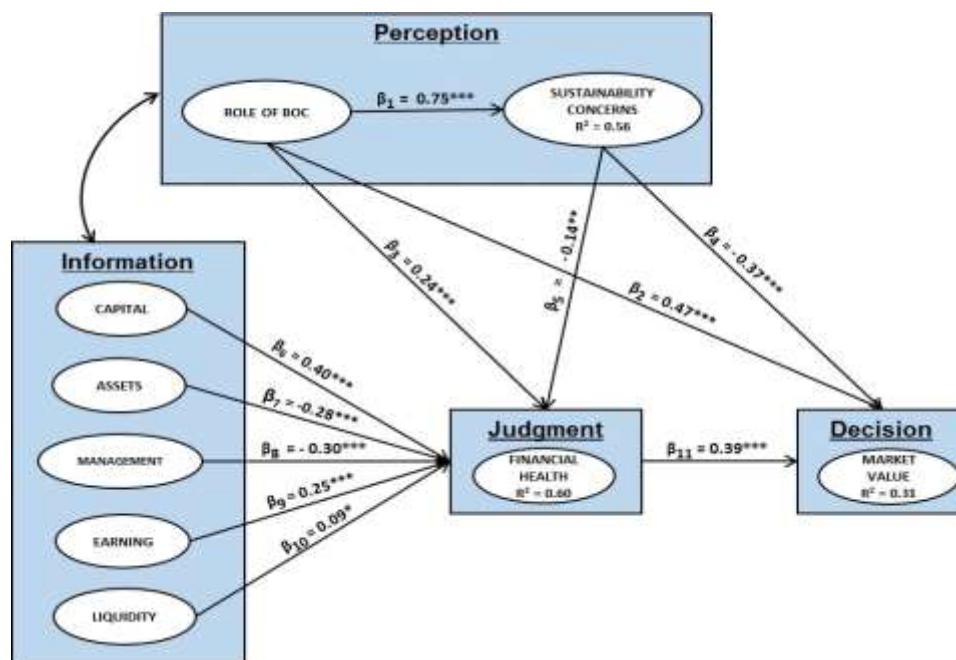
The structural model represents the relationship among constructs or latent variables hypothesised in the research model. In this study, I built and tested

four different research models to explain different impacts and integration of aforementioned constructs. To provide additional assurance that our results are not partially attributable to an incomplete first stage model, I augmented our first and second stage models by including the lagged time effect for the role of BoCs and sustainability concern, as well as examining the endogeneity effect in the third and fourth models by reversing the direction between these two constructs.

In PLS, the path among constructs can be interpreted as standardized beta weights in regression analysis. In the research model 1 (see Table 4.5, Figure 4.2) nine of eleven initial set of paths are revealed to be significant at 0.99, one initial path is significant at 0.95, and the remaining one is significant at 0.90. However, for simplicity, the inter-correlation between the perception ("P") that consists of the role of board of commissioners, and sustainability constructs and all five indicators of the bank's information ("I") is provided in Table 4.3 instead of in Figure 4.3.

In research model 1 (see Table 4.5, Figure 4.3), this study incorporated both the board of commissioners' role and company sustainability concern as investors' perception to investigate the impact on the judgment of the bank's performance in financial health and market value decision choice. This study found by following the **P → D** pathway from the Throughput Model that there is a direct significant positive influence of the role of the board of commissioners on company sustainability concern ($\beta_1 = 0.75$, $\rho < 0.01$; $R^2 = 0.56$). Further, this study revealed an indirect significant positive influence of the role of the board of

commissioners on both banks' financial performance, which are banks' financial health ($\beta_3 = 0.24, \rho < 0.01; R^2 = 0.60$) and firm value ($\beta_2 = 0.47, \rho < 0.01; R^2 = 0.31$) through company sustainability concern. Moreover, this study also found that the banking sustainability concern has direct negative influence both its financial health and market value performance ($\beta_5 = -0.14$ and $\beta_4 = -0.37; \rho < 0.01$). Those results reveal that both corporate sustainability concerns and company financial health acts as partial mediators in the relationship between the board of directors' role and firms' market value. Thus, I finds the judgment of bank's financial health has significant direct positive effect on the decision of the firm's value ($\beta_{11} = 0.39, \rho < 0.01$), which is consistent with prior research.



Figure

4.3 : Research Model 1 the Board of Commissioners' Role on Corporate Sustainability Concerns

Table 4.5: The Role of Board Commissioners Leading to Higher Sustainability Concerns and Company Performance

Pathways	Model 1	Model 2
Role BoC → Sustainability Concern (β_1)	0.75***	-
(P→D) Role BoC → Firm's Market Value (β_2)	0.47**	0.27
(P→J) Role BoC → Firm's Financial Health (β_3)	0.24***	0.14
(P→D) Sustainability Concerns → Firm's Market Value (β_4)	-0.37***	-0.11 *
(P→J) Sustainability Concerns → Firm's Financial Health (β_5)	-0.14***	-0.14**
(I→J) Capital → Financial Health (β_6)	0.41***	0.37***
(I→J) Asset → Financial Health (β_7)	-0.28***	-0.26***
(I→J) Management → Financial Health (β_8)	-0.30***	-0.28***
(I→J) Earning → Financial Health (β_9)	0.25***	0.27***
(I→J) Liquidity → Financial Health (β_{10})	0.09*	0.06
(J→D) Financial Health → Firm's Market Value (β_{11})	0.39***	0.41 ***
Role BoC * Sustainability Concern → Firm's Financial Health (β_{12})	-	-0.06
Role BoC * Sustainability Concern → Firm's Market Value (β_{13})	-	0.002
Multiple R2 (explained variance): Sustainability Concern	0.56	-
Financial Health	0.60	0.61
Firm's Market Value	0.31	0.29

Notes: *Significant at $p < 0.1$ (t value > 1.66); **Significant at $p < 0.05$ (t value > 1.96);

***Significant at $p < 0.01$ (t value > 2.3)

Overall, those findings support hypotheses 1 and 2, which leads to the conclusion that board of commissioners in Indonesian banking companies plays an important role to increase and pursue banking companies' sustainability concern. Thus, the banking companies' sustainability concern is a mediating factor in the relationship between the role of the board of commissioners and company financial performance. Moreover, this study also noticed that banking companies' better financial health would lead to higher market value. Further, ignoring the perception of the board of commissioners' role and sustainability concerns, the stakeholders apparently gave a great deal of attention to higher quality of banks' capital, earnings and liquidity information ($\beta_6 = 0.40$, $\beta_9 = 0.25$; $p < 0.01$; and $\beta_9 =$

0.09; $\rho < 0.01$). Finally, the results suggest that lower banks' assets and management ($\beta_7 = -0.28$ and $\beta_8 = -0.30$, $\rho < 0.1$) may lead to improved financial health.

In research model 2 (Table 4.5, Figure 4.4), this study expanded the model by allowing the perception construct of both the role of the board of commissioners and company sustainability concern separately as well as interact each other to influence company financial performance. Similar to research Model 1, banking sustainability concern continues to have a direct negative effect on both financial health ($\beta_5 = -0.14$, $\rho < 0.05$; $R^2 = 0.61$) and market value ($\beta_4 = -0.11$, $\rho < 0.1$; $R^2 = 0.29$). However, this study failed to find a direct significant influence of the role of the board of commissioners on banking financial health and market value ($\beta_3 = 0.14$ and $\beta_2 = 0.27$, $\rho > 0.1$).

More importantly, the moderating effect between the role of the board of commissioners and sustainability concern does not have any significant impact on either financial health ($\beta_{12} = -0.06$, $\rho > 0.1$) or market value ($\beta_{13} = -0.002$, $\rho > 0.1$). However, this study found a significant positive correlation between the role of the board of commissioners and sustainability concern ($r = 0.14$, $\rho < 0.1$), which supports prior research by Jo and Harjoto (2011) and Beltratti (2005). It reveals that the complementary effect among internal corporate governance, in particular the board of commissioners' role, and sustainability concern exists and is robust.

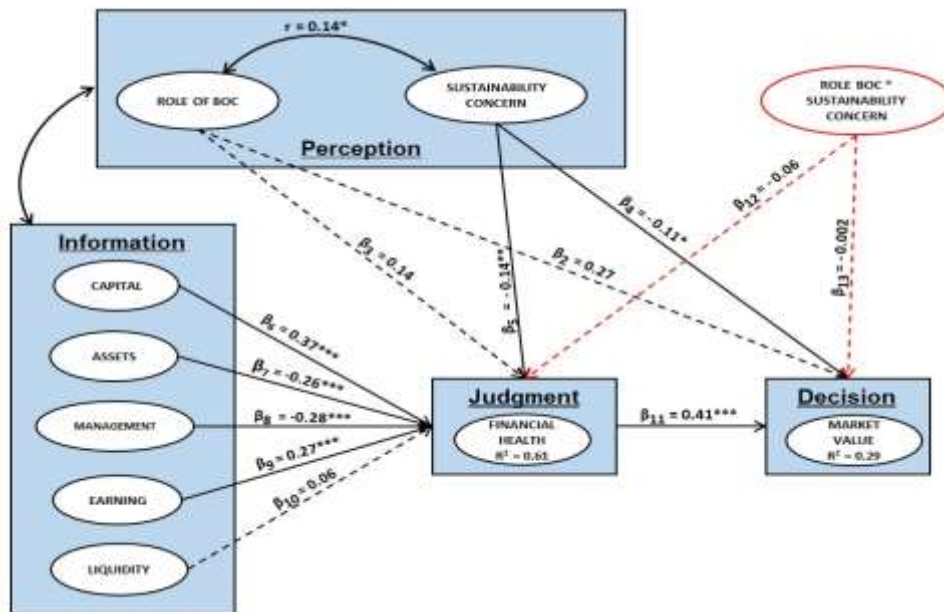


Figure 4.4 : Research Model 2 Interaction between the Board of Commissioners' Role and Corporate Sustainability Concerns

In research model 3 (see Table 4.6, Figure 4.5), this study continued to explore the effect of the previous period ($t-1$ period) of role of the board of commissioners on both current (t period) sustainability concerns and company financial performance more deeply. This study used lagged role of board of commissioners to determine current sustainability concern and the further impact of current bank's financial health and market value. Overall, this Model 3 displays similar result with Model 1. First, this study investigated the relationship of all aforementioned constructs using the agency theoretic pathway (**P→D**). This study found that internal corporate governance mechanisms from the lagged role of board of commissioners have a significant positive influence on current company sustainability concern ($\beta_1 = 0.75$, $p < 0.01$; $R^2 = 0.56$); and continue to have a negative impact on firm's current market value ($\beta_4 = -0.75$, $p < 0.01$; $R^2 = 0.31$).

Table 4.6 : The Lagged of the Role of Board Commissioners Leading to Higher on Sustainability Concerns and Company Performance

Pathways	Model 3
Lagged Role BoC → Current Sustainability Concerns (β_1)	0.76***
(P→D) Lagged Role BoC → Current Firm's Market Value (β_2)	0.47***
(P→J) Lagged Role BoC → Current Firm's Financial Health (β_3)	0.28***
(P→D) Current Sustainability Concerns → Current Firm's Market Value (β_4)	-0.37***
(P→J) Current Sustainability Concerns → Current Firm's Financial Health (β_5)	-0.11
(I→J) Lagged Capital → Current Financial Health (β_6)	0.35***
(I→J) Lagged Asset → Current Financial Health (β_7)	-0.27***
(I→J) Lagged Management → Current Financial Health (β_8)	-0.23***
(I→J) Lagged Earning → Current Financial Health (β_9)	0.21***
(I→J) Lagged Liquidity → Current Financial Health (β_{10})	0.07
(J→D) Current Financial Health → Current Firm's Market Value (β_{11})	0.34***
Multiple R2 (explained variance): Current Sustainability Concerns	0.57
Current Financial Health	0.47
Current Firm's Market Value	0.27

Notes: ***Significant at $p < 0.01$ (t value > 2.33)

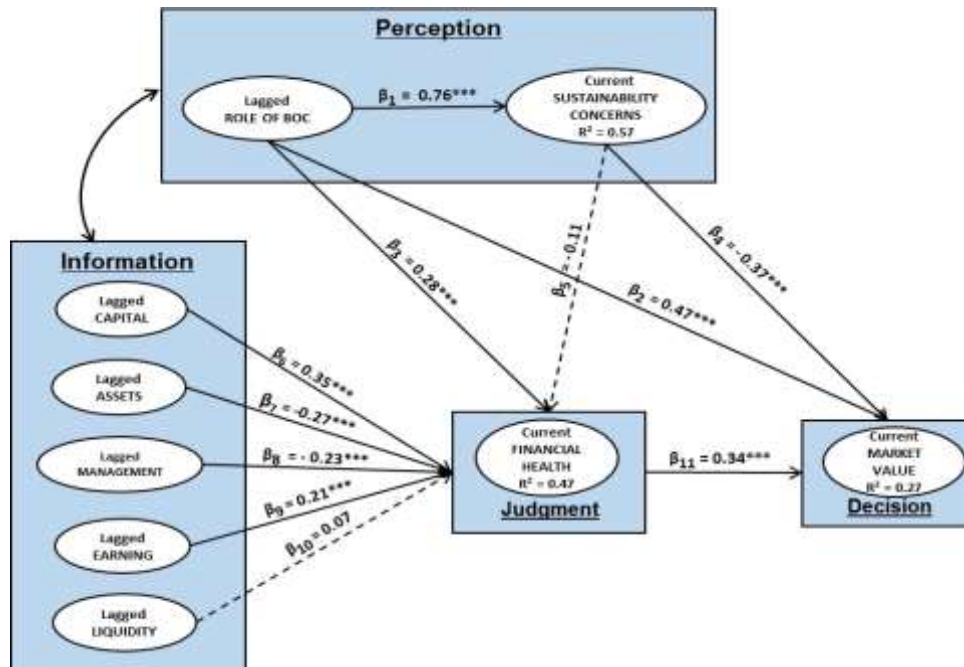


Figure 4.5 : Research Model 3 Lagged the Board of Commissioners' Role on Current Corporate Sustainability Concerns

Table 4.7 : The Lagged of the Company Performance and Current Sustainability Concerns Leading to Improve Current BoC's Role

Pathways	Model 4
Current Sustainability Concerns → Current the Role BoC (β_1)	0.75***
Lagged Firm's Market Value → Current the Role BoC (β_2)	0.21***
Lagged Firm's Financial Health → Current Role BoC (β_3)	0.06*
Lagged Firm's Market Value → Current Sustainability Concerns (β_4)	-0.001
Lagged Firm's Financial Health → Current Sustainability Concerns (β_5)	-0.09
(I→J) Lagged Capital → Lagged Financial Health (β_6)	0.37***
(I→J) Lagged Asset → Lagged Financial Health (β_7)	-0.32***
(I→J) Lagged Management → Lagged Financial Health (β_8)	-0.34***
(I→J) Lagged Earning → Lagged Financial Health (β_9)	0.27***
(I→J) Lagged Liquidity → Current Financial Health (β_{10})	0.06
(J→D) Lagged Financial Health → Lagged Firm's Market Value (β_{11})	0.46***
Multiple R2 (explained variance): Current Sustainability Concerns	0.01
Current The Role BoC	0.65
Lagged Financial Health	0.58
Lagged Firm's Market Value	0.21

Notes: *Significant at $p < 0.1$ (t value > 1.66); ***Significant at $p < 0.01$ (t value > 2.33)

Further, in research model 4 (see Table 4.7, Figure 4.6), this study applied additional analysis by changing the direction of the relationship among the constructs. This study employed and put in place both company financial performance measures as construct predictors for corporate governance and sustainability concerns. I used both lagged (t-1 period) financial health and firm value to determine current (t period) sustainability concern and the role of the board of commissioners. This study found current sustainability concern to have significant positive influence on current the role of board of commissioners ($\beta_1 = 0.75$, $p < 0.01$; $R^2 = 0.65$).

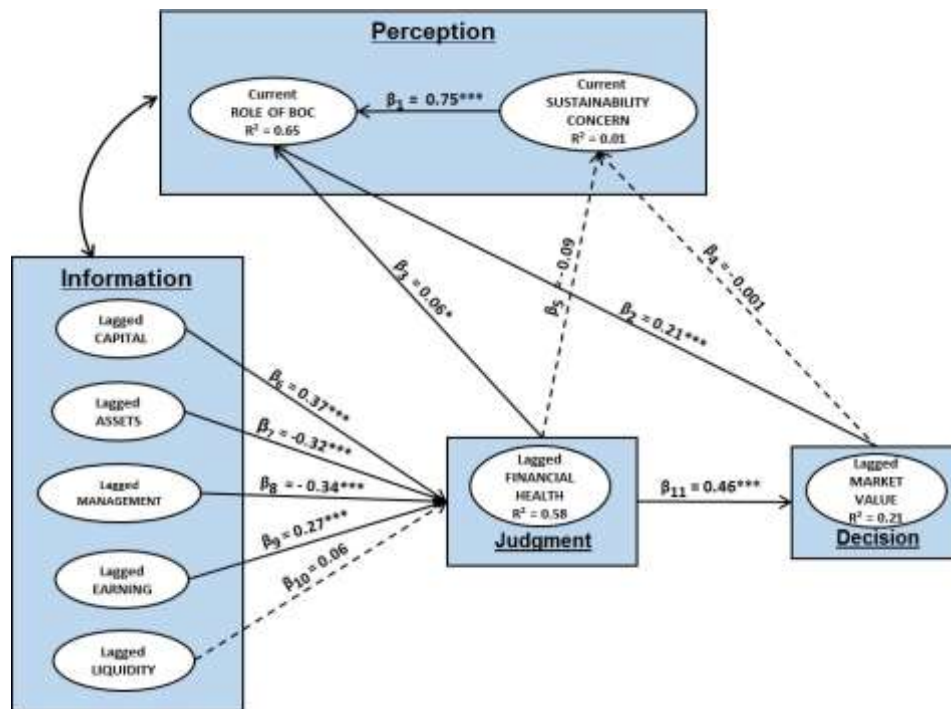


Figure 4.6 : Research Model 4 Lagged Company Financial Performance On Current Sustainability Concerns and the Role of the Board of Commissioners

However, this study documented a different impact from lagged company financial performance on the role of the board of commissioners and sustainability concern. Previously, company's financial health and market value had a positive significant influence on the role of the board of commissioner ($\beta_3 = 0.06$, $\rho < 0.1$ and $\beta_2 = 0.21$, $\rho < 0.01$). However, the impact from lagged financial health and market value shows negative insignificant influence on sustainability concerns ($\beta_5 = -0.09$ and $\beta_4 = -0.001$, $\rho > 0.1$; $R^2 = 0.01$).

4.6. Discussion

This study provides distinctive findings that consider two different perspectives, shareholder and stakeholder views, in a single model of corporate governance - corporate sustainability concern - corporate financial performance

relationship by employing the Throughput Model, a decision- making framework model developed by Rodgers (1997). This study found the board of commissioners in Indonesia banking companies is an important control mechanism to motivate managers to be more concern on corporate sustainability concerns toward corporate responsibility activities. However, a contrary finding appears between the shareholder and stakeholder perspectives when the role of the board of commissioners and company sustainability concern is tightly linked to company financial performance.

According to our framework perspective in the Throughput Model (Rodgers, 1997; Rodgers et al., 2013), adopting the agency theoretic pathway position ("**P→D**") as the shareholder perspective, this study found that corporate sustainability concerns have a significant negative influence on market value performance. Table 6 and Table 7 display "**P→D**" as the relationship between company sustainability concerns and firms' market value in models 1, 2, and 3. In that sense, the banking companies' increased sustainability concern seems not to be reflected in financial payoffs to good social performance or influencing shareholders' benefits (Brammer and Millington, 2008). It is possible for banking companies to increase significant investment expense, using their resources to provide stakeholders' benefit although it may result in lower returns for shareholders compared to the returns from other alternative investment sources.

Moreover, by following the shareholder perspective, this study revealed that the motive of Indonesian banking companies for their sustainability concerns

in daily operation is an altruism motive, engaging in CSR activities only for their own sake and hence, doing so negatively affects financial performance (Baron, 2001). This study argues that Indonesian banking companies are not really concerned with the importance of corporate sustainability activities for boosting their performance. It seems that most Indonesian banking companies failed to link business strategy and their daily operations into sustainability initiatives (i.e. financial, social and environmental) as well as ongoing internal and external communication efforts. This is because they perceive corporate responsibility activities only as damage control or as a public relation campaign, rather than as building shared values (Porter and Kramer, 2006; Michelin et al., 2013; Warren and Thomsen, 2012). Moreover, these activities can be categorized as responsive corporate responsibility with companies being good corporate citizens addressing social norms as related to business operations (Porter and Kramer, 2006).

Further, this result is also supported in research model 2, where we tested the moderation effect of corporate sustainability concern on the relationship between the board of commissioners' role and the firm's market value ("**P→D**"). The result shows that the corporate sustainability concern failed to moderate the effect of the relationship between the role of the board of commissioners and firm's market value. Corporate sustainability concerns are supposed to have a positive effect on company performance if linked to organisational strategy, decision support systems and internal incentives. These findings lead to a conclusion that Indonesian banking companies perceive the importance of corporate sustainability issues that reflect on their policies or reporting, but they

tend not to be very enthusiastic or are slightly wary about practising them in the company. From content analysis process of sustainability or corporate social responsibility report of Indonesian commercial banks, this study reveals most of the banks practises to take corporate social responsibility initiatives are fragmented, disconnected and separated away from their strategic business as the resulting outcome fail to gain and dissipate many opportunities and benefits for both companies and the societies. As I noted that Indonesia commercial banks mainly used corporate investments in corporate social responsibility activities focus on routine charitable initiatives as a short-term, tentative and sporadic strategy to overcome a negative reputation.

Moreover, this study tested the aforementioned relationship constructs in models 1 and 3 using the stakeholders' pathway position ("**I**→**P**→**J**→**D**") based on the Throughput Model. It revealed that the role of the board of commissioners as the supervisory board could be important in internal corporate governance to influence the company management to enhance corporate sustainability concern in line with the stakeholders' demand, which is reflected in better corporate social responsibility activities and may result in the increase of company market value performance. The aforementioned relationship described by Table 4.3 and Table 4.5 suggests that significant influences exist along the stakeholders' perspective pathway, "**I**→**P**→**J**→**D**". First, Table 4.3 implies a statistically significant relationship between four accounting information sources ("**I**") of capital, assets, earnings, and liquidity and the role of the board of commissioners and corporate sustainability concern ("**P**"), as implied by the "**I**→**P**" inter-correlation. Second,

Table 4.5 supports the relationship of “**P→J**” (i.e., the role of the board of commissioners →financial health; and sustainability concern→financial health), whereas the significant relationship of “**J→D**” is viewed as showing the impact of financial health on firm’s market value. The “**I→P→J→D**” pathway suggests that the role of the board of commissioners and corporate sustainability concerns exist and are effective, which counter-balance the agent theoretic pathway (“**P→D**”). The stakeholder's pathway position provides the decision process of the role of the board of commissioners in determining corporate sustainability concerns which affect corporate financial performance both in the intermediary outcome (as a judgment on financial health) and in the final stage (as investors’ decisions based on market value). This study documented in models 1 and 3 that the role of the board of commissioners has a significant positive influence on company sustainability concern.

This finding confirms our hypothesis and generally supports the existing theoretical literature, as expected, such as prior studies in a Taiwanese context from Huang (2010) and in the US banking sector from Jizi et al. (2013). Moreover, this study also noticed that the role of the board of commissioners via corporate sustainability concern indirectly leads to an extended significant positive influence on both company financial health and market value. This result also supports prior studies, which show the board of commissioners' role would be more likely to support the stakeholders' interests. The board of commissioners' functions are to supervise, monitor and motivate the management’s engagement in sustainability concerns, such as corporate responsibility activities, which will

potentially increase financial performance (Pathan and Faff, 2013; Ntim and Soobaroyen, 2013; Jizi et al., 2013; Jo and Harjoto, 2011; Harjoto and Jo, 2011).

Further, this study followed the argument of Jamali et al. (2008) and Huang (2010), which states the two-way interrelationship and overlapping effect between corporate governance - corporate sustainability concern - corporate financial performance. This study changed the relationship direction among the constructs and tested the impact of past period of financial performance on both current role of the board of commissioners and current corporate sustainability concern. This study documented that lagged financial health and market value have a positive significant influence on the role of the board of commissioners, but not a significant effect on corporate sustainability concern. This study noticed that the prior period's financial performance could increase the current period's role of the board of commissioners, however, it failed to be mediated by company sustainability concern. This result also supports the argument that the implementation of corporate governance and corporate responsibility activities is interrelated and should not be considered and sustained separately in the company strategic decision process to enhance company performance (Jamali et al., 2008; Jamali and Mirshak, 2007).

This means that Indonesian banking companies consider the past company's financial performance in determining better implementation of future internal corporate governance, particularly the role of the board of commissioners. However, this result fails to provide evidence that company financial performance

could become an exogenous variable for corporate sustainability concern. It can be concluded that corporate sustainability concern actually is robust as an exogenous, or determinant variable for financial performance, which supports the consensus among academic scholars.

This study noticed that among the indicators of the role of the board of commissioners, there is a substitution effect with the significant negative association between the proportion of independent commissioners and board ownership with board size, the board of commissioners' meetings and board compensation. It indicates that the role of the board of commissioners in banking companies with a high proportion of independent commissioners and high board ownership tends to be less dependent on the number of board of commissioners' members, commissioners' compensation and the number of joint meetings between the board of commissioners and board of directors. Moreover, it also revealed a positive association between the board of commissioners' compensation and board of commissioners' joint meeting with the board of commissioners' size and the board of commissioners meetings. It means that higher compensation for the board of commissioners, and a more joint meeting between commissioners and management complements higher board commissioner size and board of commissioners' meetings. This study supports research by Hoskisson et al. (2009), and Zajac and Westphal (1994) which revealed the substitutive and complementary effects among internal corporate governance mechanisms.

4.7. Conclusion

This study advances the discussion of the board of commissioners' role - corporate sustainability - company financial performance relationship for banking companies in a developing country context with a two-tiered CG system. This study examines two major perspectives, shareholders and stakeholders, by employing a decision-making model: the Throughput Model. Adopting this model can conceptually contribute to the calls for future research to explore the relationship between corporate governance and corporate sustainability more deeply as it proposes hypotheses to be tested in different countries and industries. This model enables the investigation of any information of accounting ratios sources that are relevant to determine the role of the board of commissioners and sustainability concern and their influence on the company's financial performance.

This study suggests that the board of commissioners as part of the internal corporate governance mechanism plays an important function by serving the stakeholders' interests by pursuing the management to engage in more corporate social responsibility activities as a company sustainability concern. However, it also highlights that corporate sustainability concerns can play as a mediating effect in the relationship the board of commissioners' role to improve the company's financial performance in terms of both financial health and market value. This study also reveals that the motive of Indonesian banking companies for sustainability concern is still an early stage motive, such an altruism, engaging in corporate responsibility activities only for their own sake. Corporate responsibility activities only provide benefit for shareholders' interests and do not

affect the benefit for stakeholders' interests. Therefore, the results may reduce the company financial performance.

Moreover, this study suggests that corporate governance and corporate sustainability are interrelated and should not be treated separately in the company strategic decision process to enhance company performance. This study also noticed that the past financial performance is important to determine better implementation of current internal corporate governance, particularly the board of commissioners' role. Additionally, this study also reveals that corporate sustainability concern is robust as a determinant factor for financial performance, which supports the consensus emerged among academic scholars.

Chapter 5. Executive Compensation, Corporate Sustainability Concerns and Company Financial Performance

5.1. Introduction

This study investigates whether executive compensation is designed to motivate managers to pursue corporate sustainability in Indonesian listed commercial banks throughout 2007-2014. In addition, this study examines further impact of executive compensation and corporate sustainability concerns on both financial health and market value performance as components of company financial performance.

5.2. Research Background

Over the last two decades, the research examining executive compensation, corporate sustainability (CS), and company financial performance (CFP) displayed a rich and growing literature within the management literature. Moreover, the research discussion has gradually increased among practitioners and academic scholars around the world following the steep rise of executive payment and sustainability issues in companies. Most literature examines impact of executive compensation levels in terms of various determinant factors as well as their effect on key firm-level variables, such as shareholders' profit, firm size, and workers' motivations (van Essen et al., 2015; Liu and Taylor, 2008; Gomez-Mejia et al., 2003; Bebchuk and Fried, 2003; Main et al., 1995).

However, as the recent worldwide corporate scandals led to firms' collapse and financial difficulties, the ongoing debates in popular media have shifted their main question to whether the high level of executive remuneration is worth paying in order to increase firms' performance and avoid a corporations' financial decline. Moreover, the continuing economic issues and global crisis have extended the debate on the importance of a corporate sustainability agenda toward corporate social responsibility initiatives and practices (Adams and Zutshi, 2004; Campbell, 2007; Carroll, 1991; Fleming and Jones, 2012; Hancock, 2005). Hence, another critical question also arises; whether managers should be rewarded for achieving corporate sustainability targets expected by the company. Companies expect high executive compensation to motivate them to conduct more sustainability initiatives via corporate responsibility activities, such as those related to environmental and social concerns, rather than merely focus on economic interests.

Executive compensation, corporate sustainability, and CFP are well-studied research topics. However, prior literature summarises that the link between those three topics still has mixed and weak results. Some studies suggest that executive compensation does not necessarily promote or consider the creation of a company's sustainable value reflected in corporate responsibility initiatives and practices. It appears to follow the view underlying the shareholder model that "no good deed goes unpunished." That is, executives suffer a lower payment for "doing the right thing". This issue gives rise to an argument that executive compensation does not fit and is not in line with a socially responsible philosophy

(Miles and Miles, 2013). Further, many scholars argue that companies may expect multi-faceted benefits in the long-run by being more socially responsible and engaging in sustainability activity aspects, such as profit, customers' and employees' loyalty, community empowerment, etc. This leads to a relationship that is known as "*sustainability-for-performance*". That is, the companies effectively maintain their performance through managing their activities and demonstrating transformation in stakeholder interaction in economic or financial, environmental, and/or social aspects (Van Marrewijk, 2003).

Most literature regarding executive compensation is derived from the principal-agent problem, which focuses on investigating company performance from the shareholder perspective, which is commonly known as "*pay-for-performance*" relationship. This pay-for-performance relationship can be tracked to the classical institutional issue about separation of ownership and control in the companies (Berle and Means, 1932). Company owners delegate company management to managers, or agents, resulting in different interests between agents, the company, and the shareholders. Therefore, companies through the board of directors, compensate managers with a remuneration structure (i.e. salary, bonus, stock options, and other perquisites) in an attempt to mitigate moral hazard, whereby managers or agents appear to focus only on maximising their own satisfaction rather than maximising shareholders' wealth. Thus, compensation is a way to achieve shareholders' interests linked to company performance (i.e. firm's stock price, or stockholder return) (Frye et al., 2006; Callan and Thomas, 2014).

This agency problem raises an important question, which is whether there is a direct relationship between high executive compensation and company performance, as the observed company outcomes have not yet produced a definitive consensus. Further work is still needed to investigate the links, due to potential different effects that need to be defined regarding the relation of certain variable measures. This situation motivates further inquiry, such as to examine whether there are indirect determinant factors, such as corporate sustainability concerns, affecting the pay-for-performance relationship, which can be suggested as a new term in this study as a *"pay-for sustainability-for- performance"* relationship. This is a relationship whereby companies may influence their executives with proper compensation, expecting them to be motivated not only to achieve high financial outcomes for shareholders, but also to engages in all sustainability activity aspects (i.e. economic, environmental and social concerns) for all stakeholders' interests (Carroll, 1979, 1991, 1999).

Consequently, firms' views may shift from a shareholder perspective to a stakeholder perspective, in which managers or executives are viewed as the agents of the stakeholders, accountable not only to shareholders but also to other stakeholders (Arora and Alam, 2005; Jones, 1995). Hence, the managers, as agents, could be responsible to both of shareholders and stakeholders by maximising shareholders' returns as well as being accountable for fulfilling their responsibilities to all their primary stakeholder's interests that can affect or are affected by the achievement company's objectives (Freeman, 1984). This perspective suggests that the shareholders' interests cannot be met without

satisfying to some degree other stakeholders' needs (Jamali, 2008). In other words, the company's success in serving shareholders' interests is likely to be affected by how a company treats the other stakeholders.

Nonetheless, very few studies have incorporated these topics in a single relationship, such as "pay-for-sustainability-for-performance" relationship, in the context of a developing country. Most prior literature has treated these relationships separately and independently as "pay-for-performance", and/or "sustainability-for-performance" relationships, with mixed and/or unclear results. Thus, research directed at those relationships remains far from complete, and it is understudied in financial sector companies, especially in the banking industry in South East Asia. Moreover, in developed country contexts, such as the United States (US) and United Kingdom (UK), or other European countries, the discourse of executive compensation has mostly focused on how the CEO's compensation can influence financial performance. This situation is considerably different from the Indonesian banking context, since the data regarding the compensation of individual executives and CEOs is not published in the capital market or is widely available to the public.

This study advances the literature by addressing the compensation of the entire team of top executives, instead of only the CEO. Moreover, this study is among the first to assess the inter-relationships among executive compensation, CS concern, and two different CFPs (i.e. financial health and firm's value) by utilising a Partial Least Square-Structural Equation Model (PLS-SEM) technique.

By using new unbalanced panel data of 252 firm-year observations (39 firms) during the period of 2007-2014, this study tests the relationship among constructs using four different research models based on shareholder and stakeholder perspectives. Both perspectives are examined by employing the Throughput Model, a decision-making model from Rodgers (1997) and Foss and Rodgers (2011), consisting of four major concepts, suggesting that decision-makers consider perception (**P**), and information (**I**) to determine a judgment (**J**) in making a decision choice (**D**).

Moreover, this study provides distinctive empirical results including lagged and moderating tests, as well as recognizing the endogeneity among constructs. A one-year lag was used between the constructs of executive compensation, corporate sustainability and financial performance, to capture the different impact of recent and past pay-sustainability-for performance relationships. Furthermore, this study proposes an alternative measurement of corporate sustainability concerns as a company's activity and manifestation of corporate sustainability by analysing the disclosed integrated content of economic, environmental, and social activities within business processes in corporate responsibility (CR) reporting, or sustainability reporting (SR), according to the modification of GRI 3.1 indicators.

Hence, the contribution of this study to the literature can be categorized in the following four areas. First, most of the results provide evidence on pay-for-performance relationships showing that a high executive compensation can

motivate managers to engage in more CS concerns measured by the GRI 3.1 indicators, as well as increase CFP. This study also supports the argument of Mahoney and Thorne (2005) and (2006) that executive compensation is a potential determinant of CS concern. This study demonstrates that executive compensation has a direct positive impact on CS concern and CFPs (i.e. financial health and firm's value) according to the agency and stakeholder perspectives.

Second, the result on the sustainability-for-performance relationships documents a robust negative relation between CS concern and both CFPs (i.e. financial health and firm's value). It can be concluded that the Indonesian banking companies' motivation in engaging in CS concerns is compliance-driven as CS is perceived as a duty and obligation or the right behaviour (Van Marrewijk, 2003). This study discovers that CS activities are conducted only for the companies' own sake, aimed to fulfil normative principles as an altruistic motive (Wu and Shen, 2013; Baron, 2001), which influences the reduction of a company's financial performance. Third, this study finds a distinctive result from shareholders' and stakeholders' perspective in explaining the pay-for sustainability-for-performance relationship. It reveals that executive compensation is designed to encourage managers to pursue more CS concerns for the sake of the shareholder interests, leading to reduced financial performance.

However, utilising the stakeholders' perspective, this study suggests that executive remuneration targets become a sign of a company's commitment to sustainability initiatives, not just as a form of window dressing and/or yet another

perverse mechanism that maintains high executive payment agreed by the board of directors for maximising return in shareholder interests. Moreover, this study acknowledges that CS concern can serve as a negative moderator as well as partial mediator in the relationship between pay-for-sustainability-for-performance. Finally, this study recognises the endogeneity of executive compensation by testing the reverse causality of CS concern as the determinant factor based on stakeholder theory to represent a company's responses to various stakeholders' demands (Belkaoui, 1992; Freeman, 1984; Callan and Thomas, 2011; Stanwick and Stanwick, 2001; Cordeiro and Sarkis, 2008).

5.3. Theoretical Review

5.3.1. The Throughput Model Framework of Executive Compensation and Corporate Sustainability

The Throughput model (Rodgers et al., 2009; Rodgers, 1997; Foss and Rodgers, 2011) is implemented since it accommodates a wide range of underlying stakeholder concerns and their interactions with the target of organisations. Further, this model allows the incorporation of organisational cognitive structures (i.e., strategic perception and judgment) within several decision pathways (Bundy et al., 2013; Narayanan et al., 2011; Mitchell et al., 1997).

The Throughout model explains decision-making pathways by employing perception (i.e. executive compensation and corporate sustainability concerns), availability of information (i.e. bank's accounting information), judgment (i.e. financial health), and decision (i.e. firms' market value) (see Figure

5.1). This study employs two of the six possible pathways to explain and describe the relationships among the constructs, which include executive compensation, corporate sustainability concerns, and CFP (see Figure 2). These two pathways are selected since they best capture: (1) *the agency theoretic pathway position* (**P** → **D**), and (2) *the stakeholders perspective pathway position* (**I** → **P** → **J** → **D**).

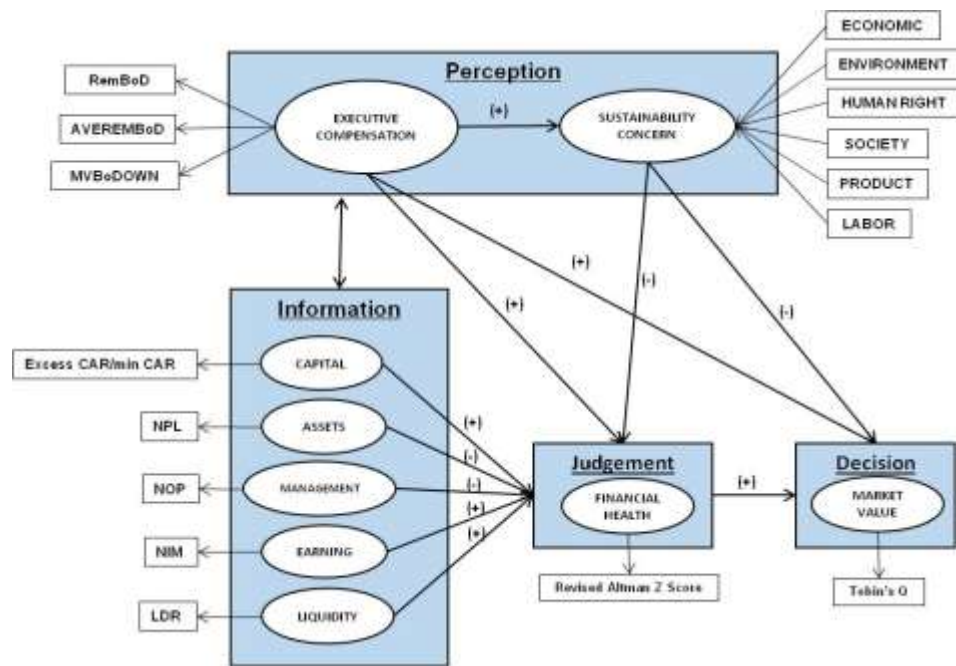


Figure 5.1 : Research Framework Executive Compensation on Corporate Sustainability Concerns

The agency theoretic pathway describes the relationship between constructs using two concepts, “**P**→**D**.” In this context, the decision makers' (i.e. investors') perception is that executive compensation encourages managers to be more concerned about corporate sustainability initiatives and increases disclosure of corporate social responsibility to reduce information asymmetry in the decision-making process. In this pathway, managers are assumed to maximise shareholders' interests and purpose on firm's market value without any

consideration of the bank's accounting "information" and "judgment" regarding the company's financial health.

The stakeholders' perspective position pathway describes the relationship among constructs using four concepts: "**I→P→J→D.**" It represents the stakeholder' perspective on the decision-making process by depicting executive compensation as well as corporate sustainability concern, emphasising a systematic and programmatic approach. This symbolises the ethics of care position, assuming that managers are compensated highly, which implies their responsibility to listen to distinct interests and to build harmony with shareholders and all stakeholders through corporate sustainability engagement, in order to gain legitimacy to enhance company performance. The decision maker follows the guidelines from verified information by analysing it (i.e., judgment) before making a decision choice. Specifically, this pathway allows decision makers to pay attention to the utility of banks' information, in order to establish their judgments on financial health.

5.4. Hypothesis Development

5.4.1. The Relationship between Executive Compensation and Corporate Sustainability

This study suggests the existence of a direct positive relationship between executive compensation and corporate sustainability, which is in line with the shareholder and stakeholder perspectives, both of which derive from the same root of the principal-agent problem (Jensen and Meckling, 1976). According

to the shareholders' perspective, executive compensation is an internal corporate governance issue that can be expected to affect managers' response. Managers are assumed to mainly represent shareholders' involvement (controlling or non-controlling interests) in the company's operations. They tend to be encouraged to pursue and disclose corporate responsibility activities properly in order to reduce information asymmetry for shareholders' purposes. In contrast, the stakeholders' perspective indicates that managers will be rewarded with high compensation if they can act as the stakeholders' managers who are responsible not only to maximize owners' or shareholders' wealth (as primary stakeholder interests), but also to create long-term value for the interests of other stakeholders, such as customers, societies, employees, and regulator (Jones, 1995; Arora and Alam, 2005).

The stakeholders' perspective assumes that managers, as agents, are rewarded not only for improving the firm's financial position, but also for motivating the company to do more corporate responsibility activities, in accordance with the stakeholders' concern. Those activities are intended to enhance customers' satisfaction and loyalty, to improve employees' safety and health, to reduce waste and pollution outcomes, and to enhance the quality of the societies, or communities, etc. (Callan and Thomas, 2014). In other words, by broadening the focus towards different stakeholders' interests, instead of merely focusing on shareholders' wealth, companies may improve their managerial decisions. However, this may result in not only the increase of shareholders'

interest expenses, but also high agency costs of being a socially responsible firm (Frye et al., 2006).

Summarising existing research, there are various results explaining the relationship between executive compensation and corporate sustainability concerns. Recently, most results appear to partially support such a relationship. Some findings show that the direct relationship indicates a positive result (Callan and Thomas, 2011, 2014; Mahoney and Thorne, 2006). However, others have documented that this relationship implies negative results (Miles and Miles, 2013; Cai et al., 2011; Frye et al., 2006) and is also investigated for a pay-environmental performance relationship only (Berrone and Gomez-Mejia, 2009; Cordeiro and Sarkis, 2008; Stanwick and Stanwick, 2001; Zou et al., 2015).

Callan and Thomas (2011) found that CEO compensation as measurement for executive compensation has positive significant on e corporate social performance. They suggest that the company's investment in corporate social responsibility may have a net benefit in the short run, which is rewarded contemporaneously. However, during over time, the benefits in terms of the company's reputation and stakeholders' appreciation from the corporate social responsibility will be diminishing, although the costs of investing in corporate social responsibility are ongoing. Therefore, the reward to CEOs for investing in socially responsible behaviour appears to be limited to the initial period in which the investment takes place.

Callan and Thomas (2014) investigate the influence of CEO compensation on corporate social performance using large balance data panel from KLD throughout 2003 - 2005. They find executive compensation have positive significant on corporate social performance parameter. They suggest that CEOs receive higher levels of remuneration in the companies which more socially responsible in the period concurrent with the activity. However, this CEO compensation does not extend into subsequent periods due to the net benefits to the company of CSR investments may be likewise short-lived period.

Mahoney and Thorne (2006) conducted a study of Canadian companies by using three components of executive compensation – CEO's salary, CEO's percent bonus, and CEO's percent stock options – as predictors for corporate social performance that measured by corporate social responsibility rating from Canadian Social Index Database (CSID). They suggest that all the three of executive compensation measure have positive significant association with corporate social responsibility rating.

The mixed findings in recent studies demonstrate that consensus on explaining this relationship has not been reached and that further studies are clearly needed in this area. Moreover, the existing studies mainly examine a one-directional relation, which is from executive compensation to corporate social responsibility or from corporate social responsibility to executive compensation. Very few studies consider testing the inverse relationship in an endogeneity test among the constructs.

This study expects the relationship between executive compensation and corporate sustainability to be positive, relying on the traditional economic view that considers money as an indicator of success and satisfaction. In this situation, high executive compensation can be an effective tool to align executive self-interest in maximising its wealth with the “company common good” results by engaging in more sustainability responsible actions.

Hypothesis 1: Executive compensation has significant positive influence on corporate sustainability concern.

5.4.2. The Relationship between Executive Compensation and Company Financial Performance

Most recent studies performed in developed countries, such as the US, UK, and other Asian countries, find that pay-for-performance relationship has a positive correlation (Banker et al., 2013; Matolcsy, 2000; Ozkan, 2011, 2007; Kato et al., 2007; Firth et al., 2006). However, some empirical studies indicate that executive pay does not in fact correlate much, if at all, with the fortunes of the company (Tosi et al., 2000; Kato et al., 2007; Abdullah, 2006; Gomez-Mejia and Wiseman, 1997; Main et al., 1995; O'Reilly and Main, 2010); while others report the existence of a negative correlation (Bebchuk and Fried, 2005, 2003).

Most of the positive results in pay-for-performance relationship studies rely on “the optimal contracting approach” pioneered by Mirrlees (1976) in which executive compensation is expected as a (partial) remedy of the agency problem (Bebchuk and Fried, 2003; Bebchuk et al., 2002). This approach indicates that

shareholders, as principal, through the board of directors agree to provide an optimal compensation contract with an efficient payment scheme for managers as the agents, who will act in accordance with shareholders' interests, aiming to maximise their value. Hence, executive compensation can be expected to control managers' moral hazard from maximising their self-interest and align it towards maximising the company's return.

In contrast, studies with negative results are mostly based on "*the managerial power approach*," which views executive compensation as a part of the agency problem (Bebchuk and Fried, 2003). This approach assumes that the separation of ownership and control leads to managers' substantial power to influence organisational outcomes, which determines the excessive amount of their compensation and "neglects" the shareholders' interests. In the design of executive compensation structures by the board of directors cannot be expected to handle and bargain at arm's length with managers. The managers remain capable of performing a strong moderating role regarding the compensation arrangement scheme, which imposes substantial cost and extracts a high amount of rent from shareholders, which ultimately reduce corporate performance.

Recent studies in the US context find that current CEO salary, not CEO bonus, is positively associated with firms' past and future performance (Banker et al., 2013). CEO cash compensation should be disaggregated into salary and bonus components. Salary should be adjusted regularly to meet the reservation utility and information rent as a signal about CEO's ability. On the other hand, CEO

bonus may be used to serve moral hazard and adverse selection by separating high-ability agents and riskier contracts. Similarly, in the UK, CEOs remain capable of arranging high own remuneration even though the company's performance (i.e. profit and share prices) is in decline and low (Ozkan, 2007, 2011). This implies that managers do not always pay attention or concern on shareholders' interests, especially in relation to executive compensation. In contrast, some logical explanations maintain that excessive executive compensation can actually have a significant negative effect on shareholder profits (Bebchuk and Fried, 2003) and reduce workers' motivation (Main et al., 1995). In comparison, most studies in an Asian context display positive results. Positive results on the pay-for- performance relationship are found in China's SOE context (Firth et al., 2006), China's listed companies (Conyon and He, 2011; Firth et al., 2006; Kato and Long, 2006) and also in Korean non-Chaebol companies (Kato et al., 2007).

These mixed results initiate this study to investigate the role of pay-for-performance in a distinctive national/institutional environment and complex industry. Our study posits that the executive compensation designed by the Board of Commissioners in the Indonesian context is an effective tool to control and align managers' moral hazard in maximising their self-interest so that the company's return can be maximised and achieve shareholders' interests. Moreover, this study also expects that executive compensation may have an indirect positive correlation with company financial performance through

corporate sustainability concern. Therefore, the second and third hypotheses will be described as follows:

Hypothesis 2: Executive compensation has positive influence on company financial health and market value performance.

Hypothesis 3: Executive compensation has an indirect positive correlation with company financial performance via corporate sustainability concern.

5.4.3. The Relationship between Corporate Sustainability and Company Financial Performance

Empirical studies to investigate the relationship between corporate sustainability and company financial performance through corporate social responsibility engagement were started in the early 1970's, with the purposes not only to find out the relationship, but also to identify the causality direction. However, during the last two decades, companies' successful development and long-term corporate sustainability activities in their strategic decisions with performance measurement have received growing attention from researchers and practitioners. However, prior empirical findings produce some conflicting and inconsistent positive or negative results, while others reveal weak statistical results.

The differing results are possibly related to companies' reasons for pursuing corporate social responsibility, as well as their other internal or external mechanisms mediating the relationship between sustainability and performance (Margolis et al., 2007). Accordingly, the literature states that companies' varied

reasons for conducting corporate social responsibility activities, such as strategic choices, altruism, and greenwashing, may be responsible for inconsistent results (Wu and Shen, 2013; Baron, 2001).

The link between corporate sustainability and company financial performance in companies with a strategic choices rationale may lead to the increase of company financial performance through the incorporation of corporate social responsibility implementation in business strategic decisions and practices. Meanwhile, the link based on an altruism motive may indicate that the company only engages in corporate social responsibility activities because of its self-interest, which negatively affects the company financial performance. From another perspective, green washing motive attempts to achieve a good corporate image, which has no significant effect on business outcomes.

Additionally, other prior studies also provide arguments on different company ambition levels and motives in conducting corporate sustainability, which are: (Van Marrewijk, 2003; Van Marrewijk and Werre, 2003)

1. Pre- corporate sustainability (Red): in this level, company does not ambition to conduct corporate sustainability. Hence, company will be initiated when it faces to pressure from outside (i.e., business closure by government, prosecution from societies, buying strike of customers, etc).
2. Compliance-driven corporate sustainability (Blue): at this level, company's motivation as a duty, obligation and/or correct behavior among society.

Company might provide welfare for the society within limits of the regulation and respond charity or stewardship consideration.

3. Profit-driven corporate sustainability (Orange): the company's motivation is business case, which conduct CS whenever it can promote profits. The company integrates social, ethical and environmental aspects into business operations with the aims to increase financial bottom line.
4. Caring corporate sustainability (Green): the company's motivation is related to human potential, social responsibility and care for the planet. The company conducts go beyond legal compliance by balancing economics, social and ecological aspects.
5. Synergetic corporate sustainability (Yellow): the company's sustainability is its motivation. The company conducts a well-balanced in economic, social and environmental aspects of corporate performance.
6. Holistic corporate sustainability (Turquoise): the company has a universal responsibility towards all other beings that related to its aspects of organization. Company conducts fully integration all CS initiatives to every aspect, and contributes the quality and continuation of life of every being and entity, now and in the future.

Moreover, the evidence on a positive relationship reflects the assumption that corporate sustainability concern will lead to financial benefits that are not subject to diminishing returns (Brammer and Millington, 2008). It happens due to the company's capability of reducing cost or increasing revenues (McWilliams and Siegel, 2000), increasing demand level and production, as well as reducing

price sensitivity (Sen et al., 2006). In contrast, the negative association reflects the assumption that there are no financial payoffs for engaging in corporate social responsibility initiatives (Brammer and Millington, 2008). By following the principal-agent paradigm, proponents of this view argue that by socially unresponsive, firms incur fewer direct costs and, *ceteris paribus*, reap higher profits. Consequently, companies that increase their corporate sustainability concern would be competitively disadvantaged without managerial benefits. Companies incur significant expense in using their resources, which could lower of the returns for their shareholders from sources of alternative investment projects.

A Recent study on positive linkage by Lys et al. (2015) documents that current CSR expenditures have a positive association with future financial performance, as measured by ROA and operating cash flow, but only insignificant association with future performance as measured with size adjusted stock return. This study states that companies undertake corporate social responsibility expenditures in the current period in anticipation of stronger future financial performance and to signal to outsiders who may infer private information about their future financial prospects. Wu and Shen (2013) who investigated 162 banking companies in 22 countries in 2003-2009 found that corporate social responsibility is positively associated with accounted financial performance measured by ROA, ROE, and net interest income; and negatively associated with non-performing loans. They suggested that strategic choice is the primary motive of banking industries to engage in corporate social responsibility. However,

research from Gunawan (2015) found that motive of the public listed of Indonesian companies conduct corporate social responsibility and report it in the annual report, or a sustainability report was merely to fulfilling the demands of communities and legitimising the business operations in their societies and environment.

Moreover, Rodgers et al. (2013) found that firm's corporate social responsibility reputation has a positive correlation to firm's value and will increase the firm's financial health and market value. They also found that the customer dimension of corporate social responsibility has a significant impact on both accounting and market-based financial performance, while the employee or the community relation dimensions only affect specific performance and/or a specific group of firms.

This study posits that in the Indonesian banking industry, as central of financial emerging country context, companies need to increase the incorporation of good triple bottom line performance into the corporate strategic decision formulation to achieve sustainability, as well as to meet high assessment criteria of company financial performance. Hence, banking corporations could be expected to take a more important part in being "better citizens," which involves responding to internal and external stakeholders' pressure, minimising negative impacts on their business, and reducing clients' environmental and social risk mismanagement. Specifically, in the banking companies context, most CEOs around the world agree that a company's commitment to sustainability has become

the most important strategic issue in recent and future competitive business scenario (Accenture, 2010). The aforementioned statements lead to the present situation of this study, as motivation's subject to a continuous search for answers. The assumption that can be used in these studies relies on the evidence of a positive association, implying that corporate sustainability concerns and its benefit can lead to banking companies improved financial performance.

This study responds to call for conceptual and empirical research, especially on corporate social responsibility initiatives in different business environments (Griffin and Mahon, 1997; Margolis and Walsh, 2003), and to avoid using only a single measure of corporate financial performance, such as surrogate of market-based performance or accounting-based performance (Rodgers et al., 2013; Barnett and Salomon, 2006). This study combines two indicators of corporate performance, which are financial health and firm market value performance, as a better investigation foundation. Hence, the question regarding whether corporate sustainability concerns are beneficial to improve company financial performance in the actual situation of the banking industry in the context of a developing country needs to be answered in this study.

Hypothesis 4: The corporate sustainability concerns have a positive influence on both company financial health and market value.

5.5. Results

5.5.1. The Statistics Descriptive

Table 5.1 contains a statistical description of the indicators of the impact of executive compensation on company financial performance through its sustainability concerns. To provide additional assurance that the results are not partially attributable to an incomplete first stage model, the first and second stage models are augmented by including the lagged time effect for executive compensation and sustainability concern in the third model. In addition, an endogeneity test with a reverse direction between executive compensation and sustainability concern is also applied in the fourth model.

Table 5.1 shows the average total cash compensation received by all executives in Indonesian commercial banks per year (RemBoD, which is IDR Rp 37,682 Million (maximum = IDR Rp. 254,915 Million and minimum = IDR Rp 867 Million); the average cash compensation received by individual executive in a year (AVERemBoD), which is IDR Rp. 4,497.48 Million (maximum = IDR Rp. 25,492 Million and minimum = IDR Rp. 289 Million); and the market value stock compensation received by the executive (RemBoDOWN), which is IDR Rp. 30,192 Million (maximum = IDR Rp. 517,755 Million and minimum = IDR Rp. 0 Million). One U.S. Dollar equals approximately IDR 13,514.

Based on data observation, I find most Indonesian commercial banks can be considered as healthy companies with the average revised Altman Z-score is 1.146 (maximum = 3.4542 and minimum = -2.905). This score is higher than the cut-off limit score of 1.1 for a non-distressed company. However, the score also

indicates that the companies are still in the grey area, which means that they are not yet categorised as safe companies. It is also known that the average company's market value is 109 percent (maximum = 161 per cent and minimum = 87 per cent), which means that the banking company's market value is over-valued.

Table 5.1 : The Statistic Descriptive

Indicators	Min	Max	Mean	Std. Dev	VIF
Tobins	0.87	1.61	1.09	0.13	1.00
ZScore	-2.9	3.45	1.15	0.69	1.00
RemBoD	867	254915	37682.45	46845.24	18.28
AveRemBoD	289	25492	4497.48	4474.76	18.11
RemBoDOWN	0	517755	30192.58	79356.70	1.8
CAR	-2.38	9.94	1.15	0.98	1.00
NPL	0.00	0.18	0.02	0.02	1.00
NOP	-0.02	1.32	0.03	0.09	1.00
NIM	0.00	0.1664	0.06	0.02	1.00
LDR	0.09	1.13	0.78	0.15	1.00
SO	0.14	0.93	0.41	0.15	1.89
PR	0.00	0.80	0.29	0.20	2.32
LA	0.00	0.95	0.24	0.21	4.40
HR	0.00	0.92	0.08	0.15	4.08
EN	0.00	0.75	0.09	0.16	6.34
EC	0.06	0.94	0.23	0.19	6.20
Valid N (listwise)	252				

Notes: **REM BoD** : Total Board of directors cash compensation in a year; **AveREM BoD** : Average of board of director compensation per person in a year; and **MV BoDOWN** : market value Board of Directors shareholders ownership; **CAR** : Capital Adequacy Ratio; **NPL**: Non-Performing Loan; **NOP** : Net Open Position; **NIM** : Net Interest Margin; **LDR** : Loan to Debt Ratio; **Z Score**: Revision Altman's Z score for financial health measurement and **TOBINS**: Tobin's Q for firm market value performance; **SO**: disclosure of corporate society activities concern; **PR**: disclosure of corporate product responsibility activities concern; **LA** : disclosure of corporate labour practices concern; **HR**: disclosure of corporate human right activities concern; **EN**: disclosure of corporate environmental activities concern; and **EC**: disclosure of corporate economic activities concern

Moreover, this study shows that company sustainability concern in Indonesian commercial banking companies is still in the early stage with poor and patchy implementation, based on their corporate social responsibility disclosure. Overall, the six indicators of corporate sustainability concern reveal that the average level of disclosure on economic, environment, and social aspects, which consist of product responsibility, labour, human rights, and society is below 50 per cent. The highest average on sustainability concerns was found in society performance disclosure with 41 per cent (maximum = 93 per cent and minimum = 14 per cent); and the lowest sustainability concern was found in environmental performance disclosure, with 9 per cent (maximum = 75 per cent and minimum = 0 per cent).

Table 5.2 : The Indicators Correlation Matrix

INDICATORS	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
Tobin Q (1)	1															
ZScore (2)	0.47**	1														
RemBoD (3)	0.29**	0.27**	1													
AveRemBoD (4)	0.30**	0.25**	0.97**	1												
RemBoDOWN (5)	0.42**	0.26**	0.66**	0.66**	1											
CAR (6)	0.23**	0.46**	-0.15*	-0.17**	-0.03	1										
NPL (7)	-0.12	-0.48**	-0.26**	-0.27**	-0.21**	-0.24**	1									
NOP (8)	-0.03	-0.45**	-0.07	-0.08	-0.08	-0.09	0.235**	1								
NIM (9)	0.25**	0.37**	0.22**	0.21**	0.23**	-0.00	-0.03	-0.15*	1							
LDR (10)	0.02	0.10	0.12	0.14*	-0.15*	-0.17**	0.03	-0.04	0.28**	1						
SO (11)	0.05	0.12	0.57**	0.54**	0.26**	-0.16*	-0.28**	-0.09	0.15*	0.18**	1					
PR (12)	-0.04	-0.03	0.61**	0.60**	0.19**	-0.19**	-0.06	0.02	0.09	0.21**	0.53**	1				
LA (13)	0.01	0.18**	0.64**	0.61**	0.21**	-0.08	-0.16*	-0.09	0.17**	0.27**	0.64**	0.70**	1			
HR (14)	0.02	0.15*	0.50**	0.47**	0.15*	-0.05	-0.15*	-0.07	0.11	0.17**	0.64**	0.66**	0.77**	1		
EN (15)	-0.01	0.14*	0.62**	0.58**	0.19**	-0.09	-0.17**	-0.05	0.07	0.18**	0.62**	0.73**	0.83**	0.85**	1	
EC (16)	0.03	0.11	0.66**	0.64**	0.32**	-0.10	-0.16**	-0.04	0.13*	0.18**	0.62**	0.72**	0.85**	0.82**	0.88**	1

Notes: *. Correlation is significant at the 0.05 (or 5 per cent) level (two-tailed). **. Correlation is significant at the 0.01 (or 1 per cent) level (two-tailed).

REM BoD : Total Board of directors cash compensation in a year; **AveREM BoD** : Average of board of director compensation per person in a year; and **MV BoDOWN** : market value Board of Directors shareholders ownership; **CAR** : Capital Adequacy Ratio; **NPL**: Non-Performing Loan; **NOP** : Net Open Position; **NIM** : Net Interest Margin; **LDR** : Loan to Debt Ratio; **Z Score**: Revision Altman's Z score for financial health measurement and **TOBINS**: Tobin's Q for firm market value performance; **SO**: disclosure of corporate society activities concern; **PR**: disclosure of corporate product responsibility activities concern; **LA** : disclosure of corporate labour practices concern; **HR**: disclosure of corporate human right activities concern; **EN**: disclosure of corporate environmental activities concern; and **EC**: disclosure of corporate economic activities concern

Table 5.3 : The Constructs Inter-Correlations Matrix

CONSTRUCTS	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
EXECOMPEN (1)	1.00								
SUSTAINCONCERN (2)	0.67***	1.00							
CAPITAL (3)	-0.13**	-0.17***	1.000						
ASSET (4)	-0.27***	-0.20***	-0.24***	1.00					
MANAGEMENT (5)	-0.084	-0.045	-0.09	0.23***	1.00				
EARNING (6)	0.24***	0.15***	-0.01	-0.03	-0.15***	1.00			
LIQUIDITY (7)	0.060	0.21***	-0.18***	0.03	-0.04	0.28***	1.00		
FINHEALTH (8)	0.28***	-0.081	0.46***	-0.48***	-0.45***	0.37***	0.10	1.00	
MARKET VALUE (9)	0.35***	-0.072	0.23***	-0.12*	-0.03	0.25***	0.02	0.47***	1.00

Notes: ***Significant at $p < 0.01$ (or 1 per cent) level (two-tailed) (t value > 2.33)

Furthermore, a correlation analysis was conducted to examine the potential substitution or complementary effect among indicators on executive compensation as an internal corporate governance mechanism construct. In Table 5.2, complementary effect is shown, with significant positive association between total cash compensation received by executive, cash compensation received by each individual executive, and the market value of stock ownership by the executive ($r = 0.99$, $r = 0.66$, and $r = 0.66$; $\rho < 0.01$). In addition, Table 5.3 shows that the inter-correlation among the constructs of executive compensation as part of internal corporate governance mechanisms and company sustainability concerns is strongly positive in order to maintain corporate financial performance ($r = 0.67$; $\rho < 0.01$).

Moreover, I found a statistically significant correlation between constructs of executive compensation (“P”) and financial information sources (“I”) of capital, assets, and earning ($r = -0.13$; $\rho < 0.05$, and $r = -0.27$, $r = 0.24$, $\rho < 0.01$); and in corporate sustainability concerns (“P”) with financial information sources (“I”) of capital, assets, earnings, and liquidity ($r = -0.17$, $r = -0.20$, $r = 0.15$, and $r = 0.21$; $\rho < 0.01$).

5.5.2. The Measurement (Outer) Model Assessment

The measurement (outer) model focuses on the relationship between a latent variable or construct and its indicators. This can be examined on individual item reliability, internal consistency or construct reliability, average variance

extracted analysis, and discriminant validity in order to analysis and assess reliability and validity both formative and reflective constructs.

In this study, the reflective measure consists of seven constructs with a single indicator, which are CAPITAL, ASSET, MANAGEMENT, EARNING, LIQUIDITY, FINANCIAL HEALTH, and MARKET VALUE, and one reflective construct with three indicators for EXECOMPEN. Moreover, this study also has one formative construct; SUSTAINABILITY CONCERNS that consists of six indicators (see Figure 5.1 and Table 5.4). Table 5.4 shows loading and weight magnitudes, composite reliability (CR), average variance extracted (AVE) and observed t values, as well as the significance value for each indicator associated with its respective latent construct. All of the seven reflective constructs with a single indicator and the other three indicators exceed the acceptable reliability criterion of 0.700 (Chin, 1998). Table 5.4 also displays all reflective indicators of executive compensation, bank financial ratio information and company financial performance have significant values at the 1% level.

Discriminant validity assessment was also conducted by following Hair et al. (2014) recommendation to employ the heterotrait-monotrait ratio of correlations (HTMT) criterion from Henseler et al. (2015), instead of the Fornell-Larcker and cross-loadings criterion, due to its superior performance, to ensure that the reflective construct has the strongest relationships with its own indicators. All reflective constructs' HTMT values are below 0.90, which means that the discriminant validity between pairs of reflective constructs has been established.

However, assessing internal consistency with the same method used for reflective measurements, for constructs with formative measurements (i.e., corporate sustainability concern), is not appropriate and illogical because all indicators might be completely uncorrelated (independent) across two or more components, multidimensional and does not have similar measures (in a convergent validity sense) reflecting the same underlying construct (Chin, 1998, 2010). Instead of using factor loadings, formative measures should use weight factors, which represent canonical correlations and display the values with the totally different meaning of reliability. The weights provide information about the configuration or composition of indicators, which are relatively important to create or form of the construct. Further, in PLS is appropriate to employ the traditional parametric procedure to test significance level because data is assumed as non-normal distribution.

Hence, PLS should use the non-parametric resample procedure with bootstrapping method to assess the significance level of the factor loadings or weights and path coefficient model estimation (Chin, 1998). This study estimates those by using 5,000 bootstrap samples with no sign change option for 1% significance level ($\alpha = 0.01$; one-tailed test) as a recommendation by Hair et al. (2014). It is the most conservative outcome procedures in order to avoid systematically biased significance test results. Therefore, for t -value above 2.33, 1.97, and 1.67 are reflected the loadings or weights and path coefficients have significantly different from zero at 1%, 5% and 10% of significance levels respectively.

Table 5.4 shows among the formative indicators, EC, HR, SO ($\rho < 0.01$) and PR ($\rho < 0.05$) have significant value with weight 0.796, -0.51.5, 0.394 and 0.215 respectively, but the other two remaining indicators (EN and LA) do not have significant values. This empirically suggests that corporate sustainability concern is primarily formed by corporate responsibility activities that relate to economic, human right, society and product responsibility performances.

Furthermore, the potential multicollinearity among the indicators is important for formative measures as it can generate unstable estimates. In this study, all indicators in the formative construct have variance inflation factors (VIF) ranging between 1.05 and 6.34 (see Table 5.1). The highest VIF value is 6.34 for environment indicators (EN). It is quite far above 5, as the rule of thumb, but it is still below 10, implying that all indicators do not have a multicollinearity problem and are independent of each other (Hair et al., 2014)

Table 5.4 : The Measurement (Outer) Model Result

Constructs	Loadings	Weights	Observed <i>t</i> -value	CR	AVE	Signi.- level one- tailed
Executive Compensation (Reflective)				0.94	0.85	
RemBoD	0.972	0.405	252.15			0.00
AVERemBoD	0.971	0.394	197.81			0.00
RemBoDOWn	0.806	0.278	17.86			0.00
Company Sustainability Concerns (Formative)						
EC	0.914	0.796	3.75			0.00
EN	0.808	0.010	0.04			0.485
HR	0.659	0.515	2.83			0.00
LA	0.849	0.155	0.93			0.18
PR	0.777	0.215	1.711			0.04
SO	0.775	0.394	4.544			0.00
Capital						
CAR	1.00	1.00		1.00	1.00	0.00
Asset						
NOP	1.00	1.00		1.00	1.00	0.00
Management						
NPL	1.00	1.00		1.00	1.00	0.00
Earning						
NIM	1.00	1.00		1.00	1.00	0.00
Liquidity						
LDR	1.00	1.00		1.00	1.00	0.00
Financial Health						
Z Score	1.00	1.00		1.00	1.00	0.00
Market Value						
Tobin's Q	1.00	1.00		1.00	1.00	0.00

Notes: **REM BoD** : Total Board of directors cash compensation in a year; **AveREM BoD** : Average of board of director compensation per person in a year; and **MV BoDOWN** : market value Board of Directors shareholders ownership; **CAR** : Capital Adequacy Ratio; **NPL**: Non-Performing Loan; **NOP** : Net Open Position; **NIM** : Net Interest Margin; **LDR** : Loan to Debt Ratio; **Z Score**: Revision Altman's Z score for financial health measurement and **TOBINS**: Tobin's Q for firm market value performance; **SO**: disclosure of corporate society activities concern; **PR**: disclosure of corporate product responsibility activities concern; **LA** : disclosure of corporate labour practices concern; **HR**: disclosure of corporate human right activities concern; **EN**: disclosure of corporate environmental activities concern; and **EC**: disclosure of corporate economic activities concern

5.5.3. The Structural (Inner) Model Assessment

In SEM-PLS, structural model assessment represents the relationship (the path) among constructs hypothesised in the research model that can be interpreted as standardised beta weights in regression analysis. In research model 1 (see Table 5.5 and Figure 5.2), both executive compensation and company sustainability concerns are incorporated as investors' perception of the extended impact on the bank's performance in financial health and market value. It shows that nine of the initial set of eleven paths are significant at 0.99, one initial path is significant at 0.95, and the remaining one is significant at 0.90. However, for simplicity, the inter-correlations between perception ("P"), which consists of the constructs of executive compensation, corporate sustainability concerns, and five aspects of bank's information ("I") are provided in Table 5.3 instead of in Figure 5.2.

In detail, research model 1 shows that executive compensations have a direct positive significant impact on corporate sustainability concerns and indirect significant impact on firms' market value through the mediation effect of corporate sustainability concerns ($\beta_1 = 0.67, \rho < 0.01; R^2 = 0.45$). Moreover, there is a direct positive significant influence of executive compensation on firms' market value ($\beta_2 = 0.47, \rho < 0.01; R^2 = 0.33$).

These findings confirm hypotheses 1, 2 and 3. The result also shows a direct positive significant effect between executive compensation on companies' financial health, as well as an indirect significant positive effect of executive

compensation on firms' market value through companies' financial health ($\beta_3 = 0.29, \rho < 0.01; R^2 = 0.62$). It reveals that both corporate sustainability concerns and company financial health are partial mediators in the relationship between executive compensation and firms' market value.

Table 5.5 : The Executive Compensation Leading to Higher Sustainability Concerns and Company Financial Performance

Pathways	Model 1	Model 2
Executive Compensation \rightarrow Sustainability Concern (β_1)	0.67***	-
(P \rightarrow D) Executive Compensation \rightarrow Firm's Market Value (β_2)	0.47**	0.27***
(P \rightarrow J) Executive Compensation \rightarrow Firm's Financial Health (β_3)	0.29***	0.16***
(P \rightarrow D) Sustainability Concern \rightarrow Firm's Market Value (β_4)	-0.32***	-0.08
(P \rightarrow J) Sustainability Concern \rightarrow Firm's Financial Health (β_5)	-0.17***	0.16**
(I \rightarrow J) Capital \rightarrow Financial Health (β_6)	0.40***	0.40***
(I \rightarrow J) Asset \rightarrow Financial Health (β_7)	-0.28***	-0.24***
(I \rightarrow J) Management \rightarrow Financial Health (β_8)	-0.29***	-0.27***
(I \rightarrow J) Earning \rightarrow Financial Health (β_9)	0.24***	0.26***
(I \rightarrow J) Liquidity \rightarrow Financial Health (β_{10})	0.12*	0.08*
(J \rightarrow D) Financial Health \rightarrow Firm's Market Value (β_{11})	0.36***	0.41***
Executive Compensation * Sustainability Concern \rightarrow Firm's Financial Health (β_{12})	-	-0.13**
Executive Compensation * Sustainability Concern \rightarrow Firm's Market Value (β_{13})	-	-0.007
Multiple R^2 (explained variance): Sustainability Concerns	0.45	-
Financial Health	0.62	0.63
Firm's Market Value	0.33	0.30

Notes: *Significant at $p < 0.1$ (t value > 1.66); **Significant at $p < 0.05$ (t value > 1.96);

***Significant at $p < 0.01$ (t value > 2.33)

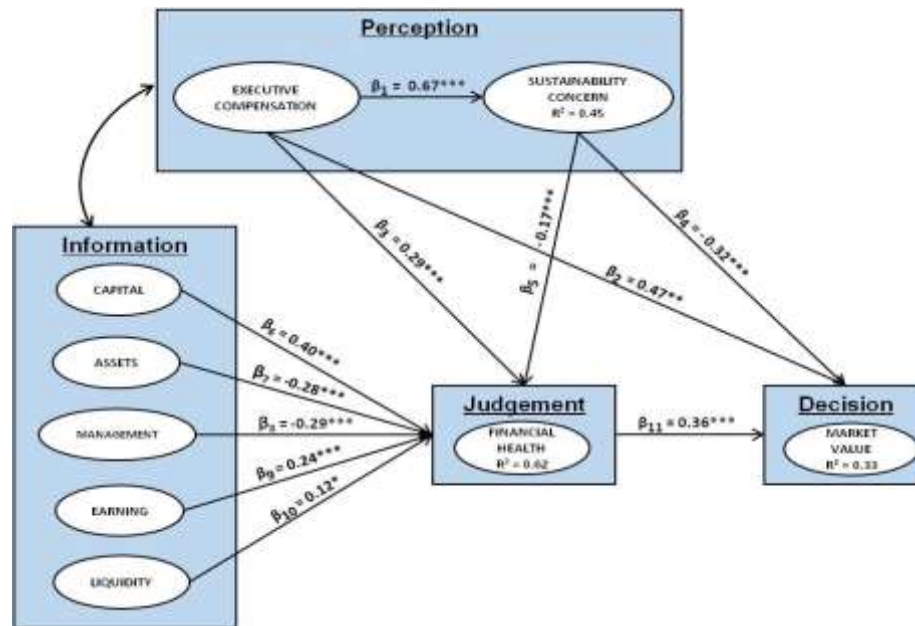


Figure 5.2 : Research Model 1 Executive Compensation on Corporate Sustainability Concerns

Moreover, a direct negative significant influence of corporate sustainability concerns on firms' value, as well as an indirect negative significant effect of corporate sustainability concerns on firms' market value through company financial health ($\beta_4 = -0.32$ and $\beta_5 = -0.17$, $\rho < 0.01$) are found. This finding does not confirm hypothesis 4. Further, this study finds that the judgment of financial health has a direct positive significant influence on the decision on banks' market value ($\beta_{11} = 0.36$, $\rho < 0.01$), which support and consistent with prior research.

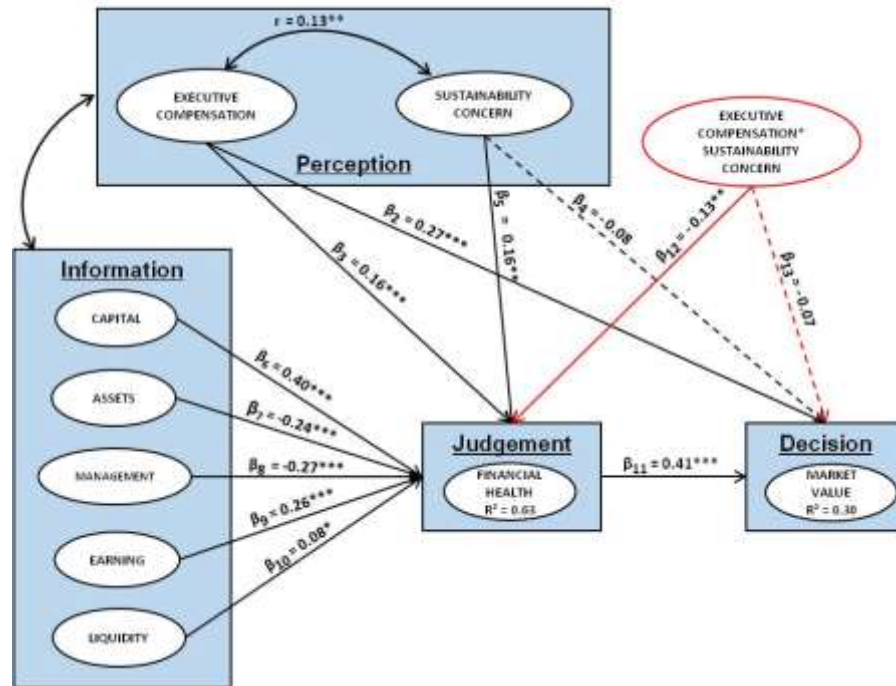


Figure 5.3 : Research Model 2 Interaction between Executive Compensation and Corporate Sustainability Concerns

Moreover, in research Model 2 (see Table 5.5, Figure 5.3), the model is expanded by allowing the perceptions of both executive compensation and CS concern separately as well as interactively to influence company financial performance. Similar to Model 1, the executive compensation continues to have a direct positive significant effect on financial health and firm value. Moreover, the result shows that executive compensation has direct and indirect significant positive effects on firms' market value through companies' financial health ($\beta_2 = 0.27, \rho < 0.01; R^2 = 0.30$ and $\beta_3 = 0.16, \rho < 0.01; R^2 = 0.63$). These results reconfirm hypotheses 1 and 2. Thus, the banking sustainability concern continues to show a direct significant negative influence on financial health ($\beta_5 = -0.16, \rho < 0.05; R^2 = 0.63$). This finding does not reconfirm hypothesis 4. However, a direct negative significant banking sustainability concern is not found on firms' market

value ($\beta_4 = -0.08$, $\rho > 0.1$). More importantly, it is revealed that corporate sustainability concerns can only moderate negative significant impact on the relationship between executive compensation and financial health, not firms' market value ($\beta_{12} = -0.13$, $\rho < 0.05$; $\beta_{13} = 0.07$, $\rho > 0.1$).

Furthermore, in Model 3 (see Table 5.6; Figure.5.4), deeper analysis was conducted regarding the effect of the past or lagged executive compensation on current CS concerns and CFP. Overall, the Model 3 produces similar result with Model 1. The study reveals that the lagged effect of executive compensation has a continuous direct positive significant impact on corporate sustainability concern as well as an indirect significant positive impact on firms' market value mediated by sustainability concern ($\beta_1 = 0.66$, $\rho < 0.01$; $R^2 = 0.43$ and $\beta_2 = 0.48$, $\rho < 0.01$; $R^2 = 0.29$).

Table 5.6: The Lagged Executive Compensation Leading to Higher Sustainability Concerns and Company Financial Performance

Pathways	Model 3
Lagged Executive Compensation \rightarrow Current Sustainability Concerns (β_1)	0.66***
(P \rightarrow D) Lagged Executive Compensation \rightarrow Current Firm's Market Value (β_2)	0.48***
(P \rightarrow J) Lagged Executive Compensation \rightarrow Current Firm's Financial Health (β_3)	0.32***
(P \rightarrow D) Current Sustainability Concern \rightarrow Current Firm's Market Value (β_4)	-0.31***
(P \rightarrow J) Current Sustainability Concern \rightarrow Current Firm's Financial Health (β_5)	-0.13*
(I \rightarrow J) Lagged Capital \rightarrow Current Financial Health (β_6)	0.35***
(I \rightarrow J) Lagged Asset \rightarrow Current Financial Health (β_7)	-0.27***
(I \rightarrow J) Lagged Management \rightarrow Current Financial Health (β_8)	-0.22***
(I \rightarrow J) Lagged Earning \rightarrow Current Financial Health (β_9)	0.19***
(I \rightarrow J) Lagged Liquidity \rightarrow Current Financial Health (β_{10})	0.10
(J \rightarrow D) Current Financial Health \rightarrow Current Firm's Market Value (β_{11})	0.34***
Multiple R^2 (explained variance): Current Sustainability Concerns	0.43
Current Financial Health	0.49
Current Firm's Market Value	0.29

Notes: * Significant at $\rho < 0.1$ (or 10 per cent) (t value > 1.66);

*** Significant at $\rho < 0.01$ (or 1 per cent) level (t value > 2.33)

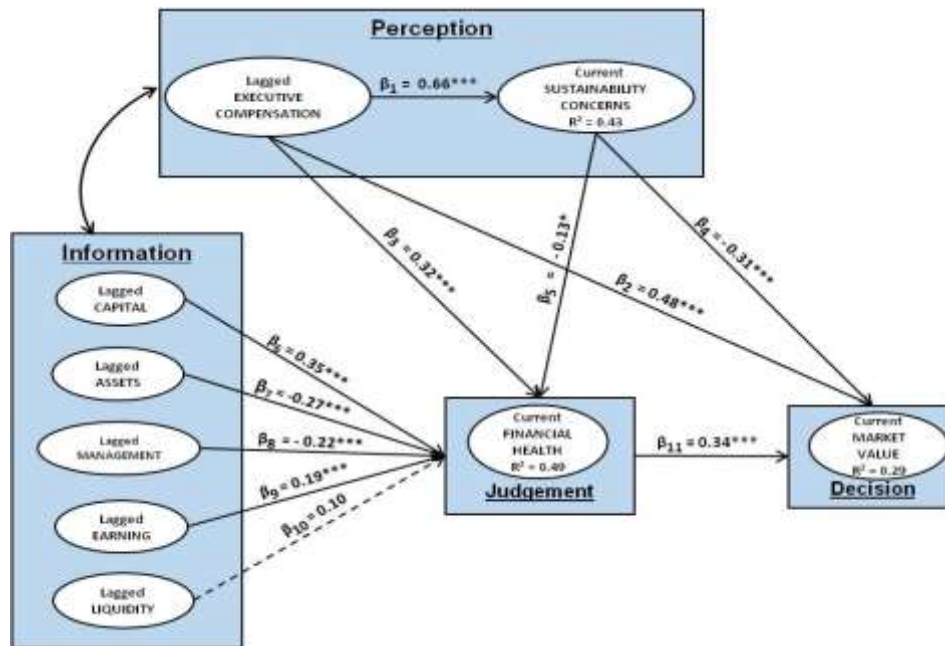


Figure 5.4 : Research Model 3 Lagged Executive Compensation on Current Sustainability Concerns

Further, the current CS concerns and financial health constructs in Model 3 have become partial mediators in the relationship between past executive compensation and current firms' market value performance. Those result was found after analysing every path within the lagged executive compensation and both current CS concern and current CFP ($\beta_3 = 0.32, \rho < 0.01; R^2 = 0.49$ and $\beta_{11} = 0.34, \rho < 0.01; R^2 = 0.29$). Similarly, there is a direct negatively significant influence of current CS concern on current firms' value as well as an indirect negative significant effect of current CS concern on current firms' market value through current company financial health ($\beta_4 = -0.31, \rho < 0.01$ and $\beta_5 = -0.13, \rho < 0.1$).

In model 1 and model 3, stakeholders' judgments based on past banks' financial information (lagged CAMEL) regarding the current company financial

health did not consider all of the perceptions on (the lagged) executive compensation and (the current) company sustainability concern. Instead, the judgment only considered (the lagged) higher quality of banks' capital, earnings, and liquidity information ($\beta_6 = 0.40$, $\beta_9 = 0.24$; $\rho < 0.01$ and $\beta_{10} = 0.12$; $\rho < 0.1$ or $(\beta_6) = 0.35$ and $(\beta_9) = 0.219$; $\rho < 0.01$); and lower (lagged) banks' assets and management ($\beta_7 = -0.28$ and $\beta_8 = -0.29$, $\rho < 0.01$ or $(\beta_7) = -0.27$ and $(\beta_8) = -0.22$, $\rho < 0.01$).

Interestingly, in research Model 4, (see Table 5.7, Figure 5.5), additional analysis is conducted by changing the direction of the relationship among the constructs. Both CFP and CS concerns are placed as predictors for executive compensation following Banker et al. (2013) suggestion. In the first stage, lagged financial health and firm value are used to determine current sustainability concerns and executive compensation. Both lagged financial health and firm value are found to have positive significant impact on current executive compensation ($\beta_2 = 0.28$ and $\beta_3 = 0.12$, $\rho < 0.01$; $R^2 = 0.57$). In contrast, neither lagged CFPs has significant impact on current CS concern ($\beta_4 = 0.02$ and $\beta_5 = 0.07$; $\rho > 0.1$; $R^2 = 0.01$). In the second stage, it was found that current CS concern has a positive significant impact on current executive compensation ($\beta_1 = 0.65$; $\rho > 0.1$).

Table 5.7: The Lagged Company Financial Performance and Current Sustainability Concerns Leading to Improve Executive Compensation

Pathways	Model 4
Current Sustainability Concerns → Current Executive Compensation (β_1)	0.65***
Lagged Firm's Market Value → Current Executive Compensation (β_2)	0.28***
Lagged Firm's Financial Health → Current Executive Compensation (β_3)	0.12***
Lagged Firm's Market Value → Current Sustainability Concerns (β_4)	0.02
Lagged Firm's Financial Health → Current Sustainability Concerns (β_5)	0.07
(I→J) Lagged Capital → Lagged Financial Health (β_6)	0.37***
(I→J) Lagged Asset → Lagged Financial Health (β_7)	-0.32***
(I→J) Lagged Management → Lagged Financial Health (β_8)	-0.34***
(I→J) Lagged Earning → Lagged Financial Health (β_9)	0.27***
(I→J) Lagged Liquidity → Current Financial Health (β_{10})	0.06
(J→D) Lagged Financial Health → Lagged Firm's Market Value (β_{11})	0.46***
Multiple R^2 (explained variance): Current Sustainability Concerns	0.01
Current Executive Compensation	0.57
Lagged Financial Health	0.58
Lagged Firm's Market Value	0.21

Notes: ***Significant at $\rho < 0.01$ (or 1 per cent) (t -value > 2.33)

The results are similar to the ones found in research Model 3. The result shows that the stakeholders' judgment based on banks' financial information (lagged CAMEL) about lagged company financial health does not consider all of the perceptions on current executive compensation and current company sustainability concern. Instead, the judgment was made by paying attention to higher quality of lagged banks' capital, earnings, and liquidity information ($\beta_6 = 0.37$, $\beta_9 = 0.27$; $\rho < 0.01$ and $\beta_{10} = 0.06$; $\rho > 0.1$; and lower quality of lagged banks' assets and management ($\beta_7 = -0.32$ and $\beta_8 = -0.34$, $\rho < 0.01$).

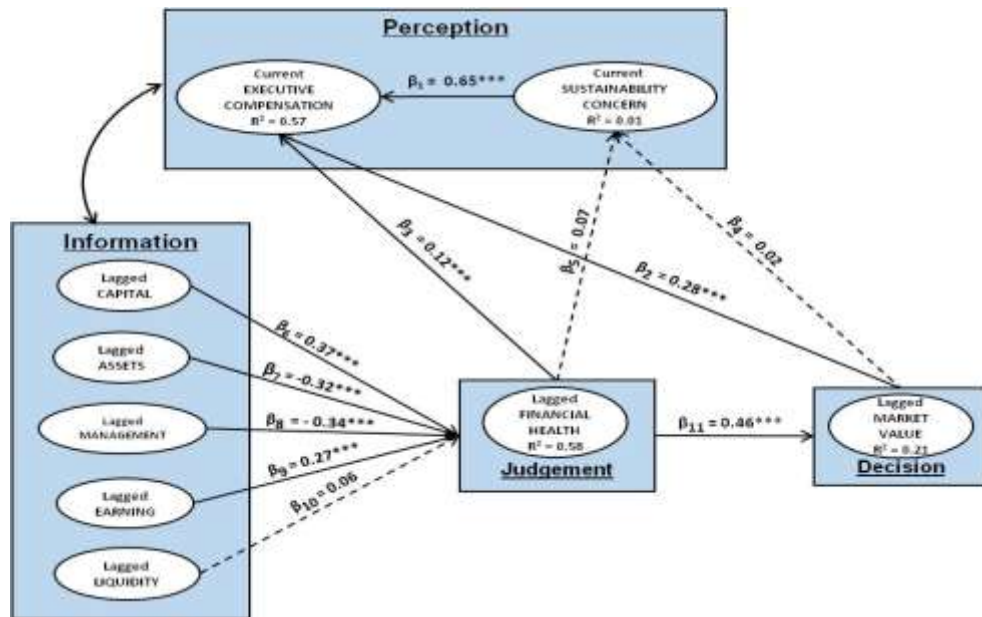


Figure 5.5 : Research Model 4 Lagged Company Financial Performance On Current Sustainability Concerns

5.6. Discussion

While there are rich and abundant studies on executive compensation, corporate sustainability concern, and CFP, the pay-for-sustainability performance relationship as a single study has not generally been explored extensively in a developing country's commercial banking companies' context, particularly in Indonesia. Moreover, gigantic corporate scandals and economic failures around the world, especially in the Asian region, have been brought to companies' attention so that they try to remain sustainable by engaging in CSR initiatives in their operations and by focusing on the deep investigation regarding excessive executive payment. Those actions are aimed to achieve higher company financial performance. Considering those facts, this study provides some interesting and intriguing findings.

The shareholder perspective which depict from the agency theoretic pathways shows in research Model 1 in Table 5.5 and documents that executive compensation in Indonesian commercial banking is designed to motivate managers to attend more to corporate sustainability concern by engaging in more CSR activities. It was found through this study that executive compensation has significant positive influence on corporate sustainability concern. Moreover, the linkage of pay-for-performance has a positive result, in which executive compensation has direct and indirect significant positive influences on firms' market value through corporate sustainability concerns. Those findings confirm both the first and the second hypotheses in this research. Moreover, those results reflect that executive compensation is linked not only to market value performance, but also to corporate responsibility practices at a fundamental level of shareholders' view. This result also supports the prior studies suggesting that the pay-for-performance relationship is positive (Banker et al., 2013; Matolcsy, 2000; Ozkan, 2011, 2007; Kato et al., 2007; Firth et al., 2006), and more likely to support the shareholders' interests .

Furthermore, within the shareholder perspective on the linkage of pay-for-performance and sustainability-for-performance based on the Throughput Model, particularly the agency theoretic pathway ($P \rightarrow D$), it is found that corporate sustainability concerns have a negative significant influence on the firm's market value. The result represents the notion that high executive compensation designed to encourage managers to pursue more corporate sustainability concerns aimed at shareholder interests would lead to reduced firm's

market value. In this situation, the result tends to support the managerial power approach, in which high executive compensation integrates itself in the agency problem. This means that managers do not pay attention to and care less about shareholders' interests regarding the firm's market value. They tend to utilise their substantial power to increase sustainability concern by creating expense using the firm's resources for managerial purposes, such as charitable and philanthropic activities, rather than for shareholders' interests.

In comparison, based on the shareholder perspective, the study results depicted in Table 6 reveal the relationship of sustainability-for-performance to have a significant negative result. Contrary to the hypothesised positive relationship, this study finds that corporate sustainability concerns in Indonesian commercial banking has a significant negative influence on both a company's financial health and market value. The managerial purposes alter the company's image to one that is more concerned with sustainability, which signals a good, sensitive, informed, balanced, and modern corporation. Besides, corporate sustainability concern reflected through corporate responsibility activities does not always relate to higher corporate financial performance, especially when it is not included as a part of a corporate strategic decision posture that requires sensitivity, responsiveness, and efficiency. This, ultimately, results in lower corporate performance.

Moreover, the linkage of both pay-for-performance and sustainability-for-performance based on Throughput Model perspective, which is the ethics of

care (stakeholder) pathway, is the counter-balance of the agency theoretic (shareholder) perspective pathway. Utilising both Tables 5.3 and 5.5, it can be suggested that significant influences exist along the stakeholders' perspective pathway of **"I→P→J→D."** First, Table 5.3 implies a statistically significant relationship between the bank accounting information sources (**"I"**) of capital, management and earnings, and executive compensation and corporate sustainability concern (**"P"**); implying **"I→P."** Second, Table 5.5 supports the negative relationship of **"P→J"** (i.e. corporate sustainability concern→financial health); whereas the significant positive relationship of **"J→D"** is viewed as showing a significant positive impact of financial health on firms' market value. The ethics of care (stakeholder) pathway suggests that the expectation of investors' decisions on high market value is effective and acceptable.

On the other hand, high executive compensation is exerted to motivate managers to implement more corporate sustainability concerns to serve all stakeholders' interests, including shareholders as the primary stakeholders, as a counter-balance mechanism to the agent theoretic pathway. Executive compensation aiming to encourage managers to engage corporate responsibility practices for all stakeholders' interest could be an important mechanism as a remedy to align and to mitigate the principal-agency problem. By following the stakeholders perspective, this study suggests that corporate sustainability becomes an executive remuneration target that signals a company's commitment to sustainability concerns, not just a form of window dressing and/or yet to be another perverse mechanism that maintains high executive payment agreed by the

board of directors in return of shareholder interests. The stakeholders pathway's position provides an executive compensation decision process to facilitate corporate sustainability concern motivation, which affects company financial performance both as an intermediate outcome (as a judgment in financial health) and in the final stage (as investors' decisions based on market value).

In research Model 2, by allowing executive compensation and corporate sustainability concern independently and interact each other to influence company financial performance, this study identified corporate sustainability concern can serve as both a negative moderator and partial mediator construct for the positive relationship between executive compensation and company financial health. The result supports the argument that executive compensation, as the implementation of internal CG, with CSR initiatives are interrelated and should not be considered and sustained separately in the company strategic decision process, in order to enhance company performance (Jamali et al., 2008; Jamali and Mirshak, 2007).

Additionally, in research Model 3 depicted in Table 7, the linkage of pay-for-sustainability-for-performance was tested by examining the past period (i.e. the data lagged) of executive compensation, current corporate sustainability concern, and current financial performance. In research Model 3, the three streams of research, which are the linkage of pay-for-performance, the linkage of sustainability-for-performance, and the linkage of pay-for sustainability-for-performance, obtained similar results to research Model 1.

In research model 4, this study changes the relationship direction among the constructs and tests the impact of the prior period (the lagged) CFP on both current executive compensation and current corporate sustainability concern. Moreover, the research follows the argument that there is a two-way interrelationship and overlapping effects between executive compensation-corporate sustainability-CFP and the consideration of corporate sustainability concern as determinant factors based on stakeholder theory to represent company responses to various stakeholders' demands (Belkaoui, 1992; Callan and Thomas, 2011, 2014). It is found that the lagged CFP (financial health and market value) has a positive significant influence on executive compensation only. It is reflected in a company's commitment to its stakeholders as well as its interactions with the community at large. Moreover, the lagged CFP could increase the current period's executive compensation. This means the Indonesian banking companies consider that the past period company performance as tightly linked to the better implementation of current internal CG, particularly in higher executive compensation. However, this result fails to provide evidence that CFP could be an exogenous variable for corporate sustainability as stated by Huang (2010). It can be concluded that corporate sustainability is actually robust as endogenous or as a determinant variable for CFP, which supports the general consensus emerging among academic scholars.

Further, based on the manual content analysis method from disclosure in sustainability reporting according to GRI 3.1 indicators, this study reveals that the motivation most of the Indonesian banking companies to engage in corporate

sustainability concerns is regulation compliance, in which corporate sustainability is perceived as a duty and obligation, or correct behaviour (Van Marrewijk, 2003). Moreover, this study discovers that the average disclosure score of corporate sustainability indicators is mostly below 50%, which is considered low. Thus, corporate sustainability activities tend to be conducted for companies' own interests only with an altruistic motive aimed to fulfil normative principles, not to be aligned with the company's vision or to be integrated into strategic decisions. This altruism motive may contribute to reduced company financial performance (Wu and Shen, 2013; Baron, 2001).

5.7. Conclusion

This study-modelled discussion about the linkage of pay-for-performance and sustainability-for-performance provides a richer context including two major perspectives, shareholder and stakeholder views, in a single model of the pay-for-sustainability-for-performance relationship by employing the Throughput Model, a framework of decision-making model developed by Rodgers (1997). The Throughput Model enables to examine about what and how the types of information sources are captured, which are relied upon for making a decision regarding the effect of executive compensation on corporate sustainability concern. This type of analysis suggests future avenues of study when modelling important theories (i.e., agency, legitimacy and stakeholder) within the executive compensation and corporate sustainability area for other types of business environment or for cross-industry analysis.

As noted, this study reveals that executive compensation, as a determinant factor of corporate sustainability concern, is designed to motivate managers to implement better and to disclose more CSR activities that are tightly linked to company financial performance, according to the shareholder and stakeholder perspectives, as suggested by Mahoney and Thorne (2006) and Callan and Thomas (2014). Executive compensation is designed by the board of directors to encourage managers to serve multiple stakeholders' interests, an assertion supported by stakeholder theory (Belkaoui, 1992). However, it might explain managers' support for more CS concerns as they represent responses to demands from various company constituencies, which would have a negative effect that will dampen company financial results (Cordeiro and Sarkis, 2008; Stanwick and Stanwick, 2001).

Chapter 6. Corporate Governance Mechanisms, Executive Compensation and Company Financial Performance

6.1. Introduction

This study investigates the potential influence of the board of commissioners' (BoC) role and ownership structure on executive compensation and company financial performance in public listed of Indonesian commercial banking companies for period 2007-2014. The board of commissioners' roles is reflected from the governance reforms through the new BI regulation are expected to create internal mechanisms that can reduce the supremacy of shareholders as well as empower the other stakeholders at the same time. It serves as an active device together with the bank's management to create and develop internal control systems and risk management, as protection for a broad range of stakeholders' interests.

This study suggests that the BI regulation represents the stakeholders' concern for the board of commissioners' role in executive compensation, by overseeing managerial functions, designing and setting up a compensation plan with the aim of motivating executives, or managers to ensure their activities align with both shareholders' and stakeholders' interests. This study will assist future policy and decision makers to help establish company objectives and strategies through the role of BoCs, work to achieve them, and monitor performance, especially to determine proper executive compensation and higher company financial performance. Moreover, this study provides lessons from the past in

understanding the role of BoCs that is vital to understand corporate behaviour and with respect to setting policy to regulate corporate activities, such as executive compensation, in a concentrated ownership dominant context.

6.2. Research Background

Over last two decades, much of the literature focuses the attention on the relationship of corporate governance mechanisms, executive compensation, and performance (CG-pay-performance), which have been done in the context of developed countries with a one-tier CG system, such as in the United States (US) (Makri et al., 2006; Coombs and Gilley, 2005; Cornett et al., 2008; Core et al., 1999) and United Kingdom (UK) (Ozkan, 2011; Thompson, 2005; Ozkan, 2007; Conyon, 1997). The steep raise the interests of CG-pay-performance relationship in many countries are inevitable from massive attention of business practitioners, media, academic communities as well as regulators of listed companies. Moreover, the existing evidence on this relationship in the banking industry and financial institutions is rarely covered and has not been a subject of debate, although there has been increasing focusing on the CG aspects in the US, UK, and elsewhere.

Indeed, most prior studies focused on the impact of different or separately CG factors on executive compensation in the dispersed ownership have shown somewhat mixed and mostly took attention on the amount of CEO compensation rather than on the total compensation received by all the top executives or managers with the aims to boost the corporate performance

(Pandher and Currie, 2013; John et al., 2010; Musteen et al., 2009; Boyd, 1994; Ozkan, 2007, 2011). Moreover, most studies do not consider the possibility of concurrent substitutes, or complementary effects that involve moderating or mediating variables, which may influence this relationship in different systems of governance and ownership structure (Misangyi and Acharya, 2014; Desender et al., 2013).

In fact, very few studies documented investigation on a combination of several CG mechanisms, such as the BoCs role and ownership structure as a bundle within a two-tiered CG system in an emerging country context, such as the Indonesian context. The interaction of the BoCs role with their executives will differ substantially in type of monitoring, contribution to strategy, and subsequent coordination role depending on how the ownership structure faces distinct institutional pressures (Boyd et al., 2011). These combinations of CG mechanisms are rarely covered in the literature and mostly addressed in non-financial sector companies. Hence, this kind of research is still needed to examine and clarify how different forms of monitoring and compensation have different impacts on company outcomes (Hoskisson et al., 2009).

This study focuses on the BoCs' role, which is reflected on the BoCs' tasks, functions and requirements as the supervisory board in the company structure. This BoCs' role is the first and most important aspect from of the Bank Indonesia (BI) regulation reforms in 2006. Indonesia is an Asian developing country with a two-tiered CG system where companies have two separate boards,

the supervisory board, known as the board of commissioners (BoCs) and the management board. Moreover, Indonesia is one of the twenty largest economies in the world, with a substantial growth rate, high capital formation from foreign investors and typically concentrated firm ownership.

Hence, the dynamic CG practices in the Indonesian context, which has a different regulatory, organisational and social environment from developed countries, which mostly adopt a one-tiered CG system, are likely to affect different goals and performance, with implications for the setting of agency problems and executive compensation. Consequently, the BI as the bank regulator and external supervisory body play a more active role in establishing standards and rules to make banking management practices more accountable and efficient for all stakeholders' interests. For this reason, the BI issued in 2006 regulation number 8/4/PBI/2006 and amendment number 8/14/PBI/2006 concerning mandatory implementation of CG for all Indonesian commercial banking companies. This requires all Indonesian commercial banking companies to adopt internal mandatory compliance with eleven aspects of CG to build their self-monitoring systems.

This regulation represents the public interest, including the stakeholders (customers, creditors, managers, societies, and other shareholders) as an effort to improve bank performance, protect stakeholders' interests, and ensure the bank's compliance with prevailing regulations and legal responsibilities. The BoC role is expected an essential step for different stakeholder groups to assert stakeholder

interests while ensuring that the bank's governance practices do not undermine the broader goals of macroeconomic growth and financial stability. It is expected to create internal mechanisms that can reduce the supremacy of shareholders as well as empower the other stakeholders at the same time.

This BI regulation adds the BoCs' responsibilities through mandatory specific requirements and legal duties in their decision-making practices and strategic aims. It serves as an active device together with the bank's management to create and develop internal control systems and risk management, as protection for a broad range of stakeholders' interests. Moreover, this regulation is expected to act more efficiently as a proactive substitute for CG mechanisms. The stakeholders' concern in the BoCs role have three primary functions: (1) protecting shareholder interests, (2) monitoring and advising on the management operations, and (3) facilitating incentive alignment and information to protect the interest of stakeholders, such as minority shareholders, managers, customers and creditors, etc.

Therefore, in the Indonesian banking context, the role of BoCs which focuses on the stakeholders' concern is more important and appropriate than the shareholders' concern only. The BI regulation represents the stakeholders' concern for the BoCs role in executive compensation, by overseeing managerial functions, and setting up a compensation plan with the aim of motivating executives, or managers to ensure their activities align with both shareholders'

and stakeholders' interests to achieve company goals of higher company financial performance.

Theoretically, the BoCs acts traditionally as the primary internal governance mechanism and representative of the controlling shareholders or the principals. It is expected to mitigate agency problem by overseeing management operations to fulfil legal compliance, avoid improper behaviour such as managerial malfeasance and letting the controlling shareholders have significant shares outstanding (Shleifer and Vishny, 1997; Fama and Jensen, 1983a; Fama, 1980). They oversee company's management strategies, policies and operations, provide advice and ensure the managers obey to any internal or external supervision recommendation including its implementation (Fama and Jensen, 1983b; Jensen and Meckling, 1976). They also become primary actors in designing and determining executive compensation with the aim to align the executives and the principals' best interest by providing appropriate management compensation schemes (Ward et al., 2009; Conyon and He, 2011; Ayadi and Boujèlbène, 2013; Jensen, 1993; Jensen and Murphy, 1990).

This study examines the theme of executive compensation that paid to Indonesian bank management and company finance performance were affected by the higher stipulation of mandatory corporate governance mechanisms in particular reference on the BoCs' role and ownership structures. Moreover, this study attempts to identify the implication for executive compensation to reduce corporate malfeasance and dissipation by following the process of investors' CG-

pay-performance decision-making framework model depicted in the Throughput Model, according to agency theoretic position and stakeholders' position pathways (Foss and Rodgers, 2011; Rodgers, 1997).

The Throughput Model was implemented because it allows to study of organisational cognitive structures (i.e., strategic perception and judgment) and decisions in different decision pathways (Narayanan et al., 2011). From this model, this study raises three questions. First, what is the effect the stakeholders' concern of the BoCs' role on executive compensation by following mandatory the BI governance codes? Second, what is the effect of ownership structure on the relationship between the stakeholders' concern of BoCs role and executive compensation? Third, what are the complementary, or substitution effects of CG mechanisms and executive compensation on company financial performance? This study answer those question for the Indonesian banking companies context where the type industry, and business operation differ economically and culturally from those in the US, UK, or other European countries, to make the analysis meaningful.

Hence, this study attempts to fill these gaps in the literature by investigating the combination of monitoring from the supervisory board role with ownership structure to determine executive compensation for banking companies in a developing country in South East Asia region, Indonesia. It also enriches the literature on CG-pay-performance as well as contributes internationally of one of the most recent highly public and policy debates in Indonesian banking industry.

This makes the study more relevant and meaningful to understand theories and relevant explanatory factors in a non-US, or, non-UK, or non-European context.

This study finds a significant positive relationship between corporate governance mechanisms (i.e. board of commissioners' role and ownership structure) and executive compensation with the further positive impact on both company financial health and market value performance. This means, the stakeholders' concern of the BoCs role in a concentrated ownership dominant context could not restrain excessive executive compensation in Indonesian commercial banking companies. The increase of inquiry of internal control mechanisms according to the BI regulation can lead to higher payment of executive compensation; however, it improves company financial performance.

By following the Throughput Model, this study reveals that those mechanisms are important mechanisms in making a company's decision not only to align shareholders' interests (according to the agency theoretic pathway) but also a wider stakeholders' interests (according to stakeholders pathway) to increase both companies financial health and market value performance. This study also finds that Indonesia's concentrated ownership has strengthened the positive relationship between the stakeholders' concern of the BoCs role and executive compensation. Moreover, this study also notes the complementary effect among the indicators of the BoCs role and substitution effect among the indicators of ownership structures on company financial performance.

This study differs with other CG-pay-performance literature due to investigate compensation for the whole team of top management instead focus only the CEOs that commonly appear in the prior literature. Thus, unlike most of the world's business communities, the management compensation structures in Indonesian banking are still a relatively well-kept secret. The Indonesian securities regulator have mandated that the public should be provided with information about the total compensation that a company pays to the board of directors and the managers; however, it does not require to disclose the executive compensation for any individual of managers or directors.

6.3. Theoretical Review

6.3.1. Corporate Governance Reforms and Executive Compensation in Indonesian Commercial Banking

The legal framework of corporate governance for limited liability companies/LLC (PT) in Indonesian has been regulated in the Corporation Law number 1/1995 and amendment number 40/2007. According to this law, all Indonesian companies' monitoring and structure is separated into two tiers. Hence, contrasting in the US, UK, and/or Japan that are adopt a one-tiered CG system, all Indonesian-banking companies are different both in regard to CG system and ownership structure, which are a two-tiered and concentrated of stock ownership respectively. This follows the Continental-Asia system, as do Germany, Netherlands, Japan and China.

Certainly, publicly listed companies in Indonesia have three important modern CG features in common with other developing countries: "professional" managers, shareholders, and a supervisory board. The agent, or manager as the CEO, or the president of the board of directors (BoDs) is appointed in the general meeting of shareholders and must be an independent party of the controlling shareholders. The controlling shareholders act significantly through a supervisory board called the BoCs. It has a great influence in control, monitoring the responsibility and advising the managers, who are responsible for a company's daily operations.

Most companies in Asian emerging countries, typically have dominant control by the institution or business group, family ownership, which control more than 50% of firm equity, weak protection of the controlling ownership for minority shareholders, infrequent significant shareholders changes, and lack of external corporate governance mechanisms (Young et al., 2008; Shleifer and Vishny, 1986; Morck et al., 2005; Dharwadkar et al., 2000; Shleifer and Vishny, 1997). Therefore, in Indonesian companies, the traditional agency theory with the separation of ownership and control seems to work differently. Concentrated ownership by a business group or family tends to lead to an agency problem that does not follow a principal-agent (PA) conflict, as in Anglo-Saxon countries, but between principal and principal (PP conflict). PP conflict allows expropriation to occur between controlling shareholders and minority shareholders (Lukviarman, 2004). The controlling shareholders in the Indonesian context are a source of governance problems instead of the solution via their control mechanism.

In a concentrated ownership structure, the controlling ownership might gain investment return through tunnelling activities that are facilitated by pyramid ownership structures (Shleifer and Vishny, 1986). Moreover, the companies often reveal counterproductive and ineffective control mechanisms, which they may have adopted from the CG model product of the developed countries, such as Anglo-Saxon countries. This is because the companies resemble that CG model only in form but not in substance (Young et al., 2008).

Furthermore, the Indonesian financial and capital market policy has been reformed by Government Regulation 29/1999, which initiated liberalizing, internationalizing and inviting capital inflow from the foreign investors. The regulation allows foreign investors to own up to 99% of shareholders' equity of Indonesian companies. Since this regulation, the ownership structure of Indonesian commercial banking has changed by the increase of the role of foreign investors in the domestic banking market. Quite a few significant domestic share ownerships have changed their ownership to be controlled by foreign investors. Moreover, several government banks have been privatized by reducing their ownership to public domestic or foreign organization ownership. However, changes in the Indonesian banks' ownership were not followed by significant reformation of the bank governance structures until the new CG regulation was enacted in 2006.

The first and important aspect of the implementation of mandatory CG according to the BI regulations 8/4/PBI/2006 is mandatory CG, which relates to

the compulsory status of the BoCs requirements. Unlike in nonfinancial companies, a failure to oversee the BoDs', or managers' operations of banks by the BoCs can cause various serious negative implications for the broader national economic obligations and macro-financial stability. Like the managers, the BoCs members are legally appointed by shareholders at the general meeting of shareholders to determine strategic decisions and “supervise affairs of managers” on behalf of the shareholders. The chairmanship of the BoCs can be held by one of the controlling shareholders or an independent individual.

According to the regulation, the BoCs' member shall consists of minimum three individuals as both independent and executive commissioners. Moreover, the BoCs' member should have at least 50% hold as non-executives (independent) commissioners. The publicly listed banks are required to have independent commissioners who are designated by the banks. These commissioners are expected to represent the stakeholders such as public or minority shareholders. The regulation is intended to alleviate potential agency conflict between the majority (controlling) and minority (public) shareholders. In addition, the BoCs is mandated to conduct internal meeting at least four times per year, which are mandatory for the members to attend no less than twice per year. All members of the BoCs (including BoDs) must disclose share ownership of amounts exceeding 5%.

Furthermore, this regulation states that Indonesian banks are mandated to make a CG Report with their self-assessment quality of corporate governance and

submit to the Bank of Indonesia as well as publish it on their website annually. The companies must disclose the total amount and structure of executive compensation earned by all the BoCs and the executives or BoDs in the CG Report or the Annual Report. However, it is not compulsory to disclose information that relates to any individual executive's compensation, such that of the CEO, or Chairman, and other individual commissioners or directors. Hence, data on any individual executive's compensation in Indonesian banking corporations is not practically available to the public.

Interestingly, the progressing higher payment of executive compensation in Indonesian banking started in 2007 after the BI corporate governance regulation was made mandatory for all commercial banking companies. A BI survey in 2012 reported that the executive compensation (salaries, bonuses, allowances, and other benefits) received in four of the largest banks in Indonesia was categorized as the highest among all banks in the South East Asia region (www.bi.go.id). Further, the survey revealed that the average executive compensation was more than Rp.12 billion/year (\$1.2 million/year) with a ratio of salary to overhead cost of 2.44%. This average payment was higher than that of other banks in South East Asian countries, such as Malaysia, Philippines and Thailand (except for Singapore banks) where executive compensation was only \$560 thousand, \$110 thousand, and \$730 thousand per year respectively (www.bi.go.id). Therefore, this study support argument of Shleifer and Vishny (1997) and Sapp (2008) that states the excessive executive compensation would become a key part of corporate governance mechanisms and attract the

stakeholders' attention to maintaining corporate performance by serving the shareholder's value creation and fulfilling the stakeholders' interests.

6.3.2. The Throughput Model Framework the Board of Commissioners' Role on Executive Compensation

Figure 6.1 shows the framework research and describes how decision makers are encouraged to articulate the shared sense of the company's value creation and how to bring its core stakeholders together based on the Throughput Model pathways. This study depicts a combination of corporate governance mechanisms from the constructs of stakeholders' concern in the BoCs' role, the ownership structure and executive compensation as "*perception (P)*" in the model framework. Decision makers (i.e., investors and managers) evaluate the quality of corporate governance mechanisms (both the BoC's role and ownership structures) to seek influences and interrelationships with the extent of executive compensation. Decision makers use capital, assets, management, earning and liquidity (CAMEL) ratio to capture "*information (I)*" that can determine "*judgment (J)*" on company financial health in order to make a "*decision (D)*" on the company's market value.

This study employs two of the six possible pathways to explain and describe the relationships among the constructs of corporate governance mechanisms; executive compensation and corporate financial performance (see Figure 6.1). These two pathways are: (1) *the agency theoretic pathway position* ($P \rightarrow D$), and (2) *the stakeholders' perspective pathway position* ($I \rightarrow P \rightarrow J \rightarrow D$).

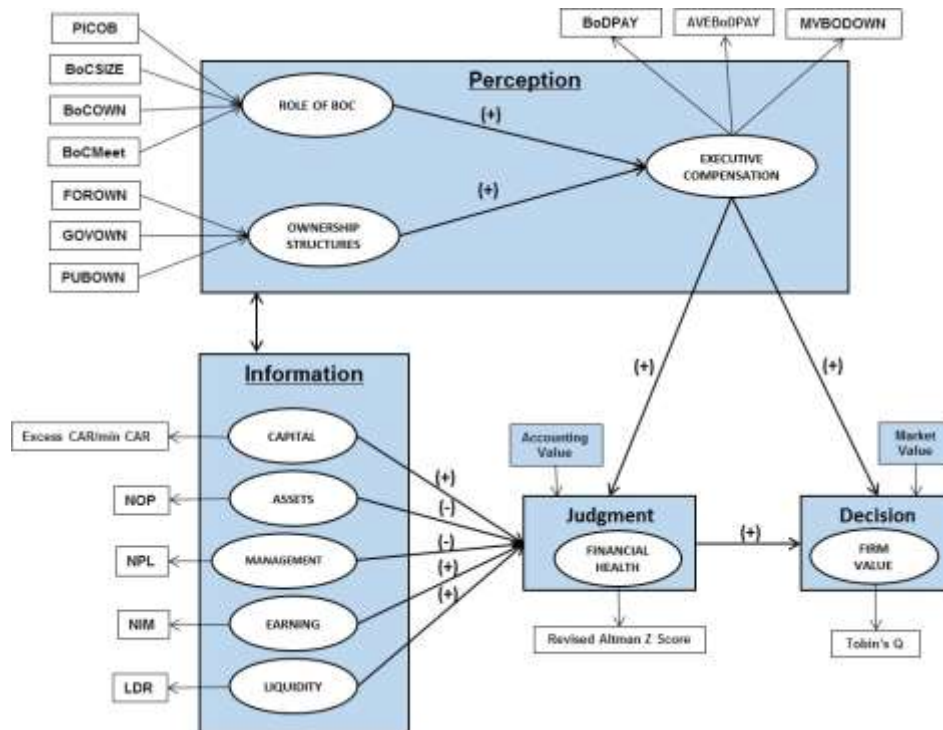


Figure 6.1 : Research Framework the Board of Commissioners' Role on Executive Compensation

The agency theoretic pathway represents the decision makers in the company that is assumed will exert an egoist viewpoint to maximise their self interest by following two concepts, “**P→D**,”. In this context, the decision makers’ framing of the governance mechanisms (i.e., the BoCs' role and ownership structure) together with executive compensation leads them to make decisions on the firm market value without any judgment on the financial health (i.e., downplaying or ignoring “J”), as well as disregarding all of the bank’s information (i.e., downplaying or ignoring “I”). The tenets of this pathway rely on the rational choice perspective of the decision makers that are fundamentally described to be able to maximise individuals' objective as established outcomes.

The stakeholders' position pathway represents the decision makers' viewpoint to follow a systematic and programmatic approach in the relationship among constructs according to four concepts; **"I→P→J→D"**. This pathway is symbolising the ethics of care position, which is focused on an eagerness of the decision makers to learn and observe a wider distinct and previously unacknowledged perspectives. This focus of stakeholder position is on responsiveness to need, empathetic understanding, and the interrelatedness of people, rather than on individual rationality or universal moral rules. It emphasizes relations between people rather than the preferences or dispositions of individuals; it entails thoughtful relations that are thought to have primary value.

The decision makers should consider to synchronise different stakeholders interests, such as employees, suppliers, customers, shareholders, and the community and follow the guidelines in verified information through its analysis (i.e., judgment) to make a decision choice. In this context, the decision makers depict the corporate governance mechanisms from the BoCs roles and ownership structure as well as executive compensation, which are influenced by existence of bank's financial ratio information in order to establish their judgments of financial health and determine decision choice on firm's value.

6.3.3. The Relationship Corporate Governance, Executive Compensation and Company Financial Performance

Literature on CG-pay-performance mostly documents that companies implement corporate governance mechanisms to ensure the CEOs or managers are

paid fairly in order to mitigate CEOs', or managers' expropriation behaviour of the shareholders' wealth (Ozkan, 2007; Conyon, 1997; Conyon, 2014; Conyon and He, 2011; Conyon and He, 2012; Randøy and Nielsen, 2002; Sapp, 2008; Core et al., 1999; Filatotchev and Allcock, 2010). Other studies suggest that performance increases when the bundles of governance mechanisms work together as complements (Aguilera et al., 2008; Misangyi and Acharya, 2014). In turn, the complementary mechanisms with compensation policy aims to determine the managerial incentives properly that can support and align both managers and shareholders' interests (Jensen et al., 2004). Moreover, this complementary mechanisms will protect the shareholder economic value from any attempts of the managers that can reduce the long-term of company's value (Hoskisson et al., 2009; Forbes and Watson, 1993; Jensen and Meckling, 1976).

However, much literature on CG-pay-performance relationship was restricted to investigate the influences by conducting diverse mechanisms independently and separately from each other, such as the board of directors structure and composition (Ayadi and Boujèlbène, 2013; van Essen et al., 2015; Ozkan, 2007; Core et al., 1999; Conyon and He, 2011; Basu et al., 2007; Ding et al., 2010), adoption of mandatory CG mechanisms (Chalevas, 2011), types of investors and ownership structure (Hambrick and Finkelstein, 1995; Hartzell and Starks, 2003; Unite and Sullivan, 2003; Khan et al., 2005; Werner et al., 2005; Musteen et al., 2009; Su et al., 2010; Yoshikawa et al., 2010), the duality of leadership (Dalton et al., 1998; Boyd, 1994), and compensation committee (Conyon and He, 2004; Conyon and Peck, 1998).

Further, many prior studies on CG-pay-performance have been done and concentrated in the US context with a one-tiered corporate governance system (Makri et al., 2006; Cornett et al., 2008; Coombs and Gilley, 2005; Core et al., 1999); and especially, in US banking (John et al., 2010; John and Qian, 2003; Crumley, 2008). In comparison, there are similar prior studies focusing on other developed countries, such as the UK (Ozkan, 2011; Thompson, 2005; Ozkan, 2007; Conyon, 1997), in European commercial banking (Ayadi and Boujèlbène, 2013), in Japan (Basu et al., 2007)) and Korea (Kato et al., 2007).

A company has to set the optimal combination or "bundle" of internal and external CG mechanisms through the effectiveness of executive compensation (Jensen et al., 2004; Rediker and Seth, 1995; Jensen, 1993) in order to shape company performance. This set of mechanism needs to be performed not only for cost-efficient monitoring purposes (Ozkan, 2011, 2007), but also to make it more difficult for management to misbehave, contrary to the shareholder interests (Dicks, 2012). However, the implementation of "effective" CG mechanisms does not necessarily have a direct impact on the optimal corporate performance (Ward et al., 2009).

Companies with poor implementation of CG, (i.e. a broader stakeholders' viewpoint) may not only tend to be forced to overpay their executives (Bebchuk and Fried, 2003), but also moderate the use of executive compensation in order to set up executive payment based on executive performance targets (Coles et al., 2001). Those arguments support empirical finding from US companies context by

Core et al. (1999) that states greater agency problems will be occurred when corporate governance mechanisms are weak, as reflected in higher payment for their CEO than companies' performance.

Core et al. (1999) suggest to examine how other countries in different corporate governance systems can mitigate agency problems to control managerial opportunistic behaviour through excessive executive compensation. However, this study noticed that only a few of empirical studies investigate in developing countries with two-tiered corporate governance system in the Asian context, such as China (Firth et al., 2007; Kato and Long, 2006; Firth et al., 2006) and Malaysia for South East Asian countries (Abdullah, 2006). Hence, this study measures two different indicators of firms' performance: (1) market value based performance by Tobin's Q as final investors' decision; and, (2) the company's financial health as investors' judgments on making a decision, which is measured by the Altman Z-score revision model. This study considers to use both company financial performance due to the executive compensation packages are commonly determined by the company to have both elements of financial and accounting performance.

6.4. Hypothesis Development

6.4.1. The Relationship between Board of Commissioners and Executive Compensation

The BoCs can get power and ability to oversee executives from their professional experience and knowledge (Jensen and Meckling, 1976; Fama and

Jensen, 1983b), the board's size and structure (Ozkan, 2007; Core et al., 1999; Fama and Jensen, 1983a; Fama, 1980), the number of directors' meetings (Ayadi and Boujèlbène, 2013), and the boards' ownership (Zou et al., 2015). However, prior studies found those factors separately could affect corporate outcomes either positively or negatively.

Recent research in the US context (van Essen et al., 2015), Canadian context (Sapp, 2008), the UK context (Ozkan, 2007, 2011) and European banking context (Ayadi and Boujèlbène, 2013) showed that larger proportion of non-executive directors and board size has a significant positive association with CEO and total pay compensation, and seemed to be likely inefficient in monitoring the CEO/director's behaviour. Similarly, in China companies context (Firth et al., 2006; Conyon and He, 2011) revealed higher payment of executive compensation was related to higher ratio of the outside directors.

The independent directors are also likely to act as a substitution mechanism that can influence strategic corporate decisions for CEO's poor performance (Conyon and He, 2011; Firth et al., 2006) that can lead to higher of CEO payment. However, they may present a host of problems such in firms' poor performance if they do not have adequate experience and are unfamiliar with the complexities of the firm's environment complexities (Franks et al., 2001). Then, they may fail as a good internal control tool, leading to inefficiencies in controlling the extent of executive compensation (Mehran et al., 2011). In the situation in which the board monitoring is inefficient, the management tends to

have potential substantial power to fulfil their own benefit at the expense of shareholders' wealth via strategic options that affect organizational outcomes without the board realising (Bebchuk and Fried, 2003; Bebchuk et al., 2002; Gedajlovic and Shapiro, 1998; Hambrick and Finkelstein, 1987).

In contrast, Chalevas (2011), Abdullah (2006), Mehran (1995) and Beatty and Zajac (1994) found that the presence of independent/non-executive directors in the board had a negative association with directors' remuneration and minimised the cash fee received by executives. The evidence showed that independent director decreased the power of CEO (executive) to influence the board of directors and weaken the CEO (executive) ability to affect their compensation schemes. However, a recent study from Ozkan (2011) who investigated in UK non-financial firms showed that CEO cash compensation was not affected by the proportion of non-executive directors.

The presence of qualified independent directors has an important role to create good monitoring and provide valuable advisory services based on their specific knowledge, experience, and objectivity (Fama and Jensen, 1983b; Fama, 1980) to make unbiased opinions, develop fairness and improve the minority shareholders' rights safety against expropriation behaviour by the controlling shareholders. Hence, their competencies and incentives are not considered a governance issue to be regulated in detail (Zattoni and Cuomo, 2010). Moreover, they seems to more capable than non-independent board members to support varies company's strategic actions that distinct from the CEOs or Chairperson

actions because they are not hired or appointed by the focal firm (Zajac and Westphal, 1995; Johnson et al., 1996). Additionally, the independent directors arguably can improve quality of the boards' services in the stakeholders' interests by consistently striving to satisfy stakeholder concerns using their contacts, specific knowledge and expertise, which are intertwined with their own reputations (Zou et al., 2015; Balsmeier et al., 2014), and together with compensation policy can control executive compensation (Ayadi and Boujèlbène, 2013) by reducing the boards' tendency to support high in executive compensation payments (Chalevas, 2011).

Furthermore, the board with a large structure in proportion of independent directors and size of the board tend to be less effective and inefficient than smaller ones (Jensen, 1993). Having more directors appears to increase firm complexity (Adams and Mehran, 2012). A larger board can lead to time consumption and unresponsive behaviour in the board monitoring process, such as evaluating, recommending and approving executive proposals. Hence, the board should be a small size to gain the effectiveness of executive monitoring and communication (Ozkan, 2007; Fama and Jensen, 1983a; Fama, 1980).

Moreover, the board's role would diminish motivation to seek shareholders' wealth on the part of the board and/or the executives who have stock ownership (Jensen, 1993). Higher in the board of directors stock or option ownership may increase incentives as well as encourage managers to improve the apparent corporate performance in periods when the stock or option can be sold or

exercised (Cornett et al., 2008). Moreover, the board's role in regard to the advisory, supervisory and controlling functions over managers' operations can be achieved through their meeting activities (Ayadi and Boujèlbène, 2013). Thus, when the board has more frequent meetings, it can be assumed to be a way to seek strategic decisions to improve the company value and avoid poor results.

This study investigates and depicts differences across the banks' BoCs function and executive compensation by investigating the effect of the construct of BoCs' role with four formative indicators according to stakeholders' concerns of BoC requirements from the BI governance regulation. These indicators include the proportion of independent commissioners (PICOB), the size of BoC (BoCSize), the BoCs' ownership (BoCOWN) and the number of BoCs' meetings per year (BoCMeet). Hence, this study posits that stakeholders' concern in the BoCs' role in Indonesian banking companies is an essential factor to create good internal monitoring. However, by attaching more responsibility to the BoCs' tasks, they will be efficient in aligning the shareholders', managers' and stakeholders' interests to provide internal control using compensation motivation schemes with increased payment of executive compensation. Hence, the first hypothesis is formulated as follows:

Hypothesis 1: The role of the board of commissioners will be a positive influence on the executive compensation.

6.4.2. The Relationship between Ownership Structures and Executive Compensation

Prior study from Lipsey and Sjöholm (2001) showed that the existence of foreign direct investment have significant positively effect on labour wages payment in Indonesian manufacturing companies. They found company with foreign direct investment have a tendency to pay higher in labour wages than local investment company, irrespective of company size and input size per worker. The result in China's listed firms from research Firth et al. (2007) found that the presence of foreign ownership would be positively effected on the extent of CEO pay and pay-for-performance sensitivities. In contrast, research on Japan's largest firms found that foreign ownership in the company could reduce executive bonus payment when the invested companies took options to increase their R&D investment strategy (Yoshikawa et al., 2010).

Previous research also presumed that institutional investors in the company who become majority shareholders tend to have higher levels of alignment between the managers' and the shareholders' interests. However, the controlling majority ownership serves an important function not only to monitoring role in the shareholder-manager agency problem (Fama and Jensen, 1983b; Jensen and Meckling, 1976) but it can also lead to asset expropriation tendency of the controlling shareholder. However, in regard to the executive compensation, the managers' intention to exert higher in payment will be reduced when the principal has strong company control through the controlling majority ownership (Su et al., 2010). Shleifer and Vishny (1986) argue that the managers'

opportunistic behaviour possible to be reduced by the controlling majority ownership with non-significant managerial ownership.

Studies from Beatty and Zajac (1994), Core et al. (1999) and Hartzell and Starks (2003) found that institutional concentrated ownership have a negative significant relation to the extent of executive compensation. Corporate monitoring by large institutional investors can force and discipline the managers to focus on corporate performance and reduce the extent of managers' opportunistic behaviour, such as decisions to avoid paying excessively for executive compensation (Hartzell and Starks, 2003; Cornett et al., 2008). Moreover, presence of large institutional investors complement with executive compensation can mitigate the agency problem. When the principal has stronger corporate control, agents' intention to increase their pay packages is weakened (Su et al., 2010). In contrast, the presence of private block-holders in company can increase the CEO compensation; however, this will increase firm's profitability and improve shareholders' wealth (Firth et al., 2006). Finally, executive compensation is lower in government (states) ownership in China than in publicly trading companies (Conyon and He, 2011).

This study investigates the effect of the construct of ownership structures in a context of predominantly concentrated shareholding through reflective indicators from foreign ownership (FOROWN), public ownership (PUBOWN) and government ownership (GOVOWN). Hence, this study suggests that investors who own major shareholders' positions and institutional investors can influence the level and policy of executive compensation. In the Indonesian banking

context, most banks are owned by institutional ownership from foreign, government and public investors, which could cause the banking company to have to pay higher executive compensation. Hence, the second hypothesis is formulated as follows:

Hypothesis 2: The ownership structure will be a positive influence on executive compensation.

Moreover, as a consequence of policy reformation, the internationalization of corporate ownership through institutional concentration ownership, the presence of foreign ownership and different characteristics of ownership have become key factors in understanding the board's monitoring role (Desender et al., 2014) in making decisions pertaining to higher risk (and reward) for their executives (Oxelheim and Randøy, 2005). Hence, the third hypothesis is formulated as follows:

Hypothesis 3: The ownership structure has positively moderation effect on the relationship of the board of commissioner with executive compensation.

6.4.3. The Relationship between Executive Compensation and Company Financial Performance

Debates and issues on the topic of executive compensation topic has steadily amplified following the rising trend of executive compensation payment in companies, mainly in the US and UK (or European) context. In spite of a considerable number of theories and empirical research around the world on the

topic of executive compensation-performance, no clear conclusion, displayed mixed results and convincing answer emerges.

According to agency theory states that executive compensation should be positively correlated to firm performance. Many studies in Asia concluded that the CEO/executive compensation have positive effect on company performance. Higher executive compensation is an important incentive and motivation system for company performance (Kato et al., 2007; Unite et al., 2008; Conyon, 1997; Conyon and He, 2011; Firth et al., 2007; Kato and Long, 2006; Firth et al., 2006). Moreover, research finding from China's publicly traded firms showed that a significant positive association between company performance and executive compensation (Conyon and He, 2011). This finding support prior study from Conyon (1997) that found a positive correlation between the directors' compensation and current shareholder returns. Similarly, research in Philippines listed companies from Unite et al. (2008) supported prior studies the Chinese and Korean contexts. They found a positive correlation between executive compensation on both firms' market and accounting performances. It can be concluded that companies which is not provide an adequate executive reward might be in vain in attempts to restructures of their economic performance.

Additionally, prior studies that used a large data set in the UK context (Ozkan, 2007) and non-financial companies (Ozkan, 2011) argued that the managers often does not attentive to the shareholders' interests. The managers, or CEOs tends to arrange their remuneration should be paid in higher amount,

although the company financial performance in profit or market share price are low. Thus, these studies found significant positive association between firm performance and the CEO's cash compensation.

Moreover, several studies find that excessive payment for the executive or CEO is insufficiently linked to the CEOs', or the company's performance (Bebchuk and Fried, 2009; Bebchuk et al., 2002), and it can actually significantly negatively affect the shareholders' profits (Bebchuk and Fried, 2003). Crumley (2008) conducted research in the US banking industry has failed to find strong relationship between CEO compensation and both accounting-based and market-based company performance. Similarly, Randøy and Nielsen (2002) found there was not associated between company performance and CEO compensation the Norwegian and Swedish trading companies. In contrast, consistent with studies from Jensen (1993) and Shivdasani and Yermack (1999), a study in Malaysia market by Abdullah (2006) found a negative significant association between directors' remuneration and companies' distressed status, whereas both corporate performance (measured by ROA) and healthy company condition were not associated with directors' remuneration package.

These mixed results encourage to investigate the pay-for-performance relationship in a distinctive national/institutional environment and complex industry. This study expects that executive compensation with three reflective indicators such as total cash BoD compensation (BoDPay), average per individual BoD compensation (AVEBoDPay) and market value BoD ownership (MVBoDOWN) in Indonesian commercial banking will follow the agency theory

in which higher payment for executive should have positive influence on company financial performance. Hence, the fourth hypothesis is formulated as follows:

Hypothesis 4: Executive compensation will have positive influence both on company's financial health and market value performance.

Moreover, this study also proposes the hypothesis that the bank's accounting information have a significant influence to predict a firm's financial health (as judgment) for determining firms' market value (for decision choice).

Hypothesis 5: The bank's financial information consisting of capital, asset, management, earning, and liquidity will be associated with the company's financial health.

6.5. Results

6.5.1. The Statistic Descriptive

Table 6.1 contains the statistical description among the constructs of corporate governance mechanisms through the indicators of the role of the board of commissioners, ownership structure and executive compensation with further influence on company financial performance. The construct of board of commissioners role's in Indonesian commercial banking shows that most of the banks have followed the reforms of CG regulation by fulfilling the mandatory minimum 50 per cent of the board of commissioners being independent commissioner with a minimum of three commissioners as members of the board. It shows the average proportion of independent commissioners was 58 per cent

(maximum = 100% and minimum = 25%) and the mean of excess proportion of board of commissioners size was 165.3 per cent, which is equal to five commissioners on the board (maximum = 400% and minimum = 67%). However, I suggest that the Bank Indonesia have to more concern on the board of commissioners ownership. I found that the average board of commissioners ownership in Indonesian commercial banks somewhat above 5 per cent as the minimum requirement to disclose of the board of commissioners ownership, which is shown 5.8 per cent (maximum = 72% and minimum = 0%). Moreover, the average number of board of commissioners meetings per year is 374 per cent, which equals 15 times per year (maximum = 1,600 percent and minimum = 75 percent).

This study indicates that foreign investors controlled 25 out of the 39 Indonesian commercial banks as well as six out of ten of the largest banks' asset by the end of 2014, averaging 35 per cent (maximum= 99% and minimum=0%). In addition, this study reveals the average share of Indonesian commercial banks owned by the public is 23 per cent (maximum = 86% and minimum = 0%). Moreover, it is found that 8 of the 39 Indonesian commercial banks are controlled by the government or state, with an average shareholder ownership is 14 per cent (maximum = 100% and minimum = 0%).

Table 6.1 : The Statistic Descriptive

Indicators	Min	Max	Mean	SD	VIF
PICOB	0.25	1.00	0.58	0.12	1.20
EXCBOCSIZE	0.67	4.00	1.65	0.61	1.24
BOCOWN	0.00	0.72	0.06	0.15	1.04
BOCMEET	0.75	16.00	3.74	3.58	1.96
FOROWN	0.00	0.99	0.35	0.34	1.37
PUBOWN	0.00	0.86	0.23	0.16	1.11
GOVOWN	0.00	1.00	0.14	0.29	1.32
REMBOD	867	254915	36682	46845	18.28
AVEREMBOD	289	25492	4497	4474	18.11
MVBODOWN	0	517755	30193	79357	1.80
CAR	-2.38	9.94	1.15	0.98	1.00
NPL	0.000	0.184	0.02	.02	1.00
NOP	-0.02	1.32	0.03	0.08	1.00
NIM	0.00	0.16	0.06	0.02	1.00
LDR	0.09	1.13	0.78	0.15	1.00
ZSCORE	-2.91	3.45	1.15	0.69	1.00
TOBINSQ	0.87	1.61	1.09	0.13	1.00

Notes: **PICOB** : proportion of independent commissioners on the board; **ExcBoC Size** : percentage of excess minimum number of board of commissioners (at least three persons); **BoCOwn** : percentage of board of commissioners Shareholders ownership; **BoC Meet** : percentage of excess of minimum meeting in a year (four times a year; **PubOwn**: percentage of share owned by public; **ForOwn** : percentage of share owned by foreigner institution and individual; **GovOwn**: percentage of share owned by government. **REMBOD** : Total Board of directors cash compensation in a year; **AveREMBOD** : Average of board of director compensation per person in a year; and **MVBODOWN** : market value Board of Directors shareholders ownership; **CAR** : Capital Adequacy Ratio; **NPL**: Non-Performing Loan; **NOP** : Net Open Position; **NIM** : Net Interest Margin; **LDR** : Loan to Debt Ratio; **Z Score**: Revision Altman's Z score for financial health measurement and **TOBINSQ**: Tobin's Q for firm market value performance.

The executive compensation shows that the average total cash executive compensation per year in Indonesia commercial banks is IDR 36,682 Million (maximum = IDR 254,915 Million and minimum = IDR 867 Million). One U.S. dollar equals to approximately IDR 13,514. The average of individual the board of director' payment per year is IDR 4,497 Million (maximum = IDR 25,492 Million and minimum = IDR 289 Million) and the average market value stock

ownership compensation received by the executives or directors is IDR 30,193 Million (maximum = IDR 517,755 Million and minimum = IDR 0 Million). Moreover, most the public listed Indonesian commercial banks are healthy companies, as the average Z-score shows 1.146 (maximum = 3.4542 and minimum = -2.905). It is slightly above the cut-off limit score 1.1 for a healthy company; however, it is considered still in the gray area. Thus, the average firm's market value is 109.05 per cent (maximum = 160.81% and minimum = 86.88%).

Further, an analysis was conducted using a correlation analysis to examine the potential of a substitution or complementary effect among indicators of CG in the construct of the role board of commissioners and ownership structures. In Table 6.2, this study found a significant negative association between proportion of independent commissioners and BoCs ownership with BoC size ($r = -0.41$ and $r = -0.19$; $p < 0.01$). I also found a significant positive association between the board of commissioners meeting with the board of commissioners size ($r = 0.21$; $p < 0.01$). Moreover, in terms of the ownership structures that there was a negative significant association of foreign ownership with government and public ownership stockholders ($r = -0.29$ and $r = 0.31$; $p < 0.01$). In addition, there were various monitoring mechanisms from the role of board of commissioners and ownership structure to executive compensation which had a strong positive correlation between them (see Table 6.3; $r = 0.58$, $r = 0.62$ and $r = 0.56$; $p < 0.01$). Thus, a statistically significant positive correlation was displayed among the role of the board of commissioners ("P") and information sources ("I") of earning and liquidity ($r = 0.19$ and $r = 0.17$; $p < 0.01$) as well as a

significant negative correlation with capital and assets ($r = -0.21$ and $r = -0.19$; $\rho < 0.01$). Moreover, this study found a significantly negative correlation between ownership structure (“P”) and information sources (“I”) of assets ($r = -0.25$; $\rho < 0.01$). Finally, there was a statistically significant negative correlation between executive compensation (“P”) and information sources (“I”) of capital and assets ($r = -0.13$; $\rho < 0.05$ and $r = -0.27$; $\rho < 0.01$), and a significant positive correlation with earnings ($r = 0.24$; $\rho < 0.01$).

6.5.2. The Measurement (Outer) Model Assessment

The measurement (outer) model assessment focuses on examine reliability the individual indicator and validity the construct with its indicators for both reflective and formative indicators. The outer model assessment provides the outer loading/weighted value to measures inter-correlation reliability of each indicator, composite reliability (CR) value to measure internal consistency reliability for each construct and average variance extracted (AVE) value as a measurement for convergent and discriminant validities. In this study, there were eight reflective measures, namely EXECOMPEN that consists of three indicators: REMBoD, AVEREMBOD and MVBODOWN, FINHEALTH with one indicator: Z-SCORE, MARKETVALUE that consists of one indicator: TOBIN'S Q, and CAPITAL, ASSETS, MANAGEMENT, EARNINGS and LIQUIDITY with consist of single each indicator: EXCESS CAR, NPL, NOP, NIM and LDR respectively.

Table 6.2 : The indicators correlation matrix

Indicators	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
PICOB (1)	1.00																
BOCSIZE (2)	-0.41***	1.00															
BOCOWN (3)	0.08	-0.19***	1.00														
BOCMEET (4)	-0.07	0.21***	-0.02	1.00													
FOROWN (5)	-0.17***	0.42***	-0.27***	-0.19**	1.00												
GOVOWN (6)	-0.11*	0.19***	-0.18***	0.41**	-0.29***	1.00											
PUBOWN (7)	0.07	0.08	0.27***	0.42**	-0.31***	0.03	1.00										
REMBOD (8)	-0.21**	0.56***	-0.19***	0.43**	0.27***	0.19***	0.29***	1.00									
AVEREMBOD (9)	-0.21**	0.54***	-0.19***	0.48**	0.26***	0.21***	0.31***	0.97***	1.00								
MVBODOWN (10)	0.02	0.16***	-0.14**	0.37**	0.03	0.06	0.38***	0.66***	0.66***	1.00							
CAR (11)	0.02	-0.17***	-0.07	-0.18**	-0.04	-0.13**	0.07	-0.15***	-0.17***	-0.03	1.00						
NPL (12)	0.11*	-0.20***	0.23***	-0.06	-0.20***	0.08	-0.15***	-0.26***	-0.27***	-0.21***	-0.24***	1.00					
NOP (13)	-0.05	-0.03	-0.04	-0.01	-0.07	0.25***	-0.09	-0.07	-0.08	-0.08	-0.09	0.22***	1.00				
NIM (14)	-0.09	0.20***	-0.15***	0.07	-0.05	0.01	0.15***	0.22***	0.21***	0.23***	-0.00	-0.03	-0.15***	1.00			
LDR (15)	-0.17***	0.27***	-0.23***	-0.07	0.18***	0.05	-0.16***	0.11*	0.14**	-0.15***	-0.18***	0.03	-0.04	0.28***	1.00		
ZSCORE (16)	-0.05	0.16***	-0.14**	-0.04	0.20***	-0.31***	0.18***	0.27***	0.25***	0.26***	0.46***	-0.48***	-0.45***	0.37***	0.10	1.00	
TOBINS (17)	-0.09	0.09	-0.18***	0.06	0.19***	-0.06	0.09	0.29***	0.29***	0.42***	0.23***	-0.12*	-0.03	0.25***	0.02	0.47***	1.00

Notes: *Significant at $\rho < 0.1$ (t value > 1.66); **Significant at $\rho < 0.05$ (t value > 1.96); ***Significant at $\rho < 0.01$ (t value > 2.36)

PICOB: proportion of independent commissioners on the board; **ExcBoC Size**: percentage of excess minimum number of board of commissioners (at least three persons); **BoCOwn** : percentage of board of commissioners Shareholders ownership; **BoC Meet** : percentage of excess of minimum meeting in a year (four times a year; **PubOwn**: percentage of share owned by public; **ForOwn** : percentage of share owned by foreigner institution and individual; **GovOwn**: percentage of share owned by government. **REM BoD**: Total Board of directors cash compensation in a year; **AveREM BoD**: Average of board of director compensation per person in a year; and **MV BoDOWN** : market value Board of Directors shareholders ownership; **CAR** : Capital Adequacy Ratio; **NPL**: Non-Performing Loan; **NOP** : Net Open Position; **NIM** : Net Interest Margin; **LDR** : Loan to Debt Ratio; **Z Score**: Revision Altman's Z score for financial health measurement and **TOBINS**: Tobin's Q for firm market value performance.

Table 6.3 : The constructs correlation matrix

Constructs	1	2	3	4	5	6	7	8	9	10
Role of BoC (1)	1.00									
Ownership Structures (2)	0.58***	1.00								
Executive Compensation (3)	0.62***	0.56***	1.0							
Capital (4)	-0.21***	-0.04	-0.13**	1.00						
Asset (5)	-0.19***	-0.25***	-0.27***	-0.24***	1.00					
Management (6)	-0.02	-0.00	-0.08	-0.09	0.23***	1.00				
Earning (7)	0.19***	-0.09	0.24***	-0.00	-0.03	-0.15***	1.00			
Liquidity (8)	0.17***	0.04	0.05	-0.18***	0.03	0.04	0.28***	1.00		
Z Score (9)	0.09	0.16***	0.28***	0.48***	-0.48**	-0.45***	0.37***	0.10	1.00	
Tobin's Q (10)	0.12*	0.20***	0.36***	0.23***	-0.12*	-0.03	0.25***	0.02	0.47***	1.00

Notes: *Significant at $p < 0.1$ (t value > 1.66); **Significant at $p < 0.05$ (t value > 1.96); ***Significant at $p < 0.01$ (t value > 2.36)

Table 6.4 shows their inter-construct correlations for reflective indicators (EXECOMPEN) with the loadings factors ranged from 0.82 to 1.00, which had reached an acceptable level of reliability, over 0.700 (Chin, 1998). It means all reflective indicators for each construct were positively correlated with one another. Moreover, also CR and AVE values were above 0.700, which indicated that more than fifty per cent of the variance of the reflective indicators is due to this construct.

Discriminant validity assessment was also conducted by following Hair et al. (2014) recommendation to employ the heterotrait-monotrait ratio of correlations (HTMT) criterion from Henseler et al. (2015), instead of the Fornell-Larcker and cross-loadings criterion, due to its superior performance, to ensure that the reflective construct has the strongest relationships with its own indicators. All reflective constructs' HTMT values are below 0.90, which means that the discriminant validity between pairs of reflective constructs has been established. However, to assess the internal consistency of constructs using formative measurements was not appropriate similar to reflective measures, since all the indicators might be completely uncorrelated (independent) across two or more components (Chin, 1998). Instead of using factor loadings, the formative measures should use weight factors, which represent canonical correlations while the value meaning is very different in terms of reliability measures.

Table 6.4 : The Measurement (Outer) Model Result

	Loadings	Weights	Observ <i>t</i> -value	CR	AVE	Signi.- level 1-tail
Role of BoC (Formative)						
PICOB	-0.251	0.06	1.26			0.21
BOC SIZE	0.733	0.63	6.04			0.00
BOCOWN	0.305	0.18	4.15			0.00
BOCMeet	9.257	0.62	5.96			0.00
Ownership Structure (Formative)						
FOROWN	0.3889	0.80	10.64			0.00
GOVOWN	0.313	0.52	9.77			0.00
PUBOWN	0.620	0.85	11.96			0.00
Executive Compensation (Reflective)				0.94	0.85	
REMBOD	0.97	0.391	262.90			0.00
AVEREMBOD	0.97	0.388	220.11			0.00
MVBODOWN	0.82	0.302	16.99			0.00
Capital						
CAR	1.00	1.00		1.00	1.00	0.00
Asset						
NOP	1.00	1.00		1.00	1.00	0.00
Management						
NPL	1.00	1.00		1.00	1.00	0.00
Earning						
NIM	1.00	1.00		1.00	1.00	0.00
Liquidity						
LDR	1.00	1.00		1.00	1.00	0.00
Financial Health						
Z Score	1.00	1.00		1.00	1.00	0.00
Market Value						
Tobin's Q	1.00	1.00		1.00	1.00	0.00

Notes: **PICOB** : proportion of independent commissioners on the board; **ExcBoC Size** : percentage of excess minimum number of board of commissioners (at least three persons); **BoCOWN** : percentage of board of commissioners Shareholders ownership; **BoC Meet** : percentage of excess of minimum meeting in a year (four times a year; **PubOwn**: percentage of share owned by public; **ForOwn** : percentage of share owned by foreigner institution and individual; **GovOwn**: percentage of share owned by government. **REM BoD** : Total Board of directors cash compensation in a year; **AveREM BoD** : Average of board of director compensation per person in a year; and **MV BoDOWN** : market value Board of Directors shareholders ownership; **CAR** : Capital Adequacy Ratio; **NPL**: Non-Performing Loan; **NOP** : Net Open Position; **NIM** : Net Interest Margin; **LDR** : Loan to Debt Ratio; **Z Score**: Revision Altman's Z score for financial health measurement and **TOBINS**: Tobin's Q for firm market value performance.

Table 6.4 shows the weight factors for twelve formative indicators, the loadings factor for reflective indicators and the level of significance associated with its respective latent construct. This study found that three indicators for the

board of commissioners role (BOCOWN, BOCMeet and BOCSIZE), three indicators for ownership structure (FOROWN, GOVOWN and PUBOWN) and all reflective indicators of the bank information, executive compensation and company financial performance have significant values at the 1% level and one remaining indicator (PICOB) was not significant at 10%.

This study empirically suggests that the construct of the board of commissioners' role is primarily formed by the board of commissioners size, the board of commissioners' ownership and the board of commissioners' meeting. Meanwhile, for the construct of ownership structure is primarily formed by foreign ownership, government ownership and public ownership. Further, to test the level of significance by employing the traditional parametric procedure in PLS consider is not appropriate due to all of the data have assumed to be a non-normal distribution. Hence, this study need to employed non-parametric procedure using bootstrapping resample procedures to assess the coefficient of significance in estimating the factor loadings and path coefficients of the model (Chin, 1998). As recommended by Hair et al. (2014), this study implemented the most conservative outcome procedures with 5,000 bootstrap samples with no sign change option for the 1% significance level ($\alpha = 0.01$; one-tailed test) in order to avoid systematic bias in the significance test results. Therefore, our results reflect for every empirical “t” value above 2.36, 1.98 and 1.66 that the path coefficients are significantly different from zero at the significance levels of 1%, 5% and 10% respectively.

However, the potential multicollinearity among the indicators is important for formative measures, which could generate unstable estimates. This study found all indicators of the formative constructs to have variance inflation factor (VIF) ranging between 1.04 and 1.96 (see Table 6.1). The highest VIF value was 1.96 for the number of board of commissioners meeting. This was far below the score of five as a rule of thumb implying that all indicators did not have a multicollinearity problem and were independent of one another (Hair et al., 2014).

6.5.3. The Structural (Inner) Model Assessment

This study examines five hypotheses based on Figure 6.1 from the Throughput Model. The structural model represents the relationship between constructs or latent variables hypothesized in the research model. In PLS, the path between constructs can be interpreted as standardized beta weights in regression analysis. The PLS path coefficient for our Models 1, 2, 3 are shown in Table 6.5.

Overall, Table 6.5 shows that nine out of ten of the initial set of paths were revealed as significant at the 0.01 level, and the remaining one was significant at the 0.1 level. However, for simplicity, the inter-correlations between perception ("P"), which consisted of the constructs of the role of board of commissioners, ownership structure, and executive compensation and all five constructs of the bank's information ("I") are provided in the Table 6.3 instead of in Figure 6.2 and Figure 6.3. In Model 1 (see Table 6.5), the results support our Hypothesis 4 that executive compensation has significantly positive effect on the

company's financial health ($\beta_4 = 0.18, \rho < 0.01; R^2 = 0.60$) and company's market value ($\beta_3 = 0.27, \rho < 0.01; R^2 = 0.28$). This study also notices that the construct of financial health has a significantly positive effect on the market value of companies ($\beta_{10} = 0.39, \rho < 0.01$). Further, the results also confirm hypothesis 5 and reveal that higher quality of capital, profitability, and liquidity information ($\beta_5 = 0.41, \beta_8 = 0.25; \rho < 0.01$ and $\beta_9 = 0.10 \rho < 0.05$); and lower quality of asset and management information ($\beta_6 = -0.29$ and $\beta_7 = -0.26; \rho < 0.01$) will lead to banks' better financial health.

In Model 2 (see Table 6.5; Fig. 6.2), this study incorporates both the CG mechanisms and executive compensation as the investors' perception ("P") with further impact on the bank's performance in terms of financial health ("J") and market value ("D"). This study found that the CG mechanisms for both the construct of the board of commissioners and ownership structure had a significant positive influence on executive compensation ($\beta_1 = 0.44$ and $\beta_2 = 0.31, \rho < 0.01; R^2 = 0.44$), which supports Hypotheses 1 and 2. Further, the extended impact of executive compensation showed a significant positive influence on both the banks' financial health ($\beta_4 = 0.18, \rho < 0.01; R^2 = 0.60$) and market value performance ($\beta_3 = 0.25, \rho < 0.01; R^2 = 0.27$). Moreover, consistent with prior research, the judgment of banks' financial health shows a significant positive effect on the decision on banks' market value ($\beta_{10} = 0.40, \rho < 0.01$).

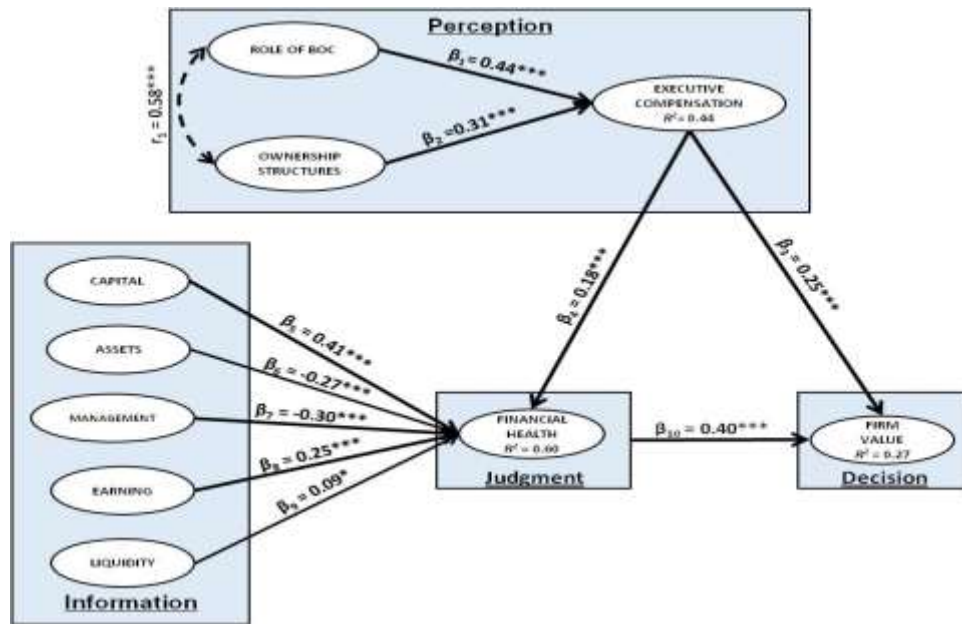


Figure 6.2 : Research Model 2 Corporate Governance Mechanisms on Executive Compensation

In Model 3 (see Table 6.5; Figure 6.3), this study expand the analysis by allowing the board of commissioners role and ownership structure to interact with each other on executive compensation. This study found both CG mechanisms have significantly positive effect on executive compensation ($\beta_1 = 0.35$ and $\beta_2 = 0.33$ $\rho < 0.01$; $R^2 = 0.50$). Further, the interaction effect between the role of the board of commissioners and ownership structure has significant positive impact on executive compensation ($\beta_{11} = 0.23$, $\rho < 0.01$). These results confirm our Hypothesis 3, that the ownership structure strengthens the relationship between the board of commissioners' role and executive compensation. Thus, executive compensation continues to have a significantly positive effect on both the financial health ($\beta_4 = 0.18$, $\rho < 0.01$; $R^2 = 0.60$) and the market value ($\beta_3 = 0.25$, $\rho < 0.01$; $R^2 = 0.27$).

Table 6.5 : The Corporate Governance Mechanisms leading to Higher Executive Compensation and Company Financial Performance

Pathways	Model 1: Executive Compensation Only	Model 2: CG Mechanisms to Executive Compensation	Model 3: CG Mechanisms & Interaction to Executive Compensation
Role BoC → Executive Compensation (β_1)	-	0.44***	0.35***
Ownership Structure → Executive Compensation (β_2)	-	0.31***	0.33***
(P→D) Executive Compensation → Firm's Market Value (β_3)	0.27***	0.25***	0.25***
(P→J) Executive Compensation → Financial Health (β_4)	0.17***	0.18***	0.18***
(I→J) Capital → Financial Health (β_5)	0.41***	0.41***	0.41***
(I→J) Asset → Financial Health (β_6)	-0.26***	-0.27***	-0.27***
(I→J) Management → Financial Health (β_7)	-0.29***	-0.30***	-0.30***
(I→J) Earning → Financial Health (β_8)	0.25***	0.25***	0.25***
(I→J) Liquidity → Financial Health (β_9)	0.10*	0.09*	0.09*
(J→D) Financial Health → Firm's Market Value (β_{10})	0.39**	0.40***	0.40***
Role BoC * Ownership Structure → Executive Compensation	-	-	0.23***
Multiple R^2 (explained variance):			
Executive Compensation	-	0.44	0.50
Financial Health	0.60	0.60	0.60
Firm's Market Value	0.28	0.27	0.27

Notes: *Significant at $p < 0.1$ (t value > 1.66), ***Significant at $p < 0.01$ (t value > 2.36)

Similarly to Models 1 and 2, the result from Model 3 can be interpreted as meaning that better financial health of a company will lead to higher market value ($\beta_{10} = 0.40$, $p < 0.01$). Further, this study also noticed that without considering the perception of CG mechanisms and executive compensation, the stakeholders apparently gave a great deal of attention to a higher quality of banks' capital, earnings and liquidity information ($\beta_5 = 0.41$, $\beta_8 = 0.25$; $p < 0.01$; and $\beta_9 = 0.09$; $p < 0.1$). Finally, the results suggest that lower banks' assets and management ($\beta_6 = -0.27$ and $\beta_7 = -0.30$, $p < 0.01$) may lead to banks' improved financial health.

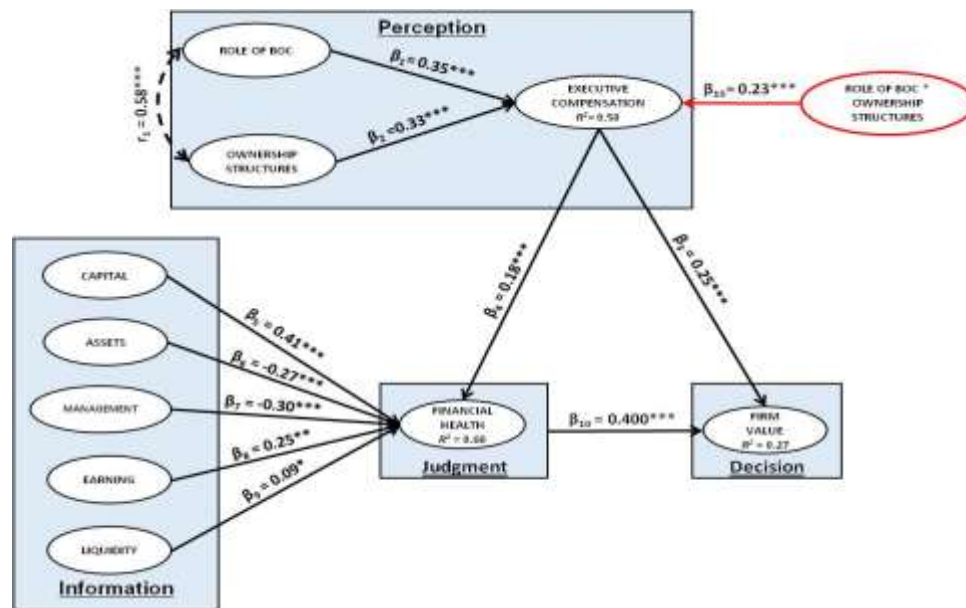


Figure 6.3 : Research Model 3 Corporate Governance Mechanisms and Interaction on Executive Compensation

In Model 4 (see Table 6.6; Figure 6.4), this study conducts deeper analysis by adding the research model to test the effect of the previous periods of CG mechanisms on the current executive compensation and company financial performance. A one year lag is used for the role of the board of commissioners, the ownership structure and all the banking financial information to determine current executive compensation with the further impact on company's current financial health and market value. Overall, the result from Model 4 is similar to the result of Models 1, 2, and 3. This study found that the past period's CG mechanisms continue to have a significantly positive effect on current executive compensation ($\beta_1 = 0.48$ and $\beta_2 = 0.21$ $\rho < 0.01$; $R^2 = 0.47$). Further, current executive compensation still has a significantly positive influence on the company's financial health ($\beta_4 = 0.23$, $\rho < 0.01$; $R^2 = 0.48$) and market value ($\beta_3 = 0.28$, $\rho < 0.01$; $R^2 = 0.25$).

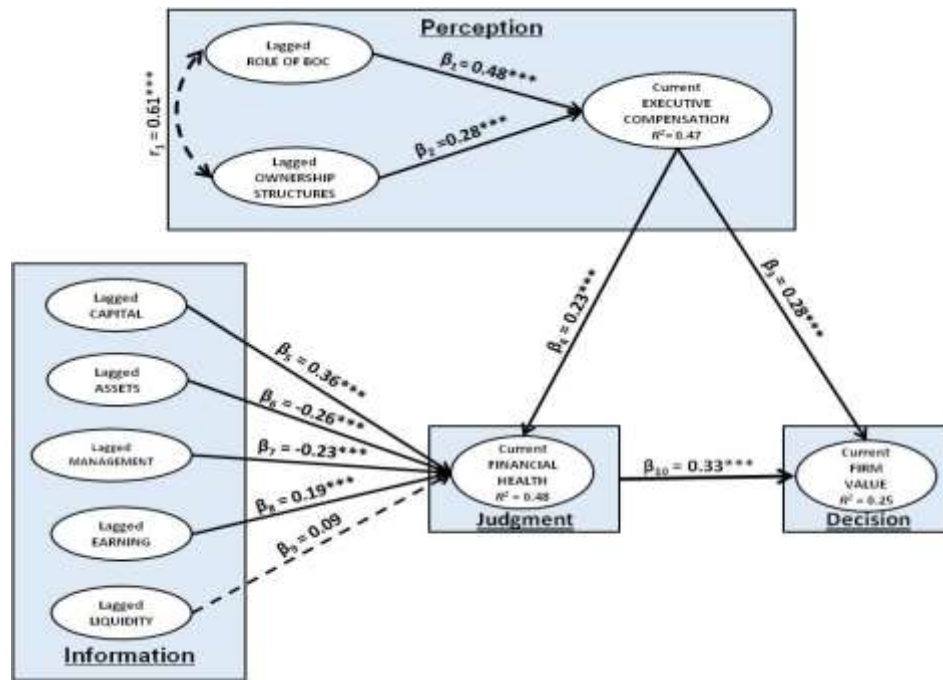


Figure 6.4 : Research Model 4 Lagged Corporate Governance Mechanisms on Current Executive Compensation

This study also continue to find that stakeholders, without considering perceptions of the banks' CG mechanisms and executive compensation, are still concerned with and pay attention to previous higher quality of banks' capital and earnings information ($\beta_5 = 0.36$ and $\beta_8 = 0.19$; $\rho < 0.01$); and lower banks' assets and management ($\beta_6 = -0.26$ and $\beta_7 = -0.23$, $\rho < 0.01$). However, previous bank liquidity does not have a significant influence to increase the bank's current financial health.

Table 6.6 : The Lagged CG Mechanisms Leading to Higher Executive Compensation and Company Performance

Pathways	Model 4: Lagged CG Mechanisms to Current Executive Compensation
Lagged Role BoC → Current Executive Compensation (β_1)	0.48***
Lagged Ownership Structure → Current Executive Compensation (β_2)	0.21***
(P→D) Current Executive Compensation → Current Firm's Market Value (β_3)	0.28***
(P→J) Current Executive Compensation → Current Financial Health (β_4)	0.23***
(I→J) Lagged Capital → Current Financial Health (β_5)	0.36***
(I→J) Lagged Asset → Current Financial Health (β_6)	-0.26***
(I→J) Lagged Management → Current Financial Health (β_7)	-0.23***
(I→J) Lagged Earning → Current Financial Health (β_8)	0.19***
(I→J) Lagged Liquidity → Current Financial Health (β_9)	0.09
(J→D) Current Financial Health → Current Firm's Market Value (β_{10})	0.33***
Multiple R^2 (explained variance): Executive Compensation	0.47
Financial Health	0.48
Firm's Market Value	0.25

Notes: ***Significant at $p < 0.01$ (t value > 2.36)

In Model 5 (see Table 6.7; Figure 6.5), this study investigate whether past ($t-1$ period) company performance affects decision makers' perception on current executive compensation by reversing the direction of impact in our model. This study posits that the past company performance is useful to arrange future optimum contracting for executive compensation schemes and minimize the complexity of the company's selection problem according to the signal of managers' or executives' capability in firm operations. This study expects executive compensation and company financial performance to be related across time and assume that managerial ability is time-specific but positively correlated over time. In other words, the board of commissioners will not be reluctant to provide higher compensation for continuing or future managers when they notice that the past corporate performance is high.

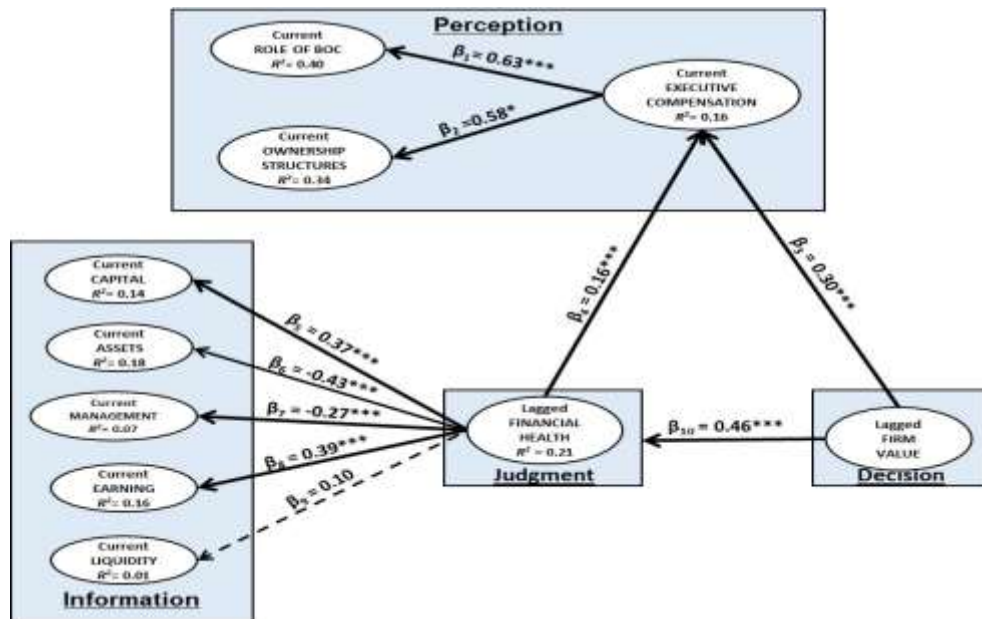


Figure 6.5 : Research Model 5 Lagged Company Financial Performance on Current Executive Compensation

The result shows that both past company financial health and market value performance have significant positive influence on current executive compensation ($\beta_4 = 0.16$ and $\beta_3 = 0.30$; $\rho < 0.01$; $R^2 = 0.16$). Then, current executive compensation has a significant positive influence on both current board of commissioners role and ownership structure ($\beta_1 = 0.63$; $\rho < 0.01$; $R^2 = 0.40$ and $\beta_2 = 0.58$; $\rho < 0.01$; $R^2 = 0.34$). Moreover, the result also shows that lagged financial health has a significant positive influence on banks' financial ratio of capital and earning ($\beta_5 = 0.37$; $\rho < 0.01$; $R^2 = 0.14$ and $\beta_8 = 0.39$ $\rho < 0.01$; $R^2 = 0.16$) and negatively significant influence on assets and management ($\beta_6 = -0.43$; $\rho < 0.01$; $R^2 = 0.18$ and $\beta_7 = -0.27$ $\rho < 0.01$; $R^2 = 0.07$).

Table 6.7 : The Lagged Company Financial Performance leading to Better Current CG Mechanisms and Higher Executive Compensation

Pathways	Model 5: Lagged Firm Performance to Current Executive Compensation
Current Executive Compensation → Current Role BoCs (β_1)	0.63***
Current Executive Compensation → Current Ownership Structure (β_2)	0.58***
Lagged Firm's Value → Current Executive Compensation (β_3)	0.30***
Lagged Financial Health → Current Executive Compensation (β_4)	0.16***
Lagged Financial Health → Current Capital (β_5)	0.37***
Lagged Financial Health → Current Asset (β_6)	-0.43***
Lagged Financial Health → Current Management (β_7)	-0.27***
Lagged Financial Health → Current Earning (β_8)	0.39***
Lagged Financial Health → Current Liquidity (β_9)	0.10
Lagged Firm's Market Value → Lagged Financial Health (β_{10})	0.46***
Multiple R^2 (explained variance): Executive Compensation	0.16
Financial Health	0.21
Role BoCs	0.40
Ownership Structure	0.34
Capital	0.14
Asset	0.18
Management	0.07
Earning	0.16
Liquidity	0.01

Notes: ***Significant at $p < 0.01$ (t value > 2.36)

6.6. Discussion

This study explores the implications of the constructs of the board of commissioners' role and ownership structure, along with executive compensation and company financial performance. The relationship of the CG-pay-performance is considered using both monitoring and incentive alignment arguments with the expectation that increase in monitoring from the stakeholders' concern of the role of the board of commissioners as a supervisory board in a predominantly concentrated ownership context can promote higher executive compensation and

better company financial performance in Indonesian commercial banking companies. Most of the hypotheses in this study are supported by our results.

Based upon the study's results depicted in Table 6.5, the agency theoretic pathway position (**P→D**) is supported as displayed by the relationship between executive compensation influences on firms' market value. Nonetheless, based on shareholder perspective using the Throughput Model, the agency theoretic pathway is balanced by the stakeholders' perspective pathway. Utilizing both Tables 6.3 and 6.5, I can suggest that significant influences exist along the stakeholders' perspective pathway of "**I→P→J→D**." First, Table 2.b implies a statistically significant relationship of information sources ("**I**") on capital, assets, earnings and liquidity to executive compensation ("**P**"); implying "**I→P**." Second, Table 6.5 supports the relationship of "**P→J**" (i.e., executive compensation→financial health); whereas the significant relationship of "**J→D**" is viewed as financial health's impact on firm's market value. The "**I→P→J→D**" pathway suggests that CG mechanisms reflecting the stakeholders' position pathway exist and are effective, which counter-balances the agent theoretic pathway ("**P→D**").

This study reveals that the stakeholders' concern in the board of commissioners' role and ownership structure have significant positive influence on executive compensation. These results confirm hypothesis 1 and are consistent with prior studies from Chinese (Ding et al., 2010), European and UK banking industries (Ayadi and Boujèlbène, 2013; Ozkan, 2007) and recently the US

context (van Essen et al., 2015). It is indicated that the stakeholders' concern in the BoC role in Indonesia banking could not restrain high payment of executive compensation. .

Moreover, this study also found that a concentrated ownership structure strengthens the positive relationship between the board of commissioners' role and executive compensation. These findings are inconsistent with prior studies that claim concentration of large ownership could mitigate managers' opportunistic behaviour by avoiding payment of excessive on executive compensation (Hartzell and Starks, 2003; Su et al., 2010; Cornett et al., 2008). The role of the board of commissioners in a concentrated ownership context could provide effective protection of shareholders (large ownership) and stakeholders from the expropriation behaviour of managers and large controlling ownership. In the Indonesian context, the findings confirm that increased board monitoring by following stakeholders' concern in CG mechanisms leads to higher executive compensation as compensative for increased management responsibility to pay attention to stakeholders' wealth in management operations. In other words, higher payment in executive compensation is a trade-off and motivation mechanism to align the stakeholders' and managers' interests.

This study documented a significant positive influence executive compensation on both banks' financial health and market value performance. Using the Throughput Model provides a decision process on executive compensation affecting both corporate financial performance as an intermediate

outcome (as a judgment in financial health) and the final stage (as investors' decisions based on market value). These findings were consistent with agency theory and supported prior studies in the Philippines, Chinese, Korean and UK. Executive compensation has been used as an incentive and motivation mechanism to align the interests of stakeholders and shareholders. The study suggests that a high level of executive compensation is effective as an incentive motivation system to boost both company financial health and market value performance.

Further, this study in Indonesian commercial banking reveals substitution and complementary effects among the implementation of mandatory CG mechanisms. This study found a significant negative association in CG mechanisms among the role of the board of commissioners indicators between the proportion of independent commissioners and board of commissioners' ownership with their size. This indicates that role of the board of commissioners in monitoring managers' behaviour concerning the number of commissioners can be substituted by the presence of independent commissioners and commissioner shareholders. It implies that companies with a high proportion of independent commissioners and board of commissioners' ownership tend to become less dependent on the board of commissioners size. Moreover, this study also noted a significant positive association between the board of commissioners' size and the number of board of commissioners' meetings. This implies that among the board of commissioners' role, the size of board of commissioners will complement the number of board of commissioners meetings.

In ownership structure, there is a substitution effect of monitoring by foreign investors, government investors and public ownership. These results support previous findings of Azim (2012), Ward et al. (2009) and Coles et al. (2001), which conclude that any independent monitoring mechanism can be complemented and or substituted by another alternative monitoring mechanism. Nonetheless, this study failed to find a substitution effect between the board of commissioners monitoring and ownership structure as suggested by Desender et al. (2013). This study found that in the two-tiered CG context with concentrated ownership predominant, the substitution effect across the board of commissioners role and the ownership structure could not be generalized in the same way as in one-tiered CG systems. In fact, this study implies that the constructs of CG mechanisms and executive compensation are set up to operate jointly and complementarily in order to mitigate the agency problem with respect to increased company financial health and market value performance. These findings were inconsistent with those of Dicks (2012) who suggests CG and incentive payment are substitutes for each other to solve agency problems, and that companies pay lower executive compensation as companies' response to improve CG through closely monitoring their management.

Finally, by reversing the direction of the framework, this study confirms that organisational performance is a key determinant of executive compensation (Tosi et al., 2000). The optimal contracting approach from the past company performance can be used to reduce information asymmetry in the managers' adverse selection context by providing information regarding the managers'

ability. It reflects that when the past performance is high, the principal can provide continuing (current) agents or managers with higher executive compensation that is attributable to agents' or managers' ability (Banker et al., 2013).

6.7. Conclusion

This study examines the main influence of the CG-pay-performance relationship in Indonesian commercial banking companies by implementing a stakeholders' concern in the BoC role that follows the requirements of the new CG regulation with ownership structure to determine the executive compensation to improve company financial performance. The BoC task in designing optimal compensation for rewarding executives (CEOs and top management) is not easy but nevertheless is an important task.

This study follows suggestions provided by Desender et al. (2013), , and Misangyi and Acharya (2014) to examine potential substitution and complementary effects of CG mechanisms on executive compensation in a two-tiered CG system, with particular reference to the board of commissioners role as a supervisory board and ownership structure. This study indicates that the BoC serves as a vehicle for multiple stakeholders' interests that is able to define the company's purposes and determine the company's responsibility for the stakeholders. This study also highlights the different impact of the BoC's role along with ownership structure, which may be effective to control managerial opportunistic behaviour on executive compensation and the resulting impact on

company financial performance, by both accounting and market-based performance measures.

This study modelled discussion of CG provides a richer context when we include two different decision pathways from the Throughput Model (i.e. agency theoretic and stakeholders' positions). The results from these studies provide some insight into the relationship of CG-pay-performance in Indonesian banking companies' practice after following the new regulation of mandatory implementation of CG aspects of the board of commissioners requirements. The benefits of the Throughput Model enable us to examine the types of information sources that are relied upon for decision-making purposes of the board of commissioners. This type of analysis suggests future avenues of study when modelling important theories (i.e., agency and stakeholders' theories) with different types of business and CG mechanisms.

Moreover, this study finds significant complementary effect between the BoC role and the ownership structure in the two-tiered CG system context, which is not consistent with prior study by Desender et al. (2013). It turns out that the substitution effect across the BoC's role and the ownership structure could not be generalized in the two-tiered CG system in a context of concentrated ownership predominance.

The results documented that higher levels of executive compensation could lead to better improvement in financial health as accounting-based performance and an increase in market value performance. The board of

commissioners in Indonesian commercial banks plays an important role and is responsible for the internal CG to oversee executive compensation. Moreover, the ownership structure showed significant influence in shaping the increase in executive payment. Further, this study also revealed that the stakeholders' perspective through the role of the board of commissioners, as the supervisory board, had a significant positive influence on executive compensation. These results confirmed hypotheses and were consistent with prior studies from China (Ding et al., 2010), European and UK banking industries (Ayadi and Boujèlbène, 2013; Ozkan, 2007) and the US (van Essen et al., 2015).

Chapter 7. Conclusions

This chapter covers five sections, including summary, reflection on the on the findings, contributions, limitations, implications, and avenues for future research.

7.1. The Thesis Findings

This study aims to quantitatively investigate the relationship between corporate governance mechanisms and corporate sustainability concerns with further impact on company financial performance in Indonesian commercial banking context based on shareholder and stakeholders perspective. The study presents three empirical findings in chapters four, five and six. The study employs a decision-making model, the Throughput Model, developed by Rodgers (1997), to describe the relationship among the constructs and analyses an unbalance panel data by using PLS-SEM technique with four different research models. Additionally, this study also provides the firm's level of corporate governance mechanisms and sustainability concerns implementation during the study period 2007-2014 through statistic descriptive analysis.

Based on the descriptive analysis in chapter two, the study found that most publicly listed Indonesian commercial banking companies have complied and adjusted their BoCs' requirements with the new BI regulation mandatory corporate governance implementation. The result shows that the average proportion of independent commissioners is 59.1 per cent, somewhat above 50 per

cent as the mandatory minimum requirement for independent commissioners proportion on the board, which is equal to three persons in an average number of independent commissioner on the board. Averagely, there are five persons in the board of commissioner, which is above the mandatory minimum of three persons. Moreover, the average number of board of commissioners meeting was found to be 18 times per year, which is also above the minimum of four meetings per year. Concerning executive compensation, it was found that there is a high gap on the average total cash of executive compensation (i.e. salary and bonus) per year between the highest and the lowest of executive compensation in Indonesian commercial banking companies. There are 13 out 39 Indonesian commercial banking companies that have high the average total cash of executive compensation per year (i.e., > IDR 32,416 million per year, one \$ equals to IDR. 13.541).

Additionally, it also can be concluded that most of the listed Indonesia commercial banks have not really concerned on and aware of sustainability practices through corporate social responsibility activities implementation. As two-thirds of listed Indonesian commercial banks have a very low grand average value of corporate sustainability concerns (i.e., < 19.54 per cent). However, Indonesian commercial banks, which owned by the government or states are relatively more concerned and aware of corporate sustainability practices implementation and represented by PT Bank Negara Indonesia, Tbk (owned by the Indonesia government), which is considered as the most concerned about corporate sustainability practices among Indonesian commercial banking

companies. I also noticed that among the six dimension of corporate sustainability performances, most listed Indonesian commercial banks are more concerned on disclosing social performance (SOC), especially society performance (SO), and indicate low attention, and probably neglect, both human rights (HR) and environmental (EN) performance. Overall, the trend of corporate sustainability concerns among Indonesian commercial banks tends to increase every year in all six performance indicators. However, this trend is still considered to be in the low level of disclosure. This study concludes that Indonesian banking companies perceive the importance of corporate sustainability issues, as reflected in their policies or reporting, but tend to be unenthusiastic, or slightly wary, in practising them in the company. From the content analysis process of the sustainability or corporate social responsibility report of Indonesian commercial banks, this study reveals that most Indonesian commercial banks mainly use corporate investments for corporate social responsibility activities, focusing on routine charitable initiatives as a short-term, tentative and sporadic strategy to overcome negative reputation. The activities are reflected on the focus of society performance disclosure such as community development, charity, disaster donation, blood donation and philanthropic actions on society.

The first empirical finding is explained in chapter four. This study concludes that the board of commissioners in Indonesia banking companies is an important control mechanism to motivate managers to be more concerned about corporate sustainability concerns through corporate responsibility activities. According to the Throughput Model research framework perspective, which is the

agency theoretic position pathway and stakeholders' position pathway, a contrary finding appears between the role of the board of commissioners and company sustainability concern, which is tightly linked to company financial performance. Based on shareholder's perspective, which is related to the agency theoretic position pathway in the Throughput Model, this study found that corporate sustainability concerns have a significant negative influence on market value performance. Moreover, the result shows that the corporate sustainability concern fails to moderate the effect of the relationship between the role of the board of commissioners and the firm's market value. Most of the banks perceive the importance of corporate sustainability issues, as reflected in their policies or reporting, but tend to be enthusiastic, or slightly wary, in practising them. Their corporate social responsibility practices are fragmented, disconnected, and separated away from their business strategy, which results in failure to gain and dissipate many opportunities and benefits for both the companies and the societies. However, based on stakeholders' position pathway, this study reveals that the role of the board of commissioners could be important in internal corporate governance to influence the company management to enhance corporate sustainability concern to be in line with the stakeholders' demand. It is reflected in better corporate social responsibility activities and may result in the increase of company's market value performance through its financial health. Additionally, this study noticed that the role of the board of commissioners in the current period has a positive association with company's financial performance in a previous period of, mediated by company sustainability concern. It supports the consensus

among academic scholars that corporate sustainability concern, through corporate social responsibility activities, is a determinant factor of company's financial performance.

The second empirical finding is described in chapter five. Within the shareholder perspective on the linkage of pay-for-performance based agency theoretic pathway in the Throughput Model, it was revealed that executive compensations have direct positive significant impact on corporate sustainability concerns and company financial health as well as indirect significant impact on firms' market mediated by the effect of corporate sustainability concerns and company financial health. However, on the linkage of sustainability-for-performance based on the agency theoretic pathway, it was found that the high executive compensation designed to encourage managers to pursue more corporate sustainability concerns aimed at shareholder's or managers' interests would lead to reduced firm market value. In contrast, based on the stakeholder perspective, this is related to stakeholder position pathway in the Throughput Model, which argues that executive compensation can motivate and encourage managers to serve multiple stakeholders by implementing better and by disclosing more corporate social responsibility activities, which will increase the company market value through its financial health.

Chapter six provides the third empirical finding. This study investigates whether stakeholders' concern on the board of commissioners' (BoCs) role, along with executive compensation, could motivate the top management or executives

to achieve higher financial performance in a concentrated ownership dominant context. This study reveals that stakeholders' concerns of the board of commissioners' role and ownership structure in two-tiered corporate governance (CG) systems promote higher payment of executive compensation and better financial performance. It indicates that stakeholders' concern on the board of commissioners' role does not restrain high executive compensation payment. It seems that higher executive compensation payment is a trade-off and motivation mechanism to align stakeholders' and managers' interests. Moreover, by reversing the research direction, this study confirms that organisational performance is a key determinant of executive compensation, which is reflected on the board of commissioners' principle that is willing to provide higher executive compensation for their current agents or managers as attributable to agents' or managers' ability in the prior company financial performance. Thus, there is a substitutional and complementary effect among the constructs and indicators of corporate governance mechanisms in determining company financial performance. This study also found that concentrated ownership strengthens the positive relationship between the role of the board of commissioners and executive compensation in order to increase company financial health and market value performance.

7.2. The Thesis Contributions

The result of this thesis makes important contributions and constitutes a significant advancement in corporate governance - corporate sustainability - company financial performance research. Indeed, to the best of my knowledge

related to the lack of studies that explores the relationship of those topics, this practices, and applications by investigating those topics in developing countries, which is Indonesian commercial banking companies context, as one important emerging market in the South East Asia countries.

This study enriches fills a gap in the existing literature in several ways. *First*, the study contributes empirically to the methodology as it used quantitative method and claims to be the first study to employ partial least square - structural equation modelling (PLS-SEM) technique to analyse shareholder and stakeholder perspectives on both independent and interdependent impacts of corporate governance mechanisms - corporate sustainability - company financial performance in a single model. Moreover, this study contributes by checking the robustness of the findings with several estimation methods to control unobserved heterogeneity, simultaneity, and reverse causality. To the best of my knowledge, there has been no prior research similar to this study using the second-generation investigation technique, such as PLS-SEM. Most of the prior research investigated those topics separately or independently by using the first-generation technique, such as regression-based approach and analysis of variance.

Secondly, this study is the first attempt employing a decision framework model developed by Rodgers (1997), the Throughput Model, to describe and assess the relationship corporate governance - corporate sustainability concerns - company financial performance through adoption the shareholder and stakeholders perspectives. By employing the Throughput Model, this study is

practically able to look inside and to explain the distinctive effects of the relationship in the decision-making process by utilising both perspectives. It is beneficial for decision makers in determining the suitable decision choices pathway for their purposes in the decision-making process.

Thirdly, this study contributes to the theoretical literature by providing recent empirical findings from Indonesia commercial banking context in a two-tiered governance system, which represents Asian emerging market. Most of the prior literature investigated those topics independently study in developed countries and very few has been done in banking industry context.

7.3. The Major Thesis Limitations

I acknowledge that this study has some limitations. *First*, the study stems from a single-country investigation with only one specific industry, commercial banking, which may not be adequate to control and to represent industry different industries. This means that the findings might not be able to be generalised and transferred to other industries or countries. Moreover, I notice that banking industry has strict regulations and is well monitored by supervisory bodies, which may have different influences on the relationship among the constructs when additional control indicators or variables among the construct are induced. One of the conditions that might influence the findings is the fact that banking industry is a strongly regulated and well monitored. These conditions could differently influence the relationship between corporate governance and corporate sustainability with their impact on company performance although it is likely to

be relevant and applicable, particularly in commercial banking in developing countries context.

Second, the sample comprises of 39 banking companies listed on the Indonesian Stock Exchange from 2007-2014, which may significantly limit the observed variations in the constructs of corporate governance, corporate sustainability, and company financial performance. However, despite the limitation of samples, this study successfully indicated significant and robust relationships among the aforementioned constructs. *Third*, this study measured corporate sustainability concerns using manual content analysis method based on modification of GRI 3.1 indicators from sustainability report or the annual report disclosures. This condition limits the recognition of quality disclosure due researcher's subjectivity of in capturing various narratives. However, in order to minimise bias response and researcher's subjectivity, this study was employed into three ranges of weighted scores in awarding the score of disclosure based on the GRI 3.1 guidelines. The score were 0 (zero), 1 (one) and 3 (three), which can be interpreted as not disclosed, partially disclosed and fully disclosed, respectively. *Fourth*, this study did not consider differentiated effects from company size and a financial health condition that may have different impacts on these relationships.

7.4. The Implications of the Thesis

Overall, by employing panel data analysis, this study successfully provides significant and robust impact on the relationships of the constructs because the panel data analysis, which is of time series combination of cross-

section observations, can obtain more optimal results, more informative data, more variability, more degrees of freedom, more efficiency, and less collinearity among constructs. Thus, it is believed that the findings contribute significantly to academicians to avenue further research, to investors to make investment decisions, and to regulators and policy makers to draft further rules and regulations

7.5. Avenues for Future Research

Future research within this context is proposed to include unlisted banks because they may represent the broader quality of corporate governance implementation and disclosure in their annual reports. In addition, it is also recommended that future research incorporate interviews with company decision makers (i.e., the board of commissioners and management) to find out how decisions are made to disclose information, particularly voluntary information about corporate sustainability initiatives. It also useful to conduct comparative studies for different business industries and countries.

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