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Quality of sustainability reporting: how is the role of foreign institutional ownership and political connections?

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Abstract

This study aims to investigate the relationship between foreign institutional ownership and the quality of sustainability reporting as a function of political connections. The research sample consists of 485 companies listed on the Indonesian Stock Exchange. The analysis technique used is Generalized Method of Moments (GMM). The results showed that political connections weakened the relationship of foreign institutional ownership and the quality of sustainability reporting. This indicates that higher political connections cause companies to sharply avoid quality sustainability reporting, because sustainability reporting requires their full transparency and disclosure.

Keywords: Foreign institutional ownership; quality of sustainability reporting; political connections.

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Calidad de los informes de sostenibilidad: cómo es el papel de la propiedad institucional extranjera y las conexiones políticas?

Resumen

Este estudio tiene como objetivo investigar la relación entre la propiedad institucional extranjera y la calidad de los informes de sostenibilidad en función de las conexiones políticas. La muestra de investigación consta de 485 empresas que cotizan en la Bolsa de Indonesia. La técnica de análisis utilizada es el Método Generalizado de Momentos (GMM). Los resultados mostraron que las conexiones políticas debilitaron la relación de propiedad institucional extranjera y la calidad de los informes de sostenibilidad. Esto indica que las conexiones políticas más altas hacen que las empresas eviten bruscamente los informes de sostenibilidad de calidad, porque los informes de sostenibilidad requieren su total transparencia y divulgación.

Palabras clave: Propiedad institucional extranjera; calidad de los informes de sostenibilidad; conexiones políticas

1. INTRODUCTION

The integration of sustainability policies and practices into a company's strategies and operations is considered to be a relevant step in realizing long-term value. Integrating sustainability into company assessments will help communicate what companies are doing to overcome global challenges from poverty, education, climate change and biodiversity (Sustainable Stock Exchanges Initiative, 2015).

Therefore sustainable practices have financial consequences from financing activities in the economic, environmental and social fields. However, the costs incurred will improve the company's reputation, which in turn will also have an impact on increasing its financial performance and market value, because companies with extraordinary sustainable development strategies are more likely to be valued by investors and have higher valuations on financial markets. In addition, companies with better sustainability performance tend to face lower capital constraints due to stakeholder involvement, in the form of more efficient contracts (Cheng et al. 2015 ; Zhao, 2015 ; Cheng et al. 2014).

Sustainability reporting, which covers aspects of economic, environmental and social performance is both demanding and a challenge for business people. Economic, environmental and social performance is relevant information for investors, suppliers, creditors, activist groups, government, media, customers and the public when making business decisions, because sustainability disclosure provides information about the corporation's vision, and short-term and long-term strategies to all the stakeholders, so that sustainability reporting disclosures have the potential to increase company value. Sustainability reporting not only includes information on the company's economic, social, and environmental performance, but also contains methods to internalize and improve its organizational commitment to sustainable development that can be communicated to stakeholders, therefore the issue of sustainability reporting is not only a corporate and investor issue but also a problem of the government as well as the regulator (Fernández-Gago et al. 2018 ; Perrault & Clark, 2016 ; Delgado-Márquez et al., 2017 ; Masud et al. 2018).

As a country that is the lungs of the world, Indonesia has required companies that have gone public to prepare sustainability reports, together with their financial reports, since 2012 because by preparing sustainability reporting, it indicates that the company has been transfused to the public and preserved the surrounding natural environment. By publishing sustainability reports, foreign investors will be more confident in investing their capital in Indonesia (www.swa.co.id/swa/tren/management). Foreign investors' insistence on sustainability reports may be a supporting factor in realizing sustainability and improving corporate governance in Indonesia.

As one of the countries that are undergoing a lot of reforms, including revamping the economic sector, Indonesia has offered the widest opportunities to foreign investors to invest in the country. But foreign investors have been educated in terms of sustainability. Foreign investors want a guarantee of corporate sustainability that is reflected in economic, environmental and social performance so their insistence on there being sustainability reports must be responded to positively with improved governance by corporations and regulators, so that Indonesia will be attractive to foreign investors and all stakeholders. Therefore the sustainability report, as a corporate communication tool with all stakeholders, becomes a necessity for the corporation, because the sustainability approach is a holistic approach that allows foreign investors to conduct a comprehensive assessment in a multidimensional framework that provides an overview of the involvement, sustainability actions and maturity of companies in each country (Aras et al. 2018; Barkemeyer et al. 2015 ; Bradford et al. 2017 ; Batista & de Francisco, 2018). But the business world in any country, including Indonesia, is often inseparable from politics, especially after the reform era in which the political system in Indonesia experienced a shift.

The political world has a pattern of interrelated relations, so the existence of entrepreneurs cannot be separated from the current political dynamics. The involvement of entrepreneurs in practical politics is already common in developing countries, including Indonesia, because it is believed to have beneficial effects for both politicians and companies. Political connections provide easy access to credit and reduce capital costs, provide tax reductions and various other policies that benefit the company (Li et al. 2018 ; Akey, 2015 ; Dang et al. 2018). A political connection does contribute to the sustainability of the company but, on the other hand, it can lead to decreased accounting performance, worse company dynamics, less likelihood of innovation because bribery practices often occur, and there can be relatively high information asymmetry. Although political connections can help companies obtain more financial resources, preferential access to commercial loans has the potential to cause an excess supply of credit and increase financial burdens, causing distortions in the allocation of social resources and causing poor performance (Bertrand et al. 2018 ; Akcigit et al. 2018 ; Hu et al. 2019 ; Krammer & Jiménez, 2019 ; Ling et al. 2016). Political connections are often a tool for scandals, and create collusion that causes distortions in the allocation of economic resources that impose substantial economic costs on society as a whole (Hung, et al. 2015; Fisman & Wang, 2014 ; Bertrand et al. 2002 ; Claessens et al. 2008).

Related to sustainability reporting, several studies have shown that companies that are politically attached, on average, have a higher corporate social responsibility performance than companies that are not involved in politics. Political engagement increases the effectiveness of government-induced corporate social responsibility policies. However, for companies that have political ties in China, corporate social responsibility performace is more likely to have a negative relationship with corporate financial performance (Reimsbach et al. 2018). Companies that have political connections are more likely to take on greater social responsibilities and disclose their practices because they will be under additional pressure (Fernández-Gago et al., 2018). Political connections are very valuable for companies operating in countries where property rights protection is weak and market support institutions are lacking, but politically motivated CSR can benefit shareholders in the short term, but at the expense of long-term social welfare (Lin et al. 2014).

This study was motivated by the government's intensive efforts during President Joko Widodo's administration to attract foreign investors to Indonesia. However, on the other hand the socio-political condition of Indonesia, which has a multi-party system, tends to encourage competition for political power and economic resources as well as a tendency for collusion and corruption scandals. Another thing is the weak governance in Indonesia and weak protection of investors, so the study of the insistence on quality sustainability reporting using Indonesian company data allows researchers to uncover the effects of the demands of foreign investors and the phenomenon of political connections in Indonesia, which will provide insights and contributions to the development of sustainability and research in Indonesia.

This study aims to provide empirical evidence of foreign investor relations and quality of sustainability reporting as a function of political connections. The observation period in this study was 2013-2017. This period is based on the consideration that in 2012 Indonesia began to require all the companies listed on the Indonesian Stock Exchange to prepare sustainability reports. This research differs from previous studies, as this research uses Indonesia as a unique setting for uncovering the facts that occur in relation to the pressure from foreign investors toward the existence of quality sustainability reporting; the existing political connections often encourage the emergence of political scandals, collusion which causes distortions in the allocation of economic resources and imposes substantial economic costs on society. Therefore, researchers place political connections as a function that moderates the relationship between foreign investors and sustainability's reporting quality. In addition, the GRI G4 indicator used in this study breaks down economic, environmental and social performance into 149 indicators, while the number of indicators commonly used in previous studies has only been 91 indicators.

The results of this study indicate that pure political connections moderate the relationship of foreign institutional ownership and quality of sustainability reporting, meaning that pure political connection weakens the relationship of foreign institutional ownership and quality of sustainability reporting. This indicates that politically connected companies generally transfer benefits that will motivate them to obscure information, and transfer monitoring and supervision from outsiders, while controlling shareholders want actual performance information to ensure that the information transfer practices by management largely originate from cronyism. politics and corruption that are hidden (Hung et al. 2018). Political connection is often a tool for scandal, and collusion that causes distortions in the allocation of economic resources, which impose substantial economic costs on society as a whole (Hung, et al. 2015; Fisman & Wang, 2014 ; Bertrand et al. 2002 ; Claessens et al. 2008).

The survival and success of an organization, in the long run, requires the support of all stakeholders, therefore managers have an important role in balancing and meeting the demands of various stakeholder groups to achieve company goals, because without the support for sustainability from stakeholders, the company will have difficulty maintaining business continuity (Smith et al. 2005 ; Ullmann, 1985 ; Clarkson, 1995).

The relationship between foreign institutional ownership and sustainability reporting, moderated by political connection, can be explained by the stakeholder theory. An effective organization will pay attention to all stakeholder relationships that can influence, or be affected by, the achievement of company goals. The concept and application of stakeholder management are basically pragmatic. Therefore an effective company will manage its relationships with all stakeholders that benefit it. Strategic plans for managing stakeholder relationships will involve developing a company's reputation as a socially responsible one. CSR activities are seen as part of the company's strategic plan to meet stakeholder demand, because there is a positive influence between the strength of stakeholders with CSR’s performance or disclosure. Therefore, the stakeholder theory also provides a potential and useful theoretical framework for testing the relationship between various company characteristics and CSR’s disclosure (Freeman, 1999 ; de Villiers et al. 2011 ; Roberts, 1992).

Agency theory also forms the basis of this research. An agency relationship is defined as a being between a principal and an agent who is contracted to perform several services on their behalf and where the agent is given some power in decision making. By its nature, agency relationships are problematic if the interests of the actors and agents are different. The agency theory is based on two behavioral assumptions. The first assumes that individuals try to maximize their utility and the second assumes that individuals tend to benefit from any incompleteness in the contract. Shareholders act as an essential counterweight to prevent the power of managerial discretion becoming unlimited and therefore potentially counterproductive (Jensen & Meckling, 1976 ; Fama & Jensen, 1983). Conflicts that occur between shareholders and management usually involve business policies, and the short-term and long-term strategies of the company. Generally managers are motivated to pursue profits and opportunities in the short term, (de Villiers et al. 2011 ; Khan et al. 2013). Meanwhile, if it is associated with social and environmental investments, it is generally a long-term goal and management may be reluctant to invest in sustainable areas because they do not directly benefit from this (Chan et al. 2013; Katmon et al. 2017). In addition, managers assume that the development of finance raised on the stock market has a negative effect on environmental quality (Sekali & Bouzahzah, 2019).

The phenomenon that occurs in Indonesia is that many politicians plunge in the business world, or vice versa: many business people are politicians. Generally they are part of the company's management. Politically connected companies generally divert benefits that will motivate them to obscure information and divert monitoring and supervision from outsiders, while controlling shareholders want actual performance information to ensure that the practice of information transfer by management largely stems from hidden political cronyism and corruption. (Hung et al. 2018). Unlike the case with shareholders, especially foreign investors, who tend to prioritize efficiency, they want monitoring from the board, adequate audit processes, and good governance (Chen et al. 2017; Desender et al. 2016 ; Tunay & Yüksel, 2017). Thus, management must consider agency costs during their decision making, because if not, then the stakeholders will react negatively meaning the impact will be a decline in value of the company (Morris, 1987). Agency conflicts often occur between shareholders and managers, therefore sustainability disclosures can be used as a medium to reduce agency problems, due to the process of monitoring, controlling and reporting for short- and long-term goals (Chang et al. 2017).

Quality of sustainability reporting includes quantitative and qualitative information about economic, environmental and social performance (GRI, 2013). The guarantee of sustainability reporting is to increase credibility, the reliability of financial statements, help build the company's reputation, and to help improve dialogue among the stakeholders so as to improve the decision making process (Sìmnett et al. 2009; Junior et al. 2014). As mentioned above, sustainability reporting is one of the pressures from foreign investors to guarantee transparency and credibility. The main motivation for foreign investment is to get regulation and business profits. Foreign ownership has a positive impact on the level of CSR disclosures. High CSR performance is useful for attracting foreign investment and enhancing the company's reputation. When the company's CSR performance increases, foreign investors tend to narrow the scope of their attention to accessible and reliable indicators such as CSR, consequently foreign ownership increases. This implies that because foreign investors generally face uncertainty and information asymmetry, they have a strong desire to reduce or avoid uncertainty and information asymmetry about investing when they choose to invest in the stock market. In this context, CSR can enhance a company's reputation in a way that serves as a meaningful and reliable signal to foreign investors. In general, an organization's reputation helps them reduce transaction costs such as searching, monitoring and coordination costs. Thus, when a company is active in CSR, the company can receive a more positive evaluation from foreign investors. Thus, foreign investors tend to invest in companies with high levels of CSR involvement. Foreign ownership will increase competitive advantage, and the relationship between CSR and foreign investment emphasizes how CSR plays a role for company performance (Lee et al. 2017 ;McGuinness et al., 2017;Muttakin & Subramaniam, 2015 ; Boubakri et al. 2016 ;Mahmood et al. 2019 ; Khanifah et al. 2020).

Sustainability reporting needs to be done independently. Independent sustainability reporting causes wider disclosure of sustainability, with a high level of application where the disclosure of economic, environmental and social information is carried out in a more transparent way, thereby supporting the theory of legitimacy (Orazalin & Mahmood, 2018 ; Plumlee et al. 2015). The level of corporate economic, environmental and social disclosure is significantly interrelated (Tubay & Leon, 2020). The disclosure of sustainability will encourage management to increase transparency, accountability and stakeholder confidence so that it will have an impact on increasing the value of the company (Li et al. 2018 ; Sing et al. 2017). However, at a higher level of profitability, investors do not show a reaction to the issuance of sustainability reports, especially companies that deal with the end consumers of sustainability reporting as it actually reduces the value of the company. This implies that good deeds, in the form of managements' attention to the environment and social matters, are considered unfavorably from the perspective of the shareholders (Goettsche et al.2016;Laskar and Maji 2016).

Politically connected companies tend to be more active in responding to government policy signals and requirements, with reference to environmental planning, philanthropic action and, to a lesser extent, benchmarking best practices, so, on average, they have a higher corporate social responsibility performance than non-political companies. Companies with political ties are more likely to take on greater social responsibility, and express their practices because they are under additional pressure (Marquis & Qian, 2014;Reimsbach et al., 2018;Gu et al. 2013;Yu & Kuo, 2016;Fernández-Gago et al., 2018). Companies with CEOs that are politically affiliated are more likely to make a greater contribution to the government than companies that are not politically affiliated. However, this relationship varies systematically, based on whether the company is state-owned, its financial condition is strong, and voting rights are concentrated (Jia & Zhang, 2013). The same goes for the shareholders, as said by Carter (2018). Who contended shareholders prefer political connections over corporate social responsibility. The advantage of wealth increases for shareholders when managers choose political connections over corporate social responsibility, while shareholders lose value when managers choose corporate social responsibility over political connections.

The following research provides different results, where the voluntary disclosure of corporate social responsibility is inversely related to corporate political connections, which is consistent with the neo-pluralist conceptualization of the state, and evidence shows that political and business elites can align their interests. The results challenge the conventional claim that companies need disclosure of their corporate social responsibility, as a legitimate tool in managing stakeholder pressure for socially responsible corporate behavior. Conversely, in neo-pluralist societies, companies can use political connections to avoid potential stakeholder pressure for involvement in corporate social responsibility (Muttakin et al. 2015). Greater political connections cause companies to sharply avoid disclosure about their corporate social responsibility due to higher levels of corruption, low corporate governance, low external pressure and the lack of the rule of law in the country (Masud et al. 2019). Politically motivated corporate social responsibility can benefit shareholders in the short term, but at the expense of social welfare in the long run (Lin et al., 2014). Moreover, Uddin et al. (2016) state that neutral, corporate, philanthropic activities that are disclosed and promoted in a corporate social responsibility report are closely related to the personal projects of powerful leaders and the ruling party's agenda. Based on the arguments above, the hypothesis development in this research is :

H: Political connection weakens the relationship of foreign institutional investors and sustainability reporting

2. METHODOLOGY

The research sample consisted of 485 companies listed on the Indonesian Stock Exchange, and consisted of nine industrial classifications of companies including agriculture; finance; mining;

basic industries and chemicals; other industries; consumer goods industry; property, Real estate and building construction; infrastructure, utilities and transportation; trade, services and investment with an observation period of 2013-2017. This period is based on the consideration that in 2012 Indonesia began to require all companies listed on the Indonesian Stock Exchange to prepare sustainability reports. All company data is obtained from the Indonesian Stock Exchange through www.idx.co.id while the sustainability reports are obtained from each company's website. If a company does not publish a sustainability report, we trace the company's sustainability report disclosure listed in each annual report. To identify political connections, we traced data sources from the House of Representatives website, http://www.dpr.go.id and from the government website http://www.gksoft.com/gov/en/id.html.

The analysis technique used in this research is a dynamic panel data regression or Generalized Method of Moments (GMM). To validate the instrument variables an over-identifying restrictions test was originally built by Sargan (1958). This citizenship test is based on the assumption that model parameters are identified through the limitation of the coefficient, and testing its validity through the over-identifying restrictions test. For robust estimations, this study will use the statistical value from the Hansen test. Furthermore, the difference in the Hansen test can also be used to test the validity of the subsets of the instrument's variables so that the variables are declared exogenous. In addition, this test offers automatic testing to weight the observed variable values and the transformation of the forward orthogonal deviations.

The dependent variable in this study is quality of sustainability reporting, as measured by the GRI G4 index which consists of 149 performance indicators, consisting of 58 general standards and 91 specific standards. Special standards' performance indicators include 9 indicators of the economic aspects, 34 for environmental aspects, 16 aspects of labor, 12 aspects of human rights, 11 aspects of society, and 9 aspects related to products. The independent variable in this study is institutional foreign investors, as measured by the proportion of share ownership by foreign institutional investors (Jennings, 2005). The moderating variable in this study is political connection, which is a dummy variable. The company is defined as being politically connected if at least one of its top officials (defined as the company's chief executive, chairman of the board, president, vice president, or board secretary or large shareholder [defined as anyone who controls at least 10% of the company's voting shares] is president, vice president, minister, Chair or member of the House of Representatives or chairman and party member), (Faccio et al. 2006). The control variables in this study are firm age, firm size, sales growth and return on equity. The following table explains the variables and their measurements:

Table 1: Variable Measurement

Variable	**Measurement**
Sustainability	Score 1 is given if the company discloses performance

Reporting Quality (SRQ)	indicators according to GRI G4, and score 0 if it does not disclose them. So, the calculation of Sustainability Reporting Quality is: $SRQ = \frac{\Sigma \text{ item disclosed}}{149}$
Foreign Institutional Ownership	Percentage of share ownership by foreign institutional investors.
Political connection	A score of 1 is given if the company has political connection and 0 if not
Firm Age	Age of the company from it was founded until the year of observation.
Firm Size	Ln Total Asset
Growth Sales	$\frac{Sales_t - Sales_{t-1}}{Sales_{t-1}}$
Return on Equity	$\frac{\text{Earning after tax}}{\text{Equity}}$

3. RESULTS and DISCUSSION

Based on the research model above, the moderation model can be written as follows:

$$SR_{it} = \beta_0 + \beta_1 FIO_{it} + \beta_2 POLLAFF_{it} + \beta_3 FIO_{it} x POLLAFF_{it} + \beta_4 FirmAge_{it} + \beta_5 FirmSize_{it} + \beta_6 GrowthSale_{it} + \beta_7 ROE_{it} + u_{it} \quad (1)$$

A summary of the statistics for the main variables can be seen in Table 2.

Table 2: Descriptive Statistics for Variables

Variable	Obs	Mean	Std. Dev.	Min	Max
SR_{it}	2,415	0.2737	0.2723	0.0000	1.0000
FIO_{it}	2,415	0.2205	0.3017	0.0000	1.0000
$POLLAFF_{it}$	2,415	0.1884	0.3911	0.0000	1.0000
$FirmAge_{it}$	2,415	33.7329	19.4300	0.0000	200.0000
$FirmSize_{it}$	2,415	0.2655	0.0463	0.0110	0.3610
$GrowthSale_{it}$	2,415	0.1745	1.6390	-2.9610	71.9030
ROE_{it}	2,415	3.1548	13.7400	-161.8900	148.2400

The main focus of the discussion in this study is to provide empirical evidence whether political connections moderate foreign institutional ownership, in terms of the quality of sustainability reporting, by using the interaction variables between political connection and foreign institutional ownership. The results show that foreign institutional ownership is significant and has a positive value, meaning that foreign institutions' increasing ownership will increase the quality of the sustainability reporting. Foreign investors generally face uncertainty and information asymmetry. They have a strong desire to reduce or avoid uncertainty and information asymmetry related to investing when they choose and invest in the stock market. In this context sustainability reporting can enhance a company's reputation if it serves as a meaningful signal and is seen as reliable by foreign investors. In general, an organization's reputation helps them reduce transaction costs such as searching, monitoring and coordination costs. Thus, when a company is active in expressing its sustainability, foreign investors will have a positive evaluation of it. Foreign investors tend to invest in companies that produce high quality sustainability reports and increase their competitive advantage. Thus, the higher the quality of the sustainability reporting is by a company, the more it will attract foreign investors to invest in it. The results of this study are in line with Lee et al.(2017), McGuinness et al., (2017), Muttakin & Subramaniam (2015), and Boubakri et al. (2016).

The result of estimating the quality of sustainability reporting using the GMM system can be seen in Table 3.

Table 3: Results of Estimation of Quality Sustainability Reporting Using the GMM System

Variable	Model 1		
	Coefficient		Std. Error
Constant	-0.2143	*	0.0527
SR_{it-1}	1.4768	*	0.0651
FIO_{it}	0.1095	***	0.0609
$POLLAFF_{it}$	0.2402		0.1509
$FIO_{it}xPOLLAFF_{it}$	-0.6499	***	0.3466
$FirmAge_{it}$	-0.0017	**	0.0008
$FirmSize_{it}$	0.4803	***	0.2517

$GrowthSale_{it}$	-0.0029	**	0.0013
ROE_{it}	-0.0009	**	0.0004
AR (1)			0.0000
AR (2)			0.2980
Hasen Test			0.4980
Difference in Hansen Test			0.3490
N (number of observation)			1932

Note: * significance at 1% level

** Significance at 5% level

*** Significance at 10% level

$$SR_{it} = -0.2143 + 1.4768SR_{it-1} + 0.1095FIO_{it} + 0.2402POLLAFF_{it} - 0.6499FIO_{it}xPOLLAFF_{it} - 0.0017FirmAge_{it} + 0.4803FirmSize_{it} - 0.0029GrowthSale_{it} - 0.0009ROE_{it} + u_{it} \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots (2) \quad (2)$$

According to the $POLLAFF_{it}$ estimation results, it is not significant, while $FIO_{it}xPOLLAFF_{it}$ is significant at a 10% level. These results indicate that the variable political connections are not significant, but the interaction variable between political connection and foreign instituonal ownership is significant and positive, which means that this model has the characteristic of pure moderation which means pure political connections weaken the relationship of foreign institutional ownership and quality of sustainability reporting. Politically connected companies generally shift benefits that will motivate them to obscure information and divert monitoring and supervision by outsiders, while controlling shareholders want actual performance information to ensure that the practice of information transfer by management largely stems from hidden political cronyism and corruption. (Hung et al. 2018). In addition, foreign investors always consider investment efficiency, and they pressure management so that companies are strongly committed to creating sustainable organizations, as well as being concerned with the values of the organization, ethics, and regulations of foreign countries that lead to more stakeholder involvement (Bae et al. 2018 ;Chen et al., 2017). On the other hand, companies that have political connections tend to be less transparent about environmental information. Directors with party head status lean toward a passive approach in environmental reporting, because every investment in environmental protection has a direct impact on the company's profitability (Zhao, 2015 ;Yu & Kuo, 2016).

The multi-party system adopted by Indonesia tends to encourage competition for political power and economic resources and scandals. Political connections do contribute to the sustainability of a company, but on the other hand they can lead to a decline in the accounting performance, the company's dynamics are worse and it is less likely to innovate because of frequent bribery practices, it has relatively high information asymmetry, and increased financial burdens resulting in distortions in its social resource allocations and causing poor performance (Bertrand et al. 2018 ; Akcigit et al. 2018 ; Hu et al. 2019 ; Krammer & Jiménez, 2019 ; Ling et al. 2016). A political connection is often a tool for scandal, collusion that causes distortions in the allocation of economic resources, which impose substantial economic costs on society as a whole (Hung, et al. 2015; Fisman & Wang, 2014 ; Bertrand et al. 2002 ; Claessens et al. 2008). Moreover, Ulum et al. (2019) says that corruption and collusion involving the executive and legislative bodies in Indonesia are already a moral hazard.

A company's dependence on its political connections, including its CEO’s membership on the board and in political parties, will affect its legitimacy (Marquis & Qian, 2014). Politics and business can align their interests, which results in challenging conventional claims that companies need CSR disclosure as a legitimate tool to manage stakeholder pressure (Muttakin et al., 2015). Companies with CEOs who are inclined to a particular political party tend to spend a greater amount of funds lobbying, make greater corporate political contributions, lobby for larger bills, and employ lobbyists in larger numbers. CEOs who lobby tend to enjoy greater managerial compensation and incentives, compared to their non-lobbying colleagues. In addition, weak governance, poor company performance and certain party-oriented tend to experience higher agency costs (Unsal et al. 2016). Thus, even though the demands of foreign investors are for sustainability, if the company has political connections they will not force the company to produce quality sustainability reports because, in general, many politicians are involved in the business world, or vice versa, many business people are politicians and they are part of the company's management so the political and business elites can align their interests.

The coefficients estimated by the GMM system and the results can be seen in Table 3. The Arellano and Bond (AB) test is performed to determine whether there is an autocorrelation event. Autocorrelation events that occur can be either first-order autoregressive called AR (1) or second-order autoregressive called AR (2). AB test results for AR (1) show a rejection of the null hypothesis that there is a significant serial correlation. In the AB test, AR (1) has a significant serial correlation, but this does not occur in AR (2) so there is no false regression. The AR (2) test results also show a rejection of the null hypothesis that there are autocorrelations at significant levels α = 5% and α = 10%. The results of this test indicate that the estimated coefficient is not false. Thus the model is robust.

Table 4: Results of Robustness Test

Sr	Coef.	Robust Std. Err.	t	P>|t|	[95% Conf. Interval]	
sr .L1	1.476872	0.0650716	22.70	0.000	1.349013	1.604731
Foreign	.1095413	0.0609178	1.80	0.073	-0.0101559	0.2292385
Politicalaffiliation	.2402263	0.1509154	1.59	0.112	-0.0563071	0.5367597

Pifo	-.6499822	0.3466698	-1.87	0.061	-1.331153	0.0311885
Firmage	-.0017101	0.0007937	-2.15	0.032	-0.0032696	-0.0001506
Firmsize	.4802286	0.2517473	1.91	0.057	-0.0144291	0.9748864
Salesgrowth	-.0029222	0.0012628	-2.31	0.021	-0.0054033	-0.0004410
Roe	-.0009389	0.0004287	-2.19	0.029	-0.0017812	-0.0000967
_cons	-.2143762	0.0527182	-4.07	0.000	-0.3179622	-0.1107902

4. CONCLUSION

Most companies do not, as yet, have a good commitment to consistently issuing sustainability reports. Generally, sustainability reports are integrated into their annual reports. Overall, the results of this study largely support the statement of the stakeholder theory, agency theory and legitimacy theory. Greater political connections cause companies to sharply avoid quality sustainability reporting due to their higher levels of corruption, low corporate governance, low external pressure and the lack of the rule of law (Masud et al., 2019). Companies with low quality sustainability reporting will be more involved in corporate political activities to offset their negative public image and manage the legitimacy gap. This finding is in line with the study of Bansal & Clelland (2004) which shows that companies that are considered to be environmentally unfriendly face an unsystematic risk and must react to any news that will bring a negative corporate image. Likewise, Cho et al. (2008) found that companies with poor environmental records tend to spend more on political activities than companies that perform better. Thus, even though foreign investors demand quality sustainability reports, it will not affect the company as long as the company has political connections with government officials, the chairperson or members of the House of Representatives, or the chairman or members of political parties. Thus political connections weaken the relationship between foreign institutional ownership and the quality of sustainability reporting.

Our study contributes to the previous literature by showing the importance of reducing political risk, managing legitimacy, and managing stakeholders because public policy is the main force behind making standards and norms in all industries. This study has implications for: 1) the importance of the effectiveness of internal governance mechanisms that will help companies to meet sustainability goals and gain legitimacy, pay attention to the interests of stakeholders and minimize agency conflict. Therefore, socially the role of public authorities and superior governance mechanisms is needed to monitor company behavior and encourage corporate sustainability; 2) the importance of company awareness to internalize and improve its organizational commitment to sustainable development, which can be communicated to stakeholders by conducting full sustainability disclosure to minimize information asymmetry; 3) the need for high commitment from every company in applying the principles of the Global Reprting Initiative (GRI) which presents a report on sustainability, guarantees financial benefits, and, by extrapolation, meets the needs of all stakeholders.

The limitation of this study is that it only reviews the structure of foreign ownership, political connections and quality of sustainability reporting. Therefore future studies would be more interesting if the quality of sustainability reporting is related to the ownership structure of government, managerial, and domestic institutions. It would be even more interesting if it is associated with the factors of corruption, collusion and institutional control.

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