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The Influence of Corporate Social Responsibility on Performance in Indonesian Companies

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Abstract

As a developing country with many corporations operated in natural resources related business, the world also demands Indonesian companies to act more responsibly. The paper examines the influence of corporate social performance (CSP) to corporate financial performance (CFP) in Indonesian companies. After analyzing the theories and previous research related to CSP and its relationship with CFP both in global and Indonesia contexts, content analysis of 2012 sustainability reporting (SR) published by Indonesian companies will then be employed using GRI (Global Reporting Initiative) index to measure the CSP of each company. There were 29 Indonesian companies which published SR in 2012. The CSP will then be correlated to ROE and ROA as measurement for CFP by involving company's asset, industry group, shareholder type, and number of independent commissioners as control variables. Results indicate that CSP has a positive impact to CFP with asset, industry group, shareholder type, and number of independent commissioners as a control variable. The research shows a significant relationship between CSP and CFP in Indonesian companies. However, as this research only using SR in measuring CSP, more research is needed to include companies that have done CSR programs but have not published sustainability reporting (SR).

Keywords – CSR, CFP, SR, Indonesia

Introduction

As has been explained by ISO 26000 (2010), social responsibility is the responsibility of an organization for the impact of its decisions and activities on society and the environment, through transparent and ethical behaviour that contributes to sustainable development, health and the welfare of society; takes into account the expectations of stakeholders; is in compliance with applicable law and consistent with international norms of behaviour; and is integrated throughout the organization and practiced in its relationships. This is in line with the concept of corporate social responsibility which proposes that a private corporation has responsibilities to society that extend beyond making a profit (Wheelen and Hunger, 2011: 72), attempting to harmonize the goal of achieving economic prosperity, environmental quality, and social justice, or turning the traditional financial bottom line to be triple bottom lines (Elkington, 1997: 2).

Many believe that corporate social responsibility (CSR) activities will bring many benefits to the company. Porter and Kramer (2006) emphasized that strategic CSR will minimize the increasing risk of government regulations, exposure to criticism and liability, and consumers' attention to social issues. Furthermore, they concluded that CSR will become increasingly important to competitive success. Meanwhile, Welter (2011) summarized the previous literatures of benefits of CSR into three groups, i.e. philosophical purposes, financial reasons, and competitive advantages.

Indonesia is currently on the number 16^{th} of the biggest economy in the world and is predicted to reach position of number 7^{th} in the world (McKinsey Global Institute, 2012). Indonesia is also the only country in the South East Asian region that become the member of G-20 (*Group of Twenty*), the forum for the governments and central bank governors from 20 major economies in the world. As a place where many companies operate in natural resources related business, the eye of the world also turn to Indonesia to be more socially and environmentally responsible.

The objective of this research is to understand the relationship between the corporate social performance and corporate financial performance in an emerging economy such as Indonesia.

Literature Review

Research on the relationship between corporate social responsibility (CSR) and financial performance has attracted many researchers for years. Generally, the research intends to prove that socially responsible activities by a company will lead to a positive impact to company's financial performance. However, there have been inconclusive results of the relationship between the two.

Oeyono, et al. (2011) listed several previous research that show the positive relationship between the CSR and financial performance, among others are research by Odemilin et al. (2010), Lawrence and Weber (2008), Moneva et al. (2007), Ruf et al. (2001), Verschoor (1998), Balabanis et al. (1998), and Cochran and Wood (1984). Meanwhile, in-depth analysis by Margolis dan Walsh (2003) on 127 previous research showed that there is positive relationship and only few negative relationship between corporate social performance and corporate finance performance. A meta-analysis of 52 previous research by Orlotzky et al. (2003) also concluded that there is positive relationship between corporate social responsibility and company's performance. For Indonesian case, Oeyono, et al (2011) investigated the level of CSR conducted by the top 50 corporation in Indonesia and its relationship with company's profitability and concluded that level of CSR, measured based on Global Reporting Initiative (GRI) guidelines, has a positive relationship with profitability, measured by company's EBITDA and EPS.

On the other hand, Oeyono et al. (2011) also listed some previous research that resulted in no strong relationship between CSR and financial performance.Among others are research by ACCA (2009), D'Arcimoles and Trebucq (2002), and Mittal et al. (2008).

Corporate Social Responsibility in Indonesia

Corporate social responsibility has gained formal legal status within Indonesian regulatory frame work since the Indonesian President and House of Representatives enacted Law Number 40 Year 2007 concerning Corporation. The article 74 of the Corporation Law states that it is compulsory for companies operate in and/or related to natural resources to conduct corporate social and environmental responsibility (CSER). That CSER fund has to be budgeted by the company and the budget can be treated as company expenses. This law has provoked many critics especially from business community because of a fear that the government will intervene too far to company's profit distribution in the form of compulsory CSR fund. That strong negative reaction might have led the government to release an ambiguous and relatively weak implementing government regulation Number 47 Year 2012, in which it does not regulate CSER for Indonesian companies in details as it should be, instead, it seemed only repeat the words that has been stated in the Law No. 40 Year 2007.

Beside the enactment of the CRS article in the Corporation law, in fact, there have many existing laws related to CSR issues in Indonesia. Laws for governance issues include Law No. 20 Year 2001 concerning the amendment of Law No. 31 Year 1999 on Eradication of Corruption Practices and Law No. 8 Year 2010 concerning Anti Money Laundering. For human rights, there is Law No. 39 Year 1999 on Human Rights. For environment issues, there is Law No. 32 Year 2009 on Environment Protection and Management. For labour practice there are Law No. 23 Year 2002 on Child Protection and Law No. 13 Year 2003 on Labour. Furthermore, concerning consumer issues, there is Law No. 8 Year 1999 on Consumer Protection, and for fair operating practices, there is Law No. 5 Year 1999 on Prohibition of Monopoly and Unfair Business Practices. Companies operated in Indonesia also have to follow Law No. 25 Year 2007 on Investment, many laws on taxation as well as laws concerning certain industries.

Special for Indonesian State's Owned Enterprises (SOE) need also to follow Law No. 19 Year 2003 concerning SOE and several SOE Minister Decrees concerning Partnership and Community Development Program (PCDP) for SOE. These regulations say that every SOE has to allocate 4% of its net profit to PCDP which is divided further to 2% for partnership program to help small medium enterprise (SME) in improving its capacity and another 2% for community development program.

The author views that the issuance of the Corporation Law, which include the regulation on CECR has misled misperception among many business community in Indonesia. As it states that CECR is compulsory for companies operated in and/or related to natural resources, many business players from non-related natural resources industries, such as banking and services companies believe that they do not need to conduct CSR activities. Consequently, there are only very few companies in non-natural resources related sector that have good and comprehensive CSR programmes. The author also sees that majority of Indonesian companies still perceive that they have been doing a good CSR programme if their companies have make some donations to natural disaster victims, or philanthropy and/or trees planting activities.

Methodology

The purpose of this study is to know the relationship between CFP (Corporate Financial Performance) and CSP (Corporate Social Performance) in Indonesia. Considering data availability, sample of this study is from 2012 sustainability reports (SR) published by

Indonesian companies. The SR publisher are from state's and regional government's owned companies as well as private's owned both domestic and foreign, listed and non-listed, both from natural and non-natural resources based. There are 29 GRI G3.1-based SRs published by Indonesian companies in 2012.

CFP is measured by its accounting-based financial performance i.e. ROA (Return on Assets) and ROE (Return on Equity). CSP is meaured using GRI G3.1 standard, consists of 9 economic indicators, 30 environment indicators, and 44 social indicators (which further consist of 11 human rights indicators, 14 labour and descent work indicators, 10 society indicators, and 9 product responsibility indicators). CSP is calculted using the following formula:

$$CSP\ (X) = \frac{\sum_{i=1}^{9} E(X)_i}{\sum_{i=1}^{9} max\ E(X)_i} + \frac{\sum_{j=1}^{30} L(X)_j}{\sum_{j=1}^{30}\ max\ L(X)_j} + \frac{\sum_{k=1}^{44} S(X)_k}{\sum_{i=k}^{44}\ max\ S(X)_k}$$

$$max\ E(X)_i = max\ L_j = max\ S(X)_k = 3$$

Where $E(X)_i$ is the i^{th} economic indicator score for X's company, $L(X)_j$ is the j^{th} environment indicator score for X's company, $S(X)_k$ is the k^{th} social indicator score for X's company. The score takes ordinal values from 0 to 3. The value is 0 if the report does not provide any information as required by the indicator, 1 if the report only give less than half of required disclosure, 2 if the report gives more than half of required disclosure, and finally 3 if the report provides the required disclosure fully.

To understand the relationship between CSP and CFP, the author used partial correlation analysis, by employing 3 control variables, i.e. asset (C1), industry group (C2), shareholder type (C3), number of independent commissioners (C4). C1 are defined as the total assets derived from the company balance sheet. C2 is number 1 – 9 industry group as set by International Standard Industrial Classification (ISIC) of United Nations, C3 is shareholder type, i.e. 1 for domestic private's owned company, 2 for foreign private's owned company, and 3 for government's owned company, and C4 is number of independent commissioners in the company.

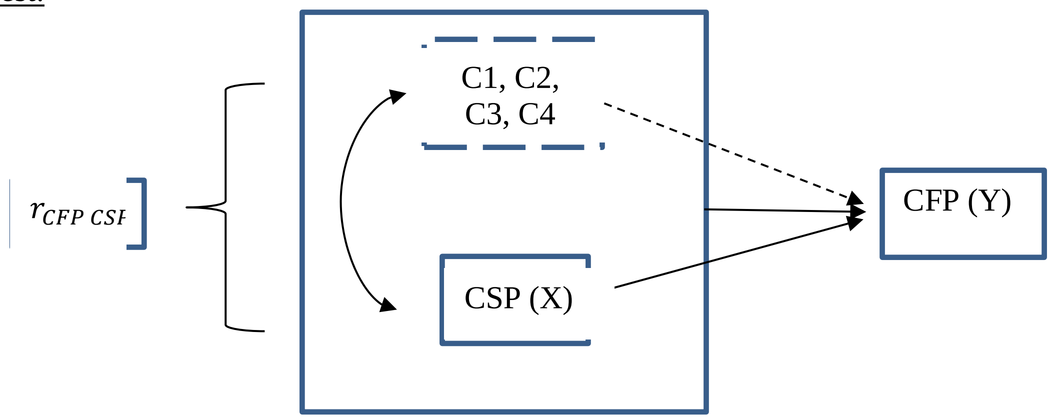
Results

Hypotheses employed in this research are:

H_1 :There is a (significant) relationship between CFP and CSP if asset (C1), industry group (C2), shareholder type (C3), and number of independent commissioners (C4) are used as a control variable.

H_0 :There is no (significant) relationship between CFP and CSP if asset (C1), industry group (C2), shareholder type (C3), and number of independent commissioners (C4) are used as a control variable.

<u>Statistical Test:</u>



Control Variables			CFP	
			ROA	ROE
asset (C1), industry group (C2), shareholder type (C3), and number of independent commissioners (C4)	CSP	Significance (2-tailed)	0.006**	0.000**
		Correlation ($r_{cfp.csp}$)	38.70%	54.30%

The (2-tailed) significant value from the partial correlation analysis between CSP and CFP (ROE & ROA), are 0.006 and 0.000. Both values are less than 0.05, which means that there is a (significant) relationship between CSP and CFP if asset, industry group, shareholder type, and number of independent commissioners as a control variable. Moreover, the partial correlation coefficient value is positive, which means increase in CSP will lead to increase in CFP.

Conclusion

This research shows that for Indonesian companies which has published sustainability reporting, its CSR activities have brought positive impacts in the form of excellent financial performance. This is an important message for business player in Indonesia who generally still sees that corporate social responsibility is more as burdensome and cost centre for the company.

However, as the number of companies which has published its sustainability reporting is still very limited, further research involving the company that has not published sustainability reporting need to be done to give a broader and more real picture of the impact of corporate social responsibility activities to financial performance of Indonesian companies.

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