

The Effect of Corporate Social Responsibility and Financial Ratio to Company's Value (Case Study of Companies Listed in LQ45 of IDX for the period 2011-2015)

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Abstract—This purpose of this research is to verify empirically whether Corporate Social Responsibility and Financial Ratio affect company's value. Twenty companies listed in the LQ45 from Indonesia's Stock Exchange were used as sample. The samples data were taken from the year 2011-2015 using secondary data from the company's financial report. The independent variable is Corporate Social Responsibility and Financial Ratio: Return On Asset (ROA), Return On Equity (ROE) and Debt to Equity Ratio (DER) and the dependent variable is company's value represented by stock price. The statistical tests conducted is: T-test and F-test. This research's results indicate that when tested simultaneously, CSR provides an effect towards the company's value. When tested partially, ROA and ROE have an effect towards the company's value while DER provides no effect towards the company's value. When all variables are tested simultaneously, results indicate that CSR, ROA, ROE, and DER provides no effect towards company's value.

Keywords—*Corporate Social Responsibility, Stock Price, ROA, ROE, DER*

I. INTRODUCTION

Corporate Social Responsibility (CSR) is a way how the company takes extra steps to make sure that the way their business operates doesn't harm the environment and that it will have a positive impact on society and the surrounding environment. Businesses that are active in doing a corporate social responsibility pays attention to the way their business operates to incorporate addressing social and cultural issues, to benefit both party in the process [1]. Corporate Social Responsibility is a business aspect that can be related to all economic activities of the company from the prosperity of the stakeholders to the preservation of the environment. Whether companies should invest in the capital market to show responsibility to society is a controversy that has been discussed for a long time. According to Becchetti, Ciciretti and Hasan [2] companies who have invested in the capital market has to be responsible towards the society, in which these investments are called socially responsible investment portfolios

The correlation between firm value and financial ratios has been the center of attention in most financial areas for the past few years. Before investing capital into a firm's stocks, investors would need to first assess the firm's value and its potential in financial growth through the analysis of financial ratios. Financial ratios are special for firms as it covers unique factors and affect the income. Financial ratios are unique for every firm as it uses the corresponding firm's financial data hence it can reflect the firm's actual value and provide the information investors need before investing into a firm [3].

A firm's value can be determined by analyzing the particular firm's cash flows, assets, organizational structure, current technology implemented, and human resources [4]. Shareholders are not the only ones who are given the rights to access a firm's financial data. As creditors provide financial loans to companies, they would require access to the company's financial data in order to be able to determine whether or not the company would be able to pay back the loan hence creditors are also given the right to access the company's financial data.

Businesses that ignore the importance of CSR might put their brand in jeopardy. Since customer nowadays prefers to spend their money on products and services they believe will not have adverse effect on the environment, they will support those businesses that have a good CSR, companies that have a terrible reputation socially and environmentally can create serious negative effects on the company's value and the overall profitability. By doing an excellent corporate social responsibility, external parties will have a good image of the company. It allows the company to maximize shareholder's equities, the reputation of the company, the prosperity of the interest' owners and the long-term viability of the company [5]. Those companies which operate under the sector or concerning natural resources, or benefited from natural resources must conduct a

social responsibility. This is stated in the Indonesian Republic Law No 40, 2007, article 74. However there is still a lot of companies ignoring the needs to do corporate social responsibility [6], so this research is to understand more that CSR is needed to increase the company's value.

Several researches on CSR and firm's performance have been done in Indonesia. Utaminingsih and Ahalik [7] have researched the relationship between earning response coefficient and corporate social responsibility by using cross-sectional data in Indonesian stock exchange.

The result shows that CSR affects earning response coefficient. A similar result is also provided by Oeyono *et al.* [8], his research shows that CSR affect financial performance. However, Kemp *et al.* [9] believe that CSR is just a corporate-level novelty between dreams and expectation.

There have been various discussions regarding the effect of financial tools on the firm value, and there is still uncertainty whether or not financial ratios affect company's value, so because of that research gap, this study is set out to clear those inconsistencies. In this particular study, the firm's value is represented through stock price and the independent variable is represented by Return on Asset (ROA), Return on Equity (ROE) and Debt to Equity Ratio (DER).

II. LITERATURE REVIEW

A. Theoretical Framework

Corporate Social Responsibility is a concept that has long existed which probably originated even before the second world war. However, it never got hold of the attention of business leaders until the 1950s when Frank Abrams published an article where he stated that CSR was every businesses' obligation [10]. Although CSR has become more and more popular as some companies become more aware of the importance of the implementation of CSR into their business, many companies still follow Friedman's school of thought; a business' sole responsibility is to use its resources and engage in activities designed to increase its profits [10]. Friedman argued that the business only has one single responsibility which is to generate profit for its shareholders in which he also implied that CSR programs should be implemented for businesses only and only if the programs implemented would generate profit. It is important to realize that CSR in itself is not focused on revenue generation, however, is in fact focused on being socially and ethically responsible towards the community and society. Corporate social responsibility is a corporation's initiatives to assess and take responsibility for the company's effects on environmental and social well-being [11].

A public purpose for Corporate Social Responsibility is to increase companies' awareness about how their business impacts the societies, stakeholders, and the environment around them. In other words, the purpose of CSR is closely related to making businesses operate ethically and sustainably. By implementing CSR, companies need to dwell in various issues including environmental effects, working environment conditions, and economic development in which the will promote businesses to operate towards sustainability. When mentioning the term CSR, one would not immediately think of profit instead one would think of environmentally and ethically sustainable business activities that a business could do to promote positive social and environmental change [12]. Corporations, especially ones whose operations involve the society or environment around them could potentially cause various adverse effects on the environment. Companies that are involved in the extraction of natural resources or are involved in the manufacturing of chemicals are most prone to causing permanent damage to local ecosystems [13].

Shareholder's interest should not be the only thing companies are concerned about; instead, companies should realize that it should also be held responsible towards the impact it poses towards the society and environment around it. Companies are responsible for its stakeholders: employees, customers, suppliers, and the surrounding society [14]. CSR could also bring benefit to the company especially concerning improving the company's market value and its business strategy [15]. By implementing CSR, its activities could, in fact, attract consumers who are interested in sustainability and could further improve the company's image. Although CSR activities may not wholly be profit generating, CSR could still in one way or another bring various financial benefits for companies implementing it.

The key to stakeholder engagement is to be as transparent to the stakeholders as possible. About what the company correctly do for the CSR program. Without engaging the stakeholders, there is no real long-term value in building a CSR strategy.

CSR should not be seen as a waste of money or resources, because an excellent Corporate Social Responsibilities action can help your organization [16]: win new business, increase customer retention, develop and enhance relationships with customers, suppliers and networks, maintain a happy workforce and retain a good working environment, save money on energy and operating costs and manage risk, differentiate yourself from your competitors. Generate innovation and learning and enhance your influence, improve your business reputation and standing, provide access to investment and funding opportunities, generate positive publicity and media

opportunities due to media interest in ethical business activities.

In the modern era, stock investments have become one of the various investment options that are quite attractive to foreign and local investors [17]. Stock investment has become common since not only there are adequate regulations, access to the stock market has been made relatively easy for investors. Stocks have become an attractive option for investment for both small and big investors with the expectation of the high rate of return. Besides investing in stocks for the high rate of return, investors could also invest in stocks for the acquisition of a company with the expectation that the company would also provide a high enough rate of return to profit and cover the cost of the initial investment. When planning the acquisition of a firm or investing in the stocks of a certain firm, it is important first to understand how well the firm is doing. A firm that is doing well as a better potential in generating higher returns thus profiting the investor. When trying to gauge the financial performance of a firm, one could look at the stock price of the particular firm. The stock price should reflect the fundamental expected value of firms. The concept of financial performance may be measured by stock price [18]; [19]; [20]; [21]; [22]; [23].

The stock price index, however, represents a number that is used to compare a particular event with other events. Hence, in this case, the stock price index is a poor indicator to describe the movement of stock prices. Since CSR has become the common firms' strategies, CSR has proven its real ability to maintain excellent relationships with stakeholders. As the relationships with stakeholders become tighter, firms may likely experience benefits in terms of reputation [19]; social responsiveness [24], governance [25], sustainability [26]; [27], financial performance [28]; [21], and community attachment [29].

In this research, the concept that is going to be used as company's value is stock price. In this study, multiple regression analysis will be used to see the effect of Financial Ratios (ROA, ROE, and Debt to Equity Ratio) on Firm Value which is Stock Price to know whether one of the independent variables has any effect on firm value.

Return on Asset (ROA)

Return on assets (ROA) is an indicator of how profitable a company is relative to its total assets. It is a profitability ratio that measures the net income produced by total assets during a period by dividing net income with the average total assets. ROA gives a measure of the efficiency of a company in managing its assets to generate earnings. This ratio shows the amount of profit earned relative to the investment in total assets [30].

The higher the ROA number, is more favorable for the company and investor because the company is earning more money on less investment. As the primary purpose of a company is to increase the profit, ROA helps as it can show how to increase their profit with less investment. Because of ROA dependency on the similar kind of industry a company is as different industries use assets differently, it is best to compare it against a company's previous ROA numbers or the ROA of a similar company, or the result can vary substantially. ROA is most useful for comparing companies in the same industry.

$$\text{ROA} = \text{Net Income} / \text{Average Total Assets}$$

Return on Equity (ROE)

Return on equity (ROE) is the amount of net income returned as a percentage of shareholders equity. Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested. Net income is for the full fiscal year (before dividends paid to ordinary stockholders but after dividends to preferred stock.) Shareholder's equity does not include preferred shares also known as "return on net worth" (RONW). ROE is primarily used for comparing the performance of companies in the same industry. As with return on capital, ROE is a measure of management's ability to generate income from the equity available to it. ROEs of 15-20% is generally considered good.

ROEs are also a factor in stock valuation, in association with other financial ratios. In general, stock prices are influenced by earnings per share (EPS), so that stock of a company with a 20% ROE will generally cost twice as much as one with a 10% ROE.

$$\text{Return on Equity} = \text{Net Income} / \text{Shareholder's Equity}$$

Debt to Equity Ratio

According to Darmadji and Fakhruddin [31], Debt to Equity Ratio represents a company's financial leverage. It is a ratio used to assess a company's overall liability to its equity. The debt to equity ratio is debt divided by equity. The numerator includes all liabilities, short term, and long term. Moreover, the denominator is the stockholder's equity. The formula is as follows:

$$\text{Debt to Equity Ratio} = \text{Total Liabilities} / \text{Shareholder's Equity}$$

B. Hypothesis Development

Corporate Social Responsibility (CSR) is a concept that has been continuously growing for the past few decades. The idea that business enterprises have some responsibilities to society beyond that of making profits for the shareholder has been around

for centuries [32]. However, whether the implementation of Corporate Social Responsibility proves to be beneficial for the firm implementing is not of absolute certainty. Hence, there has been a long ongoing debate regarding whether businesses truly need Corporate Social Responsibility. From the above previous researches that have been included to support this study, Wang [33] states that Corporate Social Responsibility has a positive effect on stock price, which means if CSR is implemented, stock price will increase while Donato and Izzo [34] believed that Corporate Social Responsibility has an adverse effect on stock price, which means that if CSR is implemented, it will reduce the stock price.

On the other hand, Zacheheaus *et al.* [35] and Preteni and Andersson [36] believed in their research that Corporate Social Responsibility does not affect stock price. Considering the situation and condition, including the possible influential factors surrounding firm's CSR, this paper aims to appraise the application of CSR as well as the financial performance of firms listed in LQ45 of the Indonesian Stock Exchange. Hence, it is hypothesized that:

Hypothesis 1: CSR has a significant effect on company's value

Financial ratios have been frequently used as indicators for investors to understand the financial performance of a company. Investors are interested in figuring out the current financial performance of companies and how they will perform in the future in other words investors are interested in predicting the financial performances of companies in the future [37]. Various financial ratios could be used in measuring the company's value and financial performance. Profitability Ratio and leverage ratio are two pretty common ratios that are used to measure a company's value. Although financial ratios are commonly used to determine a company's value, these ratios could sometimes be misleading where the ratios do not represent the company's value. This research aims to explain whether selected financial ratios (ROA, ROE, and DER) provide significant effect on the stock price.

Return on assets (ROA) is an indicator of how profitable a company is relative to its total assets. It is a profitability ratio that measures the net income produced by total assets during a period by dividing net income with the average total assets. From the research done by Kohansal *et al.* [38], Murniati [39] they examine the effect of ROA towards stock price, and the result of their findings indicates that ROA has a positive effect on stock price. The next research done by Wijaya and Yustina [40] also support this idea that ROA affects stock price. The last research that is included in this research is done by Riantani *et al.* [41]. Their research analyzed the effect of DER and ROA to closing price of the mining industry listed in BEI. The result shows that partially only return to the asset (ROA) has a significant and

positive effect to the closing price. However, other study does not agree on this result. For example, the research done by Tamuntuan [42], doesn't agree that ROA has an effect on stock price. The result of the research states that ROA does not affect the stock price. Other research which states that ROA does not affect stock price is research was done by Idawati and Wahyudi [43] titled The Effect of Earning Per Shares (EPS) and Return On Assets (ROA) against Share Price on Coal Mining Company Listed in Indonesia Stock Exchange. The result shows that when tested simultaneously, EPS and ROA has a significant effect on stock price, however when tested partially, only EPS has an effect on stock price and ROA does not. From the controversy and inconsistencies of whether or not ROA affects stock price, it is hypothesized that:

Hypothesis 2: ROA has a significant effect on company's value

Return on equity (ROE) is the amount of net income returned as a percentage of shareholders equity. Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested. From the research done by Kohansal *et al.* [38], they also examine the effect of ROE on stock price, the result of the findings indicates that ROE has a positive effect on stock price. Other findings that support this result is from Kamar [44], Murniati [39] and Mussalamah and Isa [45], the result of all of this research states that ROE has a significant effect on stock price.

On the contrary, Wijaya and Yustina [40] believe that ROE has insignificant correlation on the stock price. This result is supported by Tamuntuan [42] who also states that the result of her findings indicates that ROE doesn't have effect on stock price. So, from the research gap happening here, the result of whether or not ROE has any effect on stock price is still inconsistent. As a result, it is hypothesized that:

Hypothesis 3: ROE has a significant effect on the company's value

Debt to Equity Ratio represents a company's financial leverage. It is a ratio used to assess a company's overall liability to its equity. The debt to equity ratio is debt divided by equity. The numerator includes all liabilities, short term, and long term. Moreover, the denominator is the stockholder's equity. The research done by Kamar [44] analyze the effect of DER on the stock price on cement industry in Indonesia stock exchange and the result indicates that DER does not affect stock price. This research is supported by Riantani *et al.* [41]. Their research analyzed the effect of DER and ROA to the closing price of the mining industry listed in BEI. The result shows that partially only return to the asset (ROA) has a significant and positive effect to the closing price and DER doesn't. However, research by

Mussalamah and Isa [45] and Murniati [39] denied that. Their research states that DER had a negative and significant effect on stock price. This research gap leads to the following hypothesis:

Hypothesis 4: DER has a significant effect on the company's value

Besides testing ROA, ROE, and DER partially, this research also aims to test all three financial ratios and CSR simultaneously. The reason behind this is also because of the inconsistencies of the result that has occurred from the previous research.

- The first research done by Tamuntuan [42] analyzes the effect of ROE, ROA, and EPS toward stock price. The result of the test is inconsistent between partially tested and simultaneously tested. When tested simultaneously, ROA, ROE, and EPS does significantly affect the share price. However when tested partially, EPS has a significant effect on stock price, but ROE and ROA do not have a significant effect on stock price
- The second research was done by Kamar [44] also shows the inconsistencies. He analyzed the effect of ROE and DER on the stock price. The result shows that when tested simultaneously, DER and ROE have a significant effect on stock price. However when tested ROE partially has a significant effect on stock price and Debt to Equity has no significant effect on stock price.
- The third research also shows the same inconsistency. Mussmalah and Isa [45] analyzed the effect of EPS, DER and ROE on the stock price. The result shows that when tested simultaneously, all EPS, DER, and ROE have a significant effect on stock price, but when tested partially, EPS has a positive and significant effect on stock price, DER had a negative and significant effect on stock price, meanwhile, ROE had a positive and significant effect on stock price.
- The fourth research is done by Idawati, wiwi and Wahyudi [43] which analyze the effect of ROA and EPS toward stock price. The result shows that when tested simultaneously, EPS and ROA have a positive and significant impact on stock prices in the coal mining company listed on the Indonesia Stock Exchange. However, when tested partially, only EPS affects stock price, and ROA doesn't
- The last research is done by Riantani *et al.* [41] which analyze the effect of DER and ROA toward stock price. The investigation result found that both debt to equity ratio (DER) and return to the asset (ROA) simultaneously determined the movement in the closing price of eleven mining industries from 2005 to 2009. Partially only return to the asset (ROA) has a significant and positive effect to the closing price.

Hypothesis 5: CSR, ROA, ROE, and DER simultaneously have a significant effect on the company's value

When testing ROA, ROE, and DER simultaneously, it is found that the results are inconsistent as to when testing ROA, ROE, and DER partially. The results for testing CSR against stock price are also inconsistent where some researches indicate that CSR provides a significant effect towards stock price while other indicate that CSR provides an insignificant effect towards stock price. This research then aims to find out whether both CSR and financial ratios specifically; ROA, ROE, and DER would provide any effect towards stock price when tested simultaneously. This section describes the following contains, such as relevant theories, conceptual framework, and hypotheses.

III. METHOD

The type of this research is quantitative descriptive research. The population of this research is companies listed in LQ 45 of from period 2011 to 2015. Only 20 firms were selected due to their consistent appearance in LQ45 during the period of 2011-2015. The sampling of this study using intended sampling purpose. The independent variables of this study are CSR and financial ratio, and the dependent variable is the company's value.

So the model for this research is :

$$SP_{it} = \beta_0 + \beta_1 CSR_{it} + \beta_4 ROA_{it} + \beta_5 ROE_{it} + \beta_6 DER_{it} + \varepsilon \dots\dots\dots(1)$$

Where,

- SP_{it} = Stock Price
- β_0 = Intercept or constant coefficient
- CSR_{it} = Corporate Social Responsibility
- ROA = Return on Asset
- ROE = Return on Equity
- DER = Debt to Equity Ratio
- ε = Error component

This research aims to explain whether CSR and Financial ratios: ROA, ROE and DER poses an effect on stock price (representing the companies' value). Data will be collected as mentioned, whereby afterward standard assumption tests: Normality, Multicollinearity, Heteroskedasticity, Autocorrelation tests are conducted. If the data are confirmed to have passed the classical assumption tests, analysis is then conducted by performing T-test and F-test to verify the hypothesis proposed in this research.

The methods section describes the rationale for the application of specific procedures or techniques used to identify, select, and analyze information applied to understand the research problem, thereby, allowing the reader to evaluate a study's overall validity and reliability critically.

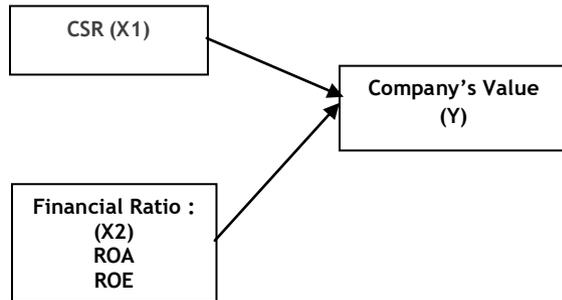


Figure 1. Framework of Research

IV. RESULT AND DISCUSSION

CSR has a p-value of $0.186 > 0.05$ meaning that CSR as a variable is significant in predicting Stock Price. The coefficient of CSR is of a negative value indicating that CSR provides a negative significant effect towards Stock Price. This result supports the research done by Donato and Izzo [34] however it is against the research done by Zaccheaus *et al.* [35] and Preteni and Andersson [36].

ROA has a p-value of $0.626 > 0.05$ meaning that ROA as a variable is significant in predicting Stock Price. Referring to Table 4.6, the coefficients of each variable can be observed. The coefficient of ROA is of negative value indicating that ROA provides a significant negative effect on Stock Price. This result supports the research done by Wijaya and Yustina [40].

ROE has a p-value of $0.486 > 0.05$ meaning that ROE as a variable insignificant in predicting Stock Price. The coefficient of ROE is of definite value indicating that ROE provides a significant positive effect on Stock Price. This result supports the research done by Kohansal *et al.* [39] and Kamar [44].

Amongst the variables of Financial Ratios, only DER is insignificant in affecting Stock Price. DER has a p-value of $0.012 < 0.05$ which means that DER is insignificant in predicting Stock Price. This result supports the research done by Wijaya and Yustina [40], Kamar [44] and Riantani *et al.* [41].

Finally, when testing the variables CSR, ROA, ROE, and DER against Stock Price simultaneously, it is found that the p-value generated from the F-test is $0.0449 < 0.05$ which means that the variables when tested simultaneously, does not provide a significant effect towards Stock Price.

V. CONCLUSION

- 1) CSR has an adverse significant effect on the company's value.
- 2) ROA has a negative significant effect on the company's value.
- 3) ROE has a positive significant effect on the company's value.
- 4) DER has no significant effect on the company's value.

- 5) CSR, ROA, ROE, and DER simultaneously has no significant effect on company's value.

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