

The Economic Impact of Corporate Social Responsibility

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ABSTRACT: This study aims to examine the relationship between socially responsible investment and future company performance. Socially responsible investment is carried out with various objectives, depending on the actors and their preferences. Good management theory explains that social investment can build trust, which will ultimately benefit the company. Some researchers have previously investigated the impact of CSR investments on companies, but the results are still inconclusive. Evaluating social investment needs to pay attention to the time lag between the investment and the economic benefits generated. The samples of this study were all companies listed on the Indonesia stock exchange in 2016-2017, except companies from the service, finance, and banking industries. CSR investment was measured by the costs incurred for social responsibility activities. The method used to estimate the parameters of the research model is the lag regression approach. The results showed a significant relationship between CSR investment and the company's future financial performance.

Keywords: CSR, firm performance, CSR Investment.

1 INTRODUCTION

Corporate social responsibility (CSR) has social and economic consequences. Companies that carry out CSR with seriousness and are supported with an appropriate implementation strategy will have benefits such as getting appreciation from the community or helping to solve problems faced by the community. In addition, CSR also has economic benefits, such as market legitimacy and financial performance. So, it can be said that CSR activities are not only seen as costs to be incurred by the company, but also an investment for the company (Hadi, 2014). Many research on CSR and financial performance have been conducted. Although initially stated that stakeholder theory and shareholder theory are contradictory, there is evidence to say that the benefits of CSR to stakeholders and shareholders are not contradictory because CSR can enhance reputation, brand, trust, and attract customers, which in turn will increase profitability and firm value. (Jones, 1995; Porter & Kramer, 2006).

There are three hypotheses to explain CSR expenditure (Lys, Naughton, & Wang, 2015). First, companies carry out CSR activities not because they intend to increase the company value but because

they intend to provide social and environmental benefits - referred to as the charity hypothesis. Second, the company carries out CSR activities because it assumes these expenditures as investments that generate positive economic returns - referred to as the investment hypothesis. Third, CSR costs are incurred because management predicts the company's strong future performance - referred to as the signaling hypothesis. This study uses the investment hypothesis to explain social responsibility expenditure with the company's future financial performance.

Another view sees that there is an ulterior motive behind CSR. It is often called a shareholder fee view, meaning that managers carry out social responsibility activities at the expense of shareholders, perhaps for their own benefit (Jha & Cox, 2015). The results of previous studies on the consequences of CSR on the company's financial performance still showed mixed results. Several studies documented a positive relationship between CSR and corporate financial performance (Deng, Kang, & Low, 2013; Lys et al., 2015), Other studies did not show a relationship (Lys et al., 2015; McWilliams, Siegel, & Wright, 2006), and other studies have found a negative relationship between social responsibility and

corporate performance (Eriandani, Nars, & Irwanto, 2019; Jang, Lee, & Choi, 2013).

The difference in the results of previous studies may be due to they did not consider the time lag between CSR expenditure and the benefits generated. King & Lenox (2001) investigated the effect of environmental performance on period t on economic performance in period $t + 1$. One of the CSR activities is the environment. Pollution reduction provides cost savings in the future by increasing efficiency, reducing compliance costs, and minimizing future obligations (Reinhardt, 1999). Another example is shown by Stawiski and Deal (2010), the more the employees affected by CSR actions, the higher the commitment of their organizations will be, and consequently will increase their productivity. If employees are committed to the organization and performing at a higher level, it will undoubtedly have a positive effect on organizational performance in the future.

The research contribution is to add to the literature on CSR investment and the company's future financial performance, especially in developing countries. Many previous studies only used social responsibility disclosure to measure CSR activities, while this study used the amount of costs incurred for these activities.

1.1 Corporate Social Responsibility

The exploitative behavior shown in the utilization of natural resources and the lack of environmental responsibility (physical and social) has threatened the sustainability of the availability of raw materials and energy, as well as triggering social disharmony with the people in their environment and increasing labor conflicts. This condition drives social responsibility (CSR) activities.

Jackson & Parsa (2007) classifying CSR into five dimensions that must be considered for evaluating corporate CSR initiatives. These dimensions are community development, justice, and welfare of its employees, environmental protection or conservation, good corporate governance, and economic practices.

According to Dhaliwal, Li, Tsang, & Yang (2011) and McWilliams et al. (2006), CSR can change a company's reputation to a better level. Besides, it can increase the confidence of investors, customers, shareholders, and overall stakeholders, and the ability of employees to work and spend more effort and dedication. So it can be said that the company carries out CSR will strengthen its relationship with various stakeholders, including customers, investors, government, suppliers, and employees. This relationship ensures the company's minimum con-

flict with stakeholders and maximum loyalty from all stakeholders.

Social responsibility has two forms of potential financial returns for companies, namely positive additional benefits as an appreciation for positive behavior and mitigation of the consequences of negative corporate behavior. The ability of CSR to reduce the adverse effects of negative corporate behavior is expected to protect the company's financial performance if it is demonstrated before negative corporate events (Peloza, 2005). In accordance with good management theory (Orlitzky, Schmidt, Rynes, & Rynes, 2003), the relationship of CSR investment with the company's financial performance can be described as follows:

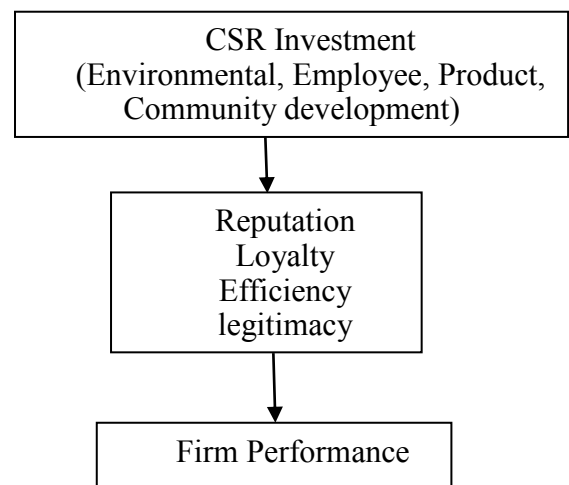


Figure 1. Conceptual Model

The conceptual model above explains that by investing in CSR, the company will get a good reputation, consumers are more loyal to the product, employees are more loyal to the company, and gain legitimacy from the public so that it will ultimately improve the company's financial performance.

1.2 CSR in Indonesia

At the beginning of the ratification of Law No. 40 of 2007, there was a strong reaction from employers for requiring every company that carries out business activities in the field of or relating to natural resources to carry out social and environmental responsibilities. This reaction is understandable because CSR departs from the concept of philanthropy, which is something that goes beyond the obligations in the regulations. In addition, throughout the world, only Indonesia has issued laws that require companies to implement CSR (Mardikanto, 2018). Indonesia has mandatory rules and social norms relating to the safety and rights of workers, compensa-

tion, fraud or corruption, environmental protection, and consumer protection. These regulations limit what companies should or should not do, even though their implementation is often problematic. In practice, weak regulatory and legal enforcement mechanisms, such as the unavailability of a judicial mechanism to hold corporations accountable for corruption and legal uncertainty, often occur because of social norms about community and environmental problems that can weaken legal implementation. Understanding CSR as a concept in Indonesia is still weak, inconsistent, and cannot be concluded. CSR is often seen as a western concept related to philanthropic actions or acts of concern for social and environmental problems. A common misperception is that CSR ultimately only adds to the burden of the company or the cost of the company. Very few consider it an investment. These results in companies reluctant to adopt CSR in their company policies (Waagstein 2011). The assumption that CSR is a social cost that does not provide any benefit to the company is wrong. CSR costs incurred by companies are investments that directly or indirectly, in the short term or the long term, will provide benefits much higher than just the value of money incurred.

1.3 CSR investment and Financial Performance

CSR investments can improve future financial performance in several ways. Corporate social responsibility is used by leading organizations to build good relationships not only with external but also internal stakeholders, for example, with employees. Commitment to CSR activities can help companies attract and retain high-quality employees (Greening & Turban 2000). Skilled employees and talented managers are critical resources for the company because, in the end, it can improve company performance.

CSR commitments can also increase the marketing effects of products and services, which in turn increase sales of goods and services (Fombrun 2005). Kotler & Lee (2005) explained that product attributes are not related to product function, but rather to the image of a product in the eyes of consumers. If customers have positive perceptions about the company's product quality, environmental awareness, and community relations, it can blur the line between good management practices and social performance (Prahalad & Hamel 1994). Positive perceptions, such as companies by outside stakeholders, can lead to increased sales or reduce stakeholder management costs. Dhaliwal, Li, Tsang, & Yang (2011) proved that the disclosure of CSR activities could reduce the cost of capital of a company.

Investment in CSR enhances the company's public image and provides unique comparative marketing benefits, mostly among consumers who are increasingly socially aware, which in turn, increases the company's long-term revenue (Burke & Logsdon, 1996). Overall, previous research has shown that CSR investment is associated with increasing financial performance. However, the majority of studies on this topic investigated the relationship between social responsibility and financial performance for short periods (Margolis & Walsh 2003), so this research tries to see this relationship with a time lag.

H: CSR investment leads to improvements in future firm financial performance

2 RESEARCH METHODS

The samples of this study were all companies listed on the Indonesia stock exchange in 2016-2017, except companies from the service, finance, and banking industries. The companies must meet the following criterion of have submitted an annual report that includes information regarding the amount of CSR investment. Another criterion is the availability of data for control variables. The total sample obtained was 209.

CSR investment was measured by the amount of costs incurred to carry out environmental, social, and donation activities, employees, and products. This study used the total investment because not all companies inform the amount of investment for each dimension of activity. The company's financial performance was measured by return on assets (ROA) with a gap of one year. Data were analyzed using a normality test, multicollinearity, heteroscedasticity test, and automatic correlation test. Hypothesis testing was done using simple lag regression, with the statistical model below:

$$ROA_{i,t+1} = \beta_0 + \beta_1 InvCSR_{i,t} + \beta_2 LEV_{i,t} + \beta_3 Size_{i,t} + \beta_4 PBV_{i,t} + \varepsilon \quad (1)$$

The control variable is LEV which measures the ratio of debt to assets, Size was measured by ln total assets, and PBV is the ratio between market value and book value.

3 RESULTS AND DISCUSSIONS

3.1 Result

The regression results for Equation (1) are shown in Table 1. The coefficient on CSR investment, β_1 , is positive and significant. A positive value for β_1 indicates that there is a positive relationship between the release of current CSR and the company's future performance. The coefficient on the control variable is also consistent with our expectations. The results in Table 1 show that a higher level of CSR expenditure is associated with a lower level of book leverage, the coefficient is negative and statistically significant. The price to book ratio also shows a positive coefficient, although it is not statistically significant. While the size of the company shows a negative coefficient.

Table 1. Empirical Results (Dependent variable: future firm performance)

Variable	B	t
Constant	-0.206	-1.985
InvCSR	0.016	3.894***
LEV	-0.100	-4.285***
Size	-0.001	-0.295
PBV	0.001	1.094
Adj. R2		0.158
F Sig		10.730***
n		209

***significant at 1% **significant at 5% *significant at 10%

3.2 Discussion

The regression model shows that there is a relationship between CSR investment and the company's financial performance. This is in line with good management theory. The good management hypothesis is used to explain why the better the performance of social responsibility will make better company's financial performance (Margolis & Walsh 2003). The large value of CSR investment is assumed to reflect the number of social responsibility activities. The theory explains that there is a high correlation between good management practices, namely by carrying out social responsibility because it improves relationships with key stakeholder groups so as to produce better overall performance. It is difficult for stakeholders to know whether management is acting in accordance with their interests, stakeholders must gather more information about management activities to ensure. CSR activities signal stakeholder management quality to stakeholders, so there is no need to gather more information signifying monitoring costs are also reduced.

Greater CSR investment and better performance in all dimensions of CSR enable companies to attract better employees more quickly, facilitate difficult and expensive negotiations for problems with society or government, and avoid paying fines for environmental problems. These things have proven to be able to improve the company's financial performance in the future. The results of this study enrich the previous literature, which says that in developing countries, CSR has not provided benefits because it is only aimed at meeting regulations. In fact, CSR investment can improve financial performance in companies in Indonesia.

4 CONCLUSION

The results of this study support good management theory. Social responsibility can be considered as a strategy that creates legitimacy, reputation, and competitive advantage. CSR investments in various dimensions will bring effectiveness and cost reduction through various ways that ultimately improve company performance. Satisfied workers compensate companies by increasing productivity and reducing costs of use and training, satisfied clients increase transactions for goods through repetitive buying behavior, satisfied investors lend capital at a lower rate, reducing capital costs - satisfied community will legitimize the company, ecological management leads to favorable conditions, and better suppliers reduce the cost of quality certification.

The implication of this research is to provide the fact that in Indonesia, CSR investment can drive company performance in the long run. That is, shareholders and management need not worry that social responsibility only consumes company resources. The limitation of this study is; first, not many companies disclose their spending on CSR activities. Second, the disclosure is inconsistent as not every year the companies disclose it in the annual report making it difficult to observe in the longer term.

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