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Corporate Social Performance And Corporate Financial Performance: The Influence CSP Over Sales And Gross Margin In Indonesia

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Abstract

The emergence of corporate social responsibility (CSR) initiatives currently suggests that CSR policies has changed from what seen before as an unnecessary and even a burden to business function into an unprecedented ways to increase corporate value and indirectly contribute to the increase in sales. Using a reliable source of data on corporate social performance (CSP), this study would explore and tests the relationship between corporate social performance and corporate financial performance and the impact it has on sales and gross margin with the expectation of providing insight into sales strategies that may be utilized to reach the optimum impact to the relationship. The sample selected from listed companies of Indonesia Exchange (IDX), and the data set includes from Financial and Annual Reports of listed companies in IDX. The relationships are tested using time-series regressions. Results indicate that CSP and CFP have a positive relationship in both directions, supporting the perspective that CSR programs have fundamentally positive impact. Results also indicated the elevated CSP leads to increase on gross margin, indicating that customers are willing to pay a premium price for the products and/or services of a company with CSR initiatives. It is argued in this paper that firms may increase their sales by investing in CSR—assuming increases in CSR investments leads to a higher CFP—as long as the programs could transform from socially responsible, philanthropic endeavor, into something that increased the value of the company.

Keywords: Corporate Social Responsibility, Corporate Social Performance, Corporate Financial Performance

Introduction

Corporate Social Responsibility (CSR) has been explained by White (2006) referred to achieving business success in ways that abide by ethical rules and respect people, social communities and the natural environment. And for decades, whether CSR engagement can create a sufficient financial return to justify the efforts that companies have made to be socially responsible remains controversial by Kurucz et al. (2008). To take into account Barnett's (2007:794) statement that was said "after more than thirty years of research, we cannot clearly conclude whether a one-dollar investment in social initiatives "returns more or less than one dollar in benefit to the shareholder." Friedmand (1970) asserted the opinion that managers only core mission is to realize profit maximization for their shareholders. If they conduct CSR activities and contribute company's resources and assets to the society, it will harm the shareholders' economic interests and hinder profit maximization. Still in Freeman (1984), firms should fulfill multiple CSR to meet different stakeholder's interest. And that is because once various stakeholders' demands were met, in return, stakeholders will invest more money and offer more resources for the companies to operate smoothly; therefore, companies may gain higher profits and realize financial growth. During the past decades, empirical studies have investigated the relationship between corporate social performance (CSP) and corporate financial performance (CFP) have developed opinions regarding the relationship. Some of the literatures has shown a positive association between CSP and CFP

(Waddock & Graves, 1997; Simpson & Kohers, 2002; Li et al., 2013). Others also have revealed a negative relationship between CSP and CFP (Davidson & Worrell, 1988; Becchetti & Ciciretti, 2006; Surroca & Tribó, 2008). Except for the positive and negative correlation findings, scholars have also found other relationships between CSP and CFP.

Furthermore, a neutral or no association of CSP and CFP relation has been revealed by McWilliams and Siegel (2001) and Choi and Jung (2008). Despite the proliferation of literature on CSP-CFP relationship, controversy and uncertainty still persist (Orlitzky et al., 2003). The lack of consensus of the relationship perhaps may be attributed for three different reasons. Previous studies who explored the relationship of CSP-CFP deal with different dimensions altogether. Just like Caroll,1979 mentioned "CSR is a multidimensional construct that contains a variety of corporate behaviors and activities in various dimensions including economic, social, and environmental." Scholars have investigated CSP-CFP link either in a single aspect of CSR such as the welfare of employees and philanthropic giving, or by constructing a comprehensive study towards all CSR dimensions (Orlitzky et al., 2003). Different dimensions of CSP can be motivated differently, and may accordingly have diversified implications for CFP under different contexts (Margolis & Walsh, 2003). Consequently, it is necessary to focus on one particular aspect of CSP in the study of CSP-CFP relationship (Rowley & Berman, 2000). The methods of measuring CSP are various (Griffin & Mahon, 1997). They varied with each other. And the last one that contributed to the differentiation is the different adoption of CFP measures contributes to the diversified results in the current literature. It is argued by (McGuire et al., 1988; Margolis et al., 2007) that CSP is more highly correlated with accounting-based CFP measures than with market-based ones.

The problems that would be discussed in this study are: Does better CSR performances lead to better financial performance?; Would an increase of expenditure for CSR performances lead to an increase on sales?; How CSR performance could lead to a higher gross margin?

Literature Review

Corporate Social Responsibility

Corporate Social Responsibility will be defined, in accordance with financial theory, the main objective of a corporation is to maximize the value of shareholder's wealth. This is very straightforward and complements the financial interest of shareholders. Corporations, however, were also impacted by stakeholders other than shareholders, constituents who are often motivated by non-monetary interest such as the impact of the company has created onto its surrounding environment and local communities. Corporate social responsibility programs include activities to improve the environment, the indigenous people whose lives in the surround areas on where the firm's operates, and local habitats along with the lives of all the stakeholders of an organization. And to merely state that a corporation is socially responsible and abides in ways to positively impact society is not sufficient, that is the reason evidence of concrete CSR strategies is required. Whether such actions are beneficial to the financial performance on the business side will be examined in this study.

World Business Council for Sustainable Development (1998) Corporate Social Responsibility is the continuing commitment by business to contribute to economic development while improving the quality of life of the workforce and their families as well as of the community and society at large. Based on Commission of the European Communities (2002; 347 final: 5) "CSR is a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis." Kotler and Lee (2005) "Kotler's highlights five methods for the implementation of a CSR program: cause promotions, cause-related marketing, social marketing, philanthropy and volunteering."

SRI-KEHATI Index

PT Bursa Efek Indonesia in cooperation with the *Yayasan Keanekaragaman Hayati Indonesia* (*Yayasan KEHATI*), launched the stock price index named SRI-KEHATI. SRI-KEHATI stands for Sustainable and Responsible Investment Keanekaragaman Hayati. SRI-KEHATI was launched in Jakarta on June 8th, 2009 and is the first index in the Southeast Asian region to determine the performance of the companies featured in Indonesia in how they do business sustainably by considering the social and environmental aspects.

This index was intended to provide additional investment guidelines for investors to create a new benchmark index which specifically includes issuers that have excellent performance in fostering sustainable enterprises, as well as have an awareness of environmental, social and good corporate governance. This index also provide information to companies of the research to establish reference and benchmark for Sri-Kehati Index. To become a member of the index, initial selection was made to choose potential shares and taking into account the criteria's as: Total Assets were presenting the size of the Issuer SRI, namely Emiten-issuers that have total assets > Rp. 1 Trillion, according to the audited annual financial report; Price Earning Ration (PER) issuers included in this criterion is that a PER positive (PER>0); Free Float Ratio or public ownership must be >10%.

From the initial selection, they received a list of names of potential issuers to be included into the SRI-KEHATI index members. Furthermore, to choose 25 best stocks, deeper ranking was needed by considering the fundamental aspects, namely by considering six main factors as follows: Environmental; Community; Corporate Governance; Human Rights; Business Behavior; Labor Practices & Decent Work. SRI-KEHATI performed the index every 6 months which is the beginning of each May and November.

Previews Research

Lopez, Garcia, & Rodriguez (2007) analyzed CSP and financial performance found a negative relationship. The theory behind this finding is companies that engage in CSR programs are at a disadvantage because they are incurring unnecessary and avoidable costs. One limitation of this study is that it only analyzes the short-run relation between CSP and financial performance, concluding that "the effect of sustainability practices on performance indicators is negative during the first years in which they are applied" and suggests long-term research must be done to strengthen such a conclusion. The finding of a negative correlation between CSR and CFP, through uncommon finding compared to other similar empirical studies, indicate that more current research needs to be done on this topic.

Friedman (1970) argued "there is one and only one social responsibility of business—to use its resources and engaged in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud." Which is to say that a corporate executive sole duty of the employers of the business, is to make as much money as possible within the boundary of law and ethical custom.

Aupperle, Carroll, and Hatfield (1985) the study concluded that there is no statistically significant relationship between social responsibility and financial performance. The four components of CSR programs in this study were economic, legal, ethical, and philanthropic responsibilities. In order to avoid some methodological problems of measuring CSP in previous studies, they created their own measurement for CSP and, through empirical testing, concluded their methodology was reliable.

But the question remains, how can there be no relationship whatsoever between CSP and CFP? A study conducted by Ullmann (1985) attempted to answer the question. There are also a lot of intervening variables between CSP and CFP for there is a reason to expect any relationship at all. In addition, indication also arises on where there are many measurement problems that still exist to measure the intangible impacts of corporate social responsibility.

Jones (1995) instrumental stakeholder theory was formed based on two theories, and suggests that there is a positive relationship between corporate social performance and corporate financial performance. First, the instrumental theory is an economic theory that predicts what results would occur as a result of management decisions. The second theory, the stakeholder theory as an ethical theory that proposes managers duty to put stakeholders needs first and foremost in order to increase the value of the firm. The instrumental stakeholder theory, argues that the stakeholders satisfaction influence financial performance. On the other hand, this theory also asserts that corporate executives could increase the efficiency of their organizations by aligning the business to meet the desires of the stakeholders. Past empirical evidence emphasizes, that the stakeholders as a whole, see some value in CSR programs. Therefore, the instrumental stakeholder theory suggests CSR programs could increase stakeholder satisfaction and in the end, financial performance.

Orlitzky, Schmidt, and Rynes (2003) conducted meta-analysis has the most comprehensive study with positive results. A meta-analysis is a strong method of research because it weighs the parameters of individual studies, as opposed to aggregating studies. This specific meta-analysis examined 52 studies with a 33,878 sample size over a 30-year span. Orlitzky told us in conclusion, that not only does the CSP have a positive influence over CFP, but vice versa as well, a two-direction relationship exists between the two variables. This conclusion supports the instrumental stakeholder theory, because managers reap the financial benefits by meeting the needs of the stakeholders. Due to the reciprocal nature, the benefits of the relationship between the stakeholders and the organization, this study supports the position that CSR programs are associated with multiple tangible long-term financial benefits.

According to Palmer (2012) significantly positive relationships exist in both directions with corporate social performance and corporate financial performance and supporting the view that CSR programs have positive impacts on the bottom-line. The study also indicate that increased CSP leads to increases in gross margin, indicating that some customers are willing to pay a premium for the products and/or services of a company with CSR initiatives.

CSP is also found to be positively associated with prior financial performance, supporting the theory that slack resource availability and CSP are positively related. CSP is also found to be positively associated with future financial performance, supporting the theory that good management and CSP are positively related. (Waddock and Graves, 1997).

Hypothesis

Hypothesis 1: CSR performance results in improved financial performance.
Hypothesis 2(a): Improved CSR performance leads to an increase in sales.
Hypothesis 2(b): Improved CSR performance leads to an increase in gross margin.

Research Methodology

Measurement

Corporate Financial Performance

Both hypotheses involve analyzing the impact of CSP have two financial variables. Those are sales and gross margin. Sales will be measured in two ways: total sales to total assets ratio and total sales to number of employee's ratio. Total sales is scaled in order to receive a more reliable conclusion. Then, to measure gross margin as gross profit to total sales ratio.

This study will focus on accounting-based measures of CFP and define financial performance as return on assets (ROA). Based on a Harvard Business Review article, composed by Hagel and Brown (2010) the best way to measure company performance is ROA because "ROA explicitly takes into account the assets used to support business activities. It determines whether the company is able to generate an adequate return on these assets rather than simply showing robust returns on sales."

Implications for analyzing CFP based on accounting measures include the possibility of distortions from inflation (Demsetz and Villalonga, 2001) and bias from differences in accounting methods across corporations. However, ROA is the accounting variable least likely to be manipulated (Yoshikawa and Phan, 2003). Return on assets is measured as net income divided by total assets.

Corporate Social Performance

The problem of choosing in measuring corporate social performance. Past studies have used a wide variety of methods to measure CSP: self-constructed surveys (Aupperle, 1991), The *Fortune reputation survey* (Brown and Perry, 1994), the Dow Jones Sustainability Index (Lopez et al., 2007), CRO's *Best Corporate Citizens* (Martin & Wallace, 2009), and the KLD Index developed by Kinder, Lydenberg, Domini and Co (Waddock and Graves, 1997; Hull and Rothensberg, 2008). The multidimensional nature of Corporate Social Performance involving both internal (governance, employees, etc.) and external (environment and communities affected) are factors that must be considered when measuring corporate social performance. The measurement used is from fundamental aspects of Sri-Kehati index, to be taken into account, Environmental, Community, Corporate Governance, Human Rights, Business Behavior and Labor Practices & Decent Work.

Size, Risk & Industry

Past studies suggest that size, risk, and industry affect both firm financial performance and CSR (Ullman, 1985; McWilliams and Siegel, 2001), so each of these variables are controlled for in this study. Size is an important control variable because as firms grow, they have more resources to dedicate to CSR programs than smaller firms. According to Udayasankar (2007), the smaller the firm, the less likely they are to participate in CSR programs "given their smaller scale of operations, resource access constraints and lower visibility." Assuming that the larger the firm, the more resources it can devote to CSR initiatives. In addition to better access to resources, larger firms have more ways with the public because they have larger advertising and marketing budgets. Industry also needs to be controlled for given the differences in stakeholder interest and industry-specified CSR concerns (Waddock and Graves, 1997). Company size is measured using total assets, number of employees, and total sales. Industry is measured through dummy variables for each industry. As for risk, risk is measured using long-term debt to total assets ratio.

Sample

This study cover 68 companies from 147 companies (79 companies excluded) in manufacturing sector and also including companies listed in SRI-KEHATI index from respective industries included in Indonesian Stock Exchange (IDX). Judgments sampling method had been used in this research, which is one form of *purposive sampling* by sampling a predetermined based on the intent and purpose of the study with the following criteria: Public companies listed in IDX from year 2010-2016; Companies included in the SRI-KEHATI index; The Company has completed data on the implementation of corporate social performance.

Data Collection Method

The type of data required is secondary data. Data used in this research are annual reports and financial statements from companies included in SRI-KEHATI index and manufacturing industries were gained from the respective companies' websites and also from Indonesia Stock Exchange (IDX) or www.idx.co.id.

Research Model

$$Y = \alpha + \beta\eta * \eta$$
$$H_1: CFP = \alpha + \beta_1 CSP + \beta_2 LTD + \beta_3 Sales + \beta_4 TAssets + \beta_5 NoEmp$$
$$H_2(a): \frac{Sales}{TAssets} = \alpha + \beta_1 CSP + \beta_2 LTD + \beta_3 Sales + \beta_4 TAssets + \beta_5 NoEmp$$
$$\frac{Sales}{TEmp} = \alpha + \beta_1 CSP + \beta_2 LTD + \beta_3 Sales + \beta_4 TAssets + \beta_5 NoEmp$$
$$H_2(b): GM = \alpha + \beta_1 CSP + \beta_2 LTD + \beta_3 Sales + \beta_4 TAssets + \beta_5 NoEmp$$

Results and Discussion

Research Results

Table 1: Multiple Regression Analysis

Dependent Variable:	Model 1 *ROA*	Model 2 *Sales/Assets*	Model 3 *Sales/Employees*	Model 4 *Gross Margin*
Independent Variable: CSP	,019***	-0,06**	377,495***	,023**
Control Variables				
Long-Term Debt/Total Assets	-,293***	-0,956***	177,820	,022
Total Sales	8,540E-10***	7,251E-***	6,395E-5***	-2,024E-9**
Total Assets	1,856E-10**	-6,846E-10*	-1,456E-6	6,397E-10***
Number of Employees	-1,192E-6**	-6,856E-6**	-,095***	1,065E-6
Observation	408	408	408	408
R^2	0,254	0,372	0,203	0,191

*$p \leq 0.1$; **$p \leq 0.05$; ***$p \leq 0.01$

Source: Output of SPSS v23

Hypothesis 1: CSR performance results in improved financial performance.

Table 1in model 1, indicated that CSP has a significant positive relationship with financial performances (ROA) at ≤0.01 level when ROA is the dependent variable, thus support Hypothesis 1. The R^2 value of 0,254 (25%) in this model is good enough as it goes above 20%. This result supporting by Waddock and Graves, 1997 CSP is also found to be positively associated with prior financial performance; Palmer, 2012 concluded significantly positive relationships exist in both directions with corporate social performance and corporate financial performance and supporting the view that CSR programs have positive impacts on the bottom-line.; Orlitzky, Schmidt, and Rynes, 2003 told us in conclusion, that not only does the CSP have a positive influence over CFP, but vice versa as well, a two-direction relationship exists between the two variables.; Jones, 1995 suggests that there is a positive relationship between corporate social performance and corporate financial performance. The other hand Lopez, Garcia, & Rodriguez (2007) analyzed CSP and financial performance and found a negative relationship. But this result not supporting by Aupperle, Carroll, and Hatfield, 1985 the study concluded that there is no statistically significant relationship between social responsibility and financial performance.

The results raise questions such as why does an increase in Corporate Social Responsibility performance leads to an increased financial performance. This study defined CFP as return on assets. First of all, CSR has become a competitive advantage because they improve corporate image to the general public. On top of that enhanced reputations, firms may also benefited from an increase in customer and investor loyalty. Next, CSR initiatives gives employers with better capability to attract better employees, ability to increase employee's morale and productivity. Also, CSR initiatives help to reduce corporations risk (i.e. corruption, nepotism, bribery, defect product recalls or pay fines), because CSR programs helps good ethical behavior, transparency and above all improve the attitude of stakeholders towards the corporation.

It is also showed to explain why companies are willing to invest into CSR over the past years, because they are expecting returns into the programs, and in the end has enlightened the executives perception of such policies from an unnecessary addition has changed into a critical business function. The results assume that increases in CSR are spending leads to an increase in CSR performance.

Hypothesis 2(a): Improved CSR performance leads to an increase in sales.

Table 1 in Model 2, sales/assets has a significantly negative relationship with CSP at $p \leq 0.05$ level. Model 2 also showed us that the long-term debt to assets ratio (risk) is negatively significant at $p \leq 0.01$ level. Total sales gave us a positively significant relationship at $p \leq 0.01$ level. Total assets show negative significant at $p \leq 0.1$ level and employees shows negative significant relationship at $p \leq 0.05$ level.

Model 3 in table 1 tested the ratio of sales/employees as the measurement for sales. CSP has showed positive significant at $p \leq 0.01$ level. Risk represented by LTD/A has not a significant relationship. Total sales to sales/employees show a highly positively significant relationship at $p \leq 0.01$ level. Total assets shows no significant relationship and number of employees showed negative significant at $p \leq 0.01$ level.

The results for both regressions in Model 2 & 3, therefore, partially agree with Hypothesis 2(a). While the relationship between CSP and sales/assets ratio is negatively, CSP and sales/employees ratio itself showed that higher CSR initiatives a firm has, more employees they had. For linear regression from model 3 showed a low R^2 value, below 25%. In contrast model 2 gives better value at 37%, much better than model 3, thus model 2 is considered to be the preferred model for H2 (a) where an improved CSR performance would lead to better sales.

Hypothesis 2(b): Improved CSR performance leads to an increase in gross margin.

Table 1in model 4, showed regression analysis using gross margin as the dependent variable and CSP as the independent variables. Now then, the result shows that gross margin has a significant positive relationship with CSP at $p \leq 0.05$ level. In the meantime, risk (LTD/A) has no significant relationship. As for total sales gives us a negatively significant relationship at $p \leq 0.05$ level, while total assets showed a positive relationship at $p \leq 0.05$ level and number of employees showed not significant relationships. The R^2 value of 19%, is too low that the model not recommended to predict gross margin through corporate social performance.

Conclusion

Corporate Social Performance & Return on Assets

The results as a whole indicated that a portion of customers, are willing to pay more for products and/services from socially responsible aware firms, while there are also customers who are unwilling to buy the higher priced products/service. Chances are the customers did not accept the products at a premium or they have no qualms whether the company runs considerable CSR programs or not. The results from Hypothesis 1, tells us that the improved CSR initiatives would lead to an improved ROA, and considering ROA can be broken down into sales (S/A & S/Employees) and gross margin, it can be said that firms in this case, would still reaps a lump of financial gains from the implemented CSR programs. Firms could also take the evidence from this study to manage their sales strategies to optimize their benefits from CSR. Here are two specific CSR strategies a company could applied to enhance their sales and gross margins.

Corporate Social Performance & Sales

An increase in CSR performance would lead to an increase in Sales/Employees ratio, while on the contrary, there is find no support in terms of Sales/A ratio to CSR performance because that leads to a decrease in sales. The results suggested that a particular kind of customers are willingness to buy the products and/or services of companies despite higher CSR performances. That is why companies may suffer slightly decrease on customer base. As the implementation of CSR initiatives, it may lead to an increase in prices. But the results also give us a new perception that the higher the CSR performances a company has, the more people are willing to work in that particular sustainable companies. Those are well aware of their surroundings and give positive values to their surrounding communities.

Corporate Social Performance & Gross Margin

Hypothesis 2(b) statement where improved CSR performance leads to an increase in gross margin. The result give us indication that some customers are willing to pay a product and/or service at a premium from companies with an effective CSR initiatives. Many of them will increase their product prices along with an increase in CSR investments to offset their expenditure and their belief where customers will find it more valuable in the CSR programs, than the additional cost of the product. Indicating that customers will accept premium prices as long as there is something good in it, in this the CSR initiatives the companies held. People are willing to pay extra for sustainable products and products with positive social/environmental impact.

Research Limitations

The major limitations of this research is the limited availability of data, where there is a large scarce of data, particularly annual reports pre-2010 in many industries listed in this study. There is also a substantial researches that must be done concerning the relationship between corporate social responsibility and corporate financial performance. As more reliable data becomes available on CSR, it may be particularly useful to determine whether or not the relationships in this study hold true over time. It also may be worth it to examining time lags other than one-year lag between each of these seven years evaluated in this study because it would help describe on how long it will takes, on average for firms to reap maximum advantage for CSR investments.

Suggestions for Future Research

Firstly insufficient observations and data at this moment restrict the possibility of investigating this problem over a longer time period. Therefore, we suggest (suggested) a longitudinal research in the future that may provide insight into the cause-and-effect of the CSP-CFP link as well as how the degree to which the financial payoffs are associated with particular CSR strategies varies over different time scope. Secondly, the fact that a lot of companies in industries covered did not have complete financial statements nor annual reports in year 2010-2016 covered, severely limited this research. A complete sample with more observations might alter the CSP-CFP correlation. Henceforth, future studies to analyze the CSP-CFP relationship with a larger sample size and substantial data would certainly be valuable.

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