CORPORATE SOCIAL RESPONSIBILITY AND FINANCIAL PERFORMANCE: EVIDENCE FROM INDONESIAN BANKING SECTOR

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Abstract

Corporate social responsibility (CSR) has the potential to make positive contributions to the development of society and businesses. Organizations are beginning to see the benefits from setting up strategic CSR agendas. The increasing attention to CSR is based on its capability to influence firm's long term performance, especially financial performance. There are more Indonesian companies participating in caring communities, and contributing to the community with specific actions to publicize their CSR related activities. Previous empirical studies have indicated an unclear relationship between CSR and financial performance. Most of studies focuses on manufacturing sector, whereas many industry have indirect relevancy with CSR, example banking sector. This study uses quantitative methods with positivism approach. Research objects were 15 banking companies listed at Indonesia Stock Exchange based on population criteria with observation period 2008-2011. This study uses secondary data derived from annual reports and financial statements. Data analysis uses Path Analysis. Research results show CSR affects on all financial performance measurement namely Return on Assets (ROA) and Return on Equity (ROE). These results reinforce the accumulating body of empirical support for the positive impact of CSR on financial performance. This research implication is banking companies need to increase quality of CSR, both from implementation dan information disclosure. This quality improvement provides an opportunity for company to increase its profits primarily from financial side. CSR is a long-term investment that can give an advantage if done consistently. CSR can be used to address interest conflicts among stakeholders so firm value will interact positively. Good financial performance also demonstrates good firm value.

Keywords : banking, CSR, financial performance, ROA, ROE

1. Introduction

Recently *Corporate Social Responsibility/CSR* made into a concept that is often heard even though its own definition is still a debate among some practitioners and academics. On the one hand CSR is considered by the company can increase the cost and reduce company's profit. Now the philosophy shifts. CSR can increase company's profit through CSR programs that conducted by the company. The program can become a long-term investment that is expected to increase company's profit.

In Indonesia, CSR is stated in Undang-Undang Nomor 40 Tahun 2007 about Perseroan Terbatas that require industry or corporations to implement it. But this obligation is not an incriminating one. In recent years many companies have become increasingly aware of the importance of implementing CSR programs as part of their business strategy. The company is faced with three things, from the economic aspect, the company must be profit oriented and from the social aspect, the company must contribute directly to the community so that the company is not only faced with responsibility in the pursuit of profit only, but also must pay attention to their social responsibility and environment. If public community considers that the company is not pay attention to their social and environmental aspects, do not feel directly contribution and even feel the negative impact of the company's operation on the environment and their life, then the condition will surely cause public community resistance.

The company's commitment to contribute to the development of the nation by taking into the financial or economic, social, and environmental aspects (triple bottom lines) is the main issue of the concept of CSR. Triple Bottom Lines was a concept developed by Elkington (2004), 3P refers to planet, profit and people, namely financial value, social value and environmental values to ensure company value grows continuously (sustainable).

Today many companies are beginning to recognize the importance of CSR activities as a long-term investment that will benefit the company in the future. In understanding the

benefits, it can not be separated from the relationship between CSR and firm performance. This topic became a debate among related economies about how CSR activities can generate profits for stakeholders. Much research has been done on the relationship and influence between CSR and firm performance, especially on the financial side and corporate value, although the results are still inconclusive and still not convincing because many factors behind (Ullman *et al.,* 1985; Griffin and Mahon, 1997; Margolis and Walsh 2003; Vogel 2005; Margolis *et al.,* 2007) that creates opportunities for further investigation.

This study uses Return on assets (ROA), and Return on equity (ROE) as firm financial performance. ROA is an indicator for corporate profitability, ROE is an indicator for company efficiency while ROS is an indicator for profit (Bodie *et al.,* 2002 in Dincer dan Dincer, 2011). Much of the previous research has focused on the manufacturing industry because it has a direct impact by the CSR policy. Yet on the other hand many industries that indirectly also have a link with CSR, for example banking industry. This is a gap for this research that is expected to be able to reveal CSR activities of banking industry in supporting the achievement of corporate goals to generate profits. The advantages referred to in this study are prosperity for shareholders and maximization of firm value.

Banks can report what they do to ensure that their loans and investment policies do not facilitate harmful industrial activities. On the other hand, banks consume large amounts of resources, such as paper and energy, and make waste. Therefore, the policy on how they contribute to the conservation of energy and natural resources and recycling activities is an important aspect of their social activities (Branco and Rodrigues, 2006). The banking industry may not be in touch with the environment directly, but still has the responsibility to report its activities transparently to the public.

Based on description above, there is a research gap. First, there was not a clear relationship between CSR study on financial performance. There was little empirical evidence

of previous research in banking industry in addition to manufacturing industry. Previous research has shown inconsistencies results obtained by different researchers. The main objective of this paper is to examine the effect of CSR on financial performance in the banking industry in Indonesia. This study attempts to contribute to the existing knowledge in the field by examining the extent to which CSR relates to the financial performance of banking industry.

2. Theoretical Framework and Hypothesis Development

This paper develop the theoretical framework based on two main things, namely Corporate Social Responsibility/CSR and financial performance. McWilliams and Siegel (2000) define CSR as a social action that arises outside the company's interests. CSR is a corporate action strategy and has consequences on costs, CSR can affect the company's financial performance. In addition, CSR conducted by the company can also reduce social risks and can be a long term benefit for. CSR may be an advantage or a disadvantage for a company depend on the effectiveness of CSR applied by the company.

The idea that a company's business has some responsibility to the community in addition to providing benefits to shareholders has been around for centuries (Carroll and Shabana, 2010). CSR is a genuine effort of the company to minimize negative impacts, compensate for residual negative impacts and maximize the positive impacts of its operations in the economic, social and environmental aspect of all its stakeholders, to achieve sustainable development objectives (A+ *CSR* Indonesia).

Harmoni and Andriyani (2008) explained CSR often interpreted as a link between decision-making with ethical values, the fulfillment of legal principles and respect for human dignity, society and the environment. As well as personal codes of conduct, CSR reflects the individual ethics applied by a company, especially its top management. But CSR can also be encouraged and even forced from the outside, either by the government, or by consumers.

From many various CSR definitions, there is one similarity that CSR can not be separated from the interests of shareholders and stakeholders of the company. This concept is then translated by John Elkington as a triple bottom lines, namely: Profit, People, and Planet.

Figure 1. *Triple Bottom Line of Sustainability*
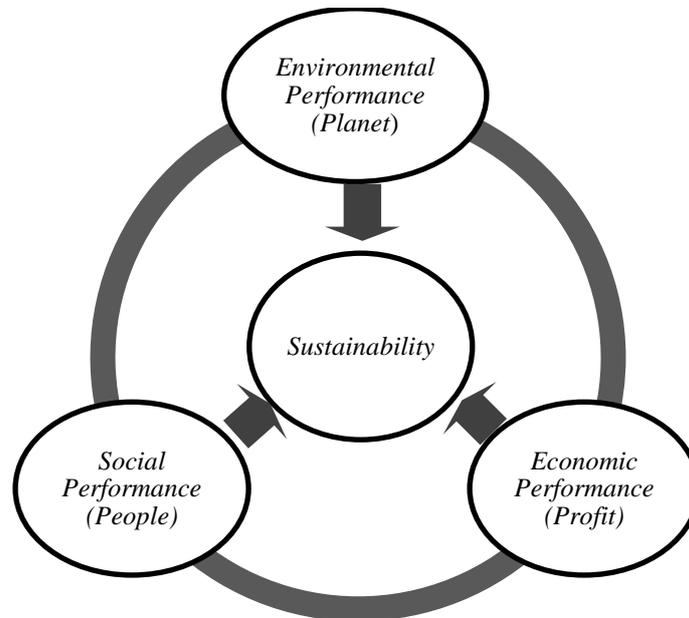
Source: Dao *et al.,* (2011)

The purpose of CSR should be able to increase corporate profits, welfare of employees and society, while improving the quality of the environment. Profit, as a profit oriented business entity, the company must still be oriented to seek economic benefits to ensure the survival of the company so that the company can continue to operate and develop.

People, to ensure survival and enhance the competitiveness of company, company must have concern for the well-being of employees and human beings who are valuable assets in the organization and country. The form of social-oriented CSR programs or people is the provision of scholarships for students around the company, the establishment of educational and health facilities.

Planet, environmental awareness and biodiversity sustainability can be done through the implementation of environmental greening program, the provision of clean water facilities,

the improvement of settlements, the development of tourism. Susiloadi (2008); Harmoni and Andriyani (2008); Titisari *et al.,* (2010); Khan *et al.,* (2012)

Financial performance is one factor that shows the effectiveness and efficiency of an organization in order to achieve its objectives. Effectiveness is achieved if management has the ability to choose the right goal or an appropriate tool to achieve the goals set. Efficiency is defined as the ratio between input and output that is with certain input to obtain optimal output (Pertiwi and Pratama, 2012). Firm financial performance is the result of many individual decision which are made continuously by management. Therefore, to assess the firm financial performance, it is necessary to include the cumulative and economic impacts of the financial impact of the decision and consider it using a comparative measure.

To obtain an overview of the firm financial development, it is necessary to conduct an analysis or interpretation of the financial data of the company concerned, in which the financial data is reflected in the financial statements. The measure used in financial analysis is the ratio. Financial ratio is an activity comparing the figures in the financial statements by dividing the numbers one with the other numbers. This financial ratio is used to evaluate the company's financial condition and performance (Kasmir, (2008:104).

Orlitzky *et al.,* (2003) used meta analysis found that *Corporate Social Performance* (CSP) relates with financial performance that measured by *ROE* dan *ROA*. Sturdivant dan Ginter (1977); Orlitzky *et al.,* (2003); Bird *et al.,* (2007) found that CSR activities has positif effect with firm financial perfomance. Bowman and Haire (1976) in Hackston and Milne (1996) argued that the higher of the company's level profitability, the greater of social information disclosure that the company does. Based on the description above it can be drawn hypothesis as follows:

H1. CSR significantly effect on financial performance that measured by Return on Assets

(ROA)

H2. CSR significantly effect on financial performance that measured by Return on Equity (ROE)

3. Research Method

Beside of the problem, objective and theory, this study uses quantitative method with positivism approach with the form of associative research. The research approach uses positivism approach because the research starts from theory then the theory is derived into model and test the model empirically. Quantitative method based on Indriantoro and Supomo (2002: 12) emphasizes the testing of theories through the measurement of research variables with numbers and performs statistical data analysis. The nature of this study is quantitative research that reveals the size or magnitude of an influence or relationship between variables expressed in the figures, by collecting data which is a supporting factor to the influence between the variables concerned then try to be analyzed.

This study uses census sample because all population members become research objects. Samples were 15 companies. These were Bank Artha Graha Internasional Tbk, Bank Bukopin Tbk, Bank Central Asia Tbk, Bank CIMB Niaga Tbk, Bank Danamon Tbk, Bank Internasional Indonesia Tbk, Bank Mandiri (Persero) Tbk, Bank Mega Tbk, Bank Negara Indonesia (Persero), Bank Nusantara Parahyangan, Bank OCBC NISP Tbk, Bank Pan Indonesia Tbk, Bank Permata Tbk, Bank Rakyat Indonesia (Persero), Bank Victoria International.

This study uses CSR as independent variable and financial perfomance that measured by ROA dan ROE as dependent variables. *Return on assets (ROA)* used to measure company's the effectiveness of the company in generating profits by utilizing its own assets owned. *Return on equity (ROE)* is the important ratio for the common stockholder, because this rasio shows the rate of return generated by the management from the owner company's capital.

Calculation of CSR uses CSR disclosure index (CSRDI) that conducted by dichotomous approach. Each item in CSR research instrument was given value of 1 if disclosed and value 0 was not disclosed CSR. Furthermore, scores of each item were summed to obtain score overall for each firm. Data source to calculate CSRDI come from year t (Haniffa and Cooke, 2005)

$$CSRDI_j = \frac{\sum X_{ij}}{n_j}$$

Explanation:

$CSRDI_j$: *Corporate Social Responsibility Disclosure Index* company j

n_j : total *item* for company j, nj ≤ 56

X_{ij} : *dummy variable*; 1= if *item* i disclosed; 0 = if *item* i not disclosed 0 ≤ $CSRDIj$

         ≤ 1

CSR that uses in this study is data from annual report and calculated by CSR disclosure Index (CSRDI). CSRDI calculation in this study follows GRI 3 (Global Reporting Initiative) standard sspecifically for the financial sector; it is Financial Services Sector Supplement (FSSS) which is consists of three focus disclosures, namely products and services/services, social and products as sustainability reporting. This study uses 16 items of disclosure from Financial Services Sector Supplement (FSSS) GRI and 40 items of disclosure from GRI 3, consist of economic indicator (6 items), environmental (8 items), labor (10 items), human rights (5 items), public community/social (4 items), dan product (7 items) (www.globalreporting.org).

Formula to calculate Return on assets (ROA) and Return on equity (ROE as follows:

$$ROA = \frac{Earning\ After\ Interest\ and\ Tax}{Total\ Asset}$$

$$ROE = \frac{Earning\ After\ Interest\ and\ Tax}{Equity}$$

The type of data uses in this study is quantitative data sourced from the secondary data of annual reports and financial statements with the period of data collection 2008-2011. Data of independent variable begins years on 2008-2010, while for the dependent variables begins on year 2009-2011. This research uses descriptive analysis, inferential analysis and content analysis. Descriptive analysis to explain the description of all research variables while the inferential analysis to test the hypothesis. The inferential analysis used is ordinary least square (OLS) or regression analysis. Content analysis is used to measure corporate social responsibility disclosure. In determining the number of disclosures, tabulation techniques are used for each sample company based on a checklist of social disclosures. Score 0 (No): if item not disclosed and score 1 (Yes): if item disclosed.

4. Results

4.1 Descriptive Analysis

Tabel 1. Average Descriptive of Research Variables (in %)

Variables	2008	2009	2010	2011	Average
CSRDI (X)	50	56	55	-	53,38
ROA (Y$_1$)	-	1,31	1,57	1,66	1,51
ROE (Y$_2$)	-	14,40	15,71	15,42	15,18

Source: survey data analysis, 2013

Table 2. Regression parameters of X, on Y1 and Y2

Dependent Variable	Independent Variable	R	R Square	Adjusted R Square	Std. Error of the Estimate
ROA (Y1)	CSRDI (X)	.652a	.424	.411	.60331
ROE (Y2)	CSRDI (X)	.593a	.351	.336	5.56395

Source: survey data analysis, 2013

Table 3. t Test Results the effect of X, on Y1 dan Y2

Dependent Variable	Independent Variable	Std. Coef. Beta	ε	T	Sig. (t)
ROA (Y1)	CSRDI (X)	0,652	0,906	5,632	0,000
ROE (Y2)	CSRDI (X)	0,593	0,936	4,828	0,000

Source: survey data analysis, 2013

Table 4. Linear Regression Results the Effect of X, on Y1 and Y2

Dependent Variable	Independent Variable	R	R Square	Adjusted R Square	Std. Error of the Estimate	F	Sig(F)
ROA (Y1)	CSRDI (X)	.652[a]	.424	.411	.60331	31,715	0,000
ROE (Y2)	CSRDI (X)	.593[a]	.351	.336	5.56395	23,306	0,000

Source: survey data analysis, 2013

Tabel 5. Result of Hypothesis Testing from the effect of dependent and independent variables

H	Dependent Variable	Independent Variable	t	Sig	Result	Information
H_1	CSRDI (X)	*ROA (Y1)*	5,632	0,000	Significant	Accepted
H_2	CSRDI (X)	*ROE (Y2)*	4,828	0,000	Significant	Accepted

Source: survey data analysis, 2013

Table 1 describes about CSR disclosure average in general on research period. Table 2 and Table 4 shows the magnitude of the determination coefficient (R^2) of each variable. The magnitude of influence of variable X (CSRDI) to variable Y_1 (ROA) is 42,4% (0,424) while the influence of X variable (CSRDI) to Y_2 (ROE) is 35,1% (0,351) and other factors influence Variable Y_2 (ROE) is about 64.9%. Table 3 and Table 5 shows the value of path coefficient on the relationship between variables X (CSRDI) to the variable Y_1 (ROA) of 0.652 with the value of t arithmetic and the value of significance respectively of 5,632 and 0,000. The t value greater than the critical t value (5,632>

2.015) and the smaller significance value of the alpha 5% (0,000 <0.050) states that there is a significant relationship between X variable (CSRDI) to the Y_1 variable (ROA) with an alpha tolerance limit of 5%. The value of path coefficient on the relationship between variables X (CSRDI) to the variable Y_2 (ROE) of 0,593 with the value of t arithmetic and the value of significance respectively of 4,828 and 0,000. The t value greater than the critical t value (4,828 > 2.015) and the smaller significance value of the alpha 5% (0,000 <0.050) states that there is a significant relationship between X variable (CSRDI) to the Y_2 variable (ROE) with an alpha tolerance limit of 5%.

4.2 Discussion

H1:   Statement that CSR significantly effect on financial performance that measured by Return on Assets (ROA) was **accepted**

Data analysis result showed that CSR has significant positive effect on company financial performance that measured by Return on Assets (ROA). Indonesia banking company realize that social and environmental performance improvement will support economic performance improvement as indicated by higher company's financial performance. In this case, CSR activity was considered as one beneficial asset for company. When company must pay for CSR implementation, it was not seen as a cost that can reduce corporate profits. From results obtained it can be concluded the benefits of ROA increased with improvement in company's CSR activities. By doing CSR then profits can be maximized. This study confirmed opinion of Kang et al., (2010); Uadiale and Fagbemi (2011); Chen and Wang (2011); Setiawan and Darmawan (2011); Ehsan and Kaleem (2012). ROA obtained by comparing earning after interest and tax to total assets. In the banking company this ratio is included in the ratio of profitability or earnings ratio that describes the amount of corporate earnings derived from investment activities, corporate services and financial operations (Chisti, 2012).

It shows that better CSR leads an increase ROA. Banking companies in Indonesia are aware that improving the social and environmental performance will support the improvement of economic performance as indicated by the improvement of the company's financial performance. In this case CSR activity is considered as one of the profitable assets for the company so that when companies have to spend for the implementation of CSR it is not seen as a cost that can reduce corporate profits. ROA indicates the bank's position in asset management and is included in the rentability valuation group for bank health so that high ROA also shows that the bank concerned has a good performance.

H2:   Statement that CSR significantly affect on financial performance that measured by return on equity (ROE) was **accepted**

Analysis data result showed that CSR has significant positive effect on company's financial performance that proxied by ROE. Improving CSR activities to increase returns of equity can makes Indonesian banks companies have been able to fulfill concept of Triple Bottom Lines. CSR was a reflection of planet, profit and people concept, while ROE was a reflection of profit concept. Return on Equity (ROE) was main thing that addressed by investors because it shows profit that derived from capital/equity provided by company owners. The higher ROE, the better company in investors eyes. It means that CSR activities that will increase ROE also increases investors' assessment to company. This study confirmed research of Chand (2006), Kang et al., (2010); Uadiale and Fagbemi (2011); Dhkili and Ansi (2012).

ROE indicates the bank's position in capital management and is included in the rentability valuation group for bank health. Return on Equity (ROE) is considered as one of the important things in determining the profitability of a company because it shows the rate of return generated by the management of capital / equity provided by the owner of the company. This suggests that the increasing disclosure of social responsibility information leads to increased ROE. By improving CSR activity along with increasing returns from equity,

Indonesian banking companies have been able to fulfill the concept Triple Bottom Lines. CSR is reflection of people and planet concept, while ROE is a reflection of the profit concept. CSR activity managed to convince the owners of the company to deposit capital as an investment that one of them used as a financing of CSR activities. These investments in the future generate profits so as to encourage the same reinvestment in the future.

5. Conclusion and Implication

From the research, it was found that CSR activity has effect to financial performance that measured by ROA and ROE. The results from this research reinforce the existing empirical findings on the positive impact of CSR initiatives on financial performance. Because there is indeed a positive relationship between CSR and financial performance measures. It can be concluded that improving CSR activity can improve company financial performance, especially in their profitability. These results indicate that improvement of CSR makes banking companies has a chance to improve its financial performance during social responsibility activities and disclosure was considered as an investment and not as an expense that reduces profits. CSR activity must be done sustainably to get maximum results for the company.

Implication banking companies need to increase quality of CSR, both from implementation dan information disclosure. This quality improvement provides an opportunity for company to increase its profits primarily from financial side. CSR is a long-term investment that can give an advantage if done consistently. CSR can be used to address interest conflicts among stakeholders so firm value will interact positively. Good financial performance also demonstrates good firm value. Future research could look at establishing the predictive power or causalities of CSR investment and financial performance of banking company.

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