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# The Impact of Strategic Corporate Social Responsibility on Operating Performance: An Investigation Using Data Envelopment Analysis in Indonesia

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**Abstract**
*The trend of Corporate Social Responsibility (CSR) is continually growing and businesses are struggling to comply and maximize on its benefits. This paper aims to investigate the relationship between strategic Corporate Social Responsibility including its individual elements and operating performance. Do firms strategize CSR to improve their operating performance? The paper uses annual reports of financial and non-financial publicly-listed companies from the Jakarta Stock Index. The Global Reporting Index framework was applied for the content analysis to quantify the aggregate score for CSR. A mathematical programming model 'Data Envelopment Analysis' was conducted for the research. It allows the identification of CSR elements that a company should chose to improve its CSR engagement. For both groups, the results reveal that there is no significant impact between CSR and operating performance. However, different results were obtained when the elements of strategic CSR were individually investigated. Both divisions showed that different components of CSR are affecting operating performance. Non-financial companies seem to strategize on their CSR programs by performing only on economic aspects whereas the financial group chose to only implement environmental activities to improve their operating performance. The results may infer that Indonesian publicly-listed companies are not fully committed to implementing their CSR plans; however, they are strategizing to maximize on them.*

***Keywords:*** *Strategic CSR, Corporate Social Responsibility, Operating Performance, Data Envelopment Analysis, Indonesia, GRI, Content Analysis*

## 1. Introduction

To exist and survive in today's competitive market, it is no longer acceptable for a business to gain profit at the expense of creating environmental devastation or neglecting social needs. Firms are believed to be a part of a larger economic system in which their operations will affect other components of the system, thus impacting the system itself as a whole (Sutanto, 2008). As a result, several governments, activists and the society as a whole are pressuring companies that commit costly irresponsible actions to alter the way they operate. According to Huang (2010), a firm's decisions should be relevant not only to its internal stakeholders but include all external parties such as customers, suppliers, non-governmental organizations, the local community, society and the environment. To fulfill the demands of different stakeholders, corporate social responsibility (CSR) is used as a legitimate tool for corporate strategy (Sutanto, 2008). The product of CSR reporting is a holistic view of the company that allows the appreciation of the creation of value that can both harm or help the larger system (Leduc, 2011).

The World Business Council for Sustainable Development describes sustainable development as: "continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large". The statement is consistent with Oeyono et al. (2011) views on the three pillars of sustainable development which includes consideration of economic, social and environmental aspects - the Triple Bottom Line approach to sustainability. The trend in corporate strategy has shifted from a narrow perspective of maximizing shareholder value at any cost, to a broader objective of considering social and environmental values in economic decisions (Welford, 2004).

With the growing trend of CSR, companies would like to know how make CSR activities profitable or at least financially meaningful for them. The use of DEA as a non-parametric linear programming technique is expected to enable managers to identify the best element of CSR that the company should select in order to improve the companies' interest in their decision-making process. (Belu & Manescu, 2009)

## 2. Literature Review

In accordance with the strategic advisory group on CSR, the International Organization for Standardization defines CSR as "...a balanced approach for organizations to address economic, social and environmental issues in a way that aims to benefit people, communities and society" (Leonard & McAdam, 2003). According to Deegan (2009) the triple bottom line concept of sustainability encompasses social, economic and environmental elements.

The following theories used in this research explain why companies choose to engage in CSR activities. Stakeholder and legitimacy theories are included to show how they interrelate and overlap in practice. Institutional Theory is also relevant since it is an extension of both stakeholder and legitimacy theories (Deegan, 2009).

The research uses Global Reporting Initiative (GRI) to measure CSR since it is a widely accepted reporting framework for an organization's triple bottom line. GRI is intended to be utilized by organizations regardless of size, sector or location. Furthermore, the framework is agreed among a wide range of stakeholders as an indicator of sustainability performance with a diverse range of stakeholders considered: business, labor, non-governmental organizations, investors and accountants.

In this paper, the profitability ratio Return on Asset (ROA) is defined as a measure of a firm's earning ability and indicator for operating performance. The higher value of ROA indicates a higher efficiency of the firm to produce more income from the assets they own (Gibson, 2009). Belu and Manescu (2009) used ROA when measuring how CSR impacts the company's operating performance. Their research suggested that CSR and its components are negatively related with ROA. Research has revealed strategic decisions in CSR with a positive relationship with a company's performance (Baron, 2005), (Boesso & Michelon, 2010), (Hine & Preuss, 2009), (Heal, 2004), (Quairell-Lanoizelée, 2011).

Belu and Manescu (2009) advocated that operating performance is determined by several factors including the firm's size, leverage, capital intensity, retained earnings, sales, price-to-book ratio and dividends-to-book ratio. Their paper followed the previous study findings conducted by Manescu and Starica (2007) where the determinants are comprised of the same factors.

## 3. Research Methodology

Based on previous research findings the author creates an initial hypothesis. Further, other studies also promote the belief that if perceived benefits in engaging in CSR are higher than the costs, implying strategic form of CSR, companies will forgo short-term economic gain to reap a larger amount of benefits in the long-run (Siegal & Paul, 2006), (Ioannou & Serafeim, 2009). Using past information conducted in the field of strategic CSR and operating performance, the initial hypothesis is as follows:

H1: Strategic CSR positively affects operating performance.

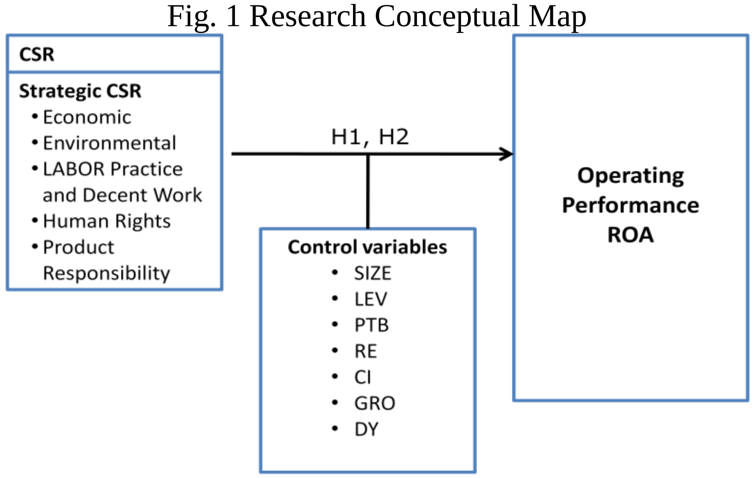
A second hypothesis is also included in this paper in order to determine further the relationship between CSR and operating performance. The hypothesis is formulated to understand which elements of CSR have the greatest impact on operating performance:

H2: All CSR elements positively affect operating performance.

The author used annual reports of publicly-listed companies in the Indonesian Stock Exchange (IDX) that conducted CSR in 2008-2010 as the sample. Due to differences in regulations the sample is divided into two groups: financial companies and non-financial companies. The division will allow a meaningful way to interpret the findings since they are subject to different laws and regulations. Non-financial companies such as agricultural, mining and oil are mandated by the law to perform CSR.

In this paper, to properly assess the indicators of CSR, the author adopts content analysis method using the GRI framework to examine the annual reports of companies: Economic (ECO), Environmental (ENV), Labour Practices (LA), Human Rights (HR), Society (SOC), and Product Responsibility (PR). The research uses frequency and word count as a technique of the content analysis. The word count method enables less room for subjectivity and filters conspicuous intentions of CSR report writers (Nuzula and Kato, 2010).

Fig. 1 Research Conceptual Map



The purpose of Data Envelopment Analysis (DEA) is to create an index score relative to the other units of CSR performance. Thus, the ratio obtained is the base for the CSR index used as a dependent variable in the model. The efficiency score obtained in DEA will be used to measure CSR, and the weights generated will be used as the measure for each individual CSR element. DEA will allow focusing on the best CSR performers and eliminating the rest. The DEA is based on Belu and Manescu's (2009) model.

$$\max_{\theta,\lambda} \theta y^{ij}$$

$$\text{subject to, } \theta y^{ij} \leq \sum_k \lambda_k y^{ik}, \; i=1,\ldots 6$$

$$\lambda_k \geq 0, \; k = 1, \ldots j \ldots, N$$

$$\sum_k \lambda_k = 1$$

Where, y - CSR scores; j=1….N - number of firms; i - CSR elements; K - firm under scrutiny; $\lambda_k$ - weights of each CSR element.

In the construction of CSR indexes, y is assumed to be the CSR scores as measured through the content analysis provided by the GRI framework. The number of firms in the sample is represented by j=1….N. The CSR dimension is measured by i, which divides CSR into six categories: Economic Performance, Environmental, Labor Practices, Human Rights, Society and Product Responsibility. K indexes the firm under scrutiny and □k represents the assigned weights of each dimension.

The optimal set of weights is company specific and will favor dimensions where company performance is better as a result of the business strategy employed by the manager. Furthermore, DEA is able to identify which elements of CSR the company should improve on due to the minimum CSR engagement in the area (Belu & Manescu, 2009). The use of DEA in strategic CSR means that managers can select best which activity should reflect the companies' interests in their decision-making process.

Numerous researchers use ROA as an indicator of operating performance (Burja, 2011; Dooley & Lerner, 2004; Karagiorgos, 2011; Ashok & Kunal, 2003; Bauwhede, 2009; Belu & Manescu, 2009; Ivan, 1999). ROA captures a firms' ability to utilize assets efficiently, reflects general profitability of a firm and is a ratio that is often used for analysis by firms. Furthermore, it is free from short-term consideration of its owners regarding the size of the capital.

ROA = Earnings before Interest and Taxes / Average assets

This paper includes a one year lag between CSR and ROA to ensure that the data are contemporaneous. That is, the CSR in year t will be reflected on ROA in year t+1 because it takes time for company's CSR engagement to reflect in the performance, since stakeholders will only know what CSR strategy is employed by the company after the annual report is published. The elements of CSR will be broken down into Economic (ECO), Environment (ENV), Labour Practices (LA), Human Rights (HR), Society (SOC) and Product Responsibility (PR).

The models used in the research are as follows:

$$ROAt+1 = \alpha + ROAt + \beta 1CSRit + \beta 2SIZEit + \beta 3LEVit + \beta 4PBVit + \beta 5REit + \beta 6CIit + \beta 7GROit + DYit + \varepsilon \quad (1)$$

$$ROAt+1 = \alpha + ROAt + \beta 1ECOit + \beta 1ENVit + \beta 1LAit + \beta 1HRit + \beta SOCit + \beta PRit + \beta 2SIZEit + \beta 3LEVit + \beta 4PBVit + \beta 5REit + \beta 6CIit + \beta 7GROit + DYit + \varepsilon \quad (2)$$

The research incorporates commonly used control variables when analyzing operating performance determinants (Nugent, 1998), (Wernerfelt & Hansen, 1998; Belu & Manescu, 2009;

Spanos et al., 2004; Capon et al., 1990; Ashok & Kunal, 2003; Bauwhede, 2009). The control variables in the research are as follows:

Table 1: Control Variables

| Control Variable | Meaning | Formulae | |
|---|---|---|---|
| SIZE | Size | Natural Logarithm of Assets | (2) |
| LEV | Leverage | Total liabilities/Shareholder Equity | (3) |
| PTB | Price-to-Book Ratio | Market Value/Book Value | (4) |
| RE | Retained Earning | Retained Earning | (5) |
| CI | Capital Intensity | Capital Expenditure / Fixed Assets | (6) |
| GRO | Firm's Growth | 2 Year Percentage Change in Sales | (7) |
| DY | Dividends-to-Book Ratio | Dividends Paid/Book Value | (8) |

## 4. Findings and Discussion

*Hypothesis 1* - Table 2 shows strategic CSR and ROA have no significant relationship. The companies may not engage in strategic CSR, instead performing an altruistic form of CSR, that is, committing to philanthropic responsibilities (Lantos & Cooke, 2003). This result is supported by Aupperle, Carrol and Hatfield who proved that there is no relationship between strategic CSR and a company's operating performance (Tsoutsoura, 2004).

Another explanation for the lack of significant relationship can be how CSR is perceived by Indonesian companies. Although past studies (Heal, 2004) show that long-term profitability is related with CSR - only if it generates higher profit - the statistical results in Indonesian companies show otherwise. Therefore, since there is no significant relationship between strategic CSR and operating performance, companies in Indonesia do not believe that engaging in CSR will result in long-term benefit or higher profit.

Table 2: Regression Results for Hypothesis 1, Financial Companies

| Independent variables | Coefficients | t-statistics | p-value |
|---|---|---|---|
| (Constant) | .021 | .806 | .423 |
| $ROA_t$ | .725 | 9.492 | .000*** |
| CSR | .020 | 1.129 | .263 |
| SIZE | 9.437E-5 | .023 | .982 |
| LEV | -.003 | -1.566 | .122 |
| PBV | .003 | .422 | .674 |
| RE | -3.051E-7 | -.184 | .855 |
| CI | -2.791E-5 | -3.314 | .001*** |
| GRO | 5.406E-6 | .228 | .821 |
| DY | .044 | .890 | .377 |
| F-Stat (p-value) | 17.003(.000) | | |
| Adjusted $R^2$ | 0.652 | | |

*** indicates significance at 1% level; a. Dependent Variable: $ROA_{t+1}$; b. ANOVA: .000[a]
SIZE-size; LEV-leverage; PBV-price to book value; RE-retained earnings; CI-capital intensity; DY-dividend to book ratio

The positive relationship with ROAt and ROA which is consistent with Belu and Manescu's (2009) work since past ROA performances can influence the values of ROA and therefore, is essential for controlling past performance effects. The negative relationship in capital intensity is consistent with Pandey's findings (2005). Belu and Starica (2007) advocated that higher investment in technology can result in higher profitability due to innovation and enhanced knowledge. In the Indonesian context this can be due to the inefficient process of knowledge enhancement and innovation processes despite investing in sufficient capital. Thus, although there is an investment in technology, it does not result in profitability because innovation and knowledge enhancement are stifled.

Table 3 depicts a positive relationship with ROAt-1 and ROA is similar to the findings with the financial group. The significant impact of Price-to-Book value on operating performance is similar to the findings of Manescu & Starica (2009). Generally, in Indonesia the higher the price-to-book value, the higher the company performance; since the stock price is a reflection of the revenue and the future outlook of the company. The rest of the control variables and CSR demonstrate no significant relationship with ROA.

The lack of CSR impact on operating performance for non-financial category is consistent with the findings of the financial group. This group of companies might engage in altruistic rather than strategic motive which is supported by Aupperle, Carrol and Hatfield (Tsoutsoura, 2004). According to Lantos and Cooke (2003), the altruistic motive improves corporate communication through donations because they are widely perceived. Their symbolic feature enhances publicity compared to costly advertising and they may entitle the company to obtain tax breaks (Valor, 2007).

Typically for non-financial companies, another explanation can be due to the mandatory CSR laws enacted by the Indonesian government, Company Act No. 40 year 2007 (Siregar & Bachtiar, 2010). Companies in mining and agricultural industries must conduct CSR; otherwise they will face possible lawsuits and stiff penalties.

Table 3: Regression results for Hypothesis 1, Non-Financial Companies

| Independent variables | Coefficients | t-statistics | p-value |
|---|---|---|---|
| (Constant) | .024 | 1.027 | .305 |
| $ROA_t$ | .698 | 15.256 | .000*** |
| CSR | .017 | 1.388 | .166 |
| SIZE | -.001 | -.475 | .635 |
| LEV | .000 | .268 | .789 |
| PBV | .006 | 3.870 | .000*** |
| RE | 4.369E-7 | .763 | .446 |
| CI | 1.411E-7 | .103 | .918 |
| GRO | -1.527E-5 | -1.448 | .149 |
| DY | .004 | .122 | .903 |
| F-Stat (p-value) | 80.151(.000) | | |
| Adjusted $R^2$ | 0.733 | | |

*** : indicates significance at 1% level; a. Dependent Variable: $ROA_{t+1}$; b. ANOVA: .000[a]; SIZE-size; LEV-leverage; PBV-price to book value; RE-retained earnings; CI-capital intensity; DY-dividend to book ratio

*Hypothesis 2* - Table 4 displays that ROAt and ENV positively affect ROA while LEV and CI negatively. Manescu & Starica (2007), Birger & Wernelfelt (1998), and Bauwehede (2009) confirm the negative relationship of leverage (LEV) with operating performance. They advocated that companies with strong financial performance have a higher tendency not to borrow more. The finding could be explained by a higher amount of vulnerability if the firm exposes itself when leverage is high, whereas firms with good performance tend to avoid decreasing risks of downturns in economic activity and plummeting interest rate increases (Nugent, 1998).

According to Belu and Starica's (2007) higher capital intensity (CI) should result in higher profitability. However, this is under the assumption that higher investment in technology would in fact result in enhancement of knowledge. For Indonesian non-financial companies the relationship is negative, thus one can assume that higher investment in technology does not always result in improvement of knowledge, which may be due to problematic knowledge transfer as well as ineffective use of new technology.

ENV impact on ROA indicates that companies might engage in merely altruistic CSR for some of its elements but engage in strategic CSR in dealing with the environmental aspect (ECO). Hart and Ahuja as well as King and Lenox have discovered a positive link between engaging in environmental element of CSR and profitability (Oberholzer & Prinsloo, 2011). The high impact of environmental element can be due to the requirement of compliance with environmental regulations which can stimulate new technology, enhance productivity and reduce waste (Manescu & Starica, 2007). King and Lennox revealed that engaging in pollution

Table 4: Regression results for Hypothesis 2, Financial Companies

| Independent variables | Coefficient | t-statistics | p-value |
|---|---|---|---|
| (Constant) | .038 | 1.242 | .219 |
| $ROA_t$ | .654 | 8.888 | .000*** |
| ECO | -4.523 | -1.099 | .276 |
| ENV | 1.213 | 3.310 | .002*** |
| LA | -1.821 | -.474 | .637 |
| HR | -.036 | -.209 | .835 |
| SOC | -2.654 | -.697 | .488 |
| PR | .168 | .217 | .829 |
| SIZE | .002 | .375 | .709 |
| LEV | -.004 | -2.342 | .022** |
| PBV | .004 | .657 | .514 |
| RE | -2.341E-6 | -1.293 | .201 |
| CI | -2.737E-5 | -3.481 | .001*** |
| GRO | 1.028E-6 | .047 | .963 |
| DY | .023 | .507 | .614 |
| F-Stat (p-value) | 14.267(.000) | | |
| Adjusted $R^2$ | .707 | | |

*** indicates significance at 1% level; a. Dependent Variable: $ROA_{t+1}$; b. ANOVA: .000[a]
SIZE-size; LEV-leverage; PBV-price to book value; RE-retained earnings; CI-capital intensity; DY-dividend to book ratio

prevention can result in higher ROA while Russo and Fouts explained that the environmental element of CSR is more apparent in high growth industries (Manescu & Starica, 2007). Four banking companies are in the top 10 of complying with GRI in Australia in relation with environment, labor and human rights; showing that banking industries may also place importance on environmental issues (Khan, 2010).

The lack of engagement in CSR in other elements shows that Indonesian financial companies choose to focus on certain elements only. This is in agreement with Porter and Kramer's view which is about making choices on which social issues to focus on since it is aimed to improve a firm's competitive edge (Boesso & Michelon, 2010). Since firms have limited resources, they have to focus on certain issues and financial companies in Indonesia place emphasis more on environmental aspects as opposed to other elements since they may consider this element crucial.

No engagement in other areas can be explained by the view of CSR in Indonesia. Strategic CSR is supposed to result in long-term profitability as well as improve stakeholder relationships with employee, consumer and regulatory decisions resulting in enhanced legitimacy (Heal, 2004) (Brammer & Millington, 2005) (Quairell-Lanoizelée, 2011) (Tsoutsoura, 2004). From all elements of CSR, only ENV affects ROA and that may imply that Indonesian financial companies believe that conducting CSR in other elements will not result in higher operating performance or legitimacy which is already adequate and no further CSR is necessary to improve reputation.

Table 5: Regression results for Hypothesis 2, Non-financial companies

| Independent variables | Coefficient | t-statistics | p-value |
|---|---|---|---|
| (Constant) | .018 | .717 | .474 |
| $ROA_t$ | .690 | 14.968 | .000*** |
| ECO | 1.622 | 2.636 | .009*** |
| ENV | -.053 | -.359 | .720 |
| LA | .587 | .883 | .378 |
| HR | .009 | .540 | .590 |
| SOC | .509 | 1.379 | .169 |
| PR | .057 | .946 | .345 |
| SIZE | .000 | -.220 | .826 |
| LEV | .000 | .072 | .943 |
| PBV | .006 | 3.686 | .000*** |
| RE | 4.920E-7 | .851 | .396 |
| CI | -7.366E-7 | -.519 | .604 |
| GRO | -2.014E-5 | -1.882 | .061 |
| DY | .003 | .079 | .937 |
| F-Stat (p-value) | 52.550(.000) | | |
| Adjusted $R^2$ | .735 | | |

*** indicates significance at 1% level; a. Dependent Variable: $ROA_{t+1}$; b. ANOVA: .000[a]
SIZE-size; LEV-leverage; PBV-price to book value; RE-retained earnings; CI-capital intensity; DY-dividend to book ratio

From table 5, ROAt, ECO and PBV display a significant relationship with ROA; while the remaining CSR elements and control variables have no significant relationship. ROAt, ECO and PBV demonstrate a positive relationship with ROA, which implies that an increase in them will result in a higher operating performance. The positive relationship with ROAt and operating performance is similar with the findings of Belu and Manescu's (2009), which suggests that it is important to control for past performance effects. The impact of PBV on ROA is in line with past research between the two variables showing a positive relationship (Belu & Manescu, 2009) (Manescu & Starica, 2009). The author assumes that in the Indonesian context of non-financial companies, since the stock price is a reflection of the revenue and the future performance of the company, the higher the PBV, the larger value of ROA can be achieved.

The trend in higher engagement of CSR in economic element can be explained by the stakeholder theory, with the tendency of corporate management to meet the expectations of powerful stakeholders (Deegan, 2009). In this case, companies are more concerned with shareholder's interest since the economic aspects of CSR are disclosure regarding the revenue, operating costs, employee compensation, dividends and tax. Although non-financial companies perform other forms of CSR, it is not very apparent since they lack urgency and power to enforce the claims (Mitchell et al., 1997), thus the other stakeholders' needs are not reflected in the annual report of the company.

Another explanation of this trend in merely the economic aspect of CSR is because of the enforcement of the Mandatory CSR law limited to Mining and Agricultural companies. As argued by Quairell-Lanoizelée (2011), companies will only conduct CSR if they can reap higher profit. Since companies engagement is limited to economic events, it can be assumed that companies believe engaging in other forms of CSR will not result in higher profit. From an institutional theory perspective, companies are more interested in certain CSR elements to attract and retain legitimacy (Jackson & Apostolakau, 2010). Indonesian non-financial firms may not deviate from the economic part of CSR since the other elements might indicate diverting profit to other investments that do not necessarily increase the value of company (Valor, 2007), hence jeopardizing shareholder's interest.

## 5. Conclusion

This paper investigates the relationship between strategic CSR and operating performance using Data Envelopment Analysis in all IDX companies in the year 2008-2010. DEA allows the construction of efficiency scores and weights resulting in an aggregate measure of CSR that favors the elements the company possesses a competitive advantage in, making the calculation of strategic CSR possible.

Initially, both financial and non-financial companies' strategic CSR has no association with ROA. Firms in Indonesia do not believe that engaging in CSR will result in long-term benefit or higher profit. They might be still deeply focused on financial gains rather than moral obligation which impede their awareness of their impact on environment and society. Furthermore, they may not believe engaging in strategic CSR will boost employee welfare, strengthen ethics, or improve regulatory decisions.

However when broken down to its elements, financial companies display a positive impact on the environment on operating performance while leverage and capital intensity negatively affect it. Indonesian firms are strategizing by performing only the environmental aspect of CSR. That may imply that conducting CSR in other elements will not result in higher operating performance or legitimacy which is already adequate and no further CSR is necessary to improve reputation. Since conducting CSR is not compulsory for them, they will not engage in any aspects of because of opportunity cost forgone if they were to engage in activities with no direct benefit to the business.

Non-financial firms' high engagement of CSR in economic elements reflects their concern with the shareholders' interests. The economic part of CSR is disclosure revenue, operating costs, employee compensation, dividend and tax. The most valid explanation of this trend is the enforcement of the Mandatory CSR law limited to Mining and Agricultural companies. Since these firms must implement CSR, they chose the economic CSR aspect which they believe will maximize their performance.

There are inherent limitations in this paper. Despite the varied research in Indonesia regarding CSR and corporate performance, only a few of them are on strategic CSR and even fewer on individual elements of CSR. The results of this research are only applicable to Indonesian companies. The difference in regulations, culture and societal expectation might reveal different outcomes in other countries, which is especially true with European countries that prioritize environmental and social issues.

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