

CHAPTER I

INTRODUCTION

1.1. Background

Indonesian and multinational companies are nowadays competing in Indonesian market and keep on focusing how to gain higher market shares in order to maximize their profits and fulfilling shareholders' interests. Friedman (1990) said, the main purpose of every business is to maximize profit, and every organization thought that they were only responsible to their shareholders and not to society as a whole. Every company would have different strategies in running their businesses, but only have one common goal which is getting as much profit as possible. There are some ways that could be done in order to maximize profit which are minimizing costs, reducing unnecessary expenses, and increasing sales of the company.

In recent years, as the issue of global warming, deforestation, and controlling pollution are increasing rapidly, Corporate Social Responsibility (CSR) is also increasingly becoming a part of company's strategy. According to Kotler and Nancy (2005), nowadays, instead of focusing more on marketing side and how to increase sales through marketing channels and promotions, organizations were started to consider using Corporate Social Responsibility as a tool to increase their revenues and brand awareness. Some companies probably thought that CSR was all about giving donations and charities, while other companies thought more and also do more to the society.

Basically, implementing Corporate Social Responsibility to the company forces its business model to be socially responsible and environmentally sustainable. Socially responsible means that company's activities should benefit the society, and environmentally sustainable means company's activities should not harm the environment. The Body Shop, Starbucks, and Microsoft are few example of companies those successfully implemented Corporate Social Responsibility into their products, strategies, visions and missions.

Corporate Social Responsibility is not only donating money as the society thought so, but Corporate Social Responsibility is way broader than what people think it is. It is important to measure the relationship between customers' purchases on a particular product with the organizations' involvement on socially responsible acitvities, because Corporate Social Responsibility is usually just considered and applied as one of marketing tool. Implementing Corporate Social Responsibility in the right way would not only increase the number of revenues, but also gives positive impacts and benefits to the society, and leads to the higher profit.

To measure the level of Corporate Social Responsibility internationally, there is a globally accepted indicators called Global Reporting Initiative Sustainability Reporting Guidelines Guidelines. "The Global Reporting Initiative (GRI) is an international, multi-stakeholder effort to create a common framework for voluntary reporting of the economic, environmental, and social impact of organization-level activity, in order to improve the comparability and credibility of sustainability reporting world-wide" (IISD.org)

As per Global Reporting Initiative Sustainability Reporting Guideline version 3.1 which was released on 2011, there are 7 aspects that must be fulfilled in order to claim that a business is socially responsible, which are economics, environmental, social, labor practice and decent work, human rights, society, and product responsibility.

A basic way to measure the performance of a company is by observing its profit and calculating profitability ratio. The profitability ratio used in this thesis are is Return on Equity (ROE).

According to KPMG International Survey of Corporate Responsibility Reporting, 95% of the 250 largest companies in the world report their Corporate Social Responsibility activities, mostly came from Europe, while only around half of Asia Pacific companies report on their Corporate Social Responsibility activities. In order to cope with this huge gap, this research was created with an intention to increase the company's awareness regarding Corporate Social Responsibility activities and its reporting in Asia, especially in Indonesia.

Friedman (1970) implied that the company was only responsible in making profit instead of giving part of shareholders' benefit to the society. This statement is no longer working in current economic conditions since a lot of companies worldwide are voluntarily done Corporate Social Responsibility activities in many ways. Hence, researchers were started to analyse whether there is any relationship between Corporate Social Responsibility activities done by the company and whether it is beneficial to shareholders. Tsoutsoura (2004) study of "Corporate

Social Responsibility and Financial Performance” was showing that there is a positive relationship between Corporate Social Responsibility and profitability. This study is used as a based in developing a similar research in the manufacturing and mining companies in Indonesia.

In Indonesia, the issue of Corporate Social Responsibility is showing an upward trend, from giving as an expense, to giving as an investment. A lot of companies are started to implement Corporate Social Responsibility principles in their business operations, and disclosing those activities in their annual reports, regardless there is no formal regulation on Corporate Social Responsibility Disclosures in Indonesia. Prior study “Perbandingan Kinerja Keuangan antar Perusahaan-Perusahaan yang Menerapkan Corporate Social Responsibility : Studi pada 21 Perusahaan Manufaktur yang Terdaftar di Bursa Efek Indonesia” conducted by Widyastuti and Agustina (2010) revealed that consistently disclosing Corporate Social Responsibility activities is giving a positive impact on profitability performance of the company. Furthermore, Dinanti’s (2011) research of “Analisis Pengaruh Corporate Social Responsibility terhadap Profitabilitas Perusahaan” was also given that there is a positive relationship between Corporate Social Responsibility Disclosures with one of the profitability ratios.

The topic of this thesis is *“The Impact of Corporate Social Responsibility Disclosure on Companies’ Profitability Performance (An Empirical Study of Companies Listed on Indonesia Stock Exchange).”* This topic is chosen in consideration of there are a lot of companies in Indonesia which are relying or directly related to natural resources, especially Indonesian mining and

manufacturing sectors. In addition, Law of the Republic of Indonesia, number 40 of 2007, concerning Limited Liability Company, article 74 stated that every organization which business activities are related to natural resources, should perform Social and Environment Responsibility. In the other words, companies are not only responsible to their shareholders, but also to their stakeholders, or in this context, society as a whole. This thesis is also created in order to increase awareness regarding implementation of Corporate Social Responsibility activities by companies in Indonesia and disclosing those activities in the annual report or establish separate sustainability report, and the report should be accessible for public.

1.2. Research Problem

The writing of this thesis is intended to examine the relationship between Corporate Social Responsibility disclosures and company's profitability ratio. Relying on the above background, then we formulate the problem as follows :

Whether disclosing Corporate Social Responsibility activities in the annual report would affect company profitability performance?

1.3. Research Purposes

According to the background and research problem, the purposes of creating this research are :

1. Analyze and find out the number of Corporate Social Responsibility activities disclosed by the listed companies.

2. Analyze the relationship between the number of Corporate Social Responsibility disclosures with company profitability performances.

1.4. Research Benefits

a) For academics

The benefit of this research is completing previous researches on implementation of Corporate Social Responsibility Disclosures in the annual report of the companies listed on Indonesia Stock Exchange, and also adding new knowledge regarding studies on the impact of Corporate Social Responsibility Disclosures to companies' profitability performances.

b) For companies

The benefit of this research is as a consideration to management when creating company's strategies and regulations, in order to maximize the responsibility on corporate social activities and implement greater development of social accounting in the organization. This research also created in order to guide the management in deciding what type of Corporate Social Responsibility activities that suitable to be implemented in Indonesia, and advising them to disclose those activities in the annual report or publish separate sustainability report.

c) For government

The benefit of this research is creating a framework regarding Corporate Social Responsibility disclosures in the Sustainability Reporting format, so that government could consider in making a mandatory standard on Corporate Social Responsibility reporting which suitable to the macroeconomic conditions in Indonesia.

d) For society

The benefit of this research is giving more information to the public, such as customers, shareholders, employees, surrounding communities, and society, on companies which have applied and disclosed their Corporate Social Responsibility activities and those companies which have not applied and disclosed Corporate Social Responsibility activities in their companies' strategies. Furthermore, this research encourages other companies to disclose their Corporate Social Responsibility activities in their annual reports. In addition, this research also educates society with types of Corporate Social Responsibility activities commonly applied and implemented by those companies listed in Indonesia Stock Exchange for these past few years.

1.5. Scope of Research

The focus analysis of this research will study samples from populations on both manufacturing and mining companies listed in Indonesia Stock Exchange, with criterias as follow :

1. Samples used in this research are taken nfrom manufacturing companies and mining companies in Indonesia.
2. Companies are listed in Indonesia Stock Exchange (IDX) from year 2009 until 2011.
3. Research subjects are the annual reports of the sample companies.
4. Corporate Social Responsibility activities are disclosed in the annual reports.

1.6. Writing Scheme

In order to ease this research, this research is divided into five chapters, which are as follow :

Title of the research :

“The Impact of Corporate Social Responsibility Disclosures on Companies’ Profitability Performance: an Empirical Study of Companies Listed on Indonesia Stock Exchange”

Chapter I INTRODUCTION

In this chapter, it will discuss more about the background of this research, research problems, purposes and benefits of conducting this research, scope of the research, and the writing scheme of this research.

Chapter II THEORITICAL BASE AND HYPOTHESIS DEVELOPMENT

This chapter covers theoretical explanation of Corporate Social Responsibility, principles and definitions regarding Corporate Social Responsibility, benefits of implementing Corporate Social Responsibility principles, types and examples of Corporate Social Responsibility activities, Indonesian legal basis regarding Corporate Social Responsibility, Corporate Social Responsibility Disclosures, Return on Equity and its relationship with Corporate Social Responsibility Disclosures, conceptual framework, hypothesis formulation, and some of previous researchs regarding Corporate Social Responsibility and Corporate Social Responsibility Disclosures related to company profitability performance.

Chapter III RESEARCH METHODOLOGY

In the third chapter, it covers population and samples used in this thesis, data collection techniques, research empirical model, definition of operational variables, methods of analyzing data, goodness of fit test, and also hypotheses

tests, including both simultaneous significance test (F-test) and partial significance test (t-test).

Chapter IV DISCUSSION AND ANALYSIS

This chapter covers overview of the research objects and variables, data analysis (including descriptive statistics, classical assumption test, goodness of fit test, and hypotheses test), discussions related to the results, and the relationship between Corporate Social Responsibility Disclosures with Return on Equity as a part of company profitability performance.

Chapter V CONCLUSION AND RECOMMENDATIONS

This chapter contains conclusion from the entire research and discussions that previously had been done. This chapter also covers useful suggestions and recommendations for the future researchs and other companies in Indonesia.