

CHAPTER I

INTRODUCTION

A. Background of the Research Study

Since year 1990s some of Indonesian companies already do the social program as the program to communicate to the society through community relations/community development program. Companies done the community relations / community development programs are the companies that using the natural resources, such as OGM (oil, gas, and mining), plantation, companies that produce waste, and the others. Those companies tried really hard to do the Corporate Social Responsibility (CSR); they even use the communication estimation to do the CSR. Business development and global demand for all the business sectors to do the fair business and using ethics make a CSR activity grow well.

Although the CSR has been practices since 1990s in Indonesia, the first legal basis was only issued in 2007 through Limited Liability Company Law (Law Number 40 Year 2007) and Investment Law (Law Number 25 Year 2007). The laws assert the purpose of CSR policy as follows: (1) to optimize the role of private sector in building a welfare society, and (2) to reduce the potential for social gap between “company community” and “local community” who live in area surrounding the company’s operation area (Law Number 40 Year 2007, s. 5; Law Number 25 Year 2007, s. 4) and also Article 74 of Indonesia’s Limited Liability Company Law mandates that companies

involved in operations that affect natural resources create and implement corporate social responsibility programs. Companies that do not carry out or implement “social and environmental responsibility” programs will be subject to government sanctions.

CSR embodies an organization’s behaviors that contribute to societal good (Sen and Bhattacharya, 2001; Smith, 2003). McWilliams and Siegel defined CSR as the actions that appear to further some social good, beyond the interest of the firm and that which is required by law (McWilliams and Siegel, 2000). It can be concluded that CSR is the actions in which the firms take into account their involvement in the social activities as well as mitigate the effects of their business on the community and natural environment, whether CSR might be an advantage or disadvantage for the firms depended on the CSR applied by the firms.

Coffey and Fryxell (1991) found that corporations with high levels of CSR are attractive to investors, especially institutional investors. Consistent with these findings, Waddock and Graves (1994) found that institutional investors and CSR are significantly positively related. The growing dominance of institutions in the capital market is reflective of the concentration and increasing wealth of these institutional investors (Brancato and Gaughan, 1991). As a result, institutional investors’ decisions in the capital market would likely relation companies stock values. Thus, companies that are concerned about their financial performance should also be concerned about maintaining high levels of CSR that have the high relation of the investors’ decision. Hence, corporate social activities are becoming part of

normal company operations considerations to make a good impression to the investors that impact to their decision in investment.

While international organizations like the Organization for Economic Co-operation and Development (OECD) and United Nation (UN) envision CSR as a comprehensive management paradigm that includes concepts like human rights, employee relations, environment and science, bribery and corruption, consumer interests, and taxation, the understanding of CSR in Indonesia tends to focus on community development, economic development, educational projects and programs. This is at least in part caused by the fact that such projects are often required in the environmental relation permits of resource extraction companies, who undergo a good deal of domestic and international research of their operations. Because a lot of resource extraction activity occurs in remote and rural areas where government services are limited or absent, these companies face very high community expectations to provide such services themselves. Despite significant investments – especially by large multinational firms – in CSR projects, there is limited general awareness of those projects, even among government regulators and officials.

In recent day, the demand to do the CSR are increasing, it's including the companies in Indonesia, especially when the companies wants to strengthen their position and power in global market or even when the companies just try to make a relation with the companies from a develop countries to make a joint venture or such things. Usually the business partner would asks about the company's CSR program that company have and done,

in another way, it can be said that CSR as a business stimulant for companies to strengthen the power and position in the market. Based the previous research study which conclude that only several Indonesian companies and disclose enough information about the companies' CSR program, such as Djarum Tbk., Unilever Indonesia Tbk., Astra International Tbk., Aqua (Danone), Indosat Tbk., and several mining companies from all the PLCs in Indonesia, this study's purpose is to find the relation or relations of the CSR disclosure towards the IO in Indonesian companies' to develop the Indonesian business economic for being global.

When companies tend to do the CSR, they have to know about the CSR itself, CSR is a commitment to improve community well-being through discretionary business practices and contributions of corporate resources (K Kotler, P., and Lee, N. (2005) Corporate Social Responsibility, John Wiley and Sons, Inc., Hoboken, New Jersey, page 3). It can be said that CSR is the important instrument to support the company strategic to get the image that they want and the commercial goals. Based on Kotler and Lee concept of CSR, there are 6 options:

- 1) Cause promotion, it's when company gives sponsor to a CSR activity that recently being the society concern to gain the company image.
- 2) Cause-related marketing, the companies gives a donation as the result of the products selling; many Indonesian companies implement this option especially when it comes to a special time such as Idul Fitri, for example some companies make an advertisement that said "one packaging for one meal" it's usually happen in Ramadhan, but there

also some companies that usually do that not only in specific time, for example Aqua-Danone, the company gives a donation for those who need clean water in Papua for every specific amount of mineral water sold.

- 3) Corporate social marketing, usually the companies' gives a campaign to change the society habit.
- 4) Corporate philanthropy, the companies will give a donation for them who are needed, this option usually choose by Indonesian television companies, they will choose specific person who has a touching story of their life to be help and then publish their story in a programs that related to humanity.
- 5) Community volunteering, in nowadays, many companies already allocated few hours per year from the employees' working hours for the social work this activity counted in Key Performance Indicator (KPI) for each employees.
- 6) Social responsible business practices, the point is to adopt the practical business that match with the social issue that happen in that time.

Those six options can be used by the companies that want to do the CSR, but the companies need to consider about the vision and mission of the company also. Based on the Philip Kotler and Nancy Lee's book, the successes of CSR is about how it will support the company to achieve the goal. The company has to select the right option of the CSR programs that compliance with the company's vision and mission, so that they can gain the

company's image for the future which show the vision and mission of the company to show the company's character, the image and character that public will always remember, because CSR are really powerful to build the future market, build the image now, get the result later, it's how CSR works.

The growth in shares held by institutional investors will increased considerably when the companies adopt the CSR, because CSR consider as an important object in companies activities, it's said that CSR is a general statement to indicating a company's obligation to utilize it economic resources in its business business activities to provide and contribute to its internal and external stakeholders (Chapple and Moon, 2005; Vilanova et al., 2009; Kok et al., 2001). In an effort to meet all stakeholder expectation, companies need to improve CSR while also improving financial performance. Waddock and Graves (1994) put forward two theories to explain the causality relationship between CSR and financial performance: *slack resource theory* and *good management theory*. Under *slack resource theory*, a company's improved financial performance may result in the availability of excess funds that can be used for CSR activities. Thus, conducting CSR requires the use of funds obtained from the success of financial performance. According to this theory financial performance comes first. The *good management theory* holds that CSR come first. Based on this theory, a company perceived by its stakeholders as having a good CSR reputation will be more attractive in such a way that it will lead to improved financial performance through market mechanism.

In early 2000s, although there are so many companies that listed in the Indonesian public listed companies, but only several companies that really realized about the importance of CSR and do the CSR, but as the development of the CSR in Indonesia and the government also realize about the importance of the CSR for both society and companies, because those CSR done by the company can help people who needed but cannot reach by the government yet and also, those CSR can build the companies' image to make a strong image for the future market that attract the institutional investors and make a better economic condition, based on that knowledge, nowadays many Indonesian companies start to do the CSR. Recently when many Indonesian companies start doing CSR, those companies will also tried to be as transparent as they can, because the investors need to know what their CSR programs and approximately how much they spend for those CSR activities that can consider as how strong the image the companies want to build, but still the transparency of the CSR in Indonesia is less than the other countries. This study purpose is to discover if there is any relation of the CSR done by the company toward the Institutional Ownership (IO) in Indonesian companies, and also did the disclosure of the CSR or Corporate Social Responsibility Disclosure (CSRSD) has an important role to measure the CSR value done by the company, so that the company would know about the importance of CSRSD for the growth of the company and the development of the business. In 2009 the Indonesian Biodiversity Foundation KEHATI and IDX launch the Indonesian Stock Exchange KEHATI-SRI Index to track the performance of Indonesian "corporate champions" with good sustainable

business practices. It also sets a reference and benchmark for best practice performance for investors and corporations.

B. Problem Formulation

Based on some news about CSR in Indonesia, the Indonesian companies' awareness of CSR is still low, it is because the meaning of CSR and the purpose of CSR in Indonesia still debatable. A lot of Indonesian companies does CSR programs that not fit with their image and did not compliance with the companies' vision and mission, the other companies does the CSR that only brought profit but actually the companies doesn't consider the properness of doing those program in Indonesian society. Based on that fact, only several companies are transparent report about the companies' CSR activities, the transparency can be consider with the company gives the explanation and the amount of the companies' spending for the CSR activities. The big and trusted companies usually being transparent about the CSR report, usually those companies are powerful companies that already gain people's trust and have a strong image for those CSR programs that they done, the big companies that give clear CSR report in their annual report such as Danone, Djarum, Unilever, Astra International, Perusahaan Gas Negara.

In other country such as Malaysia, companies in Malaysia already give full report of the CSR they had done, they give the description and even the amount of money they spent for those CSR program. In prior study in Malaysia, a research conduct by Saleh, Zulkifli, and Muhamad, that try to

figure out is there any relation of CSRD toward IO proved that there is a positive and significant relationship between CSRD and IO. The research confirms that increased active involvement and promotion of CSR activities brings together the interests of stakeholders, therefore having a positive on IO, the research also proved that a disclosure of CSR activities can also be used as leverage to attract institutional investors to actively invest in Malaysian PLCs that have solid platforms for socially responsible practices (Saleh, Zulkifli, and Muhamad, 2009). In Indonesia there is a similar research with the research conduct by Saleh, Zulkifli, and Muhamad, it conduct by Fauzi, Mahoney, and Rahman in year 2007, but it's failed to find the relation of CSRD toward IO in Indonesian company. The research failed to find the relation of CSRD and IO in Indonesia because the research only uses one year annual report in year 2005. In year 2005 many company hasn't realize about the CSR and doesn't including the CSR report in their annual report, and also Indonesian government hasn't make the regulation about the CSR in that year. The main idea of this study is try to find the relation of CSRD toward IO in Indonesian companies with a better CSR report of each companies that listed in Sri-Kehati index which is an index of Indonesian Public Listed Companies (PLCs) that has a good performance and CSR activities and also using 6 years data (2007-2012) to make the data more valid, by using this study, hopefully Indonesian companies will realize the importance of the CSRD to develop their business. Is it corporate social responsibility disclosure (CSRD) impact toward institutional ownership (IO) in Indonesian companies?

C. Scope of the Research Study

Nowadays in Indonesia, many companies didn't give the full report of the CSR program they had done in their annual report, only several companies would give the transparency of the CSR report, for example Djarum, Tbk., Unilever, Astra International, Aqua (Danone), Indosat, and several mining companies from hundreds PLCs in Indonesia. From those PLCs in Indonesia, the companies that give a really good CSR programs that fitted with the companies' image and gave a full transparent report of the CSR programs or can be said that the companies disclose a lot of their CSR program, those companies will be chosen by the Indonesian Biodiversity Foundation KEHATI. The KEHATI organization will only choose the companies with a good business practices. In order to make the study be more focus on identify the relation of CSRD toward IO in Indonesian companies, the authors will give the scope that will focused on KEHATI-SRI index in Indonesia using 6 years data, 2007-2012, and using the CSR report that written in companies' annual report about the information of the CSRD that done by the company. The authors choose KEHATI-SRI index or Sri Kehati index, because Sri Kehati index using the 25 stocks selected that apply good governance principles and concern for the environment. There are few selection steps by the Sri Kehati index the initial selection is made to pick stocks that could potentially become members of the index, namely taking into account the following criteria:

- 1) Total Assets. Total assets present the size of the Issuer, the issuer-the issuer that has total assets of Rp1 trillion based on annual auditan financial statements.
- 2) Price Earning Ration (PER). PER issuer is included in this criterion is that has a positive value.
- 3) Free Float Ratio. Free float or share ownership of the public must be greater than 10%. From the initial selection were obtained a list of names issuers potentially will be selected to be listed in Sri Kehati index.

The standards above already eliminated a lot of stocks, but it's still contained the list of companies stock that will be chosen further more. Next to choose the best 25 stock, those list of names that potentially chosen will be ranked further by considering the aspect of fundamental namely by consider 6 major factor as follows:

- 1) Environmental
- 2) Community
- 3) Corporate governance
- 4) Human rights
- 5) Business behaviour
- 6) Labour practices and decent work

Based on those long selections method that Sri Kehati index use which use the fundamental factors usually use for the CSR. The authors tend to use the index because the long selection method that Sri-Kehati index consider the fundamental aspect which is the aspect made the CSRD score of each companies.

D. Research Motivation

This study based on the previous studies in some countries that already proves that the CSRD has relation toward IO, which usually the increasing of the CSRD done by companies, the IO would also increasing. For example in Malaysia, the increasing of active involvement and promotion of CSR activities brings together the interests of stakeholders, therefore having a positive on IO, and also disclosure of CSR activities can also be used as leverage to attract institutional investors to actively invest in Malaysian PLCs that have solid platforms for socially responsible practices. Based on that statement, the author try to discover if that statement also affected for Indonesian companies, did the disclosure of CSR activities of Indonesian PLCs will affected IO's.

E. Benefits of the Research Study

- a. For The Writer: the benefits of this study for the author is to prove the relation of the disclosure of CSR in Indonesian PLCs toward IO in recent year, so the author can discover the development in Indonesian CSRD and IO.
- b. For The Companies: if this study can prove there is relation of CSRD toward IO, companies can use this study as the consideration to disclosure the CSR activities that the companies done to attract the IO, because the institutional investors may feel more secure if they retain their portfolio investments in the companies that are actively engaged in CSR practices.

c. For The Readers: this study can give more knowledge for the readers about the importance of CSR activities that conduct by the companies and the disclosure of the CSR will have relation toward institutional investors' decision or not. It will show the different side of the importance of CSR in Indonesia.

F. Objective of the Research Study

This study try to discover CSR activities which are represented by CSRD in Indonesian PLCs annual report and its relation toward the IO. Saleh, Zulkifli, and Muhamad (2010) try to discover any relation of CSRD toward IO in Malaysia; the research proved that there is positive relation between CSRD and IO which mean the increasing of CSRD in Malaysian PLCs, have the positive and significance relation with the institutional investors' decision for their investment. The research confirms the increasing of active involvement and promotion of CSR activities brings together the interests of stakeholders. The research also proved that a disclosure of CSR activities can also be used as leverage to attract institutional investors to actively invest in Malaysian PLCs that have solid platforms for socially responsible practices

Teoh and Shiu (1990) observe the institutional owners' attitudes towards CSR and sources of information about the activities. They discover that the investors does not usually change their decisions about their investment on the basis of company's statement around CSR that is contained in the annual reports. Otherwise, the institutional investors accept CSR information in the account if they are being tuned on the specific issues, and

being obtained from the disinterested parties. Graves and Waddock (1994) try to explore the relations between corporate social and IO. The study used a single value of social performance index for the measurement of eight characteristics of the social performance developed by Kinder, Lydenberg, Domini and Co., Inc (KLD) and they formed two models. The results of Graves and Waddock (1994) study show that the performance and number of institutions that hold stocks of a corporation are positive and significantly related, they conclude that involving in CSR activities invokes no negative response from institutional investors.

Mahoney and Roberts (2007) examine the relations of corporate social responsibility on financial performance and institutional ownership, they used four years panel data for a sample of Canadian companies. The research found that there is no significant relation of companies' composite social measure on the number of institutions investing in the companies' stock. The research also found that the relation of firms' social ratings regarding their international activities and product quality towards the number of IO is significant.

Neubaum and Zahra (2006) studied about the link between the IO and social performance of the Fortune 500 companies in the U.S. The study discovered that a relation between the IO and social performance is significant and positive if long-term ownership exist.

Based on those previous research, it is proved that theoretical and empirical relations between CSR and institutional investors exist. Spicer (1978) argues that, institutional investors would consider firms with low

social responsibility as becoming riskier investment. The risk emerges from the possibility of damaging sanctions resulting from legislative action or regulation action, decision of court, or consumer of relation. Heiner (1989) stated that institutional investors are more able than the individual investors to absorb and arrange information about the activities of CSR. Conclusion from the previous researches is that most of the studies in developed market found positive significant relationships between CSR and institutional investors.

This study will try to examining any relation of CSRD toward IO in Indonesian PLCs. This study will use IO as dependent variable is presented by number and percentage of shares owned by institutional investors, and CSRD as independent variable represents CSR activities of PLCs in Indonesia.

G. Research Report Outline

This thesis consists of five chapters:

Chapter I: Introduction. The first chapter consist the background of the study, which the author think the CSR in Indonesia quite interesting, because even almost all the Indonesian companies start to do CSR but not many of those companies really know the importance of the CSR and its disclosure can relation to the institutional investors decision. This chapter also explain about the limitation of the study which conduct in Indonesia using 25 companies that the stocks listed in KEHATI-SRI index and

using 6 years data, 2007-2012, it because KEHATI-SRI index is the stock index in Indonesia that make the selection using fundamental aspects that related to the variables of CSRD score of each companies. This study is quite interesting for the authors, not many information about the prior study of this topic in Indonesia, because not many people already realize the CSRD relation the institutional investors decision, but the companies itself has to consider about the companies performances and financial performances to attract the investors, greater amount the companies spent for the CSR program mean that the better company performance that the company have.

Chapter II: Theoretical Background. This chapter consists of the brief description about the previous study about the relation of CSRD toward IO in many countries, also a brief description about the other research related to the study that can support the study, and also a description about all the variables used in the study and hypothesis development in the study.

Chapter III: Research Methodology. In this chapter the authors try to explain about the research sample which is the companies the stock listed in KEHATI-SRI index and using 6 years data, 2007-2012, annual report data of each company. The data used in the study were found in companies' website or Idx, because the data used is the data from annual report of each company. Variable used in this study are independent and dependent variables. Dependent

variables represented by the number and percentage shares held by the institutional investors. Independent variables represented by the CSR and dimension of CSR that used to scoring the CSR and also the set of control variables. The analysis tool of the study is Generalized Least Square (GLS) which is more appropriate method compared to Ordinary Least Square.

Chapter IV: Data Analysis. This chapter consists of the data analysis that the authors get from the data that the author gather. The regression result of the data.

Chapter V: Conclusion. This chapter would explain about the data result, did the CSR relation the IO, how to implicate the conclusion from the study, the limitation of the study, and the suggestions for the other researchers that will conduct a research with the same topic.