THE EFFECT OF CORPORATE SOCIAL RESPONSIBILITY ON CORPORATE RISK: THE MODERATING ROLES OF INTELLECTUAL CAPITAL AND BRAND REPUTATION

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DECLARATION OF ORIGINALITY

I am, Aini Musfiroh, hereby declare that this thesis is real and accurate to be my own work, especially written for partial requirement to complete Undergraduate Program of Accounting, and has not been presented in any other occasion before. I bear full responsibility for my undergraduate thesis.

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MOTTO AND DEDICATION

But Allah is your protector and He is the best of helpers.

(QS Al Imran: 150)

And you see the mountains, thinking them rigid, while they will pass as the passing of clouds. [It is] the work of Allah, who perfected all things. Indeed, He is Acquainted with that which you do.

(QS Naml: 88)

And let not their speech grieve you. Indeed, honor [due to power] belongs to Allah entirely. He is the Hearing, the Knowing.

(QS Yunus: 65)

I dedicate this thesis to:

My beloved mom, dad, sister,

and brother

My beloved family

My very best friends

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ABSTRACT

This research is conducted to analyze the effect of corporate social responsibility on corporate risk (total risk) with role of moderating variables: intellectual capital and brand reputation from manufactured companies listed in IDX during the period of 2014 to 2016.

The sample data used in this research are companies listed in IDX and publish their annual reports during 2014-2016 where data can be used to calculate all the required variables. Based on the sample selection technique which is purposive sampling method, there are 360 companies that meet the criteria of the sampling method.

This research has met the classical assumption test (normality and multicollinearity) and then performed statistical F-test and t-test. From the result of hypothesis testing, it can be concluded that CSR has a negative and significant effect on corporate risk, IC does not moderate the relationship between CSR and corporate risk, BP moderates the relationship between CSR and corporate risk.

Keywords: CSR, corporate risk, intellectual capital, brand reputation.

ABSTRAK

Penelitian ini dilakukan untuk menganalisis pengaruh CSR terhadap risiko perusahaan (total risk) dengan peran variabel moderasi yaitu intellectual capital dan brand reputation pada perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia selama periode 2014 sampai 2016.

Sampel data yang digunakan dalam penelitian ini adalah perusahaan yang terdaftar di IDX dan menerbitkan laporan tahunan selama periode 2014 sampai 2016 di mana data tersebut dapat digunakan untuk menghitung semua variabel yang dibutuhkan. Berdasarkan teknik pemilihan sampel yaitu dengan metode purposive sampling, terdapat 360 perusahaan yang memenuhi kriteria pengambilan sampel.

Penelitian ini telah memenuhi uji asumsi klasik (normalitas dan multikolinieritas) dan kemudian dilakukan uji F dan uji t. Dari hasil uji hipotesis yang dilakukan, dapat disimpulkan bahwa CSR memiliki pengaruh negatif dan signifikan terhadap risiko perusahaan, IC tidak memoderasi hubungan antara CSR dan risiko perusahaan memoderasi hubungan CSR dan risiko perusahaan.

Kata kunci: CSR, corporate risk, intellectual capital, brand reputation.

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CHAPTER I

INTRODUCTION

1.1 Research Background

Globalization is the result of a social process that creates, extends, and cultivates interdependencies and exchanges of information around the world and increases the awareness of enhancing individual interconnection between local and distant (Smallman & Brown, 2011). Therefore, globalization offers many opportunities between groups to cooperate and expand the relationships between them as well as between individuals. Rapid rates of the development of technology, the easier to establish cooperation, and quicker of gaining information are the examples of the advantages of globalization. However, the impact of globalization can be a challenge for companies because globalization is a source of uncertainty and risk (Ktyle & Ruggie, 2005). Globalization increases interdependence and uncertainty in business conditions that lead to an increased risk that faced by firms (Ktyle & Ruggie, 2005).

Corporate risk is a fundamental metric in finance (Hamilton, 1994). Corporate risk can be interpreted as a bad event that has a negative impact on the company. Risks can affect a company's decisions because of the changeability of business conditions and this uncertainty is a constraint for companies to achieve their goals. When the company runs its operations smoothly with the help of forecasting and strategy, it will be influenced by risks that can damage the company, such as the declining in purchasing power, unfavorable government rules, unstable economic and political conditions, product defects, and service errors will harm the company's financial performance. Therefore, firms need to manage risk well to maximize the company value (Fatemi & Luft, 2002). Thus, firms that face lower risk will be more confident in achieving their goals because they can increase stakeholder trust and overcome the problem of uncertainty.

Over the years, firms have been interested in risk management; they realize the importance of risk management. The objective of risk management to be achieved is in managing the company to prevent firms from default risk. Moreover, going concern is the focus of companies where they need to prevent financial losses by reducing the likelihood of risk that can harm the company, such as the risk of lack capital, the risk of default, volatility incomes, the risk of sanctions, negative event threats.

There are two types of total risks, including systematic risks and unsystematic risks. Systematic risks are also called as market risks or general risks; it comes from external market factors like economic conditions and inflation. Unsystematic risks are also called firm-specific risks are affected by internal factors such as strategic decisions, product defects, and service failures (Kim, Y *et al*., 2013).

Based on previous research, corporate risk can be measured by volatility stock return. Volatility stock return is necessary topic to be discussed because higher volatility stock return leads to vulnerable cash flow and harder financing fulfilled (Fama & French 1992; Markowitz 1952). Therefore, higher volatility stock return experienced by firms will indicate greater uncertain financing in the future. Thus, it implies more difficult for firms to obtain trust from investors, moreover when firms face risk in declining stock return continuously. Therefore, higher volatility stock return cause greater risk that the firm faces, which is included as harder to manage its capital funding from external parties, harder to maintain income and wealth in the long run.

One of the main objectives of a company is to maximize profit. It can encourage a company to do inappropriate decision which is only based on internal needs. However, some operations are very influential to the internal and external parties. Therefore, firms are high pressure to behave ethically towards the society and protect the environment (McWilliams, 2000). Effective stakeholder management may be a tool to successfully resolve dilemmas such as generating high returns for shareholders, while at the same time meet the expectation of other stakeholders (Freeman, 1984). In the recent decades, the awareness of behaving socially responsible has increased and it is important for companies to consider it (Walker *et al*., 2008). Besides, employees, consumers or society as a whole have become increasingly sensitive to the social performance of companies and the degree of social responsibility displayed by companies (Harrison & Freeman, 1999).

Firms are no longer expected to be a self-centered entity, it will lead to isolating itself from the community in which they work, thus it causes to negative reputation because the community will criticize what firms do for their needs.

Firms must both efficiently focus on generating firm value for internal needs and improving the welfare of stakeholders in the long-run.

Accordingly, stakeholders require firms to not only provide quality services but also engage in activities to protect the economic, natural, and social environments of their local communities (Bohdanowicz & Zientara, 2008). In conducting its business, a company needs internal and external support, also legal operation. The involvement of company has a huge role in economic growth for Indonesia. But on the other side of its presence, a firm is not only encouraged to generate more profit and welfare for internal needs, but a firm is also encouraged to provide a positive impact on the welfare of stakeholders. Internal and external factors are very influential on the success or failure of the business. Firms are also vulnerable to external factors like communities perspective, governments' regulation, and global pressure. Accordingly, firms are pressured to engage in CSR as legal institutions who comply with government rules and they must realize that their operations influence toward internal and external parties.

By doing CSR, the company will improve the good relationship between a firm and stakeholders like investors, the government, and banks that play role in their investment decisions (Meij, 2016). There are many benefits of implementing CSR, one of them is information from firms become more transparent. By transparent information, it will reduce asymmetries information between firms and stakeholders, thus it will reduce corporate risk. Cheng *et al*. (2011) argue that firms with better CSR performance face lower capital constraints. CSR activities provide product knowledge to consumers by distributing safe products, doing social activities, and giving stakeholders' rights. CSR activities are also useful to distinguish itself from competitors. It also leads to consumer's awareness of the existence of the company's products so as to improve the company's brand position. Thus, it can make companies get more capital easier. There are many reasons for firms to engage in CSR but maybe even more important is that when organizations are not engaging in CSR, they may face risks, for example reputational damage and legal sanctions (Alder & Gooch, 2013).

An excellent CSR reduces the changeability stock return that influenced by the sensitivity of prices to market conditions, that reflects as changes in inflation or interest rates, that happens on all stocks. The favorable image of being a "good citizen" in product and equity markets motivates investors to invest and retain the shares of a firm (Fombrun *et al.*, 2000; Godfrey *et al.*, 2009). When a negative event occurs, the reputation of being socially responsible mitigates the negative assessments and the resulting sanctions for a firm (Godfrey, 2005), therefore will reduce the changes in stock return's movements which comes from the market conditions.

Some researchers state that CSR has a significant and negative effect on total risk. There are Meij (2016), Jo & Na (2012), Salama *et al*. (2011), and Spicer (1978) the first researcher that investigates the integration between CSR and corporate risk. However, there are the different results on the integration between these variables, such as Chen *et al*. (1980) that examine the integration between CSR and financial performance, where total risk is used as one of the indicators of financial performance. They argue that there is no significant relationship between

CSR and total risk. Another researcher is Kim (2010) find CSR has a significantly positive effect on total risk. So, this research is interesting because it is useful to investigate the research gap, it is also useful to improve evidence about the correlation between CSR and corporate risk.

Over the last few decades, many researchers have been investigated the relationship between corporate social responsibility and financial performance (e.g., Griffin & Mahon 1997; Waddock & Graves 1997; Orlitzky *et al*., 2003; Barnett & Salomon 2006; Surroca *et al*., 2010). This research will be an interesting topic because the integration between corporate social responsibility and corporate risk remains lack to be investigated mainly in Indonesia. Over the years, firms begin to be interested in disclosing corporate social responsibility activity, however, many firms have not yet disclosed their corporate social responsibility, and the reason is that corporate social responsibility activity can lead to increasing costs, moreover when firms are involved in income decline. So, it is an interesting discussion to test the trade-off between investment in the form of corporate social responsibility and corporate risk is worth it. Therefore, this research can also be useful to motivate firms to engage in behaving socially responsible.

The difference between this research and previous research is intellectual capital and brand reputation placed as moderating variable for the integration of corporate social responsibility and corporate risk. Some research argue that CSR has negative and significant effect on corporate risk. Investors can attribute poor CSR reputation of a firm to poor management (Alexander & Buchholz, 1978) and consider such firm as a risky investment (McGuire *et al*., 1988). For example, when companies are not actively publishing their CSR activities, particularly firm caused environmental damage such as avalanche, waste disposal, environmental pollution, thus communities may claim that a company is environmentally irresponsible. By contrast, other scholars suggest that focusing on CSR distracts firms from their core businesses and drives them to allocate their resources to matters irrelevant to their mission (Friedman, 1970). For example is a company that allocates high cost for CSR activities may cause disadvantage outcome, moreover when communities know the intention of firms in engaging CSR only for generate more profit in short-run, thus its benefits are not balanced with the cost incurred. Therefore, firms need to manage cost allocation, thus CSR will become a good investment. Accordingly, the writer is interested to investigate whether the high quality of mangers (in the form of high intellectual capital) will help in managing the cost incurred of CSR activities. Therefore, firms with higher intellectual capital will face lower risk.

Some scholars suggest that CSR may have a negative influence on the company when CSR activities are not clear felt by stakeholders (Jo & Na, 2012). Moreover, when stakeholders know the intention of the CSR project is only to increase profit, rather than doing the right thing, thus stakeholders will criticize this intention (Lindgreen & Swaen, 2010). Therefore, companies need to create good relationship with stakeholder and build good image. Accordingly, the writer is interested to investigate whether firms with better reputation may increase stakeholders' trust and firms will face lower risk.

According to Peloza (2005), the reputation of a firm is probably the most valuable asset of any firm and managers will do anything to protect it. A related phenomenon in Indonesia such as The Food and Drug Monitoring Agency (BPOM) has revoked the distribution licenses for four instant noodle products from Korea that contain pork. The four products are Samyang's U-Dong, Nongshim's Shin Ramyun Black, Samyang's Instant Noodle Kimchi (Kimchi-flavored Instant Noodle) and Ottogi's Yeul Ramen for containing pork but did not announce it on the packaging of the products.

According to Meij (2016) consumers punishing bad behavior more than rewarding firms for good behavior. Lapindo Brantas is a case in point, Lapindo mud disaster in 2006 have embarrassed the Indonesian government because it is owned by the family of Aburizal Bakrie, the Minister of Social Welfare that period. Although Lapindo Brantas has denied the allegations of this incident due to drilling errors, but Lapindo Brantas said that it was due to tectonic earthquakes or natural disasters. The effect of this incident was still felt in 2016 when Lapindo Brantas planned to conduct gas drilling activity again but it has not been allowed by the Ministry of Energy and Mineral Resources, the public response was also negative, causing protests, and public worries. Even though the compensation was in line with residents' needs. They still opposed the gas drilling activity as they were traumatized by the Lapindo Brantas mudflow disaster. It means that residents argued exploration activity may cause the same disaster again. So, when firm already has a bad image it will be difficult to get resident's trust again, means that it is difficult to restore the good image by directly engaging in CSR.

According to Chen *et al*. (2010) intellectual capital (IC) has a strategic and crucial role within firms, because one of the efforts in achieving firms' goal is to increase its intellectual capital. Public (2000) described that intellectual capital consists of human capital and structural capital and it needs capital employed to achieve the value creation. PT Unilever Indonesia is a phenomenon in point, PT Unilever Indonesia is ranked first the largest company in Indonesia, Forbes version in 2016. As we know, innovation is one way for success to be achieved. Innovation is the result of the experience, idea, and superiority of human resource. It includes the components of intellectual capital. Innovations are made by Unilever Indonesia that lead to more successful than other large firms are by providing sachets, bottles, packaging and press packaging in a variety of products. The products are cheaper than the rivals with the same quality.

Based on these reasons, the researcher is interested to investigate the integration between CSR on corporate risk. Then, the title of this research is about **"The Effect of Corporate Social Responsibility on Corporate Risk: The Moderating Roles of Intellectual Capital and Brand Reputation".**

1.2 Research Problems

Based on these considerations, then the formulation of problems and restrictions in this research is to determine the effect of CSR on corporate risk and to investigate the effect of intellectual capital and brand reputation on the integration of CSR and corporate risk. Therefore, according to the background that has been examined, then the research problems of this research are as follows:

1. Does corporate social responsibility have a significant and negative effect on total risk?
2. Does CSR induce the greater decrease in total risk for firms with the higher intellectual capital than for firms with the lower intellectual capital?
3. Does CSR induce the greater decrease in total risk for firms with the higher reputation than for firms with the lower reputation?

1.3 Research Objectives

According to the research problems above, the objectives of this research are:

1. To analyze and conduct a research on the effect of CSR on total risk.
2. To analyze and conduct a research on CSR induces the greater decrease in total risk for firms with the higher intellectual capital than for firms with the lower intellectual capital.
3. To analyze and conduct a research on CSR induces the greater decrease in total risk for firms with the higher reputation than for firms with the lower reputation.

1.4 Research Benefits

According to the objectives research, this research can provide benefits to:

1. For academics

   The research is expected to provide more knowledge about the effect of CSR on corporate risk, intellectual capital and brand reputation can moderate the relation between CSR and corporate risk.

2. For companies

   The results of this research is useful for providing evidence on how CSR can mitigate risk, it can also encourage companies to implement CSR.

3. For investors and potential investors

   It is to provide information on how they have to consider corporate risk, CSR, intellectual capital, and brand reputation before they make an investment in the companies.

4. For further researchers

   The result of this research is expected to be developed by the further researchers. They can add any contributions so it will be more useful and it has additional information for the users.

1.5 Systematic Writing

The systematic in writing this thesis are as follows:

CHAPTER I INTRODUCTION

This chapter explains the description of the topics to be discussed. It also describes the background of the problems on which this research is based, the research contribution, the objectives and benefits of the research.

CHAPTER II LITERATURE REVIEW

The literature review contains the theoretical review which the research is used, some of the previous research and the results. This chapter also contains conceptual framework that underlies the hypotheses to be tested and explains how the writer could conclude the hypotheses.

CHAPTER III RESEARCH METHOD

This chapter describes how the research will be carried out operationally. Therefore, this chapter discusses the variables and the definitions of the variables, population, samples, sources of data, data collection methods, and analysis data.

CHAPTER IV DISCUSSION AND ANALYSIS

This chapter contains the description of the object of research, quantitative analysis, and the interpretation of the hypothesis testing results.

CHAPTER V CONCLUSIONS AND SUGGESTIONS

This chapter is the last chapter in thesis writing that contains conclusions, limitations, and suggestions for further researcher.

ATTACHMENT

The attachment contains the list of sample companies and the results of measuring the effect of CSR on corporate risk and the effect of intellectual capital and brand reputation on the integration between CSR and corporate risk.