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# CORPORATE SOCIAL ENVIRONMENTAL RESPONSIBILITY EXPENDITURE, FOREIGN INVESTMENT AND CORPORATE FINANCIAL PERFORMANCE

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### ABSTRACT

The accounting system of corporate social and environmental responsibility (CSER) costs is still unable to disclose and accumulate the true value of CSER activities. The costs of CSER is known as CSER expenditure. The CSER expenditure consists of three elements namely expenditure of environmental management, expenditure of social contribution, and expenditure of research and development of production. The purpose of this study is to examine the relationship between the elements of CSER expenditure on foreign investment activities and its impact on corporate financial performance. Sample of this study consists of 132 manufacturing companies for period of 2012-2016. The results of this study show that the elements of CSER expenditure have significant influence on foreign investment and corporate financial performance.

**Keywords:** social environmental responsibility, expenditure, investment, financial performance

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### 1. INTRODUCTION

The concept and practice of social and environmental responsibility (CSER) is an activity undertaken by the company as a reflection of the implementation of business ethics in realizing the responsibility to society and environment. Implementation of CSER is not only as a cost of expenditure, but also as a long-term investment for the company. Unstable financial and economic conditions, changes in new economic situation, environmental degradation and climate change, wealth and poverty, widespread corruption, widespread conflicts in society and unstable social conditions are problems facing the corporation in carrying out its activities. Corporation face various risks to maintain corporation financial performance by increasing sales of products produced. Risks facing the company related to the interests of stakeholders are consumers, employees, shareholders, community and the environment and government. This is a challenge for companies in determining business strategy as the implementation of policy implementation in accordance with government regulations.

Government provisions in the implementation of social and environmental responsibility motivate companies to carry out their obligations to maintain a consistent social, economic and environmental balance in the long term. Provisions requiring companies to engage in social and environmental responsibility activities are contained in Article 1 point 1 of the Capital Investment Law No. 25 Year



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2007. The law emphasizes that investors are all forms of investment activities, either by domestic investors or a foreign investor to do business in the territory of the Republic of Indonesia. Purpose of the issuance of Capital Market Law is to provide legal certainty, existence of transparency and provide equal treatment to investors both from within and outside country. The obligation to carry out social and environmental responsibility for every investor is regulated in Article 15 letter b UUPM. 25 Year 2007 stating that every investor is obliged to carry out corporate social responsibility. The purpose of study is that corporate social responsibility is a responsibility inherent in investment company to keep creating a harmonious and balanced relationship. Although only some companies have not disclosed additional information regarding the amount of costs incurred in financial statements related to social and environmental responsibility activities.

Investors who will invest in Indonesia need information about ability of corporate that perform social and environmental responsibility obligations. This capability is demonstrated by an increase in performance that includes improved financial performance and increased investment. However, the main problem in disclosure of information in corporation annual report listed on the Indonesia Stock Exchange has not yet had awareness to disclose expenditures on social and environmental responsibility implementation obligations. In addition, regulator has not provided a provision on how to disclose information on minimum expenditure amounts for social and environmental responsibility activities presented in financial statements. Amount of expenditure used for implementation of social and environmental concerns of company has not been reflected in financial statements, so that implementation of social and environmental responsibility activities disclosed still can not describe whether corporate is able to allocate funds for purpose of improving the corporate financial performance.

Corporate that are able to manage finances, social and environmental well in the long term can show the sustainability. Company finance is sustained by corporate increasing revenue and lowering costs. Increased revenue can be seen from increase in sales. The increase in sales is related to corporate financial performance that shows the corporate reputation is also getting better. While the ability to use costs more efficiently, product refinement and innovation as well as lower costs in complying with regulations can minimize corporate spending (Belkaoui and Karpik, 1989, Bartolomeo et al., 2000, Schaltegger and Synnstedt, 2002, Carroll and Shabana, 2010). Expenditure in carrying out corporate social and environmental responsibilities becomes an important strategic corporate policy as an investment. This strategy policy is to reduce the pressure from investors, consumers, government and various stakeholders concerned. This policy is to increase public trust so as to attract investors to invest (Moser and Martin, 2012, Attig et al., 2014, Samet and Jarboui, 2017b, Samet and Jarboui, 2017a)

Research in the area of social contribution and environmental protection of firms associated with corporate investment has been widely practiced, as in Orlitzky et al. (2003); Verbeeten et al. (2016); and Lin et al. (2017). The result of the research shows influence of CSER disclosure on increase of company investment. Company investments can include environmental waste reduction, energy efficiency and environmental protection. Investments add economic benefits by increasing profitability as a corporate sales success. While long-term investment in form of benefits from intangible assets such as improving image of corporate through research and product development. With these concepts CSER activities can increase investment in corporate. Research that examines effect of CSER activities can increase investment from outside investment companies is still limited. This is very interesting when associated



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with state of manufacturing industry companies in Indonesia that still require foreign investment to build infrastructure projects because the budget required is very large.

Corporate in carrying out social and environmental responsibilities use funds derived from capital. A study examining effect of capital expenditures on CSER activities and their effects on corporate financial performance is now an increasingly interesting theme for research. However, there is still no research that examines the elements of capital expenditure used for social contribution and environmental protection associated with corporate financial performance. The amount of use of funds or expenditures for CSER activities can be used as a strategic consideration for the sustainability.

CSER activity disclosed in corporate financial statements can be used as a consideration of sustainability. Financial reporting trends that can demonstrate sustainability by business community continue to increase, but stakeholders doubt the value of corporate. Existence of such CSER activities may increase the cost of spending, which relates to reporting standards, guidelines and rewards. Reputable corporate demonstrate an effective ability to improve scope and technical quality of public reports. This ability can contribute to simple participation in environmental and social programs, which ultimately become solution provider to problem. In addition, corporate also considers Sustainability-Oriented Innovation (SOI) strategic approach in which CSER is part of a sustainable corporate culture and is naturally incorporated into product innovation in industrial enterprises (Calabrese et al., 2018, Maas et al., 2016).

The role of corporate social and environmental responsibility is becoming increasingly important, investment in environmental protection and social contribution has been a key strategic decision. Strategic decisions on social and environmental responsibility are used to reduce pressure from investors, consumers and other interested groups to increase the level of investment. Conventionally business leaders around the world believe that additional financial burdens and additional costs for the company serve as improving CSER performance, and this dominates the perceptions of various business sectors (Kolk and Pinkse, 2010, Deegan, 2002, Bhardwaj et al., 2018). This also applies to manufacturing industries in Indonesia, following government policies in spurring high economic growth, focusing on investing in physical facilities and social investment and contributing and preserving environment. Government policies that encourage companies to voluntarily make environmental and social investments. The second area deals with investment performance with respect to environmental performance (eg, environmental waste reduction, energy efficiency, etc.), economic benefits (eg, long-term cost reduction and profitability) and intangible benefits such as enhancing corporate image. Many research papers have been published in these two areas, but no empirical evidence has proven about the cost effectiveness of environmental protection and social contribution.

This study uses three types of costs incurred by the company for internal and external interests of CSER is social activity costs, cost of environmental conservation, and expenses incurred for research and development related to the sustainability of the company. Costs incurred by corporate for internal purposes affect corporate earnings, while spending on CSER activities both for individuals, communities and environment can not be accounted for as direct output (Yook and Kim, 2018). Besides, expense of doing research and development on industrial companies is very important for the sustainability of corporate and become the expenditure component that supports CSER activity. This study emphasizes the role of environmental accounting used in management and finance accounting. Information on the use of



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funds that can improve sales performance into information that can be forwarded to internal and external companies in the face of government policies in the implementation of CSER for liability corporation. Industrial companies in Indonesia motivated to perform CSER's obligations as an aspiration in maintaining social, economic and environmental balance. Government for the implementation of CSER can remain well implemented. By implementing the policy, companies can improve relational networks as effective stakeholder approach strategies. This strategy can improve corporation financial performance especially in manufacturing industry, where business activities have better economic, social and environmental impacts. Corporation can use legitimacy strategies involving grassroots organizations ie civil society and improve social policies between regulators and corporation related to the benefits of CSER (Zhao, 2012, McWilliams et al., 2006), in addition it affects the health, work safety and welfare of workers (Lin et al., 2017) especially in manufacturing industries whose production activities could damage reputation if the corporation fails to fulfill its social and environmental responsibilities (Wu and Chen, 2015, Jones et al., 2006).

The problem in this study began with the expenditure of CSER activity is still not much disclosed and considered expenditure elements can play a role in increasing foreign investment and company sales. Manufacturing companies are experiencing various obstacles in meeting the regulators' policies, so that a strategy to regulate the use of the issued funds can indicate future sustainability. Some manufacturing industries have not been able to manage finances well and disclose the amount of spending spent on CSER activity as information that supports investors' decision to invest. Corporate that are able to disclose and properly account for expenditure of social and environmental responsibility activities will increase sales. This study also aims to re-examine differences in results from previous studies which suggest that social and environmental responsibility activities are not able to improve performance as in research of Friedman (1979), Crisóstomo et al. (2011), Michelon et al. (2015), and Melloni et al. (2017). While some research on social and environmental responsibility activities is related to performance improvement Ullmann (1985), Balabanis et al. (1998) and Lys et al. (2015).

## 2. LITERATUR REVIEW AND HYPOTHESIS DEVELOPMENT

Studies that evaluate the influence of social and environmental responsibility on corporate performance have been conducted in various countries since 1972, the results show mixed results from various approaches and methodologies (Margolis and Walsh, 2003). Research shows the influence of social and environmental responsibility activities can degrade financial performance because consumers feel burdened to bear the cost incurred by the program. This may affect the confidence of stakeholders and lower companies, as in Ullmann (1985), Balabanis et al. (1998) and Lys et al. (2015). A study showing no relationship between social and environmental responsibility and firm performance in Friedman (1979); Crisóstomo et al. (2011); Barnett and Salomon (2012); Michelon et al. (2015); Melloni et al. (2017). These studies still have loopholes in results of research. study of relationship between social responsibility and environment to the corporate performance still received considerable attention in current accounting research.

Disclosure of CSER will describe the motivation, determination of actions and assessment of managers. Policy of delivering CSER expenditure amounts in financial statements may reflect performance of the managers and directors of company (Healy and Palepu, 1993, Al-Tuwajri et al., 2004). Corporation that has social participation as a responsibility to participate in continuously building



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community, region and country through its business activities is a successful enterprise. In addition, the company also has a responsibility to prevent and overcome the negative impact of various business activities. The use of funds used in social and environmental activities is attributable to an increase in sales results not only in terms of short-term, long-term investment successes. This is an opportunity to develop a sustainable future investment (Joseph et al., 2016). CSER expenditure can fix the problems faced and be a liaison between corporate and stakeholders. CSER activity as published information can protect shareholder value (Ullmann, 1985, Cho et al., 2012, García-Sánchez and Martínez-Ferrero, 2016).

Good management practices can avoid environmental risks and to control rights and responsibilities of stakeholders, companies reduce external financing and thereby reduce reliance on internal cash for investment (Botosan and Stanford, 2005). The sustainability of the company depends on the value of asset whose use of funds is clear to interests of stakeholders in this case can function to run social and environmental activities and for benefit of future investment (Burchell et al., 1980). This study uses corporate resource capabilities used to control interests of stakeholders. CSER perspective expenditure is based on the resources it possesses and can provide directly to internal benefits and consider external interests. The use of internal funds in Investment and CSER expenditure helps companies develop innovative new resources and capabilities of corporate knowledge and culture. As a result, CSER expenditure can improve company performance and investment so that future sustainability can be well planned and well integrated (Russo and Fouts, 1997, Frynas and Stephens, 2015, Hart, 1995, McWilliams and Siegel, 2011).

Analyzing the social costs and environmental costs that are part of social accounting information often experience constraints because it starts from voluntary disclosure then usually use social and environmental accounts that are only known by the internal company. Stakeholders will monitor and respond in event of a high alteration of cost and result in reduced dividends to be received. Social costs are calculated between income and expenses. Meanwhile, to analyze the environmental costs related to life cycle of the product. This social and environmental cost becomes a tool to show that the company is able to solve soda and environmental problems so as to inform the company's sustainability. Cost information is in the components of financial statements that are sometimes not shown explicitly because the regulators' specified information is only a disclosure of social and environmental activities (Gray and Bebbington, 2000, Taleb et al., 2015, Deegan, 2016).

The theoretical concepts used in this study to explain why the expenditure of CSER activities conducted by the company can improve the performance of the corporation. Margolis and Walsh (2003) show that the activities of social and environmental responsibility affect financial performance of corporation. Disclosure of CSER information expenditure allows companies to be perceived to have ethical and moral responsibility. In the framework of resource theory, if a corporation has potential resources in conducting social, environmental and sustainable activities as unique and different responsibilities between one corporation and another, then it can be a competitive advantage. Resource-based advantages in use of funds for social and environmental activities provide the benefit of developing new resources and capabilities related to the corporation knowledge and culture. The corporate reputation can be understood as a fundamental intangible source that can be formed or spent as a consequence of a decision to engage or not in activities and reporting (Branco and Rodrigues, 2006).

Corporate that have good environmental conservation costs are good news for investors and potential investors, and give them interest to invest. Firms with high levels of environmental responsibility



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will be responded positively to boost the stock of foreign investment. Corporate compliance in carrying out social and environmental responsibilities to company, aims to improve the company's image and reputation. Corporation also has concerns in the allocation of funds for the implementation of social and environmental responsibilities can improve productivity, financial performance and creation of added value is better (Brown and Foster, 2013, Ioannou and Serafeim, 2010, Hillman and Keim, 2001). Investment or expenditure, in activities not related to primary purpose of enterprise, is transfer of resources from shareholders necessary to maintain capital structure to regulate the additional expenditure of social and environmental responsibility activities.

Expenditure from social and environmental responsibility activities, using resources inherent in managerial decisions that affect cost behavior (Chen et al., 2018, Moser and Martin, 2012, Barnea and Rubin, 2010). Much of the previous research on CSER has analyzed the drivers and distinguishes CSER expenditure activities or costs and impacts of CSER activity costs on corporate performance finance. Besides, foreign investment is very concerned about superior product innovation, so cost of research and development is a component that will increase the success of product sales. Thus, the first hypothesis is:

#### **H<sub>1</sub> CSR expenditure elements have a positive effect on future foreign investment**

In Indonesia, managers generally see CSER activity costs as an additional burden attached to product rather than long-term investment for sustainability, which is undoubtedly a positive impact on financial performance. This foreign investment will be directly related to production, social and environmental activities will be reduced if product sold declines. The cost attachment of social and environmental activities increases following an increase in foreign investment, with some manufacturing firms in Indonesia listed in funding financed by investors who want to expand sales of a product. In this study examine the elements of CSER Expenditure (social, environmental and Research and development) to demonstrate the effectiveness of cost management for environmental protection and social contribution activities in response to changes in the business environment. Companies that have foreign investment shares will require companies to comply with regulatory obligations to carry out social responsibility activities.

#### **H<sub>2</sub> CSR expenditure element positively affects the corporate financial performance**

Sales analysis pays attention to growth in product demand as critical to success of foreign investments that invest funds. Foreign investment shows a high confidence in production activity as evidenced by the increase in sales. The higher foreign investment will encourage corporation to run the strategy in increasing sales because corporate reputation becomes better. Foreign investment is very influential on the trust of activities that are not related to main objective of corporate is transfer of resources from shareholders necessary to maintain strength of capital.

#### **H<sub>3</sub> Foreign investment positively affects corporate financial performance**

The cost of social and environmental activities is usually attached to products produced, foreign investors already have products that have been proven to increase sales. Higher social and environmental spending will increase the confidence of foreign investors. The trust of these foreign investors will be able to increase reputation and trust of the consumers so as to increase number of sales of company's products. However, when managers can not lower their social and environmental responsibility activities, the



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amount of manufacturing inputs of manufacturing companies will decrease based on changes in production needs (and sales), sales revenue may decrease without decreasing costs due to lack of trust from foreign investors.

**H<sub>4</sub> Foreign investment mediates relationship between CSR expenditure elements and corporate financial performance.**

### 3. RESEARCH METHOD

This research uses approach related to implementation of CSER. The implementation which is analyzed based on linear equation system. Path analysts were selected in this study with the aim of testing the causal relationship between variables due to the limited power associated with the sample size as well as the model complexity in the estimation. The use of path analysis is also concerned with the ability to analyze causal relationships between variables when estimating individual paths in the model. Path analysis allows the use of regression methods to test the causal relationship between several variables in this study consistent with previous theories on CSER practice in manufacturing firms. Structural Equation Model (SEM) using path diagrams allows to include all observed variables in accordance with existing theoretical models. The model of regression equation in this study is as follows:

$$\text{Foreign\_Inv}_{t+1} = a_1 \text{Social}_t + a_2 \text{Environmental}_t + a_3 \text{R\&D}_t + \varepsilon_1 \quad (1)$$

$$\text{CFP}_{t+1} = c'_1 \text{Social}_t + c'_2 \text{Environmental}_t + c'_3 \text{R\&D}_t + c'_4 \text{Foreign\_Inv}_t + \varepsilon_2 \quad (2)$$

The selected samples are manufacturing industry companies listed on the Indonesia Stock Exchange in the period 2013 to 2015, based on 132 companies there are only 49 companies that can be used as samples in this study. With the following data at table 1

Table 1. Sample selection

Criteria	Number
Manufacturing companies that do not IPO and delisting 2013-2015	132
Manufacturing companies that do not disclose amount of social, environmental and research spending and development	<u>54</u>
	78
A manufacturing company that has no foreign ownership	<u>29</u>
Amount of research samples	49

### 4. FINDING AND DISCUSSIONS

Test path model is intended to see the suitability of the model. Estimation with Maximum Likelihood requires that the observed variable must satisfy the multivariate normality assumption. Normality analysis is done by observing CR value of each variable is below the result of data test shows cr value kurtosis 1,761 it means overall multivariate normal data distribution because under 2.58, so assumption of normality of data fulfilled at 1% level of significance. Goodness of Fit Measure that got result of CMIN fit



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index of 0.00 with value  $p = 0.000$ ;  $GFI = 1$  ( $> 0.90$ );  $NFI = 1$  ( $> 0.90$ );  $CFI = 1.00$  ( $> 0.90$ );  $RMSEA = 0.00$  ( $\leq 0.08$ ) which means the empirical model meets the criteria specified and expressed in accordance with the empirical data. The results of the processing shows the model of path analysis as follows:

Figure 1. Path Analysis Model

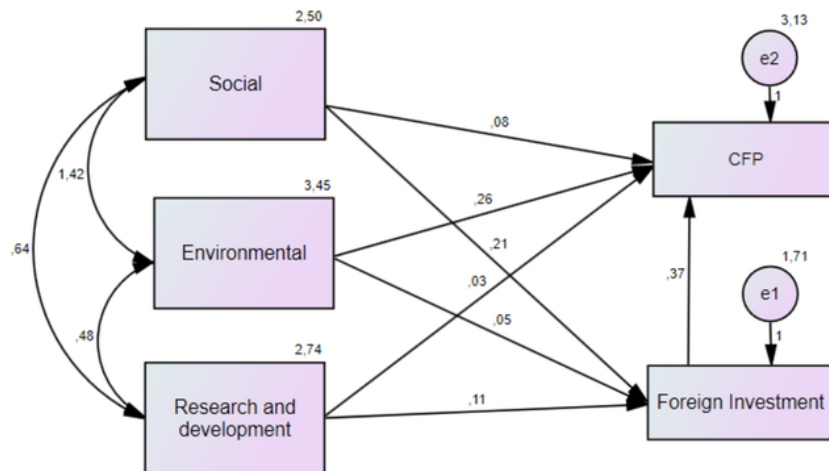


Table 2 shows descriptive statistics, which have independent variables of foreign Investment and corporate financial performance (CFP) in this study was tested with tree element corporate social environmental reporting expenditure. The test of hypothesis proposed in this research is analyzed based on  $p$  value. Testing the hypothesis can be seen in Table 3.

Table 2. Descriptive Statistics

	Minimum	Maximum	Mean
Corporate social environmental Reporting Expenditure			
social	98.939.800	87.014.429.650	4.356.386.154,16
Environment	23.500.000	1.081.050.000.000	13.562.521.776,76
R&D	24.038.747	73.150.000.000	8.193.251.129,55
Foreign Inv	32.046.700	46.875.122.110	3.076.118.364,74
CFP	2.580.590.920	26.948.000.000.000	3.381.404.933.047,13



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**Notes:** CSER, Sosial : Amount Social Expenditure; Environment, Environmental: Amount Environmental Expenditure; R&D : Amount research and development Expenditure; Foreign Inv: Amount shares foreign investment; CFP (Corporate Financial Performance ): Amount sales.

Tabel 3. Hypothesis testing

			Estimate	S.E.	C.R.	P	Label
Foreign_Inv	<---	R&D	,106	,068	1,568	,117	par_1
Foreign_Inv	<---	Social	,209	,080	2,618	,009	par_2
Foreign_Inv	<---	Environmental	,048	,067	,727	,468	par_6
CFP	<---	R&D	,032	,092	,346	,729	par_7
CFP	<---	Environmental	,255	,090	2,823	,005	par_8
CFP	<---	Social	,077	,110	,701	,483	par_9
CFP	<---	Foreign_Inv	,371	,112	3,310	,001	par_10

Table 4. Summary of hypotheses tests

Brief description of hypotheses relationships			p-value	Conclusions
H1				
Social	→	Foreign Invest	,009	Supported
Environmental	→	Foreign Invest	,468	Not supported
R&D	→	Foreign Invest	,117	Not supported
H2				
Social	→	CFP	,483	Not supported
Environmental	→	CFP	,005	Supported
R&D	→	CFP	,729	Not supported
H3				
Foreign Inv	→	CFP	,001	Supported
H4				
Social	→	Foreign Invest → CFP	,003	Supported
Environmental	→	Foreign Invest → CFP	,685	Not supported
R&D	→	Foreign Invest → CFP	,450	Not supported



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The test results show that CSER expenditure element that influences foreign investment is expenditure used in social contribution this is supported by results of research from Pinkston and Carrol (1996), Chapple et al. (2005), Bardy et al. (2011) and (Chapple and Moon, 2016) who demonstrate social responsibility to give the view that company has conducted ethical behavior in accordance with wishes of investors. Social contribution is also able to show that companies can overcome social problems to get a better appreciation in improving the corporate reputation in view of investors. This is in accordance with resource-based theory that is using unique activities such as social contribution in increasing investor confidence. Investors in investing capital argue that the problem of social contribution made by the company has been in accordance with government regulations, so the risk of the company to be narrow (Belkaoui and Karpik, 1989). The expenditure of the social contribution disclosed in the financial statements can provide more convincing information to investors to invest in manufacturing companies in Indonesia.

The test results prove that foreign investment can improve corporate financial performance because corporate reputation increase and to be good reputation to gain trust from investors and can improve the company's financial performance in this case can be seen from the increase in product sales this is in accordance with research conducted by Flammer (2013), Flammer (2015) and Batten and Vo (2015) This result proves also that the increase of foreign investment in Indonesia is getting better and able to improve corporate financial performance, this is supported by the policy given by the regulator. Interesting results of this study is the social and environmental responsibility activities that are able to reveal the environmental conservation cost expenditure can play a role in improving corporate performance with the investment made by foreign investors. Corporate with foreign investments have better accounting information systems because in reporting social and environmental responsibilities not only disclose CSER activities but also CSER expenditures in the financial statements. The capability of firms with social responsibility supported by foreign investors shows good financial performance. Managers are able to manage more effective spending and better transparency of financial reporting. A sustainable company is a company that is able to maintain the company's financial performance by balancing the willingness of the stakeholders.

#### 5. CONCLUSION

This study aims to examine influence of social and environmental responsibility expenditures that affect performance of companies and foreign investment. This research can be a useful source of information for shareholders and the public to see the corporate financial performance by taking into account the elements of social and environmental responsibility expenditures covering three components: social expenditure, corporate protection expenditure on the environment and research and development of the company. In addition, this study can also be used by companies to increase the disclosure of the value of social and environmental responsibility activities expenditures for the sustainability of corporate performance in the future through influential and significant indicators. The main purpose of this study is to present empirical evidence of the suitability and effectiveness of cost management related to environmental conservation and social contribution activities. Increased information on social activity spending can increase foreign investment trust and corporate financial performance in manufacturing companies in Indonesia.

Based on the results of research shows the element of social contribution expenditure able to play a role in increasing investment of foreign investment. The expenditure of social contributions may affect



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corporate financial performance if supported by an investment of foreign investment. Expenditures for environmental conservation and research and development engagement have not played a role in cost management. This shows the stickiness of the charge on improve the value of CSER management and provide insight into sustainability. This research motivates companies that have not disclosed information on CSER expenditure in the annual financial statements. Foreign investment in Indonesia is instrumental in increasing sales so as to improve corporate financial performance. The results provide evidence that CSER activities that reveal the amount of expenditure can provide relevant information to foreign investors for decision making. This study provides a more conception that accounting is instrumental in calculating the value of CSER expenditure in form of better reporting standards.

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