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Corporate social responsibility, financial performance and risk in Indonesian natural resources industry

Devie Devie, Lovina Pristya Liman, Josua Tarigan and Ferry Jie

Abstract

Purpose – *With an attempt to give a deeper explanation regarding the manifestation of socially and environmentally responsible cultures among Indonesian natural resources industry, this paper aims to highlight the empirical confirmation on the correlation of corporate social responsibility (CSR), corporate financial performance (CFP) and risk. Likewise, corporate risk's role as a mediating variable in the indirect effect of CSR on CFP is also examined.*

Design/methodology/approach – *Kinder, Lydenberg and Domini's (KLD) measurement approach is used as a basis to assess social responsibility activities as it gives more social rating transparency. CFP captures both accounting- and market-based measurements, whereas volatility of stock return is adopted as a proxy of firm risk. Partial least squares analysis is conducted on 40 Indonesian listed firms in natural resources sector, with observation years from 2008 to 2016.*

Findings – *It is revealed that CSR positively affects CFP, although the correlation is stronger in the long run. Significant negative influence to risk is also discovered. However, risk has a significant adverse correlation with CFP when two years' lagged value is used. Hence, CSR affects CFP through risk in the long-term, both directly and indirectly.*

Practical implications – *The empirical result suggests that CSR serves as a tool in managing the risk of enterprises and performance, especially in the long-term. Accordingly, firms should incorporate CSR as a strategic investment and manage a strong relationship with stakeholders.*

Originality/value – *This report expands further prior works and contributes to CSR and financial management literature by discovering the true nature of CSR effects as an investment in the future. This is the first study which tests and proves that CSR in Indonesian natural resources industry plays a significant role as a strategic risk management instrument that leads to a sustainable and long-lasting financial performance.*

Keywords *Corporate financial performance, Corporate social responsibility, KLD, Natural resources industry, Firm's risk*

Paper type *Research paper*

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1. Introduction

For the past few decades, the natural resources industry has been experiencing tremendous growth (Pan *et al.*, 2014), followed by occurrences of social and environmental contraventions. It is suspected that natural resources' business risk is comparatively high, where some Chinese and sub-Saharan African organizations cut off their operations because of their large hazardous pollution or deficiency (Ackah-Baidoo, 2013). Nonetheless, their management team is less likely to adopt economic, social and environmental practices unless it could result in financial advantages. Consequently, disputes and conflicts continue to arise, impacting entities' stability and performance. Accordingly, enterprises are starting to establish efforts to manage risk and pursue a sustainable performance by adopting social responsibility policies.

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Corporate social responsibility (CSR) has grown tremendously in emerging markets like Asia, including Indonesia. Indonesian Government has passed government regulation no. 47 of 2012 ([Peraturan Pemerintah No 47. Tahun, 2012](#)) to protect and enforce business operations, especially in the field of natural resources, to do social endeavor. Nevertheless, CSR may not have been applied effectively in Indonesia compared to other countries in Asia ([Cheung, 2010](#)) because of some poor and inconsistent misperception that CSR is an additional cost rather than future investment ([Waagstein, 2010](#)). On the other side, the insubstantial law only gives limited clarity regarding the objective, direction and implementation of CSR. Executing social practice particularly needs proficiency, system and resource to understand this broad and ambiguous concept, which many Indonesian firms do not possess. Aside from that, there is growing existence of social and legal problems such as poor legal enforcement and corruptive action. These two issues result in a weak CSR implementation, legal uncertainties and bureaucracy in Indonesia. The same CSR issues are also seen in extractive industries globally; integrated system is highly required to handle the complexities of CSR across all parties responsible. Additionally, there is growing pressure for resource benefit sharing through regulations, fiscal assertiveness and some prohibitions that impact organizations' business strategies and social license. On top of that, cumulative sustainability effects result in different approaches of corporates to establish a relationship with government and civil society for their sustainable development. Correspondingly, mandatory companies dealing with mining, agriculture and basic sectors would be the main focus of the analysis as they are most likely to create negative environmental and societal impact and risk. Practicing CSR policies is consequently expected to compensate their controversial business operations.

By implementing CSR, entities may benefit from better positioning as they have a good reputation by doing good deeds to the society and public, even if it requires them to sacrifice some profits. Having a good corporate image might drive the workers to work more efficiently and achieve higher productivity and performance, as well as attract qualified employees ([Stuebs and Sun, 2010](#)). Good CSR policies could lead to higher stock return as there is a positive association between the return of the adjusted market in the subsequent period. Likewise, investors are now attracted to invest not only in companies with short-term profit but also those with long-term and sustainable profits. Consequently, engagement in CSR enhances firms' ability to perform better in short and long terms, as suggested by prior studies ([Yu and Choi, 2014](#); [Cheng et al., 2014](#)).

As businesses are now facing rising complicated risk, CSR could further act as a risk management tool in corporate strategies ([Jo and Na, 2012](#)) by minimizing and creating an "insurance-like" shield to preserve performance when facing probable occurrences of future crisis financially, socially or environmentally. Information transparency, strategies and philanthropy could be improved; hence, firm's risk would eventually be scaled down and level of profitability could be gradually upgraded ([Mwelu et al., 2014](#)). In a business environment with a high risk that the entities are operating, CSR may be an instrument to increase reputation and create value, hence leading to a sustainable survival for entities ([Irwin, 2017](#)).

Accordingly, even though many parties believe that CSR may possess a meaningful impact toward firm performance and risk, some still debate whether the investment in CSR actions can really add value or it is just a trend that everyone pursues. As stated by [Park \(2017\)](#), CSR begins to be viewed as having an indirect association to corporate financial performance (CFP) instead of direct association; thus, deeper examination on the mediating or moderating variables needs to be done. Consequently, despite numerous studies regarding CSR and CFP, this examination explores further and deeper by combining a new variable, risk, into account as a mediator. In this competitive environment, the capability to prevent and mitigate risk then becomes a crucial aspect for a firm's continuity and survival because of the repercussion on firm's economic value. Enterprises that do not engage in

CSR as their extensive risk management program may become more vulnerable. As stated in a study by [Palmer \(2012\)](#), in the late 1990s, Nike faced reducing reputation as *New York Times* blamed the company for not being ethically responsible as they operated sweatshops to minimize production costs. As a result, they hired accounting firms and conducted audits to assure stakeholders regarding their adequate labor policies. This caused them to immediately establish social responsibility programs focused on labor and employment issues. Even more, they seriously tried to answer labor needs by interviewing almost 10,000 Indonesian young laborers. In the end, they could regain their reputation by mending the relationship with stakeholders. This is done by answering their opinions and needs in their CSR schemes. Nike's example proves that CSR implementation as business strategies could develop a corporate image, reduce business risk and acquire economic prosperity.

Even so, CSR as a risk management tool to mitigate risk which boosts firms' performance has not yet been studied in Indonesia. Prior studies also examined the relationship of CSR to performance and risk separately. Hereinafter, this script is the first that attempts to give a deeper explanation regarding the manifestation of CSR cultures in relation to firm performance with risk as a mediator. Insights obtained supposedly contribute to both theory and practice. It might be done by enriching CSR and management literature and answering questions pondered by many responsible organizations who would like to have a balance between its CSR, risk and financial performance. By measuring the impact of CSR performance both short and long terms, this research explains the stakeholder theory more in depth. The result hopefully is useful for both internal and external parties of the company, such as managers, investors and financial analysts, as well as CSR policymakers.

Relevant literature is reviewed and hypotheses regarding CSR, CFP and risk are articulated in Section 2. It is followed by broader explanation of sample, measurement and research model in Section 3. Section 4 discusses the research results, and Section 5 concludes.

2. Literature review and hypotheses

2.1 Corporate social responsibility

CSR is generally referring to a company's voluntary actions to integrate environmental and social concerns into the business and toward stakeholders to achieve sustainability ([ACCA, 2015](#)). Substantial care and considerable debate have been drawn regarding sustainability issues, CSR and its practical implementation ([Jain et al., 2016](#)). This triple bottom line concept of "People, Planet and Profit" ([Žak, 2015](#)) takes into account essential values to weigh a firm's success, such as economic, environmental and social. Furthermore, social responsibility policies could act as a guideline and corporate strategy to deliver responsible actions according to business environment and risk.

[Montiel et al. \(2012\)](#) have used signaling theory to explain further potential benefits when a firm adopts CSR practices. Those enterprises are dominated by a sense to give signals about the management quality. On the other hand, believers in agency theory argue that managers (agents) may not act on behalf of investors (principal), thus creating a conflict of interest by undertaking earnings management ([Agustina et al., 2015](#)). On top of that, stakeholder theory says that an entity should not function for its own interests but should provide benefits and be accountable to stakeholders as well. According to [Oeyono et al. \(2011\)](#), the survival of the company depends on the stakeholders' support that must be sought. Stakeholders' practices carried out by managers would result in a more profitable performance, especially when they take a chance to develop such differentiation with the use of CSR ([Chtourou and Triki, 2017](#)). Social disclosure is considered as a part of the social contract dialogue as seen by legitimacy theory. When the firm fulfills the contract, the organization is legitimized, resulting in strengthened corporate reputation and competitive advantage ([Usman and Amran, 2015](#)).

Social investors and stakeholders put great interest in enterprises with several motivations that drive them to value social ratings. They seek ratings that accommodate clarity regarding past social attainments and prevailing management procedures that determine prospective social completion. Notwithstanding that, despite numerous approaches are available to measure CSR, no standard has been established because of missing conclusions of its inherent significance and considerably heterogeneous dimensions (Galant and Cadez, 2017). Following prior studies (Sun, 2012; Jo and Na, 2012), this paper uses a widely used and the most influential approach, Kinder, Lydenberg and Domini's (KLD) method. It rates companies within some specific areas, taking into account both strengths and concerns of sustainability issues. KLD concern ratings were then found to be an adequately acceptable sketch of firms' past environmental performance and hence offer transparency to related parties (Stubbs and Rogers, 2013).

2.2 Corporate social responsibility and corporate financial performance

Plenty studies have been conducted worldwide to examine meanings of CSR, including toward CFP. Corporate performance is a specific measurement used to assess the success of a company in managing and allocating resources to generate profits. Companies, investors and academics have one prime question regarding whether it pays off to engage in social responsibility. Although evidence gathered is still inconsistent for both developed and developing countries, there are generally three-dimensional (positive, negative and neutral) debates on the association between CSR and CFP (Crisóstomo *et al.*, 2011). According to Park (2017), these inconclusive outcomes are because different scholars tend to focus on different factors such as the characteristics or external determinants.

The positive association could be found in stakeholder theory, where firms in which the management team preoccupies actions that elevate social performance would reap better financial performance than other organizations in the long run. When CSR and CFP correlation is analyzed using accounting-based, market-based and investor-based measures, commitment to CSR is likely to raise the firm's performance (Alikaj *et al.*, 2017). It has been studied that CSR builds a good reputation and has a positive predictive power for a company's valuation (Cheung, 2010). It may become a sustainable competitive advantage for the firm, as long-lasting relationships between the firm and its stakeholders are being developed (Alikaj *et al.*, 2017). Nevertheless, some argued that stakeholder theory could result in opportunism and selfish justification by the manager, different and inequitable interests of stakeholder and hard decision-making to bring fairness into stakeholder representation (Iwu-Egwuonwu, 2010).

The negative association is commonly found in the neoclassical economic school of thought and utility theory that argues that CSR is not able to enhance the value of an organization (Sun, 2012). CSR induces charges that could be retrained or relocated to other agents (e.g. customers or the government) (Famiyeh, 2017), so there are hardly any economic advantages from spending large expenditures to become socially responsible. Finally, the neutral association between CSR and financial performance is found, where additional costs incurred by implementing social responsibility are covered by gains arising from it (Oeyono *et al.*, 2011).

Among these studies, most findings are related to the positive relationship that being socially responsible could lead to a rise in an entity's performance (Yu and Choi, 2014; Oeyono *et al.*, 2011; Cheung, 2010). Resembling late studies, the following hypothesis is then introduced:

H1. CSR has a positive impact on CFP.

2.3 Corporate social responsibility and firm risk

Risk profiles of responsible companies are argued to be different (El Ghoul *et al.*, 2011). CSR may encourage managers' ethical behavior that could positively influence the firm reputation and indirectly build up the firm value and decrease financial risk. According to Jo and Na (2012), under the risk-reduction hypothesis, there are five main factors that lead to improvement in risk management when entities do CSR. They suggested that socially responsible companies could create insurance-like effect of goodwill and moral capital, leading to preservation of financial performance; decrease in cost of equity, cost of debt and cost of capital; enhancement in market appeal and corporate shared value; increase in transparency; and promotion of access to market, which eventually will help managers to mitigate risks. However, to do this, valuable resources could be redirected from other projects as it leads to lesser competitiveness and more vulnerability to market shocks. Being responsible also requires trade-off between fulfilling claim and creating cost for stakeholders.

Particularly, most studies showed that CSR is negatively correlated with business risks, for both systematic and unsystematic risk, and can assist the firms in mitigating firms' risks by eradicating the information asymmetry of internal and external stakeholders (Jo and Na, 2012). The major study also noted that organizations with high level of risks intentionally engage in CSR conducts to lower their risk (Iwu-Egwuonwu, 2010). Accordingly, the second hypothesis made for this research study is:

H2. CSR has an adverse impact on a firm's risk.

2.4 Corporate social responsibility, firm's risk and corporate financial performance

CSR could be seen as activities that can create values for a firm by influencing reputation, risk profile and cost of debt, which lead to improvement in economic performance. A recent study by Mwelu *et al.* (2014) found out that advancement in risk management of manufacturing firms could gradually escalate the profitability levels so that it is recommended for them to manage risk to make sure that the profitability levels is not negatively affected. Both internal and external aspects may affect a firm's performance, where such changes may possess a risk to the firm's performance and its sustainability. This inherent risk in the firm's operation may affect a firm's profitability. Additionally, business risk or the uncertainty related to the firm's functioning environment is contemplated in the fluctuations of operating income and hence has a negative impinge on the profitability (Vakilifard and Oskoue, 2014).

Environmental disclosures may lessen risk and a firm's cost of debt, which can affect the firm's structure and relevantly affect its strategy and profitability as well (Magnanelli and Izzo, 2017). By managing risk, shareholders' value could be improved. However, this is only applied under a circumstance where agency cost, flaws in the market and any asymmetric information disturb the performance of a perfect capital market (Pagach and Warr, 2011). In addition to this, by managing risk and reducing stock price volatility, organizations may expect steadier earnings as the possibility of inferior outcome could be minimized. Consequently, reducing risk could enhance the performance of the firm. As stated in previous hypotheses, CSR could improve the financial performance of entities and mitigate the risk of companies; therefore, a third hypothesis is constructed for this study:

H3. Firm's risk could mediate the relationship between CSR and CFP.

3. Research methodology

3.1 Sample

To achieve the aim of this study, a partial least squares (PLS) analysis is done through a collection of secondary data, testing of hypothesis and identification of correlation. The

sample firms involve listed entities in Indonesia Stock Exchange (IDX) from 2008 to 2016. The companies are running their business in the natural resources industry sector, specifically mining, agriculture and basic industries. This study uses all secondary data sufficiently provided by annual reports, sustainability reports, Bloomberg and other reliable sources.

Eventually, as seen in [Table I](#), total sample observed that meets the criteria in this research is 40 companies for nine years, which is 360 firm-year observations. Besides, second testing is done to examine the long-term effect of using 40 companies for seven years.

3.2 Measures

Measurement of corporate social responsibility: KLD method is chosen as a basic proxy of CSR level as it has been widely used in previous leading management journals ([Nguyen and Nguyen, 2015](#); [Alikaj et al., 2017](#); [Price and Sun, 2017](#)). Also currently known as environmental, social and governance, this approach portrays multi-dimensional measure of CSR by capturing both strengths and concerns of social issues. Because of publicly available data, this social rating method enables researchers to access it easily and compare results with different kinds of literature. Following prior studies, this work uses five areas of CSR issues relevant to Indonesia, namely, community, diversity, employee relations, environment and products. Any activities conducted by the firm in correspondence to the issue areas are given score 1, otherwise, 0 is given when the firm does not meet the criteria stated. Next, the score of total strengths is deducted by total concerns to get Net CSR, as used by former KLD indices ([Lin et al., 2017](#)). The detailed explanation of each strength and concerns in KLD issue areas could be seen in the [Appendix](#).

Measurement of corporate financial performance: Accounting- and market-based measures are used to measure financial performance as the independent variable. This is aimed to give broader and clearer picture that captures both short-term and long-term performance of an entity. As an outcome reflection of managerial actions, accounting-based measures catch the historical part of the financial performance. They may also address market performance concerns such as market inefficiencies ([Eccles et al., 2011](#)). However, it may be biased because of influence from management's manipulation and different accounting function. In contrast, market-based measures center upon organizations' forward-looking aspect, so is less susceptible to management's misappropriation ([Al-Matari et al., 2014](#)). Because of its contemporariness, it also captures long-term performance, intangible asset utilization and variability in CSR faster. Nevertheless, it is only available for publicly listed companies. Consequently, to address both concerns and capture better view on the performance of Indonesia enterprises, both measures are used in this study. Comprehensive measures such as return on equity (ROE), net profit margin (NPM) and earnings per share (EPS) are used as accounting-based measures, while share price (SP)

Table I Summary of the sample observed

<i>Sampling criteria</i>	<i>No. of companies</i>
Companies in the area of natural resources as in accordance to government regulation no. 47 of 2012 in IDX from 2008 to 2016	129
Listed companies which did not consistently publish their annual reports from 2008 to 2016	30
Companies which do not have sufficient financial and CSR information in their annual report and/or sustainability reports	59
Number of companies which fulfill the criteria	40
Total sample used in model 1 (40 × 9)	360 firm-year
Total sample used in model 2 (long-term effect testing) (40 × 7)	280 firm-year

and firm's value expressed by Tobin's Q (TOBQ) are used to reflect market-based measures.

Measurement of risk: A firm's risk is reflected using total risk that represents the total of systematic and unsystematic risk. Systematic or market risk may alter a tremendous number of assets and pinpoints market aspects (like country's economic growth rate and interest rate), which commonly provokes returns to move in parallel. It is directed by the variability of organizations' cash flows to the operation that is not under management's authority (Nguyen and Nguyen, 2015). Subsequently, this risk cannot be diversified away as it prevails in all portfolios (Duan *et al.*, 2010). On the other hand, the firm-specific risk only impacts to at most a limited asset size and portrays price volatility in relation to organization's management and operational efficiency.

Measurement of firm's size, leverage and age: This research is done by controlling some variables that may be affected by dependent variables, incorporating firm's size (SIZE), leverage (LEV) and age of long-term assets (AGE) (Sun, 2012; Jo and Na, 2012; Crisóstomo *et al.*, 2011). These variables are selected because of their proven significant influence toward CFP. Table II presents all variable definitions and data source used.

3.3 Model

This study would like to show whether CSR influences a firm's financial performance and risk in a positive, negative or neutral way and the role of risk as the intervening variable that alters CFP. An additional analysis is done to examine the direct and moderating effect of control variables, such as SIZE, LEV and AGE, in strengthening the relationship of CSR toward CFP. A thorough examination is conducted to see the existing correlation not only in short-term but also long-term. This is to give a better understanding of the longer-term influence of social responsibility investment. For short-term, this paper uses contemporaneous indicators of CSR, CFP and risk, whereas for long-term, lagged values of CSR is used instead, with two years of a time difference. Model 1 of CSR impacts toward CFP and risk is expressed in the equation below:

Table II Variable definitions and data source

<i>Variable(s)</i>	<i>Definitions</i>	<i>Data source</i>
Net CSR	Difference between total strengths score and total concerns score	Annual and sustainability report, reliable websites
Return on equity (ROE)	Percentage of net income over total equity	Annual report and Bloomberg
Net profit margin (NPM)	Percentage of net income over net sales	Annual report and Bloomberg
Earnings per share (EPS)	Profit of the year divided by the number of issued shares	Annual report and Bloomberg
Share price (SP)	Market value of common stock over the number of issued shares	Bloomberg
Tobin's Q (TOBQ)	Market value of assets over book value of assets	Bloomberg
Total risk (VOL)	Standard deviation of daily stock return	Bloomberg
Firm size (SIZE)	Natural log of total assets	Annual report and Bloomberg
Leverage (LEV)	Total liabilities over total assets	Annual report and Bloomberg
Age of long-term assets (AGE)	Ratio of net value of PPE to gross value of PPE	Annual report and Bloomberg

$$CFP_{it} = \alpha + \beta_1 \times CSR_{it} + \beta_2 \times RISK_{it} + \beta_3 \times SIZE_{it} + \beta_4 \times LEV_{it} + \beta_5 \times AGE_{it} + \beta_6 \times CSR_{it} * SIZE_{it} + \beta_7 \times CSR_{it} * LEV_{it} + \beta_8 \times CSR_{it} * AGE_{it} + \varepsilon_{it} \quad (1)$$

$$RISK_{it} = \alpha + \beta_1 \times CSR_{it} + \varepsilon_{it} \quad (2)$$

where i and t denote firms and time periods, respectively. Additional testing using model 2 is carried out to examine the long-term effect with two years' lagged value of CSR. It is suggested by [Magnanelli and Izzo \(2017\)](#) that CSR does not generate an immediate impact as stakeholders require time to absorb new disclosure, which may alter their decisions.

3.3.1 Validity and reliability According to [Kock \(2015\)](#), a multivariate statistical model must involve validity, reliability and multicollinearity tests but not the normality test. Further, [Ronkko et al. \(2014\)](#) said that PLS has been recommended for handling non-normal data. Many recent studies on PLS urge researchers to drop the normality test. Validity in this study including convergent and discriminant validity is analyzed from the correlation coefficient between indicator score and the latent variable score, represented by the factor loading value. When factor loading value is greater than 0.5, then the convergent validity criteria are fulfilled. Moreover, discriminant validity test is passed when the cross loading value for each indicator is bigger than the loading value of other latent variables ([Kock, 2015](#)). A variable with one indicator has a factor loading of 1, which fulfills the criteria. As observed in [Table III](#), indicators of variable CFP fulfill convergent and discriminant validity.

After passing validity test, reliability and multicollinearity of variables must be ensured by looking at composite reliability, Cronbach's alpha and full collinearity variance inflation factor (VIF) values. Composite reliability test is conducted where the value must be greater than or equal to 0.70. As a second reliability criterion, Cronbach's alpha value should be bigger than 0.6. To fulfill the collinearity test, VIFs must be lesser than 3.3 or 10 in a more relaxed criterion ([Kock, 2015](#)). As portrayed in [Table IV](#), all variables have passed the reliability and multicollinearity tests.

4. Research results and analysis

4.1 Sample description

[Table V](#) provides the descriptive statistics of each variable, comprising of the minimum, maximum, mean and standard deviation value. It reports the values for both models where Model 1 uses contemporaneous values of CSR, CFP and risk with 360 firm-year investigations. Model 2 uses two years lagged value of CSR with a sample of 280 firm-year investigations.

Table III Combined loadings and cross-loadings									
Indicators	CSR	CFP	RISK	SIZE	LEV	AGE	SIZE* CSR	LEV* CSR	AGE* CSR
<i>Model 1 (same year)</i>									
ROE	0.267	(0.817)	0.052	−0.564	0.111	0.154	−0.123	0.096	0.019
NPM	0.253	(0.804)	0.067	−0.395	−0.072	0.115	−0.062	0.092	0.016
EPS	−0.239	(0.659)	0.020	0.408	0.010	−0.288	0.083	−0.135	−0.048
SP	−0.284	(0.654)	0.023	0.508	0.009	−0.208	0.076	−0.104	−0.003
TOBQ	0.083	(0.763)	−0.179	−0.080	−0.079	0.318	0.008	0.092	0.026
<i>Model 2 (lag-2)</i>									
ROE	0.282	(0.814)	0.084	−0.57	0.05	0.197	−0.144	0.091	−0.001
NPM	0.224	(0.812)	0.058	−0.405	−0.044	0.069	−0.076	0.114	−0.06
EPS	−0.219	(0.664)	−0.039	0.421	−0.001	−0.339	0.137	−0.121	−0.088
SP	−0.286	(0.646)	−0.05	0.523	0.005	−0.226	0.118	−0.108	0.021
TOBQ	0.069	(0.780)	−0.047	−0.09	−0.021	0.392	−0.07	0.061	0.142

Table IV Reliability and collinearity values

	CSR	CFP	RISK	SIZE	LEV	AGE	SIZE* CSR	LEV* CSR	AGE* CSR
<i>Model 1 (same year)</i>									
R^2		0.334	0.079						
Adj. R^2		0.319	0.077						
Composite reliability	1.000	0.859	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Cronbach's alpha	1.000	0.794	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Avg. variance extraction	1.000	0.552	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Full collinearity VIFs	1.617	1.383	1.249	1.885	1.258	1.271	1.192	1.142	1.225
<i>Model 2 (lag-2)</i>									
R^2		0.352	0.110						
Adj. R^2		0.333	0.107						
Composite reliability	1.000	0.862	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Cronbach's alpha	1.000	0.798	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Avg. variance extraction	1.000	0.557	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Full collinearity VIFs	1.684	1.401	1.320	1.884	1.282	1.326	1.289	1.184	1.235

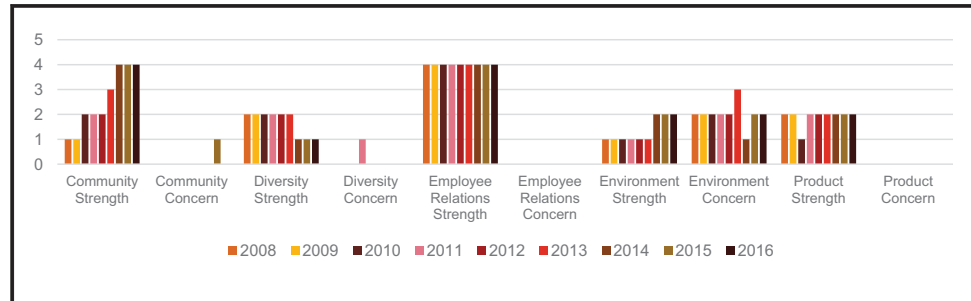
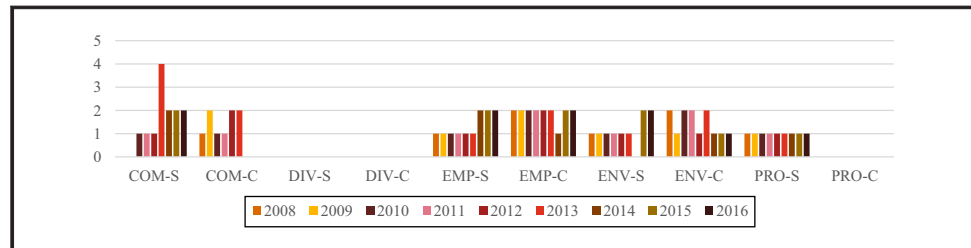
Table V Descriptive statistics

Indicators	Minimum		Maximum		Mean		SD	
	Model 1	Model 2	Model 1	Model 2	Model 1	Model 2	Model 1	Model 2
Net CSR	−2.000	−2.000	14.000	13.000	7.558	7.504	2.808	2.891
ROE	−1.342	−1.342	0.703	0.703	0.114	0.099	0.159	0.159
NPM	−2.819	−2.819	0.501	0.446	0.074	0.068	0.185	0.200
EPS	−786.111	−786.111	4,212.977	4,212.977	213.006	217.841	487.470	494.466
SP	37.25	50	50,750	41,550	3,344.662	3,308.239	6,832.948	6,531.503
TOBQ	−0.028	0.148	7.353	7.353	1.301	1.339	1.084	1.107
VOL	0.0893	0.089	2.508	2.508	0.5788	0.516	0.3438	0.307
SIZE	24.850	25.083	32.112	32.112	28.909	29.028	1.597	1.602
LEV	0.037	0.037	0.948	0.816	0.441	0.438	0.197	0.196
AGE	0.148	0.148	0.915	0.915	0.575	0.573	0.160	0.158

For instance, minimum and maximum values for Net CSR are −2 and 14, respectively (13 in Model 2), where according to the KLD score used in this study, the value ranges between −17 and 17. This signifies that natural resources companies in Indonesia have undertaken ethical and social policies quite well. This might be due to the prerequisite regulation imposed by the government.

In seeing the CSR trend more closely, the CSR performance of the largest Indonesian mining corporation, Medco Energi Internasional, is taken as an example and displayed in [Figure 1](#). Exceptional performance is seen in the improved community strength as this firm continuously contributes to education and infrastructure in Indonesia. In addition to this, Medco has been successfully enhancing their safety leadership program to ensure a good health and security management system and culture that it received several Safety Awards in 2016. In environment area, Medco also managed greenhouse gas emission well such that it received Best Disclosure Award in 2015 and Environmental Achievements from Indonesian Government in 2016 ([Medco Energi Internasional, 2016](#)). Low concern is seen across all issue areas, which means that Medco could mitigate social and environmental disputes while enforcing CSR policies successfully.

In contrast, [Figure 2](#) portrays low CSR scores for PT Ratu Prabu Energi Tbk, especially in 2008 and 2009. This company has quite high concerns in community and employee relation issue areas because of several adverse effects to the community regarding investment and economic practices. Despite having their profitability increasing, they did not give

Figure 1 Medco Energi Internasional CSR profile from 2008 to 2016**Figure 2** Ratu Prabu Energi CSR profile from 2008 to 2016

dividends to shareholders (Achmad, 2013). Besides that, workforce treatment and health and safety schemes were not so good. Moreover, it is shown that they do not really enforce CSR practices in almost all issue areas, shown by the rather low scores in their CSR strengths.

4.2 Hypothesis and research result

It is hypothesized that CSR is positively related to financial performance and negatively related to firm risk. The analysis resulted supports the hypotheses constructed, consistent with the prior affirmation that CSR could significantly improve a firm's financial performance and lower the risk (Figure 3). Similar results are found in Figure 4 or Table VIII when two years' lagged value of CSR is used instead. This implies that organizations may also experience enhancing performance, especially in the long run when they are responsible to stakeholders. Additionally, a smaller p -value implies that the long-term relationship is proved to be more significant. Doing socially good and disclosing responsibility information may boost up a strong reputation that may become a sustainable competitive advantage in the long run. This is because of the long-lasting connection with the parties who have interest in the entity (Alikaj *et al.*, 2017). Price and Sun (2017) argued that CSR's reputation is positively linked to firm value. Generally, investors positively notice and perceive an entity's social or environmental efforts; thus, the firm's financial health and market value may be enhanced. This is also supported by the value-enhancement hypothesis that entities could strategically use a chance to aim at customers by using CSR actions to improve the value of the companies. Over and above that, stakeholder and legitimacy theories claim that when an organization responds and answers the expectations of various stakeholder, they could cultivate trust and lift corporate reputation. CSR participation with stakeholders could signal a long-term value which raises future financial performance (Gregory *et al.*, 2014).

Figure 3 Structural model 1 results

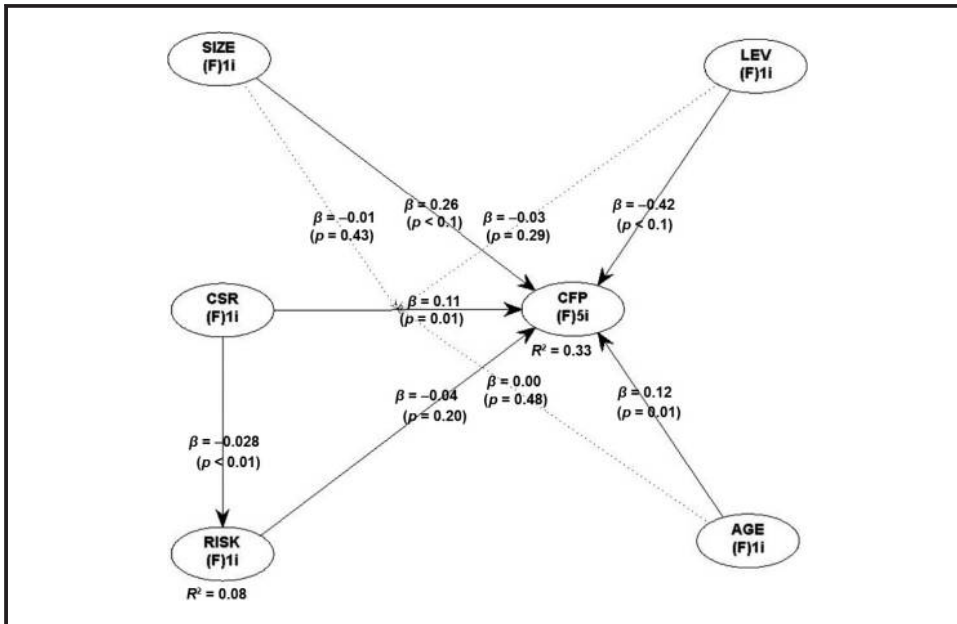
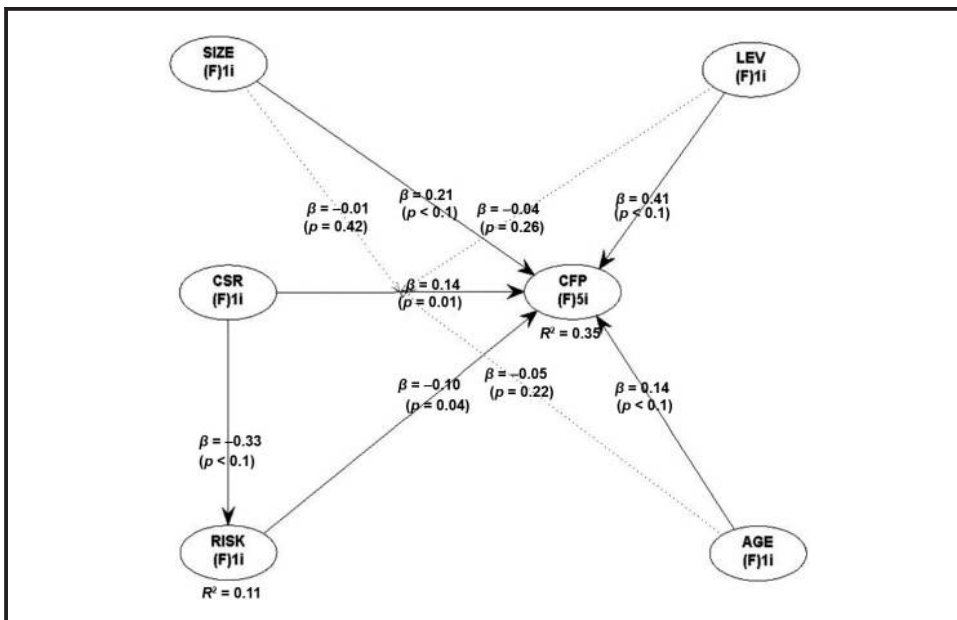


Figure 4 Structural model 2 results



By means of accounting and market-based measurements, it turns out that accounting-based measures are more relevant to reflect the financial performance of the ethical organization. The correlations detected are stronger especially for ROE and NPM, evidenced by greater factor loading and indicator weight, than other indicators, shown in Table VI. This is also coherently recommended by [Ahamed et al. \(2014\)](#) that the relationship with accounting-based measures is stronger and more significant.

Table VI Profile of CFP

Model	ROE		NPM		EPS		SP		TOBQ	
	1	2	1	2	1	2	1	2	1	2
Factor loading	0.817	0.814	0.804	0.812	0.659	0.664	0.654	0.646	0.763	0.780
Indicator weight	0.296	0.292	0.291	0.291	0.239	0.238	0.238	0.232	0.277	0.280

Additionally, CSR practices have prompt and sustaining financial repercussion. The immediate effect is suggested by the positive relationship in the first model tested using contemporaneous variables. Simultaneously, it could also be seen in the relation between CSR and accounting-based measures (ROE, NPM and EPS) representing short-term performance. It is proposed that consumers notice and encourage responsibility practices; hence, the return and profit are greater, growing quicker than the expenditures incurred. In addition to this, besides looking at the highly significant correlation in the long-term effect model, the continuing financial effect can be seen from improved market measures such as stock price and firm's value. Firm's value indicated by Tobin's Q may assess the expected long-run performance by indicating the organization's future and growth opportunities (Bozec *et al.*, 2010).

The adverse association between CSR and risk found in this research is supported by risk-reduction hypothesis (Jo and Harjoto, 2011; Jo and Na, 2012). It is proposed that by being socially responsible, an enterprise could raise information transparency and access to the financial market, offer good charm to attract consumers and accordingly enhance risk management. Accordingly, the business environment entities are currently operating the risk faced by companies; hence, management uses CSR as a new tool to manage the risk. This is because of the framework offered by CSR, including stakeholder engagement and risk protection. CSR conducted by an entity may enhance the viability of their operational performance even when bad issues happen. In this way, CSR is a good shield to preserve the risk faced by corporations.

As the association is stronger for CSR and risk two years ahead, it is suggested that a tremendous development in the socially responsible investing lead to enhancement in investors and society's awareness (El Ghouli *et al.*, 2011). Hence, time difference indeed strengthens the relationship as suggested by previous studies (Price and Sun, 2017). Price and Sun (2017) investigate the long-term impact of using panel data and autoregressive model to understand the time series structure. They found out that the influence of CSR on risk is more enduring. It is highly assumed that entities could generate insurance-like advantages, especially for adverse conditions on share prices because of CSR's prolonged and ever-lasting trait in the long run (Shiu and Yang, 2016). Ultimately, investors are offered greater confidence on the stable stock price (Price and Sun, 2017).

As seen in Tables VII and VIII, CSR has no indirect effects to CFP in both models. As a consequence, risk is not acting as a mediator between CSR and CFP, but as an independent variable. CSR and CFP association will still prevail, though the variations are not dominated by risk. Despite having a negative correlation coefficient of -0.045 , the relationship between risk and financial performance in Model 1 is contrastingly insignificant. Notwithstanding that, the result of the second test shows a significant negative correlation between those two.

This observed negative correlation is conclusively shown by other investigators who report that higher firm value could be enjoyed when firms have lower risk consequences (Florio and Leoni, 2016; Pagach and Warr, 2011). It is investigated that when corporations implement an effective risk management system within the operations, a lesser risk is presented and higher performance in terms of ROA and Tobin's Q is verified (Florio and Leoni, 2016). An adverse relationship that occurs in the result is in accordance with the

Table VII Correlation among latent variables (Model 1)

<i>The effects</i>	<i>CSR</i>	<i>RISK</i>	<i>SIZE</i>	<i>LEV</i>	<i>AGE</i>	<i>SIZE* CSR</i>	<i>LEV* CSR</i>	<i>AGE* CSR</i>
<i>Direct effect</i>								
CFP	0.113**	-0.045	0.262***	-0.419***	0.117**	-0.010	-0.030	0.002
RISK	-0.282***							
<i>Indirect effect</i>								
CFP	0.013							
<i>Total effect</i>								
CFP	0.126**	-0.045	0.262***	-0.419***	0.117**	-0.010	-0.030	0.002
RISK	-0.282***							

Notes: * $p < 0.10$ (weakly significant); ** $p < 0.05$ (significant); *** $p < 0.01$ (highly significant)

Table VIII Correlation among latent variables (Model 2)

<i>The effects</i>	<i>CSR_{t-2}</i>	<i>RISK</i>	<i>SIZE</i>	<i>LEV</i>	<i>AGE</i>	<i>SIZE* CSR</i>	<i>LEV* CSR</i>	<i>AGE* CSR</i>
<i>Direct effect</i>								
CFP	0.138***	-0.102**	0.212***	-0.412***	0.141***	-0.013	-0.038	-0.047
RISK	-0.332***							
<i>Indirect effect</i>								
CFP	0.034							
<i>Total effect</i>								
CFP	0.172***	-0.102**	0.212***	-0.412***	0.141***	-0.013	-0.038	-0.047
RISK	-0.332***							

Notes: * $p < 0.10$ (weakly significant); ** $p < 0.05$ (significant); *** $p < 0.01$ (highly significant)

initial aim of enterprise risk management, which is to boost entities' short-term, and especially long-term, value to its stakeholders and enlarge opportunities to grow (Shiu and Yang, 2016). It is suggested that by reducing and managing risk better, enterprises in natural resources sector could benefit in an improvement in their future's financial performance. Likewise, it is revealed that CSR-risk and risk-CFP associations are related in long-term. Both adverse associations between CSR to firm's risk and firm's risk to CFP will consequently result in a positive effect of CSR toward CFP. CSR could serve as a tool in mitigating risk, where it leads to incrementing corporate performance.

The contribution of risk management in long-term performance in terms of accounting performance and market evaluation is found to be consistent with a study in Italian context by Florio and Leoni (2016). This rather contradictory result in the first test may be due to the nature of CSR, which has a longer effect on both risk and performance. Hence, the true nature of the influence of CSR could be experienced when organizations could maintain continuous CSR effort. Arguably, CSR activities require long-term efforts to uncover their value (Shiu and Yang, 2016). The insignificant impact of risk on CFP in short-term could mark that risk influenced by CSR is not significantly a predictor of firm's performance. There is an increasing significance of continuously being good to society and community as CSR requires time to fully establish and fulfill social values expected by stakeholders (Price and Sun, 2017).

Findings in this study are followed by several implications. It is suggested that firms' goal must not just to increase profits, but organizations should also focus on how they make them. Relationship with stakeholder plays a critical role in the increment of overall business. Firms could depend on stakeholders' trust, which would help to alleviate the asperity in times of critical situation (Nguyen and Nguyen, 2015). Natural resources companies must not only do CSR as required by the government regulation but also should go beyond that

by continuously and actively integrating CSR as long-term investment and business strategies instead of a burden. CSR engagement gradually develops to have more long-term and enduring nature where organizations merely notice recent advantages and improvements. In addition to this, it takes longer to build a strong and trustworthy relationship with stakeholders than to break their trust. Hence, market and other stakeholders will react later after they have obtained more confidence on socially responsible firms. As a consequence, the enduring effect of CSR could only be enjoyed when enterprises could establish a long-lasting effort in CSR engagement. Moreover, for investors, it would be beneficial and safer for socially responsible investors to inject capital in socially responsible organizations, because they could generate incrementing returns in the future with lower risk. Ultimately, for Indonesian Government, they might also promote the regulation in relation to CSR violations in terms of legal consequence, followed by regulated sanctions. CSR policies should be promoted to all Indonesian organizations so that disputable social and environmental issues could be scaled down. Corporate law definition, objectives and direction must be clearly drawn out as well to encourage the application of CSR.

4.3 Control variable analysis

Furthermore, the research model also takes into account three other variables to control for SIZE, financial risk and AGE. Findings from the control variable analysis illustrated in [Tables VII](#) and [VIII](#) suggest the following:

- As shown by highly significant ($p < 0.01$) positive impact of size toward CFP, bigger corporations may conduct CSR schemes better than the smaller ones, resulting in better firm performance ([Sun, 2012](#)). Entities with different sizes may take part in CSR engagement with the same motivation. Even so, the level of financial performance could vary because of the better resource allocation and access, superior organizational visibility and greater economies of scale for bigger enterprises ([Chtourou and Triki, 2017](#)).
- Strong significant ($p < 0.01$) adverse relationship is found between LEV and CFP. As a result, businesses with lower LEV ratio may handle its asset more efficiently, and therefore, their performance is more sustainable ([Crisóstomo et al., 2011](#)). When entities cut off their debt, they could save some certain cost that is, extracted out of future earnings that would lift profitability. In this way, lower level of LEV may cause companies to demonstrate better social and environmental responsibility enforcement.
- It is indicated that AGE and CFP in Model 1 is positively and significantly ($p < 0.05$) related, where the association is more significant ($p < 0.01$) in model 2. Organizations that have younger assets are more responsive and reactive in doing social and environmental responsibility actions. They could better handle strict regulations imposed by government agencies to protect environment. This is because of the nature of newer assets that is basically planned to fulfill the regulation, whereas older assets need to be upgraded gradually to answer regulative needs. Furthermore, younger assets work more efficiently than the older ones, which saves more cost on maintenance and upgrade.
- SIZE, LEV and AGE are revealed to significantly affect CFP more directly rather than as moderating variables. Even though combined with CSR, these control variables have an insignificant impact to CFP. Therefore, these control variables are neither strengthening nor weakening the relationship of CSR to CFP.

5. Conclusion and limitation

This paper aims to scrutinize the association between CSR and CFP that is mediated by firm's risk. To present a more reliable view, CSR is measured using KLD ratings while CFP

proxies capture both accounting- and market-based measures. Both short-term and long-term effects are examined to give a deeper understanding of CSR as an investment in the future. Eventually, CSR is proven to be significantly associated with CFP and firm's risk, as presented in *H1* and *H2*. Risk should be treated as a predictor variable instead of a mediator as the direct significant correlation to CFP exists, especially in the long-term. This proves that risk does not completely explain the relation of CSR and CFP, leaving the prevailing CFP altered by CSR, although the risk is not dominating. Besides, CFP is better portrayed using accounting-based measures.

The positive association to CFP, which is coherent with previous findings (Sun, 2012; Park, 2017), supposedly answers and clarifies the stakeholder theory, as well as the almost five decades of debate between experts and researchers. The contribution in this investigation has been to confirm the significance of CSR engagement to financial performance through risk. While previous scholars only constructed a model to investigate the direct relationship of CSR to CFP and CSR to firm's risk, this study suggests that the two relations are actually correlated with each other, especially in long-term. As firms become more socially responsible, they can manage to mitigate risks, which may lead to superior financial performance, enhancement in firm value and growth in reputation. It might be done by enhancing capital efficiency, cutting down costs on immaterial uncertainties, encouraging risk-based developments and building investor trust so that organizations could enjoy more stable earnings. Besides, lowering risk by using CSR may add value to investors who have the tendency to be risk averse, as well as decreasing the costs of financial distress.

The generalizability of results in this paper is subject to certain limitations. Limited to the sample, different results may be obtained when different companies in other sectors are used. Over and above that, future research may examine the comparison of companies who are legally required to do CSR with those organizations that have free decisions to behave socially responsible or disclose their CSR-related policies and implementations to the public, whether in the same or different countries. KLD dimensions may not be significantly relevant for Indonesian organizations and may be subject to author's judgment and subjectivity. Limited to the proxies used for the variables, further research may use other indicators, making the measurement more specific, use other alternative indicators for financial performance or combine other indicators for firm's risk, such as market risk (beta) or firm-specific risk. Finally, limited to the publicly available data, information not disclosed in other sources might have another effect toward the relationship of CSR, CFP and firm's risk.

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Appendix

Table A1 KLD strengths and concerns		
<i>Issue areas</i>	<i>Strengths</i>	<i>Concerns</i>
Community	Charitable giving Innovative giving Volunteer programs Support for housing Support for education	Negative economic impact Tax disputes Investment controversies
Diversity	CEO Board of Directors Work/life benefits	Non-Representativeness Major controversies
Employee relations	Strong union relations Retirement benefits strengths Health and safety strengths Employee involvement	Poor union relations Retirement benefit concerns Health and safety concerns
Environment	Beneficial products and services Pollution prevention Recycling	Hazardous waste Substantial emissions Regulatory problems Ozone-depleting chemical Agricultural chemical Climate change
Products	Quality R and D/Innovation	Product safety Marketing/Contracting concerns Antitrust problem

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