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Research paper

Economy and Social Commitment-Based Investment and Role of Board of Directors (BOD) toward Corporate Value

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Abstract

Economy and social commitment-based investment is a corporate investment policy strategy which can generate profits that are able to improve corporate values and meet the interests of stakeholders. Corporate social responsibility (CSR) activity is a high-cost program, but some companies consider that it does not give significant results to their corporate values. This study aims at bridging the gap between the study and practice of the CSR. It was conducted at go public companies in Indonesia from 2012-2014. The result of this study shows that the intensive role of the Board of Directors (BOD) strengthened the effect support of economy and social commitment-based investment to enhance the corporate values.

Keywords: *Economy and social commitment-based investment, role of the BOD*

1. Introduction

Corporate Social Responsibility (CSR) is a form of the company's commitment to build, together with related stakeholders, a better quality of life, especially of community where it operates. The CSR has a very important role in encouraging more corporate social responsibility to create a balance between economic, social, and environmental developments. In developing countries, the CSR gets a significant attention from the government, academia, and civil society. The government as the regulator confirms that the company's commitment to CSR is reflected in the regulation on the company's obligation to implement the CSR as stated in Article 74 of Law Number: 40 of 2007 regarding Limited Liability Company.

In fact, not all companies carry out their CSR obligations. The companies assume the CSR as a waste because the company's budget is absorbed for unprofitable activities. Today the CSR practices are carried out as a public relation activity that builds a corporate image and that prioritizes programs viewable by public rather than by companies, which basically have the same position in the CSR stakeholders. The companies prefer donating the CSR funds to an existing program to creating their own initiatives (Bhattacharyya & Nag, 2012).

Socially-oriented investment is the use of company funds for social and environmental interests as a form of the CSR to the stakeholders. The use of funds for the CSR gains indirect benefits. The CSR generate profits with regard to the benefits of creating goodwill of stakeholders (Ullmann, 1985; Jones, 1995; Waddock and Graves, 1997). The theoretical bases and the instrumental theories that explain this perspective are Stakeholder Theory (Jones, 1995) and Good Management Theory (Waddock and Graves, 1997; Orlitzky et al. 2003). The companies that implement the CSR can avoid the costs of fines or claims on environmental issues proposed by community (Waddock and Graves, 1997).

A gap of the studies on the CSR is shown by their results, which claim that the CSR brings about negative impacts on the corporate values. The cost on the bottom line is high and will always reduce the profits and wealth of the shareholders (Preston and Bannon 1997). Investment made by companies in India in the CSR program affects a financial performance. The result of the study shows that the CSR investment return is undetectable, but it is found not later than one year after it is created, and the investment in environmental initiatives is proved to have negative impacts on performance (Bhattacharyya & Nag, 2012). Based on the gap between the studies and the phenomena mentioned above, the objectives of this study are: (1) to assess the economy and social commitment-based investment toward the corporate values; (2) to examine the role of the BOD in strengthening the economy and social commitment-based investment strategies to enhance the corporate values.

2. Material and Method

The economy and social commitment-based investment is a corporate investment strategy which integrates simultaneously-oriented economic and social investments. The aim of this strategy is to combine the advantages of an investment using a motive of getting profits as much as possible with a social investment or a corporate social responsibility. This is to maximize the creation of value aligned between the shareholders and the stakeholders (Indriani and Wahyudi, 2013). This concept is derived from the synthesis of agency and stakeholder theories in line with Jensen (2001); Graves and Waddock (2000); and Davis (2005).

The BOD is the most important mechanism used by the shareholders to monitor the management (Perry and Shivdasani, 2005). The BOD represents the owners of the organization and is responsible for ensuring that the organization is effectively managed. It is also responsible for adopting control mechanisms to ensure that the management of behavior and action is in accordance with the interests of the owners.

This study applied the intensity of the role of the BOD as an approach used by the board in performing its functions and role. The intensity of the role of BOD was measured using a composite method through combining composition and process attributes. Process attribute used the proxy of meeting frequencies among the BOD, the committees, and the directors (Zahra and Pearce, 1989). The composition attribute used the proxy of the number of independent boards.

Based on the above explanation, the hypothesis can be constructed as follows: "Return on investment-based on economic and social commitments supported by the higher intensity role of the board will increase the corporate value ".The built empirical research models can be illustrated in Figure 1 as follows:

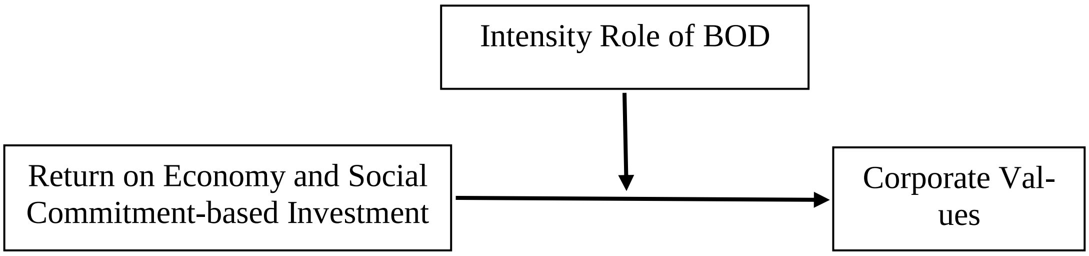

Fig1: Empirical research model

The population included all companies listed on the Indonesian Stock Exchange both manufacturing and non-manufacturing companies from 2012 - 2014. The sampling method used the purposive sampling. The criterion samples used in this study were as follows: (1) annual reports which were consistently published by companies from 2012-2014; and (2) corporate governance and implementation of the CSR, which was applied and disclosed in the annual report.

The variables used in the study were: (1) return on economy and social commitment-based investment – ROESI (Indriani and Wahyudi, 2013); (2) corporate value by proxy value of Tobin's q (Q); and (3) moderating variable: the intensity role of the board (IRB). The economy and social commitment-based investment was measured in two different dimensions, namely: the dimension of corporate financial performance and that of corporate social performance. The former was measured by using ROA (McGuire et al. 1988; Waddock & Graves, 1997; Preston & O'Banon, 1997; Johnson & Greening, 1999; Crisostomo et al. 2011; Wissink, 2012). Meanwhile, the latter was measured by using the ratio of the proportion of funds allocated to corporate social responsibility activities of the net profits (Bhattacharyya and Nag, 2012). ROESI was measured by the proxy of corporate abilities to provide funds for the CSR activities of the assets used by the investment (Indriani and Wahyudi, 2013). The IRB was measured by using the proxy of meeting frequencies (Vafeas, 1999; Conger et al. 1998; Collins and Kofi, 2011) and the proportion of independent board of the total number of commissioners (Hermalin & Weisbach, 2003). The data of the research were analyzed by using the moderating regression analysis and moderation testing by using residual test.

3. Result and Discussion

The data used in this study were panel data. To fulfill the consistent data from 2012-2014, 141 data of observation companies were collected. During the data screening, there were 18 outlier data in the samples so that the screened data used in the subsequent processing were 123 observational data.

The testing of the IRB as moderating variable used the residual test. The residual analysis was used to test the effect of deviations from the model. The focus of this analysis was the lack of fit, which was generated from the deviation of the linear relationship between independent variables. The Lack of fit was indicated by the value in the residual regression (Ghozali, 2005: 157). In this case if there was a match between the ROESI and the IRB (small or zero residual value) and both the ROESI and the IRB were high, the Q would be high and vice versa. Table 1 show whether or not the IRB was the moderator variable and in this case, it was indicated by the coefficient (b1) of Q which was significant and negative direction. The result of the test shows that the coefficient of Q had a significance of 0.08 in the negative direction. It is obvious that there was a match between the ROESI and the IRB. Therefore, the ROESI was higher, and it was supported by increasing the IRB and thus the Q would be higher (the hypothesis was verified).

Table 1: Result of hypothesis testing

	Critical Ratio	Prob.	Direction	Description
ROESI → Q	2,051	0,042	positive	significance
ROESI → Q moderated by IRB (residual test)	-1,766	0,080	negative	hypotheses verified

Sources: result of data analysis, 2016

The return on the economy and social commitment-based investment had a positive impact on the creation of corporate values. The result of the test supported the theory of good management, which states that there is a high correlation between good management practices and corporate social performance. This is a concern that the domain of corporate social performance can enhance relationships with stakeholder groups staple (Freeman, 1984), resulting in better overall performance. The results of this study provided an empirical support for financial performance as the dependent variable that is in line with McGuire et al. (1988) research in support of the theory of good management. Waddock and Graves (1997) describes social performance as a predictor of financial performance. The result also supported that of research by Indriani and Wahyudi (2013) that the synchronization of the economic investment and the oriented social strategy will have an impact on the value creation.

The result of this study shows that the intensity role of board (IRB) which is a corporate governance mechanism (Vafeas, 1999; Perry, 1996; Conger et al, 1998 ;. Collins and Kofi, 2011; Cotter and Silvester, 2003; Klapper and Love, 2002; Shan and McIver, 2012) could moderate the return on economy and social commitment-investment on the corporate values. This study provided evidence that the intensity role of the board would establish good corporate governance.

Previous studies have shown a change in the role and functions of the supervisory board from the role of monitoring to the role of services and strategies in decision-making (Fama and Jensen, 1983; Zahra and Pearce, 1989; Kassinis and Vafeas, 2002; Nicholson and Kiel, 2007; Mallin and Michelon, 2010). This study, more specifically, discussed the expansion of the role of the board of directors in governance theory within the framework of agency theory, dependence, and resources of stakeholders. The intensive role of the BOD was an evidence of its seriousness in performing its functions proactively and independently so as to strengthen the implementation of a policy on the economy and social commitment-investment to enhance the corporate values. The result of this study shows that in this case the role of the board referred to the implementation of a conflict resolution hypothesis in which the company or its executives was subject to the supervision of shareholders through the role of the board. Effective corporate governance forced the executives to do their best for the shareholders and the stakeholders. Under the effective management, the executives utilized the CSR involvement to resolve conflicts between the stakeholders to maximize the values of shareholders (Harjoto and Jo, 2011). This result was in line with the Agency-Stakeholder theory, claiming that the monitoring structure and the law enforcement mechanism is to reduce the loss of utilities (Hill and Jones, 1992; Jensen, 2001).

4. Conclusion

The economy and social commitment-investment was an investment company policy strategy to enhance the values of shareholders. The economy and social commitment-based investment strategies would be able to increase the corporate values depending on the mechanisms of corporate governance in the context of the intensity of the role of the board of directors. The board required a change in role from the role of monitoring into the role of services and strategies in decision-making. The board proactively took the role independently and objectively that it supported the company's policy on the economy and social commitment-based investment strategies to increase the values of shareholders and those of stakeholders.

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