

# THE EFFECT OF OWNERSHIP STRUCTURE, PROFITABILITY, LEVERAGE, AND FIRM SIZE ON CORPORATE SOCIAL RESPONSIBILITY (CSR)

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## ABSTRACT

Corporate Social Responsibility (CSR), indicator used was the index of CSR disclosure with 64 companies listed in Indonesia Stock Exchange period of 2012 as the samples. This research used multiple regression analysis. The results show that institutional ownership, managerial and foreign has no effect on CSR. This indicates that the ownership structure could not improve CSR in the company. On the contrary, profitability has an influence on CSR. It indicates that companies with high profits have the fund flexibility to implement CSR programs that have been set. Moreover, corporate debt levels also affect the CSR with the negative direction. This means that companies with high debt levels will usually focus more on managing faced business risks rather than on CSR program. Last, company size has no effect on the company CSR.

**Keywords:** CSR, ownership structure, profitability, leverage, firm size

## INTRODUCTION

Corporate Social Responsibility (CSR) is a mechanism for an organization to voluntarily integrate social and environmental concerns in its operations and its interaction with stakeholders. CSR is a business commitment to continue to act ethically, operate legally and participate in improving the economy, the quality of life of employees and their families and improving the quality of the public at large (The World Business Council for Sustainable Development/WBCSD). CSR can be seen as a strategic and competitive program for the company in business competition. CSR can provide many benefits for the companies and communities. First, there is an increase in profitability for companies. The companies that implement CSR would normally be assessed normally by society so that their products will be more attractive and it will improve the financial performance. Second, it reduces the risk from the surrounding communities. Third, it

increases the reputation of the companies which can be viewed as a social marketing for the company.

Many various activities are conducted on behalf of the company. The Corporate Social Responsibility (CSR) ranges from simple activities such as providing aid money to the comprehensive program to empower the community. CSR can also be done internally in the company. For example, it can be training for employees and their families, adequate working facilities, nurseries, scholarships for the employees' children, and with outside companies such as CSR community or communities. There are variations in CSR activities held by the company because the company looked at the importance of CSR in different ways. There are three reasons why companies do CSR, namely: (1) compliance, (2) minimizing the risk and (3) creating value (Bhatt, 2002). First, the compliance means the company is willing to undertake CSR activities due to regulatory demands like stated in Law No. 40 of 2007. This law mandates the company

to carry out CSR programs. Second, it is to minimize risks. The company develops and implements policies and procedures to minimize damages or losses that may result from the company operations or business associates. Third, creating value means that the company creates social value involving the community in it like building community institutions. Moreover, the Practice in CSR implementation has many variations. Swandari and Firdaus (2013) showed that the intensity variations or differences in applying CSR in South Kalimantan. It shows various CSR from the manipulative, minimal and serious activity. For example, the "A" company gave a little fund to build a mosque, but in fact the mosque is funded by surrounding communities. Besides, the companies that earnestly implement CSR have a clear plan and will control the success of CSR from time to time, so people are satisfied with the implementation of the company CSR. On the other hand, the companies that do not apply CSR seriously will make community.

There are several variables that may be related to CSR. For example, it can be the ownership structure. The ownership structure is very important since it can influence strategic aspect of the company including CSR as said by Porter (1990) that the purpose of the company was determined by the structure of ownership, owners and creditors motivation, corporate governance, and processes that made up the incentive motivation of the manager. The ownership structures are divided into institutional ownership, managerial ownership, and foreign ownership.

CSR will be considered as an important factor by institutional shareholders. The implementation of good CSR will ensure the sustainability of a company that the institutional investors will prefer to invest in companies with good CSR. In the research by Oh *et al.* (2011) about the influence of the ownership structure of companies in Korea, it showed the effect of share ownership by managers negatively affected the rating shareholding where as CSR managers from outside the company had no effect on CSR. In addition, Dincer (2011) examined the effect of ownership structure on CSR in the Istanbul Stock Exchange as the CSR was measured by the report that refers to the Global Research Initiative (Global Reporting Initiative, 2006). The results indicated that ownership by the government had a positive effect on CSR.

Porta, Lopez-de-Silanes, and Shleifer (1999) conducted research on the ownership structure too. The sample was large and small companies in various countries around the world. The ownership structure divided into five types. There are the family or the individual, state ownership, the ownership by a financial institution (bank or insurance), the ownership of the company, and the mixed ownership (cooperatives or trust). The results showed that only about 36% percent of the large companies in the world whose ownership was in the company (spread). 30% were in control of the family, 18% were state ownership, and the rest was institution and mix. The results also showed that the share ownership was

relatively widespread in the country that had a good legal system that was deemed capable of protecting the interests of individual shareholders like in the US. While for countries other than US (where protection of minority shareholders was weak), was relatively concentrated on ownership in the hand of the company (the controlling shareholder). Even the large companies had a tendency to have a controlling shareholder. It could be said that there had been no clear separation between ownership and control in many companies in various countries other than the United States. According to Wiwattanakantang (2001), ownership by a family was associated with high levels of debt.

Moreover, Fauzi, Mahoney, and Rahman (2007) stated that large companies did not only give priority to financial performance when buying shares of other companies, but they also paid attention to other important or other strategic aspects like longterm benefit of a company. In addition, the institutional shareholders usually have a company pension funds, banks, and insurance companies. They want to invest in the good company at the insistence of their clients. A good company can be indicated as the company with the good implementation of CSR. According to Oh *et al.* (2011), the institutional ownership had the positive effect on CSR. On the contrary, Pushner (1995) stated that there was a negative relationship between institutional ownership with leverage and the leverage with productivity. Then, Shleifer and Vishny (1997) argued that institutional ownership can influence the organizational decision by applying power. Institutional ownership also had adequate information about both the businesses and the ability to forecast it.

In developed countries, its ownership is relatively spread out, so there is a separation between ownership and control. The main conflict that arises is the conflict between the owners and controllers. The manager has the potential to perform actions that are detrimental to shareholders. Ownership of shares by managers is expected to harmonize the actions of managers with the interests of the owners. In the case of Indonesia, the structure of corporate ownership is highly concentrated in individuals and families. It means that individuals and families have the majority of shares, so they control the company. The manager is just an assistant of the shareholders for their interests. Sometimes, the managers may have family relations with the largest shareholder. Although these companies employ professional managers, a strategic decision is still held by the company shareholders. These conditions are supported by Claessens, Djankov, and Lang (2000). Soliman *et al.* (2013) conducted research on the effect of ownership structure on CSR in Egypt. It showed ownership by managers is negatively related to CSR in companies listed on the Egyptian stock market. That research supports the idea that most managers still have relevance to the controlling shareholder. When controlling shareholder is not too concerned about the interests of other parties, the manager will support the policy. Managers can also have a different

opinion like more concerned with CSR. However, the number of shares held are not allowed them to oppose the policy of controlling shareholders. Ownership of shares by the manager does not necessarily make the company implement CSR programs well.

Along with the financial liberalization, many countries continue to be open to the entry of foreign investors. It is undeniable that the presence of foreign investors can have positive impacts. Khana and Palepu (1999) examined the effect of ownership on the performance of foreign and domestic companies that are in the group and independent. The results stated that there was a significant difference in the performance monitored by a foreign company compared to the domestic one. The companies that were monitored by foreigners had a better performance. The possible reason was that foreign institutions chose a company which was associated with the group and had a better level of transparency. In addition, they had better the capability of monitoring than the domestic one.

Foreign ownership can also affect the company's CSR. Foreign owners must have had experience investing in many countries. Foreign investors bring in new management techniques, mechanisms of corporate governance and information technology (Arun & Turner, 2004). CSR activities are part of corporate governance that foreign ownership is associated with implementing a better CSR. Oh *et al.* (2011) described that foreign ownership had a positive effect on CSR.

The other factors that may be important to the company related to CSR is profitability. Nurkhin (2009) has shown the effect on the profitability of CSR. The companies that have more profit can have more flexibility in using the funds. Therefore, the companies with high profits can execute CSR programs that have been planned well.

The next factor that should be taken into consideration is the level of debt or leverage. OgoImagai (2013) stated that many of the manufacturing companies relied more on debt as the major source of finance than the capital itself. The use of high debt may increase the risk of the company. It is because the high levels of debt mean the high amount of interest expense that must be paid. As a result, the availability of funds to implement the CSR program is reduced.

The firm size may have an effect to the CSR too. According to Bayoud, Kavanagh, and Slaughter (2012), the various factors affecting CSR in the Libyan capital markets revealed that firm size had an effect on CSR. Many large companies have a good and comprehensive CSR program and are truly capable of empowering the community.

This research is different from the previous research, especially research in foreign countries. It is because the conditions in Indonesia are relatively unique with weak law enforcement. The factors that have an effect on CSR in the other countries may not have an effect in Indonesia. This research shows differences in the intensity and seriousness regarding the implementation of CSR on various forms of

ownership structure which are important to be known by policymakers and investors. For the research limitation, researchers only use one year CSR data. The period is short, so researchers can not observe the dynamics of CSR from the company from time to time.

More importantly, there are two purposes of this research. First, it is to examine the effect of ownership structure (institutional ownership, managerial ownership, foreign ownership) on CSR. Second, it is to examine the effect of profitability, debt levels and the size of the company on CSR.

## METHODS

This research is a causal research. The causal research tests the effect of several independent variables on the dependent variable. The dependent variable in this research is CSR, while the independent variables are the ownership structure consisting of institutional ownership, managerial ownership and foreign ownership, profitability, leverage and firm size.

The data used are secondary data such as data about CSR and ownership structure and several other variables such as profitability, leverage and the firm size. The data used is Corporate Social Responsibility Disclosure Index (CSRDI) of the Global Reporting Index. The data is qualitative data about the disclosure of CSR derived from the annual report. In addition, the data of ownership structure and other variables are obtained from the company annual report.

The populations for this research are all companies in the manufacturing sector in the BEI. There are 160 companies in the list. Then, the sampling technique in this research is purposive sampling with the criteria that the companies are listed on the Stock Exchange in 2012 and have issued an annual report containing information on CSR for three consecutive years. Therefore, based on this criteria, there are 64 companies obtained as the samples.

The dependent variable (Y) is CSR. This variable is measured using the Corporate Social Responsibility Disclosure Index (CSRDI) based on the Global Reporting Initiative (GRI). The index calculation of CSR is done with the approach dichotomy meaning every item of CSR in this research instrument is rated. The perfect disclosure of CSR information will be given the score 2. If the disclosure is less than perfect, it scores 1. The score 0 is given to the CSR information with no disclosure. There are about 72 studied items. The entire scores of the company are summed to obtain the overall score. If a company has an excellent CSR disclosure, the total score will be 144.

The independent variables are the ownership structure (institutional ownership, managerial ownership, and foreign ownership), profitability, leverage and firm size. The institutional ownership is the percentage of ownership owned by the local institutions, and managerial ownership is the

percentage of shareholding held by the manager. Foreign ownership is ownership by foreign institutions. The profitability is calculated by the ratio of net profit by dividing the tax by equity. Meanwhile, the leverage is counted from the total of debt divided by total capital, and the firm size is calculated from the natural log of total assets.

Based on the variables used, the model of research is formulated. It can be seen below.

$$CSR = a_0 + b_1 INST + b_2 FOREIGN + b_3 MNJ + b_4 PROFIT + b_5 LEV + b_6 LNSIZE + e \quad (1)$$

Which means:

- CSR = CSR index,
- INST = Institutional Ownership
- MNJ = Managerial Ownership
- FOREIGN = Foreign Ownership
- PROFIT = Profitability
- LEV = Leverage
- LNSIZE = Firm Size
- e = The Error Term

The research model must fulfill the classical assumptions. The classical assumption is to test the assumptions of normality, multicollinearity, and heteroscedasticity. Meanwhile, auto correlation test is not performed because the data used is the cross section data. This type of data is data collected from many companies for in only one year.

Moreover, F test will test the hypothesis that the independent variables have the effect on the dependent variable simultaneously. On the contrary, T-test is used to test the effect of each independent variable on the dependent variable. The steps carried on in the t-test is as following: (1) to formulate a hypothesis,  $H_0: \beta_0 = 0$ . It means that independent variable ( $X_i$ ) does not have a significant effect on the dependent variable ( $Y$ ); (2)  $H_0: \beta_0 = 0$ . It implies that the independent variable ( $X$ ) has no effect on the dependent variable ( $Y$ ) partially; (3)  $H_a = b_1, b_2, b_3, b_4, b_5, \text{ and } b_6$ . It means that the independent variable ( $X$ ) has an effect on the dependent variable.

## RESULTS AND DISCUSSIONS

The classical assumption made in this research are the normality, heteroscedasticity and multicollinearity test. The overall test of classic assumption shows there is a problem in classical assumption so the model can be used for prediction.

Table 1 shows the result of the test on the effect of institutional ownership, managerial ownership, foreign ownership, profitability, leverage and firm size on CSR. The F value is 2,561 with a significance level at 0,029. It means that the independent variables affect the CSR simultaneously. Moreover, the T-test results show that the variables of INST or ownership by local institutions have a coefficient of -1,344. It is negative with a significance level of 0,184. It means

INST has no effect on CSR. Next, for the variable of MNJ or ownership by managers or controlling companies shows a value of -0,352 with a significance level of 0,726 in T-test. MNJ has no effect on CSR. FOREIGN variable or ownership by the foreign institution is -0,951 with a significance level of 0,346. Thus, FOREIGN has no effect on CSR.

Table 1 Effect of Institutional Ownership, Managerial Ownership, Foreign Ownership, Profitability, Leverage and Firm Size on CSR

Model	Unstandardized Coefficient	t statistic	Significance
Constant	1,150	15,491	0,000
INST	-0,144	-1,344	0,184
MNJ	-0,114	-0,352	0,726
FOREIGN	-0,094	-0,951	0,346
ROE	0,002	2,255	0,028
LEV	-0,077	-2,531	0,014
LNSIZE	0,000	0,707	0,482

F stat = 2,56 (significance at  $\alpha = 5\%$ )  
Adj R<sup>2</sup> = 0,129

(Source: Appendix, the results of the data with SPSS)

Furthermore, the results of the T-test for ROE (Return On Equity) of the profitability show a value of 2,255 with the positive significance level of 0,028. This is measured by ROE with positive effect, or it will increase the value of CSR. T- test for the variable LEV or leverage indicates the value of -2,537 with the significance level of 0,014. It means that the level of debt will reduce the value of CSR. Then, LNSIZE variable or the size of the company shows t-statistic of 0,707 with a significance of 0,482. It implies that the firm size does not increase the value of CSR.

According to the statistical analysis, most of the variables have no effect on CSR. These variables are INST, MNJ, FOREIGN and LNSIZE. INST variable has no effect on the value of CSR index meaning that the local institutional could not perform good CSR activities. This result is in contrast to research by Oh *et al.* (2011). They said that the ownership institution had effect on CSR. The cause may be the CSR activities that are still seen as weight by the company that considers it as unnecessary. Meanwhile, the result supports the research by Swandari and Firdaus (2013).

Next, the variable of MNJ also has no effect on CSR. It implies that managerial ownership does not make the company perform a comprehensive CSR program. These results are different from the research by Oh *et al.* (2011) and Soliman, El Din and Sakr (2013). The results of their research explained that managerial ownership affected the CSR negatively. This is possible because the small portion of ownership

has little influence in the strategic decision making including decisions about the implementation of CSR programs. This is coupled with the fact that not all managers have stock in the company. On the contrary, the result is the same as the research by Swandari and Firdaus (2013).

In addition, FOREIGN variable has no effect on CSR too. It means ownership by foreign institutions do not have the effect on the company's CSR program. The result is in line with the research by Swandari and Firdaus (2013). However, these results are in contrast with Yong Oh *et al.* (2011) who stated that foreign ownership had an effect on CSR. This may be due to several reasons. First, the average of foreign ownership is below 50%, so they are not the only party that decides the implementation of CSR in the company. Second, it is the low awareness of foreign institutions in implementing a comprehensive CSR program. It is because the demand in gaining economic benefits is higher than implementing CSR programs.

Furthermore, profitability variable as measured by ROE shows the effect of the profit level on CSR. It has a positive effect on CSR implying the company must have sufficient funds to implement CSR programs. This supports the research finding by Nurkhin (2009).

The variable of LEV has negative effects on CSR. This may indicate that companies with high debt levels will have a high degree of risk. This means the company will secure more its position in front of the creditors in advance than to fund CSR programs.

Last, LNSIZE variable has no effect on CSR too. This implies the size of the company does not affect the company in conducting the CSR programs. The firm size does not make the implementation of a comprehensive CSR.

## CONCLUSIONS

This research aims to analyze the effect of institutional ownership, managerial ownership, foreign ownership, profitability, leverage and the firm size on CSR. The results show that institutional ownership, managerial ownership, and foreign ownership have no effect on CSR. This indicates that the ownership structure is not capable of promoting CSR in the company. Meanwhile, profitability has the influence on CSR that companies with high profits fund have the discretion to implement the planned CSR programs. In addition, corporate debt level or leverage affects the CSR in the negative direction. It indicates that companies with a high debt level will focus more on managing the faced than CSR. Last, firm size has no effect on the company CSR. In contrast to the original assumption, it turns out to big companies do not always pay attention to CSR. Furthermore, it is also suggested that the research can be replicated in another sector with the hope that ownership structure will be proven to have a positive influence on CSR.

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