

## CHAPTER II

### THEORETICAL FRAMEWORK

#### II.1 Development of CSR Concept

According to the Synergos Institute the fundamental aspects of CSR are environmental stewardship and corporate governance. The concept of environmental stewardship is an agri-environment scheme; a term used to describe national (or local) schemes that pay farmers to farm in an environmentally sensitive way, run by the Department for Environment, Food and Rural Affairs in England (Defra) On the other hand, corporate governance is defined by Sir Adrian Cadbury at the Global Corporate Governance Forum at World Bank in 2000 as follows "Corporate Governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society"

The definition given by Sir Adrian Cadbury; the first man, who created the regulation on corporate governance in 1992, generally discusses about separation of interests. Eventually, the Organization for Economic Co-operation and Development (OECD) established a set of principles as guidance for implementation of good corporate governance, namely:

1. Ensuring the basis for an effective corporate governance framework

2. The rights of shareholders and key ownership functions,
3. The equitable treatment of shareholders,
4. The role of stakeholders in corporate governance,
5. Disclosure and Transparency,
6. Responsibilities of the Board.

However, the system of corporate governance varies from country to country partly as results from cultural differences and historical circumstances. Moreover, the system is different from one corporation to another due to the different structure of the company and the focus of ownership in the company. The differences are usually on the role of the stakeholders, the priorities of the stakeholders and the importance of financial markets. In Indonesia, as formulated by the National Committee on Corporate Governance (NCCG) the principles adapted for implementation of good corporate governance are:

1. Transparency,
2. Accountability,
3. Responsibilities of the Board,
4. Independency,
5. Fairness.

Compared to the OECD principles, the NCCG principles are more focused on a narrower subject, namely the segregation of duties. This area concerns much with the accounting area. Whilst, the OECD principles deal with a broader issue which is the interests of stakeholders as a whole.

In the past, the general standpoint on these principles was that they were only intended for the shareholders. However, certain events have triggered a shift in the point of view. At one time, laws and regulations were considered only to protect shareholders but now it is regarded as a standard applied in organizations to protect every concerning stakeholder. The society has come to realize that they are also stakeholders because they are affected by the company's activities. Apart from the society, stakeholders also include employees, shareholders, investors, environment and the government. CSR is a means to meet the company's obligations and responsibilities towards their stakeholders. Therefore, by conducting CSR a company is showing that they are also committed to their stakeholders not just their shareholders.

CSR essentially deals with the impact of a company's actions on society moreover requiring a manager to consider his acts in terms of a whole social system, and holding him responsible for the effects of his acts anywhere in that system. By implementing CSR beyond compliance, an organization will be considered as a good corporate citizen. In addition, corporate citizenship is defined as "The contribution a company makes to society and the environment through its core business activities, its social investment and philanthropy programs, and its engagement in public policy" The concept is broken down into three components which are:

- Corporate social *responsibility* – emphasizes obligation and accountability to society,
- Corporate social *responsiveness* – emphasizes action, activity, and
- Corporate social *performance* – emphasizes outcomes, results

Frederick (1978) in his working paper entitling *From CSR1 to CSR2: The Maturing of Business-and-Society Thought* said “Thus, CSR2 (Corporate Social Responsiveness) is the capacity of a corporation to respond to social pressures.” In addition, Wood (1991) said Corporate Social Performance (CSP) is “a business organization’s configuration of principles of social responsibility, processes of social responsiveness, and policies, programs, and observable outcomes as they relate to the firm’s societal relationships.”

Presently, being a good corporate citizen has been made easier considering the many regulations supporting the implementation of CSR, an increase in company’s responsiveness towards their social responsibilities and the performance of the company in order to meet the social responsibilities. On the contrary, in the past there are mainly two models known related to CSR, the economic model stating that the invisible hand of the marketplace protects societal interest and the legal model which says that laws protected societal interest. This situation was not very favorable for CSR implementation. From the 1950s to the present the concept of CSR has gained a considerable acceptance and the meaning has been broadened to include additional components. Not long after, the viewpoint evolved, several individuals changed their point of views.

As quoted by James Reidel in his lecture in 2002 McGuire said that “CSR mandates that corporations not only have economic and legal obligations, but also certain responsibilities to society that extend beyond these obligations” Following that, Reidel also quoted Epstein who made the following statement: “CSR relates primarily to achieving outcomes from organizational decisions concerning specific issues or problems, which by some normative standard have beneficial rather than adverse effects upon pertinent corporate stakeholders. The normative correctness of the products of corporate action have been the main focus of CSR”

Following that statement and enhancing it, is Carroll's definition of CSR. According to Carroll's four part definition, CSR encompasses the economic, legal, ethical and discretionary (philanthropic) expectations that society has of organizations at a given point in time. The society requires the company to be profitable and obey laws and regulations. In addition the society expects the company to do what is right, fair and just, they desire the company to be a good corporate citizen; generating profits in an ethical manner.

In order to understand Carroll's four part definition easier a pyramid; widely known as pyramid of CSR; is illustrated.

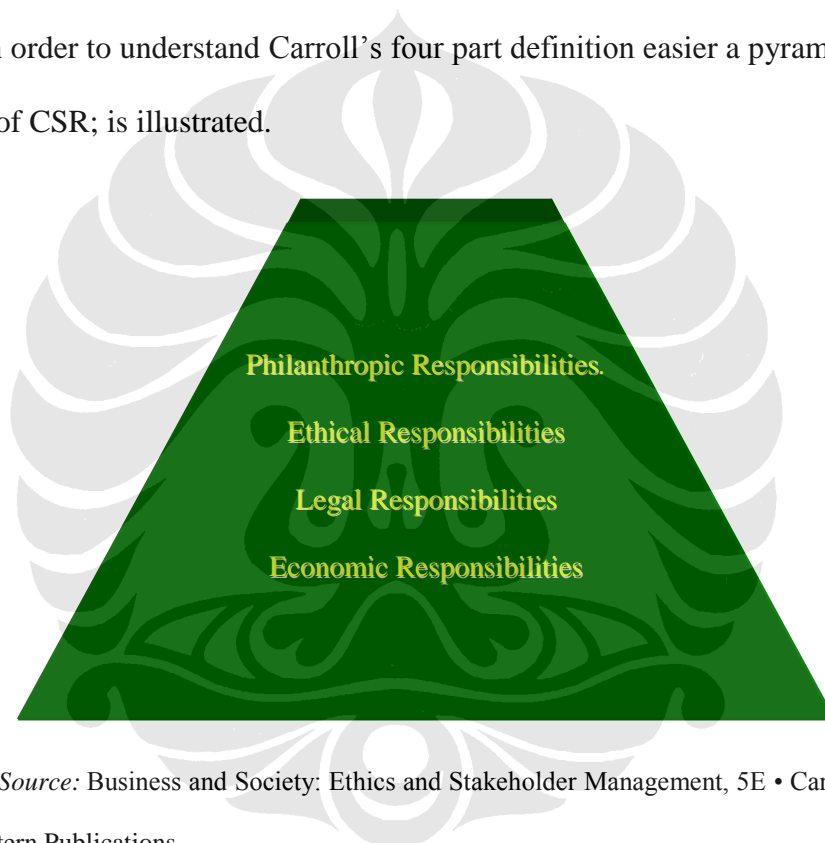


Figure 2.1 *Source:* Business and Society: Ethics and Stakeholder Management, 5E • Carroll & Buchholtz (2003) South Western Publications

Parties in favor of CSR have said that CSR addresses issues by being proactive; CSR also protects business self-interest, addresses social issues caused by business and allows business to be part of the solution. On the contrary, there are also some people contradictive of CSR. The opposing side argues that CSR restricts the free market goal of profit maximization, dilutes the primary purpose of business, and limits the ability to compete in a

global marketplace. They are under the impression that business is not equipped to handle social activities.

James Reidel in his lecture at the David Eccles business school, University of Utah stated that he believes people may be separated between the ones in favor of and against CSR but in the 21<sup>st</sup> century businesses have to start thinking about their responsibilities, to be exact:

- Demonstrate a commitment to society's values and contribute to society's social, environmental, and economic goals through action,
- Protect society from the negative impacts of company operations, products and services,
- Share benefits of company activities with key stakeholders as well as with shareholders,
- Demonstrate that the company can make more money by doing the right thing.

The previously mentioned concept of corporate citizenship embraces three aspects covering the responsibilities namely corporate social responsibility, responsiveness, and performance. There are three perspectives following the link between social and financial performance. The first perspective gives away the thought that corporate social performance (CSP) drives the relationship, the second perspective believes that corporate financial performance (CFP) drives the relationship, and the third perspective sees the existence of an interactive relationship among CSP, CFP and corporate reputation. See figure.

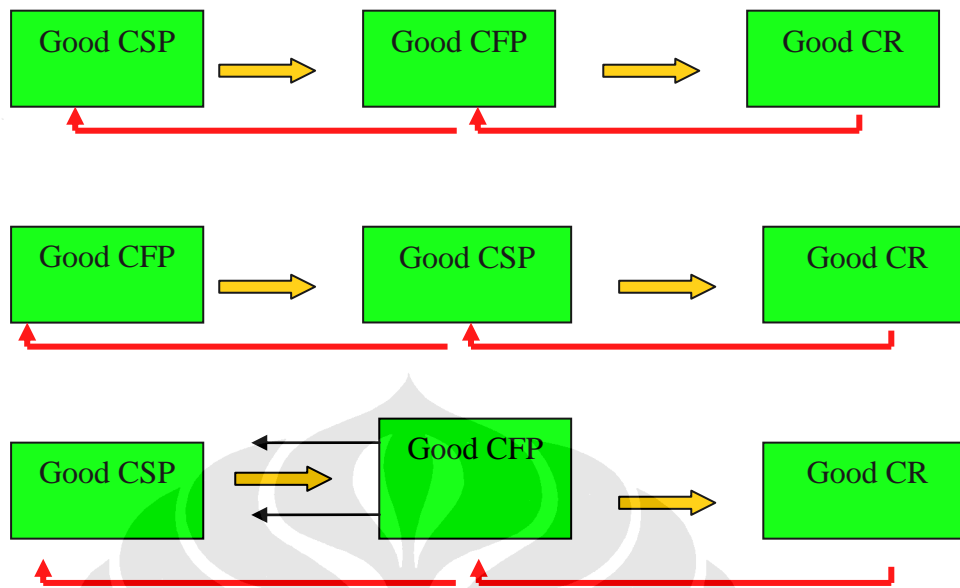


Figure 2.2 Source: James Reidel's presentation in 2002 at the David Eccles Business School, Utah, USA. "Corporate Citizenship, Social Responsibility, Responsiveness and Performance"

The conventional view believes what constitutes a good citizenship is charitable donations and local community action, e.g. employee volunteering, youth projects, unemployment schemes, etc. Corporate citizenship focuses on direct physical environment of the company furthermore it is deemed important because a stable, prosperous environment is good for business.

The citizenship encompasses three rights:

- Social rights: freedom to basic commodities (right to education, healthcare, welfare, etc.). The field area of this right for example are community projects, feeding homeless people, improving deprived neighborhoods, infrastructure in developing countries

- Civil rights: freedom from abuses (free markets, private property, freedom of speech, etc.). Land ownership/rights of indigenous are an example of the arena included in the civil right.
- Political rights: freedom to actively participate in societal decision making (right to vote, to hold office, etc.) i.e. lobbying and party financing, involvement in privatization of regulation.

These rights, on the one hand do not translate into corporate entitlements – e.g. rights to healthcare and education, or rights to vote. But on the other, corporations may still be active in the field of citizenship, in a rather different way. Whilst the government is the traditional guarantor of individual citizenship, corporations increasingly find themselves involved in the roles and functions previously associated with the government.

In administering the citizenship rights, the roles and functions of government have not yet been found in some areas such as providing decent working conditions in developing countries and protecting workers' civil rights in countries with oppressive regimes. Additionally, the government ceases to administer some of the citizenship rights as can be seen from privatized social services such as healthcare, education, etc. To add up, the administration of the rights in corporate involvement in global governance is beyond the reach of nation state government.

Gallie (1956) said that “Many view corporations are alike with citizens. Debates rose whether corporations ‘are’ or ‘are like’ citizens. Moreover, citizenship is still a ‘contested concept’ because citizenship is internally complex and the rules of application are relatively open.”

Truthfully, corporations can behave just like citizens for these reasons:



- Companies are made up of humans,
- They also carry a face in the society,
- Their functional identities differ from one another,
- Each of their legal identity is distinctive,
- Corporations are in other words social enterprises.

By perceiving corporations as citizens the implication is corporations have the right and the duty to participate in societal decision making

## **II.2 Significant Ethics Issues in Business and the Accounting Profession**

Ethical business is important for corporations planning to be sustainable. Directors, executives, and accountants have come to acknowledge certain approaches for some decisions and key aspects of a corporation's activities such as awareness, accountability and governance which should be managed in a certain manner. Thus, ethical decision making and ethics risks and opportunities should be taken into account and thought carefully.

### **II.2.1 Ethical Decision Making**

In making decisions, it is no longer adequate to only see the decisions from a legal standpoint. Decisions should also be ethical. According to Brooks (2006), "a decision or action is considered ethical or "right" if it conforms to certain standards. Philosophers and business ethicists have found that one standard alone is insufficient to ensure an ethical decision. The ethical decision making (EDM) framework proposes that decisions or actions should be compared against four standards for a comprehensive statement of ethical behavior. The framework assesses and evaluates the ethicality of a decision by examining the:

- Consequences or well-offness created in terms of net benefit or cost (consequentialism);
- Rights and duties affected (deontology);
- Fairness involved (justice);
- Motivation or virtues expected.”

The first three which are the philosophical approaches, are examined by focusing on the impacts of a decision on shareholders and other affected stakeholders, an approach known as stakeholder impact analysis. The fourth on the list is an approach known as virtue ethics.

Consequentialists aim to maximize the utility produced by a decision furthermore it requires analysis on harms and benefits to multiple stakeholders and how to arrive at a decision that produces the greatest good for the greatest number. Hence, to be considered ethical an act or a decision should have more favorable consequences than its negative consequences. On the contrary, the focus of the deontology approach is on the obligations or duties prompting decisions taken or actions rather than on the consequences. Brooks (2006) added that “A deontological approach raises issues related to duties, rights and justice considerations and suggestions to use moral standards, principles and rules as a guide to making the best ethical decision. Augmenting the consequentialist approach with a deontological analysis specifically including fair treatment will guard against the situation where the desire for what some consider as beneficial consequences (ends) will be allowed to justify using of illegal or unethical actions (means) to achieve the desired ends”

On the other hand, virtue ethics are more concerned with aspects behind the moral character demonstrated by decision makers. Brooks (2006) supported this statement by saying “Virtue ethics focuses on the character or integrity of the moral actor and looks to moral

communities, such as professional communities to help identify ethical issues and guide ethical action” The absence of a “right” reason for virtuous action may appear academic. But without that reason some businesspeople tend to act for greedy self-interest and are more likely to commit unethical acts. For that reason, a “right” reason for every virtuous action is needed. Adversely, too much virtuosity may cause executives or employees acting emotionally or taking too much risk, or harming others unnecessarily prior to being well-informed.

An illustration below; adapted from AACSB (The Association of Advanced Collegiate School of Business EETF Report, June 2004; gives an easier understanding of the EDM approaches and criteria:

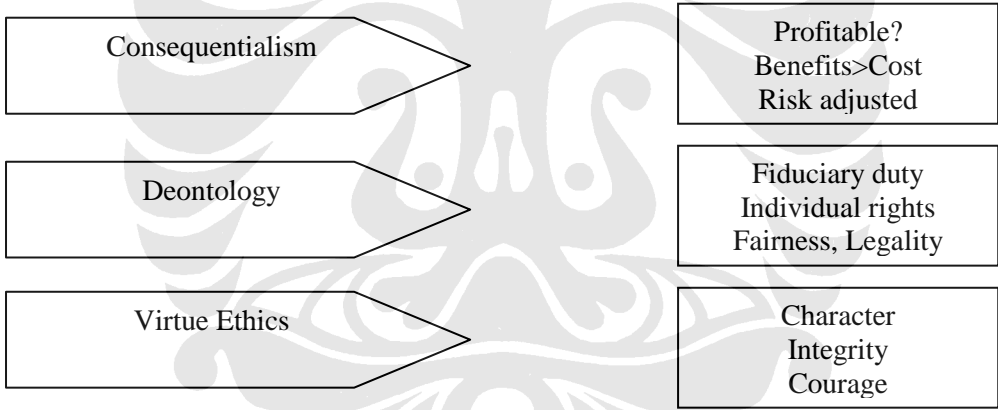


Figure 2.3 Source: See AACSB EETF Report, June 2004

It should also be noted what constitutes benefit is the greatest good for all or good states of affairs meaning every concerning party will gain from the decision made. The outcome of positive consequences can further be interpreted according to views adopted. Hedonistic utilitarianism defines a good action as one that results in an increase in pleasure, and the best action is one that results in the most pleasure possible. However, one might take a stand on non-psychological goods as the relevant effect. Thus, one might have a perspective

that positive consequences translate to an increase in material equality or political liberty. To further see the differences among the three approaches a comparison of the theories by Curtis Brown from the Department of Philosophy at Trinity University may be helpful.

	<b>Consequentialism</b>	<b>Deontology</b>	<b>Virtue Ethics</b>
<b>Example</b>	<b>utilitarianism</b>	<b>Kantianism</b>	<b>Aristotelianism</b>
<b>practical reasoning model</b>	means-ends reasoning: how do I get what I want/what's good?	how do I determine what's rational?	what habits should I develop?
<b>personal identity ( what is essential to the self?)</b>	will & reason + desires	will & reason (desires are thought of as outside forces with the potential to thwart rationality)	will& reason + desires + character traits
<b>Rationality</b>	getting what you want	doing what reason requires (at a minimum, not having inconsistent or self-contradictory policies)	having the kinds of desires which reason determines are best
<b>central question</b>	what ought I to do? (act orientation)	what ought I to do? (act orientation)	what's the best sort of person to be? (agent orientation)
<b>main object of evaluation</b>	consequences (states of affairs)	Acts	people (agents)
<b>the good</b>	<b>BASIC NOTION</b>  (for most consequentialists, maximum happiness or something similar)	right action itself (? or possibly states of affairs brought about by right action? or states of affairs in which people who act rightly are rewarded?)	whatever results from the actions of good people? happiness? acquisition of goods internal to practices (MacIntyre)?
<b>the right</b>	actions that maximize the good	<b>BASIC NOTION</b>	the sort of thing a virtuous person would do in the situation
<b>Virtue</b>	being disposed to maximize utility (for simple versions of consequentialism, there will be just one big virtue; more complex versions might have many)	positive attitude toward doing one's moral duty(?)	<b>BASIC NOTION</b>  (but may be analyzed, e.g. as those dispositions necessary for the attainment of happiness)

Figure 2.4 Source : [http://www.trinity.edu/cbrown/intro/ethical\\_theories.html](http://www.trinity.edu/cbrown/intro/ethical_theories.html)

Besides the EDM approaches illustrated, there is also a tool for assessing decisions and actions called the Stakeholder Impact Analysis. In the past, only the impacts of decisions on the interest of the company’s owners or shareholders are considered. The impacts are

usually measured based in terms of the profit or loss involved. Since it is no longer relevant to look at it from this standpoint, the traditional view has been modified in two ways. Brook (2006) stated that “First, the assumption that all shareholders want to maximize only short-term profit appears to represent too narrow a focus. Second, the rights and claims of many non-shareholder groups, such as employees, consumers/clients, suppliers, lenders, environmentalists, host communities, and governments that have a stake or interest in the outcome of the decision or in the company itself are being accorded status in corporate decision making.”

Both shareholders and these non-shareholders form the set of stakeholders. Companies are coming to realize that they will not be able to reach its maximum potential and may even perish if it loses the support of any set of its stakeholders known as *primary stakeholders*.

At the present, the number of ethical investors has increasingly grown in the portion of investors in corporations. They are more interested in longer time-horizons and in how business is ethically conducted. Brooks (2006) moreover said “Ethical investors apply two screens to investments: do investee companies make a profit in excess of the appropriate hurdle rates, and do they earn that profit in an ethical manner?” Ethical investors have developed informal and formal networks to keep them well-informed about corporate activities, decide how to vote proxies, and how to approach the Board to get them to pay attention to their concerns in such areas as environmental protection and excessive executive compensation. These ethical investors believe that a company should be managed in a broader basis than short-term profit only.

Corporations are more aware of the fact that in the past they have been legally and pragmatically accountable to shareholders but they are also becoming increasingly

accountable to stakeholders. The figure gives a brief description on corporate stakeholder accountability.

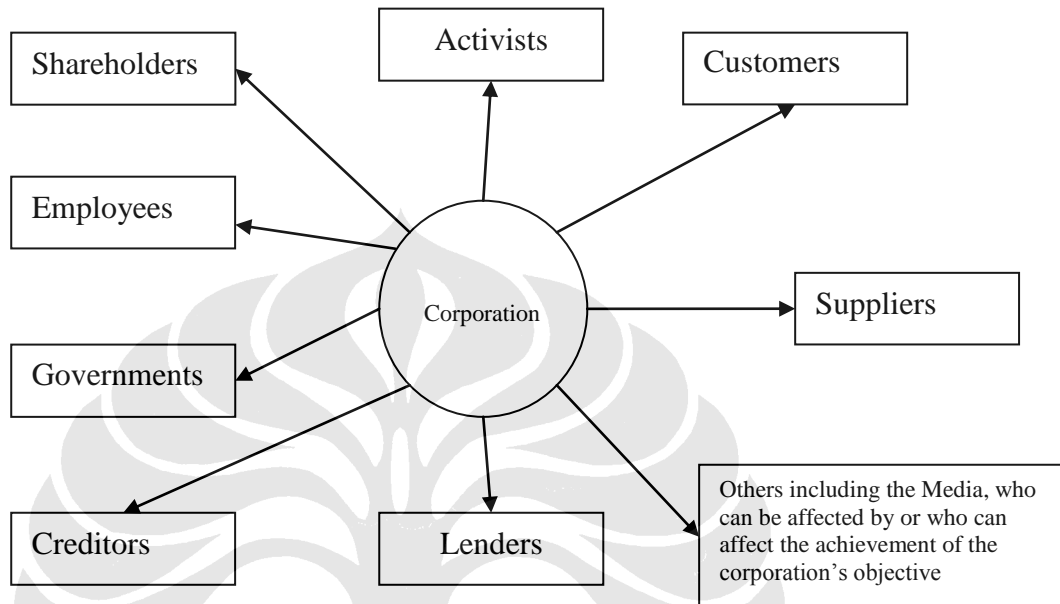


Figure 2.5 *Source* : Business and Professional Ethics for Directors, Executives, and Accountants by Leonard J.Brooks (2006)

Brooks (2006) gave away the thought that “The multiplicity of stakeholders makes it easier to identify a set of commonly-held interests to be used to focus analyses and decision making on ethical dimensions. The following are the three commonly-held or fundamental interests of the stakeholders:

1. Well-offness—the proposed decision should result in more benefits than costs
2. Fairness—the distribution of benefits and burdens should be fair
3. Right—the proposed decision should not offend the rights of the stakeholders and the decision maker.

All three interests must be satisfied in order for a decision to be considered ethical.”

Impacts on stakeholders caused by decisions and actions taken can be quantified or non-quantified. Profit is an example of a quantifiable impact that is fundamental to the interests of shareholders and is essential to the health of companies however there are items which are not included in profit that is measurable directly and indirectly. The impacts from the decisions and activities not included in the determination of the profit may have caused the impact itself. According to Brooks (2006), Externalities—consequences of production ignored in pricing, factors such as environmental damage that results from the way something is produced but not taken into account in establishing the market price of the good and materials concerned— and their impacts can often be measured directly by the costs incurred by others. Corporations ignoring externalities over time will find that they have underestimated the true cost of the decision when fines and expenses incurred or bad publicity emerges. Other externalities exist when the cost is included in the determination of the company's profit, but the benefit is enjoyed by persons outside the company.

Besides the quantifiable impacts, it is previously stated that there are also non-quantifiable impacts. The non-quantifiable impacts in the analysis are fairness among stakeholders and the rights of the stakeholders. Fairness is not an absolute concept and it requires responsibility and perspective to judge fairness accurately. Even Brooks (2006) thinks that “In many cases, even where protection is afforded through statute, considerable judgment is required to know when an individual's rights are being violated.”

The usefulness of a stakeholder impact analysis depends on the full identification of all stakeholders and their interests. The significant impacts on the position of each stakeholder must also be firmly grasped. Values included in cost-benefit analysis or risk-benefit analysis weighted, or the NPV created can be ranked according to the impact created on the stakeholders involved. The ranking of stakeholders and the impacts on them based on their

situational capacity to withstand is also used when non-measurable impacts are being considered.

Mitchell, Agle and Wood (1997) suggest that “Stakeholders and their interests be evaluated on three dimensions:

1. Legitimacy or legal and/or moral right to influence the organization;
2. Power to influence the organization through the media, government or other means;
3. Perceived and real urgency of the issues arising.”

It is often not considered that an organization’s stakeholders are constantly evolving, as does the power they have depending on the urgency they feel about issues brought to their attention. Rowley (1997) has said that “..a set of stakeholders be considered as a dynamic network and that projections should be made about who in the network will influence whom, to forecast which issues and interests will become more important”

Several approaches employing stakeholder impact analysis have been developed to provide guidance about the ethicality of proposed actions to decision makers. Brooks (2006) said “Choosing the most useful and proper approach depends on whether decision impacts are short rather than long run, involve externalities and/or probabilities, or take place within a corporate setting. Approaches may be blended into a tailored hybrid approach to best cope with a specific situation” There are mainly three approaches 5-Question Approach developed by Graham Tucker, Moral Standards approach developed by Velasquez and Pastin’s approach. To get more insight in these three approaches concisely, the three tables explaining each approach briefly on the next page may be of help.



<b>Moral Standards Approach</b>	
<b>MORAL STANDARD</b>	<b>QUESTION OF PROPOSED DECISION</b>
<b>Utilitarian:</b>	
Maximize net benefit to society as a whole	Does the action maximize social benefits and minimize social injuries?
<b>Individual rights:</b>	
Respect and protect	Is the action consistent with each person's rights?
<b>Justice:</b>	
Fair distribution of benefits and burdens	Will the action lead to a just distribution of benefits and burdens?
*All three must be applied: none is a sufficient test by itself	

<b>5-Question Approach</b>	
<b>IS THE DECISION</b>	<b>STAKEHOLDER INTEREST EXAMINED</b>
1. profitable?	Shareholders'—usually short-term
2. legal?	Society at large—legally enforceable rights
3. fair?	Fairness for all
4. right?	Other rights of all
5. going to further sustainable development?	Specific rights

<b>Pastin's approach</b>	
<b>KEY ASPECT</b>	<b>PURPOSE OF EXAMINATION</b>
Ground rule ethics	To illuminate an organization's and/or an individual's rules and values
End-point	To determine the greatest net good for all concerned
Rule ethics	To determine what boundaries a person or organization should take into account according to ethical principles
Social contract ethics	To determine how to move the boundaries to remove concerns or conflicts

Figure 2.6 *Source* : Business and Professional Ethics for Directors, Executives, and Accountants by Leonard J.Brooks (2006)

Apart from these three approaches, an assessment of the motivation, virtues and character traits involved in comparison with those expected by stakeholders must be incorporated so that a comprehensive ethical analysis can be obtained.

However, according to Brooks (2006) “..virtue expectations have not yet been widely regarded as important in stakeholder impact analysis. “Therefore, it would be wise to include the assessment of virtue ethics expectations as a separate step in any EDM process to strengthen governance systems and guard against unethical, short-sighted decisions. Consequently, decision makers should take motivations and behavior expected by stakeholders into account specifically in any comprehensive EDM approach, and organizations should require accountability by employees for those expectations through governance mechanisms

To sum up, there are three steps to be taken for an ethical decision:

1. Identify the facts and all stakeholder groups and interests most likely to be affected,
2. Rank the stakeholders and their interests, identifying the most and weighting them more than other issues in the analysis
3. Assess the impact of the proposed action on each stakeholder group interest with regard to their well-offness, fairness of treatment and other rights, including virtue expectations.”

## **II.2.2 Ethics Risks and Opportunities**

According to Leonard J. Brooks in his textbook in 2006 in order to manage ethics risks and opportunities, there is a set of tools to effectively deal with them, and they are as follows:

- Ethics risk management;

- Ethics strategies and tactics for effective management of stakeholder relations;
- Workplace ethics;
- International operations;
- Corporate social responsibility performance and accountability;
- Crisis management.

Brooks (2006) defined ethics risks as “..those risks of not meeting stakeholder expectations, where not meeting expectations leads to a potential loss of support for a corporation’s objectives and exceeding expectations leads to an opportunity to garner support through the creation of a competitive advantage.”

Moreover Brooks (2006) also concluded that “The Sarbanes-Oxley Act of 2002 suggested that to be effective risk management should be an integral part of good governance when it brought governance reform to SEC registrant companies around the world and spawned similar governance reform regulation in many other national jurisdictions. Unless, corporations begin to consider a full ethics risk management framework, they will continue to suffer from risks and lose opportunities they do not foresee. Directors and executives who are responsible for monitoring all ethics risks, must design in-house audit or review processes or specifically contract with designated outsiders to perform those reviews. External auditors will not normally be expected to raise all ethical risks or opportunities with management or the Audit Committee of the Board.”

The external auditors tend to do only what they are instructed to do as what is specified in the standards of procedure The new point of view of the emerged accountability of corporations to stakeholders has stated that stakeholder satisfaction is based upon corporations’ respect on the interests of each stakeholder group from whom the corporation

wants and needs support to reach its strategic objectives. Brooks (2006) emphasized that “Without the stakeholder support perspective, an investigator may not recognize risks that could lead to loss of support or opportunities for the creation of competitive advantage based on support.”

There are three phases involved in the process of ethics risk and opportunity identification and gap assessment:

1. Phase 1: identification of the corporation’s major stakeholders and their interest.
2. Phase 2: consider corporation’s activities and assess the risks of not meeting or opportunities of exceeding expectations.
3. Phase 3: preparation of the reports generated by the process.

The following figure illustrates the ethics risk and opportunity identification and gap assessment:

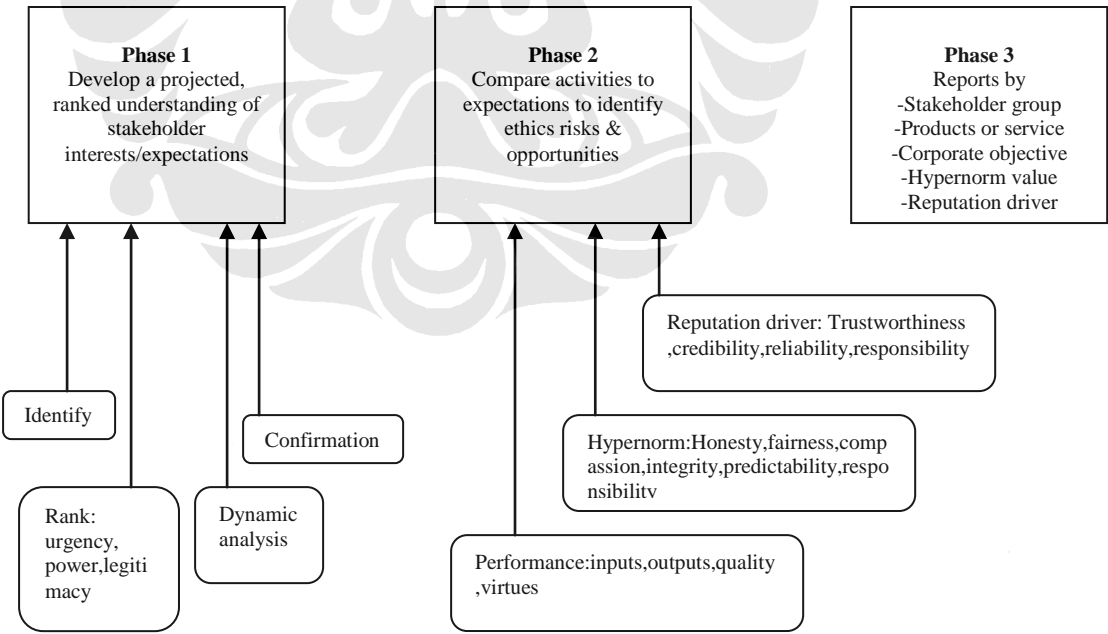


Figure 2.7 Source : Business and Professional Ethics for Directors, Executives, and Accountants by Leonard J. Brooks (2006)

Strategies and tactics may be developed and modified so that they will be able to deal with each stakeholder or group based upon an assessment of stakeholder interests. Corporations should also consider possible changes in stakeholders' interest. Brooks (2006) said that "This continuous reconsideration of stakeholder interests and potential gaps from corporate behavior could be part of the organization's environmental scanning or issues management programs, and could provide input into its business-government relations program" Stakeholder gap analysis can be very useful in creating and maintaining overall stakeholder support.

In addition to that, corporations are now increasingly aware that they are accountable to stakeholders as a whole not just to its shareholders. As a result, organizations are now more and more interested in measuring the performance that various stakeholders are interested in. Stakeholders are usually interested in finding out what is going on, how management techniques are working and what to report to board committees and for compliance.

In addition Brooks (2006) has suggested that an organization developing a comprehensive framework for CSR should consider its strategic goals both as an operation and how it wishes to appear as a corporate citizen, the culture of its operations will encounter the interests of its stakeholders, both in domestic and foreign markets. This will prompt the company to formulate a strategy with ethical objectives which consider the interests of the stakeholders and cultures to be dealt with. Furthermore, a corporation doing CSR is expected to give positive impacts on its stakeholders and make disclosures about the impacts.

At the present, organizations can keep track of their CSR through the use of measurements or indicators. These measurements or indicators of CSR can take many forms. There are about eighty of those used by EthicScan Canada's Corporate Ethics Monitor. The measures of fact are grouped into categories covering:

- Codes or statements of guidance, their currency and their reinforcement;
- Job creation;
- Relations with communities and local stakeholders;
- Environmental management programs;
- Environmental performance;
- Ethical sourcing and trading practices.

Corporations deciding to do a CSR measurement program need to consider how it will report on performance, and to whom the reports are available. When a company decides to issue the report to the public then it should be better if an audit assurance of the CSR reports is made. Brooks (2006) stated that “The provision of assurance for CSR reports is in its infancy as far as standards of professionalism are concerned, particularly with regard to scope, techniques, and standard audit/certification reporting” Moreover, it should be noted that ISO auditors and SA8000 auditors are certified by the organizations involved.

#### *II.2.2.a International Operations*

Brooks (2006) has proposed that when any corporation operates outside of its domestic market, the normal guidance offered must be reconsidered as to:

- How their usual operating practices will impact on the local economy and culture;
- Whether different local foreign practices should be endorsed or banned;
- The reaction to these changes by domestic stakeholders and particularly by primary stakeholders including major customers and capital markets.

Brooks (2006) also stated that multinational corporations may have a significant impact on local cultures that they would not have domestically. They must be careful not to have unfavorable impacts on local:

- Labor markets;
- Raw material and other input markets;
- Political and legal processes;
- Religious and social customs.

Cultural imperialism may incur if a multinational corporation fails to bear in mind the local religious and/or social customs. Perhaps the most difficult problems arise when the values of the primary stakeholders differ from those in the local foreign country. The most common differences noted in recent years have included approval of bribery and use of child labor. Many corporations choose location for operations in a country for reasons such as its cheap labor, lower environmental protection costs, or other reasons. Businesspeople should pay attention and consider about the emerging globalization and the new broader accountability towards stakeholders.

Companies should consider the fact that damage in their reputation is usually the most significant impact they will suffer. The impact of lost of reputation translates into losing future revenues in a very large magnitude. After all, reputation is the greatest asset a company can have, and without it a company would not be able to survive and will eventually collapse. In addition, there is an impact on the morale of domestic employees to be considered from engaging in practices not considered worthy.

### II.3 Corporate Social Initiatives

Corporate social initiatives are major activities undertaken by a corporation to support social causes and to fulfill commitments to corporate social responsibility (Kotler and Lee, 2005). In performing and fulfilling their social responsibilities, companies have several options. Kotler and Lee (2005) classify the options into six activities, as follows:

1. Cause Promotions (Increasing awareness and concern for social causes): Funds, in-kind contributions, or other corporate resources provided to increase awareness and concern about a social cause or to support fundraising, participation, or volunteer recruitment for a cause. The promotion can be done in several ways such as initiate and manage companies' own promotions, become a major partner in an effort, or be one of several sponsors.
2. Cause-related Marketing (Making contributions to causes based on product sales): A commitment to make contribution or give donations as a percentage of revenues to a specific cause based on product sales. Generally, this is for an announced period of time, for a specific product, and for a specified charity. Often for this activity, corporations become partners with non-profit organization, creating a mutually beneficial relationship designed to increase sales of a specified product and to generate financial support for the charity.
3. Corporate Social Marketing (Supporting behavior change campaigns): The support companies give to the development and/or implementation of a behavior change campaign intended to improve public health, safety, and environment, or community wellbeing. The behavior change differentiates this initiative from cause promotion since cause promotion focuses on supporting awareness, fundraising, and volunteer recruitment for a cause.



4. Corporate Philanthropy (Making a direct contribution to a cause): Direct contributions made by companies to a charity or cause, frequently in the form of cash grants, donations and/or in-kind services. This is the most traditional of all corporate social initiatives and for a long time was approached in a responsive, even ad hoc manner. Companies are now becoming more pressured to move to a more strategic approach, choosing a focus and tying philanthropic activities to the company's business goals and objectives.
5. Community Volunteering (Employees donating their time and talents): The support and encouragement companies give to employees, retail partners, and/or franchise members to volunteer their time to support local community organizations and causes. This activity may be a stand-alone effort or it may be done in partnership with a non-profit organization. These activities may be organized by the corporation, or employees may choose their own activities and receive support from the company through such means as paid time off and volunteer database matching programs.
6. Socially Responsible Business Practices (Discretionary business practices and investments to support causes): A company adopts and conducts discretionary business practices and investments that support social causes to improve community well-being and protect the environment. Initiatives may be conceived of and implemented by the organization or there may be in partnership with others.

According to Synergos Institute, the most general forms of CSR activities in Indonesia are corporate philanthropy and community relations (community development). Additionally, from the study of Saidi and Abidin (2004) the common pattern of CSR activities in Indonesia

are direct involvement, through foundations or company's social organizations, become partners with other parties, and support or form a consortium.

Public Interest Research and Advocacy Center (PIRAC) did a research on the subject of the potential of CSR in Indonesia, based on their research in 2002 the total fund collected for CSR was US\$ 11.500.000 or the equal amount of Rp.115.000.000.000, 180 companies participated and there was 279 CSR activities. Furthermore, the research shows that multinational companies are the largest contributors with national companies came in second and local companies in the last place.

#### **II.4 Benefits from CSR Implementations**

Integrating social responsibility in business strategy does not necessarily mean creating a burden and cost that will make a company's strategy less effective. Business for Social Responsibility; a leading nonprofit global organization providing businesses with information, tools, training, and advisory services related to integrating CSR in their business operations and strategies; did a research and they have come to a conclusion that companies have experienced a range of these bottom-line benefits:

1. Increased sales and market share

Cone/Roper conducted many surveys showing strong evidence that companies can benefit significantly from connecting themselves to a cause.

2. Strengthened brand positioning

In the book *Brand Spirit* by Hamish Pringle and Marjorie Thompson, they said that by making contributions linking company or a brand to a relevant charity or cause, the "spirit of the brand" will get benefits.

3. Improved corporate image and clout

According to Business for Social Responsibility, companies that demonstrate they are engaging in practices that satisfy and go beyond regulatory compliance requirements are being given less scrutiny and more free rein by both national and local government entities.

4. Increased ability to attract, motivate, and retain employees

Studies conducted by Cone/Roper indicate that a company's participation in social initiatives can have a positive impact on prospective and current employees, as well as the other stakeholders.

5. Decreased operating costs

Several business functions have incurred decreased operating costs and increased revenue from grants and incentives as a result from the implementation of CSR.

6. Increased appeal to investors and financial analysts

Praveen Sinha, Chekitan Dev, and Tania Salas suggest that demand for investments in firms deemed socially responsible can be enhanced as some mutual funds are mandated to make investments in only those companies deemed socially responsible (for instance, CREF's Social Choice Fund).

## **II.5 Millennium Development Goals (MDGs)**

In September 2000, 147 Heads of State and Government representing 191 nations endorsed the Millennium Declaration. This declaration laid out a set of ambitious goals for poverty reduction and social progress to be accomplished by the year 2015.

The Millennium Declaration is an international commitment to time-bound, specific and measurable aims to reduce poverty at large and advanced social development. It suggests that everyone should be involved and encourage their counterparts to contribute to the

achievement of the MDGs because it is now a growing concern of the people of the world. “The resulting MDGs mark a point at which the world acknowledged that global poverty levels are beyond the responsibility or capability of individual governments and that the international community also has an obligation to address the current unsustainable and unacceptable situation.” (Osodo, Prewitt, Richmond ; 2003)

Indonesia as one of the members in the UN is also participating in the achievement of the MDGs. President Susilo Bambang Yudhoyono in his speech during the Opening Ceremony of the Regional Ministerial Meeting on MDGs in 2005 stated that “The MDG is not only for improving the lives of our generation, but also of our future generations”

The eight concerning goals are

1. Eradicate extreme poverty and hunger
2. Achieve universal primary education
3. Promote gender equality and empower women
4. Reduce child mortality
5. Improve maternal health
6. Combat HIV/AIDS, Malaria and other diseases
7. Ensure environmental sustainability
8. Develop a global partnership for development

In order to greatly contribute to the achievement of these goals a collective action must be taken therefore companies and institutions are encouraged to undertake actions so that the public will be inspired to participate in the achievement of the MDGs.

## II.6 CSR Regulations

The government, particularly the Ministry of Environmental Affairs (KLH) conducts assessments and evaluations objectively towards various Community Development (CD) programs done by companies registered for the Program for Ranking Performance in Management of Natural Environment (PROPER). PROPER's performance ranking system has five color indicators reflecting the performance as a whole; gold, green, blue, red, and black. Corporations given the color red and black are the disobedient ones; the blue companies comply with the regulations, whilst the green colored ones are companies managing the environment beyond compliance with the regulation.

In order to obtain the recognition for the color green and gold (beyond compliance), three aspects are evaluated.

The aspects are:

1. Implementation of Environmental Management System
2. Utilization of Resources,
3. Realization of Community Development.

To date, no company has been rated gold due to the indicator for achievement in the community development activity criteria that still needs to be developed towards a measurable rating.

Along with the indices and ratings coming out to the surface in discussions internationally and locally in the nation; Indonesia, and the development of ISO 26000 as an

international standard providing guidance for social responsibility, KLH expects contributions so that performance rating indicator in PROPER can be developed.

The importance of engaging the community is underlined in The Environmental Management Law established in 1997 point number 5, 6, and 7 stating the rights and obligations of the community and natural environment. This law is further supported by the Government Regulations (PP RI) No.27/1999 about the Analysis on Impacts to the Environment (AMDAL) citing the transparency of information and the roles of the society. The involvement of local communities in planning, building, and the operation of the corporation become crucial. By involving them in worthy ways, it can bring more understanding to the people about the purpose and the objective of the project. Furthermore, this involvement is regarded as a check and balances mechanism between the community and the company.

In addition, the latest establishment of regulations on CSR is Law (Undang-undang) No.25/2007 and the frequently discussed draft of Company Law article 74 stating companies operating in areas relating to natural resources must meet their social and environment responsibilities

From the start, a business philosophy that brings together company with the community as a unity should be embraced. Achda (2006) uttered the following statement, “..thus forming a harmonious relations framework between the company or industry and its strategic environment. The fundamental of the good relationship must be placed within the symbiosis –mutualistic principles of mutual understanding and mutual benefit. Through this concept, it is expected that the community will be able to behave courteously and cooperatively toward company existence, while the company would continue to operate in a

healthy manner in pursuing economic profit while still increasing social responsibility for its environment, without having to worry over any social disturbance.”

For a long time CSR had been a voluntary activity so it is of no wonder its application is still freely interpreted based on the interest of the respective corporation. To bridge the gap that exists between the differences in implementing CSR, the government decided to set up some regulations so that the laws will have the ability to regulate, to restrict and to enforce. Earlier, social responsibility is considered as a non law responsibility however in Indonesia it is now progressively becoming mandatory. The government is setting up new policies so that companies disobeying the new established law will be given a penalty. Additionally, the application of CSR is still freely interpreted based on the interest of the companies conducting it. Thus it is very important to set up CSR regulations in Indonesia, so that the rules will be able to regulate the conduct as well as have a binding power. Seemingly CSR that was initially intended to be voluntary in nature needs to be raised to the level of mandatory. Some existing regulations on CSR will be discussed in a more comprehensive manner in the following sub subchapters.

### **II.6.1 PROPER KLH**

*Program Penilaian Peringkat Kinerja Perusahaan dalam Pengelolaan Lingkungan Hidup* (Program for Ranking Companies’ Performance in Management of Natural Environment) or more often shortened, PROPER is a program carried out by KLH, the program ranks companies’ performance in managing natural environments. The underlying bylaw behind the implementation of PROPER is the Minister of Environmental Affairs’

decree No.127/2002 and UU No 23/1997 on the subject of natural environment management. The establishment of this law is so that every concerning stakeholder will be informed of the company's performance on environmental management. Moreover, PROPER is often used as an instrument to measure CSR implementation in a company.

PROPER is regularly announced to the community so that the company will get an incentive or disincentive on its reputation depending on its obedience level. The use of color indicators in assessment of PROPER is a form of communicating the performance of the company to the society, starting from the most excellent, gold, green, blue, red and closing with the worst, black. By simplifying the indication, people will be more aware of companies' compliance level on the environmental management. In addition, more detailed information on how the companies manage the environment is also accessible.

PROPER evaluates whether companies are in compliance with the rules of:

1. Water pollution control,
2. Air pollution control ,
3. Management of dangerous and toxic cesspools (Limbah B3),
4. AMDAL (Analysis on Impacts to the Environment),
5. Sea pollution control.

Companies are obliged to meet these rules. If they do so, they will gain a blue status; if not they will either obtain a red or a black status depending on its resistance level. In order to achieve the green or gold status, corporations are required to do more than just what they are required to do (beyond compliance). They have to voluntarily employ additional instruments



such as the environmental management system, community development, deployment of natural resources and cesspool. In attaining the blue status a system of elimination is used; to attain a green or gold status, a weighting system is adopted. To date, no company in Indonesia has achieved the gold status.

The figure on the next page shows bylaws on which PROPER is based.



Figure 2.8 Source : <http://www.menlh.go.id>

As can be seen from the schematic, PROPER does not have any rules specifically backing up the application of community development. This is due to the characteristic of this area; a social matter, the mandate of which is not particularly in the area of KLH thus no incentive is given for corporations to do more than what they are required to do. But the

progress on community development (CD) has been very impressive from non existence in 1995 to community relation in 2003 and finally community development in 2005. In evaluating CD, these criteria are listed commitment, implementation program, community involvement, the result and the acceptance level in the society.

In general, how far a company has complied with the regulation can be regarded as a yardstick of its achievement in CSR implementation. And if the criteria of assessment are already specified further than it will be easier to know the specific compliance level. Next, the performance of expenditures and the cost savings made from the management of environment can be calculated. The data produced from this step can then be developed to measure CSR performance in the form of Triple Bottom Line Report.

Unilever Indonesia has been given the green status in PROPER by the KLH for its factories in Cikarang and Rungkut three times in a row meaning its operations have complied beyond what it is required to.

## **II.6.2 PP RI No 27 Tahun 1999: AMDAL**

Whenever a factory is built in Indonesia it must go through a certain process called AMDAL (Analysis on Impacts to the Environment). AMDAL is an evaluation of the significant and great effects to the environment which is performed in the planning phase and used in making decisions. Points evaluated in the AMDAL process are the physical-chemical aspect, ecological aspect, socio-economy aspect, socio-cultural aspect, and public health

aspect complementing the feasibility study of a business plan and/or activity. After performing the evaluation, three documents will be produced:

- Documents of Analysis of Impacts to the Environment (AMDAL),
- Documents of Environment Management Plan (Rencana Pengelolaan Lingkungan Hidup) or the RKL,
- Documents of Environment Monitoring Plan (Rencana Pemantauan Lingkungan Hidup) or the RPL.

AMDAL is the documentation of the AMDAL process. RKL is the documentation of plans the company has formulated in reducing the effects of the company's operations on the environment whereas RPL is the documentation of plans on the monitoring of the effects of the company's operations on the environment.

Organizations performing AMDAL in which its operations wish to increase the conformity in managing the environment can ask for an Environmental Audit voluntarily. This can be an internal management and monitoring tool. The execution of the audit refers to the Decree of The Minister of Environmental Affairs No.42/ 1994 on the subject of General guidance on Environmental Audit execution.

### **II.6.3 Law of Republic Indonesia Number 25 of 2007 Concerning Investments Article 15**

The critical condition of the level of awareness of companies in Indonesia in the importance of considering the stakeholders instead of only the shareholders has prompted the

government to establish a certain law. This new law is Law of Republic Indonesia Number 25 of 2007 (UU No.25/2007) concerning investments. This law was supposed to complement the other law related to the fulfillment of CSR; the Company Law article 74. Currently, The Company Law article 74 is still in the form of draft being discussed in the House of Representatives (DPR) whilst UU No.25/2007 was signed by President Susilo Bambang Yudhoyono on April 26<sup>th</sup>, 2007. This law might be easier to produce and establish because the objective is to attract investors. The binding regulation is covered in chapter IX on the subject of Rights, Obligations, and Responsibilities of Investors article 15.

The following statements can be found in article 15 in the concerning law:

Every investor shall have obligations:

- a. to apply the principle of good corporate governance;

*Elucidation of Article 15 item a: Sufficiently clear*

- b. to implement corporate social responsibility;

*Elucidation of Article 15 item b:*

*“Corporate social responsibility” means a responsibility mounted in every investment company to keep creating relationship which is in harmony, in balance and suitable to the local community’s neighborhood, values, norms, and culture.*

- c. to make a report on investment activities and submit it to the Investment Coordinating Board;

*Elucidation of Article 15 item c:*

*An investment report that contains an update of investments and obstacles the investor faces is submitted periodically to the Investment Coordinating Board and the regional government responsible for the field of investment.*

- d. to respect the cultural traditions of the community around the location of investment business activities; and

Elucidation of Article 15 item d: Sufficiently clear

- e. to comply with all provisions of laws and regulations.

Elucidation of Article 15 item E: Sufficiently clear

Besides article 15, supporting statements on the matter can be found in chapter II entitled “Principles and Purposes”, article 3 that the conduct of investments should be based on several principles some of which are similar to the principles of corporate governance established by OECD. The principles are legal certainty, transparency, accountability, equitable and nondiscriminatory treatment against country of origin, togetherness, efficiency in justice, sustainability, environmentally-sound, independence, and balanced advancement and national economic unity. Moreover some of the purposes of the conduct of investments are related to the problems CSR tries to address. Some of the purposes are to improve sustainable economic development, to turn economic potentials into real economic strength by use of funds derived from both home and abroad, and to improve public welfare. Sanctions on violation of the law is also discussed in the concerning Law in chapter XVI article 33-34.

Unilever Indonesia as a multinational company in the form of a limited liability company abides by the new law. Even though the conduct of CSR which was done accordingly and more thorough was done in 2000 when UPF was established, Unilever has been conducting CSR since it was first established in the year 1933. Therefore, the shifting in the CSR status from voluntary to a liability by the new established law does not affect the company significantly.

## II.6.4 Global Reporting Initiative

Sustainability reporting is the action where an organization publicly communicates their economic, environmental, and social performance. At times when social responsibility is a matter necessarily conducted and frequently discussed in companies and the well-being of the stakeholders is a concern of companies, a comparable document reporting on the companies' sustainability performance is required. The Global Reporting Initiative (GRI) successfully fills this role, GRI is a standard used by organizations worldwide as a guideline in sustainability reporting. It was established by the United States based non-profits Coalition for Environmentally Responsible Economies (CERES) and Tellus Institute, with the support of the United Nations Environment Program (UNEP) in 1997. The Guidelines aim to make financial statements in the 20<sup>th</sup> century more comparable to the statements in the 21<sup>st</sup> century. It is the most common framework used in the world for reporting. More than 1000 organizations from 60 countries use the Guidelines to produce their sustainability reports.

The latest improvement on the GRI is the G3; "Third Generation" of the GRI's Sustainability Reporting Guidelines, launched in October 2006. These guidelines are applicable to small companies, large multinationals, public sector, non governmental organizations (NGOs) and other types of organizations globally. How the guidelines are formed; through the multi-stakeholder consensus seeking approach; enables them to be so broadly applicable. The G3 is the base for reporting framework, illustrated is the framework containing the core product of the Sustainability Reporting Guidelines, as well as Protocols and Sector Supplements.

## G3 Reporting Framework

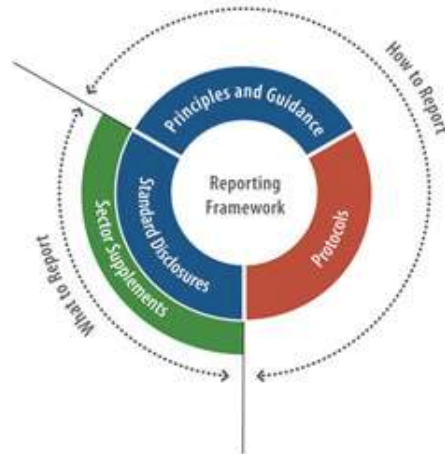


Figure 2.9 Source: Global Reporting Initiative Homepage, <http://www.globalreporting.org>

Protocols are the ideas behind each indicator in the Guidelines. They include definitions for key terms in the indicator, compilation methodologies, intended scope of the indicator, and other technical references. There are six indicator protocols namely economic, environment, human rights, labor, product responsibility, and society.

Sector Supplements complement the use of the core Guidelines by capturing the unique set of sustainability issues faced by different sectors such as automotive, financial services, logistic and transportation, mining and metals, public agencies, tour operators and telecommunications.

The G3 consists of two parts, part one reporting principles and guidance and part two standard disclosures. In part one the following can be found:

- Principles to determine report quality: materiality, stakeholder inclusiveness, sustainability context, and completeness.
- Principles to define report quality: balance, comparability, accuracy, timeliness, reliability, and clarity.
- Guidance on how to set the report boundary.

Whilst part two contains of three types of standard disclosures that should be included in sustainability reports and they are:

- Profile
- Management Approach
- Performance Indicators

The principles help reporters define the report content, the quality of the report, and give guidance on how to set the report boundary. Materiality, stakeholder inclusiveness, comparability and timeliness are included in the principles whilst disclosures on management of issues and performance indicators are covered in disclosure items.

Sustainability reporting leads to improved sustainable development outcomes because it allows organizations to measure, track, and improve their performance in specific issues. Organizations are much more likely to effectively manage a measurable issue. Besides that, reporting sustainable performance also promotes transparency and accountability; two of the principles of corporate governance.



## CHAPTER III

### PT. UNILEVER INDONESIA, TBK.

#### III.1 Company Profile

Unilever, an Anglo-Dutch company, has been operating in Indonesia for over 74 years. Unilever Indonesia has expanded, becoming a US\$900 million business with a market capitalization of US\$2.6 billion. With its purpose to meet everyday needs of people everywhere, Unilever is one of the largest consumer product businesses in Indonesia, and has been quoted in Jakarta Stock Exchange since 1981 when it went public. The company listed 15% of its shares on the Jakarta Stock Exchange and Surabaya Stock Exchange following the approval from the Chairman of Badan Pelaksana Pasar Modal (Bapepam). Unilever has three subsidiaries in which its ownership is direct, the subsidiaries are PT Anugrah Lever, PT Technopia Lever and PT Knorr Indonesia. The company also has a sister company operating in Indonesia namely PT Kimberly-Lever Indonesia (PTKLI); PTKLI is engaged in the production, development, marketing, distribution of toiletries, tissues, feminine products and disposable diapers. The following are some of the brands marketed in Indonesia:



Figure 3.1

Starting in the year of 1933 with a small soap factory in Batavia, PT.Unilever Indonesia,Tbk. has grown for almost more than 73 years along with the people of the nation. At the present, Unilever is producing over 100 products in their two factories in Cikarang and Rungkut, ranging from shampoos and teas to detergents and margarines. The company is represented in 14 product categories and has nine factories plus seven dedicated SMEs serving as third party manufacturers. It has a network of over 400 key distributors delivering its brands directly to over 700,000 shops. The company has 3,000 employees and a total of 20,000 people employed by SMEs whose businesses are directly linked to that of Unilever Indonesia. Unilever's products can be found throughout Indonesia, in various outlets, from small kiosks to large supermarket chains.

As a consequence, the operations of Unilever lead to impacts all over Indonesia. Together with this influence, they possess a great deal of responsibilities. Unilever has gained a thorough understanding of the dynamics of Indonesia's economy, society, and environment, for that reason they are confident that their success is related to Indonesia's strengths. Every day, they strive to create solutions benefiting to both Indonesia and Unilever. Energy savings to reduce emissions and production costs, increasing the capacity of supplier and their customers is just one solution amongst many.

Being a market leader and trendsetter in the country requires continuous and sustainable effort. Since its establishment in 1933, Unilever has made substantial investment to strengthen its brands and develop its human resources. Producing various food products, hygiene and personal care products in Indonesia; many of which are well-known, Unilever maintains to stay true to their commitment furthermore the strength of their products is unified to add vitality in life. Unilever is proud to put its name in every packaging of its brands so that people know who they are and what they do and stand for. This is reflected on

their mission adding vitality to life. Unilever fulfils the needs for nutrition, hygiene, and personal care through a variety of brands helping the society feel good, look good and get more out of life.

The close bond with the local cultures and markets around the world strengthen the relationship with the consumers and become the foundation for future growth. In this relationship, Unilever shares knowledge and international expertise with the local customers thus making them a “multi-local multinational” company. As a “multi-local multinational” the Company has organized various community projects in accordance with Unilever’s worldwide principles and built the concept of sustainable development into decision making process. In these projects the Company has accumulated a great deal of knowledge which it aims to use for the greater benefit of society.

The company’s long term success demands a full commitment to exceptional performance standard and productivity, working together effectively, and the will to embrace new ideas and the constant will to learn. They believe that in order to succeed, a company needs to have a high standard of corporate behavior towards everyone they work with, the environment affected by their operations and the community they grow with. This is the road to achieving a sustainable and profitable growth, creating long term value for the shareholders, people, and business partners.

Unilever is known worldwide, its branches are spread throughout the globe from Algeria to Zambia, USA to Indonesia. As a multinational company operating on a large scale, Unilever has many employees under its wings. These employees are also considered as the stakeholders of Unilever. They are organized into divisions headed by directors and officers. An illustration in the form of a chart is created to comprehend the organizational structure of the company easier. See figure.

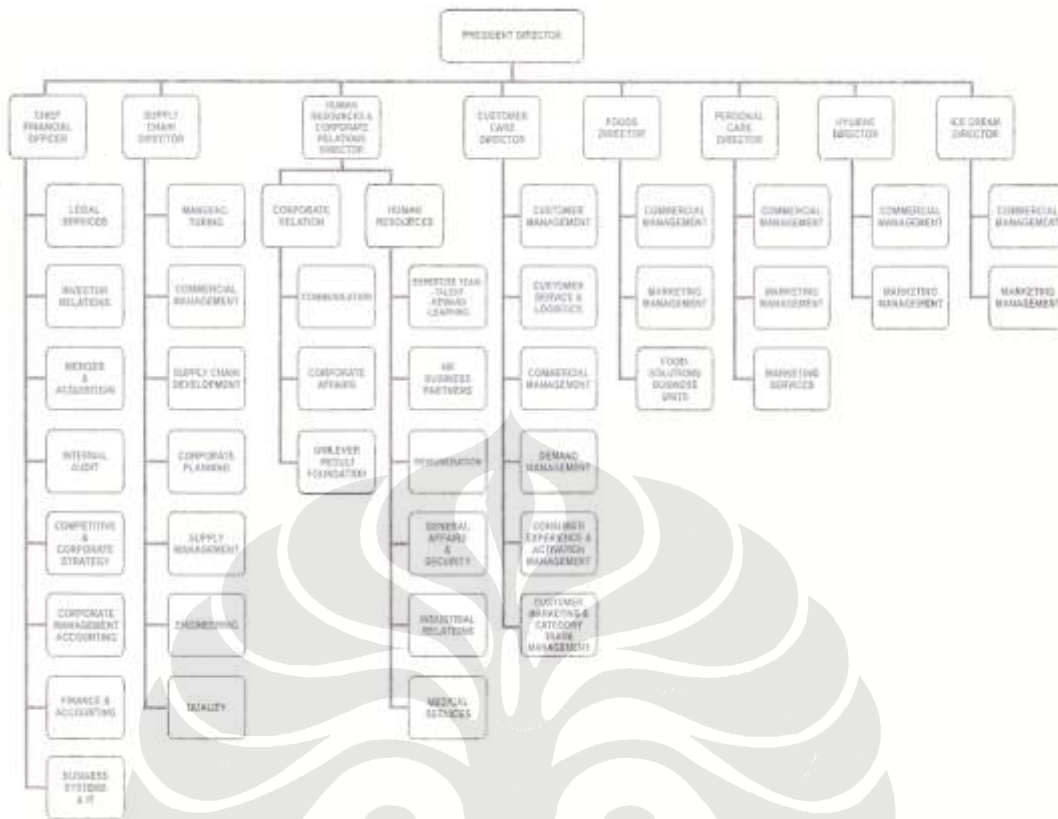


Figure 3.2 Source: PT.Unilever Indonesia Tbk.'s 2006 Annual Report

In order to create values for the stakeholders not just their shareholders they are committed to do the best in acting in accordance with the social responsibility by means of CSR. This is accomplished through the establishment of The Unilever Peduli Foundation formed in November 27<sup>th</sup>, 2000. This foundation can be regarded as the ultimate manifestation of the company's social responsibility. The establishment of this foundation is a significant step towards a simultaneous sustainable growth with the community and environment. Unilever strives to share its resources to contribute in the effort of achieving a better quality of life. Their mission is to unlock community's potential, giving added value, strengthening the synergy and become the catalyst in inspiring the development of

partnership. They continuously enhance their corporate reputation by promoting sustainability in the environment, people and the growth of business.

UPF basically consists of four divisions namely environment, health education, small and medium enterprises, and community relations which is further broken down into humanitarian aid, care for area surroundings and employee volunteering. The four divisions are managed by division managers which are headed by a general manager. The position of general manager is currently held by Mrs. Sinta Kaniawati. UPF employs two secretaries for the organization in general and two assistant managers helping the environment program manager and the SME program. Two persons are hired for the administration of UPF mainly for the financing and accounting. The organization structure of UPF under the wings of corporate relations department is illustrated in the next page.

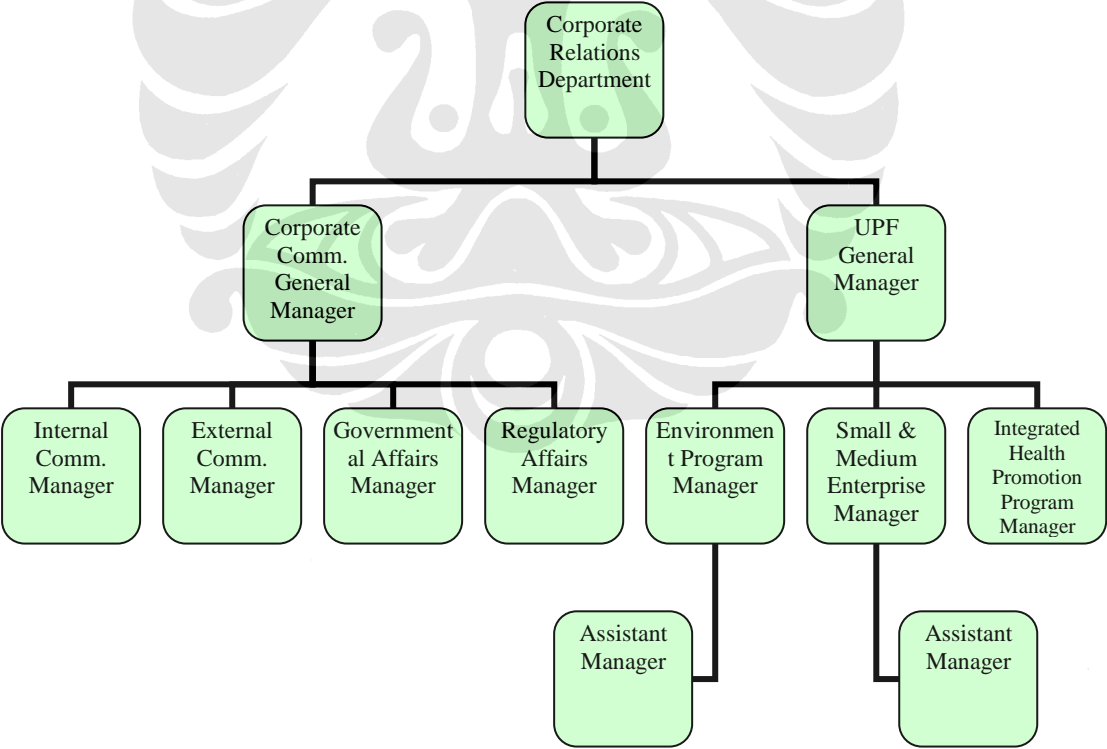


Figure 3.3

Each of the CSR initiatives is formed with a comprehensive consideration. Unilever always begins the initiatives starting from something small to maintain effectiveness in the development of the programs. Afterwards, Unilever moves fast to replicate or expand on the previous successes so that the impact of the concerning social initiatives become bigger. Through out each initiative, Unilever seeks out inputs, suggestions, and comments from the stakeholders, mainly from the target community. This results in a more effective, efficient, and well-targeted corporate contribution.

The foundation allows greater opportunity for the development of people's initiatives. UPF also gives opportunity for Unilever to share UPF's knowledge between programs and initiatives developed by various Unilever brands in numerous areas. By streamlining the ways that they share resources, they will make greater contribution to the community.

As evidence, after 7 years since UPF was established the company received many awards for its achievements in excellent CSR conduct which shows how the company is committed in performing CSR. In 2005, PROPER declared that out of 23 companies Unilever Indonesia achieved 2 green statuses for its factories in Cikarang and Rungkut. The status has been received successfully three years in a row. Besides on a national level UPF has also been recognized internationally as can be seen from the list of awards UPF received for UPF's CSR projects:

- Environment Excellence Award – ASEAN Forum CSR (September 2003)
- International Energy Globe Awards – Energy Globe Austria (November 2005)
- The Best CSR Program – Business Review magazine (August 2007)
- The Grand Winner for Lifebuoy Program – AFCSR (September 2007)
- The International Green Apple Award – The Green Organisation,UK (November 2007)

These awards serve as a milestone, not only that it highlights the Company's CSR conduct furthermore it shows that UPF is highly committed to its CSR programs.

### **III.2 Good Corporate Governance at Unilever Indonesia**

Good corporate governance is vital to every company striving to achieve a sustainable development and become success while simultaneously maintaining its position in the long run. For that reason, the company struggles to apply the principles of good corporate governance in every activity they do. Long before the principles of corporate governance were founded, Unilever global has implemented the principles in doing their business. The same goes to Unilever Indonesia; everything implemented at Unilever global is also applied at Unilever Indonesia. Every Unilever branch is consistent with the global Company.

These principles of corporate governance are further reflected and integrated into the mission of the company and their "Code of Business Principles" These documents have become a guide for management, employees, partners and the other stakeholders in each of their activities. The documents clarify the company's manner in integrating the principles of good corporate governance into its operations at every level. In order to prompt the awareness and the comprehension of these principles, the *Blue Umbrella* team is set up.

The Blue Umbrella is a team consisting of members of the Company from the legal department and other departments but mostly from the finance department. They were first formed about three years ago. They are only established in Indonesia and not at Unilever global, the team is responsible to the Board. The team employs creative and interesting ways to communicate, share, and solve problems when there are misinterpretations of existing legal documents. Methods of communication employed include a theatrical method encouraging the expression of every GCG principles.

In addition, the team is considered to be a medium for ‘whistle-blowing’. A whistleblower is an employee, former employee, or member of an organization, especially a business or government agency, who reports misconduct to people or entities that have the power and presumed willingness to take corrective action. Generally the misconduct is a violation of law, rule, regulation and/or a direct threat to public interest, such as fraud, health/safety violations, and corruption. Moreover, the team is specifically assigned to put together the Code of Business Principles and further socialize the principles to the employees and other concerning parties. This socialization process is to minimize violations on existing regulations and rules.

Aside from the Blue Umbrella team, Unilever also has *Unilever Leadership Forum* (ULF) which is a formal media to share ideas, strategies, and best practices among the heads of the several brand divisions in Unilever. ULF is a development from a previous program, Senior Line Management Forum which was changed in 2006. This forum is held quarterly and attended by approximately 80 attendants representing different brands and divisions. Additionally, the forum gives opportunities for senior leaders to share their ideas and plans for upcoming periods.

Unilever hopes that the Blue Umbrella team and Unilever Leadership Forum will be an effective media for the staffs to interpret the GCG principles genuinely. From their annual report it is stated that sustainability is also implemented directly in several elements of the company’s corporate governance, namely:

- Unilever co-operates with the Safety and Environment Assurance Committee (SEAC) in the UK, to assure that the whole decision making process concerning the safety and the environment of the products are done separately from commercial decisions.



- They also collaborate with the Central Safety, Health, and Environment Committee (CSHEC) in developing policies, procedures, and standards for health, safety and environment, and spreading safe behavior and management of accident investigations.
- Unilever's Crisis Management Team is not only responsive to crises hitting the nation or the company's operations but they also pro-actively manage various potentially harmful issues.

Being a multinational company listed in the Jakarta Stock Exchange, surely the Company must adhere to the regulations in Indonesia and that does not exclude the principles of corporate governance formulated by the NCCG. The principles established by the NCCG are results from research the committee conducted on principles in implementing GCG mainly adopted by public companies. From their research, they concluded and came down to an agreement on the principles of corporate governance urgently needing attention in Indonesia. Unilever Indonesia is one of the companies being questioned; additionally the Company is already established on those five principles formulated. However, the Company tends to refer towards the CG principles established by the OECD since it is an Anglo-Dutch company. But for compliance, the Company adheres to existing regulations in Indonesia as long as the regulations are consistent with the CoBP. For example, for its financial reporting the Company complies with the PSAK and IFRS as required by the officials. Whilst, for the reporting to its London office; the headquarters, it is only necessary to follow the IFRS.

Unilever Indonesia's annual report also specifies on the structure of their boards along with their functions to enhance corporate governance. Supporting the implementation of good corporate governance, Board of Directors (BOD), Board of Commissioners (BOC), Corporate

Risk Management Team, Corporate Relations, Investor Relations, Audit Committee, and a Corporate Secretary are appointed.

BOD comprises one President Director and four Directors or more. Members of the BOD are appointed by Shareholders at the Annual General Meeting, as of the date resolved at the Meeting until the closing of the third Annual General Meeting of Shareholders following the appointment of the Directors concerned. Their main duties are to lead and manage the company in accordance with the objectives of the company and to utilize, maintain and manage the assets of the company in the interests of the business. The BOD meets at least monthly and at any time deemed necessary. Moreover, they held twenty-four formal meetings in 2006 with 90% attendance.

BOC consists of one President Commissioner and three Commissioners or more. The appointment of the members of BOC is similar to the BOD. They are charged with the duty to supervise the policy of BOD in running the management of the company, to perform such other duties as determined by the General Meeting of Shareholders from time to time and give consultation to the BOD and to do such other matters as provided in the Articles of Association of the Company. They meet at least four times in a year. The BOC held four formal meetings in 2006 with 85% attendance.

Supporting the function of BOC is Audit Committee. The role of the audit committee is to assist the Board of Commissioners in fulfilling their oversight responsibilities regarding the integrity of the Company's financial statements, risk management, internal control, compliance with legal and regulatory requirements, the external auditors, performance, qualifications and independence, and the performance of the internal audit function. The Audit Committee comprises a minimum of three members, meets at least four times a year, and reports directly to the BOC. The Committee members are appointed by the members of

the BOC. The Group Audit Manager ensures that the committee is supplied with sufficient information and they update the BOC on all the critical issues regularly throughout the year.

The Audit Committee has several principal activities inclusive of:

1. Consider reports from BOD on a quarterly basis and annual financial statements, additionally review the Annual Report and accounts prior to publication
2. Discuss with the external auditors on the scope and outcome of the external auditors' annual audit
3. Review the Company's overall approach to risk management and control, and its processes, outcomes and disclosure, including:
  - External audit's interim and year-end reports on the status of risk management and control and management's responses.
  - Annual report from the BOD on business risks and positive assurance on operating controls, corporate policies and CoBP compliance
  - Monitoring progress of the implementation of the requirements under section 404 of the Sarbanes-Oxley Act with respect to internal controls over financial reporting
4. Recommend the board on the matter of appointment of external auditors
5. Engage in discussion and reviews of the Internal Audit Department's audit plan and resource requirements
6. Conduct self-assessment of its own performance and keep the Audit Committee charter updated

The committee held five formal meetings in 2006 with 93% attendance.

The Corporate Risk Management Team is led by the Chief Financial Officer with members comprising the Group Audit Manager, Financial Controller, Divisional Commercial

Managers, Business Systems Manager and Corporate Secretary. They assist the Board to carry out their responsibilities of ensuring effective systems of risk management and internal control are in place. In 2006, no material weaknesses were detected in risk management and control systems.

CR is led by Human Resources and Corporate Relations Director with members consisting of Corporate Communications Manager, General Manager of UPF, Corporate Secretary, Legal Services Manager, Corporate Industrial Relations Manager and the General Affairs Manager. They assist the Board on external matters of relevance to the business, to advise the Board on issues of CSR, and to review the corporate relations strategy.

The CFO; helped by all members of the Board and Corporate Secretary, is mainly the ones responsible for the Investor Relations. Unilever is committed to establish more effective ways of shareholder communication.

Apart from the previously discussed functions ensuring the implementation of GCG, a Corporate Secretary is appointed specifically based on the regulations established by the Bapepam; Decree No.IX.I.4 concerning the appointment of Corporate Secretary and every listed public company is obligated to appoint one, the Corporate Secretary is responsible for:

- Monitoring the Company's compliance with Company Law, Articles of Association, Capital Market stipulations
- Maintaining regular and transparent communications with the authorities and capital market players on all governance issues, corporate actions and material transactions.
- Providing up-to-date and accurate information about PT.Unilever Indonesia Tbk to shareholders, media, investors, analysts and general public on regular basis.

- Attending all the Board meetings and record the minutes of proceedings of the meetings; to keep the Board updated with the relevant regulatory changes and their implications.

It is widely known that Unilever is a company that cares for its stakeholders. Contrary to this, in 2005 the Company failed to report significant information concerning a large sum of money spent on purchase of machineries. This is considered to some people, a violation to the principle of keeping the shareholders informed. Responding to that subject, the Corporate Secretary has said that the exclusion of the concerning transaction is because the nature of the transaction was not yet certain moreover based on the accounting principles, transaction with the nature of uncertainty should not be reported yet until it reaches a certain degree of certainty.

All stakeholders are considered equal from the Company's perspective, no party or interest group is favored above another. The fundamental interests of the stakeholders, namely well-offness, fairness, and right are considered in the decision making process so that decisions made will be ethical. Regarding the well-offness, the Company always considers whether the proposed decision will result in more benefits than costs to the stakeholders. The distribution of benefits and burdens is also fair in other words it is mutual for the Company and the stakeholders. And of course for any decisions made, it is assured that it does not offend the rights of the stakeholders and the Company. In this process of ethical decision making, the Company always maintains its character or integrity, to help identify ethical issues and guide ethical action.

Unilever also believes in achieving sustainability through their brands and of course in reaching this objective Unilever is helped by the actively participating stakeholders in their

operations. Unilever has developed several social missions some of which are for Unilever's brands. They are confident that brands possessing social and spiritual missions will do better and become more attractive to the consumers. In addition, these missions will also inspire the employees in achieving the sustainability target.

To add up, the Corporate Secretary considers that Unilever is already on the right track in implementing good corporate governance. Also, with a uniform definition in CSR as defined by the Chairman of Unilever PLC, Patrick Cescau, the consistency in implementation of CSR will be better and more standardized from one branch to another. The Corporate Secretary said that many might be confused with issues that UPF is handling right now such as waste management, growing trees to make the Earth greener, etc. because many do not see any relevance to the business that the Company conducts. The Company is merely trying to conserve the resources and protect the next generation, consistent to what it is trying to achieve, sustainability. Moreover, Mr. Franky Jamin; the Corporate Secretary; emphasizes that CSR is one of the components in implementation of good corporate governance at the Company. CSR is already integrated in the Company's activities and strategy.

### **III.2.1 Code of Business Principles**

Unilever's code of business principles (CoBP) describes the operational standards that everyone at Unilever follows, wherever they are in the world. It also supports the Company's approach to governance and corporate responsibility. CoBP reflects how the Company conducts business which is also reflected on their CSR conduct.

The CoBP basically consists of twelve sections namely compliance, worker, consumer, keeping shareholders of PT. Unilever Indonesia Tbk. informed, business partner, CSR, environment, innovation, competition, business integrity, conflict of interest, and social

activities. Discussion on the section of CSR is given in the subchapter entitling CSR from Unilever Indonesia's perspective while the remaining principles will each be briefly discussed in this section

The CoBP is effective on each individual working at Unilever. Apart from the workers and the management, the CoBP also applies on third parties doing transactions with Unilever. There are four important aspects in CoBP, namely honesty, integrity, transparency and respect of human rights and interest of our people. The Company values their commitment because they are a company producing consumer goods therefore it is important for them to make a commitment to all those aspects. The following is the brief version of the company's CoBP; a summary made on the important points of CoBP.

#### *III.2.1.a Compliance*

Unilever, as a social group and a multinational company always try its best to fulfill its social responsibility to the community and the workers. The Company has developed its own value, norms, and culture as contained in legislation in the interest of legitimate business. These are further developed into internal regulations. Besides internal regulations, there are also external regulations on which the Company must comply. External regulations are government regulations adopted and applied by the Company. Adoption to such regulations reflects long-term commitment to sustainable business operations which the Company is willing to make. For the application and compliance of such regulations, the Company must first socialize them throughout the people in the Company (institutionalization process). In order to make the enforcement effective, Unilever has to prepare a social control mechanism in which each violation is subjected to a penalty.

### *III.2.1.b Workers*

In respect of workers, it is necessary to recruit only the best through appropriate and accountable as well as non-discriminative selection. Evaluation in the selection process is fully based on competence, knowledge, skill and readiness to work. Moreover the Company realizes the need of improvements in skills of its existing workers to keep up with the current development. Therefore, the Company gives its workers opportunities to participate in training programs according to their respective jobs. In addition, the Company acknowledges the fact that there will be no productivity without good, healthy and safe work atmosphere so the Company provides its workers with protective devices. The workers also have to realize that they must adhere to the regulation on their use. Establishment of labor union is a basic right at the work place guaranteed by both national and international laws. However, it is necessary for the labors to take into account the Company's capacity in finance in fulfilling their demands.

### *III.2.1.c Consumers*

According to article 1 paragraph 2 of Law No.8 regarding Consumer protection, consumer is everybody using goods and/or services available at the community, in own, family's, other's and other being's need but not for sale. The Consumer protection law mostly provides regulations on companies however it is not intended to impede the companies but to protect both the consumers and companies.

In its operation, a company should adhere to the farthest possible extent to the prevailing legislation. The Company as a producer of goods and services has to label their products properly. Any promotion made should be appropriate without giving any misleading information. Companies should do all of the foregoing to attract consumers to purchase their



products and to keep them harmless from any claim of consumers in case of violation of rights protected by law, namely safety and comfort in product use.

#### *III.2.1.d Keeping Shareholders of PT.Unilever Indonesia Tbk. Informed*

The Company shall operate according to internationally acceptable good business practice. Unilever will provide shareholders with information in a timely manner as well as regularly and reliably about activities, structure, financial situation and performance of the company. Information is delivered because the law provides so and relation with the shareholders is maintained in the basis of trust. For the shareholders, information serves as guidance in monitoring their interest in the company as well as the decisions they have to make on their shareholdings. Transparency of information will establish harmonious and long lasting relations with shareholders for better company performance.

#### *III.2.1.e Business Partner*

Unilever is a company operating based on a high CoBP. It realizes that its success is not only attributable to its products but also to its attitudes towards its customers, suppliers, and business partners in its business interaction as well. The Company requires its business partners to apply principles consistent to those of Unilever. One of them is in generating profits, the Company is committed not to honor nor make any payment of any form which is not in compliance with the prevailing provisions, such as facilitating payment to make the products of Unilever accepted or used by the public. Another aspect that must be taken into account by the workers of the Company is that in building relationship with business partners is environmentally friendly cooperation.

### *III.2.1.f Environment*

Environment is an important aspect which the Company takes into account in its operations. There are mainly three aspects, namely first environment directly relating to production, second, environment indirectly relating to production but constituting the impact of company products available at the community, and third, environment outside activities of the company but indirectly affecting the company performance. In addition, the Company manages its operation based on an international management standard in management system; the ISO 1400. The standard includes health, safety, and consumer safety in using the Company's products. It also covers three major aspects to be exact, management system audit/positive guarantee, report of activities relating to environment and investigation and report of incidents/events. All of them are based on evaluation of environmental aspect, investigation of incidents and audit of compliance based on the given protocols.

### *III.2.1.g Innovation*

Innovation can be in terms of product innovation or process innovation. It means improvement or newly improved. It can also be in terms of goods and/or services or engineering/technology including marketing of a certain product. It serves as a source of competitiveness superiority based on creativity obtained through among other transfers of technology. It is also considered as the principal function of commercial business.

### *III.2.1.h Competition*

The existence of competition gives significant contribution to the existence, innovation and economic growth. Competition will also motivate companies to produce affordable quality products and improve the quality of the products and services for customer

satisfaction. However, market competition requires regulations for common benefits and protection. In Indonesia, competition in market is regulated under Law of Competition (Law No.5 of 1999) regarding Prohibition of Monopolistic Practice and Unfair Competition.

As a market leader most of which products are enjoying major market share, Unilever has a significant potential to decrease the intensity of competition in the market. However, it does not do so because it realizes that competition is needed to motivate the Company to always give the best to their customers. The Company's commitment to apply the CoBP indicates the determination to be the market leader and maintain its market position without having to break the rules. By honoring creativity, innovation, hard work in all lines of production, Unilever products will certainly dominate.

#### *III.2.1.i Business Integrity*

Business integrity is applied by the components of company or a limited liability company, particularly the Board of Directors and workers in running its business. It also means that each component of the company, particularly the BOD and the workers should be honest and obey the prevailing legislation. Furthermore, they are prohibited from giving or receiving bribes in any kind whatsoever. In running its business the Company must comply with the articles of association, Law No.1/1995 regarding Limited Liability Company and other relevant legislation, by honoring honesty for fiduciary duty of the Company. The BOD and workers have to avoid any bribery and other unlawful acts.

To contribute to its attainment corporate bodies and their organs and workers have to enforce business integrity principle in addition to other such as compliance, social responsibility, environmental recovery and evasion of conflict of interest. The most important thing is creation of legal culture and moral quality of its human resources, in terms of point of

view, perception and behavior of the community member as a legal subject, particularly legal culture in law enforcement.

### *III.2.j Conflict of Interest*

Conflict of interest occurs when a worker cannot prevent personal interest from interfering decision making process. In a company it may occur due to a very urgent personal need, unclear company policy, and improper leadership/behavior of superior and co-worker's behavior. Each component in the Company has to acknowledge these so that impartiality in business activities is enforced and developed. Direct competition, power abuse, and divulging company's secret are some of the actions considered to be conflict of interest.

#### *III.2.1.k Social Activities*

To the government, the Company is very important since regardless of the scale, it is a part of economic power to produce goods and services to fulfill people's needs. Therefore, the government has an interest in and is responsible for the survival and the success of the Company. Hence, the Government should establish a favorable climate for Indonesian economy and business sector development. Furthermore, to the Company and businessmen, it is a place to exploit capital and gain profit. Therefore, cooperation is very important to materialize the respective parties' interest. Unilever will cooperate with the Government and other organizations such as trade association to develop other law/regulation that can affect their legitimate business interest. In the framework to develop other law/regulation, the Government acts as a facilitator/mentor while the Company and trade association as business partners. Cooperation in the legal development is expected to support smooth and create higher production and productivity. Any material provided in the law or other regulation

should be based on mutual needs, strengths and business benefit principles among the relevant parties. Moreover, it is clear that Unilever will only cooperate with those who improve and maintain its business interest by developing regulation that can support, encourage and influence its business interest. To add up, the Company will not cooperate with any organization with political interest.

### **III.3 CSR Programs at Unilever Indonesia**

Referring to the triple-bottom line approach, Unilever makes sure that they cover every aspect of the approach namely Health and Hygiene, Environment and the Local Economy. A more comprehensive explanation on each aspect will be provided in the next subchapters.

#### **III.3.1 Health and Hygiene**

Initiatives in health and hygiene include programs promoting behavioral change in the objective to improve the health and hygiene of the people of Indonesia. The Company formulates the following six programs to achieve that objective:

1. Lifebuoy “Berbagi Sehat”

The program has a mission to make 220 millions of Indonesians feel safe and secure by improving their health and hygiene needs. Unilever promotes a healthy lifestyle and proper hand-washing through an educational program reaching more than 100.000 students and housewives. Lifebuoy also held educational seminars for elementary school teachers from all over Indonesia so that they promote healthy habits to students through games and interactive learning. In a different program, the National “Terima=Kasih” program, Lifebuoy awarded loyal consumers with a consumer promotion and set aside an equal amount to build health

facilities such as toilets and hand-washing facilities at 20 elementary schools in Yogyakarta and Purwakarta.

## 2. Pepsodent “Dental Health”

Pepsodent’s social mission is to free Indonesian children from cavities for a better future. Together with moms, schoolteachers, universities, dentists and government agencies, Pepsodent created a dental health education program for Children called the Pepsodent School Program focusing on the importance of night-brushing. Since 2000 Pepsodent provided Free Dental Check Ups (FDCU) annually allowing detection of the dental health issues earlier and encourage participants to pay attention to dental health. In 2006, Unilever International and World Dental Federation (FDI) formed a partnership supporting a similar purpose.

## 3. Rinso “Berani Kotor itu Baik”

The program has a social mission of helping Indonesian children learn and develop by giving them freedom to experience life without fear of getting dirty. Rinso knows the value of creative activities and active outdoor play but Rinso also understands that the parents are concern with children playing outside. On the other hand, these activities have an important role in a child’s physical and mental development. In 2006, Rinso launched the “Let’s Play, Don’t be Afraid of Dirt” Campaign.

## 4. Dove ”Campaign for Real Beauty”

Dove seeks to make women feel beauty everyday. In 2006 for the program “Real Beauty Real Program” campaign Dove held a photo competition celebrating photos of women with their friends.

## 5. Close-Up HIV/AIDS Campaign

Close-Up's social mission is to mobilize Indonesian youths to see, feel, hear and take action to help spread information on HIV/AIDS. Along with its partners using the slogan of "Brani Ngomong Brani Buktiin" Close-Up embarked on an HIV/AIDS educational campaign to reach out to youth—the same demographic it considers its target market. The result is over 50.000 people were exposed to information about HIV/AIDS.

#### 6. Yogyakarta Integrated Health Promotion Program

The Integrated Health Promotion Program (IHPP) was launched in 2005 in Yogyakarta by employing Unilever's experience in various initiatives and using a more thorough approach to promote health. UPF did not focus only on one aspect to be exact health and hygiene for a wide geographic area in designing the Program. UPF actually decided to pick a community and a provincial government, Yogyakarta; a province already in a similar program namely *Perilaku Hidup Bersih dan Sehat* (PHBS). IHPP integrates elements from a variety of wider programs including oral hygiene educations in schools, FDCUs sponsored by Pepsodent and improvement to sanitation facilities and hand-washing education by Lifebuoy.

### III.3.2 Environment

The Company realizes that their products produce waste most of which are in the form of plastic which is a non-degradable material which later can affect the environment. Unilever has a mission to find a solution for this problem. Through the two main initiatives it creates; community environmental program and waste packaging recycling initiative, the Company attempts to solve this problem.

A brief description on the programs is given below:

#### 1. Community Environmental Program

The Community Environmental Program runs in two major cities in Indonesia; Jakarta and Surabaya. It focuses on educating people to alleviate burden on the environment by reducing waste through segregating, recycling and composting. Since 2005, Unilever along with its partners held two environment competitions; Surabaya Green and Clean and “Merdeka Dari Sampah”, which have significantly helped the people of Surabaya to be aware of environmental issues they are facing. From a small initiative in Jambangan, Surabaya in 2001, the Surabaya Green and Clean program has come a long way. It won the International Green Apple Award in 2007 for Best Environmental Practice.

2. Waste Packaging Recycling

This initiative addresses the question of what to do with segregated, recyclable waste packaging by improving the capacity of the informal recycling sector. Unilever has been working with AIDUPI (the Indonesian association of plastic recycling industries) and the communities of the Community Environmental Program by encouraging separation of recyclable plastic from household garbage and other techniques which are still being investigated. A figure describing the value chain of plastic waste is illustrated below:

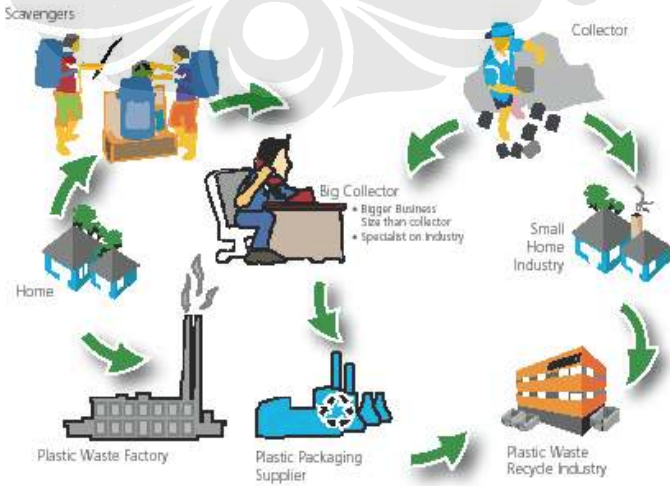


Figure 3.4 Source: PT.Unilever Indonesia Tbk.’s 2006 Sustainability Report



### **III.3.3 Local Economy**

Much of the impact from Unilever's operations is felt in the local economies through supply chain activities. Unilever collaborates with local suppliers to secure the livelihoods of the local economies. Take for example Kecap Bango, acquired by Unilever in 2000 in faith that this sweet soy sauce which is popular in Java and its vicinity would be very well-received in other areas in the nation and in its region. Since 2005, the Company has organized Bango Food Festivals in Jakarta, Surabaya, Medan and Bandung. Another initiative is the black soybean initiative. Both initiatives have a social mission to preserve the culinary heritage of the Archipelago and to enhance the livelihood of black soybean farmers.

#### **1. Kecap Bango Traditional Food**

Kecap Bango is interested in preserving the traditional Indonesian food. A string of previously successful Bango Food Festivals led to the creation of a TV program called "Bango Cita Rasa Nusantara". This program basically aims to promote Indonesian dishes to a larger audience.

#### **2. Black Soybean Initiative**

Kecap Bango obtains its unique taste from black soybeans planted by farmers between rice-growing seasons in the island of Java. On another matter, number of farmers growing black soybean are becoming fewer. In addition, many of the farmers lack the resources and technical knowledge to produce high quality black soybeans. Since the year 2000, Unilever has been joining forces with Universitas Gadjah Mada (UGM) in a program aimed to acquire black soybeans directly from the local farmers. In 2002, the program simply started with only 5 farmers farming 25 hectares. The program has clearly come a long way, in 2006 the number of farmers participating in the program has reached 5.000 and Kecap Bango was able to meet its 21% needs of black soybeans from this program.

The growth in areas utilized for farming black soybeans and number of farmers participating in the program from the year of 2002 until 2006 can be seen in the graphics illustrated.

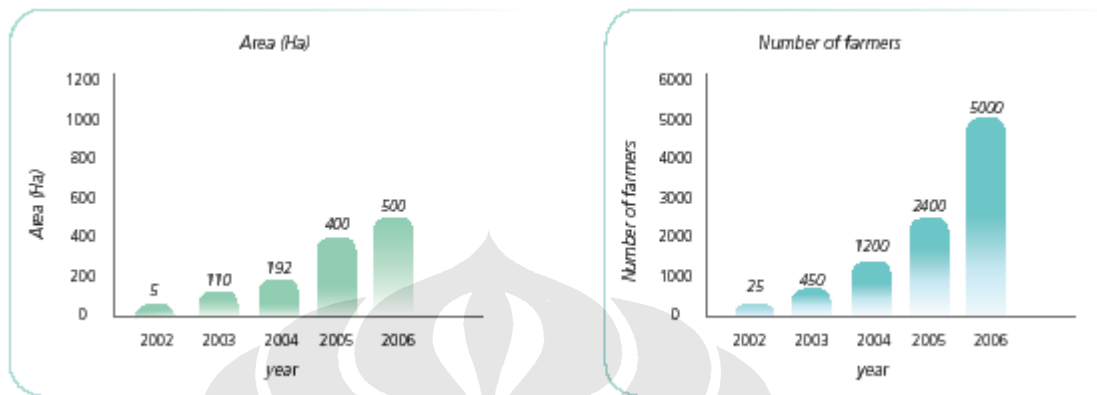


Figure 3.5 Source: PT.Unilever Indonesia Tbk.'s 2006 Sustainability Report

### III.3.4 Progress on Unilever Indonesia's CSR Programs as of October 5<sup>th</sup>, 2007

The Corporate Relations Department; inclusive of UPF, holds progress meetings twice annually with the Board of Directors to keep them well-informed on running programs. At the meetings, the managers responsible for each program present to the Board and deliver the latest information on the programs. After the presentation, the Board gives away their thoughts, suggestions and perhaps critics to the managers on the running programs so that in the future the programs will be better.

The latest progress meeting to date was on October 5<sup>th</sup>, 2007. Managers at UPF also participated in the meeting. The meeting informed the Board on updates on the following projects:

#### 1. Black Soybean Initiative

The area of coverage of this initiative has expanded. Areas covered now include Ciwalen, Ngawi, Madiun, Nganjuk, Klaten, Jogja and Trenggalek. Total land utilized to date is 1.176 hectares. Currently, four farmer cooperatives have been directly linked to Unilever and more

others will be built and linked to financial institutions. In 2008, it is planned that the area of land utilized will reach 1.500 hectares for producing 750 tons of black soybeans and will fulfill 40% of total Black Soybean requirement.

## 2. Health Education Program and Community Base Marketing Yogyakarta

Targeted area for this program will include Banyuwangi, Bondowoso, Jember, Lumajang, Pasuruan, Probolinggo and Situbondo. The strategy of this program is alignment among CSR team and Depo Yogya team to develop activity scheme involving the strength from Unilever, Padmaya (local NGO) and distributor. The program is socialized in August 2007; the status will be on trial in September and October 2007 and it will be evaluated in November 2007.

## 3. Environment Programs

The latest update is the Green Apple Award given by the Green Organisation in UK for the Surabaya Green and Clean. In the future, the programs will need endorsement to appeal brands in doing joint CSR initiative with environment/UPF programs

## 4. Jogja Reconstruction and Bengkulu & West Sumatra Earthquake

In the meeting, information on the activities done by UPF to help reconstruct Yogyakarta post-earthquake and the humanitarian aid given to Bengkulu and West Sumatra after the recent earthquake are also reported and presented

### **III.4 CSR from Unilever Indonesia's Perspective**

There is an ancient Indian proverb that goes, "Treat the earth well, it was not given to you by your parents, it was loaned to you by your children. We do not inherit the earth from our ancestors; we borrow it from our children" This old Indian saying is quite similar to what Unilever holds dear to its heart when defining what constitutes a sustainable development. The definition of sustainable development given by the Brundtland Commission (1987); a

development that “meets the needs of the present without compromising the ability of future generations to meet their own needs”; is a multi-faceted concept covering the aspects of environment, social, and economy. The company looks at CSR as the impacts of their overall operations to the community. The impacts are further broken down into three impacts the impacts from the community’s activities, business operations, and extended supply chain.

The three impacts are illustrated as three levels in a pyramid as follows:



Figure 3.6 Source: PT.Unilever Indonesia,Tbk.'s 2006 Sustainability Report

Since it was first established, Unilever has made a commitment to conduct a sustainable business practice. From the illustration given above there are three levels of impacts of their operations in general. What differentiates the conduct of CSR at Unilever Indonesia currently and before UPF was established in 2000 is on the focus towards the impacts. Long before there was UPF, the company has done well on the two lower levels on

the pyramid, namely impacts from extended supply chain and impacts from business operations. The company is careful in selecting suppliers; the selection is based on appropriate business practices consistent with those of Unilever's. The company strives to create an open and cooperative relationship in working together. This strong relationship enables the company to resolve occurring problems together with the supplier and improve on quality together. At the present, the company works with 346 suppliers of chemical substances and 142 packaging suppliers, and more than 70% of them are local suppliers. The company only uses imported substances when there are no substitute in Indonesia or if the quality does not meet their standards.

Besides high quality and competitive price, how suppliers work is also an important matter in the process of selecting suppliers. The selection process includes several steps. Firstly, the company visits the supplier, observes their vision and mission, their approach towards labor issues and also the quality, health, safety, and environment system. Next, the suppliers are asked to follow the company's Codes of Business Principles (CoBP) to assure sustainable business relationship between Unilever and the selected supplier. For the strategic suppliers, an assessment by the Company through the Unilever Supplier Quality Management Program (SQMP) is done annually. These suppliers will be ranked as preferred, acceptable, or non-acceptable. For the suppliers classified in the lowest level, guidance and trainings are offered to align themselves with the working culture of Unilever so that their rank will improve.

The company periodically sets up meetings with the suppliers. In 2006, Unilever introduced a medium for the packaging suppliers through which the company tries to find ways to synchronize their vision and mission with the suppliers'. Unilever acknowledges the fact that the quality of their products depends on the quality of the raw materials supplied.

Therefore, the company collaborates with the suppliers to fully assure the quality of the raw materials is qualified as the company requires. This long-lasting relationship which is on good-terms with the selected suppliers is not easy to established, it takes more than a blink of an eye to achieve this. Unilever has built this strong relationship for a long time.

Apart from that, the company also pays a considerable amount of attention towards the impacts from their business operations in other words operations particularly at their factories. Keeping their workers in a safety surrounding is not an easy task. The Company has been employing an instrument to achieve efficiency in the working environment through the means of Total Productive Maintenance since 1992. This instrument has helped Unilever in keeping their equipment at the factories in good condition; keeping a more efficient working process; reducing idle hours on the machines and increasing the record of safety at workplace. Unilever employs indicators such as fatal accidents, lost time accidents (LTA), restricted work cases and also medical treatment cases (MTC). The Company is always trying to reduce the number of accidents.

An Environmental Management System (EMS) based on ISO 14001 is used to manage the impacts from the factories on their surroundings. The important element of this EMS is determining and monitoring targets based on Key Performance Indicators (KPIs). Data generated are further compared to existing standards in Indonesia and targets set by Unilever Global, and next gathered and analyzed as a component of Environmental Performance Report (EPR) of Unilever Global.

Cikarang and Rungkut; locations where Unilever's factories are situated, operate among large communities and the Company tries to be a good citizen among the community. Acknowledging the fact that the factories have significant contribution on the stability of the local economies and job opportunities for the people, the Company has developed several

programs to encourage the employees to be directly involved in resolving social environment issues, as prioritized by the respective community.

Since UPF was established, from the beginning the Company has been enhancing its focus to the highest level of the pyramid which is the impacts from community engagement. As concrete evidence are the CSR programs Unilever runs. Unilever has a whole section in the company's Codes of Business Principles dedicated to the principles of conducting CSR. It mainly discusses the principles that the company stands for in conducting CSR. Along with global transparency and easy access to information, the company has been taking into account social dimension for quite some time, not only for the benefit of promotion it will gain but integrating the responsibilities into its applied policy.

CSR generally consists of two major aspects, namely emergency assistance when there is natural disaster and/or in case of any other incidental need or charity; second providing social capital or philanthropy in the form of educational support or economic opportunity, improvement in health and social organization capacity in anticipating crisis.

The company expects CSR to grow in line with the company growth. Unilever thinks that CSR should not be formally performed like paying greater tax or bigger employment opportunity when the company is growing bigger but also serving as a means for the company to pay attention to the existing social issues.

Positive impacts contributed from CSR programs to the company are very significant and the programs have been helping the company to maintain its leading position in the consumer goods industry. Other than that, CSR is regarded as a competitive advantage or similar to a competitive edge possessed by the company. With this competitive edge, the company has a unique characteristic differentiating them from the other companies.

Unilever Indonesia is widely known as a company who cares for its stakeholders, hence their outstanding achievement in the conduct of CSR. From their standpoint, CSR is something that will give them intangible benefit which is of high value to the company. The benefit that Unilever has obtained and experienced since it was first established; simultaneous to the Company's first implementation of CSR, is a favorable operating condition for the company enabling them to be sustainable for more than 70 years. The company intends to keep doing CSR well so that it will keep on being sustainable for more and more decades to come.

Unilever, as a global company, has implemented its CSR to satisfy various needs of the stakeholders and the company. After tsunami strike, the company cooperated with the Asia Pacific Philanthropy Consortium, a group consisting of 100 Indonesian NGOs and several business partners and the National Navy and Air Force. CSR is also made on long-term basis for benefits of all.

Starting from 2005, the CSR theme has been connected to the company's products in health and nutrition. The program directly affects consumers and more members of the community. Programs such as the Black Soybean Initiative, Surabaya Green and Clean as well as Jakarta Green and Clean, Lifebuoy "Berbagi Sehat" and the other CSR programs Unilever runs are just some examples of the programs with visible impacts in the community. The company mainly allocates available resources to engage in resolving issues in the community through three ways, namely donation, social investment and initiative by commercial interest.

Generally speaking, its assistance in terms of donation is 44%, social investment is 23% and initiative by commercial interest is 33%. Forty-three percent of the program



concerns health (21% nutrition, 9% hygiene, and 13% other health aspects), 21% education, 9% environment, 9% economic development, 5% art and culture and 13% others.

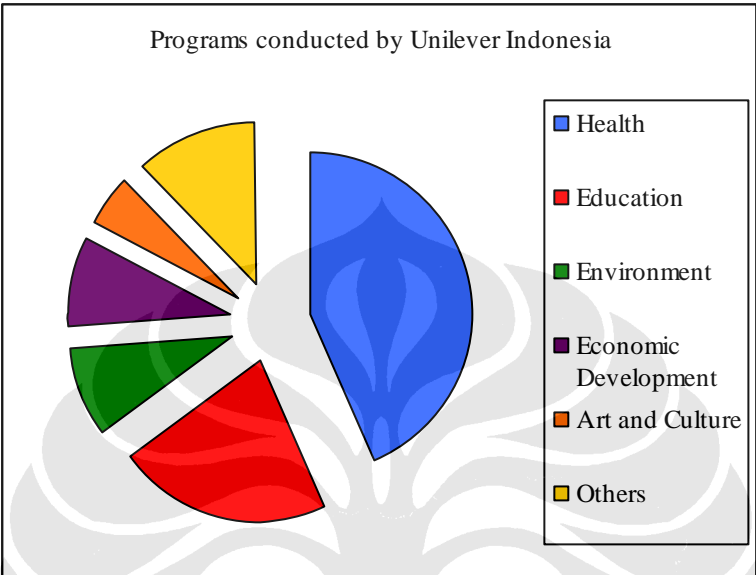


Figure 3.7

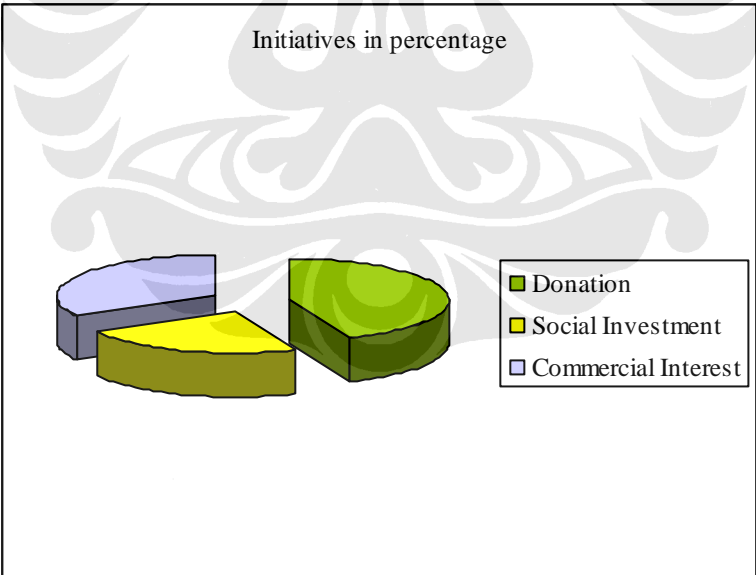


Figure 3.8

UPF being the ultimate manifestation of the company’s commitment to their social responsibilities was established in 2000 despite the fact that Unilever has already conducted

CSR since it was first founded in 1933. The former general manager of UPF; Mrs. Okti Damayanti; has said that putting the welfare of the employees and the community as a top priority has already intuitively been running through the veins of the company for a long time. The evidence can be seen from a village in Port Sunlight, UK. Unilever's mission is not limited on reaching the potential of the community and giving added value to the community but also to develop a strong synergy for partnership between the company and community.

The foundation was founded in 2000 because the company thought that the CSR of the company needs to be more edgy, more focused and more structured as well as become a strategic element of the company. The objective is for the company to build an image of a company caring for environment, community and business improvement.

The foundation focuses on several major problems, namely:

- Small-medium enterprises development,
- Water resources conservation program,
- Recycle program, and
- Public Health Education Program.

In 2003, the company introduced 3C (Consumer, Customer and Community) Program engaging company workers. This program absorbs the need of the society through its workers (living in the community) and this allows the company to adjust with the need of the people. The company can be directly involved with existing issues experienced by the community thus resolving this along with them.

In conducting CSR the company faces challenges from the inside as well as the outside. Unilever is a giant company operating in Indonesia for more than 70 years so it is highly expected that its conduct of CSR is excellent moreover they are expected to be the

benchmark in the industry of consumer goods. The interest of the community surfaces as a main agenda in one of the employees' priorities. Therefore, talents recruited are assured to know the importance of applying the 3P concept (People, Planet, and Profit) in business.

The most important factor in order to succeed in running a CSR program is the intention itself, the sincerity. This sincerity, if existed, will be felt among the partners of the program. By positioning the community as "the hero", the program will automatically go well and eventually become sustainable. UPF feels that they are on the right track, as a proof many awards; both nationally and internationally, have been received by UPF for its CSR programs. Other than that, UPF is continuously improving its programs. Evidently, its brands are starting to rise with their own social mission. All of the brands' social missions are similar in concept which is adding vitality to life; Unilever's mission.

In the organization of UPF which operates beneath the wings of the Corporate Relations Department, there are four managers; one general manager and three program managers. Each program manager is responsible for selecting, formulating and monitoring programs related to their own areas. For example, the Environment Program Manager is responsible for the Surabaya Green and Clean program and other programs concerning her area of expertise. The concept of the programs are generally based on major issues around the local surroundings, i.e. in Surabaya, before the Surabaya Green and Clean Program reached the city, research conducted shows production of waste in Surabaya was more than 8.700 m<sup>3</sup> on a daily basis. Unilever was concern of the well-being of the environment in Surabaya, it was feared that this great number of waste production will soon damage the environment. Seeing this potential, Unilever's concerning manager formulated the program to resolve the concerning matter.

Besides the concerning managers, the Board of Directors is also involved in the process of selecting the CSR programs. Together they discuss and decide on the emerging issues to be handled. Beforehand managers make proposals on the projects they feel are appropriate with the existing conditions and present the material to the Board.

Unilever as a consumer goods producer produces a variety of products under different brand names. Each brand has its own social mission and values. Therefore in conducting CSR in collaboration with brands, each brand is directed so that it is still consistent with the values globally accepted in all Unilever branches. Every program formulated is expected to be sustainable; none are more sustainable than the others. In order to achieve this sustainability objective, some factors are considered in deciding which projects are going to be conducted.

There are three areas UPF tries to give contribution to, as previously mentioned, hygiene and health, environment and local economy. For projects relating to environment, UPF expects projects organized will generate certain positive impacts significant to better the environment and will preserve the natural surroundings and its natural resources. For health and hygiene related projects, UPF hopes that the health and hygiene condition of the community will be better along with the implementation of the program, this type of programs basically attempts to promote a healthy lifestyle. Looking at the economy in Indonesia, in conducting the local economy programs, UPF decided from the start that it would help the government in stimulating the growth of small and medium enterprises, hence improving the economy in Indonesia which consisted of many potential SMEs in small provinces lacking the capacity and resources required. For the local economy programs, UPF selects programs which benefit the company and the community. All programs selected are generally relevant and consistent with the company's values, strategy and operations. So that aside from improving the stakeholders, the company will also gain from the program ran.

Mr. Franky Jamin as the Corporate Secretary of the company and representing the Company along with Mrs. Silvi Tirawaty; the Environment Program Manager; have said that in selecting and running CSR programs they are more inclined to conduct programs which will sustain for many years to come, promoting independency so that the community will not depend on the company. Therefore, they will be able to expand and grow on their own and consequentially betterment in the local economy and their lives will arise. However, occasionally humanitarian aids are still given for people in urgent need such as when disasters happen.

To inform the stakeholders on the progress of the CSR programs, a sustainability report is made. This was first issued by the company in 2004, the latest Sustainability Report (SR) was issued in 2006 and it is by far the most comprehensive one to date. Issuance of SR is not yet compulsory in Indonesia; however Unilever Indonesia voluntarily issues the report in the objective of keeping the stakeholders and the Board of the Capital Market Supervision (Bapepam) well-informed on the progress of the programs.

The format of the SR issued does not fully meet the standards as required by the GRI. The SR only qualifies one set of protocols based on the GRI Guidelines (2002) and the AA1000 Assurance Standard (2003). For the remainder, Unilever Indonesia refers to the format of SR employed by Unilever global, the company discloses only certain sections it wants to report.

The nature of the report not being very comprehensive and thorough have been informed to the stakeholders and concerning users before the issuance of the report. The company lacks capacity in this area due to the complication and complexity in the process of collecting data requirements to compile the report. Its extremely wide range of operations causing an even larger impact in Indonesia is possibly the biggest contribution in this problem

area. This makes it relatively difficult for the company to track any progress accurately and in a timely manner therefore prompting the process of making the report less efficient and not yet optimal.

Furthermore, the latest SR published by Unilever Indonesia is the second edition since it was first issued back in 2004. Not many companies have published SR; it is a rather new and unfamiliar matter in Indonesia. Hence the company is relatively new to this matter and in composing the SR it does not have any clear standard to look up to. The targeted time period for making the SR was two to three months, but the actual process took about 6 months so the company decided to only issue the SR once every two years. To improve on the process of making the SR, a lot of resources from outside the company are hired for collection of the data requirements. This is done in order to make the SR more comprehensive and making it as detailed and accurate as possible. Certain types of data such as statistical data regularly reported is easier to obtain but for other data not periodically reported, the company mostly outsources this function. Data gathered are then forwarded to the managers responsible of their own areas. Eventually the data are processed and compiled and later on producing the report itself.

On May 16<sup>th</sup>, 2007, the Director of SGS in Indonesia; the world's leading inspection, verification, testing and certification company; signed an assurance statement for the company verifying that all information and the data stated in Unilever Indonesia's 2006 SR is accurate and reliable as well as giving correct and proper description of the company's activities as stated in the report. Before the statement was issued, a team from SGS; well-assured beforehand of their independency and neutrality towards the company and freedom from any kind of bias as well as conflict of interest with the company; conducted several steps. Lead auditors are appointed for each evaluated element, namely quality system

management, environmental management system, safety and health system management, social accountability- SA 8000 (inclusive of Lead Auditor for Code of Conduct and Code of Ethic).

Unilever Indonesia attempts to constantly make improvements on its SR so that it will meet the international standards and achieving the objective of keeping the stakeholders and other users of the SR well-informed. Nonetheless, the SR has proven that it is of much good use for the stakeholders in many of their decision making process.

Regarding the establishment of the draft of Company Law point number 74 on CSR, Mrs. Okti Damayati representing Unilever has said that “this draft is an indication that not many have understood the concept of CSR moreover it is too forcing to include it in the draft of the law. To further socialize CSR, it is better if the approach used is not with punishment but rather with incentives, as motivators, to the parties related to the program. In addition, Damayanti (2007) has added that “..by integrating CSR into our daily lives consequently the activities we do will be more fulfilling and self-rewarding”

As evidence of the outstanding accomplishment of PT Unilever Indonesia in conducting CSR is the green status in PROPER awarded by the KLH for the Company’s factories in Cikarang and Rungkut three years in a row as previously mentioned in the preceding chapter. Unilever Indonesia has claimed that this achievement is nothing out of the ordinary, the procedures ran in each factory is based on the standards set up by Unilever global. The standards set up by the global office just happen to be considered extra ordinary by KLH. As a multinational company already operating globally, Unilever has a high standard in each procedure moreover standards are uniformly applied in every branch around the world.

The green status in PROPER is achieved due to the consistency in excellent operations at the factories. In addition, the company always tries to excel its operations so that it will reach the Gold rating. Efforts have been made to better both factories' performance such as substituting the usage of diesel with gas and employing sophisticated Waste Water Treatment Plant (WWTP). These attempts however, are not yet sufficient for Gold Rating on its performance in managing the environment. Furthermore, the company admits that they are still confused with the measurements KLH employs in assessing companies' performance in managing the environment. Unilever Indonesia feels that the criteria established by KLH are not very clear, thus making them unable to make efforts that will better the ranking on the company's performance.

