

CHAPTER I

INTRODUCTION

I.1 Backgrounds of Thesis

Corporate Governance is a rather new concept in Indonesia whilst from an international perspective its role has developed to be one of the core elements integrated in successful strategy implementation. In general, sources of funds for financing the company can be obtained from two sources debt and equity. Creditors set up a specific contract with the companies if a default occurs as a result the creditors will be prioritized before the shareholders. So in this point the shareholders became bearers of residual risk.

In order to compensate this problem two mechanisms are available. First, a policy ensuring managers' (agents) practices follow the shareholders' guidelines must be set up. And secondly, governance; a set of provisions making it possible for shareholders (principals) to use their voting rights to control the company's operations so that their wishes are still considered. The main issue of corporate governance lies in the manager-controlled companies where minority shareholders exist.

The first time the concept of corporate governance came out to the surface in Indonesia was in 1998. This momentous occasion was triggered by the scandals in the United States and the monetary crises hitting South America, Russia, and Asia moreover acutely Indonesia back in 1997. Based on McKinsey's research on implementation of corporate governance in 1998, Indonesia scored a disappointing 1.1 on a scale of one to five with 5 being the highest score; Indonesia's score in 1997 was 1.5. After the monetary crisis the government felt compelled to socialize and emphasize the importance of good corporate

governance. In August 1998 the government formed The National Committee for Corporate Governance Policies (Komisi Nasional untuk Kebijakan Corporate Governance), their task was to put together a National Code for Good Practice for Corporate Governance and to propose establishment of organizations needed in order to realize the implementation of the concerning policies. The Committee succeeded and published the code for Good Corporate Governance in April 2000.

Corporate governance narrowly defined basically concerns two aspects namely governance structure and governance process in a company. The structure of corporate governance in a corporation is influenced by several factors mainly by the corporation theory the company adopts, the culture and the law system implemented.

The concept of corporate governance dates back to Berle and Means' classic work, *The Modern Corporation and Private Property* (1932) "Interpretations of this work have gone through several waves, but virtually all commentators have acknowledged Berle and Means' basic concern: the separation of ownership from control in large U.S. corporations. Berle and Means' concern about the separation of ownership from control was not only about managers' lack of accountability to investors. It was also a concern about managers' lack of accountability to society in general." This eventually became the foundation for the now known agency theory.

The equity theory explains about the relationship model between companies and the owners. The agency theory along with stewardship theory was the basis for some of the most influential theoretical models employed by companies worldwide. The theory gives explanation on the contractual relationship between delegating parties (principals/owners/shareholders) and parties delegated to make decisions on behalf of the

delegating parties. The theory itself was an evolution of the equity theory which is one of the most well-known corporation theories.

At the present Good Corporate Governance (GCG) is a universal concept discussed throughout the world. . The Sarbanes-Oxley Act is one of the guidelines ensuring good corporate governance in a company. Matthew Kirdahy wrote the following statement in his article in Forbes.com emphasizing on the importance of good corporate governance. Kirdahy (2007) said “The law was adopted in July 2002 to create "transparency and accountability," Oxley said. Following the Enron collapse in late 2001, Paul Sarbanes, a former Democratic U.S. senator, and Oxley, a Republican, drafted a bill that was intended to protect anyone with a vested interest in a public company--from employees to investors--from corporate corruption. Other widely publicized scandals at the time included those at WorldCom and Tyco International. The act is now five years young and, for all intents, seems to be having the desired effect, according to one of its architects. While some in the business community have ranted and raved about what was once a compliance debacle, the new regulatory environment is now becoming business as usual”

It was once generally believed that the sole purpose of the existence of a company is to maximize shareholders' wealth. However, recurring violations of the rights of the stakeholders of the company and the lapses of many companies due to irresponsible practices have caused a shift in the previous opinion. The standpoint adapted by many companies now has shifted from creating values for its shareholders to its stakeholders —inclusive of every party related to the company not just the shareholders.

B. Tamam Achda; DPR-RI Commission Member, Head Lecturer at FISIP Universitas Nasional, Head of the Community Empowerment Center – Universitas Nasional and founder

of Community Development Institute, uttered the following statement at the National Seminar : A Promise of Gold Rating: Sustainable CSR, at Hotel Hilton, Jakarta , 23 August 2006 supporting the shifting of the standpoint of approach on CSR from shareholders to stakeholders. Achda (2006) said “..the change in Indonesia’s political order in the late 1990s had drastically altered this point of view. The public now wished an atmosphere of openness, including that related to management of various natural resources and economic activities in general. The pattern of relationship between the public and companies had also changed totally. The community is now increasingly *well informed*, so that their critical power and boldness to express their aspirations more openly have increased, including their demands toward companies operating in their midst. Therefore, companies were demanded to realize the “mistake” of the past repressive approach, and were encouraged to develop improved relationship fundamentals, thus forming a harmonious relations framework between the company or industry and its strategic environment”

One way of creating value for the company’s stakeholders is through Corporate Social Responsibility (CSR). CSR is one of the means done to fulfill some of the CG principles established by OECD mainly the ones emphasizing on the importance of the stakeholders. Milton Friedman measured the social responsibility of a company based on its earnings per share whereas US Chamber of Commerce suggests that companies consider restructuring their objectives and include social objectives aligned with their economic objectives. According to Philip Kotler and Nancy Lee (2005), “CSR is a commitment to improve community well-being through discretionary business practices and contributions of corporate resources” Broadly defined, CSR is the commitment of businesses to contribute to sustainable economic development by running business responsibly while maintaining the preservation of the environment and working with employees, their families, the local

community and society at large to improve their lives in ways that are good for business and for development. Generally, CSR is executed through three aspects social, economic, and environment or more known through the triple bottom-line approach. Through CSR the company is also promoting the implementation of corporate governance in its organization as CSR is an instrument to create value for stakeholders. In spite of this, there are not many companies implementing CSR voluntarily in Indonesia, many of them have not fully comprehend the concept of CSR. Therefore, many still feel unfamiliar with the concept.

The idea of CSR itself is not a recognizable concept in the society at large. Take for example at the Faculty of Economics of University of Indonesia where Corporate Governance is a compulsory subject only for the Accounting students, from the database of the library, since the year 2000 until 2007 roughly speaking there are only twenty one theses on the subject of corporate governance. The number becomes even smaller when topic is narrowed down to CSR. Considering this figure of small number of theses indicating a relatively low awareness of the importance of the implementation of corporate governance specifically CSR, the writer decided to adapt “Corporate Social Responsibility from A Firm’s Perspective” as the topic for the thesis hoping that it will somewhat contribute to the library and be useful to many people.

The concept of GCG along with CSR in Indonesia is still being developed and socialized, the latest report on CSR is the almost approved Company Law article 74(UU Perseroan Terbatas pasal 74), one of which paragraph states that every company operating in areas relating to natural resources is obliged to fulfill its social and environment responsibilities. Indications of approval of this new regulation in the near future provoked many business practitioners, Sofjan Wanandi; the president of Indonesian Entrepreneurs Association (Asosiasi Pengusaha Indonesia); is just one individual representing numerous

principals in business who objects to the new regulation. In general, many find that this new regulation is still filled with much uncertainty and will cause companies to incur higher cost. On the other hand, the need for this regulation is felt by many. They believe that much of the damages done to nature are caused by the natural resources exploitation activities performed by companies. The voice of these many constituents is communicated through the House of Representatives (Dewan Perwakilan Rakyat). This side believes that CSR will better the community; at most the local surrounding inhabitants, thus allowing a more sustainable life for the company.

Unfortunately, many in Indonesia still think of CSR as a cost rather than an investment moreover a tool for corporate social opportunity. A lot of companies are under the impression that CSR will not bring any benefit and if so it can only bring intangible benefits that can not be measured and quantified. This perception along with lack of enforcement of concerning regulations and incentives are some of the reasons why many companies still have not integrated CSR into their strategies and policies. A new approach, triple bottom line or sustainability reporting is required in order to quantify the implementation of CSR. This approach captures an expanded spectrum of values and criteria for measuring organizational (and societal) success; economic, environmental and social. However, to date only a few in Indonesia have adapted this approach.

I.2 Objectives of Research

The research aims to:

- Further identify and understand the condition of CSR implementation in companies operating in Indonesia by sampling PT.Unilever Indonesia Tbk.,

- Identify the motivation and the reason behind implementation of CSR beyond compliance,
- Give suggestions to companies about sustainable CSR programs aligning with the company's policy.

I.3 Benefits of Research

The writer hopes that the research done will be of many good uses to the readers and users especially to companies in Indonesia conducting CSR and the ones who have not carried it out, regulators or policy makers, investors, and academics. With a thorough understanding of the implementation of CSR and the values created it is hoped that groups of different interests previously mentioned will contribute in many ways such as:

1. For the companies obtaining comprehensive understanding of the nature of CSR, they will formulate a strategy inclusive of CSR implementation to achieve their objectives,
2. For the regulators realizing the importance of the enforcement of the concerning regulations and law, it is hoped that they produce a regulation which not only will be an incentive for the company to implement CSR but also as a yardstick so that violations to the stakeholders' rights can be prevented,
3. For the investors: become aware that a firm's goal is not only to maximize the shareholders' wealth but also the stakeholders' value which can be achieved by means of execution of CSR, and
4. For the academics, the writer hopes that this research can be used as a material for comparison or as a basis for a more extensive research so that the process of socializing and implementing CSR will improve.

I.4 Scopes and Limits of Research

The topic “Corporate Social Responsibility from A Firm’s Perspective: A Case Study at PT.Unilever Indonesia, Tbk.” is adapted for the thesis, the writer tries to discuss the topic conforming to the materials obtained from the curriculum given from the department of Accounting of FEUI along with other references obtained. The discussion and analysis of the topic will mainly be based on the subject of Corporate Governance. The thesis will be limited to the analysis and observation on three months of internship done by the writer in the respective company.

I.5 Methods of Research

Research done by the writer employs the descriptive, analysis and comparative method whilst in order to obtain the data required, the writer became involved in the company through a 3-month internship. Besides the internship, the data required are also obtained from books, articles, seminar materials and web sourcing. Both methods simultaneously hold strong and significant roles in supporting the research, complementary of each other.

I.6 Format of Presentation

The product of the research will be presented in the following format:

Chapter 1 is a preface or an introduction to the thesis; it consists of backgrounds of the thesis, objectives of the research, benefits of the research, scopes and limits of the research, methods of the research and the format of presentation. In chapter 2 the writer will present the theoretical framework for the thesis such as the development of CSR concept, significant ethics issues, types of corporate social initiatives, benefits of CSR implementation, The Millennium Development Goals and CSR regulations. A company profile of the company

taken as a sample will be provided in chapter 3 along with the implementation of good corporate governance and CSR at the respective company. Chapter 4 analyzes the conduct of GCG and CSR at the respective company. As a final point, chapter 5 provides the conclusions and suggestions made on the research done.

