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CORPORATE SOCIAL RESPONSIBILITY IN INDONESIA: REGULATION AND IMPLEMENTATION ISSUES

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ABSTRACT

This research aims to answer and elaborate the questions as follows; First, which one better, whether the CSR will be the mandatory or voluntary merely ? The second question is how far the scope of CSR in Indonesia ? Third, how is the implementation CSR in Indonesia? The study was analyzed with the reflexive-law theory that used to be handled the limitation of formal law approaching as the intervention of state in the area of private law, including the corporation. The reflexive law theory also trying to find the solution of the limit of law with the self-regulation, hence corporation obliges to report the social reporting to the states.

This study is conducted by using normative legal research and socio-legal research. It is committed by reviewing various regulations, concepts, theories and practices of CSR in Indonesia The data were collected through library and field research. This study measures the validity and reliability by using observation approach and documentation study toward various regulations and documents of CSR on MNCs, National Private Corporation and State Owned Corporation in Indonesia. This research found that: first, CSR as the corporation activity can be legally bound by the regulation in Indonesia, based on Constitution of Republic Indonesia 1945 and the moral value. In another side, the research also found that the government needs to support the corporation doing CSR with the tax deduction policy, in order to eliminate operational cost of corporations. Second, within that obligation, the most important thing is that to give an authority to corporations to have self-regulation and to give social reporting toward the society. Third, definition of CSR in the Limited Liability Company Act 2007 and Investment Ac 2007 must be revised with similar concepts and definitions of CSR and more clearly as a reference.

Keywords: Corporate Social Responsibility, Social Reporting, Self Regulation.

INTRODUCTION

Corporate social responsibilities is strictly regulated in Indonesia, there are Law No.25 year 2007 concerning Investment. Law No.40 year 2007 concerns Limited Liability Company (LLC Act, 2007) and Law No.19 year 2003 concerning State Owned Corporation (SOC Act, 2003). This condition happens regarding to the Constitution of Republic Indonesia 1945 which stated that national economic and social welfare must be regulated by the government in order to the biggest society's wealth. Besides, in line to continuous developing principle, government wants to prevent and decrease the environmental damage which caused by corporate operation without caring the environment and society condition. But, this condition raises many controversies.

First

Many parties stated that CSR is done based on voluntary principle. Hence, CSR can not measure up to mandatory (Sutton, 2003). For example, International Labour Organization stated that:

> *"CSR is an area of voluntary initiatives in which enterprise develop their own approaches that go beyond legally required action to consider the impact of their activities on their workers, communities of operation and stakeholders (Diller, 2004.) ".*

Second

Make CSR compulsory is contradicted with the nature of companies which is profit taking, not to do such a social activities.

> *"A business corporation is organized and carried on primarily for the profit of the stakeholders. The powers of directors are to be employed for that end (Review I.C.a.C.L, 2002).*

Third

The wide range of CSR both theoretical and practical is rapidly increased. CSR which in the very beginning only purposed to protect the labor, it has included the environmental system, human right issues, until anti-corruption (Meeting U.G.C.o.t., 2007). Therefore, it is become not easy for "law" to regulate CSR; it is because law has limitation (Jenkins, 2014).

Forth

Related to the financial sources. In the act of government business organization article 88 subsections 1 SOC Act 2003, stated that:

> *"BUMN can set aside some part of their net profit to develop the small business/koperasi and development of society surrounding government business organization."*

Meanwhile LLC 2007 Act article 74 subsections 2 explicitly stated that:

> *"Social and environment responsibilities are an obligation for each corporation which is budgeted and calculated as corporate expenses which fair and proper."*

Fifth

Regarding the variance of CSR. Before it is obligatory programmed in Indonesia, there were many corporate which already run this program in so many motif and its model. There are several corporate did it for "do well and to look good", part of promotion, up to corporate sustainability strategies. It has so many forms. There were donations, partnership or community development society empowering (Kotler & Lee, 2008).

From above explanation, research of CSR in Indonesia became important to be done, in

order to answer these several questions. *First,* how the CSR regulation in Indonesia, it is a must or voluntary? *Second,* how does the scope of CSR regulation implemented in Indonesia? And third, how are the problems during the implementation CSR in Indonesia?

This research used reflexive law theory for the needs of analysis. Reflexive law theory is used to overcome the deadlock condition of formal law approach. (Hess, 1999). Reflexive law theory is trying to minimize the complexity and diversion of society trough extensive law. Reflexive law theory tries to solve the limit of law in controlling the society which is complex and effective. The purpose of regulation whish based on reflexive law theory is to support the proactive and responsive management toward the social problems, by directing the corporate behavior pattern by self regulation.

RESEARCH METHODS

This study is conducted by using normative legal research and socio-legal research. It is committed by reviewing various regulations, concepts, theories and practices of CSR in Indonesia (Chambliss, 2008). The data were collected through library and field research. Moreover, this study measures the validity and reliability by using observation approach and documentation study toward various regulations and documents of CSR on Multi-National Corporation, State Owned Enterprises and the National Private Enterprise in Indonesia.

REGULATION AND IMPLEMENTATION ISSUES ON CSR

Regulating CSR in Indonesia: Mandatory or Voluntary?

The discussion of CSR whether it should be obligated or voluntary was started from the basic purposes of cooperation. Basically, a corporation was formed in order to get profit for the shake of shareholders. Meanwhile, CSR pretend to push the corporate to be aware toward the society's needs (stakeholders). The very first discussion was started by Adolf Berle and E. Merrick Dodd at the beginning of 1930 in United State (Sheehy, 2003).

Adolf Berle is focusing in the importance of law protection to the shareholders which should be prioritized (Kelly, 2001). Shareholder primacy doctrine was supported by the master of the law which stated that the shareholders have to get an absolute law protection as the consequences for these four reasons; (1) hold the residual claims; (2) have the greater risk; (3) have the greatest incentive to maximize firm value, and; (4) have the least protection (Sheehy, 2003).

Frank-Knight and Hart stated that, firms profit taking action is a logic consequence of business which always faces uncertainty business environment and threatened by loss possibility (Frank-Knight and Hart, 1964). This concept is one of the explanations that profit taking becomes a normative right because of the risk and uncertainty in business itself. Profit is the reward for risk taking; profit is due to take assumption of risk.

The court's decision also supporting the doctrine, as it showed in Dodge versus Ford Motor Company case. Michigan Supreme Court said:

> *"A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end* (Lee, 2004)*."*

The case law clarifies the main purposes of corporation is to maximize the shareholders interest, not the needs of society.

In implementing CSR, business morality aspect should be clearly re-defined. If the director or management of corporate, such donation in the name of company, in truth he did a personal action, because director is an agent of the shareholder (fiduciary duty doctrine) (Coelho, McClure & Spry, 2003).

This means basically use the corporate asset for social is immoral because it betrays and steals the shareholder rights. Management does not have any right besides maximally effort in profit taking and there is no obligation to do social action by using the corporate asset (Bakan, 2007).

CSR as a form of obligation to propoerties chanelize is reputed contravene corporate private property right. Corporation as private institution has an owning right which fully protected by the law. Private property right has to be secured by the state law as the sacred rights (*sacred rights of private property*) (Smith, 1827).

Meanwhile E Merrick Dodd argumentation said that the purpose of corporation is not merely for the shareholder, but society protection also (Wells, 2002).

Dodd opinion has born stakeholder theory. This theory is established based on opinion, if the management of corporation only looks for as much as profit for the sake of shareholder, that so the business will go out of the line. Corporate will exploit labour and push the consumer and business partner. Hence, the profit taking of corporation should be expanded to stakeholder needs fulfilling also (Bertens, 2000).

Corporate assets are private owned, but it should be purposed to society. Just as John Rawls related with gifted character:

> *"Gifted talent and natural ability, do not consider it as personal asset, but it is should be considered as public assets. Gifted character of someone is public asset which entrusted to him. Every benefit of it should be fortunate all parties, especially for poor (least advantage)* (Rasuanto, 2005).

Related with philanthropy, in truth it is come from Greek: *philos* (love) and *anthropos* (human) which mean love of fellow being. Philanthropy was founded in all of religion (theological approach) as a morality (Wade, 1998). Islam knows *zakat*, *infaq* and *sodaqoh*. In Christian knows *misericordian*, Jewish knows *Tsedaqah*, Hindus knows *dartra darteva* and *danaam parmrath*, Buddhist knows *thambun* and *thantaan* which the core is set aside some asset to others. This precept illustrated that in some part of owning there were the right of anyone else who need it is a universal moral value.

Hence, the change of the corporate purposes paradigm from only to profit taking (Etcheverry, 2004). Reconstruction of corporate law should create a space in order to social justice. The corporate asset is not privately owned, but also it should useful for others, especially for poor people (Rasuanto, 2005). Kenneth Boulding quotes the past paradigm by cowboy economic, such as:

> *"A cowboy lives in an open wide area. He will take anything in anywhere he can found it. The area is wide and the source seems never run out. He will litter along the way. The cowboy economics vision illustrated as an open wide unlimited land which provide any kind of natural sources and throwing garbage" (Korten, 1993).*

Hence, a new paradigm is needed in order to change this condition (Calder & Culverwell,

2005). Sustainability development is a convergence between economics, environment and social welfare. It is familiarly called triple bottom lines (Kiroyan, 2007).

Nowadays, profit taking action for the shareholder is still became a strong norm in corporate law of several countries. But, there are some countries which try to optimize CSR in their constitutions. England has the Company Act 2003 which regulates the obligation of Board of Director to implement CSR. In India, the obligation to implement CSR regulated in Company Act 2013 ("Company Act," 2013). Filiphine has regulated CSR in Corporate Social Responsibilities Act 2007 ("Responsibilities Act," 2007). Meanwhile in Netherland, nows CSR draft is being processed to be investigated is it possible to regulate it by using Dutch Company Act (Graafland, Eijffinger & Coldeweijer, 2004) and also Spain, CSR has been discussed in the Spanish Parliament Summit Meeting related with *"a draft corporate social responsibilities act"* (Luna & Pio, 2004).

Besides the purpose of corporation, CSR regulation debate between obligate constitutively or voluntary moral obligation, so far it is tending to morality rather than constitutively. Because of the voluntary character and it is in ethics area, several countries and international organization regulate CSR in code of conduct (and then it is well-known as soft law) (Goel, 2005). Besides it is controlled by code of conduct, many companies committed their self to do CSR in self-regulation (self-governance) (Ishikawa, 2005). But, both two things are considered ineffective because it has no strength compared to constitution.

Besides, there are several questions: is corporation a moral agent just like a human? Moral agent simply defined as a party who has a responsibility to act as a morality (Halliday, 2000). Greenwood give his overview that there are similarities between corporation and individual, if it is seen from their responsibilities as a society member toward government (Greenwood, 2005). Further, corporations have rights that human citizens lack.

Technically, Joel Feinberg explain that in the past moral obligation was only obligated to personal, it is moved into collective obligation of corporation. Any activities of part or corporate partner become moral collective obligation (Feinberg, 1968). Based on Joel Freiberg, collective moral obligation is not because of there is an error, but it is more tends to morality or *group liability without fault,* such inappropriate action or embarrassing action (Feinberg, 1968).

But, there is an ancient word of Rome: Quid *Leges Sine Moribus?"* which means "what is the meaning of law if there is no morality". Moral have to be always become the spirit of law. Whether in the process of law formation or the execution of constitution, ethics taka a very important role.

Next, obligate the corporate to do CSR is considered as contradict with efficiency principle. Efficiency is optimization of the existence sources to get maximum profit (Posner, 2014). But, mostly this principle creates a dangerous excess, Corporation will be more tends to use lower price of raw materials but it is harm the environment, exploit labour and others. Efficiency could be dangerous and ignore the existence of human being (Sheehy, 2003).

Hence, efficiency principle has to give an advantage also toward society. Every corporation activities which create disadvantages for society is considered as contradict condition toward law (Madden, 1998). In this case, the ideal CSR regulation is the regulation which is not contradicts to the business principle, but also aware to social interest. Because however, the most efficient regulation, if cannot give justice, should be annihilate (Rawls, 1973).

The Scope of CSR Regulating

The scope of CSR is greatly improved. At very beginning it is only in the term of employer, consumer and partner right protection and also related with the society surrounding the corporation. Nowadays, the scope of CSR requests the corporation to be aware to the environment, respecting the human rights and run the clean business from bribe and corruption.

CSR and Labour Right

CSR related with the human resources issues, it is raised because of the right of labour which unprotected. At beginning of industrialization in Europe and United States, labours are hardly exploited just like a slave (modern slavery) (Cabral, 1998). At that time there are no work schedules, age limitation, working safety, salary system and others labour rights protection (O'Connor, 2005). Workers were roughly acted with a poor condition of work and did not be given the well safety working facilities (*sweatshop workers*) (Hallare, 2004).

Indonesia regulates the Labour Act through Law No.13 Year of 2003 Concerning Labour Relation ("Labor Act," 2003). In the article no. 67 until no. 101 which consider the under age, woman and invalid workers, work hour limitation, wealth and work safety, also salary and prosperous.

There is an up-to-date approach in giving the rights of workers in the term of CSR, by giving the employee stock opinion plan (ESOP). This ESOP concept gives a chance for the workers to joining in keep some of companies stock (Solomon & Collins, 1986). Workers are motivated to give a good performance in order to increase the productivity of corporation and on the other hand, workers will receive some part of company profits. Win-win solution (Solomon & Collins, 1986).

CSR and Consumer Protection

In Indonesia, consumer is protected by Law No 8 Year of 1999 Concerning Consumer Protection ("Consumer Protection Act," 1999). Consumer Protection Act 1999 also includes the responsibilities and obligation of companies.

But consumer protection, if it is seen from the concept of CSR is not only the issue of violation of the law or not. Moreover, the losses of assets. But it is more than that; the concept of CSR in consumer protection is a moral obligation to provide the best service for the consumer, of course, without law violation.

CSR and Environment

The scope of CSR is often associated with environmental problems. In many countries, the fact is that law of the environment is formally conducted by constitution (Franz & Pfahl, 2006). In Indonesia, the environment is regulated in Law No. 32 Year of 2009 Concerning Environment Management ("Environment Act," 2009). The targets which want to be achieved with these regulations is to achieve harmony and balance between humans and the environment and; ensuring the interests of present and future generations.

But environmental problems are global problems. United Nations Conference on Environment and Development (Rio Declaration) in 1992 which produced 21 agendas (Earth Action Plan). In 21 agendas, there are 3 areas of study: (1) social and economic dimension (2)

conservation and resource management for development and (3) Strengthening the role of major groups in society from the executor parties (Ahmad, 2001).

But an environmental issue which associates with CSR in essentially is Sustainable development. This is to ensure that the recent needs and preservation of natural resources, without any compromise, should consider also the needs of future generations (Herrmann, 2004).

CSR and Human Right

The cognition of economic power which able to endanger the human dignity has becomes various parties thought. In the last decade, a lot of evidence and testimony of human rights violations, as the impact of corporate operations, especially Multi National Corporation (MNC). Some of them are violations of Human Rights in India by Enron Corporation (Watch, 1999), Shell, Mobil and several international oil companies which operates in Nigeria (Manby, 1999; Watch, 1999) and Unocal and Freeport-McMoRan which is claimed by Burma and Indonesia citizens. This is a crucial argument for linking the presence of MNC and it is very potential to be a subject of national and international laws that is submit to the legal regime of human rights (Ruggie, 2007).

The European Union has recommend to consider human rights for private business toward society (Davidsson, 2002). United States use the Alien Tort Claims Act 1789 (ATCA) to overcome the human rights abuses by corporations (Fishman, 2006).

Talking about human rights in the context of CSR, often linked with the issue of civil rights such as economic rights, political rights and cultural rights (Dickerson, 2001). Universal Declaration of Human Rights (*The Universal Declaration of Human Rights (UDHR)*) which contains several articles related to the CSR, there are article 22, article 25 and article 26.

In Indonesia has also regulate about Human Rights through Law No. 39 year of 1999 (Human Right Act, 1999).

Mentioned in Article 40 that:

> "*Every person has the right to live and decent life*" and in Article 41 subsequence (1) *"Every citizen has the right of social security which is needed for decent living and for his personal development as a whole".*

This means that CSR has been regulated in human rights laws and constitutions in Indonesia.

CSR and Anti-Corruption Movement

Recent developments in the scope of CSR is about corporate involvement with the issue of corruption (Hess & Dunfee, 2000). The business world is shocked, when the incident of Enron Corp. bankruptcy in October 2001, suddenly collapsed and had to bear the loss more than U.S. $50 billion. Tragedy was followed by WorldCom who lost up to U.S. $11 billion and declared lost assets worth U.S. $110 billion. Global Crossing, Adelphia Inc. Tycon and then follow to collapsed.

Corruption is a crime that has a very wide impact. Not only the destruction of the economic system but also have an impact on the social situation. The cases above have shown that corporate bankruptcy because of manipulation and corruption led to a lot of unemployment and social welfare issues. Besides corruption can destroy the market system and social development (Burger & Holland, 2006).

In 2004 the United Nations Global Compact launched the business movement Anti-

Corruption namely: *Businesses should work against all forms of corruption, including extortion and Bribery* (Oshionebo, 2007).

Indonesia had regulated the corruption of corporation, through Law No. 31 Year of 1999 concerning Eradication of Corruption (Anti-Corruption Act, 1999), which contains corporate as a corruption subject can be punished by sanction.

But in fact, the existence of various regulations issues related to CSR is not working properly, because CSR is something beyond the rules. According to the reflexive law theory this is the failure of formal law in dealing with complex conditions. To overcome this problem, it is important to make special rules on CSR.

Implementation of CSR by the Multi National Corporation, State Owned Enterprises and the National Private Enterprises

There was confusion and differences in definitions and concepts of CSR in the legislation in Indonesia, causing difficulties in the implementation. Since there were differences of CSR definition in Investment Act 2007 and LLC Act 2007 then, the overlapping implementation is not unavoidable.

Therefore, at this time, corporations in Indonesia implement CSR with vary motives and models, such as donation (charity), community development and business strategy. Multi-National Companies have a strong commitment to implement CSR as sustainable business strategy. Because of regulatory uncertainties, MNC refers to code of conduct that is made by international institutions or self-regulation that is in the corporate regulation. National Private Companies are also doing the same thing. There are various motives in the implementation of CSR. Such as donations, community development program and community empowerment. For state-owned enterprises have a clearer reference. Through the Regulation of the Minister of BUMN No.: Per-05/MBU/2007, CSR of state-owned enterprises conducted by the Partnership Program and Community Development (Program Kemitraan dan Bina Lingkungan/PKBL).
Another problem arising in the implementation of CSR is about the source of funding. Article 74 paragraph (2) of LLC Act 2007 mentions that:

> *"Social Responsibility and the Environment is the obligation of the Company that is budgeted and accounted as Company's cost and the implementation due regard to decency and fairness."*

Whereas, the funding of CSR for state-owned company (SOC) in Article 88 verse (1) SOC Act 2003 mention that "State Owned Corporation could set aside part of its net income for development of small business/cooperatives and community development around the SOC". This is clarified in Article 9 verse (1)-(3) Per-05/Mbu/2007, that PKBL funding sourced from shelve of its profits after tax for a maximum of 2% (two percent).

Regulatory differences are caused debate. Indonesian Chamber of Commerce objected if the CSR is budgeted, because companies that have not got profit yet, should not be burdened to implement CSR. It means that CSR funding would be fair if it is taken from some profits. However, the source of CSR needs to be budgeted, because the social impact caused by the corporation has occurred since they operate.

According to the author, if the CSR viewed as corporate activities to improve the people's quality of life (contribute to economic development while improving the quality of life of the local community and society at large); it is not always associated with costs. CSR can be

done by hiring employees from the local community, cooperation building with a small business or developing partnerships with local farmers.

It seems difficult to set a formal law due to the diversity of CSR practices since formal law has various limitations. Antony Allot explained that there is text limitation to regulate all of social phenomena in the rule of law. Because the law can work effectively influenced by: (1) *instrument legal term and;* (2) *contextual interpretation* (Allott, 1980). To overcome the complexity of these social activities, reflexive law theory provides solutions for corporate (social institution) to be given an authority to regulate themselves (self-regulation). It means that CSR implementation motives and models should be determined by each corporation themselves.

CONCLUSION

CSR is a corporate activity that can be obligated by law based on several things: *First,* the purpose of the corporation which only seek profit nowadays is not relevant. Therefore, the format of corporate law must be changed, because the corporation incorporated under the laws of the certain area, should in line with the society interests where the law is. Corporations must change the paradigm with the aim of making profit (profit), creating a social welfare (people) and preserving the environment (planet). *Second,* CSR are based on moral and ethical values. In accordance with *"Quid Leges Sine Moribus?"* What does the law mean if not accompanied by morality? *Third*, CSR that is only based on the principle of voluntary (voluntary) cannot be run effectively and not measurable. It would be better if it is being obligated (mandatory) because it has a binding force of law (with sanctions) and provide legal certainty.

Since the concept and scope development of CSR, it is necessary to make special regulation about CSR. According to Reflexive law theory, the special regulation is required because of the failure of formal law to regulate complex society. It has limitations in managing the growing of social phenomenon rapidly and diversely.

First, the problem of regulation in LLC Act 2007 and Investment Act 2007 must be revised with similar concepts and definitions of CSR and more clearly as a reference. *Second*, related with sources of funding should not be definitively determined because CSR is not always associated with costs, such as hiring employees from the surrounding community or in partnership with farmers and local SMEs. *Third*, the diversity of the CSR implementation models and motives by corporations should be appreciated. Because these activities are essentially a form of corporate awareness to address social problems and improve the society quality of life. The diversity is difficult to avoid, because the condition faced by the corporation and the society are very diverse. Corporations should have a freedom to define the scope of CSR in accordance with the circumstances faced. According to the reflexive law theory, the government must give an authority to the corporation to govern themselves (self-regulation) in determining the implementation of CSR.

IMPLICATION

The result of this study provides a clear implication in the regulation of CSR in Indonesia. In consequence, every company in Indonesia; Multi-National Corporation, State Owned Enterprises and the National Private Enterprises, has a legal obligation to implement CSR. Furthermore, exciting findings from this study also explain the importance of CSR concept to be applied in the regulation and policy values of business ethics in each company. By this

implementation, every company will tend to maintain its business sustainability.

DISCUSSION AND LIMITATIONS

This study has limitations on empirical evidence data sources which obtained from the document and interview only. Therefore, this study needs to be studied further by adding primary data through direct observation on the way of companies in implementing the CSR. Interesting contributions of this research, among others, contribute to the development of science in the field of corporate law and social empowerment. Further studies are expected to prove that the CSR concept required by law can bring goodness to business and overcome social problems. Also, further research is required by using qualitative and quantitative approaches, to obtain a more in-depth and measurable description.

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