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The Influence of Environmental Performance towards Creating Shared Value

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Abstract. The company performance is not about the financial performance, but also need to consider other factors, such as environmental performance and social performance. The three factors, named Triple Bottom Line (TBL) that plays an important role in the company's performance evaluation. By applying TBL, it is believed that the company can create shared value to the stakeholders. Moreover, the topic of environmental performance and CSV is still limited especially in Indonesia. Therefore, the purpose of this research is to analyze the influence of environmental performance towards Creating Shared Value (CSV) empirically. The research sample is 29 public listed companies in Indonesian Stock Exchanges that published the sustainability reports from 2006-2014 (purposive sampling techniques). The results show that the influence of environmental performance towards CSV is not only in the short term (the current year) and but also in the long term (3-4 years later). The environmental performance would influence CSV significantly in the next 2 years, and could not influence CSV in the same year, the next 1 year, the next 3 years and the next 4 years. It indicates that the environmental activities need a longer time to influence CSV.

Keywords. Creating Shared Value, Environmental Performance, Long Term, Sustainability Reports, Indonesia

Introduction

The company performance is not about the financial performance, but also need to consider other factors, such as environmental performance and social performance. The three factors, named Triple Bottom Line (TBL) that plays an important role in the company's performance evaluation. By applying TBL, it is believed that the company can create shared value to the stakeholders. The objective of this research is to analyze the environment performance towards CSV. Because the trend is for disclosure of environmental performance to be mandatory, a company's environmental performance plays an important role in business today (Kitzmueller & Shimshack, 2012). Past research showed that the topic of CSV is still very limited (Wójcik, 2016), and the closest research available is influence of the environmental performance on the financial performance. The research regarding environmental performance with CSV is also limited; the closest research is financial performance with CSV (Jones et al., 2014) which shows that financial performance influence CSV. Therefore, that will become our research gap. So, this paper will answer how the environmental performance influences CSV empirically. This paper will contribute to the research in environmental performance and CSV empirically as research in this topic is very limited. The results shows that the environmental performance could influence CSV significantly in the next 2 years, and could not influence CSV in the same year, the next 1 year,

the term of years and indicates that the CSV should be considered as long term investment rather than a short term expenses. For managerial implication, the company should relate CSV with the company strategy, and if the company conducts environmental performance continuously, then the company would to be able create CSV. We also give the example of the best practice of disclosure of environmental performances by Semen Indonesia (Persero Tbk) which disclosed 94% of environmental information, and this will be a benchmark for other companies to follow.

Literature Review

The theory that underlying the environmental performance is the legitimation theory that says: "… a system-oriented view of organization and society… permits us to focus on the role of information and disclosure in the relationship among the organizations, the state, individuals and gap" (Gray et al. 1996). Therefore, the company's activities should be in parallel with the society's goal. The legitimation theory explains why the environmental disclosure disclosed the information voluntarily, the reason for that is accountability and visibility that considered as one way to legitimate the company's activities and socially responsible that need to consistence with the social norms (Deegan & Rankin, 1996) (Clarke & Sweet, 1999), (Cormier & Gordon, 2001); (Deegan et al., 2002); (de Villiers & van Staden, 2006).

Creating Shared Value

The concept of CSV was introduced in 2005 by the Vice-President of Public Affairs at Nestle, Niels Christiansen. Christiansen presented the concept to Porter and Kramer in 2006 and they published the article "Creating Shared Value" in 2011 and it acquired major attention (Christiansen, 2014). According to Porter and Kramer (2011), the concept of shared value can be defined as "Policies and operating practices that enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities in which it operates. Shared value creation focuses on identifying and expanding the connections between societal and economic progress".

The differences between CSR and CSV are based on the definition; CSR is to have social advantages without considering the cost or effort to be done, for example sharing company value to the society. While CSV is creating new opportunities and new value, so that the company is being internally motivated to create CSV and not being pushed by the external factors (Visser, 2010). The differences between CSR and CSV based on Porter and Kramer (2011) can be seen in table 1.

CSV will replace CSR in the future, because CSV is more than CSR in directing investments towards society. CSV is integrated with a company's profitability and competitive advantage positioning, also increasing the company's resources and expertise to create economic value. CSV activities have already been implemented by Coca Cola, Nestle, Novo Nordisk, Intel, and InterContinental Hotels Group. Colectivo Coca Cola at Brazil has the initiative to increase the work opportunities for low income young people, strengthen the company's retail distribution channel, and also increase branding to boost the sales. The company trained the young people for retail business, business development, and entrepreneurship. The program has been successful; approximately 30% of the trained young people have got their first job at Coca Cola or Coca Cola partners, and at least 10% have been able to set their own business with the financial support from the company, and on business perspectives, the investment at Colectivo has been profitable in two years' time (Porter et al., 2011).

Table 1. The difference between CSR and CSV

CSR	CSV
Values: doing good	Values: economic and societal benefits relative to cost
Citizenship, philanthropy. sustainability	Joint company and community value creation
Discretionary or in response to external pressure	Integral to competing
Separate from profit maximization	Integral to profit maximization
Agenda is determined by external reporting and personal references	Agenda is company specific and internally generated
Impact limited by corporate footprint and CSR budget	Realigns the entire company budget
Example: Fair trade purchasing	Example: Transforming procurement to increase quality and yield

Source: Porter and Kramer (2011)

Environmental Performance

Nowadays, company performance does not rely on only the financial performance such as: profit, because it does not reflect the company performance. The other factor that influences the company performance is the environmental performance in the form of environmental (sustainability) reporting (Gray et al., 1993); (Mathews, 1997); (Salzmann et al., 2005). The benefit of disclosing environmental reports is that the company would have the "good image" for the business (Bennet & James, 1998); (Orlitzky, 2005); (Salzmann et al., 2005).

Previous research

The previous research about Triple Bottom Line (TBL) and CSV topic are still limited (Wójcik, 2016). Based on the concept consists of TBL: Profit, People and Planet (3P), the Planet concerns about the environmental issues (Elkington, 1994). The closest research available is the influence of the environmental performance towards the financial performance. The results show that the environmental performance could influence the financial performance positively (Russo & Fouts, 1997); (Hart & Ahuja, 1996); (Al-Tuwaijri et al., 2005); (Pogutz & Russo, 2009); (Sánchez & Lorenzo, 2012); (King & Lenox, 2001). Meanwhile, the opposite result show that environmental performance could not influence the financial performance (Jaggi & Freedman, 1992); (Sarumpaet, 2005).

The research about environmental performance to CSV are also limited, the closest research is the financial performance towards CSV (Jones et al., 2014) show that the financial performance influence CSV. The measurement for financial performance: cash flow, profitability, liquidity, capital structure, financial distress, and annual risk and return on investment. Moreover, the measurement for CSV use the model from Porter & Kramer (2011): reconceiving product and markets, redefining productivity in the value chain, and enabling cluster development. Therefore, the influence of environmental performance towards CSV in Indonesia becomes the research gap.

Research Framework

The research framework of the influence of Environmental Performance to CSV can be seen in picture 1.

Picture 1. Research Framework

The environmental performance measurement is from Ratnatunga & Jones (2012) and could be seen on table 2.

Table 2. Environmental Performance Measurement

No.	Indicators	Measurement
1	Energy Use	Total of energy used
2	Water Usage	Total of water usage
3	CO2 Emissions	Total CO_2 emissions released
4	Hazardous Waste	Total of hazardous waste
5	Habitats and Species Conservation	Number of trees planted
6	Awards and Recognition	Number of awards and recognition received

Source: Ratnatunga & Jones (2012)

Creating Shared Value Measurement

The CSV measurement is from Porter et al. (2011) and can be seen in table 3.

Table 3. CSV Measurement

Level of Shared Value	Business Results	Social Results
1.Reconceiving product and markets: How targeting unmet needs drives incremental revenue and profits.	• Increased revenue • Increased market share • Increased market growth • Increased productivity	• Improved patient care • Reduced carbon footprint • Improved nutrition • Improved education
2.Redefining productivity in the value chain: How better management of internal operations increases productivity and reduces risks.	• Improved productivity • Reduced logistical and operating costs • Secured supply • Improved quality • Improved profitability	• Reduced energy use • Reduced water use • Reduced raw materials • Improved job skills • Improved employee incomes
3.Enabling cluster development: How changing societal conditions outside the company unleashes new growth and productivity gains.	• Reduced costs • Secured supply • Improved distribution infrastructure • Improved workforce access • Improved profitability	• Improved education • Increase job creation • Improved health • Improved incomes

Source: Porter et al. (2011)

The CSV measurement divided into three categories: (1) reconceiving product and markets; (2) Redefining productivity in the value chain; and (3) Enabling cluster development. Each of the activities has business and social measurements that have the same measurements, then we modified the measurements into 1 category (modified) CSV measurement that can be seen in table 4.

Tabel 4. Modified CSV Measurement

No.	Indicators	Measurement
1	Increased Revenue	(Revenue $_t$ – Revenue $_{t-1}$) / Revenue $_{t-1}$
2	Improved Profitability	(Profit $_t$ – Profit $_{t-1}$) / Profit $_{t-1}$
3	Improved Education	(Educational Expense $_t$ – Educational Expense $_{t-1}$) / Educational Expense $_{t-1}$
4	Improved Employee Income	(Salary Expense $_t$ – Salary Expense $_{t-1}$) / Salary Expense $_{t-1}$
5	Improved Health	(Health Expense $_t$ – Health Expense $_{t-1}$) / Health Expense $_{t-1}$
6	Reduced Operating Cost	(Operating Expense $_t$ – Operating Expense $_{t-1}$) / Operating Expense $_{t-1}$

		(Energy Usage $_t$ – Energy Usage $_{t-1}$) / Energy Usage $_{t-1}$
8	Reduced Water Use	(Water Usage $_t$ – Water Usage $_{t-1}$) / Water Usage $_{t-1}$
9	Reduced Carbon Footprint	(Carbon Emission $_t$ – Carbon Emission $_{t-1}$) / Carbon Emission $_{t-1}$

Source: Porter et al. (2011)

Hypothesis Development

We expect that the environmental performance will increase the financial performance. That is, when the company disclosed environmental performance in the CSR (Corporate Social Responsibility) report and/or Sustainability Report, it will increase the financial performance, such as revenue or profit. The research about the research of environmental performance to CSV is limited. The closest research we could find is the financial performance influence CSV (Jones et al., 2014). The measurement for financial performance: cash flow, profitability, liquidity, capital structure, financial distress, and annual risk and return on investment. Then, the measurement for CSV use the model from Porter and Kramer (2011): reconceiving product and markets, redefining productivity in the value chain, and enabling cluster development. Based on that, we concluded that our hypothesis would be: Environmental performances could influence CSV.

Research Methodology

The population of this research is 121 companies listed in Indonesian Stock Exchanges (IDX) and non-listed that published the sustainability reports from 2006-2014. As to get the sample, the purposed sampling techniques applied and after excluding companies in financial or banking industries, we have 29 companies as seen in table 5.

Table 5: The sample selection criteria

Population:	**Total**
Companies listed in IDX and published sustainability reports	97
Companies not listed in IDX and published sustainability reports (Companies listed in Sustainability Report Award - SRA)	24
Total Population	121
Less: Financial/Banking Industries	(92)
Total Sample	29

Since CSV is also applied for the long period, we will use several period, for example: companies could influence CSV in the same period (Lead 0), 1 year later (Lead 1), 2 years later (Lead 2), 3 years later (Lead 3), and 4 years later (Lead 4).

Variable Operationalization:

1. Every measurement will be rank based on percentile (bigger size has bigger value).
2. Then, calculate the average by divided the total rank with the total number of measurement.
3. If the indicator measurement shows the opposite direction, then the indicator will be rank based on percentile with the value being reverse (bigger size has smaller value).

Control Variables

Variable control that mostly used in the research topic of TBL, sustainability, and CSV are company size, industry type, Capital Intensity. We add one more control variable which is dummy variable to see the differences of CSV from one year to another. The list can be seen in table 6.

Control Variables

No.	Control Variables	Measurement	Source
1	Company Size	The logarithm of total assets	Al Farooque, Van Zijl, Dunstan, & Karim (2007)
2	Industry Type	Environmentally Sensitive Industry (ESI) score: 1 and Non ESI score: 0). ESI: (1) Mining, (2) Basic and Chemistry Industry, (3) Infrastructure, Utility, and Transportation. Non ESI: (1) Agriculture, (2) Consumers Good, (3) Property and Real Estate, (4) Financial Institution, (5) Trading, Service and Investments, (6) Various Industries	Cho & Patten (2007)
3	Capital Intensity	The logarithm of total assets divided by total employees	Huselid, Jackson, & Schuler (1997)
4	Dummy year	Year 2013 as the base year because most of the data is in that year	-

Regression Analysis

To test the hypothesis, the influence of environmental performance to CSV, we use lead 0 to lead 4 to see the impact on different year. Lead 0 means that environmental performance in the current year will influence CSV in the current year, Lead 1 means that environmental performance in the current year will influence CSV in the next one year, Lead 2 means that environmental performance in the current year will influence CSV in the next two year, Lead 3 means that environmental performance in the current year will influence CSV in the next three year, and Lead 4 means that environmental performance in the current year will influence CSV in the next four year. The statistical models are as follow:

Model 1 (Lead 0):

$$CSV_{it}=\beta 0_{it}+\beta 1ENV_{it}+\beta 2SIZE_{it}+\beta 3IND_{it}+\beta 4CI_{it}+\beta 5D2006_{it}+\beta 6D2007_{it}+\beta 7D2008_{it}+\beta 8D2009_{it}+\beta 9D2010_{it}+\beta 10D2011_{it}+\beta 11D2012_{it}+\beta 12D2014_{it}+\varepsilon i$$

Model 2 (Lead 1):

$$CSV_{it+1}=\beta_{0it}+\beta_1ENV_{it}+\beta_2SIZE_{it}+\beta_3IND_{it}+\beta_4CI_{it}+\beta_5D2006_{it}+\beta_6D2007_{it}+\beta_7D2008_{it}+\beta_8D2009_{it}+\beta_9D2010_{it}+\beta_{10}D2011_{it}+\beta_{11}D2012_{it}+\varepsilon i$$

Model 3 (Lead 2):

$$CSV_{it+2}=\beta 0_{it}+\beta_1ENV_{it}+\beta_2SIZE_{it}+\beta_3IND_{it}+\beta_4CI_{it}+\beta_5D2006_{it}+\beta_6D2007_{it}+\beta_7D2008_{it}+\beta_8D2009_{it}+\beta_9D2010_{it}+\beta_{10}D201_{it}1+\varepsilon i$$

Model 4 (Lead 3):

$$CSV_{it+3}=\beta_{0it}+\beta 1ENV_{it}+\beta_2SIZE_{it}+\beta_3IND_{it}+\beta_4CI_{it}+\beta_5D2006_{it}+\beta_6D2007_{it}+\beta_7D2008_{it}+\beta_8D2009_{it}+\beta_9D2010_{it}+\varepsilon i$$

Model 5 (Lead 4):

$$CSVit_{+4}=\beta_{0it}+\beta_1ENV_{it}+\beta_2SIZE_{it}+\beta_3IND_{it}+\beta_4CI_{it}+\beta 5D2006_{it}+\beta_6D2007_{it}+\beta_7D2008_{it}+\beta_8D2009_{it}+\varepsilon i$$

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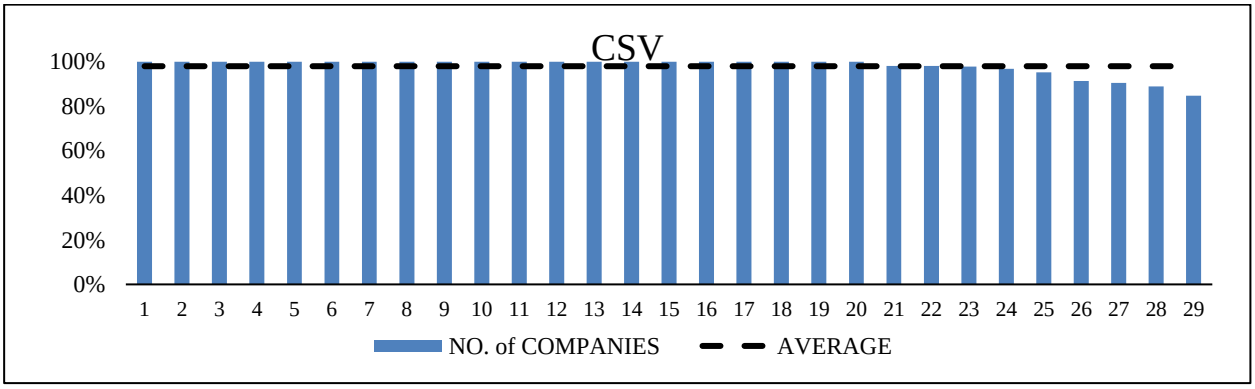
Notes:
CSV_{it+n} : Creating Shared Value at period of t+n
n : 0-4 years
ENV_{it} : Environmental Performance at period of t
$SIZE_{it}$: Company Size at period of t
IND_{it} : Industry Size at period of t
CI_{it} : Capital Intensity at period of t
$D2006_{it}$: Dummy year 2006
$D2007_{it}$: Dummy year 2007
$D2008_{it}$: Dummy year 2008
$D2009_{it}$: Dummy year 2009
$D2010_{it}$: Dummy year 2010
$D2011_{it}$: Dummy year 2011
$D2012_{it}$: Dummy year 2012
$D2014_{it}$: Dummy year 2014
ε_{it} : Standard error at period of t
$\beta 0_{it}$, $\beta 1_{it}$, …, $\beta 16_{it}$: Coefficient Correlation at period of t

Results and Discussion

The disclosure compliance of CSV indicators is 23 out of 29 companies (79%) disclosing the CSV information in the sustainability report is above the average (98%). The rest 6 companies are disclosing it below average (21%). This indicates that CSV disclosure could be considered good, and can be seen in table 7.

Table 7. CSV Disclosure



The 18 out of 29 companies (62%) disclosing the environmental performance in the sustainability report is above the average (70%). The rest of 11 companies are disclosing it below average (38%) and can be seen in table 8. This indicates that the environmental performance compliance disclosure needs to be improved.

The environmental performance indicators are: energy usage, water usage, tree plantation, CO_2 Emission, hazardous waste, and rewards. Thus, the indicators that need improvements are: hazardous waste and rewards. The best practice is Semen Indonesia (Persero) Tbk. that disclosed 94% of environmental performance in sustainability report and can be seen in table 9.

Table 8. Environmental Performance Disclosure

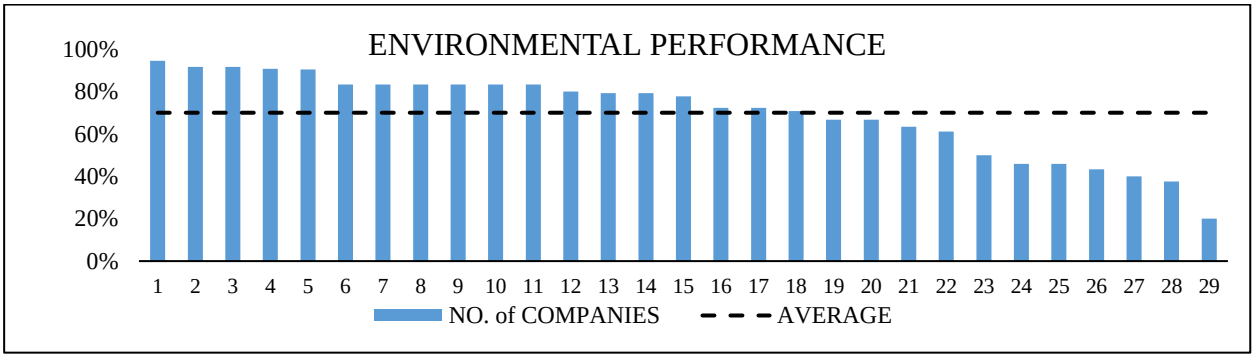


Table 9. Environmental Performance Indicator Compliance

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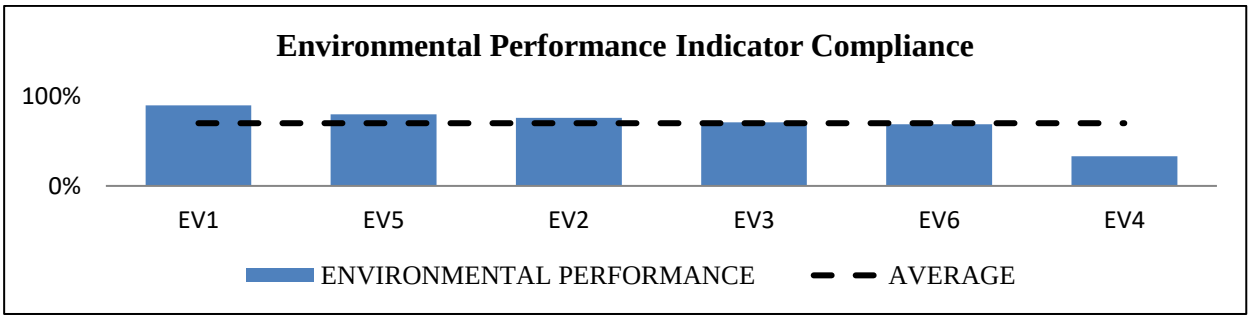

Notes:
EV1 Energy Usage
EV5 Tree Plantation
EV2 Water Usage
EV3 CO_2 Emission
EV6 Rewards
EV4 Hazardous Waste

Classical Assumption Test

The classical assumption test shows that: multicollinearity test, autocorrelation test, heteroscedasticity test, and normality test have passed and can be seen in table 10.

Table 10. Summary of Classical Assumption Test

Classical Assumption Test	Requirements	Results	Summary
Multicollinearity Test	Un-centered VIF < 10	12.3204	No Multicollinearity
Autocorrelation Test	Probability Chi-Square >5%	0.2875	No Autocorrelation
Heteroscedasticity Test	Probability Chi-Square >5%	0.6598	No Heteroscedasticity
Normality Test	Probability >5%	0.8734	Normal

Hypothesis Testing

To test the hypothesis, we use E-Views to have the t-test and F-test and also the adjusted R-squared. The results can be seen in table 11.

The F test sign shows that the model of environmental performance towards CSV is fit from period 0 to 4. Moreover, the t-test shows that the environmental performance could influence CSV significantly for the next two years. The CSV should be treated as a long-term investment (Rixen, Böbel, & Chailan, 2013).

This might be because the indirect impact of implementing environmental activities to CSV. The example of environmental activities is renewable energy, water savings, decreasing carbon emission, managing waste, habitats and species conservation. For example the benefit for tree planting would be helping to cool down the temperature, less air and water pollution, and improving the life quality. The company also could get the "good image" by being an environmental-friendly (green) company. The customers' and investors' purchasing decisions might be influenced by it.

Table 11. Summary of Hypothesis Testing

	Model 1/Lead 0	Model 2/Lead 1	Model 3/Lead 2	Model 4/Lead 3	Model 5/Lead 4
Independent Variable	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**
Constant	0.0002	0.0074	0.00025	0.02345	0.11205
Env Performance	0.1782	0.35375	**0.04315	0.3611	0.3348
Control Variables					
Size	0.4722	0.3497	0.1638	0.4579	0.4314
Capital Intensity	0.2083	0.1378	*0.0790	0.1708	0.4075
Industry	0.4162	0.4097	0.2448	0.4488	0.4082

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Dummy Year	(2007,2008,2011)***, (2006,2012,2014)**	(2010,2012)***, (2006,2012)**, 2009*	(2009,2010,2011)***, 2008**	(2008,2009,2010) ***, 2007*	(2007,2008,2009) ***, 2006**
F test Sign	0.14%	1.58%	1.55%	3.44%	6.54%
Adj R-squared	15.15%	12.25%	16.08%	19.29%	24.69%
No. of Observation	131	103	77	51	31
*** Level of significance 1% ** Level of significance 5% * Level of significance 10%					

The value of adjusted R-squared means that the environmental performance influences CSV 12.25% - 24.69%, the rest will be influenced by other variables such as financial performance, social performance, governance performance, or empowerment performance. For the control variables, (1) Size does not influence CSV, this might due to the majority of the company sample is big companies. Therefore, the bigger companies and the smaller companies do not differ in influencing CSV. (2) Capital Intensity does not influence CSV in period 1, 2, 4, and 5. It influences CSV in year 3. This might happen because of the sample mostly in a good financial condition and the capital intensity is also higher, and the companies published the sustainability report in average 5 years period. (3) Industry does not influence CSV in all period of observation. The Environmentally Sensitive Industry (ESI) and Non ESI do not differ in influencing CSV. This might be due to the small sample size (29 companies). (4) Dummy year in from period 1-5 have different in CSV value, it means that dummy year could influence CSV.

Conclusions

Theory Implication

The environmental performance could influence CSV significantly in the next 2 years, and would not influence CSV in the same year, the next 1 year, the next 3 years and the next 4 years. It could mean that the results of environmental activities need a longer time to influence CSV. The example of environmental activities is the tree planting, and the benefit would be in the long term. The temperature will be cooler, less air pollution, and fresh water usage savings. The company will have good image and it will increase the revenue.

Managerial Implication

Since environmental performance will take 3 years to influence CSV, therefore the company should relate it with the company strategy, and assume that environmental performance as long term investment and do it continuously to be able create CSV.

In terms of the sustainability report comprehensiveness, the environmental performance showed average 70% from the total activities. The improvement should be more information on the hazardous waste, and rewards in environmental activities. Notes for the environmental award, it might be because most of the sample did not get the award, and indicate that the environmental activities still need improvement. As the benchmark of the best practice in the sustainability report disclosure in environmental, Semen Indonesia (Persero Tbk) has already disclose 94% environmental information.

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