THE ROLE OF CUSTOMER LOYALTY IN MEDIATING CORPORATE SOCIAL RESPONSIBILITY AND THE COMPANY’S FINANCIAL PERFORMANCE

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ABSTRACT

Purpose: This study aims to examine and analyze the mediating effect of customer loyalty on the influence of Corporate Social Responsibility toward financial performance.

Design/methodology/approach: This research is a quantitative study using secondary data taken from Indonesia Stock Exchange 2014-2017. The data analysis technique used is the WarpPLS 6.0 program which is carried out in two testing stages; the direct and indirect impacts of Corporate Social Responsibility variables on financial performance.

Findings: The result indicates that the customer loyalty variable partially mediates the effect of Corporate Social Responsibility on financial performance. It means customer loyalty does not fully mediate the effect of Corporate Social Responsibility on financial performance.

Research limitations/implications: CSR measurement uses an index that calculates CSR based on the quantity not the quality of implementation.

Practical implications: This research provides an illustration to the company that the implementation of proper and serious CSR has an impact on growing the company’s financial performance.

Originality/value: This research is a development from previous research by adding consumer loyalty as a mediating variable.

Paper type: This is categorized as a research paper.

Keyword: customer loyalty, Corporate Social Responsibility, financial performance

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I. INTRODUCTION

Currently, business competition among companies occurs not only in domestic but also in international spheres. Joining such business competitions is as a technique to increase the number of sales which directly improves the company's financial performance. However, to enter international trade, a company must pay attention to the consumers' characteristics from which the export will take place. Consumers have become attentive in choosing the products to buy. People tend to choose products by companies that care about the environment or that implement corporate social responsibility (CSR). Based on a survey conducted by the Booth-Harris Trust Monitor in 2001, the majority of consumers donot buy products with a bad or negative image (Taylor, 2001).

CSR involves any corporate social responsibility activities dealing with accountabilities in the economic, environmental and social aspects. According to (Carroll, 1979), CSR is a company responsibility in the fields of economics, ethics, law and philanthropy. CSR activities are expected to have a positive impact on the company's financial performance and provide benefits to the community and the environment.
In Indonesia, there was a case of business ethics violation in a company of well-known mosquito repellent brand. This mosquito repellent is withdrawn from the market due to the use of active substances of propoxur and dichlorvos which may endanger humans health (Wijaya, 2019). The withdrawal of products has an impact on the company's financial performance because consumers become afraid of using them.

In Indonesia, the implementation of CSR is an obligation (mandatory) for every company, which is stated in Law No. 40 of 2007 on Company Law (PT). Correct and continuous implementation of CSR improves the company's financial performance. Based on Good Management Theory, a company with a good social performance has an impact on stakeholders' positive reputation, so that it will improve the company's financial performance (Waddock and Graves, 1997). In order to increase profitability, companies, occasionally, ignore the fact that their operations have a negative impact on society and the environment. A company is part of elements that also establish society within social system. Such circumstance creates a reciprocal relationship between the company and its stakeholders. Hence, the company must carry out its double roles; fulfilling the requirements of both company and the stakeholders. According to (Freeman and McVea, 2001), stakeholder theory describes the company responsibilities toward the involved parties (stakeholders). Furthermore, according to Dowling and Pfeffer, (1975) in legitimacy theory, the company's organizational activities should be in accordance with its social environmental values. There are two aspects for a company to gain legitimate support: (1) the company organizational activities must be in accordance with the value system in society; (2) the reportage on company activities should also reflect social values.

However, the previous studies display the inconsistent results of the effect of CSR on financial performance. This topic becomes a debate due to its varying results. Some researchers find a negative relation between CSR and the company’s financial performance (Friedman, 1970 ; (Waddock and Graves, 1997 ; (Iwata and Okada, 2010) ; (Chetty, Naidoo and Seetharam, 2015). Meanwhile, other studies find a positive relation between CSR and the company’s financial performance (Porter and Kramer, 2002) ;(Weshah, Awwad and Hajjat, 2012). Pelzoa and Papania, (2008) even discover zero relation between CSR and the financial performance. Lu et al., (2014) examines CSR and financial performance related to specific community contextualization. Maigian, (2001) finds that purchase intensity of French and German consumers is more influenced by corporate philanthropic activity than American consumers. This signifies that cultural and geographic factors influence consumer buying behavior of a company product. As the company conducts more social activities, the consumers become more loyal to buy their products, which will improve the company's financial performance.

Based on the background above, the researcher will study, academically, on the indirect relation between CSR and financial performance. This relation is influenced by the degree of consumer loyalty to products or services produced by a company that carries out social activities. According to Fombrun, (2005), the differences of business practices and stakeholders’ perceptions of company operations in different countries provide a different understanding of CSR. The assessment of relation between CSR and financial performance must take into account diversity and country specifications of stakeholder priorities and measurement of financial performance (Pedersen, 2006). One of the company's stakeholders is consumer. Consumers make purchases of products or services based on several considerations, such as quality, value of goods, prices, previous consumer testimonials and other added values. These considerations are general considerations made by consumers. However, as the world develops, companies are currently required to carry out sustainable development through CSR activities. CSR activities carried out by the company are expected to provide benefits to the performance of the company, society and the environment. In addition, CSR activities also change consumer perceptions of the products or services produced by the company. In other words, CSR activities of a company can be a consideration for consumers in choosing the products or services they will buy. According to Arli and Lasmono, (2010), CSR is a concept that still in the process of being applied in developing countries because consumers tend to ignore and do not support CSR. This fact is in contrast to consumers in developed countries who are more supportive of a company CSR implementation. Hence, when they choose what to buy among similar price and quality of products or services, CSR becomes one of determining buying factors; they will buy products from companies with a good reputation for social responsibility. The following is the hypothesis proposed by the researcher:

H1: CSR has a positive effect on financial performance
H2: CSR has a positive effect on consumer loyalty
H3: Consumer loyalty has a positive effect on financial performance
H4: Consumer loyalty mediates the effect of CSR on financial performance
II. METHODOLOGY

This research is an empirical study examining the role of customer loyalty variables in mediating the relation of CSR and the company’s financial performance. The data used is secondary data taken from the Indonesia Stock Exchange, manufacturing companies listed in 2014 - 2017 using purposive sampling. The following is a sample selection table based on the criteria:

<table>
<thead>
<tr>
<th>Table 1. Sample Selection</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing companies listed on the IDX in 2014-2017</td>
</tr>
<tr>
<td>Companies not continuously listed on the IDX during the period of 2014-2017 and have incomplete reporting</td>
</tr>
<tr>
<td>Companies suffering losses in certain years during the period of 2014-2017</td>
</tr>
<tr>
<td>Companies using dollars in reporting</td>
</tr>
<tr>
<td>The number of manufacturing companies as the target population</td>
</tr>
</tbody>
</table>

The numbers of sample taken are 58 companies listed on the IDX in 2014-2017 and in line with the determined sample requirements, so that the total samples are 232 firm-years.

The dependent variable in this study is the company's financial performance as proxied by Return on Assets (ROA), the independent variable used is CSR and the mediating variable is consumer loyalty (LK).

<table>
<thead>
<tr>
<th>Table 2. Operational Variables and Variables measurements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Variables</td>
</tr>
<tr>
<td>Dependent Variable: financial performance</td>
</tr>
<tr>
<td>Independent Variable: CSR</td>
</tr>
<tr>
<td>Mediating Variable: Consumer loyalty</td>
</tr>
</tbody>
</table>

The analysis in this study uses path analysis because this type of analysis enables to test variables simultaneously or those related to direct and indirect effects. The data will be processed using PLS 6.0 Warp program.

The procedure for testing the hypothesis of consumer loyalty as a variable that mediates the effect of CSR on financial performance is carried out in two steps (Baron and Kenny, 1986):
2. Estimating the indirect effect simultaneously with the path pattern of CSR → customer loyalty → financial performance.

The conclusions related to the mediating variables are as follows:
1. If the effect of CSR on financial performance remains significant and does not change when the CSR variable is included in the model as an additional predictor variable, then this variable as a mediator is not supported.
2. If the effect of CSR on financial performance decreases but remains significant when the consumer loyalty variable is included as an additional predictor variable, then this variable is supported as a partial mediation.
3. If the effect of CSR on financial performance decreases to a point where it is not statistically significant when the consumer loyalty variable is included as an additional predictor variable, then the variable is supported as a full mediation.
### III. RESULTS AND DISCUSSION

Result Based on table 3, Corporate Social Responsibility has a mean value of 0.239 indicating that the companies that are the object of observation have not maximally implemented CSR. Financial Performance (ROA) has a mean value of 0.091, indicating that companies that are the object of observation have not achieved optimal financial performance on average. Consumer Loyalty (LK) with a mean value of 0.017 indicating that companies that are the object of observation has the average level of consumers who do not have a high level of loyalty.

<table>
<thead>
<tr>
<th>Variables</th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>CSR</td>
<td>232</td>
<td>0.052</td>
<td>0.662</td>
<td>0.239</td>
<td>0.131</td>
</tr>
<tr>
<td>ROA</td>
<td>232</td>
<td>0.000</td>
<td>0.527</td>
<td>0.091</td>
<td>0.090</td>
</tr>
<tr>
<td>LK</td>
<td>232</td>
<td>0.000</td>
<td>0.283</td>
<td>0.017</td>
<td>0.040</td>
</tr>
<tr>
<td>Valid N (listwise)</td>
<td>232</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The criteria for goodness of fit used are Average Path Coefficient (APC) and Average R-Squared (ARS) where the p value must be less than 0.05 or significant, and the Average block VIF (AVIF) value as an indicator of multicollinearity must be less than 5. Based on the results of model testing, the criteria for goodness of fit for the model are met, the APC value of 0.292 with p value <0.001, the ARS value of 0.162 with a value of p = 0.003, while the AVIF value of 1.198.

Table 5 shows that CSR has a significant positive effect on financial performance (path coefficient is 0.279; p-value is <0.001), so H1 is accepted. CSR also has a significant positive effect on consumer loyalty (path coefficient is 0.416; p-value is <0.001), so that H2 is accepted. Then, consumer loyalty has a significant positive effect on financial performance (path coefficient is 0.180; p-value is 0.003), so that H3 is accepted.

Based on table 4, the direct effect of CSR variable on financial performance has a significant positive effect (path coefficient of 0.352; p-value of <0.001). Furthermore, the result of the indirect / mediation effect test in Table 5 shows that CSR has a positive effect on financial performance with the results of the path coefficient of 0.279; p-value of <0.001. In this test, the path coefficient between CSR and financial performance has decreased from the first test stage to the second stage of testing, from 0.352 to 0.279 and remains significant, while consumer loyalty also affects financial performance with the path coefficient of 0.180; p-value of 0.003. This supports H4 which states that consumer loyalty mediates the influence of Corporate Social Responsibility on financial performance partially (partial mediation).

<table>
<thead>
<tr>
<th>Coefficient</th>
<th>Path Coeff.</th>
<th>S.E</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>CSR → KK</td>
<td>0.352</td>
<td>0.062</td>
<td>&lt;0.001</td>
</tr>
</tbody>
</table>

Source: processed data

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<tr>
<td>CSR → LK</td>
<td>0.416</td>
<td>0.061</td>
<td>&lt;0.001</td>
</tr>
<tr>
<td>LK → KK</td>
<td>0.180</td>
<td>0.064</td>
<td>&lt;0.003</td>
</tr>
</tbody>
</table>

Source: processed data

| CSR : Corporate Social Responsibility |
| LK : Consumer Loyalty |
| KK : Financial Performance |

The result of testing the effect of CSR on financial performance shows a significant positive effect. This means the more developed CSR, the greater the financial performance. This result is in accordance with the good management theory which explains that companies implementing the positive CSR activities will attract the stakeholders (consumers) which, later, will improve the company's financial performance (Waddock and Graves, 1997). A good company CSR implementation will have a positive impact on all their operational aspects. Even potential investors also look at the company's social performance as the consideration aspect for the investment, so that it will improve the company's financial performance. The results of this study are consistent with other researches (Porter and Kramer, 2002) ; (Saia, Carroll and Buchholtz, 2003) ; (Brammer
and Millington, 2005) ; (Galbreath, 2010); (Saleh, Zulkifli and Muhamad, 2011) ; (Weshah, Awwad and Hajjat, 2012), that find a significant positive relationship between corporate social responsibility and financial performance. The result of testing the effect of CSR on consumer loyalty shows a significant positive effect. This means that the more developed CSR, the higher consumer loyalty. The result of this study is in line with legitimacy theory which states that companies will get recognition from the community if they are able to act appropriately according to the norms and rules in a society. Legitimacy is a psychological state of taking sides of people and groups of people who are very sensitive to the symptoms of their physical and non-physical surrounding environment. O’Donovan, (2002) argues that organizational legitimacy is viewed as an entity that a company desires or seeks from society. Thus, legitimacy is a potential benefit or resource for the company to survive (going concern). By implementing Corporate Social Responsibility, public will acknowledge the existence of the company by using its products and make repeated purchases which is known as consumer loyalty. Today, consumers encounter different problems. They are dealing with a value crisis, natural disasters, climate change and regional disparities and financial crises in developed countries. These problems encourage the company management to play a constructive role in society by introducing CSR as the company's strategy to achieve consumer loyalty and sustainable competitive advantage. CSR affects customer loyalty particularly when a company faces an intense business competition and growing consumer desires. The results of this study are consistent with the research conducted by Maigman, (2001) that the intensity of consumer purchases in France and Germany is more influenced by corporate philanthropic activity than consumers from America. This means that cultural and geographic factors influence consumer buying behaviour of a company's products. If the company conducts more intense social activities, consumers become more loyal to buy its products.

The results of testing the effect of consumer loyalty on financial performance show a significant positive effect. This means that the greater consumer loyalty, the higher financial performance. Globalization and free trade change the business environment and increase global competition. To remain competitive and provide financial satisfaction to owners and shareholders, managers are very dependent on how effectively they can cope with continuous and unexpected changes. The ability to respond quickly and effectively and provide satisfaction to consumers is a way to compete and be successful in many companies (Gursoy and Swanger, 2007). Customer satisfaction is the result of customer perceptions of the product or service purchased. Consumers are satisfied if a product or service purchased is of high quality (Dharmmesta, 1999). A quality of product or service is related to its expected value, sometimes the product exceeds the consumers’ expectation, and the product or services hold fulfill the needs of its users (Kotler and Armstrong, 2012). If customers are satisfied with the product or service, they will repeat the purchase. According to Swastha, (2009), consumer loyalty will reach its highest point when a product or service provide the maximum satisfaction, so they will not switch to another product. The results of this study are similar to research done by Reichheld and W. Earl Sasser, (1990) which concludes that loyal customers behaviours consist of sustainable relation, the increase in scale or scope of the relationship, and the results recommendation of consumers’ trust that the value quantity received from one supplier is greater than that of other suppliers. Loyalty creates profits by increasing revenue and reducing costs to maintain customers, low customer price sensitivity and costs decreasing for customer service with a delivery service system. Mullen, (2007) states customer loyalty have an impact on business success which will increase profitability because they always buy products or services repeatedly, they will even provide information to other customers to do the same thing (Babu and Kumar, 2010).

The results of testing consumer loyalty mediating the effect of CSR on financial performance are supported. The testing results in a path coefficient between CSR and financial performance which has decreased from the first testing phase to the second testing phase, from 0.352 to 0.279 and remains significant. Similarly, Baron and Kenny, (1986) state that the influence of X variable on Y variable decreases but remains significant when Z variable is included as an additional predictor variable, then the variable is supported as a partial mediation. The implementation of CSR is not only carrying out social or philanthropic activities, but also conducting economic, legal and ethical actions. The company main objective is related to economic goal of achieving the maximum profit. Hence, the process of achieving such profit must be done legally and ethically. The term ‘legal’ means the company must comply with applicable laws and regulations. For example, the utilization of chemicals according to standard usage rules, the obedience toward tax regulations, excellent and safe products to be used by customers. Companies must also consider the balance of nature, so that the products have good quality and are in line with conformance dimension which means the design and operating characteristics according to the standards.

Implementing CSR properly improve the products quality so that consumer loyalty will increase. Consumers will be loyal to products or services influenced by product or service quality factors (Dharmmesta, 1999) and image (Mardalis, 2005). The quality of the product or service of a company must have durability, reliability, accuracy, ease of maintenance and other element attributes to the product (Kotler and Armstrong, 2012). This consumer loyalty increases revenues, because there are cost savings related to promotions.
Furthermore, consumer loyalty also escalates profitability, because loyal customers will always buy products or services repeatedly (Mullen, 2007). They will also provide information to other customers to do the same (Babu and Kumar, 2010).

IV. CONCLUSION

This study examines and analyses the mediating effect of customer loyalty on the effect of CSR toward financial performance by employing secondary data of Indonesia Stock Exchange in 2014-2017. This research concludes that the consumer loyalty variable partially mediates the effect of CSR on financial performance.

Implementing CSR correctly improves products quality which is safe for consumers’ usage. With this product quality, consumers conduct repeated purchases and provide recommendations to other consumers to use the product. This consumer loyalty increases the company's profit, thus the financial performance will also increase.

This study measures CSR level uses an index based on the quantity not the quality of implementation. Future research is expected to use the calculation of CSR based on the quality of implementation and alternative measurement of different variables to produce more accurate research.

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