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COMPANY PROFITABILITY LEVEL AND CORPORATE SOCIAL RESPONSIBILITY DISCLOSURE: EVIDENCE FROM INDONESIA

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ABSTRACT
Currently it is widely agreed that profitable firms will more likely engage in corporate social responsibilities (CSR). Basically, most companies are willing to perform, report and disclose their CSR when they are profitable. But this research aims to investigate deeper whether the level of profitability itself influences corporate social responsibility disclosure. The division into high and low level profitability groups is achieved by using the median on companies' profitability level. That allows to determine the impact of other factors on CSR disclosure in both types of companies. The samples used are listed companies on the Indonesia Stock Exchange (IDX) from 2010 to 2013. The annual report as the main source was used to extract and measure all variables for the study. CSR disclosure information was based on GR3 guidelines. This paper employed multiple regression to analyze the data. The results show that higher profitability level companies do not show a significant relationship with CSR disclosure, whereas companies with lower profitability are significantly but negatively related to CSR. This research concludes that higher profitability companies do not consider profit as a reason to perform their social duties and the lower profitability level group suggests that more profit means less CSR disclosure. It turns out also that company size is the main influencer for CSR disclosure.

INTRODUCTION

The concept of corporate social responsibility has become a trend for most companies to strengthen and improve their name and eventually their profitability. Publicly-listed companies should have and issue corporate social responsibility report (also known as a sustainability report) in their annual report. A large number of companies are engaged in a serious effort to define and integrate CSR into all their business aspects than at any previous time (Tsoutsoura, 2004). The number of firms disclosing CSR in their annual report is constantly growing because of their awareness of how important is CSR for their company's profitability. It seems that for the companies, all of the effort to define and integrate CSR, is just merely to enhance their names to the public by showing what they have given back to the environment and society. From the International survey conducted in early 2002 by PricewaterhouseCoopers, it was found that 70% of global chief executives believe that conducting CSR in their companies was essential for improving their profitability (Ekatah, Samy, Bampton, & Halabi, 2011).

It is undeniable that the goal of every company is to generate high profit, maintain growth, expand internationally, and become a monopoly. Businesses will attempt everything to achieve those goals. By reaching those goals, they will improve their financial performance. According to Gozali (2016), the greatest dimension that reflects corporate performance is financial performance that is profitability. Profitability level is one of the most important factors to measure the financial performance of a company. There are already several published studies that examined the relationship between CSR and financial performance. Waddock and Graves (1997) and Kartadjumena, Hadi and Budiana (2011) found that there is a positive relationship between CSR and company's profitability. In contrast, other researchers established that there is a negative relationship between those variables (Lopez, Garcia, & Rodriguez, 2007).

For companies to properly conduct CSR, they may incur additional costs, but these expenses could increase the companies' value in the future. There are other factors that can also influence CSR performance. This paper considers only company size, growth, and leverage. Therefore, the purpose of this research is to test whether the level of profitability has an impact on CSR disclosure.

This paper could contribute to investors with better judgment decision since they could differentiate responsible firms as those that are involved in social corporate activities for society. This study also promotes the development of literature and research on corporate social responsibility in Indonesia as a developing country. The findings of this study could be useful for accounting policymakers to further improve policies on CSR in Indonesia.

The rest of this paper is organized as follows. Literature Review relates the theoretical framework on corporate social responsibility. Materials and Methods describes the research methodology used in this study. Results and Discussions presents the empirical analysis and the findings while the last chapter proposes the conclusions of the paper.

LITERATURE REVIEW

In this era of globalization, the competition has become fiercer than ever. Every company is competing to be the best in the market. In order to compete, a company has to come up with a strategy that must go beyond best practices. According to Misani (2010), it must be a strategy that is unique and valuable that differentiates the company from its competitors. Companies believe that such a strategy could provide them with competitive advantages. Implementing CSR can be treated as a factor that could create competitive advantage for the companies that implement it.

CSR strategy can turn into competitive advantage only if the competitors are unable to imitate it. Unfortunately, many companies that are conducting CSR do not aggressively differentiate their social activities from the ones that are adopted by their competitors (Lopez et al., 2007). CSR has three competencies that logically may lead to competitive advantages. CSR competencies allow company to decrease its financial risk specifically by gaining quality employees and also help enhance its reputation in the eyes of the public (Misani, 2010)

Conducting CSR into company strategic planning is not an easy task. This is because in order to conduct CSR properly a company requires additional funds that may incur additional expenses for the company. Waddock, & Graves (1997), Tsoutsoura (2004) and Gamerschlag, Moller, and Verbeeten (2010) found that a company with good financial performance will have more resources available to invest in CSR programs. It could also be true that a company experiencing financial problems will face insufficient resources to invest in CSR activities. They have to invest their resources in the short term rather than long term like CSR. Although conducting CSR will provide benefit, it still requires a lot of funds to realize it. Due to this, CSR depends on the abilities of resources that a company owns. It is widely agreed that company with higher profitability is more likely to enjoy a better financial performance.

The area that defines Corporate Social Responsibility (CSR) is increasingly covering a wide range of issues such as plant closures, employee relations, human rights, corporate ethics, community relations and the environment (Moir, 2001). Yet, it still does not have a uniform definition, not even clear boundaries (Robins, 2005). In early 2008, there were more definitions about CSR passing through Google (CSR Indonesia, 2007). That may be due to the factor of different groups of people coming out with different definitions. One representative mainstream definition of CSR was based on the Commission of European Commission proposal and then specified by Deegan (2009) that CSR was “a concept whereby companies integrate social and environmental concerns in their business operations and stakeholder relations on a voluntary basis”

A great number of theories could be related to CSR; however, only of few of them are closely and highly connected to CSR. According to some prior studies of Moir (2001) and Blomback and Wigren (2008) stakeholder, legitimacy, and social contract theories are closely related to CSR. Peters and Mullen (2009) stated that groups of stakeholders are believed to affect the sustainability of companies and consequently, companies have to interact with groups of stakeholders. The concept of CSR involves the approach of the company’s relationship with the group of stakeholders. In this regard, CSR can be defined as a company’s commitment to improve and be responsible toward society and the environment while recognizing the interests of the stakeholders (Peters & Mullen, 2009). In relation to

CSR, the stakeholder theory helps companies to identify which stakeholders they are responsible to. The theory discusses which groups or individuals might be affected by business activities.

The concept of legitimacy theory asserts that an organization continually endeavors to ensure that it is considered as operating within the bounds and norms of society. By doing so, businesses are perceived by outsider parties as legitimate since it is defined as "a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" (Deegan, 2009). Organizational legitimacy is based on their behavioral and general perception that can be accepted by a concerned group.

The concept of social contract theory is based on the idea that the society has an implicit and explicit expectation about how the organization of the business should follow and obey in their operation (Deegan, 2009). In order to have better understanding, Blomback and Wigren (2008) defined society as residing on the number of social contracts which are held between different groups in the society. These contracts are included as a guidance for organizations to behave according to social norms.

Countless studies between CSR and profitability have been done over few decades (Saleh, Zulkifli, & Muhamad, 2008). Tsoutsoura (2004) studied the relationship between CSR and financial performance of most of S&P 500 companies and found a positive relationship between the two variables. Then he argued that conducting CSR in a company will improve its brand image and reputation in public eye, and may lead to better financial performance. He also advocated that a company conducting CSR will have better financial performance. Another study by Ekatah et al. (2011) analyzed the relationship between CSR and profitability and discovered a positive relationship between the two variables. Oeyono, Samy, and Bampton (2011) established that there is a positive relationship between CSR and financial performance.

Lopez et al. (2007) conducted a survey on the manufacturing industry. They proposed that when a company achieves a high profit, it is considered as being able to fulfill its fundamental needs. Due to that the company will thrive to meet its needs in the next level which are social and appreciation needs. They also stated that a company with higher profit tends to have more resources for conducting CSR and thus show more CSR disclosure. Therefore their findings show that there is a positive relationship between profit and CSR disclosure. Gamerschlag et al. (2010) also found out that CSR disclosure was positively associated with profitability. They studied the determinants of voluntary CSR disclosure on 470 German companies, with one of the determinant being profitability. In their paper, they argued that profitability of a company is associated with CSR disclosure. Using the GRI framework as the indicator to measure the level of CSR disclosure by companies in Germany, they found that higher profitability of companies is associated with more CSR disclosure than less profitability companies.

Lin, Hsuan and Yin (2010) stated that less profitable companies will have less resources for social responsibility activities than highly profitable companies. Companies will be less likely to conduct social responsibility activities when they are currently experiencing weak financial performance

(Lin et al., 2010). Rouf (2011) established that profitability of companies affected their CSR disclosure. A similar study conducted by Ehsan and Kaleem (2012) about the relationship of financial performance of companies and CSR showed a positive result.

Some studies have different results. Babalola (2012) demonstrated that there is a negative relationship between CSR and profitability in Nigeria companies. Previous studied that have been done by Lopez et al. (2007), which studied the relationship between sustainable development and corporate performance. They are using profitability as the proxy to measure the performance of companies. Aras, Aybars and Kutlu (2009) found that there was no link between CSR and financial performance. A similar result has been found in the studies by Lin et al. (2010) and Reverte (2009) who revealed that there is no relationship between CSR and financial performance.

The above discussions suggest that financial performance is positively affecting CSR disclosure. Thus the first hypothesis states:

H1: Ceteris paribus, the level of profitability positively affects CSR disclosure

The size, growth and leverage are used as the control variables in this research study. According to Itkonen (2003), larger firms do more socially responsible business than the smaller ones. Aras et al. (2009) argued that company size is positively significant related to CSR; that is, larger companies tend to disclose more CSR than smaller companies. Based on the above, we interpret that company size is a determining factor of CSR disclosure. We propose the following hypothesis:

H2: Ceteris paribus, company size is positively correlated to CSR disclosure

Another prior study also found out that the growth of company shows a positive significant relationship between growths rates of company with levels of CSR disclosure. This result indicates that the higher the growth of a company, the higher the level of CSR disclosure by the company (Adebayo, 2000). From the discussion above, the following hypothesis is formulated:

H3: Ceteris paribus, company growth is positively associated with CSR disclosure

More leveraged firms provide more information about voluntary disclosure with the aim of lessening the costs of agency and capital (Haniffa & Cooke, 2005). According to Jensen and Meckling cited from Reverte (2009) a higher level of leverage will lead companies to disclose more voluntary information in their annual report in order to reduce their agency theory costs. However, companies with a lower level of leverage might drive the credit stakeholder to put less pressure on the management to voluntarily conduct CSR activities (Reverte, 2009). In contrast, Ehsan and Kaleem (2012) demonstrated that leverage is negatively and significantly related to CSR. They showed that company tends to allocate their available funds to the most important goal of the company, which is paying its business debts. The above arguments prompt us to propose the following hypothesis:

H4: Ceteris paribus, leverage positively impacts CSR disclosure

MATERIALS AND METHODS

The population of this research study is 442 companies that were listed on the Indonesian Stock Exchange in 2010 to 2013. Some 82 companies listed from 2011 were excluded and 221 companies have incomplete data. The sample was reduced to 139 companies. The sample was then divided in to two categories which were companies with high and low profitability levels. The classification is achieved by collecting all the companies' profitability results from 2010 to 2013 and sorting them from lower to higher.

The median is then established to determine the level of profitability cutoff. According to DeFusco, McLeavey, Pinto, and Runkle (2007), median is the middle point of an observation and if it is applied properly, it can serve as a basis to divide the observation into lower end and higher end. Profitability means higher or equal to the median or cutoff of 0.090 is categorized as the higher profitability level group of companies and the remainder of the sample as the lower profitability category. The final classification provides 70 companies of higher level of profitability and 69 of lower profitability companies. The different levels of profitability aim to provide meaningful results based on the research aim.

The research uses content analysis, word count as the measurement method to quantify CSR disclosure. For the content analysis of annual reports, the methodology developed by Guthrie and Petty (2000) was considered relevant. In content analysis, any bilingual information should be unified (Indonesian and English) and only language must be counted (Hermawan & Mulyawan**,** 2014).

For the independent variable, the Return on Equity (ROE) serves as the proxy for profitability. Waddock, and Graves (1997); Aras et al. (2009); Rouf (2011); and Ehsan and Kaleem (2012) have utilized ROE in their studies related to profitability. Some of them found a positive and others a negative relationship with CSR. Consequently, the author aims to uncover whether the level of profitability of companies impacts CSR disclosure. ROE = Net income / Total equity

Hypothesis 1: Company with higher (lower) level of profitability has significant and greater (lesser) impact on CSR

Aras et al. (2009) inferred that there is a positive and significant relationship between company size and CSR. They stated that it is because larger companies tend to disclose more CSR than smaller companies. SIZE = Natural log of Total Assets

Hypothesis 2: There is a positive significant influence of Size on CSR

DeFusco et al. (2007) showed that growth of company positively and significantly affect level of CSR disclosure. That is the higher the growth of company, the higher its level of CSR disclosure.
GROW = [(Current total assets – Past total assets) / Past total assets] x 100

Hypothesis 3: There is a positive significant influence of Growth on CSR

According to Reverte (2009) a company with higher leverage discloses more CSR with the aim of reducing their agency theory costs but

those with low leverage show less pressure to the management to perform CSR activities. Company tended to allocate their available funds to their most important goal which is paying their debts. Debt to ratio (LVRG) is used as the proxy for leverage.
LVRG = Total debts / Total assets

Hypothesis 4: There is a positive significant influence of leverage on CSR

The following models aim to capture the relation between firm's profitability level and CSR disclosure:
Model 1: Higher profitability companies: $CSR = \beta_0 + \beta_1 PROF_{HP} + \beta_2 SIZE_{HP} + \beta_3 GROW_{HP} + \beta_4 LVRG_{HP} + e_{HP}$
Model 2: Lower profitability companies: $CSR = \beta_0 + \beta_1 PROF_{LP} + \beta_2 SIZE_{LP} + \beta_3 GROW_{LP} + \beta_4 LVRG_{LP} + e_{LP}$
Where, CSR – Corporate social responsibility; PROF – Profitability level; SIZE – Firm size; GROW – Growth; LVR - Leverage

RESULTS AND DISCUSSIONS

Descriptive Statistics

The descriptive statistics results in Table 1 for higher profitability companies sample shows that based on minimum, maximum and mean the standard deviation of PROF is less dispersed from the mean value and thus indicates that the companies are making less profit during the sample period. Similarly, the second group the standard deviation of PROF is also less spread from the mean value and thus shows that the companies' profit is decreasing. From those results, the group of higher profitability discloses more CSR compared to the other group.

Table 1. Descriptive statistics

	Higher Profitability					Lower Profitability				
	N	Min	Max	Mean	Std. Dev.	N	Min	Max	Mean	Std. Deviation
CSR	280	5	1562	191.74	210.003	276	4	690	92.46	88.1235
PROF	280	0.09	0.83	0.31	0.31432	276	-2.118	0.089	-0.061	0.3152
SIZE	280	3.91	13.02	8.49	1.9387	276	1.1	11.23	6.982	2.1005
GROW	280	-1.38	1.61	0.2018	0.32855	276	-1.54	9.29	0.274	1.0629
LVRG	280	0.02	1	0.5603	0.23407	276	0.01		0.586	0.4466
Valid N (listwise)	280					276				

CSR= CSR level, PROF= Profitability level,
Growth= Growth rate, SIZE =Size, LVRG = Leverage.

Independent Samples t-test

Table 2 shows a significant value at 0.031 - the value is below 0.05 - which means that it can be assumed that the two groups of data are significantly different from each other. That also proves that the methodology of dividing the data into two groups is applicable.

Table 2. Independent sample test

		Levene's Test		95% Confidence Interval of the Difference			
		F	Sig.	t	Sig. (2-tail)	Lower	Upper
PROF	Equal var. assumed	4.746	.031	7.690	.000	.18120	.30670
	Equal var. not assumed			7.546	.000	.17973	.30817

Correlation Analysis

From table 3, for higher profitability company, SIZE is highly correlated to CSR, which may indicate that those companies would tend to disclose more CSR. There is a weak and negative relationship between growth and CSR. The positive correlation between CSR and LVRG may suggest that company with higher leverage will disclose more CSR in their annual report.

The results in table 3 for lower profitability level where all the variables are not normally distributed show that PROF has a positive weak relationship with the dependent variable. SIZE shows similar result which is consistent with the other group. Growth and leverage disclose no significant relationship with CSR. All the correlation results in both categories show no multicollinearity between the independent variables.

Table 3. Correlation

		Higher Profitability					Lower Profitability				
		CSR	PROF	SIZE	GROW	LVRG	CSR	PROF	SIZE	GROW	LVRG
CSR	Pearson	1	0.065	$.609^{***}$	-0.096	$.243^{***}$	1	0.018	$.442^{***}$	-0.05	-0.013
	Sig. (2-tail)		0.28	0	0.111	0		0.773	0	0.425	0.832
	Spearman	1	$.185^{***}$	$.674^{***}$	-0.112^{*}	$.232^{***}$	1	$.175^{***}$	$.442^{***}$	0.082	0.087
	Sig. (2-tail)		0.002	0	0.063	0	.	0.005	0	0.188	0.16
	N	280	280	280	280	280	276	276	276	276	276

CSR= CSR level, PROF= Profitability level, Growth= Growth rate, SIZE =Size, and LVRG = Leverage

Multiple Regression Result Analysis

From table 4, the adjusted R-squared discloses that about 37% of independent variables explain the changes of CSR. For high level profitability firms, PROF is insignificant which may mean that it does not affect CSR. The finding is supported by Lin et al. (2010) and Reverte (2009) who confirm that there is no significant relationship between profitability and CSR. However, Gamerschlag et al. (2010) stated that a company with good financial performance will have more available resources to invest in CSR programs. Rouf (2011) revealed that CSR disclosure positively impacts profitability. Since profitability of companies in higher profitability category shows no significant relationship with CSR, the H1 hypothesis is rejected.

For the high profitability category, the insignificant profitability level relationship with CSR is disproving the finding of Tsoutsoura (2004) who affirmed that companies believe their brand image will improve if they conduct CSR in their business, it is possible that companies with high profitability may assume that they already have the public trust and a good brand image. For them, disclosing CSR may be of a higher priority more than just to satisfy their shareholders or expand the companies and earn more money. The other possible reason lies within Indonesian companies that may think that conducting CSR is an unimportant factor in terms of bringing advantages to their business. Gayatri (2011) confirmed that many businesses experience the lack of understanding and awareness of CSR.

Table 4. Regression Results

Regression results – Higher profitability					Regression results – Lower profitability			
Variable	Pred.sign	Coefficient	t-Stat.	P-value	Pred. sign	Coefficient	t-Stat.	P-value
C		-352.672	-7.145984	0		-39.187	-1.87799	0.0615
PROF	+	-17.9258	-0.3244	0.7459	+	-31.9697	-2.35121	0.0195**
SIZE	+	66.76422	7.852638	0.000***	+	20.12135	6.09823	0.0000***
GROW	+	-52.1977	-2.41247	0.0165**	+	-6.43474	-2.88098	0.0043***
LVRG	+/-	-15.864	-0.34379	0.7313	+/-	-14.494	-1.68732	0.0928*
Adj. R-squared		0.368767				0.202635		
F-stat.(p-alue)		41.1638	0			17.455	0	

Dependent variable is C= CSR, *Significant at 0.1 level; **Significant at 0.05 level; ***Significant at 0.01level

Company size shows a positive significant relationship with CSR. This might be confirmed by the availability of resources by large companies. Aras et al. (2009) claimed that size and CSR are positively related since bigger companies performed more CSR activities than smaller ones. Siregar and Bachtiar (2010) found that there is a positive relationship of total assets toward CSR reporting. GROW shows a negative significant impact on CSR. This might indicate that during their growth, company will need more resources to sustain the momentum and therefore forgot any other expenses such as CSR. The finding is the opposite of some prior studies that found that the growth of a company positively affects CSR disclosure. Adebayo (2000) pointed out that the higher the growth, the higher the level of CSR company disclosure. The results of the last variable exhibit no relationship between LVRG and CSR.

The regression results of lower profitability companies in table 4 demonstrate a strong significant relationship between CSR and all the independent variables. The adjusted R-squared implies the independent variables explain about 20% of the change in CSR. The significant relationship between PROF and CSR insinuates that when company profitability increases their CSR disclosure diminishes and vice-versa. This finding is consistent with Babalola (2012) who found a negative relationship between CSR and profitability. The companies under the lower profitability category have immense ambition to increase their profit. They always try to expand and grow their companies. That might be the reason why they primarily allocate their funds to expand their business rather than performing CSR activities. In their view, conducting CSR is an additional expense for the company, which burdens them because of insufficient resources. This finding of negatively significant effect of PROF and CSR allows the author to accept the H1 hypothesis.

SIZE shows a strong positive significant relationship with the dependent variable. This result is similar to those of the higher profitability category which indicated that the larger the size of company the more CSR will be disclosed. GROW displays a significant but negative impact on CSR. During growth the company will perform less CSR which is similar to other group. The last variable LVRG shows a negative and weakly significant effect on CSR. The finding is supported by Ehsan and Kaleem (2012) who validated that there is a negative and significant effect between LVRG and CSR. A company will primarily attend to their most important objective which is paying its debts.

CONCLUSIONS

Several conclusions can be drawn from the results. The higher profitability companies tend to disclose almost twice as much CSR compared to those of lower profitability. This study partially allows us to discern the potential factors that drive these firms to have some different or similar determinants of CSR. The division criteria of companies by level of profitability reveals that profitability is not the main factor determining a company's social activities.

The level of profitability is not a priority for companies to disclose CSR. Since the highly performing companies will mostly be profitable, they disclose CSR because of different factors. They are financially sound and are also able to acquire more if necessary. Most of them should be also very grateful to society, so they perform CSR voluntarily. The other group of companies inversely depends upon the level of profitability when disclosing CSR. Profitability level signals them that their financial performance is improving and it is time to sustain the growth by spending more on expansion rather than on social programs. Their expansion approach will leave them with less funds for CSR. They will engage in more social actions then that will be the time to engage and disclose social actions when their financial performance starts to deteriorate. Their objective is to obtain future gain in the form of an increase in profitability. This firm category is just substantiating the positive branch of the stakeholder theory.

For both groups of companies, size and growth are similarly important factors to performing CSR. Larger firms are inclined to disclose more CSR. They ensure that they are part of the society and should act accordingly by performing more social duties. Company growth is inversely related to CSR. Firms experiencing growth will focus more on sustaining the trend and neglect their social responsibilities, and when growth has ended, they will then support society by performing more CSR. For both factors, CSR comes second to the welfare of the firm.

Lastly, for most of Indonesian companies the size factor is the main driver for social performance. The lack of understanding of corporate social responsibility and concern about climate change issues such as the alarming depletion of most of the world's natural resources impedes them to contribute and engage more. There is a need for more businesspeople to learn to look forward to the future of the world and not solely seek the improvement of the financial performance for today.

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