THE IMPACT OF CORPORATE SOCIAL RESPONSIBILITY DISCLOSURE TO MARKET REACTION WITH PROFITABILITY AS MODERATING VARIABLE

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Abstract:

The research examines the impact of profitability as moderating variable to the relationship of CSR disclosure and the market reaction. Using 105 samples that are taken form 15 listed resource-based firms from 2007-1013, it was found that the profitability does positively impact the relationship of CSR disclosure to the market reaction. The result also implies that both firms and investors are concerned about the CSR disclosure. More profitability enables firms to conduct more CSR activities to eventually be reported in the firms' annual reports that will be used by investors in making investment decision. Investors are attracted to the firms that disclose more CSR activities, and higher profitability will be appreciated more by the investors because it means that in addition to generating high profit, firms are also capable of doing more CSR activities.

Keywords: corporate social responsibility disclosure; market reaction; abnormal return; profitability; profit

INTRODUCTION

As the world develops, competition among firms becomes tighter, and market demands are getting harder to be satisfied, firms are in extremely high pressure. Firms should not only strive for profitability, but should also contribute to their social relations, corporate governance, and impacts on the environment. This is as a consequence of the exploitation of natural resources by the industrial sector that often results in severe environmental degradation, although they have contributed to the growth of the nation.

As a result, the demands that firms should be more socially responsible are growing globally. The demands were initiated in the publication of Global Reporting Initiatives in 2000 and ISO 26000. Regulations concerning the corporate social responsibility (CSR) are also made by governments of many nations around the globe in order to "force" the firms to engage in the CSR activities, including Indonesia.

In Indonesia, the regulation concerning CSR activities is in Law of 40/2007 Paragraph 74 on Limited Liability Corporate and Government Regulation of 47/2012 on Corporate Social and Environmental Responsibility. Based on the regulation, it was concluded that CSR is mandatory for Indonesian resources-based firms, because those firms are considered had caused social and environmental damages in previous time. These firms have neglected social and environmental aspects that resulted in disadvantages to the surrounding communities in particular and the environment in general (Hendarto and Purwanto, 2012).

In trying to meet the regulation and public pressures, firms will disclose their CSR activities in the annual report. As the report was intended to be the base of making investment decision, the investors who have concern about the CSR activities would react to the disclosure, and those who do not have concern about such activities would only react to other information they perceive as important. The ones who concern about the CSR activities will find the firms attractive that they will be interested to buy more stock. As the demand of the stock increases, the price of the stock will increase as well. Therefore, the more the disclosure of the CSR activities, the more will investors react to the information, and contrarily, the lower the disclosure, the lower is the likeliness of investors' reaction.

To be able to do and disclose their CSR activities, firms need to allocate certain number of funds. These funds primarily would be from the profit that firms generate since the profit would be one of the main sources for firms to be able to continue their operational activities. Therefore, the more the profit that the firms earn, the more is the ability of firms to disclose their CSR activities that eventually will result in investors' reaction. This is in line with the agency theory, where it states that the more profit a firm generates will lead to broader disclosure of its social information. On the contrary, legitimate theory argues that profit has negative effect towards the disclosure of CSR because firms with higher profit will not disclose information other than the good financial performance of the firms.

Research Question

The research question formulated is: "does profitability positively impact the relationship between CSR disclosure and market reaction?"

Research Objective

This research is aimed at examining and proving empirically whether profitability has positive impact to the relationship between CSR disclosure and the market reaction.

THE HYPOTHESES DEVELOPMENT

Firms are part of elements establishing the society in social system that results in a reciprocal relationship between firms and the stakeholders (Sayidatina, 2011). This is explained by stakeholder theory stating that one of the responsibilities a firm has toward its stakeholder is by disclosing social information (Dwijayanti et al., 2011). Disclosure on CSR activities is necessary due to the fact that firm "owes a duty to the society or has a social contract" (Karagiorgos, 2010). The central idea is that an organization's success is dependent on how well it manages the relationships with key groups such as customers, employees, suppliers, communities, financiers, and others that can affect the realization of its purpose. (Freeman and Phillips, 2002).

Corporate disclosures provide a firm an opportunity to spread value information mainly to financial stakeholders as stock analysts, capital markets and institutional investors, and therefore get evaluated on its financial measures (Karagiorgos, 2010). Corporate social responsibility disclosed in the annual reports of firms as the fulfillment of the regulation and public pressures will give additional information to the parties using the reports for their investment decisions. Information is said to be having value added if it results in reactions to do transaction in the stock market. CSR disclosure is expected to give signals and can enhance the firm value in investors' point of view. It indicates that firms implementing CSR expect to be responded positively by the market that it can maximize its long-term profit (Kelana and Wijaya, 2005; Cheng and Christiawan, 2011). The more the CSR disclosed by the firm, the more investors will be attracted to invest in the firm. The more investors attracted to invest in the firm, the higher the price of the firm's stock because of the higher demand of the stock. The changes in stock price are the result of the market reaction.

There are numerous researches regarding corporate social responsibility. However, despite the prominence of CSR on the global corporate agenda today, it still remains a topic of "hot debate" because of its equivocal impact on bottom line performance. At the center of this debate is "do investors care about CSR?" The popular press is filled with mixed opinions on this issue. On one hand, it seems that mainstream investors do not care about CSR (Yu et al., 2013). As a result, the normative implications of research on corporate social responsibility are still uncertain (Servaes and Tamayo, 2013).

The conflicting results regarding the effect of CSR disclosure to the market reaction exists because of the simple model and the inconsistent measurement (Belkaoui and Karpik, 1989; Sembiring, 2005). Cheng and Christiawan (2011) in their research entitled The Effect of Corporate Social Responsibility to Abnormal Return concluded that investors do consider the CSR for making decision. Hendarto and Purwanto (2012) found that Indonesian firms undertaking voluntary CSR activities gain positive abnormal return when the announcement of mandatory CSR is released. The research conducted by Brammer, Brooks, and Pavelin (2005) about Corporate Social Performance and Stock Returns: UK Evidence form Disaggregate Measures concluded that firms with higher social performance scores tend to achieve lower returns, while firms with the lowest possible corporate social performance scores of zero considerably outperformed the market.

Since the problem lies in the simple model and inconsistent measurement, this research adds profitability to the observation as moderating variable. The profitability is added in order to have more references to explain the impact of CSR disclosure to the market reaction. When used as moderating variable, Rosiana, Juliarsa and Sari (2013) found that profitability has the ability to strengthen the influence of CSR disclosure to the firm value. On the other side, Wirokosumo (2011) concluded that there is no effect of profitability as moderating variable to the relationship of CSR disclosure and the firm value.

The main reason that profitability is added as moderating variable is that because a firm needs to allocate certain number of funds in order to be able to conduct the CSR activities. To allocate this certain number of funds, the firm must be able to enhance its financial performance. For the firm itself, enhancing financial performance is a must that the stock can attract the investors (Astiari et al., 2014). Thus, the financial performance, which is measured by profitability, is very crucial for the firm's operation as well as its attractiveness to the external parties (investors, creditors, etc.). Profitability implies firm's ability to pay higher dividends, to pay off its debts, and to do its operation in the future which includes doing its CSR activities that has been its obligation. Therefore, firms are striving for more and more profitability.

Based on the legitimacy theory, the profit negatively affects the disclosure of CSR (Donovan and Gibson, 2000; Sembiring, 2005). The reason is that firms with high profit will assume that reporting the information other than the good financial performance of firms is not necessary. In contrast, when the profit is low, the firms will expect that the user of the report will obtain the "good news" of the firms' performance. The lower profit is not attractive to the investors that causes decreasing demand of the stock, thus the stock price will decline. This is proven in a research conducted by Saraswati and Basuki (2012) in Astiari et al. (2014) showing that firms with broader CSR disclosure tend to have lower stock price.

On the other hand, the higher profit will enable the firm to do more CSR activities that eventually will be reported in its annual report. This is supported by the statement of Maskun (2013) saying that profitability is a factor that enables management to freely and flexibly disclose the social responsibility to the shareholders. The argument is aligned with the agency theory stating that the more the profit of a firm the broader is the disclosure of the social information (Sembiring, 2005). Firms with higher profitability will then have the ability to disclose more CSR information that is expected to be responded positively by the investors through the change in the stock price.

The more profitable a firm becomes, the more the tendency of the firm to focus too much on striving for profitability that the environment and society are more likely to be abandoned. However, if the environment and society are abandoned, it will cause legal issues to the firms to the certain extent that will hinder firm's operational activities that would cause bad image to the investors' point of view. Therefore, firms would give more concern in disclosing their CSR to give good signal to the investors in their decision making process.

Since doing the CSR activities would need cost, the firms with high profitability are then more capable to disclose more CSR activities. similarly, the ones that have lower profitability will as well have lower ability to disclose their CSR activities because of the lower funds allocated to the activities. The information of CSR activities disclosed in firms' annual report will eventually be used by the investors in making their investment decision. This means that profitability has an impact in disclosing the CSR disclosure to facilitate the needs of investors to make their investment decision. Therefore, profitability has the capacity to positively impact the relationship between CSR disclosure and the market reaction. Considering this, the hypothesis is developed as follows:

H1: Profitability positively impacts the relationship of CSR and market reaction

RESEARCH MODEL

The regression model of the research is as follows:

$$CAR = \alpha + \beta_1 CSRI + \beta_2 PRFT + \beta_3 CSRI \times PRFT + \beta_4 PBV \ +$$
$$\beta_5 DER \ + \beta_6 SIZE + \varepsilon$$

Where:
CAR : Cumulative Abnormal Return
α : Constant
β_1- β_5 : Coefficient
CSRI : Corporate Social Responsibility Index
$PRFT$: Profitability
PBV : Price to Book Value
ε : Residual

By using 95% confidence level or level of significant (α) = 5%, the criteria to make decision are as follows:

1. H1 is accepted if p < 0.05 and $\beta_1 > 0$.
2. The moderating effect of profitability toward the relationship between the CSR disclosure and market reaction is determined from the significance of coefficient$\beta_3 CSRI \times PRFT$. H2 will be accepted if p < 0.05 and $\beta_3 \neq 0$.

DATA ANALYSIS AND DISCUSSION

Sample Selection

Table 3.1

Sample Selection

Criteria	Firms
Listed resource-based firms in 2013	106
Firms not publishing annual report consecutively	(79)
Firms using currency other than Rupiah	(11)
Firms not actively trade during the window period	0
Firms conducting confounding activities	(1)
Total Sample	15

Descriptive Statistics

Descriptive statistics are the tool used to explain all the variables used in the research and show the comparison among them. The outlier data can also be detected through descriptive statistics. This research uses 105 data that are explained in the descriptive statistics table below:

Table 4.1

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
CAR	105	.0501	.4724	.267379	.0912926
CSR	105	.0595	.4405	.256009	.0883208
PBV	105	.35	16.97	3.3630	2.71439
DER	105	.1515	5.5039	.945801	1.0355677
SIZE	105	25.4179	31.0583	28.977998	1.3659549
ROA	105	-.0438	.4264	.131832	.0919454
CSR.ROA	105	-.0151	.1167	.036654	.0302674
Valid N (listwise)	105				

Hypotheses Testing

Table 4.9

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.719(a)	.517	.486	.0630927

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.392	6	.065	16.420	.000(a)
	Residual	.366	92	.004		
	Total	.758	98			

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta	B	Std. Error
1	(Constant)	-.046	.210		-.222	.825
	LagCSR	.422	.124	.409	3.398	.001
	PBV	.001	.004	.020	.227	.821
	TRDER	.012	.022	.053	.532	.596
	LagSIZE	.006	.008	.081	.726	.470
	ROA	-.015	.128	-.014	-.119	.906
	LagCSR.ROA	1.044	.361	.343	2.889	.005

The value of adjusted R square is 0.486 which means that all the variables involved in the test have the ability to explain 48.6% of cumulative abnormal return. The significant value of F-score presented is 0.000, implying that the regression model is fit and all the variables involved have simultaneous impact to the cumulative abnormal return. While all control variables do not have significant impact to the market reaction, the significant impact exists in the effect of LagCSR and LagCSR.ROA.

Both hypotheses are accepted as the significant value of LagCSR is less than 0.05 and its beta shows positive number; 0.422, and since the LagCSR.ROA has significance of 0.005, and the beta is 1.044. It is concluded that the CSR disclosure does have positive impact to the market reaction, and the profitability does impact the relationship of CSR disclosure and market reaction.

Discussion

Corporate Social Responsibility Disclosure and Market Reaction

Based on the regression result, the first hypothesis is accepted. The positive beta of CSR disclosure to the market reaction means that the more the disclosure, the more will the investors in the market react to it, while the significant impact means that investors do consider CSR disclosure when making investment decision.

The CSR disclosed in the firms' annual reports contribute to higher firm value in investors' point of view (Servaes and Tamayo, 2013) that the investors are attracted to buy more of the firms' stock. This leads to the increase in firms' stock prices as a result of the increasing demand of the stock. The increase in the stock prices eventually results in the positive abnormal return. It can be concluded then, that the investors do take CSR into their consideration when making investment decision.

Moderating Effect of Profitability

The role of profitability as moderating variable means that the profitability could either strengthen or mitigate the relationship of CSR disclosure and the market reaction. The result of this research shows a positive significant impact of profitability to the relation of CSR disclosure and market reaction.

Thus, the agency theory is confirmed through this research because of the positive impact of profitability to the relationship of CSR disclosure and the market reaction. The positive impact of profitability means that firms with high profitability have higher ability to disclose more CSR activities, and contrarily, when the profitability is low, so is the disclosure. The signaling theory is also proved through this research, stating that the management always tries to disclose private information that is perceived as attractive to the investors and shareholders, especially when the information is perceived as good news (Suwardjono, 2010).

The result of the research shows that the disclosure of CSR activities is perceived as good news both by the firms and the investors. To the firms, they have the chance to establish positive image by reporting their involvement in social and environmental activities. The positive image established is expected to gain positive reaction from the investors. To the investors, the good news behind the CSR disclosure is that in addition to being obedient to the regulation, firms can balance their management of the operational activities as well as their social and environmental activities. Doing so also implies that the firms have good relationship with the surrounding environment and society that it may prevent the firms from conflicts that can harm their business.

Conclusion

After testing the hypotheses using 105 numbers of observations from 15 resource-based firms listed in Indonesian Stock Exchange from 2007-2013, it is concluded that:

1. The corporate social responsibility activities disclosed in the annual report of firms does positively impact the market reaction. The result implies that investors do concern about the CSR activities disclosed by the firms in their annual reports.
2. The profitability has positive impact to the relationship between CSR disclosure and market reaction. Both investors and firms are aware of the importance of CSR activities. In addition to perceiving the CSR disclosure as part of fulfilling the regulation, it is also a strategy used to show firms' ability to maintain good relationship with surrounding society and environment that it might support firms' business activities.

Limitation and Suggestion

Many firms do not consequently publish their annual reports that the research has only 15 firms in the sample. In addition, some firms do not use Rupiah as the currency that the number of sample becomes smaller. As a consequence, the result might not be applied to other resource-based firms excluded from the research that it could be the reason for doing other research. Since there are many factors influencing the market reaction, the variables in this research might not represent all the factors affecting market reaction. Thus, it could become the basis for other research that it would have more variables used to more precisely explain the impact of CSR disclosure to the market reaction.

The other limitation is that the data were directly trimmed without any consideration of the firms and their years. The transformation was conducted in order to normalize the data and to eliminate the autocorrelation problem. It could make the form of data change to the non-time series data. Therefore, the next researches could have time series data so that the research would have more exact representation of the result.

Furthermore, compared to other nations, regulation regarding CSR disclosure in Indonesia is still new. In addition, Indonesian capital market is also still considered as developing. Consequently, how CSR disclosure impacts market reaction might always change along with the development of Indonesian economy as a whole together with the investors' experiences. It would therefore always be a new and interesting topic to be discussed due to the unpredictable economy, establishment of regulations, and differences in perception of firms and the investors.

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