

SOCIAL DISCLOSURE AND PROFITABILITY: STUDY IN INDONESIAN COMPANIES

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ABSTRACT

We tried to investigate the causal relationship between profitability and corporate social responsibility disclosure. We choose listed companies under Kompas100 index as our sample to test whether profitability ‘granger cause’ CSR disclosure and whether CSR disclosure ‘granger cause’ profitability. We conduct multiple regression analysis to see the effect. ROA, ROE and NPM are used as the proxy for profitability and the number of lines in sustainability report as the proxy for CSR disclosure. We find that there is no link between profitability and CSR disclosure and that profitability is not the main reason for company to publish CSR report. This study is limited to companies listed in Kompas100 index. The findings of this study can give insights to the managers and investors that there is no link between profitability and CSR disclosure.

Keywords: CSR, profitability, granger causality

INTRODUCTION

In recent years, the disclosure of corporate social responsibility (CSR) has been receiving massive attention from company’s stakeholders including, investors, employees, government as well as customers. This is also followed by the companies that are starting to disclose their environmental and social activities in their annual reports as it will increase their value to the stakeholders (Qiu, Shaukat, & Tharyan, 2014). Such disclosure consists of financial and non-financial information on company’s interaction with both internal and external environment (Guthrie & Ward, 2007) as well as the contribution that have been made to the environments. From the economics perspective, CSR disclosure creates opportunity costs for the company as they have to bear for direct costs (data collection, audit, information dissemination, etc) as well as indirect costs (litigation costs, competition costs, etc) (Qiu, Shaukat, & Tharyan, 2014).

However, companies are still willing to disclose voluntarily. In Indonesia, there is not fixed accounting standard on disclosure and there is no law that reinforce such

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disclosures to be made by the companies. Therefore, in Indonesia, social and environment disclosure is still voluntary. Past studies have mentioned legitimation theory as the reason for social and environmental disclosure that is being forced by the public and aims to attract the attention of stakeholders (Qiu, Shaukat, & Tharyan, 2014). Social and environment disclosure is believed to be important for companies to a good image to the stakeholders, thus, disclosure can be seen as a business strategy for the company as a part of its competitive advantage (Aerts, Cormier, & Magnan, 2008). Therefore, it can be said that a business interest to increase reputation and value added drives companies to disclose social and environment information in their annual reports. However, some studies point out that disclosure as a legitimation tool does not create value for the companies (Cho & Patten, 2007). This issue is still a debatable topic for some researchers, nevertheless, many studies show that social and environment disclosure create value for the companies.

Russo and Fouts (1997) points out that good environmental performance and effective communication may gives competitive advantage for the companies, including strong reputation. Aerts et al (2008) find that adequate and relevant environmental disclosure not only increases environmental legitimation but also helps analysts to predict better earnings. Furthermore, Armitage & Marston (2008) also explain that objective environmental disclosure improves firm's reputation and valued by the investors. Good reputation and competitive advantage will improve companies' ability to operate better and increase sales. Therefore, environment and social disclosure will increase firm's values.

Firm's value can also be seen from the performance of the company, such as the ability of the company to generate profit. In its relation to environmental and social disclosure, there is only a handful of studies that explore the their relationship. Qiu, Shaukat, & Tharyan (2014) find that companies with higher profitability have higher disclosure compared to other companies. This finding is supported by Suhardjanto & Miranti (2008) that point out there is a significant difference in environmental disclosure between companies with higher profitability (those that are above average sample profitability) compared to companies with profitability below the average.

Our study tries to examine empirically the causality relationship between social disclosure and firm's profitability. This study makes several contributions. Firstly, it

extends the current literature as it explores the relationship between social disclosure and firm's profitability. As the social and environmental disclosures are still made voluntarily, our study tries to prove whether high social disclosure causes high profitability and vice versa. Thus, this will add insight to the company about the importance of environmental and social disclosure.

LITERATURE REVIEW

Legitimacy Theory

The theory of legitimacy discusses corporate and community interactions. (Aerts et al., 2008) reveals that legitimacy refers to contracts made between communities and companies. When the company fulfills the contract, it can be said that the company has been legitimized. Furthermore, legitimacy is an alignment between the social values that are performed by the company with the norms prevailing in society. It can be concluded that legitimacy is something that is given by society and sought by the company and is a source that can make the company survive (Aerts et al., 2008). Environmental disclosure is one way companies get the 'status' of society for its existence. By making such disclosure, the company may feel that its activities have been legitimated by the society or the environment in which it operates.

Social and Environmental Disclosure

There are two types of disclosures that can be done by the company: mandatory disclosure and voluntary disclosure. Mandatory disclosure is the minimum disclosure required by the competent authority (Tax, Act, SAK, or Bapepam). While voluntary disclosure is the company's willingness to make such disclosure. Disclosure is an important tool for communicating the economic, environmental and social performance of an enterprise (Russo & Fouts, 1997). Environmental disclosure is also a form of corporate social responsibility. Through environmental and social disclosures in annual reports, communities can monitor the activities undertaken by the company in order to fulfill its social responsibilities.

Since the environmental and social disclosures are still voluntary there has been no standard setting in the disclosure. The majority of companies in the annual report and

sustainability report usually refer to the reporting standards recommended by the Global Reporting Initiative (GRI). GRI in its reporting standards considers three indicators / aspects, namely economic / performance indicators, environmental performance indicators, and social performance indicators. There are four indicators for the social indicators themselves, namely human rights performance indicators, society performance indicators, labor performance indicators, and product responsibility performance indicators.

On environmental indicators, the GRI recommends several aspects of the environment that should be disclosed in the annual report. There are 30 items recommended by GRI and consist of 9 main aspects where the nine aspects are: materials, energy, water, biodiversity, emissions and waste, products and services, regulatory compliance, transportation, and overall costs incurred to preserve living environment

Previous Study

From the existing literature, the majority of previous studies discussed the effect of environmental performance on the financial performance of the company (Elsayed & Paton, 2005; Salama, 2005; Sarumpaet, 2005). These studies yield different results, such as, Sarumpaet (2005) find that environmental performance has no effect on financial performance. This is inconsistent with the discovery of Salama (2005) that mentions there is a relationship between environmental performance and financial performance of the company. Meanwhile, a study conducted by (Elsayed & Paton, 2005) found a neutral impact of environmental performance on the company's financial performance.

Furthermore, several studies have also studied environmental disclosure and firm characteristics (Qiu et al., 2014; Suhardjanto & Miranti, 2008). Suhardjanto and Miranti (2008) found that profitability and industry had a significant effect on environmental disclosure. While (Qiu et al., 2014) found that firms with high profitability make higher environmental disclosures than other companies.

Siregar and Bachtiar (2010) examine the size of the firm, foreign ownership, the size of directors, leverage, and profitability. They found that profitability and leverage had no effect on corporate social disclosure. The research of Siregar and Bachtiar

(2010) uses content analysis in the measurement of social disclosure and multiple regression in examining the relationship between variables. In line with Siregar and Bachtiar (2010), Hermawan and Mulyawan (2014) also explained that profitability has no effect on social disclosure. They did not find the effect of ROA, ROE and NPM on profitability. However, Qiu et al (2014) discloses different results in his research where there is a relationship between profitability and social disclosure. The next difference is in the method used by Qiu et al (2014) where they seek a causal relationship between profitability and social disclosure.

The relationship between social disclosure and profitability

It is believed that there is a positive relationship between high environmental and social disclosure values and firm profitability. With environmental and social disclosure, the company not only gains legitimacy from the public but is also exposed to contract costs or reputation fees that are risks that must be taken by the company. According to Aerts et al. (2008) firms with higher profitability will be more willing to bear these costs. Therefore, it is reasonable to assume that firms with higher profitability will result in wider and more objective social and environmental exposure.

In this study, the measurement of profitability of the company is measured using Net Profit Margin (NPM), Return to Asset (ROA) and Return to Equity (ROE), where the selection of this variable refers to the study of Siregar and Bachtiar (2010), Hermawan and Mulyawan (2014) and Qiu et al (2014).

H₁: There is a causality relationship between NPM and CSR

H₂: There is a causality relationship between ROA and CSR

H₃: There is a causality relationship between ROE and CSR

Furthermore, several studies on firm characteristics and CSR have found that firm size has an influence on CSR (Siregar and Bachtiar) as the larger the company, the more resources it can use to carry out social activities. The findings are also consistent with the findings of Qiu et al (2014), which reveal that firms with large economic resources have greater disclosure value.

METHODOLOGY

Population and Sample

The population of our study is all of the companies listed in the Compass 100 Index by 2015 and 2016 respectively, except for financial and financial sector companies. Furthermore, the selected company is a company that has a complete financial report for two years and its financial reporting is written in rupiah. Therefore, the total of companies that become sample in this research as many as 41 companies.

Definition of Operational Variables

In this study there are three types of variables are dependent variable (independent variable) and variable control (control variable). The value of social disclosure is the dependent variable of this study where this value is measured from the number of sentences contained in the sustainability report of the company. This measurement is similar to the content analysis study used by Siregar and Bachtiar (2010) and Hermawan and Mulyawan (2014) referring to Haniffa and Cooke (2005). Furthermore, the free variable consists of profitability, where ROA, ROE and NPM become the proxy on this variable. Firm size and leverage are the control variables of this study. Details of the definition of operational variables can be seen from the table below:

Table 1. Variable Operational Definition

Variable	Symbol	Measurement
The value of CSR	CSR	The number of lines disclosed in an activity
Profitability	ROA	Earning Before Interest and Tax divided by Total Asset (EBITt/TAt)
	ROE	Earning Before Interest and Tax divided by Total Equity (EBITt/TET)
	NPM	Net Income divided by Sales (Npt/Salest)
Firm size	SIZE	Natural log from total asset
Leverage	DER	Total debt to total equity ratio

Granger Causality Model

Granger causality model is used to test the hypothesis of this study. This model is used to analyse whether there is causality between the variables. The models that are used in this study are as follow:

RESULTS AND DISCUSSION

Table 2. Descriptive Statistics

	Minimum	Maximum	Mean	SD
<i>Panel A: Year 2015</i>				
CSR	16	389	151.561	89.71958
ROA	-5.3	45.8	8.800976	9.996026
ROE	-13.52	177	21.42463	34.14212
NPM	-0.069741	1.078629	0.1565253	0.1920748
Size	7.935945	12.41079	9.633823	1.0931
DER	0.0758276	13.33836	1.461229	2.057594
<i>Panel B: Year 2016</i>				
CSR	0	419	144.8537	86.66215
ROA	0.21	41.6	8.869756	9.261004
ROE	0.2	134.1	17.11049	23.57338
NPM	0.0028092	0.407767	.1341646	0.1085295
Size	2.274886	12.47555	9.522078	1.553035
DER	0.0050917	14.14534	1.287426	2.174107

Table 2 presents the descriptive statistics of this study. Panel A explains the descriptive statistic of 2015, which can be seen that the minimum number of sentences is 16 and the maximum sentence in social disclosure is 389. Furthermore, from 3 proxies measuring profitability, it can be seen that the minimum value of each ratio is negative which gives an indication that there are companies, which suffered losses in 2015. While in 2016, there are companies that do not make visible disclosure, as the value of CSR is 0, which means there is no sentence in sustainability reporting that explains the items of social disclosure. In contrast to 2015, in 2016 there is an increase in profitability ratios where the minimum ROA, ROE and NPM values are negative.

Table 3. The Effect of Social Disclosure on Profitability

	Dependent Variable: Profitability		
	Koef.	t	Sig
<i>Panel A: CSR → ROA</i>			
(constant)	-1.238	-0.425	0.674
ROA ₂₀₁₅	0.832	15.982	0.056
CSR ₂₀₁₅	-0.003	-0.406	0.687
CSR ₂₀₁₆	5.918	1.973	0.056
Size ₂₀₁₆	0.096	0.317	0.753
DER ₂₀₁₆	-0.048	-0.226	0.823
<i>Adjusted R²</i>	<i>0.904</i>		
<i>Panel B: CSR → ROE</i>			
(constant)	-7.514	-0.496	0.623
ROE ₂₀₁₅	0.299	3.949	0.000
CSR ₂₀₁₅	0.074	1.707	0.097
CSR ₂₀₁₆	0.048	1.071	0.291
Size ₂₀₁₆	-0.571	-0.363	0.719
DER ₂₀₁₆	4.167	3.477	0.001
<i>Adjusted R²</i>	<i>0.587</i>		
<i>Panel C: CSR → NPM</i>			
(constant)	0.079	0.881	0.384
NPM ₂₀₁₅	0.266	3.348	0.002
CSR ₂₀₁₅	0.001	1.502	0.142
CSR ₂₀₁₆	0.002	0.573	0.570
Size ₂₀₁₆	0.004	-0.418	0.679
DER ₂₀₁₆	0.009	1.279	0.209
<i>Adjusted R²</i>	<i>0.313</i>		

From panel A, it can be seen that there are inconsistencies between variables of social disclosure value where the coefficient value for CSR 2015 shows negative number and in 2016 the value of CSR coefficient is positive. Furthermore, from the results of this regression there is no significant variable in explaining profitability. The explanatory power of this model is 90.4% (adjusted R²) where the independent variable of this model can explain by 90.4%.

Furthermore, in panel B, the coefficient of CSR shows a positive value, which can mean that the more social disclosure of the company will be the higher ROA of the company. However, similar to the effect of CSR on ROA, the effect of social disclosure value on ROE is not significant where the level of significance for CSR2015 and CSR2016 is more than 0.05 (respectively, 0.097 and 0.291). The value of adjusted R² of this regression is also smaller than the regression in the previous variable is 0.587 (58.7%) where the ROE variable can only be explained by the independent variable of 58.7% where the remainder is explained by other factors outside the model.

In panel C, it can be seen that the coefficient of CSR value for both periods is positive but very small. These findings may indicate that there is a positive relationship between NPM and the value of social disclosure where the higher the value of corporate disclosure will be the higher the value of profitability (ROE). Similar to ROA and ROE, CSR's impact on profitability is also insignificant. When viewed from the adjusted value of R², the regression results on the NPM variable also show a small value. Variable NPM can only be explained by independent variable of 31.3%.

In all three panels, firm size shows a positive relationship with profitability where the bigger the company will be the higher profitability of the company. Meanwhile, for leverage there are different results from each panel result of regression. In panel A, where leverage is tested to predict ROA, it is found that there is a negative relationship between DER and ROA (DER coefficient of -0.048). While in panel B and C, the coefficient of DER shows a positive relationship between DER and ROE and NPM. However, the significant relationship is the influence of DER on ROE with significance value of 0.001 (p-value <0.05).

Table 4. The Effect of Profitability on Social Disclosure

	Dependent Variable: CSR		
	Koef.	t	Sig
<i>Panel A: ROA → CSR</i>			
(constant)	8.741	0.160	0.874
CSR ₂₀₁₅	0.661	5.970	0.000
ROA ₂₀₁₅	-4.096	-1.507	0.141
ROA ₂₀₁₆	5.918	1.973	0.056
Size ₂₀₁₆	1.848	0.326	0.747
DER ₂₀₁₆	1.425	0.359	0.722
<i>Adjusted R²</i>	<i>0.618</i>		
<i>Panel B: ROE → CSR</i>			
(constant)	13.694	0.246	0.807
CSR ₂₀₁₅	0.679	5.630	0.000
Size ₂₀₁₆	2.083	0.361	0.721
DER ₂₀₁₆	-2.629	-0.516	0.609
ROE ₂₀₁₅	0.027	0.080	0.936
ROE ₂₀₁₆	0.655	1.071	0.291
<i>Adjusted R²</i>	<i>0.588</i>		
<i>Panel C: NPM → CSR</i>			
(constant)	18.640	0.328	0.745
CSR ₂₀₁₅	0.802	7.268	0.000
Size ₂₀₁₆	1.333	0.227	0.821
DER ₂₀₁₆	2.502	0.572	0.568
NPM ₂₀₁₅	-20.034	-0.035	0.728
NPM ₂₀₁₆	-60.44	-0.573	0.570
<i>Adjusted R²</i>	<i>0.576</i>		

In panel A, it appears that the coefficients of ROA for 2015 and 2016 show different relationships. There is a negative relationship between ROA and CSR by 2015 but, different relationships are shown in 2016 where they turn positive. From both values it is also seen that each coefficient has a significance level above 0.05 (each of 0.141 and 0.056). As for adjusted R² value of 0.618 means CSR can only be explained by independent variable of 61.8%.

Furthermore, in panel B, it appears that ROE has a positive relationship to CSR means the higher the ROE of a company will be more and more social disclosure made by the company. Similar to findings on ROA and CSR relations, the two ROE coefficients show no significant value (respectively of 0.936 and 0.291 for 2015 and 2016). The value of the regression coefficient of regression results is 0.588 where only 58.8% of CSR can be explained by independent variable influence.

In Panel C, the relationship of NPM and CSR shows a negative relationship where if the disclosure value is high then the firm's NPM performance will decrease or can be interpreted with companies that have low NPM value will tend to make greater disclosure. However, the value of each NPM coefficient is not significant ($p\text{-value} > 0.05$). Furthermore, this regression model can only explain CSR of 0.576 or 56.7%. Furthermore, firm size shows a positive relationship where the larger the size of the company will be the wider the disclosure made by the company. The same discovery was also found in the DER variable, which also has a positive relationship with CSR. These results are inconsistent with the results of previous regressions that evaluate the announcement of social disclosure to profitability.

It can be concluded that there is no causality relationship between profitability and social disclosure value where profitability is represented by proxy ROA, ROE and NPM. It can be interpreted that high profitability value can not cause high disclosure value and vice versa. These findings are in line with the results obtained by Siregar and Bachtiar (2010), Hermawan and Mulyawan (2014) and Sarumpaet (2005) which explain that there is no effect of profitability to CSR. However, this finding differs from findings from Qiu et al (2014) and Elsayed & Paton (2005) in which both studies suggest that financial performance affects the value of corporate social disclosure.

This result may indicate that in conducting social disclosure the company only aims to meet legal requirements. Another explanation may be that CSR has a negative effect on financial performance because social disclosure creates additional costs that reduce the profitability of firms and competition (Friedman, 1962). Furthermore, the results may also indicate that firms with high financial performance do not invest their resources in social performance (Makni et al, 2008). Conversely, high disclosure rates are unrelated to financial performance that may be due to the voluntary nature of social

disclosure causing managers to have no purpose other than reporting to the stakeholders of the company.

From firm size test, there is no influence of firm size on the value of social disclosure. This may indicate that the size of the firm does not affect the high value of disclosure. This finding differs from previous findings which concluded that there is a relationship between firm size to disclosure value (Fauzi, 2008, Chauhan and Amit, 2014; Nawaiseh, 2015). However, these findings are in line with findings from Nawaiseh (Hossain, Islam and Andrew, 2006) stating that there is no influence between firm size and disclosure value. Similar to firm size, leverage is also found to have no relationship to the value of disclosure. Nawaiseh (2015) argues that high corporate leverage values usually lead to high disclosure rates because companies want to show debtholders that they are not violating debt contracts. We found a positive relationship between leverage and disclosure value but the relationship was not significant. This can be possible with a small amount of research data so that it cannot clearly see the relationship between variables.

CONCLUSION

This study examines the causality relationship between corporate profitability and social disclosure value. The results of this study indicate that there is no causality relationship between profitability and social disclosure value where high profitability cannot encourage high social disclosure and vice versa. This indicates that profitability cannot be used as a reason for the company to conduct extensive social disclosure.

LIMITATION AND FUTURE RESEARCH

This research only examines those companies listed in Kompas100 index; therefore, the results of the study might not yield satisfying results. It is suggested for future research to use bigger study sample to be able to find the relation between profitability and social disclosure.

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