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The Effect of Corporate Social Responsibility Disclosure on Earning Management and Firm Value: Evidence from Indonesia

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Abstract

The aim of this research is to provide empirical evidence on the impact of CSR disclosure on earnings management and firm value. The population used in this study were all manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2018. The sample in this study was 114 companies selected through purposive sampling. The results of data analysis show that CSR has a positive effect on Firm Value. CSR disclosure is one form of activity that companies carry out in influencing their stakeholder decisions. This is by the theory that a company is not an entity that only operates for its interests, but the main objective of the company is to meet stakeholder needs. Besides, CSR has a positive effect on Earning Management. The results of this study contrary to research conducted by prior research which states that CSR can reduce earning management because CSR not only increases information transparency but also creates interaction with stakeholders. The difference in findings in this study is because CSR disclosure in Indonesia is still low, as seen from the average CSR in Indonesia, which is 33%, and it is still not transparent so that companies tend to carry out earnings management.

Keywords: CSR, Earning Management, Firm Value, Manufacturing Company

JEL Classification Code: G32, M14, M41

1. Introduction

In today's business world, financial statements are not the only thing that is used as a benchmark in measuring the performance of a company. Potential investors do not rely solely on financial information in making investment decisions. Epstein and Freedman (1994) stated that decision making which is only seen in terms of financial performance alone is no longer relevant. Many companies manipulate their financial statements by implementing earnings management. Earnings management is a practice followed by the management of a company to influence the earnings reported in financial statements (Fischer & Rosenzweig, 1995).

Environmental Management can be defined as the management of the interaction and impact of human activities on the natural environment. Environmental management tries to identify the factors that have a stake in the conflicts that may arise between meeting the needs but protecting the environment (Keller & Richey, 2006). There are several reasons why companies participate in CSR activities. First, society generally believes that companies have a moral obligation to engage in action for the benefit of all, whether this action is profitable or not. Embracing socially responsible policies goes a long way towards attracting and retaining customers, which is essential to a company's long-term success. Businesses that engage in active CSR efforts take stock of the way they operate in the world to incorporate addressing cultural and social issues, with the aim of benefiting both in the process. Not only can CSR models increase business and revenue, but they also promote change and progress throughout the world, which often involves helping people with few or no resources. Finally, social responsibility can enhance a company's reputation (Hong & Andersen, 2011).

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Corporate social responsibility focuses on the idea that a business has social obligations above and beyond making a profit. CSR is achieving commercial success in ways that honor ethical values and respect people, communities, and the natural environment. Yoon et al. (2006) stated that CSR activities can be used to overcome customers' social concerns about a company because they can create a brand image for the company and develop positive relationships with stakeholders. Being socially responsible can strengthen both a company's brand and image. As mentioned, the public perception of a company is critical to client confidence. By portraying a positive image through taking part in CSR projects, a company can make a name for itself for not only being successful in what they do but by being socially conscious too. Many companies continue to strive to ensure that the company operates by the rules and norms that apply in the community or environment where the company is located and ensures that the company's operations are legally accepted (Deegan, 2002).

The CSR activities implemented by companies whose main objective is to improve customer service without neglecting other stakeholders have a positive impact on the expected income statement. CSR is considered as an essential and strategic factor, for sustainable growth and development, since companies should not only pursue the goal of maximizing profit for shareholders (Yang & Kim, 2018). Being a socially responsible company can bolster a company's image and build its brand. Social responsibility empowers employees to leverage the corporate resources at their disposal to do well. Besides, CSR can make customers aware of its contribution to positive activities carried out by companies that make them have a sense of trust in the company (Lenssen et al., 2007).

Previous research, conducted by McWilliams and Siegel (2000), Wang (2012), and Foote et al. (2010) believed that CSR can be used strategically to grow firm value; however, this investment can also reduce firm value by increasing costs and shifting the focus away from operational objectives. Meanwhile, Becchetti et al. (2009) and Statman et al. (2008) in their research stated that empirical findings from several studies support this point of view, which shows that investing in CSR requires additional resources so that it can increase operational costs and reduce profitability. This prevents companies from achieving their goal of maximizing profits.

Apart from looking at the effect of CSR and firm value, several previous studies have also looked at the relationship between CSR and earnings management. Research conducted by Chih et al. (2008) and Scholtens and Kang (2013) stated that CSR induces transparency and reduces the propensity towards the number of opportunities for earnings management. Some researchers argue that CSR firms are more likely to engage in earnings management, as CSR practices are strategically used for the pursuit of a manager's self-interest or to neutralize the impact of corporate misconduct. On the one hand, findings show that CSR-oriented firms provide more transparent financial information as a result of managers willing to behave more ethically and meeting the expectations of society and stakeholders. On the other hand, studies confirm that firms that invest in CSR practices show high levels of earnings management because managers try to disguise the low quality of firms' financial statements by signaling higher levels of CSR. This deflects stakeholder attention from the poor quality of the earnings of the company towards the CSR performance of the company, helping managers to legitimize the firm and themselves.

This research was conducted to reveal the impact of CSR disclosure on earnings management and firm value. From the description above there are inconsistencies in the results of previous studies, thus encouraging researchers to strengthen previous research. The purpose of this study was to determine how much influence CSR disclosure has on earning management, as well as the effect of CSR disclosure on firm value. In this study, there are still not many researchers linking CSR, earnings management, and firm value.

2. Literature Review

2.1. Stakeholder Theory

Stakeholder theory says that the company not only operates for its own interests but also provides benefits for its stakeholders (shareholders, creditors, consumers, suppliers, government, society, analysts, and other parties) because the company's existence is greatly influenced by the support provided by its stakeholders. The survival of a company depends on the support of stakeholders, and this support must be sought (Gray et al., 1995). Stakeholder theory is important in this study because this theory deals with parties who have an interest in the company, parties who will influence and be influenced by company activities, such as management accountability to stakeholders in the form of CSR activities, earnings management, and creating value for the company.

2.2. Corporate Social Responsibility (CSR)

CSR is a key factor for the success and survival of the company. The implementation of CSR can make a company have a good image in society, so it can build relationships and create a good reputation in the stock market (Lanis & Richardson, 2012). According to Aras and Crowther (2008), there are 3 main principles of CSR: 1) Sustainability, 2) Accountability, and 3) Transparency.

2.3. Earning Management

Earnings management is a method of manipulating financial records to improve the appearance of the company's financial position. Companies use earnings management to present the appearance of consistent profits and to smooth earnings fluctuations (Alves, 2012). Earnings management can be seen as real if managers have the motivation to meet profit targets which results in managers or companies ignoring good business practices. Earnings management refers to a company's deliberate use of accounting techniques to make its financial reports look better. Earnings management can occur when a company feels pressured to manipulate earnings to match a pre-determined target. In fact, given the financial manager's theoretical goal of stockholder wealth maximization, one type of earnings management which is income smoothing, is desirable, because it reduces the variability in the future expected cash flows, drives down the cost of equity and debt and maximizes share price (Huynh & Nguyen, 2019).

2.4. The Influence of Corporate Social Responsibility and Firm Value

Previous research conducted by Saleh (2011) concluded that the implementation of CSR can improve the company's financial performance. CSR prioritizes one aspect of business – its orientation toward the society at large, i.e. its social orientation – over the other business responsibilities. Stakeholder theory posits that the essence of business primarily lies in building relationships and creating value for all its stakeholders. These results indicate that activity in several levels of CSR initiatives can improve the company's financial performance which in turn can increase firm value. With companies implementing CSR, the company can be said to have met the needs of stakeholders by providing complete information so that it can gain stakeholder trust. Based on the previous literature, CSR which is a positive signal revealed by the company will influence investor sentiment. Investors can make decisions to make investments based on signals from the company. So that it can increase the value of the company. The better the company signal, the more confident investors will be in making investment decisions, which will then have an impact on the company's higher value. From this description, the research hypothesis is:

H1: *Corporate social responsibility (CSR) disclosure affects firm value.*

2.5. The Influence of Corporate Social Responsibility and Earning Management

Meanwhile, research conducted by Gargouri et al. (2010) stated that CSR affects earning management, which means that the higher the level of CSR disclosure in a company, it can improve the company's earning management practices. With the disclosure of CSR, the company seeks to continue to maintain long-term relationships with investors who are one of the stakeholders in the company, and company managers will try not to commit fraud or manipulate financial statements (doing earnings management practices in the company) to maintain investor confidence against the company. In the research of Gras-Gil et al. (2016), managers who prioritize personal interests by implementing profit management, in the viewpoint of company stakeholders, are considered to endanger the interests of stakeholders so that the level of trust in the company is lower. With the application of CSR, it can prevent the actions of managers in carrying out earnings management practices, so that the information provided is genuine. From this description, the hypothesis of this study is:

H2: *Corporate social responsibility (CSR) disclosure affects earning management.*

3. Research Method

The data collection technique in this research is using secondary data documentation. The population in this study is manufacturing companies listed on the IDX in 2018. The research sample was taken using the purposive sampling method, with the following criteria: 1) Manufacturing companies in Indonesia that have been listed on the Indonesia Stock Exchange (IDX) in 2018; 2) Disclose social information and other information needed in 2018. The CSR disclosure index based on the GRI G4.1 standard (Global Reporting Initiative), are as follows: 1) Economic Performance Indicators; 2) Environment performance indicator; 3) Labor Performance Indicator (labor practices performance indicator); 4) Human Rights Performance Indicator; 5) Social Performance Indicators; 6) Product Performance Indicator (product responsibility performance indicator). In this study, the indicators used as benchmarks only consist of the 4 indicators above. The CSRDI Corporate Social Responsibility Disclosure Index (calculation formula) is as follows:

$$\text{CSR} = \frac{\text{Total Value of “1”}}{\text{Number of item GRI} - \text{G4 2018}}$$

McNichols (1988) stated that the most common approach to estimating management's earnings (i.e., the extent to which management applies the policy on reported earnings) is aggregate accruals. In this study, to measure and calculate earnings management we use the revenue discretionary model (Stubben, 2010):

$$\begin{aligned}\Delta \text{AR}_{it} &= \alpha + \beta_1 \Delta R_{it} + \beta_2 \Delta R_{it} \times \text{SIZE}_{it} + \beta_3 \Delta R_{it} \times \text{AGE}_{it} \\ &+ \beta_4 \Delta R_{it} \times \text{AG\_SQ}_{it} + \beta_5 \Delta R_{it} \times \text{GRR\_P}_{it} \\ &+ \beta_6 \Delta R_{it} \times \text{GRR\_N}_{it} + \beta_7 \Delta R_{it} \times \text{GRM}_{it} \\ &+ \beta_8 \Delta R_{it} \times \text{GRM\_SQ}_{it} + \varepsilon_{ir}\end{aligned}$$

Where, ΔAR_{it} refers to change in receivables of a company *i* in year *t*, ΔR_{it} refers to change in company *i* revenue in year *t*, $SIZE_{it}$ refers to the natural log of total assets of a company *i* in year *t*, AGE_{it} refers to the natural log company age *i* in year *t*, AGE_SQ_{it} refers to the square of the natural log of the age of company *i* in year *t*, GRR_P_{it} refers to the growth rate in revenue, GRR_N_{it} refers to the growth rate in revenue, GRM_{it} refers to growing revenue, GRM_SQ_{it} refers to the square of the GRM of a company *i* in year *t*, and ε is an error.

The dependent variable of this study is firm value. Firm value is the value of the company as measured by the value of the shares circulating in the market. Share prices are based on expected cash flows in the coming years and not only in the current year. The Tobin Q was used in this study to calculate Firm Value, by using the Q ratio modified by Lee et al. (2019).

$$\text{TOBIN'S } Q = \frac{MVE + D}{TA}$$

Where, MVE refers to closing price end of the years × number of stock or shares, D refers to total liabilities, and TA refers to total assets.

In this study, the data was processed and analyzed using statistical tools in the form of Stata 15. The stages of analysis were as follows: 1) Descriptive statistical analysis was carried out to see the overview of the processed data; 2) Classic assumption test aims to determine and test the feasibility of the regression model used in this study, in addition to ensuring whether the data that has been processed is normally distributed, free from symptoms of multicollinearity and heteroscedasticity; 3) Multiple regression test was carried out to determine the effect and ability of the variable in explaining the independent variable and with a value below 0.05, it can be said that the relationship between the two variables is influential.

Companies that carry out CSR activities will provide greater security guarantees to investors in investing because companies that have high social and environmental responsibility will also have high survival guarantees. In this study, several limitations need to be considered for further research to develop this research. The measurement of CSR is only sourced from the company's annual report in 1 period, and there are still many companies that have not disclosed the CSR activities that are carried out by the company. To answer the limitations of this study, further research needs to pay attention to these things and can increase the number of research samples or add other variables.

4. Results and Discussion

Based on the research sample selection criteria, the number of manufacturing companies listed on the Indonesia Stock Exchange is 176 companies. 62 manufacturing companies did not disclose their Corporate Social Responsibility (CSR) in 2018. Descriptive statistical analysis is carried out to see the overview of the data that has been processed. The following table describes the results of the statistical analysis that has been carried out by obtaining the mean, minimum and maximum values, and standard deviation as follows (Table 1).

Descriptive research variables based on data acquisition from 114 manufacturing companies on the Indonesia Stock Exchange in 2018 are shown in Table 1, which shows that the average firm value variable is 2.90, while the average CSR disclosure in Indonesia is 0.33. The average earning management variable is 0.02 with a minimum value of –1.24 which is measured using the formula from Stubben (2010). The highest maximum value is the firm value variable with the highest standard deviation of 2.61. The maximum value of the CSR variable from the processed data is 0.64 with a standard deviation of 0.11.

The normality test is carried out to see whether the residual value is normally distributed or not. The normality test in this study used the Skewness Kurtosis test. Skewness Kurtosis test the data is normally distributed, with a probability value of 0.0613, which means that the value is greater than 0.05. The multicollinearity test aims to see whether there are multicollinearity symptoms or correlation between independent variables. It can be seen from the test results if the Variance Inflation Factor (VIF) value, which must be <10 or >0.1. The multicollinearity test in the study showed that the VIF values were 1.05 which were smaller than 10 and greater than 0.1. A heteroscedasticity test was conducted to see whether in the regression model there was an inequality of variance from the residual results in one observation to another. If there is an inequality of variance, it can be concluded that the data has a problem in heteroscedasticity or the data is not homoscedasticity. The results of the Heteroscedasticity test in this study showed the value of χ^2 (1) = 0.08 and Prob > χ^2 = 0.7725.

Table 1: Descriptive Statistics

Variables	Mean	Min	Max	Standard Deviation
CSR	0.33	0.10	0.64	0.11
Firm Value	2.90	3.15	10.71	2.61
Earning Management	0.02	–1.24	6.28	0.94

The value of Prob > *F* of the Firm Value variable is 0.1088, which means that the overall test has a significant effect. The Prob > *F* value of the Earnings Management variable is 0.0234. The Adj *R*-Square variable is the independent variable, and the Adj *R*-Square value for the Firm Value variable is 0.0217, which means the CSR variable is able to explain 2.1% variance in the Firm Value variable (Table 2). The Adj *R*-Square value of the Earnings Management variable is 0.0362 which indicates that CSR can explain 3.6% variance in the Earnings Management variable.

The first test is conducted to test the first hypothesis which states that CSR has a positive effect on firm value. The results of this test show a probability value of 0.041 where the value is not more than 0.05, with a *t* value of 2.06 (where the *t* value indicates a positive effect) which indicates that the relationship between the two variables is influential (Table 3). Hence, it can be concluded that CSR has a positive effect on firm value, and the first hypothesis in this study is accepted. The results of this study are in line with Saleh (2011) that CSR affects Earning Management.

The second test is conducted to test the second hypothesis which states that CSR affects earning management. The results of this test show a probability value of 0.023 where the value is not more than 0.05 and a *t* value of 2.30 (where the *t* value indicates a positive effect) indicates that the relationship between the two variables is influential. Hence, it can be concluded *t* CSR has a positive effect on earnings management, and the second hypothesis in this study is accepted. The results of this study are in line with research conducted by Chen and Hung (2020) that CSR affects earning management.

4.1. The Effect of CSR on Firm Value

Based on the results of the first hypothesis test, the output of stata 15 shows that corporate social responsibility (CSR) affects firm value. This means that the higher the disclosure of CSR activities carried out by the company, the higher the firm value. The results of this study indicate that the size of the practice of CSR affects firm value. CSR disclosure is a form of activity carried out by a company in influencing its stakeholder decisions. This is by the theory that a company is not an entity that only operates for its interests, but the main objective of the company is to meet the needs of stakeholders (Friedman, 1984). CSR prioritizes one aspect of business – its orientation toward the society at large, i.e. its social orientation – over the other business responsibilities. Stakeholder theory posits that the essence of business primarily lies in building relationships and creating value for all its stakeholders.

Table 2: Adj *R*-Square

Variables	Prob > *F*	Adj *R*-squared
Firm Value	0.1088	0.0217
Earning Management	0.0234	0.0362

Table 3: Regression Results

Variables	*t*	*p* > |*t*|	Conclusion
CSR → Firm Value	2.06	0.041	Accepted
CSR → Earning Management	2.30	0.023	Accepted

If the company can maximize the benefits received by stakeholders, stakeholder satisfaction will arise which will increase firm value. So, the results of this study are in line with research conducted by Saleh (2011) who stated that CSR can improve a company's financial performance. Companies are required to disclose all information to external parties both financial and non-financial information with the aim of increasing firm value (Machmuddah et al., 2020). So, it can be concluded that the first hypothesis can be accepted.

4.2. The Effect of CSR on Earning Management

The research results from the second hypothesis indicate that CSR has an effect on earning management. The results of this study are in line with the research conducted by Firdiansjah et al. (2020) who stated that CSR has an effect on earning management. CSR disclosure in Indonesia is still low and not transparent, so companies tend to practice high-earning management. This is in contrast to the research conducted by Gargouri et al. (who stated that CSR can reduce earning management because CSR not only increases information transparency but also creates interaction with stakeholders. The phenomenon of CSR disclosure in Indonesia is still relatively low, which can be seen in the descriptive statistics of CSR variables in this study with an average CSR disclosure in Indonesia of 33%, thus making CSR in Indonesia affect earnings management. This is also in line with research conducted by (Jordaan et al., 2018) who stated that companies with low CSR are more likely to carry out earning management, this is indicated by the average CSR disclosure in Indonesia which is 33%.

5. Conclusion

CSR is a form of activity that companies carry out in influencing their stakeholder decisions. This is by the theory that a company is not an entity that only operates for its interests, but the main objective of the company is to meet stakeholder needs. Meanwhile, CSR affects earning management. CSR disclosure in Indonesia is still low, which can be seen from the average CSR in Indonesia, which is 33%, and is not transparent, so companies tend to practice high earning management. This research is expected to be useful for the company, help the company to find better ways to increase firm value, and provide an understanding of the importance of social and environmental responsibility that is not only focused on economic interests. Through CSR activities, the company will get long-term benefits from a sustainable company and a good company reputation.

Companies that carry out CSR activities will provide greater security guarantees to investors in investing because companies that have high social and environmental responsibility will also have high survival guarantees. In this study, several limitations need to be considered for further research to develop this research. The measurement of CSR is only sourced from the company's annual report in 1 period, and there are still many companies that have not disclosed the CSR activities that are carried out by the company. To answer the limitations of this study, further research needs to pay attention to these things and can increase the number of research samples or add other variables.

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