

Determinants of Profitability Level and Level of Corporate Social Information Disclosure: Preliminary Study

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Abstract. This study evaluates the disclosure of corporate social responsibility (CSR) information and its relation to profitability using a qualitative approach with a high level of content analysis. This study collects and analyzes data and information obtained from literature. The results indicate that there is a relationship between social information and profitability and that a company is expected to reasonably profit from the honest disclosure of CSR information.

Keywords: *internationalization of SMEs, digital technology, theoretical framework*

1 Introduction

The accounting profession developed rapidly after the industrial revolution, leading to reports being used as a means of culpability to the owners of capital. With companies' alignment to these stakeholders, management quickly learned to exploit social and ecological resources, often resulting in environmental and social damage. Capitalism, being material-oriented, can be used to destroy the balance of life by stimulating the excessive development and activities that do not contribute to continued prosperity (Chwastiak, 1999).

Governments and governance structures compel firms to provide transparent information about both their economics and social activities. Furthermore, the public needs to understand the extent to which companies implement positive, proactive corporate social responsibility (CSR) activities. Conventional accounting has been highly criticized, because it does not address societal interests. Thus, CSR-related accounting practices has been developed (Anggraini, 2008).

Social sensitivity and awareness must be undertaken by companies and led by the developed countries. However, there remains debate among parties who desire wholesale corporate reporting and those who wish to keep the information confidential (Harianto & Sudomo, 1998). They seem to agree, however, with two underlying assumptions:

- Solutions to many social issues require the active role of businesses.
- Traditional profit measurements should be changed to reflect environmental protection and impact.

Financial accounting standards in Indonesia do not require companies to disclose CSR information. Therefore, the public can only hold those publicly listed firms accountable that voluntarily provide the information. Disclosure is governed, as it were, by Bapepam regulation no. KEP-134 / BL / 2006, dated December 7, 2006. Because it is not mandatory to disclose, companies must consider the costs and benefits to be gained from revealing CSR data, if there are any. If the anticipated benefits are greater than the costs incurred to disclose the information, the company might as well voluntarily disclose.

CSR theory addresses the nature and handling of this kind of information. The general idea is that, as the public becomes more aware of a firm's handling of its social responsibilities, stakeholders will be pressured to pay closer attention. Slowly, therefore, companies are opting to incorporate proactive CSR business processes at predictable costs, rather than paying penalties because of neglect. This general idea requires a deeper understanding related to the costs and benefits of CSR to stakeholders.

2 Methodology

This research is a qualitative study that applies an interpretative epistemology to observe and understand problems about the socially constructed nature of business. In the context of research design, this paradigm selection guides our entire process (Guba, 1990). The interpretive model requires us to first determine the problem

and then to provide an explanation of possible solutions (Kuhn, 1970). Lincoln and Guba identified four interpretive techniques: positivism, post-positivism, constructivism, and critical theory. Sarantakos (1998) and Neuman (2013) identified three: positivism, interpretive, and critical. Creswell (2014) defined a qualitative study as “[one] of understanding a social or human problem based on the construction of a complex and holistic image, formed with words, reporting detailed views of informants and carried out in a natural setting.” Neuman (2013) said that “data for qualitative researchers sometimes takes the form of numbers, more often written or spoken words, actions, sounds, symbols, physical objects or visual images (e.g., maps, photographs, videos).”

This descriptive study can be interpreted using problem-solving procedures that describe the state of a subject or object based on apparent facts (Soejono and Abdurrahman, 2005). Data collection is used to explain the problem of this objective research. This includes collecting and studying data and information obtained from journals and other sources. Content and discourse analyses, which rely on models, structures, and written languages, are used for qualitative data. Content analysis is used to categorize and classify behavioral data, enabling synthesis and tabulation. Our research content can be analyzed at two levels: basic (manifest) level (i.e., a descriptive account without explanations) and higher (latent) level (i.e., an interpretative analysis with answer and inferences).

3. Results and Discussion

Corporate disclosures include information contained in financial reports and complementary communications (Subroto, 2004). They typically include provisions for their optimal functioning within the capital market (Widuri, 1999). Company management generally holds an asymmetric informational advantage over shareholders and stakeholders. There are two main types of information asymmetry (Kusumasari, 2008).

- Adverse selection: where which one or more parties in a business transaction or a potential transaction have more favorable information than the other party. Accounting reporting is a mechanism for controlling adverse selection issues by disclosing information that is known to management to outsiders.
- Moral hazard: where one or more parties in a business transaction or a potential transaction can observe their actions in the fulfillment of the deal, but the other party cannot. This problem may arise because of the separation between ownership and control of the firm.

Disclosures by public companies consist primarily of mandatory and voluntary disclosures of information regulated by standard regulatory bodies. Although voluntary disclosure is an out-of-obligation disclosure, providing accounting information and other relevant information is optional (Arifin, 2004). Research in various countries has shown that annual reports tend to convey CSR well.

Companies disclose social information to build their image and to generate positive attention. Thus, disclosure is positively related to social, economic performance, and political performance, whereas it is negatively related to contract costs and supervision (Belkaoui & Karpik, 1989).

According to the Security Exchange Commission (SEC), the purpose of social information disclosure can be categorized in two ways (Mardiyah, 2002):

- Protective: information disclosure required by the capital regulatory body to protect investors from unfair treatment by the issuer.
- Informative: information disclosure for investment analysis purposes.

Unlike the SEC, Belkaoui suggested that the purpose of disclosure comprised six objectives (Widuri, 1999).

- To describe recognized items with their relevant measures, including the sizes of the financial statements.
- To describe unrecognized items and to provide useful measures.
- To provide information to assist investors and creditors in determining potential and unrecognized ratios and details.
- To provide valuable information that can be used to compare companies.
- To provide information on future cash inflows and outflows.
- To establish the investor and determine the returns.

There are three concepts applied so that the disclosed information can be more transparent, relevant, significant, understandable, and useful (Kusumasari, 2008):

- Adequate (sufficient) disclosure is the minimum disclosure required to prevent the financial overview from being misleading.
- Fair disclosure transmit the noble objectives of giving equal treatment to all potential readers.
- Full disclosure is the presentation of all relevant information.

For some, full disclosure implies overstating information and is, therefore, considered inappropriate. Excessive information can be dangerous when too much detail acts to conceal vital information, making the financial statements too challenging to understand. Harianto disclosed financial-statement elements that were least reported in his report, represented by Table 1 (Harianto and Sudomo, 1998).

Table 1. Social Issues that Should Be Disclosed to the Public in Financial Reports

| Environment | Employees |
|---------------------------------------|---------------------------------------|
| 1. Production Control | 7. Training |
| 2. Industrial Waste Research | 8. Education |
| 3. Environmental Protection | 9. Health and Safety |
| 4. Energy Conservation | 10. Pension |
| 5. Conservation of natural materials | 11. Vacation |
| 6. Support activities | 12. Minorities |
| | 13. Female Workers |
| | 14. Unions |
| | 15. Industrial Accidents |
| | 16. Employee Communication |
| | 17. Employee Bonus |
| Product | Community |
| 18. Customer Safety Monitoring | 22. Donations |
| 19. Development of Community Ideas | 23. Community Activities |
| 20. Expenditures for Customer Benefit | 24. Activity Population |
| 21. Customer Control | 25. Participation in Local Government |
| | 26. Members of Social Groups |

There are three corporate reasons for disclosing social information in annual reports (Arifianto, 2008).

- Internal decision making

Management requires information to determine the effectiveness of specific activities related to corporate social goals. Data must be made available so that the costs of such disclosures can be compared with the benefits. Although this is difficult to identify and measure, a simple analysis is better than nothing.

- Product differentiation

Managers of socially responsible companies are incentivized to differentiate themselves from socially irresponsible competitors. Contemporary accounting does not distinguish costs and benefits of CSR activities.

- Enlightened self-interest

Companies publish their social alignments with stakeholders (e.g., stockholders, creditors, employees, suppliers, customers, governments, and society) so they can influence revenue, sales, and stock prices.

Profitability is the level of net profit that can be achieved by a company when running its operations. Information worth sharing to stakeholders includes profit after interest and taxes. The higher the profit earned, the greater the company's ability to pay dividends. Thus, managers not only earn bonuses, they also gain greater power in determining company policy. Higher dividend payouts reduce the costs of capital. However, management (insiders) can use this information to increase their personal benefits. Therefore, profitability becomes an important consideration.

Profitability ratios measure a company's ability to generate profits over a given period, including the extent to which the effectiveness of overall management creates benefits. Mosman et al. showed that accountability profitability ratios were more directly related to and reflected company resilience when conducting business. Profitability ratios reflect management policies and decisions about the use of corporate resources. One measure is return on assets (ROA), the ratio between earnings after taxes vs. total assets. Profitability also reflects the policies and decisions used to manage liquidity, assets, and corporate debt (Besley & Brigham, 2003). Therefore, profitability analysis is essential for the following two reasons:

- For management, profitability is an indication of the achievement of management ability. The higher the profitability, the better the management's performance.
- For shareholders, profitability provides hope higher dividends. Furthermore, companies with the high profitability typically enjoy higher stock prices. Thus, shareholder wealth increases.

Many companies evaluate the advantages to be obtained by disclosing information in order to decide whether to voluntarily disclose. In Indonesia, social conflicts related to corporate behavior have been caused by poorly implemented CSR. PT Freeport, PT Inti Indorayon, PT Samsung, PT Exxon Mobil, and New Mont are several examples (Wahjoedi, 2004).

These and many other cases illustrate the vulnerability of the business world to social conflict when CSR is low. These conditions impact the business world and investment climate, resulting in a decline in competitiveness, both at national and global levels. This, in turn, hampers national economic growth. On the other hand, there are large companies that enjoy low social conflict, because they do CSR well. Therefore, CSR and economic performance have a reciprocal relationship.

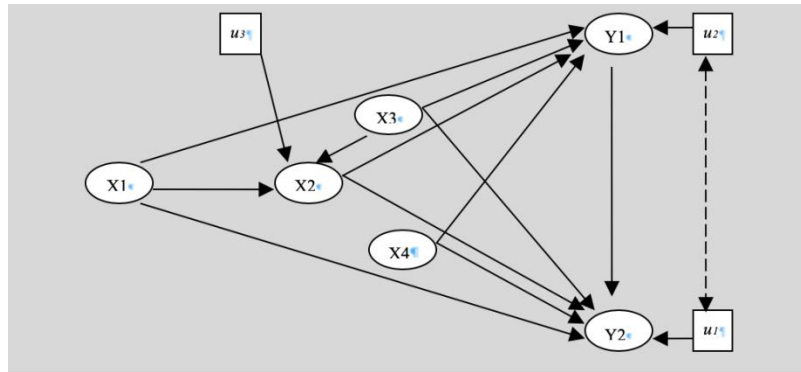


Fig. 1 Level of Profitability and Social Information Disclosure Framework in a Theoretical Causal Model.

Note: X1 = Sales Growth; X2 = Debt Level; X3 = Company Size; X4 = Public Ownership Ratio; Y1 = Level of Social Information Disclosure; Y2 = Profitability; u1 = error model-1; u2 = error model-2; and u3 = error model-3

Consumers increasingly choose product and services based on positive CSR disclosures. The Millennium Poll on CSR (1999), conducted by a team from Environics International (Toronto), the Conference Board (New York), and the Prince of Wales Business Leaders Forum (London), surveyed 25,000 respondents in 23 countries, reflecting information that shaped opinions about companies. 60% chose CSR-related qualities, whereas 40% chose corporate and brand image. Only 33% paid attention to fundamental business factors (e.g., finances, firm size, corporate strategy, management). 40% of consumers were likely to “punish” corporations with poor CSR attitudes, whereas 50% indicated they would not buy their products (see Figure 1).

There has been a lack of research linking company growth to CSR disclosure. Using the additive research model, we examined whether there is a relationship between sales growth, debt rate, firm size, public ownership ratio, and CSR disclosure levels to profitability.

Kotler demonstrated how companies maximize returns on investment through CSR initiatives (Kotler & Lee, 2007), resting on financial, social, and environmental bottom lines. The above framework aligns with Belkaoui, who said that, with community (social) awareness, management must make a company profitable (Belkaoui & Karpik, 1989). Hill et al. examined CSR practices of companies in the U.S., Europe, and Asia, and related their market values based on shares. After controlling for variables, companies that do short-term (3–5-yr) CSR did not experience significant increases in stock value. However, long-term (10-yr) CSR performers enjoyed a substantial increase in share value. Thus, short-term CSR may not provide adequate value for shareholders. However, financial conditions alone are not enough to guarantee growth in value. Sustainability can only be ensured when the company considers all CSR dimensions. The Indorayon case in North Sumatra is a good example of public pressure (Wahjoedi, 2004).

4. Conclusion

Indonesian companies have begun to realize the importance of CSR efforts. Indonesia is a disaster-prone area with slow regional growth. Companies exercising diligence with CSR reporting typically enjoy 30% tax savings, based on cost incurred. The myth that companies cannot afford CSR. On the contrary, good CSR management gives companies the flexibility to generate even more revenue over time. Company size and debt are factors considered by the company in disclosing CSR programs.

This information is useful to policymakers when influencing company reporting requirements. Although Bapepam has adopted an Annual Report Award, they have not been able to successfully measure performance across the board. Companies are expected to provide accurate, clear, and transparent information to the commu-

nity, so that reasonable social and environmental protections can be implemented. Further theoretical research is needed to examine more variables affecting CSR and disclosure.

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