International Journal of Social Science and Economic Research

ISSN: 2455-8834

Volume:02, Issue:02

THE INFLUENCE OF CSR COST IN INCREASING FINANCIAL DISTRESS

Nila Tristiarini

Faculty of Economics and Business, Dian Nuswantoro University, Semarang – Indonesia

ABSTRACT

This study examined the effect of the magnitude of CSR Cost to the possibility of the company's financial distress. CSR is a corporate activity that puts the fulfillment of stakeholder interests that could ultimately improve the long-term prosperity of the company. CSR activity would require funds to be issued by the company as an ongoing fee. The costs incurred are expected to increase the company's value in the future in the long term. However, costs incurred for CSR activities should certainly be able to be controlled by a company that is not a burden for the company that could affect the company's financial performance. With the company's inability to control the cost of CSR will increase the company's financial distress due to substantial costs for CSR activities can disrupt cash flow of the company, which in turn reduces the rate of profit. Originality of this research lies in a different perspective to look at the concept of CSR, namely at the cost of CSR and not at the disclosure of CSR as in previous studies. The study population was the whole company that includes in SRI-KEHATI index in 2009 until 2015. The sampling method in this study is using purposive sampling method. This study uses analysis tools Structural Equation Modeling (SEM) with WarpPLS program version 3.00 that is used to test the hypothesis. The results showed that the companies that issue high costs for CSR activities can positively enhance the company's financial distress.

Keywords: *Corporate Social Responsibility, Financial Distress, Efficiency Theory*

1. INTRODUCTION

Companies in their activities are certainly required to consider whether the activities that were carried out bring positive implications on improving the prosperity of the company, including when companies carry out Corporte Social Responsibility (CSR) activities. Corporate social responsibility (CSR) is a corporate activity that puts the fulfillment of stakeholder interests that could ultimately improve the long-term prosperity of the company. In accordance with the impression managemnet theory (Goffman, 1959 and Leary & Kowalski, 1990), which states that

ISSN: 2455-8834

Volume:02, Issue:02

the company conducts activities that can improve the image of the company, because the company has the goal of long-term profit maximization.

Studies that have been done previously showed that CSR activities can improve performance and even financial value of the company. The study, among others, have been conducted by Orlitzky et al. (2003), Schnietz (2005), Brine et al. (2009), Weshah et al. (2012), Servaes and Tamayo (2013), Iqbal et al. (2014), Awan & Saeed (2015) and Das & Bhunia (2016), which states that CSR has a significant positive impact to improve financial performance and corporate value. It indicates that investors react positively to the CSR activity. However, previous studies referred to the perspective of CSR disclosure of their activities, which is expected from CSR activities to improve the performance and value of companies.

The rationale of the influence of CSR charges against the possibility of financial distress is by using the concepts of efficiency theory which states that all activities of the company are expected to be carried out efficiently so as not to disrupt the continuity of the company's business, Bromley (1990). Therefore, the cost to run a CSR activity is expected not to affect financial performance which could ultimately lead to the possibility of financial distress. The concept of previous studies indicates that the implementation or disclosure of CSR can reduce the likelihood of financial distress in the company. Among other is research conducted by Goss (2009) who found that the implementation of CSR in the company negatively affect the financial distress. This research is also supported by Mecaj & Bravo (2014) who also found a negative influence of CSR to financial distress. The result of these studies show that the better and the higher the level of implementation and disclosure of CSR, it can degrade or reduce the likelihood of financial distress. In this study, CSR is not seen from the disclosure or its implementation but from how much the cost incurred by the company in carrying out CSR activities. From different perspectives, the researchers noticed that the magnitude of CSR costs can affect the likelihood of financial distress, if the cost is over-investment. So that the original purpose of the company that expects CSR activities can improve financial performance results in opposite.

This study tried to see CSR activities from a different perspective, and this is the originality of the research. The research looked at CSR from the perspective of costs incurred for CSR activities do have an impact on the likelihood of financial distress due to the over-investment of the costs incurred for CSR activities. This research needs to be done to contribute to the companies that implement CSR in order to control the costs incurred in the implementation of CSR which from the fulfillment of CSR activities that is expected to improve corporate performance and corporate value, but quite the opposite, namely become the cost that could disrupt financial performance on ultimately have an impact on the value of the company.

ISSN: 2455-8834

Volume:02, Issue:02

Based on the description of the background above, the formulation of the problem posed is how the magnitude of CSR has influence on the likelihood of financial distress of the company. This research is necessary because CSR activities that should be expected to give a positive implication on the company be exactly the opposite that will be the burden of the company that will ultimately reduce financial performance and the value of the company because the company did overinvestment on CSR activities.

2. METHOD

2.1 Population and Sample

The study population was the whole company that includes in SRI-KEHATI index in 2009 to 2015 as many as 175 companies. The sampling method in this study is using purposive sampling method, the criteria are Companies that are in SRI-KEHATI index and conduct the publication of financial statements in the research period. Thus the companies which meet the criteria as sample are 171 companies.

2.2 Research Variables and Theoretical Dimension

2.2.1 Independent Variable

The independent variables in this study are CSR Costs. CSR Cost is costs incurred by the company to carry out CSR activities. Weber (2008) developed a measurement of CSR Cost as follows:

CSR costs = donation cost + personnel costs + sustainable CSR cost + Investment cost

2.2.2 Dependent Variable

The dependent variable in this research is financial distress. Financial Distress is the stage where the financial condition decline prior to the bankruptcy or liquidation (Goss, 2009). Gordon L.V Springate has conducted research and produce a bankruptcy prediction model. Springate models are using four financial ratios to predict the potential financial difficulties in a company. Springate models can be used to predict bankruptcy with accuracy value of 92.5%. This model has the following formula:

$$S = 1{,}03\ A + 3{,}07\ B + 0{,}66\ C + 0{,}4\ D$$

Where :
A = Working capital / Total assets; B = Net profit before interest and taxes / total assets; C = Net profit before taxes / Current liabilities; D = Sales / Total assets
If the scores S> 0,862 then the company is classified as healthy and if the score S <0,862, the company is classified as potentially bankrupt.

2.2.3 Control Variable

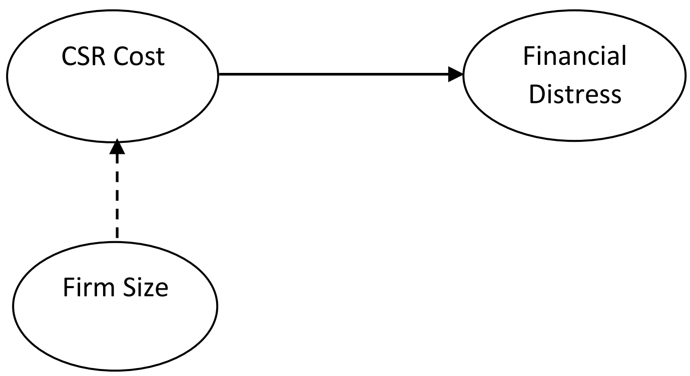
Control variables in this study are the size of company measured by the value of total assets. Total assets are the amount of current assets and long-term assets of the company.In this study the size of the company is measured with the following formula:

Total Aset = Ln (Total Asset)

2.3 Analysis Method

This study uses analysis tools Structural Equation Modeling (SEM) with a 3:00 version WarpPLS program used to test hypotheses (Latan & Ghozali, 2012). Flow chart in this study are described is presented in Figure 1:

Picture 1. *Path Analysis*



Source: developed for this research

3. RESULT AND DISCUSSION

Descriptive statistics was used to describe the characteristics of research variables that are used in this study. Therefore, an explanation of descriptive statistics of research variables is presented in Table 1.

ISSN: 2455-8834

Volume:02, Issue:02

Table 1. Descriptive Statistics of Research Variables

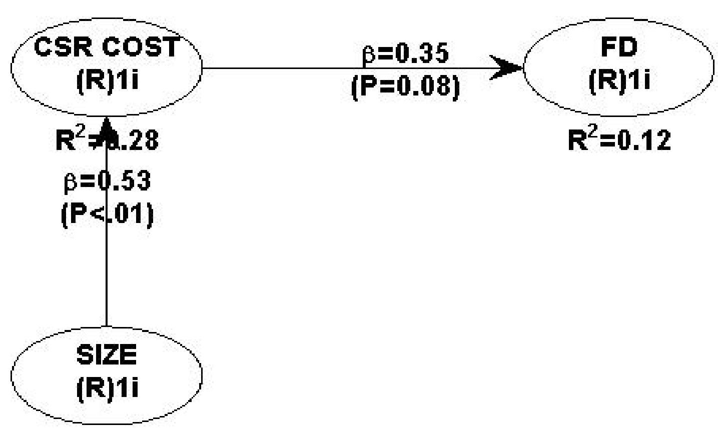
	N	Minimum	Maximum	Mean	Std. Deviation
CSR Cost	171	22,790260	31,527182	28,176758	1,423603
FD	171	-0,066925	14,076596	2,240483	1,477450
Size	171	14,870061	34,382169	30,388555	3,266773

Source: data processed used in this study
FD : *Financial Distress*
Size : Firm size

From table 1, the descriptive statistics of research variable shows that the variable of CSR Cost has an average of 28.176758 with a standard deviation of 1.423603. This shows the diversity of the data is low. The average value for Financial distress of 2.240483, with a standard deviation of 1,477450, shows that on average companies that are used as sample are classified as a healthy company (If the financial distress score obtained is > 0,862, the company is classified as healthy and if the score is <0.862, the company is classified as potentially bankrupt). While the average value of company size is 30.388555 with a standard deviation of 3.266773.

To answer the research hypothesis a path analysis that describes causal relationships between exogenous variables that is CSR Cost with endogenous variable that is Financial Distress, and control variables that is company size must be conducted. After doing a run-test, path analysis is is presented in Figure 2:

Picture 2. ***Path Analysis***



Source: data processed used in this study

ISSN: 2455-8834

Volume:02, Issue:02

Figure 2 shows the causal relationships between variables, namely CSR Cost as exogenous variables with the Financial Distress as endogenous variables, and control variable that is company size that has a path coefficient value of 0.35 with a p-value 0.08. Financial Distress (FD) has R square value of 0.12.

The test results of Path coefficients and P values to see the value of the coefficient and the level of significance is is presented in Table 2:

Table 2. Result of *Path coefficients* and *P value*

Path	**Dirrect Effect**	
	Coefficient	**P-Value**
CSR Cost →FD	0,35	0,08
Size → CSR Cost	0,53	< 0.01

Source: data processed used in this study
FD : *Financial Distress*
Size : Firm size

The test results in Table 2 indicate that the CSR Cost variable has significant positive effect on financial distress with coefficient value of 0.35 and a p-value of 0.08 (level of significance <0.10). Therefore testing of the model's equations lead to the conclusion that is consistent with the hypothesis of the study is that CSR Cost has positive effect on financial distress. This means that the higher costs incurred for CSR activities will increase the likelihood of bankruptcy of the company (financial distress). This study also proved that firm size is significantly control csr variable cost indicated by coefficient of 0.53 with a significance level of p. value <0.01.

4. CONCLUSION

The hypothesis testing that says that CSR Cost affects Financial distress is proven in this study. This shows that when companies do the financing on CSR activities, the company did over-investment, which in turn can disrupt the cash flow of the company thereby increase the likelihood of financial distress. This is done by the company in accordance with the impression management theory, which states that the company needs to do an activity that can enhance the corporate image.

The main contribution of this research is to provide empirical evidence that CSR is not only as a form of moral responsibility of companies towards stakeholders alone but more than that, CSR is a company's strategy that can be a long term financial strategy, so that CSR can be implemented

ISSN: 2455-8834

Volume:02, Issue:02

by the company not only as a burden but can provide positive implications for sustainability of company efforts. Based on empirical research model that has been developed in this study, the research problem that has been proposed can be justified with the explanation of the test results is that the company's inability to control the cost of CSR can increase the likelihood of financial distress.

REFERENCES

Awan, Abdul Ghafoor & Sobia Saeed. (2015). Impact of CSR on Firms' Financial Performance: A Case Study of Ghee and Fertilizer Industry in Southern Punjab-Pakistan. *European Journal of Business and Management* Vol.7, No.7.

Brine, M., Brown & Hackett G. (2009). Corporate social responsibility and financial performance in the Australian context. Corporations and Financial Services Division, the Australian Treasury.

Bromley, Daniel W. (1990). The ideology of Efficiency: Searching for a Theory of Policy Analysis. *Journal Of Environmental Economics And Management* 19, 86-107.

Das, Lakshmi & Amalendu Bhunia. (2016). The Impact of CSR on Firms' Financial Performance – A Literature Review. *American Journal of Business, Economics and Management* 4(4): 66-74.

Goffman, Erving. (1959). The Presentation of Self in Everyday Life, Garden City, NY: Doubleday.

Goss, A. (2009) Corporate Social Responsibility and Financial Distress. ASAC, Niagara Falls.

Iqbal, Nadeem, Naveed Ahmad & Naqvi Hamad. (2014). Corporate Social Responsibility and Its Possible Impact On Firm's Financial Performance In Banking Sector Of Pakistan. *Arabian Journal of Business and Management Review* (OMAN Chapter), Vol. 3, No.12.

Latan, H & Imam Ghozali. (2012). Partial Least Squares: Konsep, Metode dan Aplikasi Menggunakan Program WarpPLS 3.0. Badan Penerbit Universitas Diponegoro.

Leary, Mark R. and Robin M. Kowalski. (1990). Impression Management: A Literature Review and Two-Component Model. Psychological Bulletin Vol. 107, No. I, 34-47

ISSN: 2455-8834

Volume:02, Issue:02

Mecaj, Arjola &María Isabel González Bravo. 2014. CSR Actions and Financial Distress: Do Firms Change Their CSR Behavior When Signals of Financial Distress Are Identified? Modern Economy Scientific ResearchVol. 5, pp. 259-271

Orlitzky, M., Schmidt, F. & Rynes, S. (2003). Corporate Social and Financial Performance: A Meta-analysis. Organization Studies 24(3): 403–441, SAGE Publications, London, Thousand Oaks, CA & New Delhi.

Schnietz, K. & Epstein, M. (2005). Exploring the Financial Value of a Reputation for Corporate Social Responsibility During a Crisis. Corporate *Reputation Review* Vol. 7, No. 4, pp. 327–345.

Servaes, Henri & Ane Tamayo. (2013). The Impact of Corporate Social Responsibility on Firm Value: The Role of Customer Awareness. *Management Science* Vol. 59, No. 5, May 2013, pp. 1045–1061.

Weber, Manuela. (2008). TheBusiness Case for Corporate Social Responsibility: A Company – Level Measurement Approach for CSR. *European Management Journal*, No. 26, pp. 247-261.

Weshah, Sulaiman R., Ahmad A. D. & Mohammed R. & Emma S. (2012). The Impact of Adopting Corporate Social Responsibility on Corporate Financial Performance: Evidence from Jordanian Banks. *Interdisciplinary Journal of Contemporary Research in Business*, Vol. 4 No. 5, pp. 34-44, September.

