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**STUDY ON CORPORATE SOCIAL RESPONSIBILITY
DISCLOSURE'S INFLUENCE ON COMPANY'S
PROFITABILITY IN MALAYSIA**



BY

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**A thesis submitted to
School of Economics, Finance and Banking
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In Partial Fulfillment of the Requirement for the
Master of Science (Finance)**



**Pusat Pengajian Ekonomi,
Kewangan dan Perbankan**

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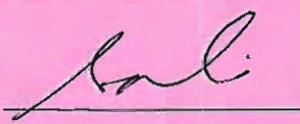
**STUDY ON CORPORATE SOCIAL RESPONSIBILITY DISCLOSURE'S INFLUENCE ON
COMPANY'S PROFITABILITY IN MALAYSIA**

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ABSTRACT

The purpose of this study is to investigate the relationship between Corporate Social Responsibility (CSR) as disclosed in the financial report of public listed companies in Malaysia and corporate financial performance which is represented by return on equity (ROE). A sample of 130 company's annual reports were analyzed to represent a sample data on CSR disclosure index and ROE for the period of study between 2007 and 2009. In addition, this study also adopted the debt ratio to act as a controlled variable. Finding of this study reveal the CSR as well as the debt ratio have significant and negative relationships with the ROE. The negative impact of the CSR on the ROE does not really support the stakeholder theory as what this study has hypothesized in the beginning. Nevertheless, these results may be affected by the costs of the CSR activities which could have caused an increase in companies' expenses, hence reducing companies' profit.

Keywords: Corporate Social Responsibility, ROE, public listed companies

ABSTRAK

Objektif utama kajian ini adalah untuk mengkaji hubungan diantara pelaporan tanggungjawab sosial korporat di dalam laporan kewangan tahunan syarikat dengan prestasi kewangan syarikat yang diukur dengan menggunakan nisbah pulangan keatas ekuiti syarikat. Laporan kewangan tahunan daripada 130 syarikat yang disenaraikan oleh Bursa Saham Malaysia telah diambil sebagai sample dan dianalisa, data tersebut menggunakan Indeks Tanggungan Sosial Korporat dan nisbah pulangan keatas ekuiti yang merangkumi data dari tahun 2007 hingga 2009. Sebagai tambahan, kajian ini telah menggunakan nisbah hutang sebagai pembolehubah terkawal. Hasil kajian ini menunjukkan tanggungan social korporat dan nisbah hutang mempunyai hubungan yang ketara tetapi negatif dengan nisbah pulangan ekuiti. Impak negatif diantara tanggungan social korporat dengan nisbah keatas ekuiti ini tidak menyokong *stakeholder's theory* seperti yang di hipotesiskan. Kemungkinan, keputusan kajian ini ada implikasi daripada kos yang terbit daripada aktiviti tanggungan sosial korporat yang mungkin meningkatkan perbelanjaan syarikat, dan secara tidak langsung memberikan kesan kepada kadar keuntungan syarikat.

Kata kunci: Tanggungan Sosial Korporat, Pulangan Ketaas Ekuiti, syarikat awan yang tersenarai.

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CHAPTER ONE

INTRODUCTION

1.0 INTRODUCTION

Corporate Social Responsibility (CSR) in Malaysia was traditionally motivated base on religious and racial values (Mustaruddin, Norhayah & Rusnah, 2010). With Malaysian government's awareness on CSR, method and technical for implementation of CSR related matters were developed. Among this guideline CSR Silver Book published by government GLC radical programme which provides companies in Malaysia a benchmark and measurement tool for CSR and as tool to measure the performance and effectiveness of the published policy. Bursa Malaysia, is a company also known as an exchange holding company, has published a CSR guideline in 2007 as a reference and guide for Public Listed Companies in Malaysia in order to carry out the implementation and report disclosure on CSR which focuses on 4 areas, namely work place, environment, community and market place.

In the year 2007, it became a mandatory for corporation listed on Bursa Malaysia to report the companies CSR practise or activity. The matter of CSR was brought even further in line with the government effort to introduced tax incentives for companies that implement CSR programs. A fund of RM 50 million was established by the Malaysian government to promote CSR activities. The corporation that demonstrate a good level of CSR practise will be recognized by the Malaysian Government and will be presented with the Prime Minister's CSR Awards at the end of each year starting from 2008. The

effort taken by the Malaysian Government is mainly to encourage more and more companies to comply and facilitated the adoption of CSR as a part of their company core values and strategy.

The important value of CSR most of the time is overlooked by the company where company do not really focus on the objective of reporting but only report it for the sake of reporting only. Most companies always eager to have their firms' brand names to be mentioned by the media. Bursa Malaysia notifies this issue since then pressure for long-term planning with higher levels of commitment and involvement and performance indicator rather than individual donations.

CSR activities focus on the action to preserve so that the environment won not be very critical element in Malaysia compared to European companies, where the environment issue becomes the second objective after the economic benefit of companies. In a survey on Bursa Malaysia's listed companies tend to score very low marks on environmental domain, (Azlan & Susela, 2007). However, things are different with most nongovernmental organizations (NGOs) where they advocate for green efforts in Malaysia. Big structures such as like the Bakun Hydraulic Dam in Sarawak, the proposed Coal Power Plant in Sabah and the proposed 100 storey Mega Tower capture a lot of public attention because of their long term on the environment. These show that Malaysian are paying attention on matters related to environmental issues and companies to be responsible for it.

The practice of CSR in Malaysia among publicly listed corporations are still at the beginning stage. The CSR understanding in the Malaysian Companies are at insignificant level compared to the companies in developed countries. Therefore, professional bodies, NGO's and the Government have taken various efforts to promote awareness of CSR to Malaysian companies by encouraging them to practise and disclose their CSR activities.

1.1. PROBLEM STATEMENT

As mentioned earlier, we are at the very beginning stage in CSR disclosure and can be said that very little concern been given by the companies on aspects regarding CSR. Most of companies are focusing on the factors that contribute inflows to the company to maximise the profitability of the company itself. The importance of CSR, in most part, has been ignored. To break this misconception, this study is carried out to show how CSR information can influence the financial profitability of a company which is the major concern of most companies. A lot of studies have been carried out to show the importance of CSR disclosure to the wellbeing or the wealth of the organisation. According to Gamerschlag (2010) from an economic view point, corporation is likely to disclose this type of information to avoid or lower the political cost. Their study indicates, that higher profitability is related to more disclosure on environmental. In addition, Dhaliwal and Radhakrishnan (2012) find that, the CSR disclosure is more likely to have an effect on company's financial performance. The relationship is greater for companies and country with more financial disclosure, suggesting that the issuance

of stand-alone CSR report plays a major role and complementary to financial reporting. Furthermore a study by Norhayah, Mustaruddin and Rusnah (2010), reveals that Malaysian Public Listed Companies (PLC) have the potential to attract and maintain the investor by involving in social activities. Even though there are number of studies on CSR, an empirical examination of the relationship between CSR and financial performance in the emerging market context is still limited.

1.2. RESEARSH QUESTIONS

The research questions of this study include:

1. Based on observation, what are the practises of CSR in Malaysia?
2. Is there any significant positive relationship between firm's performance and Corporate Social Responsibility disclosure in Malaysia?

1.3. RESEARCH OBJECTIVES

The research objectives of this study include:

1. To highlight the practises of CSR in the Malaysian business environment.
2. To examine the relationship between firm's performance and CSR disclosure in Malaysia.

1.4. SIGNFICANT OF STUDY.

This project paper is aim to give awareness to investors, stakeholders, shareholders and government on the effect of annual reporting of CSR related information in companies

financial reporting on company's financial performance. Result of this study can be used by the government to revise existing policy with regards to the CSR disclosure imposed on companies in Malaysia.



CHAPTER TWO

LITERATURE REVIEW

2.0 INTRODUCTION

In this chapter we define some concepts which are related to this study such as the definition of Corporate Social Responsibility (CSR) and reporting. Besides that this chapter also gives some overview of CSR understanding and the reporting status in Malaysia. We also discuss some theoretical and conceptual element of CSR and financial performance.

2.1. REVIEW OF RELATED LITERATURE

There has been significant growth in Corporate Social Responsibility (CSR) related matter (Haniffa & Cooke, 2005). There are many factors that cause the managements to disclose CSR internally. According to Deegan (2002), it is perceived that with the CSR disclosure, a particular companies will have better reputation and able to show compliance of certain legislation and able to attract fund. Muhamad and Zulkifli (2010) say that CSR disclosures in Malaysia are increasing progressively year by year. However, the level of information being disclosed is still limited to general statements.

According to Tsang, Yang and Dhaliwali (2011), a company's image, repo and long term revenue will be affected by poor CSR performance. This study examines the benefit of CSR disclosure 31 countries. Taking variables such as the CSR disclosure needs, legal status of labour protection, and public concern of and reaction toward CSR

issues, the scholar have divided the countries into more and less stakes oriented groups to capture the negative relationship between CSR and the cost of the capital. The relationship is more significant in stakeholders' oriented countries.

According to Snider (2003) public confident drops due to some controversially issues on financial matters such as what had happened to Lehman Brothers, Arthur Anderson and Enron Corporation. These issues lead to a strong need for CSR activities in way to change the company's reputation especially those with a negative reputation. It is also said that the CSR activities can be used to enhance the social awareness of consumer on a company, as it can bring in the brand image for the company and develop a positive relationship with the stake-holders.

According to Roberts and Mahoney (2007) the level of involvement of the company with CSR does not only improve the financial performance, but at the same time can attract positive responds from the investors. Therefore a company should realize that, CSR and financial performance are two important elements that compromise each other. The more actively involvement of a company in CSR would improve its financial performance, and the better the financial performance the higher the ability of a company to involve in a CSR activity. These relationships have been highlighted in studies by Robert and Mahoney (2007), Tsoutsoura (2004), Simpson and Kohers (2002), McGuire (1988) and Cochran and Wood (1984). For the Malaysian PLCs, as the public demand for good CSR companies should consider and take an effort to implement CSR in their business operation. It is also very important to demonstrate a good CSR practises in PLC's in Malaysia to support the government in attracting foreign direct investment

to invest in Malaysia. Due to this, CSR can be used as a tool to attract investor and to improve financial performance of a company. Siegel and McWilliams (2001) stress that cost on CSR activities should be evaluated and analysed as part of an investment decision making.

Generally, most of the surveys indicate that there are lack of knowledge and awareness of CSR among Malaysian PLCs. The result shows that still majority of companies are way too far from global best CSR practises and this triggers compulsory needs to improve the level of CSR. Even though there are various studies done in the context of the relationship between CSR and financial performance, studies on emerging market are still limited. The lacking of studies on these issues might be one of the reasons why Malaysian PLCs are still not showing an encouraging involvement in promoting CSR activity to stake-holders. Thus, by using the CSR disclosure in financial reporting as tools of CSR practices, this study is an effort to find out as well as to fill the gap thru empirically examining the impact of CSR on companies' financial performance within Malaysian context.

2.2. DEFINATION OF CSR

The definition of CSR is not abstruse. Business for Social Responsibility (BSR) defines; CSR as achieving commercial success in ways of ethical values by respecting people, communities, and the natural environment. Siegel and McWilliam (2001) define CSR as actions that appear to further some social good, beyond the interest of the firm and that

which is required by law. McWilliams and Siegel (2001) also state that the action on noticing CSR is more to law compile. Alternatively, according to Freedman (1988), the definition of CSR is the following, an action by a firm, which the firm chooses to take, that substantially affects an identifiable social stakeholder's welfare. A socially responsible corporation should take a step forward and adopt policies and business practices that go beyond the minimum legal requirements and contribute to the welfare of its key stakeholders. CSR is viewed, then, as a comprehensive set of policies, practices, and programs that are integrated into business operations, supply chains, and decision-making processes throughout the company and usually include issues related to business ethics, community investment, environmental concerns, governance, human rights, the marketplace as well as the workplace.

2.3. CSR IN MALAYSIA

The understanding of CSR in Malaysia is still at immature stage. For the time being only non-governmental organization and professional bodies are actively promoting the importance of CSR. For example, World Wide Fund for Nature (WWF) Malaysia, Federation of Malaysia Consumer Association, Business Ethics Malaysia and Association Certified Chartered Accountant (ACCA) contribute to numerous actions on social and environmental awareness (Abdul H & Atan, 2011).

A number of Malaysian Public Listed Companies (PLCs) have been integrating CSR activities across their businesses (Abdul H. & Atan, 2011). However, most of the PLCs

get low scores, and this indicates their low understanding of the CSR, especially on how it fits for their operations. According Atan and Abdul H. (2011) 40 percent of the Malaysian PLCs fall below average band, 27.5 percent fall into average band and only 32.5 percent fall above average band. Many attempts have been made by few organizations to increase the awareness of social reporting in Malaysia. There are some differences on how the CSR being carried out in Malaysia compared to other countries in terms of socio-economic and culture aspect. There are some special characters of CSR in emerging countries such as (Mustariddin, 2010):

- In emerging markets, CSR activities are less formalized in terms of CSR benchmarks, compared to developed markets.
- Formal CSR is utilized by big national and multinational corporations and particularly those that have recognized global brands or have international status.
- Commonly in emerging markets, CSR is mainly related with philanthropy or charity for example social investment in education, sport sponsorships, and public health, and other community services.
- An economic contribution is usually assumed as a crucial and practical method for companies to create social effects such as work opportunities, knowledge transfer and paying taxes.

- The motivation and involvement in CSR practices is usually related to traditional and spiritual values.

Malaysia consists of 3 large ethnic groups which are Malay, Chinese and Indian. Hence, Malaysian companies have a unique work culture known as “work ethos of eastern ethnics”, such as industry, mutual cooperation and adherence to their religious precept (Mustariddin, 2010). Generally Malaysian managers are interested to disclose the CSR related information to a focused interest group, and not to general shareholders. Susela and Azlan (2007) state that external primary stakeholders, such as the government and capital market authorities, have also exerted force, through acts and regulations, for companies to get involved with CSR activities. An example can be seen from the CSR framework for PLCs released by the Bursa Malaysia.

According to Haniffa and Cooke (2005), CSR practices in Malaysian companies are still growing and they include seasonal activities. Gardiner (2003) and Seifert (2003) stated that the size of a business is an important variable in CSR, and acts as a barometer as to why a company engages in CSR activities. The commitment of involvement of a Malaysian company in CSR increases by the involvement of the government and the Security Commission as a way of promoting CSR. Prathaban (2005) records that 65 companies registered on Bursa Malaysia contributed RM82.1 million to various charitable community programmes.

In a study done by Norhayah and Azlan (2006), they mention that the CSR activities of the Malaysian companies are usually done in the same area as their business activities. For example, Maxis Corporation brings out the direct advantages to community by promoting social development advances in information technology. The Telekom Malaysia Group brings in the digital bridge to enlighten the rural area and urban area, indirectly helps Malaysia to move one step further. In addition, Puncak Niaga Company has taken a step to increase public awareness on protecting the environment. The Public Bank Group also has a strongly belief that the company can increase its reputation and branding by complying with the CSR disclosure. Ethnicity and religion are also influencing factors for CSR activities in Malaysian companies (Norhayah & Azlan, 2006). For instance, we can see a lot of companies have shown their awareness on community by distributing some goodies during festivals. Tay Kay Luan, the Director of ACCA, Association of Southeast Asian Nations, and Australia, says that most local companies have a narrow view of the definition of CSR. The perception of Malaysian companies and leaders of the government upon CSR only restricted to do good for the community by contributions. Therefore, the CSR activity tends to focus more on activities that have direct impact on the company wealth being.

Prior studies find that Malaysian companies are involved in CSR because of the pressure from the government (refer to Azlan and Susela, 2008, Haniffa and Cooke, 2005). Azlan and Susela (2008) also state that the influence of a foreign business partners is also a contributing factor for engaging in CSR. Although, some pressure exists, Williams and Pei (1999) said that the involvement of CSR for the Malaysian PLCs has still not been

translated into a higher level of social activity and disclosure. Williams and Pei (1999) also mention that the stakeholder's require companies to be more actively involved in CSR practices as, the stakeholders are not satisfied with the numbers of companies involved in CSR practices.

2.4. THEORETICAL LITERATURE

Various studies have been shown worldwide on utilization of various different theoretical approach explaining the relationship between CSR and profitability of a company. There are 4 postulates of the theoretical relationships between CSR and financial profitability which are (Mustariddin, 2010):

- the trade-off hypothesis
- the supply and demand theory of the company
- the social impact of hypothesis
- the theory of modern corporate stakeholder explained

Trade off hypothesis, brought by Friedman (1970) where he said the only social responsibility of a company is to enhance its profits. When a company becomes involved in social and environmental activities, it incurs extra expenses and decreases the earnings of the companies. Therefore, a higher level of CSR disclosure is associated with a lower company's profitability. This situation puts the company with high social activity in a critical financial position compared to a company that does not involve in

any social activity. Looking at this scenario, the CSR can cause a negative impact on the profitability of a company.

The supply and demand theory of the company was introduced by McWilliams and Siegel (2001). Based on this theory the demand for participation of a company in CSR will increase the company profit. According to Steger (2007) in an equilibrium condition, the level of CSR may be different, however, profit may be maximized or not changed. Hence, there is no relationship between CSR and corporate financial performances (CFP). Empirical findings by Robert and Mahoney (2007) support this theory.

The social impact hypothesis constructed by Cornell and Shapiro (1987) said that the improvement of a company's CSR activities will improve profitability of company. Observation by Graves and Waddock (1997), and Robert (1992) concluded that the CSR has a positive impact on company's profitability.

Thus the predicted advantages of CSR will exceed the expenses in doing or carrying out that CSR activity. There are a few reasons for CSR disclosure (Mustariddin, 2010):

- it improves the reputation of the business
- it improves the relationship with financial institutions
- it reduces the risks of the company.

The finding of Barnett (2007), Mc Guire (1998), Jones (1995) and Shapiro and Cornell (1987) mention that the theory of stakeholder can explain the relationship between CSR and the profitability of a company. Based on these theories of stakeholder, the cost of both explicit claims and implicit claims on company resources is related to the values of a company resource. Stakeholder has an explicit claim on a company including employees, owner lender, and the government. Implicit claims demonstrate many claims on the company management towards external shareholder. Cornell and Shapiro (1987) said that, some implicit claims consist of the continuity of supplies, on-time delivery, and the increase in the quality of products, work safety, as well as involvement in social and environmental activities. The price that must be paid by stakeholders for this claim depends on the company's situation, including the financial policy applicable to the company.

The purpose of this section is based on past argument and theoretical relationships between CSR and profitability. The researchers realise that an organisation is simply oriented in the interest of that company, but still likely to contribute in efforts to increase the organisation performance. Based on the arguments on the theories in this section, those theories stress that the relationships do exist between CSR and a company's profitability. For instance, the trade-off theory supports that there is a relationship between CSR and company profitability, but the relationship is not direct. On the other hand, the stakeholder theory seem more acceptable and reasonable in explaining the relationship between CSR and profitability. This theory expresses that the interest of stakeholders is considered by the company in getting involved with the CSR activities.

2.5. MALAYSIA CONTEXT ON CSR AND CFP

A theoretical issue rises by studies of CSR in Malaysia. It seems in Malaysia managers have very high awareness but it does not follow with effort to make CSR disclosures. Abdul Hamid (2004) argues that, managers' awareness is a result of public pressure and thus should be reflected in the companies' reports in order to appear legitimate. The regulatory and political pressure on the company is believed to be one of the most important factors that influences the level of CSR (Azlan & Susela, 2007).

This study is an effort to reveal the evidence of activity related to CSR with represented by CSR disclosure in Malaysian PLCs. It also believed to be explained by the stakeholder theory because it is useful to explain voluntary CSR disclosure for two reasons. First, it distinguishes the social activity and stakeholder issues. Clarkson (1995) argued that managers deal with their company stakeholders and not with the public as a whole. Secondly, in developing a testable hypothesis, it seems like the stakeholder theory is more appropriate as mentioned by Elijido-Ten (2004). Therefore, for the purpose of this study, this theory is useful for interpretation of the analysis because stakeholder theory can be utilized as a guide for framework to test the empirical relationship between CSR and profitability has been said by Ruf (2001). CSR disclosures are still unregulated in companies in Malaysia. Hence, the stakeholder theory offers a practical framework to assess CSR by using information from Corporate Social Responsibility Disclosure (CSR D) as mentioned by Snider (2003).

Prior studies by Azlan and Susela (2007), Abdul Hamid (2004), Nik Ahmad and Malia (2004) revealed that besides the stakeholder theory, many studies in CSR, is utilizing the legitimacy theory, especially in the Malaysian context. Generally, these theories are from the political economy theories said Moerman and Laan (2005). These theories are not competing or separating each other, but are often be interpreted using the overlapping perspectives based on the political economy approach mentioned by Abdul Hamid (2004). Even though there a many differences on these two theories but the focus and objectives of the two theories are the same which is to explain the relationship between CSR disclosure and company's profitability. If we look in the aspect of business and academic literature, the stake holder theory is gaining prevalence in current years as it can be applicable to both researcher and manager's perspective.

Azlan and Susela (2008) assert that, the pressure of the government is a dominant factor in motivating the involvement of the Malaysian PLCs in CSR practices. As the market is highly competitive, companies should take initiative to improve their involvement in CSR activities as a strategy to sustain their businesses. Furthermore, if a company strategy planning is to going global or worldwide the involvement in CSR will add value because consumers in developed countries are more concern on CSR issues. Therefore, the topic of CSR involvement by Malaysian PLCs is becoming a requirement for a company planning to enter the global market and to attract the funding from investors.

Additionally, the educational level of the local consumers has also improved and are playing more active role in ensuring high commitment from companies as what Haniffa and Cooke (2005) found out. Other than that, there are also some pressures on the

companies to be more concern with social responsibility and the surrounding environment that they are operating with, mostly by environmental NGOs. NGOs are increasingly playing as important role to urge companies to be more socially responsible and in lobbying the government agencies with regard the CSR issues as indicated by Othman and Ameer (2010).

Due to heavy pressure various group, companies in Malaysia are more selective in retaining the best employ and employees and pursue a continuous innovation and product development indirectly also improving the companies competitive advantages in both local and global market. Therefore, it is reasonable to treat the involvement in CSR as a part of companies' investment for better competitive advantages and to attract more investors in order to improve the financial profitability of the company. The achievement of objective Vision 2020 to transform Malaysia into high income and developed country, involvements of company in CSR activity indirectly contribute to that achievement. Therefore, to clarify CSR disclosure practise in Malaysia PLCs can be explained by using stake holder theory and this was discussed by Othman and Ameer (2010) and in this study it can be utilized as a guideline to move further on the analysis of the relationship between CSR and profitability's in Malaysia PLC's environment.

2.6. MEASUREMENTS OF CORPORATE FINANCIAL PERFORMANCE

Mostly past studies used accounting data to represent the corporate financial performance (Tsoutsoura, 2004; Cochran and Wood, 1984). For example, three accounting variables that have been used are as below:

- return on assets (ROA)
- return on equity (ROE)
- return on sales

Simpson and Kohers (2002) use loan losses and ROA, whereas Berman (1999) uses ROA. In addition, three accounting return measures are applied initially as follows:

- the ratio of operating earnings to assets
- the ratio of operating earnings to sales
- excess market valuation

Murray (2006), Abbott and Monsen (1979) and Alexander and Buchholz (1978) use the investors' returns as proxies for financial performance. On other hand, Han and Suk (1998) employed stock returns as a dependent variables to represent financial performance and they adopt asset pricing framework as their model. According to McGuire (1988), both accounting and market variables look for different aspects of performance, and each is subjected to a particular bias. The possibility of distortion of inflation is likely to rise by the usage of accounting data. (Demsetz & Villalonga, 2001). While short-term stock returns are very volatile for a reliable measure of corporate

performance, long term returns will capture corporate performance as mentioned by Han and Suk (1998).

In summary, majority of previous research and studies have shown some major influence of CSR disclosure to the company performance in term of profitability or the financial performances.



CHAPTER THREE

METHODOLOGY

3.0 METHODOLOGY

This chapter covers the research method employed in this study. In achieving the objectives, apart from observing the trend in CSR application in Malaysia, this study also employs a panel data analysis to examine the potential relationship between CSR and corporate financial performance.

3.1. RESEARCH DESIGN

In examining the relationship between CSR and corporate financial performance, this study employs the data of 130 companies for the period of 2007 to 2009. The period was selected base on the implementation year of the CSR disclosure. Return on Equity (ROE) is the independent variable and CSR is the dependent variable. Apart from that, this study is also employing the debt ratio of a company as a controlled variable. Observation and analysis of annual reports and annual financial statements are the main methods of data collection for this study.

In this study, annual reports of 130 public listed companies listed on Bursa Malaysia's main market for years 2007 until 2009 are taken from the Bursa Malaysia official website (Bursa Malaysia, 2011). The companies included in this study are those within

the industrial sector. The reason of adopting this period of study is because the annual reports provides the information of CSR practised by PLCs where the disclosure becomes mandatory by the Malaysia Government starting 2007.

3.2. THEORETICAL FRAMEWORK

As mentioned earlier, this study carried out to investigate the relationship between Corporate Social Responsibility Disclosure (CSR D) and the financial performance of listed companies in Malaysia. The theoretical framework of this study is presented in Figure 1 below.

CSR disclosure explains the detail of CSR practise of company and this information can be gathered from the company's annual financial reports. Content analysis, similar disclosure scoring method is used as a measurement tool of CSR disclosure in this study.

The selection of item for inclusion is based on their relevance to Malaysia environment, which are classified into four indicators of CSR disclosure. Prior studies use five categories of content analysis but with different themes (refer to Haniffa and Cooke, 2005, Thompson and Zurina, 2004). Abdul Hamid (2004) use four categories and Nik Ahmad (2003) identify six types of CSR D. The number of companies that have reported on the energy theme is very rare and less than 1 percent (Thompson & Zurina , 2004). Therefore, for the purpose of this study, the energy component is considered to be part of the environment theme. This study identifies four categories of CSR D as below:

- employee information

- community involvement
- product or services information
- environmental dimension

A research instrument is designed covering items relating to the four themes and the measurement in terms of number of CSRD item is captured as an index.

CSRD index is an approach to scoring items. If the company discloses the CSR item, it scores 1, otherwise, it scores 0. To ensure that judgement of relevance is not biased, the entire annual report is read before any decision is made (Cooke, 1992). The score for each item is then summed up with equal weightage to derive the final score.

3.2.1. Controlled Variable

Previous studies have employed company size, risk and research and development intensity as control variables. Different studies used different variables as a proxy for size. Net log of sales was used in the study of Belkoui and Karpik (1989), while Chen and Wang (2011) employed total assets. Waddock and Graves (1997) used total assets, total sales and number of employees. Deegan and Rankin (1996) used annual sales of the firm in their study. The study of Patten (1992) summarized the predictors of size used in prior studies some of which are number of employees, number of shareholders, total assets, total sales, owners' equity, net worth, lines of business, average revenues and log of sales. Waddock and Graves (1997) also defined size as a significant variable

since the socially responsible behaviour disclosed by larger firms tend to be more than those disclosed by smaller firms.. In order to control for the financial risk of the company and measure the effect of the financial policy on performance, this study employs the ratio of debt (DEBT) as a control variable. Salama (2005) indicate that the increase in the amount of debt that is undertaken by the company results in an enhanced monitoring of the company by private and governmental creditors. Thus, the business risk is to be reduced according to the principle agent reasoning. A study Salama (2005) signals a significant and negative relationship between the level of debt and firm performance. As this study investigates the link between CSR and performance, it is crucial to include the level of debt as a control variable.

3.2.2. Corporate Financial Performance

Earnings Per Share (EPS) growth, stock price change, price per share change, Return On Equity (ROE), average ROE, Price Earnings (P/E) ratio, net income, net profit margin, operating earnings/assets, operating earnings/sales are some of the variables that have been used by empirical studies to denote firm's performance (Ullmann, 1985). McGuire (1988) used both accounting and stock-market-based measures. The accounting based measure employed by this study is ROE. Profitability measured by Huselid (1995) is the average ROE. In order to capture financial performance we used accounting based measures of ROE. The theoretical framework of this study is as follow:

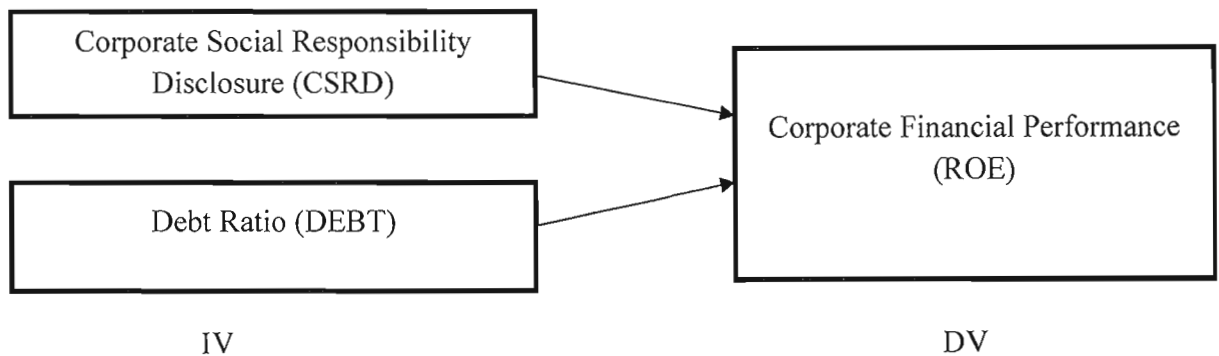


Figure 1.1: Theoretical Model

3.4. HYPOTHESIS DEVELOPMENT

Prior studies have hypothesized and state rational theoretical justifications for the entire possible outcome in which the relationship can be negative, positive or neutral between the CSR disclosure and financial performance. Waddock and Graves (1997) and Preston and O'Bannon (1997) have published the explanation in a very conceptual way of these relationship managerial opportunism hypothesis, is the rationale for a negative type of relationship, explaining that when companies overly involved in CSR activities, the managers tend to slow down the social activities, so that the short term profit can be increased, as argued by Preston and O'Bannon (1997). In other words, if the financial performance is not good, the managers try to divert the focus and spending more to CSR activities.

A natural relationship is supported by argument that the environment, wherever firms and community undertake their respective activities, is so complex that a simple, direct, relationship between CSR and financial performance does not exist (Waddock &

Graves, 1997). Larger number of investigation found a positive relationship (Waddock and Graves, 1997 & McGuire, 1988). Looking at the objective of the study the hypothesis of this study is as below:

- H1: CSR disclosure has a significant positive influence on the corporate financial performance (CFP).



CHAPTER FOUR

RESULTS AND DISCUSSION

4.0 INTRODUCTION

This chapter basically consists of three parts; first, we interpret the results of descriptive statistic for each variable. Secondly, the relationship is analysed using the panel Generalize Least Square (GLS) of a cross section weights. In this part, we identify the relationship between the dependent variable, ROE, and the independent variables, CSR and debt ratio. The interpretation on R-squared reveals the level of influence of the independent variable to the dependent variables.

4.1. REGRESSION RESULTS

In the panel data regression, we have done an observation on the dependent variable on a period of time and different point of time. So, the use cross section weight test with a fix effect fixes this by employing differences between cross- sectional entities and allowed intercept to change (Baltagi, 1995)

4.1.1. Descriptive Statistics

Table 4.1 highlights the descriptive statistics of ROE, DEBT and CSR. From the 390 observation, ROE has the mean of 0.03203, DEBT has the mean of 0.024521 and CSR

has the mean of 0.706731. The median is 0.039472 for ROE, 0.230612 for DEBT and for CSR is 0.707895. Otherwise for standard deviation ROE carries 0.583, DEBT carries 0.523476 and CSR carries 0.099.

Looking at the statistic, it show averagely ROE have a return on 3.2 percent on share invested. DEBT show 0.2 which an reasonable level of debt and on the other hand CSR show 70 percent of CSR component being disclose in the financial report.

Table 1.1: Descriptive Statistics for ROE, DEBT and CSR

	ROE	DEBT	CSR
Mean	0.030264	0.024521	0.706731
Median	0.039472	0.230612	0.707895
Maximum	3.483143	3.842671	0.995789
Minimum	-3.392540	0.384571	0.447368
Std. Dev.	0.583527	0.523476	0.092789
Skewness	-2.492854	-2.144871	0.034938
Kurtosis	36.739543	32.118762	2.950303
Jarque-Bera	27492.12	34791.11	0.119478
Probability	0.000000	0.000011	0.942010

4.1.2. Estimation Result

The panel EGLS of cross section weights regression models results show that the CSR is statically significantly at a level of 1 percent. It means that the hypothesis Ho, that no relationship between CSR_{it} , Corporate Social Disclosure at time t with ROE_{it} , return on equity at t was rejected at 1 percent level of significant. The result suggested that the coefficient of CSR_{it} corporate social responsibility disclosure at time t was -0.276088 where its value is negative. Hence, a 1 percent increases in variable of CSR disclosure was resulting 27.60 percent decrease in return on Equity (ROE). Otherwise for the

control variable, DEBT, the result suggested that the coefficient of $DEBT_{it}$ corporate social responsibility disclosure at time t was -0.093243 where its value is negative. Hence, a 1 percent increases in variable of DEBT results 9.324 percent decrease in return on equity (ROE).

Table 1.2: The Panel EGLS Result for Cross Section Weights

Independent Variables	Coefficient	t-statistic	p values
CSR	-0.276088*	-5.906964	0.001
DEBT	-0.093243	-0.830232	0.001
C	0.271226*	11.81992	0.001

Note: * Significant at 1% level
R-Square: 0.182885
Durbin Watson stat: 0.231446

R- Square is one of major element in an econometric analysis where it indicates how many percent that dependent variable fall into independent variable definition. In other words, in this multiple regression model, R- Square refers to the percentage of the total sample variation in dependent variable is explained by the independent variables (Wooldridge, 2009). Thus, it means that about 18.28 percent of variation in *ROE*, is explained by the *CSR*, and the *DEBT*.

4.2. DISCUSSION OF RESULT

As mentioned earlier, the objective of this study is to highlight the practise of CSR in Malaysian business’ environment and to examine the relationship between CSR disclosure and companies performance in Malaysia, Hence, we foresee that the EGLS, Cross section weight model is the most suitable model in our analysis. We conclude that

the CSR and DEBT are two important explanatory variables that allow the ROE to change significantly. The equation of the results is as follows:

$$ROE_{it} = 0.271226 - 0.276088 CSR_{it} - 0.093243 DEBT_{it}$$

Previous studies by Mahoney and Roberts (2007), Brammer (2006), Murray (2006), Tsoutsoura (2004) and Simpson and Kohers (2002), support this. Table 4.2 summarizes the results. The results suggests that CSR and Debt ratio are the significant factors that influence ROE. There is a significant but negative relationships between CSR and ROE, and also significant but negative relationship between DEBT and ROE. The negative relationship indicates that the higher the CSR disclosure are expected to decrease the company profitably or financial performance of the company. At the same time the higher Debt ratio are expected to decrease the company profitability. Therefore the hypotheses H_1 assume that there is positive relationship between Corporate Social Responsibility Disclosure (CRS) is rejected.

As for the level of practises of CSR in Malaysia, the result shows that moderately all the company have disclosure CSR information as we can see the min and median are high. They are several factors as disclosure of CSR information is a mandatory in corporate financial report began 2007 by Bursa Malaysia for companies listed on Bursa Malaysia. Although Bursa Malaysia requires companies to report CSR information in financial

report, specifics detail as to “how” and “what” information should be disclosed yet to be framed, perhaps facilitating the chance for the companies to provide general narrative CSR information in annual reports. Nonetheless, regulatory changes are also understood to have positive effect on CSR disclosure practises as companies want to avoid any penalties (Chu, 2013).

Other factors that could contribute to such significant compliance are increasing social awareness and the introduction of several awards as the Prime Minister’s CSR award in 2007 and the Most Outstanding Annual Report Award among other CSR awards. Prior studies in USA and Australia have indicated that companies provided extensive social disclosure following social or environmental crises, in an attempt to address the legitimacy threat (Blacconiere & Patten, 1994). Haniffa and Cooke (2005) also claimed that the increase in social disclosures in Malaysia could be attributed to the 1997 East Asian financial crisis, in order to tackle a perceived legitimacy gap. Hence, the increase in the extent and quality of CSR disclosure in the present could to a greater extent, be regarded as corporate strategy to address the recent financial turmoil, thus, averting any exposure arising from the social and political environment (Patten, 1992). Companies could also involve greater social disclosures in an attempt to appear as a socially “aware company” (Gray, 1995) particularly in time of crisis as firms tend to use disclosures in influencing the perception of the society (Deegan, 2000)

CHAPTER FIVE

SUMMARY AND CONCLUSIONS

5.0 INTRODUCTION

The aim of this study is to examine the relationship between firm's performance and CSR disclosure. In achieving the objective, this study has conducted a panel data analysis on 130 public listed companies listed on main market of Bursa Malaysia. Firm's ROE is used as a proxy for firm's performance, and functions as a dependent variable, while CSR as well as firm's debt ratio are the independent variable.

5.1 SUMMARY

In summary, result of the study indicate the significant influence of CSR and debt ratio on firm's performance. However, the signs are not as expected. A higher level of CSR is associated with a lower firm's performance. Corporate Social Responsibility (CSR) in this study consists of four major elements which are community involvement, environmental, employee information and product or service information. This study has answered the question where the CSR is found to have a significant influence on ROE but does not really support the hypothesis as it is negatively related. They are few factors that contribute to this incident as follows:

1. To run the data, we pooled 130 PLCs from different principal activity in industrial sector. This industrial sector consists of mechanical manufacturer, food manufacturer, and consumable product manufacturer and so on. CSR will have different impact or influence on this industry based on the user of the output. For example food and consumables product industry's CRS disclosure might have more influents on the profitability compared to mechanical product manufacturing. This is because food and consumable product has a direct impact on consumer, therefore consumers are more concern with the ingredients of the products as well as the environmental effect of it. So, at this point the CSR information on how the companies provide the training to the worker and welfare scheme is very important to increase consumers' confident, if not this may have a negative impact on sales, consequently profitability. Compared to the manufacturing of mechanical product, there may be a lack of concern on the issue of CSR.

2. The public, especially consumers and investors, concerns about CSR are very low in developing countries. YB. Tan Sri Nor Mohamed Yakcop, (2004) said that the terminology is very new to Malaysian people as compared to developed country. Because of that, a lower effect or reaction by the consumer or investor to the disclosure of CSR. For example, German consumers have boycotted some of the latest model of Volkswagen cars due to some environmental issues. When the environmental issue was disclosed, there was serious reaction from consumers in Germany, but the same model had been shifted to Asian countries

and had captured back the sales. Based on this case, we can differentiate the reactions of consumers in different nations regarding CSR related issues.

In this study, the sample period of study used is between 2007 and 2009. Year 2008 was the year of global economic crisis. Even though the study shows there is a significant influence of CSR on profitability, the pressure of the global economic crisis may have cause the influence to be negative.

5.2. LIMITATION OF THE STUDY

First, the use of corporate annual reports may not give a complete picture of the disclosure practices as the company may use other medium to channel the information such as the media, separate environmental and social reporting and interim financial statements. ACCA (2002) for example acknowledges this in its study by extending the scope of its investigation to include standalone environmental reports and companies' websites.

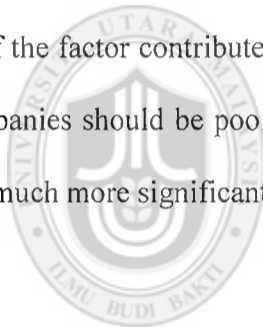
Secondly, to run the data, we pooled 130 PLCs from industrial sector. If we look at the industrial sector, it actually consist of a mix business activities where each business has different target customers. Therefore the result of this study more to an average result of a mix business activity which cannot illustrate a niche business in industrial sector.

Finally, this study focuses on industrial companies in Malaysia. Thus all conclusions derived cannot be generalized to other industries.

Nevertheless, his study adds substantial knowledge to the existing literature on CSR in Malaysia. It presents an up to date overview of CSR particularly in industrial sector.

5.3. RECOMMENDATION FOR FUTURE RESEARCH

Understanding this matter, in this study pooling companies with various business natures is one of the factor contribute to negative relationship of CSR to ROE. For future study the companies should be pool by the same business nature or same industry so that we can see much more significant relationship between CSR and ROE.



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