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# Financial Distress and Financial Perfomance: Investigating Moderating Effect of CSR

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**Abstract:** The purpose of this research is to examine the role of corporate social responsibility (CSR) in the link between financial hardship and financial success in primary consumer goods companies listed on the Indonesia Stock Exchange (IDX) in 2019-2020. This study's population primary consumer goods companies. Purposive judgment sampling was used in line with preset criteria, and a sample of 126 firms was collected. This research employs statistical analysis as well as regression analysis with moderating variables. According to the findings of this study, CSR has a favorable impact on the financial success of a companies. The company's financial performance suffers as a result of financial distress. Meanwhile, CSR cannot moderate the relationship between financial distress and the company's financial performance.

**Keywords:** Corporate Social Responsibility, Financial Distress, Financial Perfomance

## I. INTRODUCTION

To compete in today's globalized world, companies must continue to innovate and improve their corporate strategies in order to obtain good financial performance. One strategy to boost the firm's success is to engage in activities that benefit not just the company but also the surrounding community. These are CSR (Corporate Social Responsibility) activities. CSR implementation is a type of corporate responsibility towards the surrounding environment that is carried out by the firm through social activities. The company does not only have economic obligations and obligations to shareholders/shareholders but also obligations to other interested parties. The concept of social responsibility was introduced by Bowen around 1953. Bowen in Solihin (2009:1) states that the obligation or social responsibility of the company rests on alignment with the goals and values of a society. In expanding areas such as Asia, including Indonesia, corporate social responsibility (CSR) has developed quickly[1]. The implementation of CSR in Indonesia is regulated by Law Number 40 of 2007 concerning Limited Liability Companies and Government Regulation Number 47 of 2012 Article 47 regarding the social and environmental responsibility of limited liability companies. The practice of CSR in Indonesia is still voluntary and mandatory, but nowadays many companies are aware that CSR has benefits and is useful for their company's performance. Enterprises with more CSR-oriented strategies are more open and less interested in hiding negative news, resulting in a decreased chance of plummeting share prices[2].

Symptoms faced when an organization goes bankrupt mark the start of financial difficulties for the company[3]. Financial distress is a condition where the level of profit earned by the company is smaller than the total costs to be paid in the long term, so the company is considered to have failed or gone bankrupt. In running a company profit is something that is very desirable because with the company's profits it is said that the company can operate and implement the company's strategy, if a company is not able to compete between companies then the company may experience losses so that the company will face financial difficulties.

There are still numerous inconsistencies and different research in study findings connected to Corporate Social Responsibility in the relationship between financial distress and financial performance. Based on the results of research [4] stated that CSR positively affects company performance. Research conducted [5]found that production operations moderated the relationship between corporate social performance and financial performance. Research conducted [6] found that CSR-oriented company policies reduce company risk, shedding more light on the financial benefits that companies get through CSR-oriented strategies. Research conducted [7] found that CSR-oriented companies show a low level of financial distress risk. Meanwhile, according to [8] CSR is starting to be seen as having an indirect relationship with the company's financial performance rather than a direct relationship. And research [9] found no evidence of a positive relationship between CSR and subsequent performance in the European context.

Previous study findings reveal a research gap or discrepancy amongst researchers addressing CSR in the association between financial distress and financial performance. This leads to a better understanding of CSR in the context of the link between financial distress and financial performance, which necessitates more in-depth justification. As a result, the authors are interested in revisiting this issue to confirm the findings of earlier investigations. The purpose of this research is to look at the influence of CSR in the link between financial distress and financial performance.

## II. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

### 2.1 Stakeholder Theory

In 1984, R. Edward Freeman invented the first time stakeholder theory, noting that it is a theory about organizational management and corporate ethics that focuses on morals and values when controlling businesses. A firm, according to stakeholder theory, is more than just a business that functions for its own gain it must also deliver value to its stakeholders. As a result, the protection given by a company's stakeholders has a substantial effect on its performance. The assumption of stakeholder theory is based on the notion that if a business gets to be extremely large, causing citizens to become increasingly active and pay attention to the firm, corporations must demonstrate accountability or obligation more generally, not only to shareholders. The existence of this stakeholder idea serves as the foundation for determining whether a company must be able to share advantages with its stakeholders. These advantages can be obtained by implementing a Corporate Social Responsibility (CSR) program. This program's presence in the organization is supposed to improve the well-being of employees, customers, and the local community. As a result, it is intended that a strong link would be formed between the organization and its surroundings.

### 2.2 Legitimacy Theory

Gray et al. (1997) define legitimacy as a system in which companies are managed based on orientation and alignment with the interests of society. Where the company as an organization that is part of the community must pay attention to social norms in society. By applying these standards, the company's existence will gain legitimacy. This legitimacy theory is built on a social contract that binds companies as resource managers and communities as resource owners. Thus, the company's legitimacy in society is necessary for the company's long-term survival.

### 2.3 Corporate Social Responsibility

CSR is defined by the World Business Council for Sustainable Development (WBCSD) as a company's commitment to long-term economic development by collaborating with employees and their representatives, their families, local communities, and the general public to improve the quality of life, which benefits both business and society. CSR is defined by The Business Organization for Social Responsibility as doing business in a way that meets or exceeds society's ethical, legal, commercial, and public expectations that society has of business. Both definitions are broad in the sense that they include business decisions based on ethical values, legal requirements, and regard for individuals, communities, and the environment.

Corporate social responsibility reports allow parties to assess the company's CSR performance. Reference material in the form of Sustainability Reporting Guidelines (SRG) is required to analyze the company's performance in terms of Corporate Social Responsibility. SRG was introduced as part of the United Nations in 1997 by the Coalition for Environmentally Responsible Economies (CERES) as Index Global Reporting Initiative version 4.0. (GRI G4). CSR is assessed via scoring, which is based on the dichotomous technique, i.e. a variable with only one of two values. Each item in the GRI that is disclosed is awarded a score of "1" using this technique, whereas information that is not disclosed is assigned a value of "0." CSR performance may be calculated by dividing the total number of disclosures by the total number of indicators in the GRI Index. The GRI G4 index contains 91 indicators, which are classified into three categories.

**2.4 Relationship between Financial Distress and Financial Performance**

Financial distress (financial distress) is often considered a bad financial structure and brings financial risk to the company[10]. A company's financial performance is a picture of its financial status that can be checked using financial analysis tools to measure a company's positive and changing financial position that accurately reflects its business. Profit is anticipated in business since it allows the company to function and follow its strategy but, if a company is unable to compete with other firms, it may incur losses. The company will face financial distress. [11] and [12] in their research reveal that profitability and financial distress have a negative and significant causal association between. Therefore, the first hypothesis proposed in this study is:

**H1: Financial Distress hinders the company's financial performance.**

**2.5 Relationship between CSR and Financial Performance**

CSR disclosure may have a good influence on entities because by implementing CSR initiatives, the firm can offer the public trust in the company's products, therefore increasing the company's reputation in the eyes of the community [13]. ROA can quantify the company's capacity to make profits in the past and then become a prediction in the future, and it can measure the overall efficiency of capital usage. Research conducted [14] found that Corporate social responsibility activities have a positive impact on company success. [15]A positive CSR is more likely to forewarn of bad financial performance. According to research conducted by [16] CSR is positively associated to financial performance, lending credence to the notion that CSR is a strategic choice made by a company. When a company is in financial distress, management will prioritize the interests of shareholders over Corporate Social Responsibility, and they will not commit to implementing CSR in the same manner that they would accept the risk of cutting out of their budgets. Even if the corporation meets its social commitments, it finds it difficult to translate its social responsibility into corporate profitability in the same way that companies with good financial performance do. Research conducted by [17]demonstrates a negative and statistically significant causal link between CSR and financial distress. As a result, the authors employ corporate social responsibility (CSR) as a mediator in the link between financial difficulty and financial performance. This formulating the following hypothesis:

**H2: CSR is positively related to the company's financial performance.**

**H3: CSR moderates the relationship between financial distress and financial performance.**

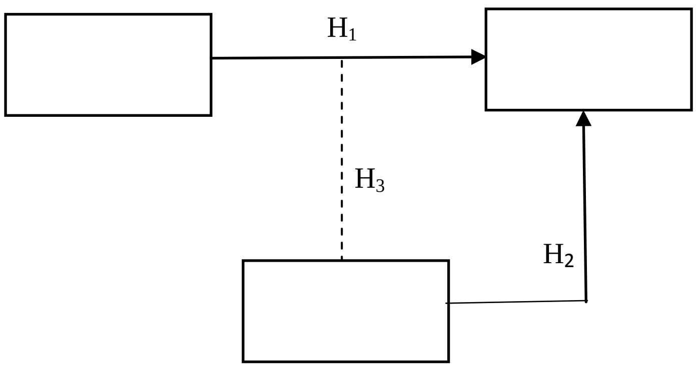


**Figure 1.** Hypotheses and conseptual framework

Figure 1 illustrates the proposed hypothesis and theoretical framework. The first and second hypotheses are provided in order to identify the influence of CSR and financial distress on financial performance. In Hypothesis 3, we concentrate on the moderating influence of CSR on the connection between financial distress and financial performance.

## III. METHOD

This study makes use of secondary data in the form of financial report (annual reports) from firms listed on the Indonesia Stock Exchange in the primary consumer goods companies sector in 2019-2020. The data for this study were obtained from the Indonesia Stock Exchange's official website (www.idx.com). The purposive sampling strategy was employed in this study. The manufacturing companies in this sample consist of:

1) Primary consumer goods companies listed on the Indonesia Stock Exchange for the period 2019 – 2020
2) Primary consumer goods companies that disclose consecutive annual reports for 2019 –2020

3) Primary consumer goods companies that disclose CSR in their annual reports and or publish sustainability reports in a row during 2019 –2020
4) Primary consumer goods companies that present financial reports in rupiah currency for 2019-2020.

Obtained a sample of 126 data that can be analyzed. Data analysis used regression analysis with moderating variables (moderated regression analysis). The regression model used is formulated:

$ROAi,t = \alpha 0 + \alpha 1Z + \alpha 2CSRi,t + \alpha 3Levi,t + \alpha 4Growthi,t + \alpha 5CRi,t + \omega i,t$

$ROAi,t = \theta 0 + \theta 1Z + \theta 2CSRi,t + \theta 3Zi,t * CSRi,t + \theta 4Levi,t + \theta 5Growthi,t + \theta 5CRi,t + \omega i,t$

Descripstion:

ROA : Return On Asset

CSR : Corporate Social Responsibility

Z*CSR : Interaction between ZScore and CSR

Z : ZScore (Financial Distress)

Lev : Leverage

Growth : Growth Rate

CR : Current Asset

**3.1 Dependent Variable**

Financial Performance is the dependent variable in this study. ROA will be used to assess financial performance. ROA is a ratio that is used to assess a company's capacity to make profits over a specific time period. ROA is used because it can assess the overall efficiency of capital usage, and ROA can determine the company's capacity to make profits in the past, which can then be projected in the future.

$$\text{Return on Asset} = \frac{ProfitAfterTax}{TotalAsset}$$

**3.2 Independent Variable**

Financial Distress is the independent variable in this study. The Altman Model proxy is used to assess financial distress. The Altman Z-score (bankruptcy model) is a measurable control tool for a company's financial situation that is in financial distress.

$Z = 0.012 \cdot X1 + 0.014 \cdot X2 + 0.033 \cdot X3 + 0.006 \cdot X4 + 0.999 \cdot X5$

Where:

X1 = Working Capital/Total Assets;

X2 = Retained Earnings/Total Assets;

X3 = Profit before Interest and Tax/Total Assets;

X4 = Market Value of Equity/Book Value of Total Liabilities;

X5 = Sales/Total Assets;

Z = Overall Index.

**3.3 Moderating Variables**

The moderating variable in this study is Corporate Social Responsibility. In this study, the amount of corporate social responsibility disclosure is quantified using the Global Reporting Initiative principles (GRI). The G4 version of the GRI standard is now the most recent. GRI-G4 provides a globally applicable framework to enable transparency and consistency, which makes information provided meaningful and dependable for markets and society. The GRI-G4 standard divides performance metrics into three categories: economics, environment, and society. The overall number of indicators contained in the GRI-G4 reached 91.

$$\text{CSRIi}=\frac{\sum Xyi}{ni}$$

Description:

CSRIi = broad index of social responsibility disclosure; and corporate environment

Xyi = value 1 if item y is disclosed; 0 if item y is not disclosed

ni = number of items of company I, ni< 91.

**3.4 Control Variable**

Control variables are factors that supplement or control the causal link between the independent and dependent variables in order to provide a more accurate and comprehensive empirical model. The following are the three control variables utilized in this study:

1) Leverage (Lev)
Leverage is used to assess a company's capacity to function with funds provided by creditors, as well as to indicate the amount of security offered by creditors.

$$\text{Lev} = \frac{TotalLiabilities}{TotalAsset}$$

2) Growth Rate
This refers the range of operational income increase in the current period vs the prior period. The higher the index value, the more profitable the firm. In general, the higher the growth rate, the more attractive the company's development prospects.

$$\text{Grow Rate} =\frac{(Present\ - Past\ )}{Past}\times 100\%$$

3) Current Ratio
The current ratio is used to assess a company's capacity to convert its current assets into cash and utilize it to satisfy commitments before short-term debt expires.

$$\text{CR} = \frac{CurrentAsset}{CurrentLiabilities}$$

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## IV. RESULTS AND DISCUSSION

**4.1 Descriptive statistics**

Table 1 is a descriptive statistical analysis that offers an overview of the variables:

**Tabel 1. Descriptive Statistics**

| Variabel | N | Minimum | Maximum | Mean | Std. Daviation |
|---|---|---|---|---|---|
| Return on Asset | 126 | -0.154 | 0.223 | 0.03617 | 0.071009 |
| Zscore | 126 | 0.115 | 4.564 | 1.24567 | 0.836816 |
| CSR | 126 | 0.001 | 0.077 | 0.01457 | 0.011366 |
| Leverage | 126 | 0.113 | 1.925 | 0.48440 | 0.242635 |
| Growth Rate | 126 | -0.645 | 30.772 | 0.28061 | 2.749066 |
| Current Ratio | 126 | 0.060 | 13.267 | 2.26990 | 2.223655 |
| Valid N (listwise) | 126 | | | | |

The following information is collected from the descriptive statistics test results in the table above:

The Financial Performance variable calculated by Return on Assets has the lowest value of -0.154 percent and the highest value of up to 0.223 percent. The average value of Financial Performance is 0.03617 percent with a standard deviation of 0.071009 percent. This shows that the typical main primary consumer goods companies listed on the Indonesia Stock Exchange in 2019-2020 has a 0.03617 percent positive financial performance.

The Financial Distress variable calculated by ZScore has the lowest value of 1.15 percent and the highest value of 4.564 percent. The average value of Financial Distress is 1.24567 percent and the standard deviation is 0.836816 percent. According to the Altman model's definition, when the Z value surpasses 1.8, the risk of bankruptcy is very low hence, 1.24567 shows that the overall risk of the observation has a low average bankruptcy.

The Corporate Social Responsibility variable calculated by the GRI-G4 Standard has the lowest value of 0.001 percent and the highest value of 0.077 percent. Corporate Social Responsibility has an average value of 0.01457 and a standard deviation of 0.011366. This means that in 2019-2020, the average CSR information published by primary consumer goods companies listed on the Indonesia Stock Exchange is 0.01457 percent of the items needed by GRI.

The Leverage variable calculated by the Debt to Asset Ratio has a value range from 0.113 to 1.925. Leverage has a mean value of 0.48440 and a standard deviation of 0.242635. The Growth Rate calculates the Growth Variable, which has a range of values from -0.645 to 30.772. Growth has a mean value of 0.28061 and a standard deviation of 2.749066. Current Ratio, which is derived by dividing current assets by current liabilities, has a value range of 0.060 to 13.267. The current ratio has an average value of 2.26990 and a standard deviation of 2.223655.

Linear regression statistical testing necessitates the testing of classical assumptions. The data passed the classical assumption test, which comprised the normality test, heteroscedasticity test, multicollinearity test, and autocorrelation test, according to the results.

The first regression equation with F = 15.058 and significant 0.000. The coefficient of determination (Adjusted RSquare) shows the number 0.360. The second regression equation with F = 12.857 and significant 0.000. The coefficient of determination (Adjusted RSquare) shows the number 0.363.

**4.2 Correlation Coefficient**

**Tabel 2. Correlation Matrix**

**Correlations**

| Variabel | 1 | 2 | 3 | 4 | 5 | 6 |
|---|---|---|---|---|---|---|
| **ROA** | 1.000 | | | | | |
| **ZScore** | 0.174 | 1.000 | | | | |
| **CSR** | 0.003 | 0.079 | 1.000 | | | |
| **Leverage** | -0.555 | -0.017 | -0.022 | 1.000 | | |
| **Growth Rate** | -0.052 | 0.098 | 0.066 | 0.082 | 1.000 | |
| **Current Ratio** | 0.372 | -0.032 | -0.074 | -0.595 | -0.044 | 1.000 |

The correlation coefficient explores the degree of relationship between the variables under consideration. Table 2 displays the Pearson correlation values for the variables utilized in this investigation. Leverage and growth rate are the only variables that have a negative impact on financial perfomance. Other elements, have a favorable impact on financial perfomance.

**4.3 Hypothesis Testing**

The results of multiple regression tests for the first and second hypotheses of this study can be seen in table 2 below:

**Table 2. Hypothesis Multiple Regression Test Results**
**Equation 1**

| Model | Unstandardized Coefficients | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|

| | | B | Std. Error | Beta | | |
|---|---|---|---|---|---|---|
| 1 | (Constant) | .093 | .020 | | 4.602 | .000 |
| | CSR | .037 | .010 | .436 | 3.810 | .000 |
| | ZScore | -2.138 | .717 | -.342 | -2.984 | .003 |
| | Leverage | -.154 | .026 | -.526 | -5.862 | .000 |
| | Growth Rate | -.001 | .002 | -.027 | -.369 | .713 |
| | Current Ratio | .001 | .003 | .047 | .520 | .604 |

From the table above, the following formula can be reflected:

ROA = 0.093 – 2.138 Z + 0.037 CSR – 0.154 Lev – 0.001 Growth + 0.001 CR + e

**4.4 Financial Distress Inhibits Company's Financial Performance**

The regression coefficient for the financial distress statistical test on the company's financial performance is -2,138, indicating that there is a link between financial hardship and the company's financial performance. When the significant level is less than 5%, or 0.05, H1 is accepted. According to the findings of this study, financial distress might have a negative impact on a company's financial success. The results reveal that the higher the company's financial success, the better the performance since the rate of return is higher. If financial performance has improved, the likelihood of financial trouble has decreased. If financial performance deteriorates, the firm will face financial trouble since it will be unable to maximize its assets to create profits.

These results are in line with research [18], [12], and [19] which reveal that financial distress hinders the company's financial performance.

**4.5 The Effect of CSR on the Company's Financial Performance**

The regression coefficient for the CSR statistical test on the business's financial performance is 0.037, indicating that there is a positive association between Corporate Social Responsibility and corporate performance. When the significant level is less than 5%, or 0.05, H2 is accepted. According to the findings of this study, Corporate Social Responsibility has a favorable impact on a company's financial perfomance. The findings revealed that the bigger a company's Corporate Social Responsibility, the better its financial perfomance. Corporate Social Responsibility (CSR) is a philosophy that demands businesses to be accountable not just financially, but also socially, in order for them to grow sustainably. Increased CSR disclosure will convey a positive signal to parties having a stake in the firm (stakeholders) and corporate shareholders (shareholders). The more information that is provided to stakeholders and shareholders, the more they will trust the firm with their invested capital, making it simpler for corporations to spend capital for corporate operations that increase profitability. As a result, the company's CSR initiatives have an impact on the company's financial performance.

These results are in line with research [15], [16], [20], and [21] which reveal that CSR is positively related to the company's financial performance.

The results of the regression test with the moderating variable can be seen in table 3 below:

**Table 3. Hypothesis Moderation Regression Test Results**
**Equation 2**

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|
| | B | Std. Error | Beta | | |
| (Constant) | .077 | .024 | | 3.294 | .001 |
| CSR | .052 | .016 | .615 | 3.334 | .001 |
| ZScore | -1.718 | .792 | -.275 | -2.169 | .032 |
| Z*CSR | -.495 | .410 | -.251 | -1.234 | .220 |
| Leverage | -.148 | .027 | -.507 | -5.585 | .000 |
| Growth Rate | -.001 | .002 | -.035 | -.480 | .632 |
| Current Ratio | .002 | .003 | .048 | .536 | .593 |

The third hypothesis testing using Moderated Regression Analysis (MRA) or interaction test presents the following equation:

ROA = 0.077 – 1.718 Z + 0.052 CSR – 0.495 Z*CSR – 0.148 Lev – 0.001 Growth + 0.002 CR + e

**4.6 CSR Moderates the Relationship between Financial Distress and Company Financial Performance**

Statistical tests for the moderating variable Z*CSR indicate a regression coefficient of -0.495 with a significant level of 0.220 above 5% or 0.05, indicating that H3 is rejected. According to the findings of this study, CSR cannot attenuate the association between financial difficulty and a company's financial performance. Nonetheless, the CSR variable has a considerable causal link with financial success since it may serve as an intervention or an independent variable. The association between CSR and financial performance is pointing in the positive direction. The more the CSR disclosure, the better the value of the company's financial success. The value of improved financial performance will suggest that the firm is in excellent financial health.

The results of this study contradict research [22] and [1] which state that CSR can moderate the relationship between financial distress and financial performance. However, this is in line with research by [17] which states that CSR has a negative effect on bankruptcy.

## V. CONCLUSIONS AND SUGGESTIONS

The purpose of this research is to examine the function of corporate social responsibility (CSR) in the link between financial distress and financial perfomance in primary consumer goods companies listed on the Indonesia Stock Exchange (IDX) in 2019-2020. Based on the findings of the investigation, it is clear that CSR (Corporate Social Responsibility) has an impact on the financial success of the organization. Financial distress has a negative impact on the company's financial performance. Meanwhile, CSR cannot mitigate the association between financial suffering and firm performance.

However, this study has limitations, including the use of samples from only primary consumer goods companies listed on the Indonesia Stock Exchange and the inclusion of financial hardship as an independent variable in its influence on financial performance. As a consequence, future study might include additional sectors or utilize all businesses listed on the Indonesia Stock Exchange, as well as extend the research period to present an overview of maximum outcomes.

A conclusion section must be included and should indicate clearly the advantages, limitations, and possible applications of the paper. Although a conclusion may review the main points of the paper, do not replicate the abstract as the conclusion. A conclusion might elaborate on the importance of the work or suggest applications and extensions.

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