CHAPTER II
THEORETICAL FRAMEWORK AND HYPOTHESES

2.1 Theoretical Background

Helfert (1996) defined firm performance as result of decision made from manager whom does management continuously. Financial report is a tool to collect more financial information of a company accurately (Munawir, 2000). The success of a company is essentially explained by the financial and non-financial performance over a period of time. Consequently, a well-performing company will strengthen the management for its disclosure quality (Miranty & Sisnuhadi, 2011). Measuring the company performance is the process of measuring the efficiency and effectiveness of the operations (Neely, Gregory, & Platts, 1995).

Sukirni (2012) argued that an increase in firm value will be achieved if the existence of cooperation between the representative of company management; manager and owner, is noticed by firm. Company's management decision-making is affected by agency conflict, because manager and owner may concern their own interest and compensation as the first consideration.

Agency theory perspective is a foundation to understanding the issue of corporate governance (Govindarajan & Anthony, 2006). The theory resulted an asymmetric relationship between owner and manager, to prevent this asymmetric relationship, Good Corporate Governance is required to manage the company to the healthiest condition (Utami & Setyawan, 2015). The corporate governance practice based on agency theory can explained as relationship between owner and manager,

manager as an agent which morally responsible for optimizing the benefits for owner and in return manager will receive compensation according to the agreement.

In this research, agency theory used to find the management difference between family company and non-family company. Indeed, family company's management will have bigger initiatives than non-family company whether using CSR disclosure or tax avoidance strategy to achieve the company's main objective to maximize the firm performance based on the profitability. The profit received by company will be shared to shareholder as their return (dividend), which is defined as private wealth, thus family firm managament may have bigger initiatives to increase the firm's value.

The World Business Council for Sustainable Development (WBCSD) defined CSR as a continuous commitment of the business community to act ethically, operate legally, and contribute on economics development, along with improving the employee and families' quality of life at the same time and enhancing the quality of local communities and society in large. Meanwhile, European Union (EU) as the organization has special concern to CSR defined CSR as a concept that mentioned the responsible for the impact it has on all relevant stakeholders.

In Indonesia, CSR activities enforced by the law regulations. The company regarded CSR as a cost that tends to burden the company, rather than consider as a long-term investment that has potential to lead company economics growth and increases its economic competitiveness and have better firm performance (http://CSR-Indonesia.com).

Social and environment disclosure behaviors can explained by the stakeholder theory. The company strives to satisfy the stakeholders in order to survive by expressing the required information. Gray, Kouhy, and Lavers (1995) stated that sustainability of a company is depend on stakeholder support, the support must find through activities company participated in. The bigger stakeholder support, the higher adaptibility of company. Tax avoidance strategies are more favorable than tax evasion cause of its legality. Corporate social responsibility practices considered as an important activity by company to get the stakeholder support and achieve higher firm performance.

Stakeholder formulated by Stanford Research Institute (SRI) in 1963. Traditionally, stakeholder is defined as a group or individual who can affect or is affected by company's achievement when operating its business (Freeman, 1984). Stakeholder act as key element that can affect the company whether it is positively or negatively, formal and informal, individually and collectively. Customers, suppliers, shareholders, employees, distributors, and local communities are the main group of stakeholders (Friedman & Miles, 2006).

Robert H. Anderson in Zain (2003) explained tax avoidance as a method to reduce taxes that are still within the limitation of tax law regulations. In approach to minimize tax expenses, there are a lot of strategies can be used. Tax avoidance and tax evasion are similar, but tax avoidance distinguished itself from tax evasion by law, tax avoidance is a strategies used by finding the weakness of regulation and do the best management to achieve a good firm performance (Wilson, 2009).

In this research, slack resources theory explains the relation between CSR and tax avoidance. Company which have good CSR practices means the company wealth of resources, it may cause them can fulfill environmental obligations and pay the tax easily (Lys, Naughton, & Wang, 2015). Supported by Campbell (2007) statement, if company has high performance, company can allocate resources for CSR activities well and afford to pay higher tax. Companies can also do more sustainability efforts without financial constraint. Contrarily, if the resources are limited, company will have limitation in CSR activities and tax allocation.

Slack is the difference between the resources provided and the total amount to be paid (Cyert & March, 2002). Bourgeois (1981) defined slack as a cushion in form of actual or potential resources which allows an organization adapted the internal pressure to change the external policy and initiate a suitable strategic to face the external environment. Slack resource theory is a theory explained company must have good financial performance to support its sustainable social activities, which mean company can practice the CSR activities when company is gaining profit or not suffering loss.

Firm performance has directly related to legitimacy. Legitimacy theory showed companies do not manage their strategic of its reputation will have a bad firm performance. Thus, this research aims to prove legitimacy theory by analyzing CSR disclosure and tax avoidance strategies affect to firm performance. Environmental and community of a company is concern to the tax avoidance policy, inconsistent with general societal expectations provides researcher a strong foundation to test legitimacy theory (Sari & Tjen, 2016). The companies that disclosed social environmental concern

in the annual report, possibility to impact the tax avoidance negatively, which means more concerns provided less tax avoidance strategic found.

Dowling and Pfeffer (1975) argued that legitimacy can be regarded as perception or assumption of uniformity that the decision made by an entity is desired, worthy or appropriate to the norm system and beliefs, whereas the organizational legitimacy is acquired when the agreement exists. Legitimacy is important for the company because legitimacy from community to company considered as company's development strategic. Legitimacy theory used to argue that the existence of social responsibilities disclosures in company's annual report over the years may affected by the stakeholders and the common objective of the company is to having an economic growth and survive in a competition. Legitimacy theory is underdeveloped which still have a lot of limitation, but it provide as a useful framework for doing CSR research (Deegan, 2002)

2.2 Literature Review

Numerous researchers had conducted researches that stated family company's management has significant influence on the firm performance. Anderson and Reeb (2003) stated that family companies have a better performance than non-family companies whether in market based measurement or accounting based measurement. Faccio, Lang, and Young (2001) found that company with outsourcing manager whom is not family member of the company have worse performance than company with family members to plan the company's management.

Based on previous researches, family company may have bigger initiatives to manage every strategy that may influence on the company's financial and non-financial performance. Those strategy involved environment, governance, resources, and resources. In the past two decades, Corporate Social Responsibility (CSR) has become an important issue in international debates (Aras, Aybars, & Kutlu, 2010). Frequently, CSR appearance is become more and considered as being relevant to companies around the world (Aras & Crowther, 2009). Strategic is key to achieving competitive advantage and the success of a business. CSR is considered as one of the most important components of company's strategic for ensuring the long term value and sustainable growth of a company (Suto & Takehara, 2016).

The relationship between CSR, tax avoidance, and a company's firm performance has been tested broadly in the financial and management fields, with plenty of results. Fayiz, Nidal, and Zallom (2016) has been done research with title *Corporate Social Responsibility and Market Value: Evidence from Jordan*. This research used Tobin's Q as market based measurement of firm performance, and CSR has disaggregated into four themes: environmental, human resources, community, and products as independent variables. Two control variables were included in the regression analysis for their possible effects: firm size and firm leverage. Annual reports of companies on the Amman Stock Exchange (ASE) for period 2006-2010 were selected. Awareness of companies relating to natural environment are increasingly using their annual reports to disclose their social informations. In this research three industrial sectors were chosen: chemical, food and beverage, and pharmaceutical and medical (P&M). The results found that environmental activities decrease profitability

(market value) for the food and beverage industry. At the same time, it has no effect on the profitability for the chemical and P&M industries.

Fauziah, Yusoff, and Adamu (2016) conducted research about the relationship between CSR activities and firm financial performance of Malaysian public listed companies. This research also divided CSR activities in four themes: environmental, community, marketplace, and workplace) and firm performance was measured by accounting based measurement: ROA and ROE. The result found that top 100 companies in Malaysia are actively implement the four CSR activities to enhance their financial performance, CSR practices can effectively help company to achieve the financial management. There are some researches has been done with ROE and ROA as firm performance measurement respectively, the result showed CSR has significant positively effect to firm performance (Yanti, 2015; Usman & Amran, 2015; Andreas, Sucahyo, & Elisabeth, 2015). Platonova, Asutay, Dixon, and Mohammad (2016) also has conducted research using ROA as firm performance measurement. Different conducted by Fauziah et al. (2016) which the CSR was not divided in four themes, this research control variables have emphasized the importance of the link between social responsibility and firm performance. Firm size, firm capital ratio, firm loan ratio, firm overhead expenses, and firm debt ratio have been used. The population is selected from Islamic banking and finance in the Gulf Cooperation Council (GCC) region over the period 2000-2014. The result concluded that CSR disclosure has positive significant impact to the financial performance.

Margaretha and Rachmawati (2016) also conducted research to found the effect of CSR (community, environment, and employee) to the firm performance

measured by ROA and Tobin's Q. The sample used in this research is primary sector companies listed in ISE for period 2010-2013. The result indicated that there no significant relationship between CSR disclosures with employee indicators and firm performance using both measurement. The environment indicator found has significant effect on ROA and no significant effect to Tobin's Q. Significant effect found for community indicator on both ROA and Tobin's Q. The result can be used for manager as consideration to improve financial performance through social activities. Elouidani and Zoubir (2015) conducted research used Tobin's Q, The ratio of Marris (MR), ROE, and ROA as dependent variables. Control variables took roles in this research with firm size, firm risk, and firm leverage. The results tested found CSR has significant negative impact on financial performance. In large companies, the significance is more obvious as the mediating factor.

Janamrung and Issarawornrawanich (2015) have been conducted research which was focused on the data during 2010-2011 of the listed Thai firms in industrial products and resources industries. To convince both industries to increase investment in CSR activities, this research firm performance measured by both exist measurement type, ROE and Tobin's Q. The result showed no relation are detected between the CSR index and ROE and Tobin's Q. Satria and Daljono (2014) have conducted same research model which is measure firm performance with both measurement type, ROA and Tobin's Q. Total sample used is 112 companies listed in ISE in period of 2011. The results showed that no significant effect tested from CSR to company's short term profitability, but there is a significant positive affect to company's future profitability.

There are numerous researches have conducted without using control variables. Candrayanthi and Saputra (2013) research aims to determine the relationship between CSR and firm performance using empirical studies to mining companies listed on the Indonesia Stock Exchange in 2010-2011. ROA, ROE, and NPM (Net Profit Margin) has been used as dependent variables. Partial test showed that the variables of CSR give a positive influence in ROA and ROE; give a negative influence for the NPM. The research conducted with ROA and ROE as dependent variables, population selected was Indonesia companies' in environmental sector. The researches found a significant positive impact from CSR o firm performance (Aryani & Amanah, 2014; Dipraja, 2014; Rahayu, Darminto, & Topowijono, 2014). Waworuntu, Wantah, and Rusmanto (2014) added EPS in the dependent variables measurement, the population was broader with 40 companies includes large and mid cap companies from ASEAN region five countries: Singapore, Malaysia, Philippines, Indonesia, and Thailand as sample. The companies selection is based on each scale, reputation, image, popularity in the sector they existing. This research found companies is keep increasing the awareness of CSR activities and disclosures, the results tested CSR is significant positively affect to firm performance. Additionally, this research has also found sustainability reports published by companies is dominate by multinational enterprises.

Kholis (2014) aims to find the influence of CSR toward financial performance of manufacturer's company. The research sample was using secondary data, which sourced from ISE website and each company official website. The research concludes that variable of CSR has a significant difference between CSR towards financial performance, which is measured by ROA, ROE, ROS. Meanwhile, the firm size as

control variable statistically has not able to moderate the relationship between CSR and firm performance. Umbara and Suryanawa (2014) found the same result with Kholis (2014), the difference is population tested. This research was conducted in the IDX, with a population of 407 companies. The research analyzed that the positive impact of CSR disclosure on the value of the corporate is categorized as a high profile company. Rosiliana, Yuniarta, and Darmawan (2014) conducted research the effect of CSR to firm performance, which the proxy are ROA, ROE, and ROS. This research distinguished itself with previous research with firm size and industry type as control variables. The data collected by using documentation and library research. The result indicates that CSR had a negative and insignificant effect on ROA, had a positive and significant effect on ROE and ROS.

As CSR issue, tax avoidance is essential for the company's long-term survival. Consumers and investors are increasingly using CSR criteria, including company's tax behavior, as consideration for do investment decisions (Hardeck & Hertl, 2014). Tjondro et al. (2016) conducted research with title *Impact of Corporate Social Responsibility Quality on Tax Avoidance with Earning Performance as Moderator Variable*. 137 companies listed in Indonesia Stock Exchange with 615 conversations were selected as sample. This research measured tax avoidance with Cash Effective Tax Rate (CETR) as dependent variable; the result proved CSR has significant positive impact on tax avoidance, when CSR quality was moderated by earning performance.

Cheok, Chen, and Rasiah (2016) examined the influence of corporate's tax avoidance on firm financial performance. This research adopts two measurement, which are effective tax rates (ETR) and cash effective tax rate (CETR). Firm

performance are disaggregated into three constructs: profitability performance (return on asset, return on invested capital, and return on sales); growth performance (growth rates of sales revenue, sales income, and net profit); market value performance (price to book ratio, Tobin's Q, and market capitalization improvement) as independent variables. The sample used is data from China Stock Market and Accounting Database (CSMAR). Sari and Tjen (2016) has been conducted research with title *Corporate Social Responsibility Disclosure, Environmental Performance, and Tax Aggresiveness*. This research took sample from non-financial companies listed on IDX during 2009-2012. Tax aggresiveness measured by effective tax rate as dependent variable, CSR disclosure as independent variable, environmental performance which is measured by PROPER base rating as moderating variable. To obtain a more appropriate result, this research used a lot of control variables which are firm size, firm leverage, profitability, firm age, blockholder, management stock ownership of Board of Director, investor intensity, market to book ratio, and industrial sector.

Kiesewetter and Manthey (2017) conducted research without control variables. This empirical analysis comprises a panel data set of 7,924 observations for the years from 2005 to 2014 for European companies. The research design found that there is positive relationship between value creation and the effective tax rate for firms with low social and environmental characteristics. The research also identifies social strengths being associated with a higher effective tax rate for coordinated market economies. Pradnyana and Noviari (2017) conducted research with corporate transparency as moderating variable, aims to obtain empirical evidence of the effect from tax planning on firm value with corporate transparency as moderating variable.

Results are variable tax planning have relation with firm value, moderating variable reinforced the effect of tax planning on firm value.

Research conducted by Ogundajo and Onakoya (2016), the study examined the impact of tax planning on the firm performance of manufacturing firms with data sample obtained from Nigerian Stock Exchange using annual reports and accounts of 10 selected firms of consumer goods sector. This research found that manager when making the firm financial planning should take tax planning as a part of it. Santana and Rezende (2016) investigates the relation between tax avoidance and firm value in Brazil. It was analyzed 323 public listed companies in the stock market from 2006-2012. Tax avoidance which proxied by total accruals and firm value proxied by Tobin's Q can control book tax differences (BTD). The results found that tax avoidance and firm value are negatively associated.

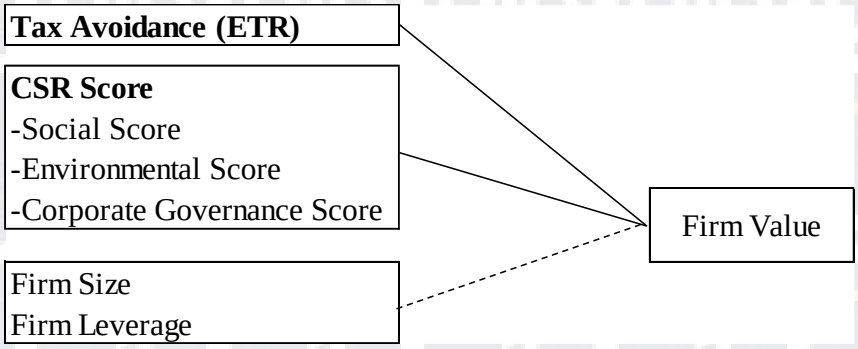

Figure 1 Research model of Tax Avoidance, Value Creation, and CSR – A European Perspective

Source: Kiesewetter & Manthey, 2017.

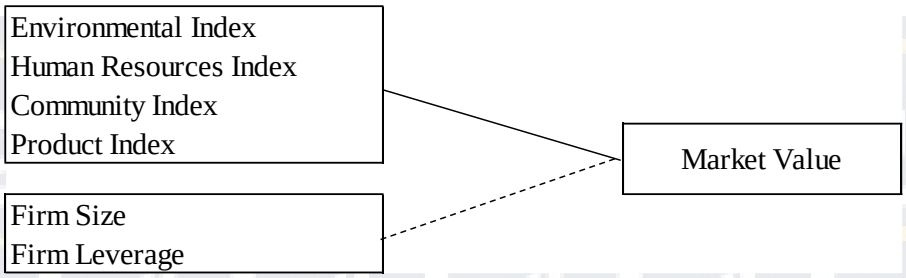

Figure 2 Research model of Corporate Social Responsibility and Market Value: Evidence from Jordan

Source: Fayiz, et al., 2016.

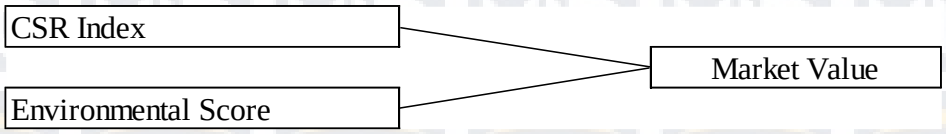

Figure 3 Research model of The Influence of Corporate Social Responsibility and Environmental Performance on the Financial Performance of SOE and Non SOEs listed on Indonesia Stock Exchange 2009-2012

Source: Yanti, 2015.

2.3 Hypotheses Development

2.3.1 The relationship between CSR disclosures and Firm Performance

The CSR activites and practices as the crucial parts of companies' participation to serve the comumunity in environment. The relevance of voluntary CSR reporting is depend on the firm management. CSR activities defined as a part of good corporate governance. More CSR activities that has implemented by companies means companies have higher awareness of stakeholders' non-financial consideration. Nekhili, Nagati, Chtoui, and Rebolledo (2017) examined CSR disclosure have significant positive impact on Tobin's Q for family firms and negative relation to non-

family firm. More CSR activities may disclosed of company to have bigger Tobin's Q which related to share market directly. Company with family members in management team have higher awareness of CSR activities and disclosures than company without family members in management team.

Hasan, Kobeissi, Liu, and Wang (2016) found that CSR disclosures has positively significant affect on firm performance proxied by Tobin's Q. The data used in the research is U.S Manuafacturing firms. The relationship in the research has strengthen by firm size, firm leverage, assets tangibility, and sales growth as control variables. Oktaviani and Nugroho (2016) has also investigated the relationship between CSR index and Tobin's Q using companies listed in Indonesia Stock Exchange. They defined that company will only disclose an information that can bring benefit and positive impact to company performance on their report or any media. Concern of company to environment may bring good impression for environment and community. Thus, company have more disclosures may have better performance.

Aryani and Amanah (2014) conducted research to found the impact of CSR disclosures on return on equity (ROE) as proxy of firm performance by using ISE companies as sample data. The result shown companies with more disclosures may have higher ROE ratio. Satria and Daljono (2014) has also conducted a research using ISE companies and focused on manufacturing sector companies. They found positive relation between CSR disclosures and firm performance. The relationship strengthened by control variables firm size and firm leverage.

H_{1a}: CSR disclosures have a positive significant effect on family companies' Tobin's Q.

H_{1b}: CSR disclosures have a positive significant effect on non-family companies' Tobin's Q.

H_{2a}: CSR disclosures have a positive significant effect on family companies' ROE.

H_{2b}: CSR disclosures have a positive significant effect on non-family companies' ROE.

2.3.2 The relationship between Tax Avoidance and Firm Performance

Tax avoidance is an effort manager put to deduct tax to pay, which can increase the firm performance through financial aspect (Dyreng, Hanlon, & Maydew, 2010). Tax avoidance is a tax agressiveness strategy that undertaken by the company to minimize the tax burden, this strategy may issue risk for company to have bad reputation in public (Khurana & Moser, 2009). Cheok et al., (2016) investigated a significant positive relation between tax avoidance and firm performance. Taxes becomes one of the government's ways to balance the nation's budget in economic reforms but tax avoidance is way for company to reduce its cost. Derashid and Zhang (2003) stated companies' profitability and tax avoidance have a positive relation. The increase of profitability may lead high earning before tax then higher tax expenses to pay, company's management team will have higher awareness of tax avoidance involvement.

Chen, Chen, Cheng, and Shevlin (2010) found that firm run by family members have less concern for tax avoidance than non-family firm. Since the minority shareholders in family firm, family members management pay more attention for transparency and willing to forgo the tax benefits. Ogundajo and Onakoya (2016) conducted research to found the impact of tax planning (ETR) on firm financial

performance by using Nigerian Manufacturing companies as the sample data. The results shown tax planning is required for companies to take it as part of financial planning in every period of time, employ an expertise for the tax plans and practices due to the strict and complexity of tax laws. In their research, firm size, firm leverage, and firm age captured the association between the independent variable and dependent variable clearly.

H_{3a}: Tax avoidance have a positive significant effect on family companies' Tobin's Q.

H_{3b}: Tax avoidance have a positive significant effect on non-family companies' Tobin's Q.

H_{4a}: Tax avoidance have a positive significant effect on family companies' ROE.

H_{4b}: Tax avoidance have a positive significant effect on non-family companies' ROE.

2.3.3 The influence of Firm Size

Firm size is playing a important on impacting CSR activities and tax Avoidance. Udayasankar (2007) stated that small firm have bigger initiatives to implement CSR activities because gain recognition needed. Small companies may also have smaller pressures of environment and community concern than medium and big companies. Medium and big companies may handle big initiatives on CSR activities because of public demand for information is higher than small companies. Setyorini and Ishak (2012) argued that there is no significant relationship between firm size and CSR disclosures. Sha (2014) found the positive significant impact of firm size on CSR

activities. Larger company is expected to practice more CSR activities then impact on the firm performance directly or indirectly.

Firm size indicates companies' stability and ability to perform its economic activities. Definitely, larger company have more human resources to manage the company tax than small company. Small company cannot manage its company's tax because lack on tax management experts (Mooji & Nicodème, 2008). A weak positive relationship between firm size and profitability has been discovered. Due to the companies' market power larger companies have the ability to charge higher price and earn higher profit since the reputation has supported the companies.

2.3.4 The influence of Firm Leverage

Firm leverage is one source of funding by debt, but large amount of debt may cause bad firm performance. Firm leverage may reduce the impact ability of company on financing, then cause company will try hard to reduce every necessary activities (Lang, Ofek, & Stulz, 1996). On the other side, because of high debt ratio may impact to companies image, management will put more effort on social environment activities to gain back some good non-financial performance (Watts & Zimmerman, 1990).

Akinlo and Asaolu (2012) examined leverage has negatively impact on firm performance. Firm with high debt ratio may have bad firm performance, thus reduction of debt is needed. Yang, He, Zhu and Li (2017) argued leverage has postively impact firm performance through implementing more CSR activities. This research found companies may have preferential treatment from bank when applying debt if they were implementing a loot of sustainable social environmental activities. Higher credit rates

and lower interest rates could be obtained by companies. CSR activities help companies to enjoy more good financial environment.

2.4 Research Model

The research model proposed in this study adopted from Kiesewetter and Manthey (2017), Fayiz et al. (2016), Yanti (2015), and Changiz (2014). The dependent variable is firm performance measured by both market based measurement (Tobin's Q) and accounting based (ROE). The independent variables in this research model are corporate social responsibility disclosure and tax avoidance. The control variables are firm size and firm leverage. The research model tested can be described as follows:

$Y = a + b.X_1 + b.X_2 + b.X_3 + b.X_4 + e$

Where: Y = Dependent variable (Firm performance)

X_1 = Independent variable (Tax avoidance)

X_2 = Independent variable (Corporate social responsibility disclosure)

X_3 = Control variable (Firm Size)

X_4 = Control variable (Firm Leverage)

a = Constants

b = Regression coefficient

e = *error*

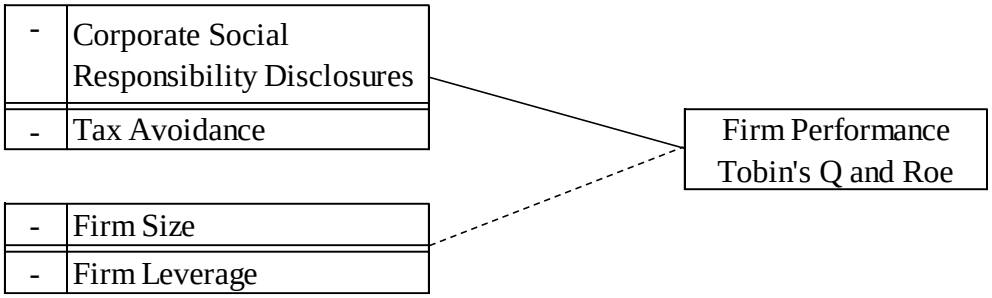

Figure 4 Research model of The Impact of Corporate Social Responsibility Disclosures and Tax Avoidance on Firm Performance

Source: Research model processed, 2018.