

CHAPTER 1

INTRODUCTION

1.1 Research Background

Stock price crash risk is the conditional skewness of return distribution that represents risk asymmetry, which usually is a downside and essential for investment decision and risk management (Kim et al., 2014). Hutton et al., (2009) stated that crash risk is conceptually based on the claim that managers detain negative news for a long period of time, leading to the stockpile of the negative news. The stock returns distribution should be asymmetric if the manager is successful in withholding the bad news from the stock market and the accumulated bad news eventually becomes known to the market once it passes the management threshold, causing a substantial decline in stock price.

According to the Indonesia Stock Exchange trading information, some stock price crashes had spanned from December 27th 2019 to March 24th 2020. PT. Astra International Tbk (ASII) experienced significant stock price changes from Rp 6.925 to Rp 3.520. PT. Perusahaan Gas Negara Tbk (PGAS) also encountered a fall in its stock price from Rp 2,250 to Rp 600. PT. Semen Indonesia Tbk (SMGR), a state-own enterprise, experienced a stock price crash from Rp 12,225 to Rp 6.575. The firm that was being hit significantly is PT. Gudang Garam Tbk (GGRM), where at the end of December 2019, its stock price was still Rp 53.250, but in March 2020, it fell to Rp 35.725 (Idris, 2020). These cases occurred in months preceding the COVID-19 global pandemic, and the world went into lockdown, affecting almost all the business sectors.

At the end of December 2020, the Jakarta Composite Index (JCI), the primary stock market index that tracks the performance of all firms listed on the Indonesia Stock Exchange, had reached the red zone at 5.853,26 points. The stock price has been even more volatile ever since due to the emergence of a new strain of the coronavirus (Sidik, 2020). In March 2020, a stock market crash caused the JCI to lose around 21.5 per cent, driven by the investors' concern about the pandemic's impact on the global economy (Prasidya & Rahman, 2020). Even

though at the beginning of 2021, the JCI point has been rebounding nonetheless, the market is still volatile, and so is the stock price crash risk.

In accordance to previous studies, the risk of stock price crashes has a positive correlation with the executive equity incentives, corporate tax avoidance, and financial reporting opaqueness, while the risk is negatively correlated with accounting conservatism (Hutton et al., 2009, Kim et al., 2011, Kim and Zhang, 2013). Moreover, firms with stronger Corporate Social Responsibility (CSR) cultures and high financial reporting ethical standards are more likely to have higher levels of openness and has less probability to hide negative news from investors, and therefore would have lower risk of stock price crashing (Kim et al., 2014). Hao et al., (2018) stated that CSR should reduce the risk of stock price crashing as firms with higher social responsibility maintain a high level of transparency; hence, the behaviour of hoarding bad news will be exhibited and vice versa, if management uses the social responsibility for its advantage, CSR should enhance the risk of stock price crashes. According to Dai et al., (2019), management more likely uses CSR reports as self-interest when the level of CSR information disclosure is low, making it difficult to know about the negative information of the firm and could cause a rise in the stock price crash risk.

CSR works as the firm's responsibility toward their consumer, community and environment while generating profit and performing a legal commitment to their stakeholders and employees (Hao et al., 2018). Based on the Indonesia Law no. 40 of 2007 on Limited Liability Firms article 1(3), the firm must participate in sustainable economic development to increase its environment's quality of life. In article 66(2c), the firm must also report on implementing social and environmental responsibility in their annual report. In other words, Indonesia's firm must participate and report on its social and environmental responsibility activity. In CSR regulation, article 74 about social and environmental responsibility states that firms operating in the natural resources industry are obliged to engage in social and environmental activities. Managers may use CSR as a personal agenda to conceal bad news about their poor performance to secure their careers. The CSR negative coefficient does not necessarily update the

readers regarding the accumulation of bad news. Therefore, it is essential to investigate the channels through which CSR restrain negative news accumulation and crash risk (Habib et al., 2017)

There is still limited research regarding the stock price crash risk in Indonesia. With businesses and the stock market are still developing, firms need to know what factor(s) affects their stock price. Parallel with the obligation for firms in Indonesia to participate and report their activity on social and environmental responsibility, this research investigates whether CSR practices has effect on stock price crash risk. The sample used is non-financial firms listed on the Indonesia stock exchange for the year 2015-2019.

1.2 Research Purpose

This research aims to investigate whether CSR influences the risk of stock price crashing in Indonesia.

1.3 Research Contribution

The results of this research inform the importance of CRS activities and disclosures on the firm's risk of stock price crashes. This research adds to the CSR research growing literature and its economic consequences as it focuses on the impact of CSR on the firm's performance and risk. For firms and stakeholders, as crash risk portrays risk asymmetry, this research could be helpful in investment decisions and managing risk by managing tail risk in the stock market.

1.4 Writing Systematic

Chapter 1: Introduction

This chapter provides the research background and a general outline of the problems regarding CSR and stock price crash risk. This chapter also described the problem formulation, purpose, benefits of research, and research systematics.

Chapter 2: Literature Review

This chapter provides the literature review from prior research in order to develop the hypothesis of whether CSR affects the stock price crash risk. This chapter also explains the grounding theory that supports this research, such as the agency theory, CSR, and stock price crash risk.

Chapter 3: Research Method

This chapter describes the research method and variables used in the research. This research uses financial data of non-financial firms on the Indonesia Stock Exchange and CSRHub data from the year 2015-2019.

Chapter 4: Results and Discussion

This chapter interprets the analysis and results of the research. In this chapter, there is a description of the results of the study regarding whether CSR affects stock price crash risk of non-financial firms listed on the Indonesia Stock Exchange for the year 2015-2019.

Chapter 5: Conclusion

This chapter contains the conclusion and limitations of this research and provides suggestions relating to the findings and future research.