

Earnings Management, Tax Avoidance and Corporate Social Responsibility: Malaysia Evidence

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Abstract

This proposed study focuses on the issues of managerial discretions, managerial entrenchment strategy and corporate social responsibility (CSR) in Malaysia with the basis of generalized agency theory where managers are inclined to satisfy their own interests at the expense of other stakeholders. This proposed study aims to scrutinize the utilisation of CSR as a strategic managerial entrenchment strategy against the cost of managerial discretions, namely earnings management (EM) and tax avoidance (TA) engaged by irrational managers. Specifically, this proposed study employs stakeholder-agency theory by examining the irrational managers' motivation in over-invests in CSR activities so as to distract stakeholders' attention from monitoring their opportunistic behaviour and securing their jobs. Further, it extends the study of managerial entrenchment strategy by incorporating managerial ownership which could magnify the relationship.

Keywords: Earnings Management, Tax Avoidance, Corporate Social Responsibility, Managerial Ownership, Agency Theory, Stakeholder-Agency Theory

1. Introduction

Upon ensuring the sustainability and survival of a business, focusing on profit maximization alone may impact the company in the long term. The top management is expected to also invest in non-financial aspects in order to enhance and maintain its reputation and legitimacy. Corporate social responsibility (CSR) has been gaining higher significance in the business community. Investors, customers and other stakeholders demand greater transparency in reporting CSR activities, and as such, the attitude towards CSR has changed dramatically over the last few decades.

The demand keeps on growing from stakeholders who anticipate companies to work beyond profit maximization and engage in more socially responsible activities that benefit the environment and community (Chapple & Moon, 2005; McWilliams & Siegel, 2001). There has been revival of interest in the CSR paradigm among the academics and practitioners. Moreover, Holder-webb, Cohen, and Wood (2009) concur that the concept of CSR which reflects the association of business organizations with the surrounding society has attracted much attention among academics and practitioners.

With many developed countries experiencing dreadful financial crises, the public progressively requires companies to take responsibility for environmental conservation, local community development and employment safety. In addition, CSR seems to be a topic that has been discussed and debated by researchers for its roles and advantages following some of the economic scandals namely the US crisis, the Asian financial crisis in 1997 and the Enron scandal. With that in mind, most companies are encouraged to pay more attention and commitment in practising CSR.

Instigating CSR activities and constructing extensive disclosure on those activities can be a magnifying mechanism to a company's well-being. Some of the benefits a company could gain are the improved financial performance, enhanced image and reputation, competitive advantage accomplishment and elevation of company's value (Amran & Abdul Khalid, 2009; Kahreh et al., 2014; Saleh, Zulkifli, & Muhamad, 2010). Building upon those positive notes of CSR, companies are encouraged to have a sense of obligation towards the society and environment in order to attain sustainability in operating their business.

Unfortunately, of late, CSR has been intentionally misused as a means of entrenchment strategy to conceal any earnings management practices. In other countries, namely the United States and the United Kingdom, it is proven that CSR has been opportunistically used as a hedging and self-defence strategy to cover the conflict of interest and opportunistic managerial discretion. This motivation is deliberately conducted by irrational managers involved with managing earnings so as to mislead the stakeholder from detecting their opportunistic managerial discretion (Choi, Lee, & Park, 2013; Prior, Surroca, & Tribó, 2008) and acquire stakeholders' support and protection (Cespa & Cestone, 2007). According to Healy and Wahlen (1999), managers manage earnings either when they want to "mislead some stakeholders about the underlying economic performance of the company" or "to influence contractual outcomes that depend on reported accounting number". Hence, this indicates that managers are motivated to alter reported earnings so as to increase their own benefits.

Traditionally, due to information asymmetry and imperfect auditing, managers may exercise some managerial discretion in computing earnings and fulfil their own interests (Healy & Wahlen, 1999). Priest (2002) discovered that the collapse of Enron was due to the failure of corporate governance and the

impact of earnings management. This scandal then stimulates the shareholders and other stakeholders' consciousness on business principles and corporate governance practices within a company. Moreover, according to previous studies, agency conflict exists when managers practice opportunistic actions to maximise their own actions, such as earnings management, which could mislead stakeholders on the true value of a company, and may cause outsiders to make false economic decisions (Xie, Davidson, & Dadalt, 2003; Zahra, Priem, & Rasheed, 2005). In Malaysia specifically, a survey conducted by KPMG to determine the level of fraud covering the period from January 2010 to December 2012, found that 27% of the respondents experienced unethical behaviour in the workplace during the survey period. To be specific, the most common unethical behaviour is management conflict of interest which accounted for 71% (KPMG, 2013). Thus, this indicates that Malaysian companies own their share of misconduct as well.

Another opportunistic managerial discretion, corporate tax avoidance (TA) is value enhancing to shareholders and therefore, managers are expected to discharge their best effort in minimising taxes (Christensen and Murphy, 2004). Unfortunately, TA allows opportunistic managers to satisfy their own interest (Desai & Dharmapala, 2009). Although managers are expected to reduce the tax liabilities for the risk-neutral shareholders to enjoy higher dividend, the separation of ownership and control could give room for the managers to make corporate tax decisions that replicate their personal interest (Hanlon & Heitzman, 2010). Desai and Dharmapala (2009) stated that TA strategy may be embarked upon by the manager when the company is practicing earning-based bonus.

Building on the justification above, this proposed study aims to examine the relationship between both earnings management and tax avoidance with CSR as well as the role of managerial ownership as the moderator for the aforementioned relationships.

This study shall contribute to the existing literature that investigates Malaysian companies in two main ways. This present study explores the relation of managerial actions, namely earnings management (EM) and tax avoidance (TA) with CSR. Prior research has concentrated either on the relationship between EM and CSR (Chih, Shen, & Kang, 2008; Ibrahim, Darus, Yusoff, & Muhamad, 2015; Kim, Park, & Wier, 2012; Prior et al., 2008) or between TA and CSR (Lanis & Richardson, 2012) demonstrating variable results and various theories applied. This study plays an integral part for Malaysian tax literature since none of the prior studies have rigorously looked into the relationship between TA and CSR. As mentioned above, this indicates that the previous research has failed to explore the direct association of EM and TA with CSR. Secondly, since CSR disclosure will be the measurement for CSR, the findings of the study will enhance the awareness of the extent and transparency of voluntary disclosure reporting among Malaysian companies. As a result, Malaysia regulatory authorities may broaden disclosure requirements or provide more detailed requirements to improve the quality of disclosure.

Malaysia is lacking in research on the misuse of CSR for managerial entrenchment strategy and thus, this study shall fill the lacuna in Malaysian literature. This study is substantial for the investors to also pay much attention on socially responsible companies as they also have the possibility of not providing transparent reporting. Policymakers only seem to encourage companies to engage and report more CSR disclosures instead of motivating desired behaviour, which could provide more incentives for the managers to utilise CSR for opportunistic actions. This study will look into EM and TA as the opportunistic managerial actions that motivate the managers to engage in more CSR activities. Moreover,

this study integrates managerial ownership as the moderating variable that may affect the respective relationships.

2. Literature Review and Theoretical Background

2.1 Theoretical Background

a) Agency Theory

Jensen & Meckling (1976, p. 308) define the agency relationship as a “contract under which one or more persons (the principals) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent”. In the business context, agents correspond to managers, whereas principals correspond to shareholders.

Agency problem arises when there is the separation of ownership and control within a company which may result to suboptimal decision making (Eisenhardt, 1989). When the desires or goals of the principal and agent are conflicted, this could cause problems within the relationship. Another problem might arise when principals face difficulties in verifying whether the agents are behaving in accordance with the principals’ goals. This respective problem relates to the information asymmetry assumption whereby one party has superior access to information, relative to the other party. Should the principals have access to information to confirm the agents’ behaviour, the agents are likely to exhibit behaviour as requested by the principal (Eisenhardt, 1989).

The agency theory can be employed to the area of CSR activities. Barako, Hancock and Izan (2006) state that voluntary disclosure is another means of mitigating agency problem whereby managers disclose more voluntary information to potentially reduce the agency cost and to convince the external users that managers are behaving in an optimal way (Watson, Shrives & Marston, 2002). Disclosures were considered as part of a monitoring platform to diminish the information asymmetry and agency problems with their resulting cost.

Notwithstanding the positive role of CSR in mitigating agency problem, it can also be misused by the managers to entrench themselves. Should the managers’ managerial discretions (specifically earnings management and tax avoidance as referred to in this proposed study) in satisfying their personal interest be detected by the shareholders and causing negative financial performance shock, CSR will be able to decrease the probability of turnover. Based on the notion that managers may buy off stakeholders’ support and protection via CSR, they are able to make themselves entrenched in the company (Cespa & Cestone, 2007; Pagano & Volpin, 2005). This proposed study shall highlight this context of discussion in investigating the relationship with CSR.

b) Stakeholder Theory

Stakeholder theory argues that managers have moral obligation to consider and appropriately balance the interest of all stakeholders (Freeman, 1984). The theory highlights the needs of managers to be accountable to stakeholders. Stakeholders are the individuals or groups that are either harmed by or benefit from the company’s decision or actions (Freeman, 1984; Jensen, 2001). Stakeholder theory takes into account a broader group of constituents other than shareholders. In a more defined view; there are eight categories of stakeholders which are investors, suppliers, employees, customers, governments, communities, politicians and trade associations (Figar & Figar, 2011).

In accordance with the stakeholder perspective, a company not only serves its traditional role which is meeting shareholders' expectations, but also meeting multiple expectations of its various stakeholder groups. Guthrie, Petty and Ricceri (2006) further explain that stakeholder theory highlights a company's accountability to be beyond simple economic or financial performance. This respective theory postulates that the management of a company is expected to execute its accountability towards its stakeholders by undertaking activities that are deemed salient by the stakeholders.

Disclosure of information plays pivotal role in the process of performing accountability to those stakeholders. The provision of a company's information should not be limited and extended on non-financial or unregulated information (Gray, Kouhy & Lavers, 1995). This is because conforming to stakeholder theory, the public has the right to know about certain facets of a company's corporate practices.

Raupp (2011) proposes that the concept of CSR has a close relationship with stakeholder theory as the company is expected to discharge its responsibility towards the society. By engaging in disclosing CSR information, a company could expect some return or benefits such as refining its image and reputation, lowering the cost of capital, attracting potential investors, reducing managerial takeover and improving the relationship with stakeholders in order to gain approval and protection (Gray, Kouhy & Lavers, 1995).

c) Stakeholder-Agency Theory

Stakeholder-agency theory is derived from Stakeholder Theory and Agency Theory. Hill and Jones (1992) proposed this paradigm to assist in enlightening some facets of company's strategic behaviour, management and stakeholder contracts relationship, institutional structures monitoring and enforcement contract between management and other stakeholders and the evolutionary procedure that forms both management-stakeholder contracts and institutional structures that enforces those contracts.

Managerial discretion has its foundation in the separation of ownership and control which can be consider as an agency cost (Davidson, Xie & Xu, 2016) because managers could act for their own benefit. This type of agency cost consists of any behaviour proceeding from the agency conflict between shareholders and managers consequently of which the managers satisfy their own interest at the expense of the others.

In accordance with the traditional view of agency, managerial discretions can be seen as any opportunity for the managers that may satisfy their own interest during the decision-making process (Berle & Means, 1932). As such, to deliberately investigate the relationship between managerial discretions and CSR, earnings management (EM) and tax avoidance (TA) shall be examined by this proposed study as to whether managers who engaged in such opportunistic activities have over-invested in CSR to entrench themselves.

With regards to stakeholder-agency theory, managers will not only serve their roles and responsibility for the sake of their company and shareholders, but also for the benefits of the stakeholders. Stakeholders can be considered very significant to a company since they have the aptitude to control and influence economic resources utilized by the company. Should the managers fail to satisfy the stakeholders' expectation, a company may experience harmful response by the stakeholders, for instance, economic resources restriction and limited media exposure. As such, stakeholder-agency theory is the modification of agency theory to accommodate theories of power owned by the stakeholders.

In the term stakeholder-agency theory, managers obligate with unique responsibility whereby they will not only be the agents for shareholders, but also for the stakeholders (Hill & Jones, 1992; Prior, Surroca & Tribo, 2008). As such, any managerial discretion undertaken by the managers will affect all groups of stakeholders.

2.2 Corporate Social Responsibility

Corporate Social Responsibility (CSR) among other factors, helps improve a company's financial performance, image and reputation as well as competitive advantage and value (Amran & Abdul Khalid, 2009; Kahreh et al., 2014; Saleh et al., 2010).

Stakeholders expect companies to set a high commitment in being socially responsible and work beyond the profit maximization target. In business operations, companies will have an immediate social contract with stakeholders consisting of shareholders, employees, investors and others. As such, stakeholders expect them to conduct business on the basis of trust and ethics (Gray, 1994).

One of the ways to inform stakeholders in relation to CSR practices is by reporting and disclosing the CSR information as a voluntary disclosure in either the annual report or sustainability report. Companies that report higher levels of CSR disclosure have strong association with share prices since this type of information provides incremental value-relevant information to investors beyond the financial accounting information (De Klerk, de Villiers, & van Staden, 2015). By the same token, Saleh, Zulkifli and Muhammad (2010) indicate that companies that emphasize on reporting high levels of CSR disclosure are able to achieve competitive advantage in the market since this type of disclosure can easily attract more foreign funds. Building upon those positive notes of CSR, companies are encouraged to have the sense of obligation towards the society and environment in order to attain sustainability in operating their business. Aside from practicing and engaging in CSR activities, companies also need to equip themselves with a significant amount of knowledge on how to disseminate this material information to the stakeholders, especially external users. Moreover, there is an urgent need to better understand on how to communicate the information in a more dynamic way towards the stakeholders (Du, Bhattacharya, & Sen, 2010). Hence, CSR disclosure could serve the role. Companies use CSR disclosure as an instrument to distribute information and communicate accountability by showing their vision for the future and account for past performances. Branco and Rodrigues (2008) suggest that in order to reach, communicate and convince the public that they are meeting their social expectations, disclosing CSR information is a critical approach that needs to be applied by the companies. With the knowledge that favourable returns will be expected from this investment, companies will be motivated to overinvest in CSR activities to fortify their place as socially responsible companies. In pursuance of projecting ethical behaviour, companies tend to report more positive news despite of reporting considerate balance on the good and bad news of information is beneficial to the credibility of the CSR reporting (Lydenberg & Wood, 2010). A company that selectively discloses good news while retaining bad news which can create a misleading positive impression of their overall environmental performance is known as greenwasher (Delmas & Burbano, 2011; Lyon & Maxwell, 2011). Increased environmental disclosure without tangible effort in improving the environmental impacts has spurred justifiable scepticism among society about the companies' transparency (Bowen & Aragon-Correa, 2014).

Therefore, in today's business environment, management is getting more sophisticated and have the skills to use CSR as a means of shifting the stakeholders' attention from any negative issues that have been

engaged by the companies or even specifically by the managers. The usefulness of CSR may be abused and exploited to conceal any opportunistic managerial discretion.

2.3 Earnings Management

Earnings management (EM) practices arise when managers discharge their managerial discretion in reporting earnings by altering financial information to distort the actual value and mislead stakeholders on the underlying economic performance of the company (Healy & Wahlen, 1999). Managers are capable of publishing distorted financial reports and using it for their own interest instead of the stakeholders'.

EM is closely related to agency theory due to existence of information asymmetry and separation of ownership between the managers and owners (stakeholders) which leads to agency cost (Xie, Davidson & Dadalt, 2003). Moreover, Leuz, Nanda and Wysocki (2003) propose that EM exists when the objectives or interests of the managers are not consistent with the stakeholders'. With that being said, this conflict of interest shall influence the managers to publish distort financial reports and convey false financial information.

In scrutinizing the nexus between EM and CSR, agency theorists posit that voluntary disclosures (in this case, CSR) are able to reduce the conflict of interest between managers and shareholders (Sun et al., 2010). However, prior research have recorded variable results (Chih, Shen & Kang, 2008; Gargouri, Francoeur & Shabou, 2010; Kim, Park & Wier, 2012; Martinez-Ferrero, Rodriguez-Ariza & Garcia-Sanchez, 2016; Prior, Surroca & Tribo, 2008). Prior, Surroca & Tribo (2008) showed positive relationship between EM and CSR for regulated company rather than non-regulated company and argue that CSR can be used to garner support and protection from stakeholders. Similarly, Pagano and Volpin (2005) claim that the level of CSR performance pertaining to the environment and employees dimensions are positively related with EM.

2.4 Tax Avoidance

According to Hanlon and Heitzman (2010), tax avoidance (TA) can be defined as the reduction of explicit taxes and it includes a broad range of tax strategies. They inferred that taxes are actually a cost, and companies may manage and plan tax strategy to lessen the cost which results in higher profitability and maximizes the shareholders' wealth. Moreover, TA is regarded as value enhancing to shareholders. Therefore, managers are encouraged to practice their best effort to maximize shareholders' wealth by minimizing taxes (Christensen & Murphy, 2004). However, Erle and Schon (2008) further stated that companies involved in TA are making decisions that are based merely on the objective of minimizing taxes and hence are regarded as socially irresponsible.*

Taxes are a motivating factor in many corporate decisions. Nonetheless, corporate TA can create significant costs and benefits. The payment of corporate taxes ensures the financing of public goods. A such, should a company fail to pay its share of tax, this could cause negative effect on society (Freedman, 2003; Landolf, 2006). Accordingly, a company that is blatantly involved in aggressive TA can be considered socially irresponsible (Schon, 2008).

* Tax avoidance in this study refers to any tax minimization strategies or subset of strategies including aggressive tax planning, tax avoidance, tax evasion, tax management and tax sheltering.

Recent literature has started to pay much interest in studying the relationship between TA and corporate social responsibility (CSR) (Hoi, Wu & Zhang, 2013; Huseynov & Klammer, 2012; Laguir, Staglianò & Elbaz, 2015; Lanis & Richardson, 2013). However, this respective relationship is still not conclusive as some studies found that socially responsible companies are less involved in tax avoidance (Laguir, Staglianò & Elbaz, 2015; Zeng, 2016); whereas Lanis and Richardson (2013) argued that tax aggressive companies disclosed more CSR related information aligned with legitimacy theory.

As mentioned above, Lanis and Richardson (2013) demonstrated that companies that are overtly engaged in TA reacted to such disapproval by disclosing additional CSR information in an attempt to ease such public concern, alter public expectation of its activities or display its noble obligation to the community. In contrary, Zeng (2016) found that companies with higher CSR ranking are less likely to engage in TA. The strategy in this result indicates that paying more taxes can build up companies' reputation and differentiate their products from those of their competitors.

2.5 Moderating Variables: Managerial Ownership

Agency theory (Eisenhardt, 1989; Jensen & Meckling, 1976) proposes that top managers wield the power to allocate resources among a broad range of stakeholders in a way that guarantees support from them. Nonetheless, the theory also posits that providing stock to managers effectively alleviate agency problem by aligning managers' interest with stakeholders'. As such, should the managers possess significant amount of equity, they are prone to make decisions that maximize the shareholders' wealth (Denis, Denis & Sarin, 1997; McConnell & Servaes, 1990). By having a large stake in corporate ownership, managers are motivated to facilitate corporate investment in social affairs to increase shareholder value as well as their personal wealth.

Prior studies correspond to the positive relationship between managerial ownership (MO) and CSR engagement. Uwalomwa (2011) found that higher level of MO leads to higher level of CSR performance as managers also have their stake in the long-term survival of the company. Jia and Zhang (2013) supported the positive relationship with the result of higher MO being associated with significantly higher probability of donation and charity, the proxy for CSR, because corporate philanthropic donation is a more valid proxy for CSR performance.

However, other prior studies have demonstrated that MO is not associated and negatively associated with CSR disclosure. Juhmani (2013) concluded that MO is not associated with CSR disclosure as MO in Bahraini companies cannot eliminate the conflict of interest between managers and shareholders as the formers' interests are still separate from the latter's interest which contribute to the inability to reduce the managers' opportunistic behaviour. Abdul Razak and Mustapha (2013) mentioned that MO is significant and negatively influences the CSR disclosure in Malaysian listed companies. They claimed that owner-managed companies (i.e. family businesses) may be less involved in social activities because outsiders' interest may be relatively small and they perceive that the costs of investing in CSR activities may far outweigh their potential benefits.

2.6 Theoretical Framework and Hypotheses Development

At the present time, studies in CSR have spiked as a result of companies being concerned with transparency and maintaining legitimacy (Alsaadi, Ebrahim & Jaafar, 2016; Du & Vieira, 2012; Muttakin, Khan & Azim, 2015). However, prior studies have indicated variable results in the relationship between

socially responsible companies and their level of transparency in earnings reporting (Kim, Park & Wier, 2012; Martinez-Ferrero, Rodriguez-Ariza & Garcia-Sanchez, 2016; Muttakin, Khan & Azim, 2015). Due to such discrepancies, this study will investigate the respective relationship by focusing on the relationship of opportunistic managerial discretion and CSR in a developing economy country, Malaysia. Due to the negative effect resulted from the irrational managers' actions, shareholders and other stakeholders shall demand monetary compensation for the losses suffered (Zahra, Priem & Rasheed, 2005). Moreover, Raupp (2011) proposes that the concept of CSR has a close relationship with stakeholder theory as company is expected to discharge its responsibility towards the society.

In the context of conflict of interest, managers prefer to overinvest in CSR as an entrenchment device (Pawlina & Renneboog, 2005) and allocated more financial resources to CSR practices (Prior, Surroca & Tribo, 2008; Surroca & Tribo, 2008). Barako, Hancock and Izan (2006) state that voluntary disclosure is another means of mitigating agency problem whereby managers disclose more voluntary information to potentially reduce the agency cost and to convince the external users that managers are behaving in an optimal way (Watson, Shrives & Marston, 2002). Disclosures were considered as part of a monitoring platform to diminish the information asymmetry and agency problems with their resulting cost. CSR activities also can be seen as a way of developing trust and close relationships with those stakeholders that have the power in controlling resources that are capable of providing warrant to the business continuity (Freeman, 1984).

Following the above discussion, stakeholders possess a vital role in managers' entrenchment strategy alongside with the managers' aggressive involvement in CSR. In order to make themselves entrenched in the company; managers shall associate themselves with various CSR activities in order to have close relationships with the stakeholders. Besides, Cespa and Cestone (2007) argue that managers will try to buy off stakeholders, support and protection which make them entrenched with the discontent shareholders affected by their misbehaviour. In line with this argument, colluding with stakeholders reinforce managers' strategy as they have the power to influence company value, avoid costly boycotts and lobbying (Surroca & Tribo, 2008).

Accordingly, managers may exercise social and environmental behaviour as it may satisfy their stakeholders' expectations, defusing possible damaging consequences to the opportunistic managerial discretions undertaken by the managers and avoid monetary compensation being demanded by the stakeholders that suffered losses as a result of the irrational managerial discretion (Cespa & Cestone, 2007; Surroca & Tribo, 2008; Zahra et al., 2005). In view of these considerations, it can be inferred that the incentives of CSR practices offer managers with a prevailing tool for conforming to stakeholders' demand and evade negative reactions for their misconduct. Put simply, CSR is used as an entrenchment mechanism.

a) Earnings management and Corporate Social Responsibility

Concentrating on the relationship between EM and CSR, several prior studies proved that managers involved in this discretionary behaviour tend to engage in more CSR activities. They promote the sustainable actions with the intentions of ensuring their continuity in its leadership position and avoid changes in the control of the company, avoid costly boycotts and stakeholders activism as well as collude with stakeholders with the aim of reinforcing their strategy and continue acting on their own interest (Cespa & Cestone, 2007; Gargouri, Francoeur & Shabou, 2010; Prior, Surroca & Tribo, 2008; Surroca &

Tribo, 2008). Moreover, Bansal (2005) indicates that managerial entrenchment strategy avoids costly boycotts and damaging campaigns in the media.

However, some of prior studies contended and reported contrasting results whereby socially responsible companies were less likely to be involved in EM practices as those companies are obliged to project a good image and showed that the managers were discharging their responsibilities towards stakeholders in an optimal way (Kim et al., 2012; Salewski & Zulch, 2014).

Despite having variable empirical evidence on the relationship between EM and CSR, this proposed study posited that managers that are involved in EM practices have more incentives to engage in more CSR activities so as to conceal their misconducts and buy off stakeholders' support.

H₁: Earnings management has a positive relationship with corporate social responsibility.

b) Tax avoidance and Corporate Social Responsibility

With regards to TA, the resulting shortfall in corporate tax revenue engenders hostility, damaged reputation and the possibility of business cessation and also significant and potentially irrecoverable loss to society (Erle, 2008; Landolf, 2006; Slemrod, 2004). As such, stakeholder theories suggest that a company seeks to legitimize and sustain its relationship by conducting its operations in a socially responsible manner and discharge its obligation to disclose the nature of its activities with the intention of regaining stakeholders' confidence (Gray, Kouhy & Lavers, 1995).

Corporate TA is a significant factor in augmenting public concern over corporations (Christensen & Murphy, 2004; Sikka, 2010). The inability of a company to pay its fair share of tax will attract community concern since it steals the government's ability to finance public goods. TA is also part of agency problem mainly due to the fact that irrational managers have the opportunity for managing self-interest whilst avoiding tax as directed by the shareholders (Chen, Chen & Shevlin, 2010; Desai & Dharmapala, 2009). However, most of the prior studies (Chen, Chen & Shevlin, 2010; Desai & Dharmapala, 2009; Lanis & Richardson, 2012) only concentrated on TA in standalone company theory (i.e. Stakeholder theory, Agency Theory and Legitimacy Theory). As such, this present study is motivated to analyse the use of CSR activities as the managerial entrenchment strategy for TA in stakeholder-agency theory.

H₂: Tax avoidance has a positive relationship with corporate social responsibility.

c) The moderating effect of managerial ownership

Further to the above study, the moderating variable of managerial ownership could influence the above relationship. In a company that has higher managerial ownership (MO), managers are driven to make decisions that maximize shareholders' value as it could also increase their personal wealth. Prior studies suggest that managers need to be involved in social affairs such as CSR activities to elevate the company's value as a whole resulting to goal congruence. Higher MO leads to greater involvement in CSR activities as the long-term survival of a company is also linked with the managers' stake (Uwalomwa, 2011). On the other hand, MO is closely related to managerial entrenchment as it serves as a takeover deterrence mechanism that promotes managerial entrenchment. The idea is, the more shares a manager holds, the less power the other owners of the company have upon a manager's decisions. MO reflects managerial entrenchment because high MO shields managers against other corporate governance mechanisms (de Miguel, Pindado & de La Torre, 2004; Stulz, 1988).

Therefore, managers that have higher stakes in the company and also engaged in misconduct will have higher incentives to involve themselves in CSR activities so as to mask their opportunistic actions and secure their job. MO will be measured based on the percentage of shares owned by top managers in a company. Centering this perspective into Malaysia ownership structure, the hypotheses proposed are as follows:

H₃: Managerial ownership positively moderates the positive relationship between EM and CSR.

H₄: Managerial ownership positively moderates the positive relationship between TA and CSR.

3. Methodology of the Study

3.1 Sample

The sample of companies for the proposed study will be taken from Malaysia companies listed in the main market of Bursa Malaysia. As of 2016, there were 806 companies listed on the main board. Any companies that fell under the financial sector, PN1 companies and GN3 companies were excluded from the total number. The rationalization in excluding these companies is to attain relevant information from those companies that have and hold strong financial stability. Hence, this proposed study shall examine 270 companies and this amount of sample can be considered as appropriate given that the size of the sample population required by Krejcie and Morgan (1970) is 260.

3.2 Measurement of Variables

a) Earnings Management

Modified Jones (1991) model (Dechow et al., 1995) will be employed to separate the non-discretionary components of accruals from the discretionary accruals. Discretionary accruals serves as the proxy for earnings management and has been used by many researchers (Alsaadi, Jaafar, & Ebrahim, 2013; Choi et al., 2013; Prior et al., 2008). Aside from being widely used, Dechow et al. (1995) claimed that the modified model is more powerful than the initial one since they adjusted the determinants of variations in revenue by considering the changes in account receivable during the examination period so that credit sales will not be included in the determinants of non-discretionary accruals. This is because companies may manage the credit sales. Hence, the following model is derived:

$$TA_{i,t}/A_{i,t-1} = \alpha_1(1/A_{i,t-1}) + \alpha_2(\Delta SALES_{i,t} - \Delta REC_{i,t}/A_{i,t-1}) + \alpha_3(PPE_{i,t}/A_{i,t-1}) + \varepsilon_{i,t} \quad (1)$$

where TA is the total accruals for company; A represents the total assets; Δ Sales is the change in sales; ΔREC is accounts receivable and PPE represents the property, plant and equipment.

b) Tax Avoidance

To measure tax avoidance, this study proposes to use the current effective tax rate as it has the ability to locate a wide range of tax strategies, either from legal strategies or illegal ones (Landry, Deslandes, & Fortin, 2013; Lanis & Richardson, 2012). The computation can be done as follows: current income tax expense divided by pre-tax book. High current effective tax rate indicates low tax avoidance.

c) Corporate Social Responsibility

This study proposes a disclosure checklist to measure CSR quality among listed companies in Malaysia. This disclosure checklist has been developed based on prior studies conducted in Malaysia namely Anas

et al. (2015), Haji and Mohd Ghazali (2013), Sadou et al. (2017) and Saleh et al. (2010). A total of 40 items were listed to comprehensively take into account all relevant CSR information, which includes environment, workplace, community, marketplace and product. The disclosure quality will then be calculated for determining the CSR index. The unweighted disclosure index approach (Anas et al., 2015; Saleh et al., 2010) is employed as a dichotomous variable. Hence, a company that disclosed a CSR item in its annual report will be given a score of “1”, and a score of “0” if otherwise (Gujarati, 2009). The total scores that one sampled company could obtain are 40 points.

d) Moderator: Managerial Ownership and Control Variables

MO will be measured based on the percentage of shares owned by top managers in a company. The company size, industry and leverage will be used as control variables as those variables may have an impact on the above relationships despite controlling the companies' characteristics.

4. Conclusion

The proposed study aims to scrutinize the misuse of CSR disclosure by irrational managers to ease public concern, mask their opportunistic managerial discretion, gain job security and create close relationship with the stakeholders in order to reinforce their entrenchment strategy. Earnings management and tax avoidance are the managerial discretion behaviours that are expected to influence and increase the CSR disclosure and the theory that stands in this study is the stakeholder-agency theory. Moreover, to provide a robust study, managerial ownership serves as the moderating variable with regards to the relationships.

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