Effect of CSR, Financial Distress, and Corporate's Growth on Earning Response Coefficient

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Abstract. *This study aims to obtain empirical evidence on the effect of corporate social responsibility (CSR), financial distress, and corporate growth on earnings response coefficient. This study uses data from manufacturing sector companies listed on the IDX during the period 2017 to 2020. Based on purposive sampling, this study uses a sample of 64 companies with a total of 256 observations. Data were analyzed using multiple regression analysis. The results concluded that corporate social responsibility has a positive effect on the earnings response coefficient, financial distress has a negative effect on the earnings response coefficient, and corporate growth has no impact on the earnings response coefficient.*

Keywords: *corporate growth; corporate social responsibility; earnings response coefficient; financial distress; Indonesia.*

Abstrak. Penelitian ini bertujuan untuk memperoleh bukti empiris tentang pengaruh *corporate social responsibility*, *financial distress*, dan pertumbuhan perusahaan pada *earnings response coefficient*. Populasi penelitian ini adalah perusahaan manufaktur yang tercatat di BEI tahun 2017-2020. Data pada penelitian ini menggunakan data sekunder yang diperoleh dari laporan keuangan dan laporan tahunan perusahaan sampel. Berdasarkan teknik *purposive sampling*, penelitian ini menggunakan sampel sebanyak 64 perusahaan dengan total observasi sebanyak 256 observasi. Data dianalisis menggunakan analisis regresi berganda. Hasil regresi penelitian ini menunjukkan bahwa *corporate social responsibility* berpengaruh positif terhadap *earnings response coefficient*, *financial distress* berpengaruh negatif terhadap *earnings response coefficient*, dan pertumbuhan perusahaan tidak berpengaruh terhadap *earnings response coefficient*.

Kata Kunci: *corporate social responsibility; earnings response coefficient; financial distress;* Indonesia, pertumbuhan perusahaan.

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How to cite this article. Immanuel, A. M., Sakti Prabowo (2021). Effect of CSR, Financial Distress, and Corporate's Growth on Earning Response Coefficient. Jurnal ASET (*Akuntansi Riset*), *Program Studi Akuntansi. Fakultas Pendidikan Ekonomi dan Bisnis Universitas Pendidikan Indonesia, 13 (2), 362-374*. Retrieved from https://ejournal.upi.edu/index.php/aset/article/view/39621
History of article. **Received:** October 2021, Revision: December 2021, Published: December 2021
Online ISSN: 2541-0342. Print ISSN: 2086-2563. DOI: https://doi.org/10.17509/jaset.v13i2.39621

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PRELIMINARY

A financial report gives a strong influence on investors' decision-making nowadays. It delivers information to the users to make decisions (Tania, 2018). One significant item that explains all operating, investing, and financing activities of a company in the financial statements during the accounting period is the company's earnings (Andreas, 2012; Chan et al., 2006), hence become one of the performance measurement tools that get special attention from every stakeholder (Takacs et al., 2020). The publication of information related to earnings can be the highest factor in attracting investors' attention (Moradi et al., 2010).

Publication related to company information such as earnings announcements will affect investors' reactions and trading volume in financial markets (Mulyani et al., 2007). Mashayekhi (2019) states that the main consequence of shareholder reactions to information, especially regarding earnings, is the changes in share prices. Awawdeh dkk. (2020) mengemukakan bahwa respon investor yang terekam melalui pergerakan saham merupakan salah satu tolak ukur untuk menilai pentingnya informasi akuntansi pada saat informasi tersebut diumumkan. Berdasarkan unit pendapatan tak terduga, Earnings Response Coefficient (ERC) mencerminkan reaksi pasar yang diukur dengan perubahan harga saham (Mahjoubi & Abanoub, 2015).

ERC is a form of signaling theory, where the company will provide a signal in the form of an income report to stakeholders, and then it will be responded to by stakeholders, resulting in changes in stock prices. Widiatmoko & Kentris Indarti (2018) state that if unexpected income has a positive direction, thus the average abnormal return will be positive. Conversely, if unexpected income has a negative direction, then the average abnormal rate of return will be negative.

Azizah et al. (2021) stated that the low-value ERC indicates that earnings information is less informative for investors in making decisions so that at the time of publication of earnings information, most investors tend to be less responsive to the earnings presented. On the other hand, the high value of ERC indicates that earnings announced by companies are informative for investors in deciding so that most investors will respond positively to earnings presented by the company.

Mahendra & Wirama (2017) mentioned that if the credibility of financial information is low, the investors’ response will be poor. One of the reasons for this poor investors’ reaction is the issue of manipulation regarding the company's financial statements.

Enron company in 2001 announced a restatement of its financial statements for the period 1997 - 2000 worth US$ 613 million (Thomas, 2002). Due to this restatement, Enron's shares price decreased by 99.71% (Healy & Palepu, 2003). In 2015 Toshiba Company was revealed to do window-dressing of US$ 2 billion for the period 2008-2014. The case caused Toshiba's stock price to fall by about 20% (Rahman & Bremer, 2017). Another financial report case occurred in Indonesia by PT Garuda Indonesia (GIAA) in 2018. The company announced a net profit of US$809 thousand while actually, the company lost US$244.96 million. This case caused the company's stock price to fall by 26.8% (Utami & Kartikasari, 2021).

The lack of credibility decreases the investors' trust in the earnings quality, resulting in the low value of the company's ERC. The company's reported earnings are responded negatively by investors with a decrease in the company's stock price. Although the company has audited its financial statements, it does not guarantee that the reported financial information reflects good earnings quality.

Awawdeh et al. (2020) stated that it is necessary to investigate the factors affecting ERC. This thought arises primarily from the need to increase the confidence of corporate stakeholders in the announcement of financial statements, to make rational and thorough decisions. In addition, ERC is considered a measure of the market's response capacity to information acquisition that indicates the higher the coefficient indicates the higher entity's earnings quality.

Hasanzade et al. (2013) stated that the market responds differently to different company's earnings information. By knowing the reasons for these differences in responses, accountants can identify items of financial information that are useful for investors in making decisions. Identifying and describing different markets' reactions to earnings information reflected by ERC will prove some empirical financial accounting research.

ERC reflects fundamental value because it brings a high correlation to stock prices (Dechow et al., 2010). Furthermore, DeFond & Zhang (2014) stated that ERC has a strong measurement consensus, low measurement error, and a short measurement window which will reduce the influence of confounding factors, and therefore this variable is a good tool in measuring the companies' earnings quality.

Previous research has discussed the variables that affect ERC, one of which is Corporate Social Responsibility (CSR). Ulum (2014) explains that CSR is a company's commitment that helps to build a sustainable economy, employee, employee's family welfare, and the surrounding community to improve the quality of life. CSR disclosure is trusted to be able to influence investors' reactions to the company's reported earnings, which can be measured by ERC (Sasongko et al., 2020). Furthermore, Abbas et al. (2020) show that companies that do not implement CSR will be more difficult to get investors. Investors tend to invest in companies that have high standards of social and environmental issues. Kim et al. (2018) stated that the relationship between CSR and ERC needs to be proved, because CSR disclosure in sustainability reports tends to be limited and less reliable, where the disclosure is not guaranteed by third parties such as the audit profession or other assurance service providers. This limitation and lack of credibility of CSR can be reduced by looking at its effect on profits and market reactions. Results show that CSR has a positive and significant impact on ERC in the research conducted by Abbas et al. (2020) and Sayekti (2015) but have a negative influence on the research of Homan (2018) and Dalimunthe (2016).

Some research also examines the influence of corporate growth on ERC. Sutoyo & Wulandari (2017) stated that companies with high growth opportunities influence investors' decision-making. A growing company indicates that the company has good prospects in the future. It signals to investors, where the higher the corporate's growth opportunities, the higher the investors' positive responses. Suwarno et al. (2017) stated that corporate growth could increase earnings and will be responded positively to by the investors. Corporate growth has a positive effect on ERC in the research conducted by Dewi & Puspaningsih (2019) but has no impact based on the study of Sari & Rokhmania (2020).

The next factor that can affect ERC is financial distress. Madhushani & Kawshala (2018) acknowledge financial distress as a condition when a company cannot pay its short-term and long-term debt. Wu et al. (2020) explained that firms with unstable finance structures are more likely to lose their market share, especially during industry downturns. Ahmad (2020) stated that financial distress causes an increase in company expenses which results in a decrease in earnings before interest and taxes. Linking ERC, as a result of the regression between investor reactions reflected in stock returns and the company's earnings, financial distress can affect earnings growth, like investor reactions that can affect ERC.

This study tries to prove the effect of corporate social responsibility, financial distress, and corporate growth on the earnings response coefficient with a case study of manufacturing companies in Indonesia.

This study differences previous studies by using financial distress, which according to the authors, has never been tested for its effect on ERC. In addition, this study also uses CSR as an independent variable with 53 indicators published by the Global Reporting Initiative (GRI) version 2016 as the latest version and still very rarely used as a proxy in measuring CSR on ERC in Indonesia. In the previous version as used by Awuy et al., (2016), CSR was measured using 84 indicators published by GRI G3, while Trisnadewi & Amlayasa (2020) used 91 indicators to measure CSR as published by GRI G4.

This study contributes to testing ERC in the context of business commitment based on CSR, financial distress, and company growth in a model that has never been tested before. In addition, this study contributes to increasing the determinant of ERC, namely financial distress. Previous studies on financial distress were conducted, for instance, to test its effect on accounting conservatism (Noviantari & Ratnadi, 2015), firm value (Valensia & Khairani, 2019), going concern audit opinion (Listantri & Mudjiyanti, 2016), and auditor turnover (Manto & Wanda, 2018). However, it has never been done to test its effect on ERC.

LITERATURE REVIEW

Signaling theory

Connelly et al. (2011) stated that signaling theory is information that will influence decision-making by stakeholders. This theory focuses on the existence of asymmetric information that causes asymmetric information between the signaling party (company) and the signaled party (stakeholder). Decision-making will be done better by stakeholders if they know the asymmetric information.

Syarifulloh et al. (2016) stated that companies must provide information or signals to outside parties. If external parties have limited information about a company, they will give a low evaluation to minimize risk in decision-making. Therefore, the company will be motivated to provide information or signals market as the basis for market participants to re-assess the company and re-evaluate stock prices.

An earnings announcement is one form of the signal given by the company. Widiatmoko & Indarti (2018) stated that the announcement of earnings information provides information that will affect the market reaction. A positive response will increase the ERC value. Vice versa, a negative response indicates a lack of expectations of the company's future earnings by investors so that the ERC decreases.

Corporate social responsibility and earnings response coefficient

Signaling theory claims that CSR disclosure is a positive signal for investors. Farooq et al. (2018) explained that earnings quality is higher for companies with a better information environment than companies with a poor information environment. CSR is a signal that a better information environment will result in higher earnings quality. Ng & Rezaee (2015) stated that CSR activities could reduce current earnings but generate higher long-term earnings by building a better working environment, and a better reputation with consumers and communities. Therefore, companies with good CSR disclosures will have high ERC values. The first hypothesis of this study is as follows:

H_1 = Corporate social responsibility has a positive effect on the earnings response coefficient

Financial distress and earnings response coefficient

Companies experiencing financial distress will have difficulties settling obligations in the future and can even lead to bankruptcy. The risk of bankruptcy due to failure to pay off the company's obligations is a bad sign for investors' decision-making. Idrees & Qayyum (2018) states that financial distress is an important factor that can affect the loss of market share, trust from suppliers, employees, and shareholders due to the high risk of bankruptcy. Campbell et al. (2011) in Fachrudin & Ihsan (2021) founded that shares of companies experiencing financial distress will experience rapid volatility of stock movement, high market risk, poor performance, and low returns. Therefore, the second hypothesis of this study is as follows:

H_2 = Financial distress has a negative effect on earnings response coefficient

Corporate growth and earnings response coefficient

Corporate growth is a signal published by the company through financial reports (Dewi & Puspaningsih, 2019). Sandi (2013) stated that higher growth of a company leads to greater potential earnings generated by the company in the future. The potential for increased profits gives a positive sign of increasing investor prosperity so that this condition will lead to an increase in market response and the company's stock price (Fitri, 2013). This situation indicates that higher corporate growth lead to higher earnings quality reported (Aristawati & Rasmini, 2018). Based on the description above, companies with high growth tend to have high ERC values. Therefore, the third hypothesis of this study is as follows:

H_3 = Corporate's growth has a positive effect on earnings response coefficient

RESEARCH METHODOLOGY

This study is quantitative research and uses secondary data from financial reports, annual reports, and stock price movements of manufacturing sector companies listed on the Indonesia Stock Exchange in 2017-2020. The data is obtained from the IDX website (web.idx.co.id), finance.yahoo.com, company sustainability reports, and other sources that are relevant to the research objectives. It runs hypothesis testing statistical analysis using Eviews 9. The sample is selected using a purposive sampling technique by determining several criteria following the research objectives. Criteria and number of sample selections are presented in Table 1.

Tabel 1. Sample Selection

No	Information	Company
1	Research population	195
2	Subtracted by the sampling criteria:	
a.	Not listed on the IDX before January 1, 2016	53
b.	Does not have complete elements/information regarding financial statements and annual reports	78
3	Research samples	64
4	Years of observation	4
5	Total observations	256

Source: Data processed by the author (2021)

Variable operation

Dependent variable

According to Sekaran & Bougie (2016), The dependent variable is the main objective in the study. The dependent variable in this study is the earnings response coefficient (ERC). The proxy used to calculate ERC in this study refers to the research conducted by Awawdeh et al. (2020), Dewi (2015), Sayekti (2015), dan Widiatmoko & Indarti (2018). The reason for choosing this proxy is because measuring ERC in this way is generally accepted and used in most ERC-related studies (Al-Baidhani et al., 2017). ERC is obtained from the following equation:

$$\mathbf{CAR_{i(-3,+3)} = \beta_0 + \beta_1 UE_{it} + \varepsilon_{it}}$$

Information:

$CAR_{i(-3,+3)}$ = Cumulative abnormal return of company i at the time of earnings announcement on days t-3 to t+3

β_0 = Constant

β_1 = Regression coefficient between CAR and EU, which is the Earnings response coefficient (ERC)

$UE_{i,t}$ = Unexpected earnings of a company i in period t

ε_{it} = Component error in the model of firm i in period t

Independent Variable

According to Grahita (2017), an independent variable is a variable that influences the dependent variable, positively or negatively. This study uses corporate social responsibility, financial distress, and company growth as the independent variables.

Corporate social responsibility (CSR)

The proxy of CSR disclosure used in this study refers to the standards or indicators published by the Global Reporting Initiative (GRI) in 2016. The reason for choosing this proxy is because GRI is one of the most influential organizations related to CSR disclosure (Fuente et al., 2017). The measurement of CSR is described in the following formula:

$$\mathbf{CSR} = \frac{\sum Xi,t}{Nj}$$

Information:

$\sum Xi,t$ = Total score of CSR disclosure of company i in year t

Nj = Total indicators according to GRI version 2016 (Nj = 153)

Financial distress

The proxy of financial distress in this study refers to the research of Altman (1968) using the Altman Z-score. Primasari (2017) states that Altman Z-score produces the most effective and accurate value in signaling information about the company's financial condition. The lower value of Altman Z-score indicates the higher level of financial distress of a company. The measurement for financial distress is described in the following formula:

$$Z = 1.2\ X1 + 1.4\ X2 + 3.3\ X3 + 0.6\ X4 + 1.0\ X5$$

Information:
Z = Altman Z-score
X1 = Working capital/total assets
X2 = Retained earnings/total assets
X3 = Earnings before interest and taxes/total assets
X4 = Market Value of Equity/Book Value of Total Liabilities
X5 = Sales/total assets

Corporate's growth

The proxy of corporate growth used in this study refers to the research used by Dewi et al. (2014), Ukhriyawati & Dewi (2019), Suryandani (2018), and Dhani & Utama (2017). The proxy was chosen because it can describe the actual growth of the company based on the growth of the company's assets. The amount of growth in the company's assets will affect the company's income and potential profit so that it can be a good indicator in measuring company growth (Putrakrisnanda, 2009 in (Kusumajaya, 2011)). Company growth is measured by the following formula:

$$\mathbf{GRWTH} = \frac{\textit{Total Assets}_{i,t} - \textit{Total Assets}_{i,t-1}}{\textit{Total Assets}_{i,t-1}}$$

Keterangan:
Total $\text{assets}_{i,t}$ = Total assets of company i in year t
Total $\text{assets}_{i,t-1}$ = Total assets of company i in year t-1

RESULTS AND DISCUSSION

This research tries to test the effect of the independent variable on the dependent variable by using one control variable. The dependent variable in this study is the earnings response coefficient. The independent variables in this study are corporate's growth, financial distress, and corporate social responsibility. The control variable in this study is firm size. This study uses multiple linear regression analysis techniques with the following equation model:

$$\mathbf{ERCSQ_{i,t} = 8{,}430 + 56{,}737CSRSQ_{i,t} + 0{,}041FDSQ_{i,t} + 0{,}202GRWTHSQ_{i,t} - 0{,}014SIZESQ_{i,t}}$$

Information:
$ERCSQ_{i,t}$ = square of earnings response coefficient of firm i year t
$GRWTHSQ_{i,t}$ = square of corporate's growth of firm i year t
$FDSQ_{i,t}$ = square of financial distress of company i year t
$CSRSQ_{i,t}$ = square of corporate social responsibility of company i year t
$SIZESQ_{i,t}$ = square of the firm size of firm i year t

Descriptive Statistics

This section clarifies the description of the data from each of the variables used in this study. Table 2 explains the statistical data description of dependent and independent variables observed in this study.

Based on Table 2, the average value of ERC is 0.079 with a median of -0.002. The positive average value indicates that investors in the manufacturing sector tend to respond positively to earnings reported by increasing the stock prices. The maximum value of observations is 20.920, which is the ERC value of the company with the code of TRIS in 2018, while the lowest ERC value is -10.283, which is the ERC value of the company with the code of NIKL 2020. The standard deviation of the ERC is 2,200.

Based on Table 2, the average value of CSR is 0.329, with a median of 0.333. The maximum value of observations is 0.444, which is the CSR value of the company with the code of UNVR 2020, while the lowest CSR value is 0.196, which is the CSR value of the company with the code of SSTM 2017. The standard deviation of the CSR is 0.033.

Tabel 2. Descriptive Statistics

	ERC	CSR	FD	GRWTH
Mean	0,079	0,329	4,523	0,065
Median	-0,002	0,333	3,032	0,042
Maximum	20,920	0,444	41,334	1,234
Minimum	-10,283	0,196	-17,709	-0,379
Std. Dev.	2,200	0,033	5,975	0,178
Obs	256	256	256	256

Source: Data processed by the author (2021)

Based on Table 2, the average value of financial distress is 4.523, with a median of 3.032. The average value of financial distress for manufacturing companies is above 2.67, which indicates that the average manufacturing company does not experience financial distress (Habib et al., 2020). The maximum value of observations is 41.334, which is the financial distress value of the company with the code of HMSP 2017, while the lowest financial distress value is -17.709, which is the financial distress value of the company with the code of POLY 2020. The standard deviation of the financial distress variable is 0.033.

Based on Table 2, the average value of company growth is 0.065, with a median of 0.042. The positive average value indicates that manufacturing sector companies generally increase their assets within the year 2017-2020. The maximum value of observations is 1.234, which is the growth value of the company with the code of 2017 ALKA, while the lowest company growth value is -0.379, which is the growth value of the company with the code of 2019 ALMI. The standard deviation of the company growth variable is 0.178.

Table 3. Regression Result

Variable	Coefficient	Prob.
C	8,430976	0,013
CSRSQ	56,73706	0,018
FDSQ	0,041109	0,001
GRWTHSQ	0,202920	0,817
SIZESQ	-0,014391	0,000
Effects Specification		
R-squared	0,3937	
Adjusted R-squared	0,177	
F-statistic	1,822	
Prob(F-statistic)	0,000	

Source: Data processed by author (2021)

Based on the test results in Table 3, the R-squared value is 0.393710. This value indicates that the variables of CSR, financial distress, company growth, and company size can explain 39.37% of the ERC variation, while 60.63% of the ERC variation is explained by other factors outside the research variables. Based on Table 3, the probability result from the F-statistic is 0.000. This value is smaller than the value of (0.05). Thus, all independent variables and control variables simultaneously have a significant effect on ERC, so the regression model of this study can be used.

Effect of corporate social responsibility on earnings response coefficient

The results of the regression test in Table 3 show that CSRSQ has a positive coefficient with a p-value below 0.05. Therefore, the study concludes that CSR has a positive effect on ERC. These results are in line with signal theory as the general theory of research. CSR is a positive sign that influences investors in making decisions related to the company's reported earnings. The positive signal received by investors regarding CSR explains that companies that carry out CSR activities also pay attention to the interests of stakeholders, not only the interests of shareholders. This attention to stakeholder interests increases future revenue potential through improving relationships quality with customers, business partners, and employees. Those activities will influence the potential revenue or profitability of the company (Cheng et al., 2014). In addition, CSR activities carried out by the company will also contribute to the company's reputation and trademark (Lindgreen & Swaen, 2010).

These results also indicate that the quality of earnings will be higher in companies that have a high CSR value. Investors view that earnings reports for companies that carry out and report CSR activities will be more relevant in making decisions compared to companies that do not carry out and report CSR activities. This relevance is shown through the behavior in which the stock returns of companies that have a high CSR value at the time of the announcement of company earnings, will be responded to better by investors, than companies that have a low CSR value.

One indicator of high earnings quality is the lack or absence of earnings management. Sayekti (2015) states that companies with high CSR activities show good management so that it will improve the quality of earnings and ERC. The lower the company's earnings management, the lower the risk that must be borne by investors in making decisions. The results of this study support the research conducted by Abbas et al. (2020), Sasongko et al. (2020), and Sayekti (2015) that state the company's CSR disclosure has a positive effect on ERC.

Effect of financial distress on earnings response coefficient

The results of the regression test in Table 3 show that the FDSQ has a positive coefficient and has a p-value below 0.05. Financial distress in this study uses the Altman Z-Score which value is inversely proportional to the level of financial distress that financial distress variable has a negative and significant effect on ERC. These results follow signal theory as the general theory of this research. Financial distress is a condition where the company has difficulty meeting its debt obligations and will prioritize debt payments to creditors before allocating its finances for company operations or dividends. This is certainly a negative sign for investors where the reported profits of the company will be divided. In addition, financial distress also indicates a company is heading for bankruptcy. Companies will lose the trust of suppliers, employees, and market share, which will ultimately reduce shareholder confidence in the company (Idrees & Qayyum, 2018). The loss of stakeholder trust will reduce the potential future earnings, while the loss of shareholder confidence will reduce the company's share price. Fachrudin & Ihsan (2021) stated that investors appreciate a healthy company's financial condition. Companies that do not experience financial distress will get better stock returns than companies that experience financial distress.

ERC is a measure of the company's earnings quality, which shows the higher the ERC value, the higher the company's earnings quality. The results of this study support the results of the research of Charitou et al. (2011), which states that financial distress has a negative effect on earnings quality. Companies experiencing financial distress tend to do earnings management (Paramita, 2018). Earnings management is carried out on the demands of investors who want the company to earn high profits, but the company cannot meet these demands. Earnings management caused by financial distress reduces the quality of earnings reported by the company so that it has a negative effect on ERC.

Effect of corporate's growth on earnings response coefficient

The results of the regression test in Table 3 show that the GRWTHSQ has a p-value above 0.05, thus it can be concluded that the company's growth variable does not affect ERC. This result indicates that the corporate's growth is not a signal that affects investors in making decisions related to reported earnings, which is, the low or high values of corporate growth do not affect the quality of company earnings. This study cannot prove the statement of Sari & Rokhmania (2020) regarding earnings in companies experiencing high growth will be responded better by investors in the form of increases in stock prices, compared to profits in companies experiencing low growth.

The growth of a company's assets requires operational control to avoid uncontrollable costs (Sari & Abundanti, 2014). The company's growth in the form of increasing company assets might be able to increase the company's operational capacity and revenue, but this does not guarantee an increase in company profits. Although there is an addition to revenue, the company also has to bear additional costs for the revenue it earns. The uncertainty of this increase in earnings causes investors to not respond to the company's growth rate on the company's ERC.

The results of this study are consistent with the results of research conducted by Sandi (2013), Santoso (2015), and Sari & Rokhmania (2020) that show corporate's growth does not affect ERC. Corporate growth is one of the considerations for investors with a long-term perspective, but the results of this study show that investors do not respond to the corporate growth on reported earnings, so investors in manufacturing companies in Indonesia may tend to focus on short-term capital gains rather than expecting higher long-term yields which cause the corporate's growth does not affect ERC.

CONCLUSION

Corporate social responsibility positively affects the earnings response coefficient. The result indicates that investors see CSR gives a positive impact on the interests of shareholders and stakeholders. It will increase potential income, popularity, and the company's trademark as well as increase the ERC.

Financial distress negatively affects the earnings response coefficient. The negative direction indicates that the higher the company's financial distress, the smaller the ERC value. The result put financial distress as a negative signal that causes companies to lose the trust of suppliers, employees, and market share, thereby lowering the value of ERC.

Corporate growth does not affect the earnings response coefficient. This indicates that investors do not see the company's growth as a certain signal that can influence decision-making. The corporate's growth does not guarantee an increase in company profits because the additional operating capacity and revenues do not necessarily exceed the additional operating costs incurred by the company, hence it does not guarantee an increase in company earnings.

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