CHAPTER I

INTRODUCTION

1.1 Background

The conventional prime objective of doing business is to satisfy shareholder's wealth by maximizing profitability and the value of the firm (Sunrowiyati, Chandrarin, & Subiyantoro, 2019). Only by doing so, will firms be able to survive the harsh competitive environment of doing business and keeping shareholders satisfied. Agency theory states that managers, as agents of the business, are responsible for making optimum decisions that give the most benefit to the principal, aka the shareholders (Deegan, 2014). By producing high profits and stable growth, managers will have fulfilled their obligation to please the shareholders. Aside from that, doing so can trigger potential investors to invest capital in the company. This in turn can help the business build even more cash and working capital essential for its growth and survival. Therefore, ensuring that the shareholders are happy should be made a priority by the business.

Shareholders are motivated to invest in a particular stock that allows them to get the highest possible return from their investment. Shareholders earn income from their investments in two ways, the first is through dividend payouts from the firm and the second is through the capital appreciation of their stock. It is their residual claim to get a share of the company's profit through dividend payouts and therefore they would prefer if the company can maximize its profitability and cut down unnecessary expenses. Subsequently, they would also like to see an increase in their stock price. This is influenced by the demand and supply of the stock in the capital market and also the accounting and non-accounting performance information disclosed by the company (Murdiono, 2018). Financial statements provide information about the performance of the company and is used as a leading tool to obtain information (Sunrowiyati, Chandrarin, & Subiyantoro, 2019). Corresponding to both items, firms are pressured to focus only on the financial aspect of business and disregard the social and environmental aspects.

Despite that, businesses exist not merely to satisfy only the shareholders. The success of a business relies on its ability to satisfy all its stakeholders. Stakeholder theory is a theory which indicates that the primary objective of doing business is to establish meaningful relationships and connections in order to generate value for all of its stakeholders (Freeman & Dmytriyev, 2017). Stakeholder theory is extremely important as it highlights that for the long term, businesses' continued existence requires the support of its stakeholders (Li, Lin, & Yang, 2016). Companies are not only responsible for presenting shareholders with a decent return on investment, but also for ensuring the well-being of a broader range of groups such as customers, suppliers, employees, community, and environment (Freeman R. E., 2007).

The due to the fact that, as described by (Freeman R. E., 1984), a stakeholder is any group or individual who can affect or is affected by the accomplishment of the goals of the company. This conveys that any action taken by a corporation could result in responses from stakeholders that could have a favorable or unfavorable effect on the firm. Without customers, the business will not be able to generate revenue. Without employees, the business will not be able to operate. Without the support of the community, the business will not be able to thrive and may be faced with protests. Thus, in this theory, it is essential to keep the stakeholders satisfied and align their goals to the goals of the business to ensure its success. This is because the poor social impact might increase the financial risk of companies and trigger misconnections with many groups and affect the credibility of the entire organization (Nurdiono, et al., 2019). A business that pollutes the environment or has unsafe working conditions might anger stakeholders and the consequences could include customers not buying the company's products, strikes by workers, penalties by the government, and protests by the local community just to name a few.

Furthermore, other than the need to satisfy all stakeholders as they can affect the business, a firm must be trustworthy, upright, and ethical in the eyes of the community. This is so that customers will feel safe and secure in doing transactions with the business knowing they are honest and principled and have the same goals as society. The theory that relates to the credibility of a business is the legitimacy theory. (Deegan, 2014) states that legitimacy theory is a theory where a firm wants to ensure it operates within the respective bounds and norms of society. The firm wants to fulfill its social contract to society that enables the firm to appear as legitimate. It is of utmost importance to be viewed as a legitimate business as adhering to the expectations of stakeholders would encourage more people to eventually support the business. As being perceived as legitimate; customers might buy more products from the business driving revenue up, better workers might want to work for the company which in the long term might improve efficiency and bring new ideas, and the local communities will happy of having such a business nearby. One of the ways legitimacy can be achieved is by disclosing to the stakeholders that the operations of the business conform to societal norms and bounds.

In this 21st century, where there is increased technological advancement and speed of information flow across the globe, a business must be watchful of their brand image to not infuriate their customers. The strategy of only focusing on the financial aspect of business and the single bottom line no longer functions. The concept of the triple bottom line is that a business is responsible for 3 main aspects which are profit, people, and the planet (Rosiliana, Yuniarta, & Darmawan, 2014). The profit aspect means that the business still needs to be focused on finding profit to allow it to continue to operate and expand. The people aspect pays attention to human welfare, such as running social services like offering students scholarships and ensuring the safety of the employees. Lastly, the planet aspect is reflected in the company's concern for the environment and biodiversity preservation, like planting trees and recycling.

According to (Townsend, 2018), 88% of consumers now prefer to buy products or services from companies that are environmentally friendly and ethical. This is because 96% of people feel that buying from ethical companies can make a difference and change the world for the better. The millennial generation, who are set to take over the baby boomers, prefer companies that are more socially and environmentally responsible. 73% of millennials, compared to 66% of other consumers, would not mind spending more money to purchase a product from a sustainable brand. Additionally, 90% of millennials would change brands if the other is implementing an environmental or social project. Therefore, with stakeholder theory and legitimacy theory considered, to please the new generation of consumers and gain a competitive advantage against other firms, businesses must now show stakeholders that they are also environmentally and socially responsible. One of the ways businesses can ensure their responsibilities to stakeholders is achieved is to implement Corporate Social Responsibility (CSR).

The concept of Corporate Social Responsibility (CSR) and the effect it has on business have been extensively debated in the academic community (Nande, 2010). CSR is a term that has been mentioned in the business community since the early 20th century. Although this is the case, it only gained more attention around the 1950s, after World War II ended. Corporate Social Responsibility is the responsibility of business towards society (Brown & Forster, 2013). CSR relates to the responsibility of companies to adopt strategies, take decisions and to follow lines of action that are beneficial and in line to the objectives and ideals of the society (Nande, 2010). In addition, CSR can also be viewed as actions made by a businessman for reasons that are partially outside the immediate economic or technical interest of the company (Nande, 2010). Businesses that are involved in carrying out CSR pay attention to the social and environmental concerns of stakeholders other than the shareholders. By implementing CSR in these areas, firms hope to be perceived as a legitimate business and attract customers in buying their products and investors in investing in their business.

The Indonesian Government, aware of the importance of preserving the environment, issued Law No. 40 of 2007 on Limited Liability Companies, in particular Article 74(1), which states that companies operating in the field of natural resources and natural resource-related fields are obliged to carry out social and environmental responsibility. And also issued Law No. 32 of 2009 on the Protection and Management of 2 Living Environment (PPLH Law), about Sustainable Development, which is the development that can meet the needs of the present generation without diminishing future generations' abilities. Although this is the case, for other firms CSR is still voluntary and its implementation is low (Fauziah, Irwanto, & Syamsun, 2016).

An article at Kontan discusses the CSR conducted by the company Djarum through its Djarum Badminton Club (Adi, 2019). As Indonesia is a country that loves playing badminton and excels in it, Djarum formed the Djarum Badminton Scholarship program aimed to contribute to excelling badminton as a sport in Indonesia. Through this, it hopes for more Indonesians to get achievements in badminton competitions worldwide. Djarum started recruiting talented badminton players across the nation since 2006. Although this is the case, in 2019, the KPAI (Commission for The Protection of Children Indonesia) has accused the Djarum badminton club of promotion of Djarum's cigarette products and the use of CSR to enhance its corporate image. Djarum was then ordered to refrain from using its logo for its recruiting campaign. Djarum agreed to this and stopped using its logo for its 2019 recruitment.

Through this phenomenon, the author would like to investigate the impact of CSR towards the value of the company to see whether disclosure of CSR leads to people buying more of the company's products, boost its financial performance, and ultimately increasing the value of the firm. Apart from Corporate Social Responsibility, the Financial Performance of the firm is another aspect impacting Firm Value. Financial Performance is one of the considerations that prospective investors see when it comes to evaluating if a share is worth investing in. Therefore, maintaining and enhancing financial performance is essential for a company to attract potential investors. Financial performance is measured through the use of financial ratios. The financial ratio is a method used by a corporation to assess and view its financial position (Stefano, 2015). Another definition by Horne & Wachowicz (2007, (Stefano, 2015)), states that financial ratios are "an index which relates two accounting numbers and the result is obtained by dividing one particular number to the other".

This research was conducted to prove whether CSR (Corporate Social Responsibility) has an impact on firm value, particularly in LQ45 companies. Measuring CSR disclosure as the independent variable in this study uses the G4 Global Reporting Initiative (GRI G4) indicators, whereas measuring firm value as the dependent variable uses Price-to-Book Value (PBV) and measuring financial performance as the interveningmediat variable will use Return on Assets (ROA). Although this research was done quite a lot, there are different results for the studies that were conducted previously. Although this research was done quite a lot, there are different results for the studies that were conducted previously. The research of (Fauziah, Irwanto, & Syamsun, 2016) and (Rahmi, Indrayeni, & Wijaya, 2019)show that CSR has no significant impact towards the stock performance of the company. While (Ardiyanto & Haryanto, 2017) and (Oktaviami, 2016) show that CSR has a positive and significant impact towards the stock performance of the company. This shows that prior research between CSR disclosure and stock performance does not show consistency. Because of this inconsistency in results and based on the background above, the author takes the title of The Impact of Corporate Social Responsibility Disclosure towards Firm Value with Financial performance as a intervening variable. The research was conducted on the LQ45 companies recorded at BEI.

1.2. Research Problem

Based on the background presented above the research problems is as follows:

1. Does Corporate Social Responsibility (CSR) Positively Affect Financial Performance?
2. Does Corporate Social Responsibility (CSR) Positively Affect Firm Value?
3. Does Financial Performance Positively Affect Firm Value?

4. Does Corporate Social Responsibility (CSR) Positively Affect Firm Value with Financial Performance as intervening variable?

1.3. Research Objective

The following are the objective of the study:

1. Prove empirically that Corporate Social Responsibility (CSR) affects Financial Performance.
2. Prove empirically that Corporate Social Responsibility (CSR) affects Firm Value.
3. Prove empirically that Financial Performance affects Firm Value.
4. Prove empirically that Corporate Social Responsibility (CSR) affects Firm Value with Financial Performance as intervening variable.

1.4. Significance of the Study

1. Writer

   Hopefully, the study could provide deeper knowledge regarding issue being discussed, experience, and the application of knowledge gained during the process of learning in university.

2. Future researchers

   The result of this study hopefully is able to give additional knowledge for future studies related to factors affecting firm value, specifically the firm's performance

3. Stakeholders

   Hopefully, this study could be useful for decision making processes and could contribute to framework regarding practice related to purchasing stock, specifically affect the firm's performance towards firm value. Furthermore, hopefully this study could provide new perspective for investors in their decision to invest in a company, where they invest can invest based on the firm's performance.

1.5 Scope of the study

The scope of the research carried out has limitations as follows:

1. The object of research taken is a company registered at Indonesia Stock Exchange (IDX).
2. The population used in this study is a company that is engaged in the Stock Market Index and listed on the Indonesia Stock Exchange (IDX) 2017-2019.
3. The dependent variable used in this study is Firm Value which is proxied by Price-to-Book Value.
4. The independent variable used in this study is Corporate Social Responsibility, which is proxied by 6 categories of CSR Disclosure Index. This includes CSRDI Economy, CSRDI Environment, CSRDI Employment Practices & Workforce, CSRDI Human Rights, CSRDI Community, CSRDI Product Responsibility.
5. The intervening variable used in this study is Financial Performance which is proxied by Return on Assets (ROA).

1.6. Systematic Discussion

The research paper systematically divided into five chapters as follows.

CHAPTER I INTRODUCTION

This chapter will discuss subchapters including background, research problem, research objective, significance of the study, limitation as well as systematic discussion.

CHAPTER II LITERATURE REVIEW

This chapter will first discuss in detail its basic concept definition, related literature review, conceptual framework, and the hypothesis development.

CHAPTER III METHODOLOGY

This chapter will state in detail what method of research is being used. This includes the population and sample, the empirical model, operational variable definition, and method of data analysis.

CHAPTER IV RESULT AND DISCUSSION

This chapter will discuss the result and empirical findings in the research in relation to the impact of board's independence, quality of audit committee, and firm's complexity to internal control disclosure.

CHAPTER V CONCLUSION

This chapter consists of conclusion and suggestion from the result and discussion preceding this chapter, along with recommendation for future researches.