CHAPTER II

FUNDAMENTAL RESEARCH

2.1 Corporate Social Responsibility

Corporate Social Responsibility is defined as a business commitment to make several contributions to sustainable economic development, one of them it can be through collaboration with employees and their representatives, their families, communities. local people and the general public to improve the quality of life in a way that is beneficial both for their own business and for development. According to Law Number 40 of 2007, CSR or Social and Environmental Responsibility is the Company's commitment to participate in sustainable economic development in order to improve the quality of life and a beneficial environment, both for the Company itself, the local community and society in general. Meanwhile, Law Number 25 of 2007 defines CSR as the responsibility inherent in every investment company to continue to create relationships that are harmonious, balanced and in accordance with the environment, values, norms and culture of the local community.

In the concept of sustainable development, the sustainability of a company depends on how much the company can be responsible for the impacts resulting from the company's activities. These responsibilities include social responsibility and financial responsibility. Responsibility is then communicated by the company to stakeholders through disclosure of Corporate Social

Responsibility (CSR). CSR disclosure is a signal given by management to all stakeholders, including potential investors for the company's future prospects and shows the added value for the economic, social and environmental impacts arising from the company's activities (Peloza & Shang, 2011).

2.2 Corporate Social Responsibility Index

The measurement of Corporate Social Responsibility activities is expressed in the Corporate Social Responsibility Index (CSRDI). Measuring Corporate Social Responsibility (CSR) is by assessing each item disclosed in the company's annual report and/or sustainability report. Corporate Social Responsibility (CSR) disclosure in accordance with the GRI (Global Reporting Initiative) sustainability reporting guidelines standards consists of 3 main categories, which include economic, environmental and social performance. Where each item from the three categories. Each category is rated 1 if disclosed and scored 0 if not disclosed. Then the value of each item is added up to obtain the CSR value as a whole for a company and compared with the GRI G4 reporting standard guidelines per respective category with total 117 items.

2.3 3P Tipple Bottom Line

According to (Carroll, 1991), there are 3 main principles for CSR, known as triple bottom lines, namely profit, people and planet (3P), and are explained as follows:

1. Profit, Companies must still focus on making profits so they can continue to operate and develop.

2. People, Companies must have concern for human welfare. For example, many companies have implemented CSR programs such as providing scholarships for students around the company, establishing educational and health facilities, providing compensation funds to communities around the company for expanding the company's territory/land.

3. Planet, Companies must pay attention to environmental conditions and the sustainability of biodiversity. Several CSR programs are based on this principle, for example in the form of reforestation, providing clean water, improving housing, developing tourism (ecotourism).

As a business actor, you can be sure that you will not be able to develop if you don't pay attention or even close your eyes to the situation and conditions of the social environment in which the entity operates and carries out its activities. Therefore, implementing CSR is emphasized as a necessity and obligation that must be implemented. CSR is a business role that must be emphasized to every entity or company so that it must be implemented. So it can be said that business should not only focus on making a profit, but also business must have and pay attention to social awareness of the surrounding environment.

2.4 Financial Performance

Financial Performance Assessment is determining the effectiveness and efficiency of operations, organizations and employees based on predetermined targets, standards and criteria. Assessing the company's financial performance is one way that management can fulfill its responsibilities and obligations towards investors in order to achieve the goals set by the company. To assess a company's financial performance, financial ratio analysis can be used. According to (Kamatra & Kartikaningdyah, 2015) Financial Performance Assessment aims to:

1. As useful information for making important decisions regarding the assets used and encouraging managers to make decisions that prioritize the interests of the company.

2. Assess each business performance to be more focused.

3. Performance measurement results are used to re-evaluate potential economic resources that can be managed and developed in the future.

According to (Meiryani et al., 2021) Benefits of financial performance assessment is to:

1. Control organizational operations effectively and efficiently by motivating employees to the maximum.

2. Supports decision making related to employees, such as: promotions, transfers and dismissals.

3. Recognize each employee's training and development needs and to provide selection and evaluation criteria for employee training programs.

4. Provide feedback to employees on performance appraisals from their superiors.

5. Provide a basis for distribution of rewards.

Financial ratio analysis can be used as a way to measure performance, financial ratios are a tool used to analyze and measure company performance using the company's financial data. Financial data can be taken from financial reports such as profit and loss reports, financial position reports, cash flow reports, and other reports. The results of performance measurement will tell you what happened, not why it happened or what should be done. An organization must use performance measurement effectively in order to identify what strategic and operational changes are needed and the processes required for these changes. Performance measurement provides a basis for organizations to assess.

1. What is the development and progress towards the targets that have been set.

2. Helps in detecting areas of strength and weakness.

3. Determine appropriate actions to improve performance.

4. Show how activities support organizational targets.

5. Help make all decisions.

6. Prioritize resource utilization.

7. Expand products and services to customers.

Measuring financial performance uses financial ratios. This ratio is used to compare and determine the relationships that exist between various financial information. Financial reports are historical, comprehensive, and processed or can be called sequential, where financial reports are the result of a combination of recorded facts, principles, traditions in accounting and personal opinions. ROA is a profitability measurement ratio that is often used by financial managers to measure overall effectiveness.

Financial report analysis is an important and most influential part of business analysis. Business analysis is an assessment of a company's economic prospects and risks. The analysis in question includes an analysis of the company's environment, strategy, performance and financial reports. Financial statement analysis is a process carried out by evaluating related data in order to obtain estimates and conclusions that are useful in business analysis (Ashraf et al., 2017).

This research uses profitability analysis to measure financial performance. Profitability analysis is evaluation of the company's level of return on asset. The focus in this profitability analysis is the value of the company and its level of profitability, and measuring profitability triggers. This analysis also includes an evaluation of the two main sources of profitability-margin and capital turnover and also focuses on the causes of changes in profitability and earnings durability. To measure profitability, the indicator used in this research is Return on Assets (ROA). Return on Total Assets (ROA) is a profitability ratio used to measure or assess a company's ability to generate profits with all funds used for company operations.

2.5 The Relation between CSR and Financial Performance

CSR program is a management decision depend on the fund they have and the management policy. Companies must spend funds to carry out CSR activities. And if CSR activities have a positive effect on financial performance, then the funds spent to carry out CSR activities will be returned, even the funds received back will be greater and have good long-term profit prospects. Companies that do not carry out CSR will tend to receive protests and/or demonstrations from the public which can result in the cessation of operational activities of a company which can cause losses, on the other hand, companies that carry out CSR well can avoid public protests so that the company can continue to operate effectively so that it can achieve its goals. overall profit. The increase in company profits is clearly directly proportional to the increase in company profitability ratios consisting of Return On Assets (ROA), Return On Equity (ROE) and Return On Sales (ROS) (Rahayu et al, 2014).

CSR can be carried out in various ways as a strategy to minimize risk and increase profitability. Implementing CSR provides many benefits, including reducing company operational costs, increasing sales volume and market share, attracting potential investors through the positive image it creates and so on. Company reputation is an important concern for potential investors.

This reputation can be assessed from the company's profitability, so reputation needs to be maintained to support the company's survival. By carrying out CSR activities, it is hoped that they will be able to achieve the company's main goal of seeking profits without ignoring the interests of stakeholders and environmental sustainability as a form of responsibility for the impacts that have been caused by the company's operational activities (Rosdwianti et al, 2016).

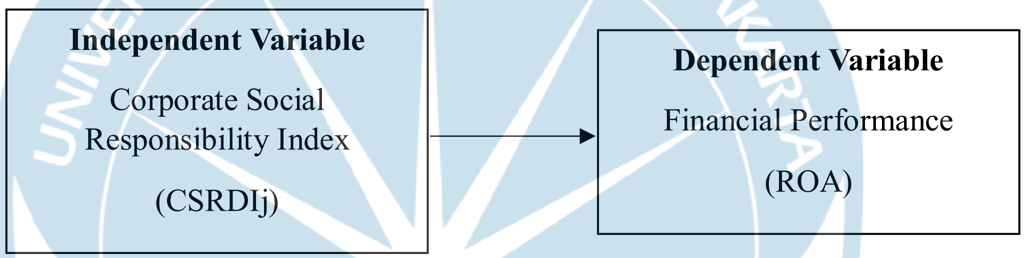

Figure 2.1

Theoretical Thinking Framework

2.6 Hypothesis Development and Previous Research

(Margolis & Walsh, 2002) found that 53% of these studies documented a positive relationship, 24% found no significant effect, 5% showed a negative effect, and 19% produced mixed results. The research results of (Bhattacharya & Sen, 2003) show that positive CSR information about a company will increase consumers' intention to buy products from the company; the potential for prospective employees to seek employment with the company; and potential investors' intentions to invest in the company.

The research results of (Meiryani et al., 2021) show that corporate social responsibility has a negative effect or has an inverse and insignificant relationship on ROE (Return On Equity). But it has a positive and significant influence on ROA (Return On Assets) and ROS (Return On Sales). Thus the hypothesis that can be formulated is:

H0: Corporate Social Responsibility doesn't have a positive effect on ROA in manufacturing companies listed on the Indonesia Stock Exchange.

H1: Corporate Social Responsibility has a positive effect on ROA in manufacturing companies listed on the Indonesia Stock Exchange.

Table 2.1

Previous Research

No.	Name	Title	Methods	Result
1	Margolis, J. D., Elfenbein, H. A., & Walsh, J. P. (2007)	Does It Pay to Be Good? A Meta-Analysis and Redirection of Research on the Relationship Between	Meta-analysis of existing studies to examine the relationship between corporate social performance and financial performance.	The meta-analysis found a positive correlation between corporate social performance and financial performance,

		Corporate Social and Financial Performance		suggesting that socially responsible behavior is associated with better financial outcomes.
2.	Oikonomou, I., Brooks, C., & Pavelin, S. (2012)	The Impact of Corporate Social Performance on Financial Risk and Utility: A Longitudinal Analysis	Longitudinal analysis to investigate the impact of corporate social performance on financial risk and utility	The study suggested that firms with higher corporate social performance scores experienced lower financial risk and higher financial utility over time.
3.	Flammer, C (2013)	Corporate Social Responsibility	Examination of the relationship between changes	The study found a positive correlation

		and Shareholder Reaction: The Environmental Awareness of Investors	in environmental performance and shareholder wealth	between improvements in environmental performance and positive shareholder reactions.
4.	Orlitzky, M., Schmidt, F. L., & Rynes, S. L. (2003)	Corporate Social and Financial Performance: A Meta-Analysis	Meta-analysis of 52 studies to assess the overall relationship between corporate social performance and financial performance.	The meta-analysis indicated a small but positive relationship between corporate social performance and financial performance.

2.7 GRI Standards

The Global Reporting Initiative (GRI) has developed a set of sustainability reporting standards that organizations can use to disclose their economic, environmental, and social impacts. The GRI Standards are organized into three main categories: Universal Standards, Topic-Specific Standards, and Sector-Specific Standards.

The Universal Standards are :

- GRI 101: Foundation – sets out the principles and content requirements for preparing and disclosing sustainability reports.
- GRI 102: General Disclosures – includes general information about the reporting organization, such as its profile, strategy, and governance structure.
- GRI 103: Management Approach – outlines the organization's approach to managing its material topics.

Topic-Specific Standards are :

- GRI 200: Economic
- GRI 300: Environmental
- GRI 400: Social

Sector-Specific Standards are :

- These standards provide additional guidance for organizations operating in specific sectors, such as mining and metals, oil and gas, construction and real estate, and others.

GRI Standard is the first global standard for sustainability reporting. The GRI standard includes modular reporting features, an interrelated structure, and displays reporting applications that are accepted by all parties to report economic aspects, environmental aspects and social impact aspects. GRI is internationally recognized as a leader in the sustainability reporting framework, with more than 20 years and hundreds of parties involved in formulating a flexible, robust and well-known reporting format for all organizations to communicate sustainability reports to the parties involved and stakeholders. In the context of the GRI Standards, the economic dimension of sustainability concerns an organization's impact on the economic conditions of its stakeholders, and on economic systems at local, national and global levels. The Standards in Economics series (200) addresses capital flows between different stakeholders. and the ultimate economic impact of an organization across society. GRI 201 discusses the topic of economic performance. This includes the economic value generated and distributed (EVG&D) by the organization; defined benefit pension plan obligations: financial assistance received from any government; and the financial implications of climate change. This concept is covered in important instruments of the Organization for Economic Co-operation and Development. The disclosures in this Standard can provide information about an organization's impact on its economic performance, and how it manages it (Yehezkiel et al., 2023).

2.7.1 Sustainability Report

A sustainability report is a report published by an organizational entity or company where there are social, environmental and economic impacts caused by daily activities. The sustainability report presents the company's values and governance model, and shows the relationship between its commitment and strategy towards a sustainable global economy. These are the concepts of sustainability :

- The idea of limited natural resources

  Natural resources have their respective portions so that their management needs to be considered, they can be used for the present and the future. The requirements for natural resources can be utilized in the future, such as steps must be taken to save natural resources, not damage the environment and increase development activities that have an impact on natural resources that can be renewed.

- Social Care Ideas

  Social variables related to society, education, equality, social resources, health, welfare, and maintaining the quality of human life now and in the future. For example, equal distribution of land and gender equality.

- The Idea of Economic Exchange -> Economic acceleration must grow to improve human welfare. its natural resources.

Current Definition of Sustainability Reporting in nature After discussing the concept of sustainability reporting, the following is a discussion of the definition of sustainability reporting. Sustainability reporting is reporting carried out by companies to measure, disclose, and the company's efforts to become a company that accounts for all stakeholders for the purpose of company performance towards sustainable development. In this reporting, there are disclosure principles and standards that are able to reflect the level of company activity related to economic, environmental and social aspects. a natural step towards empowering activities. Sustainability reporting helps organizations to set goals, measure performance and manage change in order to make their operations more sustainable (Anna & Dwi R.T, 2019). A sustainability report conveys disclosures about an organization's impact, whether positive or negative, on the environment, society and the economy. In an effort to make this happen, sustainability reporting makes the abstract real and concrete, thus helping in understanding and managing the impact of sustainability development on organizational activities and strategies. Through the implementation of sustainability reporting, it is hoped that companies can develop sustainably (sustainable growth) based on business ethics.

2.8 Legitimacy Theory

Legitimacy theory, as applied in the context of social and environmental accounting, is a conceptual framework that explores how organizations seek to gain and maintain legitimacy by conforming to societal expectations and norms regarding their social and environmental responsibilities. The theory suggests that organizations engage in certain activities and disclosures not only to meet legal and regulatory requirements but also to be perceived as socially responsible and acceptable by various stakeholders (Deegan, 2019). Legitimacy theory has proven effective in explaining why organizations engage in social and environmental reporting. It helps describe how companies adopt certain practices and disclosures to align with societal expectations and norms, enhancing their legitimacy. Legitimacy theory encourages researchers to take a historical view, studying changes in reporting practices over time. This longitudinal perspective is valuable in capturing the dynamic nature of societal expectations and organizational responses. It shows that CSR activities can be a profitable element as a company strategy, contributing to risk management and maintaining relationships that can provide long-term benefits for the company.