CHAPTER I

INTRODUCTION

1.1 Background to The Research

Generating large profits is generally the main goal of a business. This can further intensify competition between companies. According to Latifah and Luhur (2017) the more competitive economic agents are to generate greater profits, the higher the development of resources. Not only that, Gunawan and Mayangsari (2015) also revealed that companies seeking maximum profit explore uncontrolled natural resources and communities to meet stakeholder demands. This can cause global problems in terms of natural damage, climate change, global warming, social crises, and ultimately economic crises that can occur all over the world.

Based on data from the Living environment facility (Walhi) website, there are major conflicts, namely inequality in welfare/social and environmental crises. Social inequality can occur due to business actors who ignore and do not care about the conditions of society and natural conditions. One of them is the problem of river pollution due to being used as a dumping ground for hazardous waste and evictions. Environmental crimes and unlawful acts committed by corporations have caused crises and conflicts in society, such as appropriation of people's managed areas and deforestation and environmental destruction. According to data obtained from the Living environment facility (Walhi) in 2018, 73.24% of rivers in Indonesia are heavily polluted. Whereas in the Financial Services Authority Regulation 51 /POJK.03/2017 concerning the implementation of sustainable finance for financial service institutions, issuers and public companies, financing institutions are regulated to carry out responsible investment principles, as well as social and environmental risk management principles. Therefore, financial conditions are not enough to guarantee that the value of the company grows sustainably.

In Arowoshegbe and Emmanuel (2016) research said that John Elkington in 1997 through his book "Cannibals With Forks, the Triple Bottom Line of Twentieth Century Business" popularized the term triple bottom line. Where this concept tells the company that in order to grow sustainably apart from increasing company revenue (profit), the company is also responsible for protecting the earth (planet) and caring for humans (people) both employees and the community outside the company. Therefore, this concept shows that the disclosure of information by companies is not only limited to one aspect of performance, but also all indicators of sustainability performance, namely economic, social and environmental performance.

So, when we take a deeper look at the business world today, we will see very significant changes to the activities carried out by companies in the world. In the past, companies were very focused on making as much profit as possible without paying attention to other things. Because, profit for the company is very important for the success and progress of the company in the future. By fulfilling the needs of goods and services required by consumers, it is the profits that will be obtained by the company.

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Therefore, companies used to compete to find and gain profits without paying attention to the impact that will be given later on the surroundings.

However, this is different from now where many companies are starting to pay attention to sustainability issues. Where the company began to think about the reaction of the surrounding community to the company. With that, all forms of company activities in the previous year and now that have a direct impact on the environment, social, and economic. Because the development of the business world has also brought community economy, social inequality and environmental damage.

In response to the deteriorating economic situation in Indonesia, many people believe that this problem has arisen as a result of rampant corruption cases. As we know, corruption that is happening in Indonesia today is already in a very severe position and is deeply rooted in every aspect of life. The development of corruption practices is increasing every year, both in terms of the quantity of state financial losses as well as in terms of quality which are increasingly systematic, sophisticated and have expanded in scope to all aspects of society. Corruption has become an acute and systemic problem that is very dangerous and detrimental to the state and society.

One of the 'extraordinary efforts' undertaken was to form a law enforcement agency in the criminal justice system which we know as the Corruption Eradication Commission (KPK) which is stipulated in UU No. 30 Year 2002 concerning the Corruption Eradication Commission as mandated by UU No. 31 Year 1999 concerning the Eradication of Corruption Crimes. As of June 2022, there have been a number of efforts to deal with criminal acts of corruption that have been carried out by the KPK.

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Reporting from the KPK's official website, in the first semester of 2022, the KPK has conducted 66 investigations, 60 investigations, 71 prosecutions, 59 inkracht cases, and executed decisions on 51 cases. Of the total investigation cases, the KPK has named 68 people as suspects out of a total of 61 investigation orders (spirindik) issued. If broken down, there were 99 ongoing cases in the first semester consisting of 63 carry over cases and 36 new cases with 61 issued sprindiks.

Broadly speaking, corruption is closely related to negative impacts, such as poverty in transitional economies, environmental damage, violations of human rights, abuse of democracy, improper investment allocation, and undermining of the rule of law. In addition to the establishment of the Corruption Eradication Committee, rules and regulations also need to be revised so that there are no more gaps for corruption to grow and develop. Therefore, in the economic aspect of sustainability reports, organizations are expected by the market, international norms and stakeholders to demonstrate adherence to integrity, governance and responsible business practices.

In contrast to financial reports, in a sustainability report, the economic aspects of a company also discuss the flow of capital among different stakeholders, and the main economic impacts of the company on all levels of society. Disclosure of economic sustainability relates to an organization's impact on economic conditions for its stakeholders, and on economic systems at the local, national and global levels. In this economic performance report, the company must be able to provide information about the impact of an organization related to its economic performance, the existence of its market, and how the company regulates it. The impact of infrastructure investments and organizational support services and assessing their linkages to local communities and the regional economy. Organizational support for local suppliers, or those owned by women or members of vulnerable groups.

Not only that, but social inequality can also occur due to business actors who ignore and do not care about community conditions and natural conditions. One of them is the problem of river pollution due to being used as a place for hazardous waste disposal. Environmental management in Indonesia is regulated in UU No. 32 Year of 2009 which reads: "Companies that carry out their business activities in the field of and or related to natural resources are obliged to carry out social and environmental responsibilities".

Companies that are actively involved in natural resources have an obligation to take social and environmental responsibilities. This rule is also complemented by the UU Year of 2007 that concerning the Company's obligations in the preparation of the annual bookkeeping, Article 40 of Limited Liability Companies, Article 66 (2). One of them is the report on the implementation of social and environmental responsibility. Article 74 concerning corporate social and environmental responsibility. In addition, IAI's financial accounting standard (PSAK) No. 01 paragraph 9 concerning the accountability of financial statements implicitly discloses environmental and social accountability in additional environmental and value-added reports.

The company is increasingly realizing that the survival of the company also depends on the company's relationship with the community and the environment in which the company operates. This is in line with legitimacy theory which states that

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companies have contracts with the public to carry out activities based on the values of justice, and how companies respond to various interest groups to legitimize corporate actions. Legitimacy theory explains that the disclosure of social responsibility is carried out by companies to gain legitimacy from the community where the company is located. Legitimacy theory states that organizations do not only pay attention to investor rights but also pay attention to public rights (Dianawati, 2018).

CSR activities do not fully contribute to sustainable development and are often aimed at corporate green laundering or marketing tools. Due to the lack of analysis of corporate social and environmental impact measurement reports, the government monitors and measures how business activities affect the company's program commitment to natural and social environmental sustainability. Therefore the company takes social responsibility in carrying out its business activities and pays attention to the surrounding environment (Kristanti, 2020).

The issue of the sustainability of a company today is very important. Where the company must think ahead how the business carried out can be beneficial not only for internal but also external companies at this time and in the future. After the awakening to face the covid-19 pandemic, economic growth in Indonesia is said to be able to grow well and is the highest among the G20 countries. In fact, the Managing Director of the International Monetary Fund (IMF), Kristalina Georgieva, called Indonesia a "bright spot in the midst of the world's economic gloom". However, even though it is said to be good, Indonesia is still experiencing several problems such as low quality of the environment, increasing social inequality, and other problems.

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This encourages the State of Indonesia to prioritize the issue of sustainability. Sustainability Report disclosure practices have been carried out by many companies in Indonesia. At first it was only followed by mining and manufacturing companies, but over time and the rise of Corporate Social Responsibility issues, other industries briefly mentioned part of social obligations in their annual reports.

In the Brundtland report, the term sustainability was first defined. The meaning of sustainability is defined as a process of economic growth, environmental protection, and social equality. In the business world, sustainability refers to their economic, environmental, social and opportunity risks (Brundtland, 1987). The aim is that shareholders can obtain more comprehensive information to assess the performance, risks and business projects, as well as the viability of a company. Sustainability focuses on meeting the needs of the present without compromising the ability of future generations to meet their needs. The concept of sustainability consists of three pillars, namely economic, environmental and social.

The Global Reporting Initiative (GRI) issues disclosure standards used by companies around the world as a reference for writing sustainability reports. Not only that, the World Business Council for Sustainable Development (1999) also stated that the Global Reporting Initiative Report is a standard in sustainability reporting that can be applied and widely accepted by companies in the world. And after making several improvements to this standard, in 2016 to be precise in the 4th quarter, the Global Sustainability Standards Board which is a special board formed by GRI has begun to introduce GRI standards to the world at large.

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According to Aras et al (2010) In examining the relationship between sustainability and financial performance, the most important part lies in the direction of causality. Several previous researchers, one of which is Waddock and Graves (1997) regarding the theory of slack resources, argues that companies can invest more in sustainability if they have slack resources (financial and non-financial). In this study, the researcher uses the independent factor is financial performance, while the dependent factor is the practice of sustainability.

Other thoughts, stakeholder theory and most researchers argue that sustainability is a factor that improves financial performance. Platonova et al (2018) revealed that this school of thought uses sustainability as an independent factor and financial performance as a dependent factor. Not only that, but there is also a study by Jan et al (2019) which shows that sustainability practices have a significant positive relationship with Islamic bank financial performance indicators that show management and shareholder perspectives.

In the research, Puspita and Jasman (2022) pointed out the effect of sustainability report disclosure on firm value with a sig value below 0.05, namely 0.004 and a coefficient of 1.143. It can be concluded that the sustainability report has a positive effect. So that the results of this study illustrate that the increased disclosure of the sustainability report will help the company in maximizing the value of the company. This result is the same as the previous study, namely the research of Yulianingsih et al (2018) which found that the sustainability report had a positive influence on firm value. Habibi (2017) and Kusuma and Priantinah (2018) in their research also give the same results. In this study, we want to find out which disclosures have an influence on financial performance, and which have the most effect.

This study will also follow the second research of above and will use sustainability practices as the independent variable while financial performance as the dependent variable. Researchers use Tobin's Q to assess financial performance, especially regarding the value of the company so that it shows the performance of management in managing the assets of the company. Therefore, the value of Tobin's Q can provide an overview of the potential growth of the company and the condition of investment opportunities owned by the company.

This study also uses a control variable which aims to clarify the relationship between the independent variable and the dependent variable. The selection of the appropriate control variables for this study was based on several previous studies related to sustainability practices and financial performance conducted by Jan (2019). Therefore, following previous studies there are three control variables used in this study (eg Saini and Sanghania, 2018; Jan et al, 2019; Bansal et al, 2021; Tumwebaze at al, 2022; Carvajal and Nadeem, 2022) on sustainability reporting and firm performance, this study controls for three cross-sectional characteristics, namely firm age (FA), firm size (FS), and level of financial leverage (FL).

Based on the description above, the sustainability of the company seems to be related to the company's financial performance. It is this connection that gives rise to the relationship between these two fields. If the sustainability report reporting by a company creates value for the company, an interesting question arises about whether companies that get good ratings also have good financial performance. Because financial performance is needed by companies to know and evaluate the level of success of the company based on the financial activities that have been carried out, this raises the question of whether the company's sustainability report disclosure compliance affects the company's financial performance or not. Therefore, the title of this research is **"The Effect of Sustainability Report Disclosure Compliance On The Company's Financial Performance"**.

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1.2 Formulation of The Problem

Based on the background that has been stated previously, the problem formulation in this study are :

1. How does economic disclosure compliance affect financial performance?
2. How does social disclosure compliance affect financial performance?
3. How does environmental disclosure compliance affect financial performance?

1.3 Research Objectives

Based on the formulation of the problem, the objectives of this study are as follows:

1. To analyze the effect of economic disclosure compliance on financial performance
2. To analyze the effect of social disclosure compliance on financial performance

3. To analyze the effect of environmental disclosure compliance on financial performance.

1.4 Contribution of The Research

Based on the background, formulation of the problem, and research objectives, the expected benefits of this research are as follows:

1. Theoretical Benefits

   The results of this study are expected to contribute theory in the form of empirical evidence related to the effect of sustainability reports on the company's financial performance.

2. Practical Benefits

   The results of this research for investors, it is expected to help assess the company and provide useful information in terms of assisting in making investment decisions. For companies, it is expected to be useful as a means of evaluating the level of compliance in terms of reporting sustainability reports against existing standards. And also expected to increase knowledge about the effect of sustainability reports on company performance. The results of this research are also expected to be a good reference for further researchers regarding the indicators discussed in this study.

1.5 Scope of Research

Regarding problem identification, the scope of the research is limited by the following criteria:

1. The research was conducted on the companies that get ranked in ASRR 2018-2021 and listed in Indonesia Stock Exchange.

   (https://ncsr.id/list-of-winner/list-of-rating-asia-sustainability-reporting-rating-asrrat-2021/)
2. The research uses data from financial statements in audited annual reports published for the period ending December 31, 2017 until December 31, 2020.
3. The study used the dependent variable in the form of financial performance. While the independent variables in this study are economic disclosure, social disclosure, and environmental disclosure. And control variable are firm age, firm size, and leverage.

1.6 Writing Systematics

Systematics of writing arranged regularly and in detail to provide a clear and comprehensive picture of the discussion of the problem so that it is easy to understand. The systematics of writing is divided into five chapters:

CHAPTER 1: INTORUCTION

This chapter provides an overview of the problems that will be discussed in this research, including the background, formulation of the problem, research objectives, research benefits, scope of research, and writing systematics.

CHAPTER 2: LITERATURE REVIEW

This chapter contains a literature review that is used as a basis for research taken from various sources such as textbooks, journals, and previous research. Based on the description of the theory, a hypothesis will be developed for this research.

CHAPTER 3: RESEARCH METHODOLOGY

This chapter describes the research method which consists of selecting the research object, data collection techniques, and data processing, analysis, and testing techniques.

CHAPTER 4: RESEARCH RESULTS AND DISCUSSION

This chapter contains an overview of the research object, the results of hypothesis testing by describing statistical testing, as well as analysis and discussion of the test results.

CHAPTER 5: FINAL PART

This chapter is the last chapter which contains the conclusions from the research results of the previous chapter as well as the suggestions given in connection with the results of the research conducted. This chapter also contains the implications and limitations of this research.