The Effect of Corporate Social Responsibility Disclosure on Financial Performance and Its Impact on Company Reputation

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Abstract. This study aims to analyse the effect of Corporate Social Responsibility (CSR) disclosure on Financial Performance (FP) and its impact on Corporate Reputation (CR). This study uses several theoretical approaches to explain and link the variables, namely stakeholder theory and signalling theory. This article shows that the disclosure of Corporate Social Responsibility on financial performance can affect the company's corporate reputation. In addition, the empirical findings also indicate a relationship between financial performance and good corporate reputation; it is necessary to underline the importance of stakeholders' positive perception of the company's practices. This research provides insights and significantly contributes to business practitioners and policymakers on integrating CSR disclosure with financial performance and its impact on good corporate reputation in business strategy. The findings illustrate how CSR disclosure and transparency can generate financial benefits and reinforce a positive corporate image for internal and external stakeholders.

Keywords: corporate social responsibility, financial performance, corporate reputation

1 Introduction

International integration and globalisation, the presence of multinational companies in the market, rising consumer expectations, and the emergence of pressure groups have added to the causes of Corporate Social Responsibility (CSR). CSR is needed to address the social pressures that companies face, as it can directly affect the market value of the company [1]. Companies that carry out CSR practices indirectly impact corporate reputation and brand equity [1]. Therefore, the CSR discussion has become an essential point that companies and CSR activists (academicians and non-government organisations) must pay attention to.

Academics and business managers have paid a lot of attention to how CSR has evolved from being a dubious notion to a high-profile topic on the research agenda [2]; CSR has also become a critical point and is universally accepted in the business world over the past few years and CSR has become a subject of debate, comments, theory development and research. [3] argues that conceptualization and research on CSR have developed in two ways:

i. In terms of the level of analysis, research on CSR has moved from discussing macro-social impacts to analyzing CSR at the organizational level and its impact on the process and performance of the organization or companies.

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ii. With regard to the theoretical orientation, CSR field researchers have moved away from explicitly normative and ethically oriented arguments of management studies to implicitly normative and performance-oriented.

CRS existed even before World War II. Donald K. David once commented in an MBA class at Harvard University that “future executives need to pay attention to corporate social responsibility that lies on the shoulders of business leaders”[4]. Such statements can be related to the fact that CSR can be used to align business interests. Bert Spector argues that the roots of the social responsibility movement can be traced to the period 1945-1960, the early years of the Cold War. Spector argues that Dean David and other proponents of CSR ideas used this to align business interests with the defence of the capitalist free market against what was then perceived as the dangers of communism [4]. This is a brief historical explanation of the development of CSR, which is closely related to business competition.

Business competition between companies is increasingly competitive, requiring companies to have a competitive advantage to maintain their performance. Coupled with social media, abundant information is available anytime and spreads quickly; on the other hand, ongoing global trends show many competitors, entrepreneurs, and business partners. That is why a company’s reputation is becoming increasingly essential, and reputation is one of the intangible assets that maintain and increase a company’s competitiveness [5].

[6] shows that strong involvement in carrying out CSR to gain consumer recognition can encourage growth in financial performance. Signalling Theory states that a company’s reputation can be improved by improving financial performance [7] Financial performance can be improved by CSR [8]. Financial performance is the ability of a company to manage and control its resources [9]. In general, CSR activities are seen as a concept that can improve financial performance in different markets where corporate reputation is increasingly important [10]. Corporate reputation or company reputation is an image formed from good public perceptions and opinions that can positively impact companies, such as increasing investor and consumer confidence and increasing company value in the market [5]. Company reputation is an image that is formed from good public perceptions and opinions that can have a positive impact on companies, such as increasing investor and consumer confidence and increasing company value in the market [5]. CSR plays a vital role in companies to gain public appreciation, pay for perceived mistakes from an industry, and manage the company’s reputation [11]. Company reputation is becoming increasingly relevant for companies because a positive company reputation positively affects financial performance [12]. However, a bad reputation can negatively impact companies, such as reducing investor and consumer confidence and decreasing income [5]. In practice, CSR and financial performance ultimately form positive or negative corporate in several countries, especially in developing countries such as Indonesia.

One of the cases in Indonesia was related to an apartment project in North Jakarta, which was reported to have water leaks and many defects in the building. This made the buyers feel disappointed and demanded compensation from the developer. This case went viral on social media and tarnished the company’s image [13]. In addition, a survey conducted by LSI (Indonesian Survey Institute) shows that Indonesian consumers prefer high-quality products and avoid poor-quality ones. If the product produced by a property company is bad, consumers will think twice about buying products from that company [14].

Environmental problems caused by property companies are often related to the impact of the construction of housing projects and high-rise buildings, including logging forests to expand the project area, which can damage the ecosystem around the project site. Deforestation, according to reports from the Center For Environmental Law (ICEL), around 1.24 million hectares of forest in Indonesia are lost every year, and one of the causes is logging for housing development projects and multi-story buildings [15]. A study by the University of Indonesia showed that the construction of a housing project in the Jabodetabek area has caused ecosystem damage and loss of wildlife habitat around the project site.

In the context of this study, Signalling Theory and Stakeholder Theory can provide insight into how CSR disclosure practices can affect a company's financial performance and reputation. Stakeholder Theory argues that companies must meet the social needs of various stakeholders and carry out CSR because it protects the company from negative opposition and boycotts of the stakeholders, thus reducing operational costs and improving financial performance [16]. Signalling Theory is a useful theory to describe behaviour where two parties (individuals and organisations) can access dissimilar information. Typically, on one side, the sending party must choose whether to communicate (signal) the information, while the other party, the receiver, must choose how to interpret the signal. In the context of this research, Signalling Theory argues that companies that provide CSR to the community will shape their company's reputation to be good or positive [17].

Based on the theoretical conception, the core of Signalling Theory is that signalers are insiders (e.g. executives or managers) who obtain information about individuals in matters such as the product of the company itself, or the organisation that are not available to outsiders [18]; this information may include information specific to organisation's products or services, early stage of research and development news regarding sales results. Insiders may also be informed about other aspects like company reputation and pending lawsuits. Simply put, this personal information gives insiders a positive perspective on the fundamental qualities of some aspect of an individual, product, or organisation [17].

Empirical studies regarding the relationship between CSR, financial performance, and corporate reputation have promising implications for business stakeholders, including shareholders, company management, and regulators. [19] says that CSR practices have a heterogeneous influence based on their dimensions, and this effect is moderated by product categories. Therefore, CSR practices encourage consumer identification with companies, while practices oriented towards economic growth directly influence the company's reputation. [20] believes that companies that achieve an increase in organizational financial performance can maintain and enhance the company's reputation. [21] confirm that the company's financial performance affects the company's reputation and not vice versa.

This conceptual paper aims to develop an in-depth understanding of the effect of CSR disclosure on a company's financial performance and its impact on the company's reputation in the eyes of stakeholders. We attempt to analyze the latest developments in this research through comprehensive literature and provide a clearer view of the mechanisms and implications of the interaction between CSR, financial performance, and reputation.

Based on the explanation above, we want to fill in the gaps and form a conceptual framework by theoretically examining the following:

1. How does CSR affect financial performance?
2. How does CSR affect corporate reputation?
3. How does CSR affect corporate reputation mediated by financial performance?

2 Research Method

This research was developed in three stages (Figure 1). First, we collected and reviewed the literature and previous studies. We analyzed and adopted the information to be formulated into a research model. Third, we developed the instrument development. At this stage, each variable was explained, including compiling measurement items.

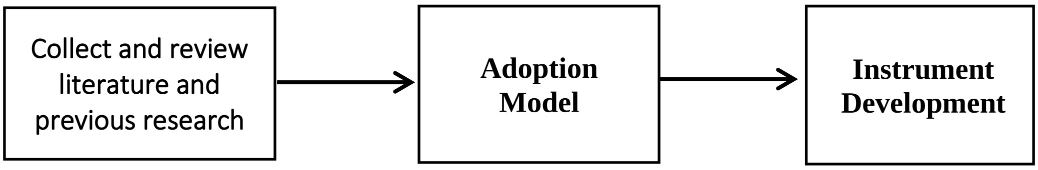

Figure 1. Research Method

While collecting literature and previous research, we used certain keywords, such as *stakeholder theory*, *signalling theory*, *corporate social responsibility*, *financial performance,* and *corporate reputation.* This study combined keywords and the snowball method into a search strategy or method. From the overall papers selected, we reviewed the research papers and summarized hypotheses and key findings to ensure that all articles met the requirements. Afterwards the conceptual research model was compiled as follows:

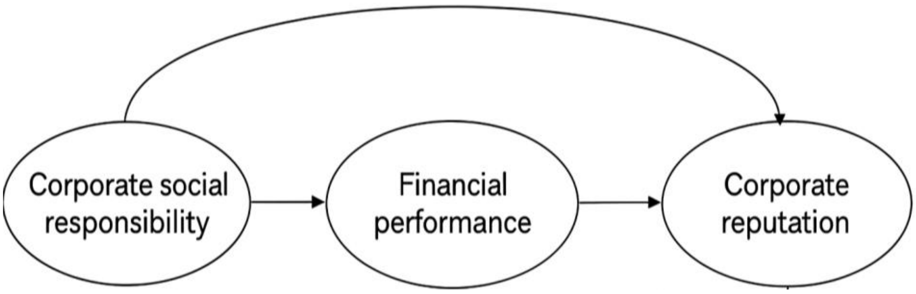

Figure 2. Conceptual Model

3 Results and Discussion

3.1 Corporate Social Responsibility, Financial Performance, and Stakeholder Theory

Stakeholder Theory, developed by Freeman (1984) cited in [22], emphasizes that companies have obligations to various stakeholders, including consumers, employees, communities, suppliers, and the environment. CSR practices that include corporate social and environmental responsibility and positive involvement in the surrounding community can create value for these various stakeholders. When a company meets stakeholder expectations and has a positive impact, this can impact the company's financial performance. Comprehensive CSR practices can influence a company's financial performance through several mechanisms:

i. Customer loyalty. Consumers tend to be more likely to choose products and services from companies that demonstrate social responsibility and care about their impact on society and the environment [23]. CSR practices that are transparent and have a positive impact can increase customer loyalty and indirectly affect company revenue.

ii. Company Reputation. Strong CSR practices can form a positive image of the company in the eyes of various stakeholders. A good reputation can generate economic benefits, including increased investor confidence, reduced cost of capital, and better access to resources [18].

iii. Operational Efficiency. CSR practices focusing on resource efficiency and environmental impact can reduce long-term operational costs. For example, more efficient energy use or good waste management can lead to significant savings.

Stakeholder Theory [24] mentions that stakeholders identify value generation as a key driver of the company; however, Stakeholder Theory also recognizes that value must be shared by a group of stakeholders, which not only includes shareholders and managers but also all parties, one of the strategies put forward, in *stakeholder theory* that companies need to carry out social responsibility (CSR) is to broaden the scope of the stakeholder analysis scope and to impress upon management the importance of building relationships with previously alienated groups (community and environment).

In accordance with the explanation above, stakeholders have an important role in the sustainability of the company. This is because stakeholders can control the resources needed to control the company's survival. Companies need to maintain relationships with customers and stakeholders by fulfilling their wants and needs, particularly stakeholders who have power over the availability of resources used in company operations, such as workers, customers and owners [25]. With this, efforts need to be made to maintain relationships with stakeholders to safeguard the interests of each party, and a sustainability report [26] then, stakeholders have transparent information related to the company's position on economic, environmental, and social aspects. In addition, a sustainability report also allows the company's performance to be assessed directly by stakeholders, which will later influence stakeholders' decisions in contributing to the company.

A number of studies support this view. [27] shows a positive relationship between CSR practices and long-term financial performance. They concluded that companies that adopt strong CSR practices tend to produce better financial performance due to building positive relationships with various stakeholders. Furthermore, [2] stated in their research that companies that are committed to CSR tend to have a better reputation, which in turn can positively impact their financial performance. [28] found that companies with better financial performance also tend to have stronger CSR practices. This supports the view that CSR practices can contribute to long-term value creation for companies.

[29] found that companies that increase involvement in CSR can increase financial performance, which is consistent with Stakeholder Theory. [30] also found that technology companies incur costs greater for CSR to be able to experience an increase in revenue and profitability accordingly. [31] found a positive relationship between CSR and the company's financial performance. However, it is different from research conducted by [32] that CSR has a negative impact on bank financial performance in the short term. Still, this relationship has a positive impact in the long term. [33] reveals that CSR positively influences CFP, even though the relationship is stronger in the long term, but has a significant negative effect in the short term or within two years.

Based on the theory and empirical findings that have been described previously, the hypothesis is: **Corporate Social Responsibility affects financial performance (H1).**

3.2 Financial Performance, Corporate Reputation, and Signaling Theory

Signalling Theory is introduced by Spence (1973) in [34] suggesting that the signal provided by the sender (owner of the information) can provide relevant information that the recipient can utilize. The receiving party will then adjust its behaviour according to its understanding of the signal.

Birgham and Houston (2014) in [35] argue that the Signalling Theory is the company's management's behaviour in giving investors instructions regarding management's views on the company's prospects for the future. [36] Signaling Theory is the impact of the existence of information asymmetry; information is a very important element for investors and business people because information essentially presents notes or descriptions for both past, present and future conditions for a company's survival. Investors in the capital market need complete, relevant, accurate and timely information as an analytical tool to make decisions.

Signalling Theory can be applied to the relationship between CSR and company reputation by assuming that CSR practices can signal external stakeholders about the company's commitment and integrity to social and environmental responsibility. Strong and consistent CSR practices can be considered a positive signal that the company has a long-term view, integrity, and commitment to sustainability, which can influence stakeholder perceptions of the company's reputation [37].

[38] found that companies that provide institutional investors and companies with larger boards show a good reputation. [38] also find significant implications for company managers that in addition to increasing financial performance, social performance and media visibility, managers must also give significant weight to good corporate governance and management quality, which is reflected through the attributes of the board of directors to enhance the company's reputation and gain competitive advantage. [39] proved that CSR has a significant effect on ROA (Return on Assets) but has no effect on ROE (Return on Equity) and NMP in LQ45 companies. In accordance with the Signaling Theory, which stakeholders and shareholders will respond to through the implementation of CSR can not only form a positive image for the company, but can also improve the company's image both in the commodity market and the capital market. Investors will be more attracted to companies with a positive image because a positive corporate image increases consumer loyalty. When consumer loyalty increases, company sales will also

increase, and the impact will increase company profitability; [40] concludes that financial performance influences a company's reputation.

Based on the theory and empirical findings described above, the hypothesis in this study is: **Financial performance impacts the company’s reputation (H2).**

3.3 Corporate Social Responsibility, Corporate Reputation, Financial Performance, and Stakeholder Theory

Stakeholder Theory argues that company management must maintain the concerns experienced by stakeholders with pleasure to ensure maximum results from stakeholders [22]. Stakeholder Theory also emphasizes that management must pay attention to stakeholder concerns. This will help maximize profits and increase shareholder returns.

CSR influences the company’s reputation. Previous research has consistently shown a positive relationship between strong CSR practices and good corporate reputation. According to [41], CSR practices can contribute to a more positive corporate image in the eyes of stakeholders, including consumers, investors and the general public. Through a commitment to social and environmental responsibility, companies can build stronger emotional bonds with stakeholders, increasing positive perceptions of the company.

[42] found that socially responsible initiatives significantly positively affect the corporate reputation and financial performance. [43] found that companies that promote corporate reputation through CSR activities are low by referring to the relationship between corporate reputation indicators and economic performance in Poland is weak because companies with better performance have more profitability. These companies are aware of the importance of company reputation.

Based on the theory and empirical findings described above, the hypothesis in this study is: **Corporate Social Responsibility affects a company’s reputation mediated by financial performance (H3).**

4 Conclusion

This research confirms the importance of solid CSR practices in achieving better financial performance and building a positive corporate reputation. Consistent and continuous application of these practices can provide long-term benefits for companies by generating added financial value and gaining the trust and support of various stakeholders. The use of theory in this study is intended to explain comprehensively, even though many studies have not widely used the theories. However, these theories can explain the influence that arises between variables significantly. The research model and supporting assumptions used in this study can contribute to furthering current discussion efforts in financial management and business administration. Therefore, this research is very relevant to further research using qualitative, quantitative, and mixed methods.

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