

# SOCIAL RESPONSIBILITY AND VALUE ADDED CREATION

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**Abstract:** The lack of firms' attention towards the impact of their operational is a serious issue for Indonesia. There are two aim of this research, first is to motivate practitioners to optimally do corporate social responsibility (CSR) and second is to find the correlation between value added and CSR. Vector Autoregression technique will be used to help achieve our objective. Twenty sample used in this research come from listed companies that arranged their CSR report based on GRI guidelines on the period 2010-2016. Result shows that the higher the CSR value, the higher MVA of the firms will be in the optimum lag 1. Thus, it means that previous CSR activities has direct impact on firms' value added..

**Keywords:** Corporate Social Responsibility, GRI, Market Value Added, Panel Vector Autoregression

## INTRODUCTION

Viewed from Legitimacy Theory and Stakeholder Theory, CSR is an activity that can create intangible asset through building of good relationships (Hur, Kim et al., 2014). This relationship is established through the ability of the company to operate inline with the expectations of its stakeholders and within the constraints of social contracts. This asset can create a competitive advantage which is the most important key to increase shareholder value (Jiraporn, Jiraporn et al., 2014; Reuter, Foerstl et al., 2010).

Nevertheless, CSR activities in Indonesia alone get less attention evidenced by a small amount of firm that successfully achieve gold score in PROPER while the red scores are continually increase. In addition, practically, the company's performance benchmark value, ROA for example, continue to decline as their CSR activities are good or improved as shown in following figure

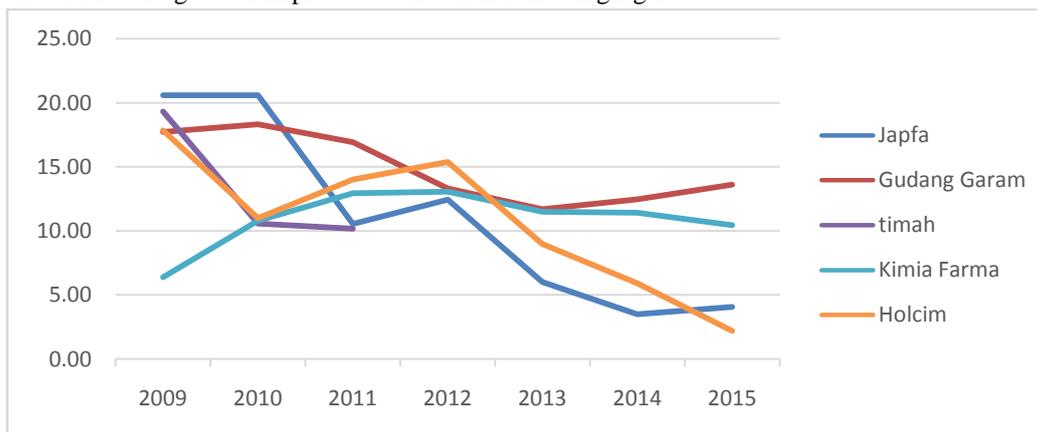


EXHIBIT 1 Financial Performance Graph of the Companies which have good or improved CSR implementation

This phenomenon indicates the possibility that the company is unable to see the relationship of CSR and financial performance. The first reason is the ratios used are ratios that use accounting data. It means that

these ratios are highly exposed by the impact of earnings management activities (Hillman & Keim, 2001). The second reason is this measurement is not able to capture CSR activity as a form of shareholder value creation activity (Shakina & Molodchik, 2014). Akibatnya, muncul mindset bahwa CSR hanya membebani perusahaan karena ukuran inilah yang ditonjolkan di laporan keuangan sebagai tolak ukur kinerja. As a result, it emerged the mindset that CSR is considered as a cost that impacts on company's profit and those ratios. Therefore, this study uses the added value measured by Market Value Added (MVA) to see the relationship between CSR and value added. MVA is a value-added benchmark initiated by Stern and Stewart and considered by both practitioners and academics as the best performance benchmark (Shakina & Molodchik, 2014).

Empirically, findings on value-added and CSR relations are still relatively small. Research conducted by Hillman and Keim (2001) and Garcia-Castro, Arina and Canela (2011) were research on companies in the United States and measured CSR using the KLD Scorecard. Bezares, Przychodzen and Przychodzen (2017) used sample from companies listed on the London Stock Exchange and measured CSR used Corporate Social Index (CSI). The overall research found a positive relationship between the variables. However, if observed, the locations of the firms studied are those firms operating in developed countries that have stronger systems and higher social demands of CSR, so CSR certainly has a more visible impact (Chapple & Moon, 2005; Jo, Kim et al., 2015; Kemp, 2001).

Mittal, Sinha and Singh's (2008) research is a research in developing countries. They chose 50 companies in India as their sample and measured CSR through the existence of code of conduct. This study found a positive relationship. The study of listed companies in Indonesia was conducted by Hidayansyah (2015) using GRI Scorecard and found a negative relationship. Kurnia and Tandiontong (2015) used two benchmarks, ISO9000 and found negative relationship, ISO14000 and found the positive relationship.

This study will examine listed companies and use panel data containing content analysis results using indicators from the Global Reporting Initiative (GRI) along with its value added (Market Value Added, MVA) during 2010-2015. The use of these panel data will cover the disadvantages of cross section data usage of such studies, ie the inability to see any possible long-term relationships (Garcia-Castro, Ariño et al., 2011). On the other hand, the use of GRI indicators as a benchmark of CSR is also estimated to give different results as GRI indicators are assessed as indicators capable of providing a comprehensive overview of a company's CSR implementation.

This study aims to examine the relationship of CSR and value added through a more comprehensive analysis of the relationship between the two variables. Vector Auto Regression (VAR) testing method is used to achieve that objective. VAR test results will show not only the relationship between the two variables, but also the optimum lag. The optimum lag will answer 'how long the long-term relationship of the two variables'. The result will also be completed by how the response of one variable in case of shock to another variable. (Gómez-Bezares, Przychodzen et al., 2017; Kurnia, 2016)

## LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

### *Legitimacy Theory*

According to the theory of legitimacy, companies operate within the constraints of norms in societies called social contracts (Brown & Deegan, 1998; Campbell, 2000; Patten, 1992). The basic assumption is that the company does not have the resources needed for operations and is only given legal rights by the community. Communities also form a social contract as a form of expectations for the costs incurred as a resource provider (Deegan & Unerman, 2006). If the company is able to keep up with this social contract, the company will enjoy rewards for its legitimacy (Brown & Deegan, 1998), like increasing performance (Goodman, Castelo Branco et al., 2006). However, if the company is not capable of being in line with existing social contracts, its legitimacy is threatened and the company will get a penalty (Brown & Deegan, 1998; Burlea & Popa, 2013).

### *Stakeholder Theory*

Stakeholders are groups or individuals that can be influenced or influenced by the achievement of corporate goals (Freeman, 1994; Jaenicke, 2013; McWilliams, Siegel et al., 2006). This theory is a theory that provides a view of how managers behave by considering that each stakeholder group has a different view of the

company (Deegan, 2002; Freeman, Wicks et al., 2004). The assumption used in this theory is that value creation is part of the business (Freeman, Wicks et al., 2004). The process of value creation can be done if the company is able to coordinate the interests of all stakeholders (Roberts, 1992).

### *Hypothesis Development*

#### *CSR and MVA relationship*

The company's survival abilities, according to the theory of legitimacy and stakeholder theory, are reflected in the company's ability to identify and pay attention to stakeholders who have power over resource, but remain within the limits of existing social contracts. If the company is able to implement it, the company will enjoy rewards in the form of good relationships with stakeholders who can legitimize its existence and give it the right to remain in the environment. The process of value creation will occur if it happens.

According to M. Pfaffer (2010) stakeholders can be divided into three categories, namely stakeholders related to capital markets (eg creditor and shareholder), stakeholder-related company products (such as consumers, communities and suppliers), and stakeholders in organizations (such as employees). If observed, the MVA calculation itself is more influenced by stakeholders related to capital market (shareholder). However, to be noted is that stakeholder-related capital markets are very dependent perceptions on the congruence level of corporate activity with non-capital market stakeholders. This congruency affects the projected returns that shareholders may acquire.

Companies that create value for their stakeholders are companies capable of achieving high productivity, competitive, and able to increase profitable funding. Companies that operate using environmentally friendly raw materials in the future are able to reduce external environmental costs, such as avoiding public demand for forest exploitation. In addition, if the company is able to operate with regard to employee welfare, the level of employee dissatisfaction will decrease and can make employees more productive and committed to the quality of goods and / or services produced by the company. As a result, consumers will also receive goods or services that are more qualified than competitors at a reasonable price. This also affects the security felt by the debtor in giving the debt, so that the company is able to grow and generate greater profits and provide higher value for shareholders.

Some studies show conflicting results between CSR and MVA variables. Mittal, Sinha and Singh (2008), Castro, et.al (2011) and Bezares (2017), showed a positive relationship, but Hillman and Keim (2001) and Hidayansyah (2015) studies found a negative influence between the two variables

#### **H1. CSR has a positive effect toward MVA**

#### *Optimum Lag achievement*

The legal foundation of CSR company has been started since 2007, through Act No. PT. 40 year 2007, but the basis for the evaluation of CSR implementation as a reference of capital market stakeholders to know the good of the implementation of CSR of a new company existed since the passing of Law number 5 of 2011. Therefore, since the year of enactment of the rule until the last year of data, (5 periods), the implementation of CSR is estimated to have an impact on the company's added value. This happens because CSR is relevant information for capital market stakeholders (Falichin, Minachul et al., 2011; Rakhimah & Agustia, 2009; Sayidatina & Muid, 2011)

#### **H2. Optimal lag of CSR implementation and Value Added will be achieved in less than 5 periods**

## **RESEARCH METHOD**

The population used in this study is all companies listed on the IDX. Sample selection is done by purposive sampling method where the criteria chosen in this research are:

- a. Listed on the IDX during 2010-2015, and publish its annual financial statements completely. Year 2010 was chosen as the beginning year of the study taking into account that the Act related to CSR activity was issued in 2007, that is Law No. 40 year 2007. The consideration of timing is done based on the length of adaptation to the rules and data update
- b. Not delisted during the study period.

- c. Publish CSR activity reports indexed G3, G3.1 or G4.

Sources of research data is a report on the implementation of CSR activities. The Osiris financial database is used for the calculation of MVA values.

#### *Operational Definition and Measurement*

##### a. *CSR activities*

The Commission of European Communities (2001) defines CSR as a concept that the company integrates social and environmental concerns in its business operations and in its interaction with stakeholders. The implementation of CSR is assessed by summing the scores obtained from the CSR company's CSR content analysis using the GRI indicator. Assessment of CSR implementation is done by weighing each indicator. The weighting of each indicator is done by counting many sub indicators for each indicator.

##### b. *Market Value Added (MVA)*

MVA is the difference between the investor's cash contribution and the expected cash value for the investor (Hillman & Keim, 2001). MVA calculations can be performed using the following formula (Hillman & Keim, 2001):

$$MVA = \text{Market Value of Equity} - \text{Capital}$$

##### c. *Research Model*

To determine the relationship between the following equation will then be tested

$$MVA_{it} = a_{0i}(t) + \sum_0^k \beta_{it} CSR_{it-i} + MVA_{it-1} + \mu_{it}$$

Explanation:

MVA<sub>t</sub> : The MVA of i firms MVA in period t

CSR<sub>t-k</sub> : Total CSR score for t-k period

A : constant

ε : error

I : 1, ..., n

T : 1, ..., t

#### *3.4 Data Analysis Method*

Data analysis was done by using Vector Autoregression (VAR) because this research aimed to examine the relation of the variables and its optimum lag. The analysis steps are as follows:

##### a. *Stationary Test*

Data obtained from the time series data generally have problems stationary, meaning that the data has unit root (Nasution, 2015). If this happens, the result will appear to have spurious regression. The test was performed by using Augmented Dickey Fuller model, Levin-Lin-Chiu, Im Pesaran, and PP-Fisher.

##### b. *Choosing the Optimum Lag*

This step is done to find out how long lag to be included in the test. Optimum lag is determined based on MBIC, MAIC and MQIC criteria. The smallest MBIC, MAIC and MQIC values of a lag describe the correct lag used in the study.

##### c. *Granger Causality Test*

Granger Causality Test is a test that examines whether the occurrence of a variable precedes other variables, on the contrary or there is a reciprocal relationship.

##### d. *Vector Auto Regression (VAR)*

The VAR approach is the modeling of each endogenous variable in the system as a function of the lag of all endogenous variables in the system (Sahabat, 2009). VAR is used if at least one of variables is stationary in the difference level. If the VAR analysis technique can be used, then there is further testing of the variables, namely Impulse Response Function (IRF) and Variance Decomposition (VD) testing. IRF test is a form of

visualization of the influence of shock level of a variable on other variables and the duration of the effect that occurs due to the shock. This visualization is then described in VD testing's result.

## RESULT AND DISCUSSION

### Stationary Test

#### EXHIBIT 2 Unit Root Test's Result

Variable	Method	P-Value Level	P-value 1st difference
MVA	LLC	0.0000	0.0000
	IPS	0.6081	0.0000
	ADF	0.5241	0.0001
CSR ALL	LLC	0.0004	0.0000
	IPS	0.7314	0.0118
	ADF	0.8731	0.0893
CSR Profit	LLC	0.0000	0.0000
	IPS	0.4243	0.0014
	ADF	0.4315	0.0282
CSR People	LLC	0.0000	0.0000
	IPS	0.5738	0.0010
	ADF	0.6634	0.0000
CSR Planet	LLC	0.0000	0.0000
	IPS	0.1847	0.0001
	ADF	0.1437	0.0000

All test methods state that almost all variables are not stationary at the level, but stationary at 1st difference. This can be seen in p-values of less than 5% for all tests of all variables. However, although the ADF test states that CSR ALL remains stationary on 1st difference, it still qualifies the use of VAR, where at least one of the stationary variables at 1st difference.

### Lag Optimum Test

#### EXHIBIT 3 Lag Optimum Test's Result

Lag	MBIC	MAIC	MQIC	Lag	MBIC	MAIC	MQIC
<b>CSR ALL</b>				<b>CSR People</b>			
1	-24.67152	-12.72273	-15.05526	1	-23.03077	-12.07772	-14.21587
2	-14.04586	-6.08	-7.635019	2	-18.45084	-10.48498	-12.04
3	-10.43929	-6.45636	-7.23387	3	-7.527315	-3.544385	-4.321895
4	-5.474491	-3.483026	-3.871781	4	-5.983702	-3.992238	-4.380992
<b>CSR Profit</b>				<b>CSR Planet</b>			
1	-23.48415	-11.53537	-13.8679	1	-25.73908	-13.79029	-16.12282
2	-19.07304	-11.10718	-12.6622	2	-14.24372	-6.277862	-7.832881
3	-10.44179	-6.458864	-7.236373	3	-9.256792	-5.273863	-6.051372
4	-	-	-	4	-5.773892	-3.782427	-4.171182

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*Granger Causality Test*

Based on the test it can be noted that two-way relationships (CSR variables affecting MVA and MVA variables affect CSR) occur in CSR relationships in general and CSR on the profit aspect. However, the CSR relationship on the planetary aspect and the people aspect of the CSR and MVA relationship has insignificant value. The significance of the relationship was evident in the opposite relationship, that is, the MVA affects CSR.

On the other hand, it can be seen that there is a positive relationship between CSR in general and CSR related to profit and MVA aspects. A positive relationship is also seen between the relationship of CSR and its own value in the past based on its coefficient number. In table 3 also seen the opposite relationship, namely the relationship MVA terhadap CSR. A positive relationship is seen in the MVA relationship to CSR, both CSR in general, and CSR in every aspect.

**EXHIBIT 4**  
**Granger Causality Test's Result**

Variable		P-Value	Coeff	Variable		P-Value	Coeff
<b>CSR ALL</b>				<b>CSR Planet</b>			
CSR	CSR	0.000	0.6877993	CSR	CSR	0.201	-
	MVA		184.4897	MVA	MVA		-
MVA	CSR	0.019	0.0017671	MVA	CSR	0.000	0.0132249
	MVA		-0.295817	MVA	MVA		0.2794255
<b>CSR Profit</b>				<b>CSR People</b>			
CSR	CSR	0.003	0.0629713	CSR	CSR	0.338	-
	MVA		11.281	MVA	MVA		-
MVA	CSR	0.001	0.0132249	MVA	CSR	0.018	0.0011185
	MVA		0.2794255	MVA	MVA		-0.7824248

*Pengujian Variance Decomposition*

Table 4 describes the Variance Decomposition of the CSR and MVA variables, that is how large the CSR variable affects the MVA and CSR variables themselves. In the first period, MVA variable is influenced by CSR variable 0% and CSR variable 0%. However, in the next period the influence of CSR itself increased up to 30% in the second period and stagnant at 31% in the period 3 to the end of the forecast period, which is period 10. Table 4 also shows that influence of previous period CSR contributed more to the CSR of the current period. The CSR of the previous period contributed to the CSR value of the current period to 99%, but the value decreased in the third period with a value of 69% and stagnated at that value until the end of the forecast period.

**EXHIBIT 5**  
**Variance Decomposition Test Result**

Forecast horizon	Impulse Variable			
	CSR-MVA	CSR-CSR	CSR-MVA	CSR-CSR
	CSR ALL		CSR People	
0	0	0	0	0
1	0.0047551	1	0.0664919	1
2	0.0083815	0.9512146	0.0635508	0.9879984
3	0.0179903	0.9513981	0.0661214	0.9890589
4	0.0201932	0.9517256	0.0678162	0.9840629
5	0.0200202	0.9523344	0.0676299	0.9853323
6	0.0199927	0.9514753	0.0673238	0.9843148
7	0.0202488	0.9510685	0.0674570	0.9846699
8	0.0203937	0.951088	0.0676322	0.984085

*Implication and Discussion*

The results of the analysis prove that CSR in general and MVA have a two-way relationship, that is CSR affect MVA and MVA also affect CSR. On the other hand, increasing in the CSR value also making increasing of the MVA value with optimum lag of less than 5 periods, that is only in 1 period. The analysis results also provide forecasting of CSR contribution to MVA values. The contribution of the CSR to MVA is predicted to be relatively low, which is only 0-0.02%. In general, the implementation of CSR, was more contributed by the implementation of CSR in the previous period.

This study also provides additional analysis of more detailed testing of every aspect of GRI to MVA. Of the three aspects of GRI (profit, people, and planet), only an increasing in the profit aspect is related to the value of MVA. As with relationships in general, CSR relationships on the profit and MVA aspects also have a two-way relationship. It means that optimum CSR implementation can bring an increasing in MVA values. The optimum lag that can be achieved is a period. On the other hand, the implementation of CSR on the aspect of people and the planet did not bring an increase in the value of corporate MVA. The relationship that turned out to be the opposite relationship, namely increasing the value of MVA improve the implementation of corporate CSR which is optimally achieved also in the first lag.

Visser (2008) states that social and environmental issues in developing countries do have a dramatic impact because, in these countries, economic development is quite rapid and business is growing fast, especially in Indonesia. Indonesia is a significant party in the world economy (Arli & Lasmono, 2010). This is the explanation of the fast response from the Indonesian's society to CSR activities, only in a previous period (Kemp, 2001)

Optimal implementation of CSR in general in Indonesia proved that CSR is able to increase the added value of the company. These findings are in line with previous findings, Mittal, Sinha and Singh (2008), Castro, et.al (2011) and Bezares (2017). This happens because the condition of Indonesia itself is rich in human resources and environmental resources. Thus, companies that are able to provide welfare for their employees and improvements in environmental aspects enjoy some benefits, such as fulfillment of credit requirements in accordance with the rules of BI no. 14/15 / PBI / 2012. The rule stipulates that the assessment of asset quality should pay attention to environmental aspects. That kind of facility makes the profit aspects of the company increase. This profit aspect is the main consideration of investment decisions and can boost the added value of the company (Zee, Stotsky, Lee, 2002).

However, improvements in CSR implementation on environmental and social aspects that do not lead to an enhancement in the value of MVA occur because the costs for the implementation of environmental management can not be attributed as intangible assets to the company (Cusack, 2008). This cost is large enough so that good implementation of CSR activities on this aspect is highly depend on the size of the company's ability to attract shareholders to invest (the higher the MVA the better the implementation of CSR). However, these efforts even become an expense for companies so it reduce the profitability of the company (Martincik dan Polivka, 2001). The inability of the firm to form an intangible asset from its environmental management efforts is due to weak internalization of regulation on the environment as well as weak supervision over it (Dasgupta, Laplante, Mamingi, 1998). This also causes the low estimation of CSR's contribution to MVA values over the coming periods.

Another underlying reason of that finding is the implementation of CSR that tends to be uniform like any other developing country (*one size fit all*) (Idemudia, 2011) Which is intended to meet the requirements of a regulation or simply follow the parent company for multinational companies (Barkemeyer, 2007). This kind of implementation makes the company unable to capture the actual issue or kind of social responsibility activities that are actually needed by the community especially on environmental and social aspects (Idemudia, 2011). In fact, this picture is a stakeholder expectation that should be met by companies according to stakeholder theory. The problem's root is the low legal system over the handling of social and environmental issues in Indonesia (Kemp, 2001). The low application of this legal system is due to social and environmental issues is just being a major issue in recent years (Waagstein, 2011). Thus, the urge for law enforcement in Indonesia on this issue is still low.

The implication is the benefits that should be felt by companies associated with CSR is low. The CSR concept of promoting stakeholder interests, such as employees, consumers, suppliers and the public, is only a corporate expenditure without any significant returns. Weak legal system in Indonesia makes the implementation of CSR is not able to affect employee productivity and consumer perceptions of the company's products (Arli & Lasmono, 2010). As a result, the cost of capital does not decrease so that stakeholders type 1 are not encouraged to contribute to a better CSR implementation.

## CONCLUSION AND SUGGESTIONS FOR FUTURE RESEARCH

### Conclusion

The formation of the mindset that CSR can create added value for the company through comprehensive empirical verification is the main objective of the research. The analysis is done using Panel Vector Autoregression technique. The test results indicate optimal CSR implementation in the 1 periods before increase the added value of the company in the current period.

### Suggestions for future research

For some of the limitations in this research, suggestions that can be used for future research are as follows:

- a. This study assesses the implementation of CSR by conducting content analysis with GRI indicators. Content analysis techniques themselves have a weakness in the form of a higher level of subjectivity. In addition, the use of GRI indicators resulted in the small amount used of samples and short study periods. Therefore, further research is expected to use other techniques that have lower levels of subjectivity and can produce longer samples and periods
- b. Several sample companies have subsidiary-parent relationships, such as Indika Energy and Petrosea. This will certainly have an impact considering that CSR report generated by the parent company also includes aspects of social responsibility carried out by its subsidiaries.
- c. Further research is expected to focus the research on one company sector. This study provides an overview of CSR and MVA relationships in general where there are companies that do not have a direct impact on stakeholders, such as companies engaged in telecommunications. Focus to one sector of the company is expected to provide different results and be able to provide additional insight into the relationship between the two variables.

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