

CHAPTER 2 LITERATURE REVIEW & HYPOTHESIS DEVELOPMENT

2.1 Stakeholder Theory

Freeman (1983) describes stakeholder theory as a framework that identifies the parties for which a company has responsibilities. It introduces the concept through two models: (1) policy and business planning models, and (2) the corporate social responsibility model of stakeholder management. The first model focuses on creating and assessing strategic decisions with groups that are vital to the company's ongoing support. The second model broadens corporate planning to account for external factors that might oppose the company's interests.

Stakeholder theory suggests that corporate social responsibility requires attention, as companies must also focus on social responsibility toward stakeholders in their environment. Freeman and McVea (2001) state that stakeholders are "Every group or individual that may influence or be influenced by the achievement of organizational goals." In another sense, stakeholders are often defined as groups that have an interest, either directly or indirectly, in a company's existence or activities. Therefore, this group may be affected by the company (Wibisono, 2007). According to Purwanto (2011), stakeholders are all parties whose existence significantly influences and is influenced by the company, such as employees, the community, competing companies, and the government.

Companies must foster good relationships with their stakeholders, especially groups that impact the availability of resources essential for operations, such as markets for the company's products, labor, and other resources (Chariri & Ghazali,

2007). Stakeholder. Theory can help management understand how to increase company value by reducing the losses faced by interested parties.

2.2 Legitimacy Theory

Legitimacy can be understood as the alignment of perceptions or assumptions that the treatment of an entity is an expected and reasonable action based on socially developed values, beliefs, norms, and definitions (Suchman, 1995). The concept of legitimacy stems from the challenge of social interaction between entities and their environment, as entities' goals align with societal values. Gray et al. (1995) describe legitimacy as an entity's conformity with a company's conditions or value system, consistent with the broader social system of which the company is a part.

Legitimacy theory proposes that companies continually strive to conform to societal norms and expectations. O'Donovan (2000) describes organizational legitimacy as something society grants to a company, and something the company desires from the community. This theory is linked to stakeholder theory, suggesting that an organization will willingly disclose its activities when it believes this aligns with community expectations.

Deegan (2000) states that legitimacy theory is based on the idea that a social contract exists between a company and its environment. This social contract explains societal expectations regarding how an organization should operate. Companies need to adapt to environmental shifts and evolving social expectations, which may change over time. Guthrie and Parker (1989) noted that if a company perceives its legitimacy is at risk, it might adopt various resistance strategies, including:

- Companies might try to inform and educate their stakeholders about updates within the organization.
- Companies might attempt to alter stakeholder perceptions without actually changing company actions.
- Companies may try to influence stakeholder perceptions by shifting focus from important issues to related, more interesting ones.
- Companies might attempt to shape and influence external parties' expectations about their performance.

In legitimacy theory, companies must consistently show that their operational activities align with social values. This is often achieved by disclosing such information in the company's financial statements. Organizations may use disclosure to address corporate concerns about social values or to shift community attention to the negative impacts of their activities.

2.3 Green Credit

Green credit emerged after the publication of the Equator Principles in 2002. It is part of the green financial system, which originated in green finance, itself developed from the idea of sustainable development. Green credit involves banks considering not only economic benefits but also environmental factors when making loan decisions.

Green credit policies directly influence the ability of heavily polluted companies to access credit, thereby affecting the distribution of credit resources. The flow of traditional credit capital from financial institutions has supported the growth of capital- and energy-intensive industries and high-value sectors, which increases

energy use and environmental pollution. This has led to a strong positive link between credit allocation and pollution emissions. Green finance can, to some degree, motivate financial institutions to take greater responsibility for environmental protection, helping promote regional energy savings and emissions reductions.

Some key aspects of green credit activities are:

- The funding side always prioritizes investments or loans based on environmental risk factors.
- Always focused on sustainable growth, an environmentally friendly industry, and social responsibility.
- Assumes clients are different from their family members, guiding and advising on projects to lower pollution levels by using scientific knowledge and methods in real life, through the application of the Environmental Due Diligence (EDD) checklist.
- Reduce costs and energy by saving money and boosting a country's Gross Domestic Product (GDP).

2.4 Corporate Social Responsibility

The World Business Council for Sustainable Development (WBCSD) describes Corporate Social Responsibility (CSR) as an ongoing commitment by businesses to adhere to norms and support the economic development of local communities or society as a whole, while also enhancing the well-being of their employees and their families.

According to John Elkington, Corporate Social Responsibility (CSR) is a concept where organizations, especially corporations, have a duty to consider the interests of customers, employees, shareholders, communities, and environmental factors in all their activities. This duty goes beyond mere legal compliance. CSR can be classified into three main categories:

1. Responsibility as a Social Duty

The view suggests that the community may accept a company if it remains within the community's limits while generating profits. The company must compensate the community for its profits since it has been permitted to carry out its activities.

2. Social Responsibility as a Social Reaction.

This perspective highlights that society expects businesses and companies to act responsibly. The company must be accountable for the environmental, social, and ecological impacts of its activities.

3. Responsibility as Social Responsiveness

This perspective suggests that many socially responsible actions are proactive and foresightful. Indicators of socially responsive behaviour include meeting community demands, predicting future community needs and working to address them, communicating with the government about current regulations and the community's anticipated desires, and demonstrating a willingness to act for the community's and any group's benefit.

2.5 Firm value

According to Noerirawan (2012), "firm value is a condition that has been achieved by a company as an illustration of public trust in the company after going through a process of activity for several years, namely since the company was founded until now." One of the company's main goals is to maximize its value; therefore, its management must do the same. As the company's value increases, shareholders' welfare increases as well. Therefore, increasing the company's value aligns with the owners' goals.

Yulius and Tarigan (2007) explain that several value concepts illustrate a company's worth: nominal value, market value, intrinsic value, book value, and liquidation value. Nominal value is the official amount stated in the company's articles of association, explicitly recorded in the balance sheet, and clearly indicated on the collective share certificate. Market value, also known as the exchange rate, is the price arrived at through bargaining in the stock market and can only be determined when the company's shares are traded publicly. Intrinsic value is a more abstract idea, representing an estimate of the company's true worth.

A company's intrinsic value reflects its overall worth, not just its asset price, encompassing its potential to generate future profits. Book value is a measure based on accounting principles, calculated as total assets minus total liabilities, divided by outstanding shares. The liquidation value is the proceeds from selling all assets after settling liabilities; this residual amount belongs to shareholders. It can be estimated similarly to the book value, using the performance balance prepared during liquidation.

2.6 Previous Research

Previous studies have examined the impact of implementing green banking and Corporate Social Responsibility on firm value. Research by Omika Dewi and I Gusti Agung (2017) shows that the application of green banking can strengthen the relationship between corporate social responsibility and the sustainability of banking companies. Research by Ratnasari and Tria (2017) indicates that daily green banking operations have a significant and positive effect on bank profitability. However, green banking policies and bank efficiency are shown to have a significant and negative effect on bank profitability.

Meanwhile, research conducted by Maramis, Nicholas. (2013) shows that banks and Bank Indonesia are parties that are not directly related and play an indirect role in enforcing Green Banking through their credit policies as a way to protect the environment. Research by Ardimas, Wahyu, and Wardoyo (2014) also found that ROA and ROE influence firm value, while OPM, NPM, and Corporate Social Responsibility (CSR) do not.

Table 1: Summary of Previous Research on CSR and Firm Value

Author(s) (Year)	Measures	CSR → Firm Value
Brammer et al. (2006).	CSR: EIRIS scores, Firm value: stock returns	Scores on a composite social performance indicator are inversely related to stock returns.
Crisóstomo et al. (2011).	CSR: The index used in this study is based on IBASE's information. Firm value: stock returns.	CSR appears to reduce firm value in Brazil, as indicated by a strong negative link between CSR and firm value.

Servaes & Tamayo (2013).	CSR: KLD scores, Firm value: Tobin's Q	CSR activities can enhance a company's value, but only when specific conditions are met.
Deng et al. (2013).	CSR: KLD scores, Firm value: Tobin's Q	High CSR acquirers achieve greater merger announcement returns, increased partners' announcement returns, and better long-term operational performance.
Harjoto & Jo (2015)	CSR: KLD scores, Firm value: Tobin's Q	Overall, CSR initiatives decrease earnings forecast dispersion among analysts, improve forecast accuracy (EMC), and enhance firm value. Firms with higher accounting and disclosure quality gain more from these initiatives.
Krüger (2015)	CSR: KLD scores, Firm value: Daily CARs	Investors do value 'offsetting CSR'; CSR events with stronger legal and social enforcement content generate a more pronounced investor reaction.
Mishra & Modi (2016).	CSR: KLD scores Firm value: stock response modeling to assess unanticipated stock return	CSR performance is associated with smaller deviations between expected and realized returns, reducing firm risk-taking levels. CSR benefits firm value by mitigating negative shocks
El et al. (2017).	CSR: environmental and social performance scores in ASSET4 Firm value: Tobin's Q	CSR performance is associated with smaller deviations between expected and realized returns, reducing firm risk-taking levels. CSR benefits firm value by mitigating negative shocks
Harjoto & Laksamana (2018).	CSR: KLD scores, Firm value: Tobin's Q	CSR performance is linked to fewer discrepancies between expected and actual returns, thereby lowering firm risk-taking levels. CSR benefits firm value by mitigating negative shocks

Sheikh (2018)	CSR: The gap between overall CSR strengths and concerns across five dimensions—community, diversity, employee, product, and environment. Firm value: adjusted Tobin's Q.	CSR does not significantly influence firm value.
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2.7. Hypothesis development

2.7.1. Green Credit Relationship with Firm Values in the Banking Industry

Green credit is a concept that assesses the activities of financial institutions by emphasizing environmental sustainability in their lending and operational practices. The banking industry plays a vital role as a financial intermediary by collecting funds from the public through savings and deposits and reallocating them as loans or credit. In fulfilling this role, banks are expected to seek not only economic profitability but also to consider environmental and social factors in their decision-making. Implementing green credit encourages banks to finance environmentally responsible projects while limiting lending to companies that could cause environmental harm. Through this approach, banks support sustainable development while maintaining financial stability and reducing long-term risks.

The relationship between green credit and firm value can be explained from a stakeholder theory perspective. Stakeholder theory suggests that companies must consider the interests of all stakeholders, including investors, customers,

governments, and society, rather than focusing solely on shareholders. When banks implement green credit policies, they demonstrate responsibility toward environmental sustainability and social welfare. This responsible behavior can increase stakeholders' trust and enhance the bank's reputation. Investors and customers tend to support financial institutions that are committed to sustainable practices, which can boost demand for the bank's services and ultimately raise the firm's market value.

Additionally, legitimacy theory explains the significance of green credit in affecting firm value. It suggests that organizations aim to ensure their operations appear legitimate and align with society's norms, values, and expectations. Banks that actively include environmental considerations in their lending policies can maintain legitimacy with regulators and the public. By supporting environmentally friendly projects and avoiding activities that harm the environment, banks can lower regulatory risks and improve their public image. Maintaining social legitimacy is crucial for long-term business sustainability, which in turn helps enhance firm value.

From a risk management perspective, green credit can also lower the chances of credit risk and non-performing loans. If a bank lends to companies that cause environmental pollution, those companies might face government sanctions, legal penalties, or operational shutdowns. Such situations can interrupt the debtor's ability to repay loans, increasing the risk of loan defaults and hurting the bank's financial results. A higher level of non-performing loans can decrease profitability and weaken investor confidence, ultimately reducing firm value. By adopting green credit policies, banks can choose borrowers with more sustainable

and responsible business practices, thereby lowering credit risk and enhancing the quality of their loan portfolios.

Based on these theoretical perspectives and risk considerations, the implementation of green credit is expected to positively impact firm value in the banking industry. Through responsible lending practices, banks can increase stakeholder trust, preserve social legitimacy, and lower financial risks. These benefits lead to improved financial performance and higher market value. Therefore, the following hypothesis can be proposed:

H1: Green credit has a positive impact on firm value in the banking industry.

2.7.2. Relationship between CSR Disclosure and Firm Value in the Banking Industry

One of a company's main objectives is to sustainably increase its value. This goal can be achieved by considering not just economic performance but also environmental and social aspects of business operations (Kusumadilaga, 2010). In this context, Corporate Social Responsibility (CSR) becomes a key mechanism through which companies demonstrate their commitment to sustainable development. CSR reflects a company's responsibility to various stakeholders, including investors, customers, employees, communities, and the government. In the banking industry, CSR activities can include community development programs, environmental initiatives, and social welfare contributions. By implementing CSR, banks seek to maintain positive relationships with stakeholders and improve their corporate image, ultimately boosting firm value.

The relationship between CSR and firm value can be explained through stakeholder theory. Stakeholder theory suggests that companies should not only focus on maximizing shareholder wealth but also consider the interests and expectations of all stakeholders. When banks actively implement CSR programs, they show accountability and concern for social and environmental issues affecting their stakeholders. This responsible behavior can build trust and support from investors, customers, and the community. As stakeholder confidence grows, the bank's reputation and market appeal also improve, positively impacting its financial performance and market valuation. Therefore, CSR activities can be a strategic tool to increase the company's overall value.

Additionally, legitimacy theory offers another perspective that supports the link between CSR and firm value. According to legitimacy theory, companies aim to ensure their operations match societal norms, values, and expectations to maintain legitimacy. Organizations that fail to meet these standards may face public criticism, protests, or regulatory sanctions, which can harm their business operations and reputation. In Indonesia, the importance of CSR is also highlighted in Article 40 of Law No. 40 of 2007 on Limited Liability Companies, which mandates that companies involved in natural resources must fulfill social and environmental responsibilities. Following these regulations helps companies sustain legitimacy in the eyes of the public and regulators. For banks, upholding legitimacy through CSR practices can lessen potential conflicts with society and promote the sustainability of their operations.

Empirical studies also support the positive impact of CSR on firm value. Research conducted by Orlitzky (2003), Zuraedah (2010), Harjoto and Jo (2011), Indriyani et al. (2012), and Servaes and Tamayo (2013) indicates that CSR has a positive and significant effect on firm value. Furthermore, McWilliams and Siegel (2001) argue that CSR initiatives can create added value for stakeholders and contribute to long-term corporate sustainability. In the banking sector, CSR activities can help prevent social conflicts such as public protests or demonstrations that may disrupt banking operations. By maintaining strong relationships with the community and other stakeholders, banks can operate more smoothly and achieve stable financial performance, reflected in profitability indicators such as Return on Assets (ROA), Return on Equity (ROE), and Return on Sales (ROS).

Based on these theoretical perspectives and empirical findings, CSR implementation is likely to increase firm value by strengthening stakeholder relationships, maintaining corporate legitimacy, and enhancing the company's reputation and financial performance. Therefore, companies that actively pursue CSR are more likely to attract greater investor confidence and achieve long-term sustainability. Based on this reasoning, the following hypothesis can be proposed:

H2: Corporate Social Responsibility has a positive effect on firm value in the banking industry.