

CHAPTER II

LITERATURE REVIEW

2.1 Corporate Social Responsibility

CSR explained as an obligation to develop community well-being done by discretionary business performance and contribution of company resources. By this definition, discretionary means that CSR is a voluntary commitment for a company to choose and conduct CSR practices in order to make a contribution to the community well-being, as well as both human and environmental concern (Kotler & Lee, 2005). According to Business for Social Responsibility, CSR is highlighted as a business decision linked to ethical value, legal constraint along with respect for people, communities and environment. Moreover, World Business Council of Sustainable Development defined CSR as a business commitment that focus on sustainable development that could help its employees and families, local community, and broader society to enhance quality their quality of life.

United Nations through its agency called United Nations Industrial Development Organization (UNIDO) defined CSR as a management concept in which company assimilates social and environmental interest in conducting business activities and communicate with its stakeholder.

In Indonesia, CSR also defined on the Constitutions No. 40 of 2007 about Limited Liability Company. According to Constitution No. 40 of

2007 article 1, paragraph 3, CSR is a commitment of corporation to engage in developing sustainable economics to improve quality of life and better environment, either for the corporation, local community or broader community. Furthermore, according to Constitutions No.25 of 2007 article 15b, CSR must be conducted by all of the shareholder, the definition of CSR based on this paragraph is responsibility of all investing company to create harmonious and balanced relationship that is suitable with the environment, value, norm, and culture of local community.

2.2 Triple Bottom Line

John Elkington in 1995, developed the idea of triple bottom line, 'people, planet, and profit'. Triple bottom line highlighted that company must not focus only on the economic value, however, company must add value to the environment and social.

2.2.1. People

People is concerned about company consideration towards the positive and negative impact of the company's operation to all stakeholder, as well as employee, family, community, supplier, customer and other person that might be influenced by the company.

2.2.2. Planet

Planet is concerned about the environmental impact of the company operation, such as carbon footprint, natural resources

consumption, and dangerous material. Moreover, company must be responsible to do waste management properly, reforestation, and restoration on the natural resources that has been destroyed.

2.2.3. Profit

Profit is concerned with how the company could contribute to the national and international economy, as well as opening job opportunity, creating innovation, paying taxes, and making wealth. Profit is sometimes misinterpreted in term of meaning, profit translated only as a financial profit that the company could generate, and only focus on the financial aspect. Profit also perceived as the profit for only the company without considering other aspects, such as social and environmental aspect. When the company could give contribution to the society and environment, it could be translated as a profit as well, therefore, it is called as societal profit and environmental profit. These concepts could eliminate the doctrine if the company's most important thing is its contribution to the social and environment.

The meaning of profit in the triple bottom line becomes very limited for company, since it only focuses on how much money that the company could gain from its operating activities. Because of that reason, Elkington suggested to recall the term of 'profit' into 'prosperity'. The new term, prosperity could reflect the original

meaning of three bottom line, since it could explain more about the economic benefit, such as creating employment, bringing new innovation, and paying taxes as an obligation to the government. Therefore, by replacing profit into prosperity, the original idea of Elkington about triple bottom line becomes more relatable, about how to minimize negative impact, and maximize the positive impact of those three bottom line (Kraaijenbrink, 2019).

2.3 Corporate Social Responsibility Indicator

Sembiring (2005), developing CSR indicator consist of seven categories of indicator, environment, energy, workplace safety and health, employment, product, social involvement, and general. The indicator is developed based on the research of Hackston and Milne (1990) with some modification to fit to be applied in Indonesia's environment.

1. Environment

- 1) Pollution management, research and development spending to reduce pollution.
- 2) Statement that shows if the operational of the company doesn't cause pollution or fulfill the regulation and law about pollution.
- 3) Statement that shows if the operational pollution has been or will be reduced.
- 4) Prevention or repairmen of environmental damage as a result of natural resources utilization, for example, reclamation or reforestation.

- 5) Natural resources conservation, as well as recycling glass, iron, oil, water, and paper.
- 6) Recycled materials usage.
- 7) Receive environmental awards.
- 8) Develop environmentally friendly facility.
- 9) Contribution in term of arts to decorate the environment.
- 10) Contribution on rebuilding historical places.
- 11) Waste management
- 12) Study the environmental impact to monitor environmental impact caused by the company.
- 13) Environmental protection.

2. Energy

- 1) Efficiency of energy usage for operational activity.
- 2) Utilization of scraps for generate energy.
- 3) Statement of energy saving by using scraps.
- 4) Energy minimization discussion.
- 5) Statement of improvement energy efficiency from the product.
- 6) Research to improve energy efficiency from the product.
- 7) Statement of company's energy policy.

3. Workplace Safety and Health

- 1) Minimizing pollution, irritation or risk in the workplace.

- 2) Promoting employment safety and physical or mental health.
- 3) Statement about workplace accident statistics.
- 4) Obeying regulation about health standard and work safety.
- 5) Accept appreciation related with work safety.
- 6) Forming work safety committee.
- 7) Conducting research to improve work safety.
- 8) Statement about health services.

4. Employment

- 1) Employ woman or disabled person.
- 2) Statement about the numbers of woman or disabled person employee in the managerial level.
- 3) Statement about the aim of employing woman or disabled person in the workplace.
- 4) Program to enhance woman or disabled person employee.
- 5) Training in the workplace.
- 6) Educational support in term of money.
- 7) Establishing training center
- 8) Statement about employee supervising that is in the resigning process.
- 9) Statement about plan for employee house.

- 10) Statement about recreation facility.
- 11) Statement about salary percentage for retirement.
- 12) Statement about salary policy in the company.
- 13) Statement about the number of employee.
- 14) Statement about managerial level.
- 15) Statement about staff disposition, where the staff are placed.
- 16) Statement about the number of staff, working period, and age classification.
- 17) Statement about employee statistics, e.g. sales per employee.
- 18) Statement about qualification of the employee recruitment.
- 19) Statement about stock ownership option.
- 20) Statement about profit share benefit plan.
- 21) Statement about the relationship between managerial and employee to improve workplace satisfaction and motivation.
- 22) Statement about employee working stability and company's future.
- 23) Developing separate report about employment.
- 24) Reporting the relationship of the company with labor organization.
- 25) Reporting distraction and employment action.
- 26) Reporting negotiation about employment.
- 27) Improvement working condition in general.

28) Information company re-organizing that affect employment.

29) Information and statistics about employment cycle.

5. Product

- 1) Information about company product development, including the package.
- 2) Overview about research expense for product development.
- 3) Disclosure about research project to improve product.
- 4) Statement about the product safety standard.
- 5) Developing a safer product for consumer.
- 6) Conducting research about product safety level.
- 7) Disclosure about the improvement of cleanliness in processing the product.
- 8) Information about product safety.
- 9) Information about product quality that is explained through the award received.
- 10) Information that could be verified if the quality of the product has been increased (for example ISO 9000).

6. Social Involvement

- 1) Donation in cash, product, service to support social activity, education and arts.

- 2) Part time employment from student.
- 3) Sponsorship to support social health.
- 4) Contributing to medical research.
- 5) Sponsorship to education conference, seminar, and art exhibition.
- 6) Scholarship program.
- 7) Opening company facility for society.
- 8) Sponsorship for national campaign.
- 9) Supporting local industry.

7. General

- 1) Statement about company's CSR objective and policy in general.
- 2) Information related with CSR that has not been mentioned above.

2.4 ROE

Return on Equity measures the return that the company get from its equity investment. ROE becomes really important in measuring company performance since it tells the overall profits of the company relative to the total investment of the company's shareholders. ROE is used by the company to measure its goal, for the reason that the main company's goal is to give maximum value to its shareholders. The formula of ROE is

established by DuPont Corporation by 1920. ROE could be computed by using the following formula:

$$\text{ROE} = \frac{\text{net income}}{\text{equity}}$$

2.5 ROA

Return on Asset (ROA) measures the ability of a company to generate profit by using its total assets that has been adjusted with other costs to fund the asset. ROA analysis will focus on the asset profitability, therefore, how the assets are funded will be not taken into account (Hanafi & Halim, 2018). ROA could be computed by using the following formula (Subramanyam, Wild, & Hasley, 2005):

$$\text{ROA} = \frac{\text{NOPAT}}{\text{Total Asset}}$$

According to the formula, NOPAT (Net Operating Profit After Tax) is a net income after tax that is resulted from the operating asset. According to (Subramanyam & Wild, 2010), NOPAT is calculated as follow:

$$\text{NOPAT} = (\text{Sales} - \text{Operating Expense}) \times (1 - (\text{Tax}/\text{EBT}))$$

2.6 Theory that Contribute to the Relationship of CSR, ROE and ROA

2.6.1. Stakeholder Theory

Positive relationship between CSR and company profitability is supported by stakeholder theory that is first introduced by Freeman in 1984. Stakeholder theory explained as a prespective of capitalism that highlighted the interconnected relationship between company with all customers, employess, investors, communities, and other

parties that have stake in the company. This theory explore that a company must benefits all of its stakeholder, not only the shareholder. Furthermore, stakeholder theory has become a dominant paradigm in the CSR concept. According to (Donladson & Lee, 1995), there are three types of use of stakeholder theory are, descriptive/ empirical, the stakeholder theory is used to descirbe and explain a particular company characteristics and behavior; instrumental, the stakeholder theory is used to understand the connections or the absence of connection between stakeholder management and old-fashioned company's objective as well as profitability and growth; normative, the stakeholder theory is used to translate the function of a company as well as the identification of moral or philisopical rules for operation and company management. Porter & Kramer (2006) observed a company that explores the idea of CSR could gain more opportunity, improvement, and competitive advantage. Additionally, they also explained if there is a mutual dependence between company and society, and it should follow the principle of shared value, therefore, the stakeholder theory will stand. Company must consider CSR as a long-term investment rather than as an unecessary expenditure, the company must shift into a modern financial goal, rather than the old-fanshioned one, since both of them will result in generating profit, however, the difference is only in

term of time, the modern one might take a longer time, therefore, it is said as an investment (Rahman & Pandey, 2020).

2.6.1. Agency Theory

Relationship between CSR and company profitability is perceived by economist and expert differently. Friedman M. (1970) argue that conducting CSR in a company will create an agency problem, where there is a conflict of interest between manager and shareholder. The agency problem could be explained through agency theory, theory that assumes if agents are self-interested, boundedly rational and different from principals in their goals and risk-taking preferences, this is happen when the principal parties occupes other parties called an agent to make decision (Payne & Petrenko, 2019). Agency theory is also used to observe the corporate governance of a comapany. Friedman also stated if manager uses CSR for their own interest, such as social, political, or carrer by charging the cost to shareholder. However, when the manager is not behave to benefit shareholders, thus it will create agency cost, a cost that is occurred because there is a principal and agent conflict of interest and disagreement related with some decision.

2.7 Previous Research

Table 2.1. Previous Research

	Research	Variable	Data Analysis	Result
1.	Bagh et al. (2017) entitled “The Corporate Social Responsibility and Firms’ Financial Performance : Evidence from Financial Sector of Pakistan.”	Corporate Social Responsibility (independent variable) and Financial Performance with ROA, ROE, and EPS as the proxies (dependent variable)	Pooled Regression Analysis	There is a positive impact of CSR towards ROA, ROE and EPS.
2.	Syamni et al. (2020) entitled, “CSR and Profitability in IDX Agricultural Sub Sector.”	Corporate Social Responsibility (independent variable) and Profitability by using ROA, ROE, and Net Profit Margin (NPM) as a proxies (dependent variable).	Linear Regression Analysis	CSR has significant effect on financial performance, CSR has negative relationship on ROA, and positive

Research	Variable	Data Analysis	Result
			relationship with ROE and NPM.
3. Jang et al. (2019) entitled “CSR, Social Ties and Financial Performance.”	CSR (independent variable), ROA and ROE as proxy of firm performance (dependent variable), and social ties (moderating variable).	Regression analysis	CSR increases firm performance in term of ROA and ROE, and social ties has negative moderating effect between CSR and financial performance.
4. Ho et al. (2019) entitled “The Impact of Corporate Social Responsibility on Financial	CSR (independent variable); ROA, ROE, NIM, and NPL as proxies of financial performance	Regression analysis	There is a positive relationship between CSR and financial performance in

Research	Variable	Data Analysis	Result
Performance: Evidence from Commercial Banks in Mongolia.”	(dependent variable); firm size, board structure, liquidity ratio, debt ratio and economic growth (control variable).		term of ROA, ROE, and NIM, and negative relationship between CSR and NPL.
5. Kartikaningdyah and Kamatra (2015) entitled “Effect Corporate Social Responsibility on Financial Performance”	CSR (independent variable); SIZE and DER (control variable); ROE, ROA, NPM, and EPS (dependent variable)	Multiple regression analysis	CSR has an effect towards ROA and NPM, while CSR has no effect towards ROE and EPS.

2.8 Hypothesis Development

ROE explains the effectiveness of a company to manage every single dollar of shareholder’s investment to be generated into net income. Higher ROE indicates that the company is more effective in using shareholder’s equity. According to Masum et al. (2019) there is positive relationship between CSR in term of environment and employment towards ROE, it

means that the company which invested more on environment and employment is more profitable. Research conducted by Arifin & Wardani (2016), Szegedi et al. (2020), and Kalai & Sbais (2019) also indicate that there is a positive relationship between CSR and ROE.

ROA explains how much net income could be made from every single dollar of asset. Higher ROA indicates higher profitability of a company. According to Prasetyo & Meiranto (2017), CSR has positive relationship towards ROA, therefore, when the company conducting more CSR, the company will have bigger ROA. Positive relationship between CSR and ROA also found by the research of Matuszak & Rozanska (2017); Jang, Lee, & Choi (2013); and Genedy & Sakr (2017). The positive relationship between CSR and ROA explains that investing in CSR activities is beneficial for the company.

H1: CSR disclosure influences ROE of consumer goods companies that are listed on the Indonesia Stock Exchange from 2011 to 2019.

H2: CSR disclosure influences ROA of consumer goods companies that are listed on the Indonesia Stock Exchange from 2011 to 2019.

2.9 Research Framework

Based on the background and the literature review that consist of theory and previous study of the relationship between CSR and profitability of company, this research will observe the influence of CSR and company

profitability in the consumer goods sector that are listed on IDX during 2011 to 2019. The researcher develop the research framework as follows:

Figure 2.1: Research Framework of the Relationship between CSR and Company Profitability

