

CHAPTER I

INTRODUCTION

1.1. Introduction

Humans obtain their needs such as water, food, clothes, and many more from the environment. This action surely cannot be stopped, as humans have to fulfill their needs to survive. As the time goes by, people start buying and selling what they can get from the environment, in this era, this can be called as a business. Business tries to get profit by providing what people need and Ferrell *et al.* (2018) state that all businesses have one primary goal, which is to make profit. On the other hand, taking things out of our nature, without a sense of being responsible to sustain will cause damage to our environment, which can be the main cause for climate change and global warming.

The issues of climate change and global warming have certainly attracted people's attention. Many actions had been taken to reduce the fatality of climate change and global warming, not only by individuals, but also by businesses. One example is the establishment for Corporate Social Responsibility (CSR). The World Business Council for Sustainable Development (cited in Henderson and McIlwraith, 2013) states that CSR refers to a company's transparent and accountable integration of social, environmental, and economic into its beliefs and values. With people's concern about environmental issues and the existence of CSR, both should motivate companies to do better especially for the environment.

In Indonesia, CSR is considered as a mandatory activity for limited liability companies. It is regulated under the Law No. 40 of 2007 concerning Limited Liability Companies and Government Regulation no. 47 of 2012 concerning Social and Environmental Responsibility of Limited Liability Companies¹. As a result,

¹ According to Article 74, paragraph 1, *the Law of the Republic of Indonesia Number 40 of 2007 concerning Limited Liability Company* (Indonesia), fulfilling CSR is required for organizations that conduct business operations in the field of and/or connected to natural resources. 'In the field' implies companies that manage and exploit natural resources. 'Connected to natural resources' implies a company that does not manage or use natural resources, but whose commercial actions have an influence on how natural resource capabilities function.

doing CSR can be seen as a forced activity to meet a legal responsibility. Being responsible by completing CSR gives good impacts to the environment. For example, in Nestle Indonesia, they opted to employ a combination generator in which the usage of fuel oil was replaced by natural gas, resulting in a decrease of up to 24 percent in the use of petroleum fuels (Nestlé, no date). But, there are mixed evidence about what impact CSR gives to company's profitability.

Since all the empirical studies in this topic are still varied, this research will contribute to give empirical evidence especially in consumer non-cyclical sector companies in Indonesia. This study consists of background, literature review, research methods, explanation of results, and discussion which all can be found in the following sections.

1.2. Motivation and Significance of Research

The motivation for carrying out this study stems from a desire to learn whether completing CSR has an impact to company's performances. People can see easily what CSR can bring to the environment, and indeed it causes great impact to nature, but if we are to compare to what CSR can bring to the company's profitability, the answers are still unclear. This study is going to focus on consumer non-cyclical sector² companies' performance in Indonesia because companies in this type of industry produce products that are required all year long, that of course will force the companies to operate well regardless of how bad or good the economic conditions are.

There are literatures that examine the impact of CSR on company values, customer loyalty, even the company profitability. The previous literature conducted by Chen *et al.* (2018), found that the companies in China that spent budget to disclose CSR experienced decrease in profitability. Sadly, the data used was from 2006-2011, which is more than 10 years ago. Research done by Hermawan and Mulyawan (2014) on listed companies in Indonesia resulted that there was no

² According to Indonesia Stock Exchange (2019), consumer non-cyclical sector means a sector where companies deliver goods and services that primarily offered to the customers. Commonly, companies in this sector provide necessities such as food, mineral water, and medicines.

relationship between CSR and companies' profitability. The other study conducted by Isnalita and Narsa (2017) on public listed mining companies in Indonesia found that CSR practiced by companies did not directly influence companies' profitability. Latest research by Fahad and Busru (2021) also concluded that there was negative effect of CSR to companies' profitability in India. Therefore, there is an existing gap since previous literatures have different outcomes. Moreover, the technology, the system, and the market will have a significant distinction compared to the past. All these variables certainly will affect how the CSR will impact company's profitability. Hence, this research will cover on this field and the objectives of this research and the hypotheses are provided in the next section.

1.3. Research Objectives and Hypotheses

The objective of this research is to investigate whether CSR has any impact on company's profitability. In order to accomplish this objective, two hypotheses have been developed:

CSR requires company to be responsible to the environment, and by this, companies need to spend their money to conduct appropriate CSR in the short run.

H1: CSR has influence on the company's profitability in the short run.

CSR requires company to be responsible to the environment, and by this, companies opted to more environmental-friendly alternatives and causing company to save more in the long-run. (i.e. reduced electricity bills, water bills)

H2: CSR has influence on the company's profitability in the long run.

All hypotheses are going to be tested and this process will be done in line with the research's methodology and design which will be described in the next section.

1.4. Research Methodology and Research Design

This research is considered as quantitative research. Vanderstoep and Johnston (2009, p. 7) stated that "quantitative research specifies numerical assignment to the phenomena under study" and this study is going to focus on the profitability of companies. There are many ways to calculate companies'

profitability. Prior to this research, Chen, et al. (2018) use Return on Assets (ROA) and Return on Equity (ROE) to measure companies' profitability, meanwhile Fahad and Busru (2020) used very wide range of variables: ROA, Tobin's Q, ESG Score as a whole and individually. The other research conducted by Hermawan and Mulyawan (2017) measure companies' profitability by using ROA, ROE, and Net Profit Margin (NPM). But this research will take a slightly different approach. Return on Investment (ROI) will be used to measure the profitability of the companies. The ratio is chosen because it represents how the company effectively use investment funds to generate profit. Second reason is because there are very little empirical findings that research on the CSR's relationship with companies' profitability that measured by ROI. The data used in this research are all secondary data such as annual reports and CSR report of consumer non-cyclical companies and those data are taken from idx.co.id.

1.5. Summary of the findings of the study

This research measured the influence of the presence of the Corporate Social Responsibility to the companies' profitability measured by return on investment. Based on the two models this research applied, this research found that there is no significant relationship between the existence of Corporate Social Responsibility to the financial performance of the company neither in the short run nor in the long run.

1.6. Research Contributions

The previous literatures' outcomes were inconsistent and the findings still have not converged to one exact conclusion. Since there are gaps in the previous literature (refer chapter 2, section 2.4), the findings of this study will fill in those gaps, especially on the influence of CSR to the company profitability. By filling in those gaps, this research hopefully can. This research contributes additional information regarding the influence of the existence of CSR to the companies' profitability, when measured using return on investment. Furthermore, the findings of this study can be taken as considerations for companies in practicing CSR in the future.

1.7. Structure of the Dissertation

This research is organized into five main chapters. Chapter 1 discusses the introduction and the programme of the whole study. Chapter 2 provides review of theoretical background and empirical findings of the influence of CSR to company profitability. Chapter 3 discusses this research's methodology in detail. Chapter 4 presents the result of this research and hypotheses testing. In this chapter, the result will be thoroughly discussed. Chapter 5 concludes the research by providing a summary of the research's findings, as well as the limitations and recommendations for future research.

