# CHAPTER II
# LITERATURE REVIEW

## 2.1. Introduction

This chapter clarifies the theories behind Corporate Social Responsibility (CSR). Section 2.2 mainly focuses on the definition and explanation of CSR itself. This section will also discuss the theories that are closely related to CSR. Section 2.3 discusses the relationship between CSR and companies' profitability. The literature gaps from the previous literature then will be addressed in section 2.4. Finally, the last section provides the conclusion of chapter 2.

## 2.2. Corporate Social Responsibility (CSR)

According to Henderson and Mcllwraith (2013), CSR defines as company practices that include economic, social, and environmental factors into decision-making while also meeting or exceeding ethical and legal requirements. This can be viewed as when achieving the company's goals, the company has to commit to act ethically, lawfully, and contribute to the economic development while also seeking ways to improve the quality of local communities and societies as a whole. Hence, it is a type of corporate sustainability development in which the company is held accountable for its operational actions to the economic, social, and environmental aspects. The implementation of CSR is supposed to have a favourable influence within those aspects.

The emergence of CSR itself is revolved around several theories. Brin and Nehme (2019) suggest that The Carroll Theory, Triple Bottom Line, and Stakeholder Theory are the main theoretical frameworks of CSR. First theory is The Carroll Theory, initially, The Carroll Theory's four-part definition of CSR as 'corporate social responsibility comprises the economic, legal, ethical, and discretionary (philanthropic) expectations that society has of corporations at a particular point in time.' (Carroll, cited in Carroll 2016). These four responsibilities then establish a foundation or infrastructure that contributes to delineating, framing, or characterizing the nature of a business' responsibilities to the society of which it is a part.

Next theory is Triple Bottom-Line Theory. ‘Elkington defines the triple bottom line itself as economic prosperity, environmental sustainability, and social justice, or what has become more popularly known as people, planet, and profit.’ (Henderson and Mlclwraith, 2013, pp. 10). In other words, there is an inseparably linked relationship between the economy, society, and the environment. As an economic entity, the company's principal purpose is to make money, thus all operations are geared toward making the most money and increasing share prices. Stakeholders are also given a role in the company's continuity and development, consequently, businesses must give benefits and social responsibility to the environment because the company's operational actions certainly have an influence on the community.

The third theory is Stakeholder Theory Rankin et al. (2018) clarify that stakeholder theory focuses specifically on individual stakeholders rather than society as a whole. In this theory, a company does not exist to be just profitable, but also to be beneficial for its stakeholders. For this research, Triple Bottom Line theory will be mainly used as the foundation of the discussion. Comparing the result and the theory will help to understand whether a company’s operational activities to the community truly contribute to its financial performance or not.

## 2.3. CSR and Company’s Profitability

CSR can be done in a variety of ways, and it can be utilized as a strategy to reduce risk and boost profitability. Reducing risk in the sense of reducing environmental harm, earning trustworthiness, and assisting in the maintenance of the company’s reputation, all of which can indirectly improve profitability. The company's reputation is one concern for potential investors, and it may be appraised based on profitability, thus it must be maintained to ensure the company's existence. It is anticipated that by completing CSR, the company would be able to accomplish its core purpose, which is gaining profit without neglecting the interests of stakeholders and environmental sustainability as a form of accountability for the consequences generated by the firm's operational operations. There are many empirical studies that discussed the relationship between CSR and company’s profitability. Interestingly, these findings are varied and this will be addressed in the next section.

### 2.4. Literature Gaps

CSR is not always, but it may give numerous benefits, such as decreasing the company's operating expenses, improving sales volume and market shares, attracting new investors due to the favorable image established, and so on. There were also studies that examined that by practicing CSR, Bhattacharya *et al.* (2021) discovered that corporate social responsibility had a beneficial influence on sales. This influence on sales outweighs any effect that corporate social responsibility may have on the brand's reputation development. Another research by Oh *et al.,* (2016) discovered CSR practiced by company influenced the increase in purchase intensions. These arguments if connected to the studies researched by Kaur and Singh (2020), Eccles et al. (2014), Cho, Chung and Young (2019), Kiessling, Isaksson and Yasar (2015), Dunn and Sainty (2009), Walker, Zhang and Yu (2016) and Khojastehpour and Johns (2014) that by praticing CSR, it gives positive impact to the companies' profitability. But there were also studies that did not succeed to find whether the existence of CSR has any influence on the companies' profitability. Previous researchers, Isnalita and Narsa (2017), Aras, Aybars and Kutlu (2010), Hamdoun, Achabou and Dekhili (2022), and by Hermawan and Mulyawan (2014) found that there is no significant relationship between CSR and companies' profitability when measured by mostly ROA and ROE. Lastly, Fahad and Busru (2021), Musleh Alsartawi (2020), Wang *et al.,* (2015), López, Garcia and Rodriguez (2007), and Lin, Hsuan-Chu, Wang and Wu (2017) found that there is negative impact of CSR to companies' profitability. In other words, practicing CSR decrease the profitability of a company.

Surprisingly, previous research findings have yielded inconsistent results, making it difficult to pinpoint the true impact of CSR on company profitability. In past studies, researchers mostly employed ROA and ROE, some also use Net Profit Margin, Tobin's Q, and market value to assess a company's profitability. However, there is very little actual evidence that uses ROI as a metric to determine profitability in the previous studies. The preceding literature likewise utilised data from before the COVID-19 outbreak, despite the fact that the pandemic brought significant impact on company profits. There are still literature gaps with these empirical findings, such as conflicting outcomes, time period differences, and various profitability measurements.

### 2.5. Conclusion

According to the analysis above, CSR focuses on three aspects: social, economic, and environmental. The existence of CSR itself has undeniably positive effects on the environment, as evidenced by Nestle Indonesia (refer chapter 1, section 1.0). However, the influence of CSR on a company's profitability is still unclear (refer chapter 2, section 2.3). The purpose of this study is to look and provide additional evidence at the impact of corporate social responsibility (CSR) on company profitability in Indonesia, specifically in the consumer non-cyclical sector. Further explanation on how this study is conducted is provided in Chapter 3.