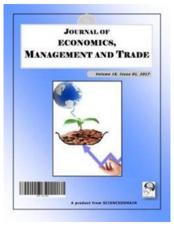

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The Impact of Corporate Social Responsibility Practice on Financial Performance of Banking Industry: Case Study: East African Commercial Banks

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Author's contribution

The sole author designed, analyzed and interpreted and prepared the manuscript.

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ABSTRACT

The purpose of the study is to investigate the impact of corporate social responsibility on financial performance in the banking sector in East African countries. The required data are collected from the Annual report and web sites issued by the banks for the year 2010 to 2016 and analyzed using Ordinary least squares (OLS) model by using Eviews9. The sample of the study consists of 35 banks in six countries. Corporate social responsibility score was obtained using content analysis of reports of the banks on various components of corporate social responsibility as reported in their audited financial reports also the variables of Financial performance was obtained from bank's financial statements. A multiple regression model was established to determine the relationship between the two variables. Control variables of GDP and financial leverage were also introduced in the regression model. The result showed that there is a positive strong relationship between CSR and ROA, while there is a negative relationship between CSR and ROE, therefore the study recommends the banks critically evaluate its existing CSR policy and to increase the wealth of shareholders.

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Keywords: Corporate social responsibility (CSR); ROA; ROE; GDP; financial leverage.

1. INTRODUCTION

The concept of corporate social responsibility has emerged exponentially in the last decades, also Corporate Social Responsibility has become an important part of planning to get and sustain the competitive advantage in the globally competitive companies. As well, Corporate Social Responsibility (CSR) can increase both long-term profitability and sustainability of the company as well as enhance the reputation of the organization. It is one of the newest Management Strategy where companies try to create a positive impact on Society while doing business. Corporate Social responsibility has been defined by different researchers in different ways [1]. According to Fraser [2], defined CSR as the continuous commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as the local community and society at large. Another researcher such Lea [3] defined as "Corporate Social Responsibility is about all types of businesses and other organizations going beyond the legal obligations to manage the impact they have on the environment and society. In particular, this could include how organizations interact with their employees, suppliers, customers and the communities in which they operate, as well as the extent they attempt to protect the environment."

In East African countries most of the commercial banks are privately owned banks, some of them are locally owned while others are foreign owned. For instance, in Kenya, there are 44 commercial banks out of which 31 are locally owned, while 13 are foreign owned [4]. Most Commercial banks of East Africa have realized tremendous growth in the last five years and have expanded to the other region [5]. The banking industry has also involved itself in automation, moving from the traditional banking to better meet the growing complex needs of their customer and globalization challenges. The banks have CSR programs that are run under own established foundations within the organization. Through the CSR programs, the banks have increased the uptake of its products and services and their names have spread widely within and outside the East African region. Examples of the foundation include KCB Foundation which is under KCB, Equity Foundation under Equity Bank, Coop Foundation under Cooperative Bank of Kenya among others [4].

According to Griffin [6] efforts have been made by a number of companies more particularly banks, to contribute in community development through CSR. For example, Bank of Africa [7] reports in 2007 they used USD 52,000 for Corporate Social Responsibility, whereby 26,000 USD was invested for classroom construction in the Dar es Salaam region. As well they provide 22,000 USD for social services including Women Empowerment Programs (WEP), Environmental Cleaning and water services in which more than 10,000 trees were planted in the outskirts of the Dar es Salaam city. According to Piprek [8] CRDB is Tanzania's fifth-largest commercial bank that was established in 1996 and has launched its microfinance initiative in 2001. Since its inception, the microfinance unit in CRDB has grown rapidly and today serves more than 78,000 clients through 157 partner institutions. CRDB (2011) states that the CRDB Bank has extended its functions in Morogoro Municipality, with more than five active branches. However, the contribution of CRDB in socio-economic development through CSR is not well documented. According to report of Dahabshiil International bank, Dahabshiil bank donated millions of US dollars to the education and health projects, and supporting relief efforts, which has had a real impact on the communities of the Horn of Africa. Previously studies have been focused mainly on the developed countries and there is less work done on measuring the impact of Corporate Social Responsibility on Financial Performance in less developed regions like East African region. In less developed countries, most of the banks are not yet quite familiar with the importance of Corporate Social Responsibility and thus don't pay much attention to the Corporate Social Responsibility [9]. Now a day's people have more knowledge about the organizations and the work they are doing for the welfare of the society. Therefore, it is important to study Corporate Social Responsibility and its impacts on the financial performance of banks in these economies.

2. CORPORATE SOCIAL RESPONSIBILITY

Today the corporate world is facing the concept of corporate social responsibility (CSR) wherever we see. At large corporations are encouraged to behave as socially responsible firms. However, in both the corporate and the academic world there is uncertainty as to how CSR should be defined. The beginning studies on CSR started with Bowen who issued “Social Responsibility of Business man in 1953. In addition to that, today, businesses that embrace CSR continue to see positive results such as; enhanced reputation, increased sales and customer loyalty, Competitive edge, strengthened relationships and expanded market share [10]. This drives the bottom line as people care about how an organization conducts business. All organizations have an impact on society and the environment through their operations, products and services and through their interaction with key stakeholders [11]. According to Carroll [12], the main attributes of CSR that contribute to profitability are those programs that focus on health, environment, education and sports. Those attributes benefit the company through improved financial performance, increased sales and customer loyalty, enhanced brand image and reputation, workforce diversification and increased ability to attract and retain employees. CSR benefits to the community include employee volunteer programs, charitable contributions, product safety and quality, corporate involvement in community education and employment opportunities. Lastly, environmental benefits include greater material recyclability, integration of environmental management tools into business plans, including life-cycle assessment and costing, environmental management standards, and eco-labeling. According to Ngowi [5], Most of East African Commercial Banks have taken keen interest in CSR in the last few years. This is evident from their annual reports and websites where they provide a statement on their CSR involvement. In most of their end of year financial reports, they dedicate pages highlighting their contributions to CSR. These institutions have engaged in activities that include education and leadership development, financial literacy and access, entrepreneurship, agriculture, Health, innovation, environmental sustainability, enterprise development, humanitarian intervention, business ethics, community development and corporate governance and workplace issues. It was quite difficult to construct a truly representative measure of CSR due to the complexity of the theoretical construct itself and because measurements of a single dimension provide a rather limited perspective of a firm’s performance in the relevant social and environmental domains [13]. In recent years, corporate social responsibility data provided by KLD have been used broadly and, in fact, have contributed greatly towards the high proliferation of CSR related studies [13]. Measurement items were introduced based on a careful literature review. To facilitate cumulative research, operationalization tested by previous studies were used. Variables were operationalized as multi-item constructs. Items included CSR practices with four stakeholders (suppliers, customers, employees and the local community) and environmental responsibility. These constructs were adapted.

In the context of the banking sector, the relation between corporate social responsibility and financial performance has not yet been investigated extensively, and the few existing studies offer conflicting evidence. For example, Chih et al. (2010) investigate a total of 520 financial firms in 34 countries over 2003-2005 and conclude that CSR and financial performance are not related. In contrast, Wu and Shen [14] analyze 162 banks in 22 countries over 2003-2009 and report that CSR is positively associated with financial performance in terms of return on assets, return on equity, net interest income, and noninterest income. Differences in the results could be related to measurement issues, differences in the sample as well as sample period [1].

3. FINANCIAL PERFORMANCE

Financial Performance can be defined as it measures the financial position of a company over a specified time period to know how efficiently a company is using its resources to generate income. Return on asset, return on equity, net profit, earning per share etc are evaluated to measure firm’s financial health (2015). Many studies attempt to assess the financial performance of commercial banks. Some of those studies focus on performance ratios: Firm performance was operationalized using items in previous research (Quinn and Rohrbaugh, 1983; Judge and Douglas, 1998; Aragón-Correa et al., 2008) through which respondents rated their organization’s performance relative to others in the industry. Perceptual measures of financial performance have been previously used in the literature analyzing SMEs because objective data on the financial performance of these firms are rarely available, largely because the owners are not legally required to publish these data. In addition, this approach was followed because it is generally assumed that CEOs are knowledgeable informants, particularly with regard to their firms' performance. Moreover, evidence suggests that CEO self-reports of performance significantly correlated with objective measures of firm performance (Mahon et al, 1997). To measure firm performance, we used a variable focused on competitive performance, similar to that adopted by Arsoy et al. [15].

4. METHODOLOGY

4.1 Sample Size and Sampling Techniques

The study-targeted commercial banks in East Africa that had invested in CSR from the year 2010 to 2016 the study employed both non-probability and probability-sampling techniques since the data was only from those banks that have incorporated CSR in their activities from the year 2010 to 2016. Investment in CSR was tested against Financial Performance (ROA and ROE) for the same period. Due to criteria of Sampling, only 35 Banks were included in the sample size of the study.

4.2 Research Instrument

To analyze the corporate social responsibility and financial performance of commercial banks selected in our sample, we use content analysis to extract information from annual reports of 35 commercial banks for 2010 up to 2016. The by using ordinary least square (OLS) model of regression. The Eviews9 was used to analyze the data collected. The coefficient of determination, R squared (R^2), the measure was used to test the significance of the regression model in explaining the relationship between CSR practices and FP. R squared is a measure of goodness of fit and shows the percentage variance in the dependent variable that is explained by the independent variable(s). The higher the R squared the better the model. The P-Value and the t-test were used to test the individual significance of the predictor variables used in the study.

4.3 Regression Models

To analyze the relation between CSR and the Financial performance (ROA and ROE), two regression models are studied: the first one estimate the relation between ROA and CSR, the second investigate the relation between ROE and CSR.

H_0: There is a linear relation between ROA and CSR.

H_0: There is a relationship between ROE and CSR.

$$ROA = \beta_0 + \beta_1 \text{ (size)} + \beta_2 \text{ (FinLEV)} + \beta_3 \text{ (GDP)} + \beta_4 \text{ (CSR)} + \varepsilon \text{ (error)}$$

$$ROE = \beta_0 + \beta_1 \text{ (size)} + \beta_2 \text{ (FinLEV)} + \beta_3 \text{ (GDP)} + \beta_4 \text{ (CSR)} + \varepsilon \text{ (error)}$$

Where:

ROE = earnings after interest and taxes/total equity for Bank

ROA = earnings before interest and taxes/total assets for Bank

SIZE = size of the firm (log of total assets) for Bank

GDP = all product prices with a period

LEV (Financial Leverage) = total liability over total assets

ε (error) = the error term

β_0 = the average performance of the bank in the absence of the control factors

5. FINDINGS AND DISCUSSION

5.1 Descriptive Statistics

Table 1 presents the descriptive statistics of the overview of CSR investment during the 2010 to 2016 period. The descriptive statistics includes standard deviation, mean, maximum, minimum and Skewness.

5.2 Correlation between Corporate Social Responsibility and Financial Performance

According to the above table, there is a positive and strong correlation between CSR and ROA with $P<0.001$, also found that there is a negative relationship between CSR and ROE. As well as there is no correlation between ROE and control variable of financial leverage. Therefore the first hypothesis of this study was accepted due to the relationship between corporate social responsibility (CSR) and return on asset (ROA), while the second hypothesis was rejected because of there is a negative relationship between CSR and ROE.

5.3 Regression Analysis

The table (Table 3a) shows the results of the regression model (1), the one that considers CSR as the independent variable. The table has two columns to indicate whether the GDP (1a) or financial leverage (1b) are used as control variables. The results showed in Table 3a confirm the hypothesis that corporate social responsibility has a positive impact on financial performance. The coefficients are positive and significant: CSR positively influences the measures of profitability ROA (P<0.001) which means that at 99% confidence interval there is a positive strong relationship between CSR and ROA P=0.0006 <0.001.

Model 1 shows that the control variables are significantly related, and a one unit increase in ROA leads to an improvement in CSR. These results also support the slack resources theory, which posits that firms with stronger financial performance are willing to invest more in CSR strategies. Note that the R2 values of the study are 75%, which measures the extent to which the independent variables can predict the dependent variable. This positive relation between CSR and ROA will motivate other companies to invest in CSR. These results support the first hypothesis of the Waddock and Graves (1997) study, which posits that better financial performance results in improved CSR performance.

The Table 3b shows there is negative relationship between CSR and ROE

Table 1. Descriptive statistics

Statistics	ROA	ROE	Lev	CSR	GDP
Mean	0.055	52.753	0.294	53.168	5.444
Mode	0.047	59.433	0.250	53.990	5.346
Maximum	0.204	98.104	1.195	0.995	8.090
Minimum	0.006	2.771	-0.153	0.047	4.124
Standard deviation	0.032	27.194	0.264	25.985	0.892
Skewness	1.705	-0.179	1.340	-0.234	1.362
	8.193	1.870	5.497	2.050	5.295
Jarque–Ber	114.193	4.158	39.707	3.315	37.524

Table 2. Correlation matrices: Correlations with 2010-2016 CSR data with financial performance data and the control variables data

	CSR	ROA	ROE	LEV	GDP
CSR	1	0.11***	-0.13**	0.22*	0.21***
ROA	0.61***	1	-0.23	0.20	-0.49
ROE	-0.13**	-0.23	1	0.03	0.29
LEV	0.22*	0.20	-0.03**	1	-0.30
GDP	0.21***	-0.49	0.29	-0.30	1

**p ≤ 0.05; **p ≤ 0.01; ***p ≤ 0.001*

Table 3a. Regression analysis of Model 1

Model 1 ROA			
Variables	**Coefficient**	**t- Statistics**	**Std.Error**
CSR	0.0006	0.063400	0.000128
Financial Leverage	0.004	0.006057	0.000338
GDP	0.0269	-0.004328	0.005662
C	0.0348	0.059584	0.033155
$R^{2=}$ 0.757059			Durbin Watson= 1.76
F statistics 4.895			
P-value = 0.0034			

Table 3b. Regression analysis of Model 2

Model 2 ROE			
Variables	**Coefficient**	**t- Statistics**	**Std.Error**
CSR	-0.00254	-2.018349	0.000126
Financial Leverage	-0.007704	3.405996	0.001293
GDP	0.006713	-2.126782	0.005071
C	0.097963	3.270046	0.029958
$R^{2=}$ 0.633449			Durbin Watson= 1.56
F statistics 4.5675			
P-value = -0.0024			

This table shows the regression results that reveal the fact that Corporate Social Responsibility has a negative relationship with return on equity. CSR includes donation, the spending of banks on the education of employees and people living in society, amounts given for the better health of employees and other people of the community, social welfare. It might possible that in the short run the company expenses will become higher while sales remain as previous therefore the net income will become lower and that is why ROE has a negative relationship with CSR. While Hassan Tehranian in 2014 found that the largest banks in America contribute social programs and practice social responsibility programs, as well they found that there is a significant positive relationship between CSR and financial performance. While Chih et al. (2010) studied 520 financial firms in 34 countries over 2003-2005, revealed that there is no relationship between CSR and financial performance.

6. CONCLUSION

The study intended to determine the effect that CSR has on the financial performance of commercial banks in East African countries. The researchers used Panel data and a regression model and found that CSR has a positive and significant effect on financial performance especially return on asset (ROA). This study concludes that CSR for the success of commercial banks since it helps to improve financial performance. GDP and financial leverage of the banks were also included as control variables in the model. One of major findings of the study is that there is a strong relationship between the independent variables (CSR practice, GDP, and financial leverage) used in the model and the dependent variable (ROA). While the other model of regression founded that there is a negative relationship between CSR and financial leverage and Return on equity but showed there is a positive relationship with GDP. It is, therefore, a noble practice for commercial banks to engage in CSR as part of their operating activities and set aside funds annually towards a social course. CSR should, therefore, be considered as part of daily operating activities and that for a firm to grow and realize its dreams, it has to engage itself morally and commit itself at improving the society’s social and living standards.

7. RECOMMENDATIONS FOR FURTHER RESEARCHERS

The study has established that CSR has a positive effect on banks financial performance especially return on asset while return on equity has a negative relationship. The banks that have spent more funds on CSR posted the highest Profit before tax. This means that the increase in the amount spent on CSR enabled the bank to reach most of its customers and the public at large through CSR projects. From the findings of this study, it is suggested that further research is carried out on the stakeholder and customer perception of CSR initiatives within the banking industry. There is a need to establish whether the CSR initiatives meet their goal and benefit their beneficiaries as well as establish their sustainability. In addition, there is a need to establish whether the customer's bank where they bank because of the banks CSR initiatives or because of product diversity, quality customer service among others.

COMPETING INTERESTS

Author has declared that no competing interests exist.

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