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Article

Causal relationship between CSR and FB in banks

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Review article

Causal relationship between CSR and FB in banks

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ABSTRACT

The present study investigates the impact of corporate social responsibility (CSR) on financial performance (FB) of Lebanese banks. Based on panel data of seven Lebanese banks, a positive relation between CSR and financial performance have been found. The research findings contribute to understand that Lebanese performant banks would adopt volunteer actions that promote social responsibility actions. Moreover, highest profit lead for a better image and legitimacy once the investments are made into human, economic, community development and environmental protection.

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1. Introduction

Every company or organization looks for improving its own profits while maximizing shareholder's wealth. An efficient corporate governance (CG) acts as a fundamental system for any foreign institutional investor looking for investing in a corporation (Thomson, 2009). The same author underline that the CG's role is to ensure transparency of financial statements and to disseminate accurate information's that are beneficial to stakeholders. Additionally, a company, striving for establishing a good CG system, aim for ensuring a proper legitimacy regarding creditors. In specific cases, legitimacy can be approached by social actions that help resolving social and economic issues. Going from such statement, the Australian Parliamentary Joint Committee on Corporation and Finance underlined that "Corporate social responsibility (CSR) is part of total governance framework". Hence, it notes that: "CSR is only one aspect of an organization's governance and risk management process" (Nasrullah, 2004). Moreover, a responsible corporate governance is entailed from corporate social responsibility and good governance acts (Ayuso & Argandona, 2007).

The drawn question is to understand at what point CSR comes into the main preoccupations of a company? For the Meeting of International Professionals, an organization performs CSR when it holds itself accountable for the consequences of its actions and decisions on the society, its prosperity and on the environment; which is known to be the "triple bottom line". Additionally, an integrated business plan engrafted into a business culture, displaying organizational goals and values through CSR application, will facilitate building a sustainable and remunerative future for all (MPI, 2015). The KLD Research & Analytics (KLD) database from 1998 to 2010 showed that "banks with stronger CSR environments have better financial performance (FP) and higher valuation" (Bolton, 2013). The same author also claimed that banks having the strongest CSR environments pertain outstanding financial performance and are least likely to go through financial distress.

Moreover, during the financial crisis firms who had the strongest CSR were subjected to the least firm-risk and were least likely to call for government assistance (Bolton, 2013). Furthermore, even though it may look like the banks' core activities affect indirectly traditional CSR issues, such as environmental and product issues; however, these effects are quite vigorous (Bolton, 2013).

Going from such statement, the main interrogation for the study will be as the following:

To what extent does CSR and the financial performance of banks enhance themselves jointly?

The goal of any bank is optimizing their financial performance, and if CSR is the way for achieving this goal, then it would be beneficial for banks to acknowledge this factor and not forgo such an opportunity. On the other hand, if a good FP was the guide for improving their CSR, then it will be an incentive for banks to improve their performance, since CSR acts as an image for the bank and a major criterion for any potential foreign investor or creditor.

2. Expected contribution

Many papers have talked about the relationship between CSR and FP of banks. Most of them have found a positive relationship, while some have found no statistically significant relationship. For instance, Brian's Bolton paper: "Corporate Social Responsibility and Bank Performance" in 2013, used a sample of U.S. banks to do an empirical study on the relationship between CSR, risk and FP of banks in the U.S. from 1998 till 2010; the study concluded that enhancing the quality of CSR at banks might lead to improving the individual bank's financial performance while cutting down the risk linked to U.S. financial institutions (Bolton, 2013).

On the contrary, in a study done by Soana (2009) titled as: "The Relationship between Corporate Social Performance and Corporate Financial Performance in the Banking Sector", samples of multiple industries were taken to study the CSR-FP link, and the results were conflicting making it inadequate to form a coherent conclusion (Soana, 2009). Hence, one of the limitations of this study was choosing companies from multiple industries which makes it inappropriate to compare incompatible companies coming from different industries.

This paper contributes to the study of Simpson and Kohers (2002), who did an empirical analysis to study the relationship between CSR and FP on a sample of companies from the banking industry, using Community Reinvestment Act ratings as a measure of social performance (Simpson & Kohers, 2002). However, the same authors added that the use of Community Reinvestment Act ratings as a measure of CSP is a limitation when measuring CSP, since measuring CSP requires broad examination techniques.

3. Literature review and hypothesis development

In 1997, Frooman performed a meta-analysis of 27 event studies to analyze the relationship between being socially irresponsible, acting illegally and the reaction on the stock market. Frooman concluded that the market reacted negatively as a response for firms being socially irresponsible and engaging in illegal behavior, which shows the positive causal relationship between CSR and FP of firms (Simpson & Kohers, 2002).

At that level, a causal direct relationship between CSP and CFP would be found. This will lead to test the following hypothesis:

H1. Banks who engage more in CSR activities perform better from a financial perspective.

It is true that banks engaging in CSR activities tend to perform better; but not all types of CSR activities are alike. While not all CSR activities add value to the financial results of the bank, those that are most directly related to the core activities of the business and that are part of the bank's operating mission do add value (Bolton, 2013). In 2008-2009, after the financial crisis, U.S. banks with weaker CSR environments were more likely to ask for assistance from the government through the Troubled Assets Relief Program (TARP). On the contrary, banks who had the best core CSR operational environment asked for no assistance from the TARP (Bolton, 2013).

Thus, banks who invest in better CSR environments can uplift their bank value and decrease their risk, as long as those investments are directed at enhancing the bank's core CSR operations (Bolton, 2013). Across a variety of financial measures, it has been shown that firms with stronger CSR environments perform better than firms who carry weak CSR environments (Shen & Chang, 2009a, 2009b). In 2008, seven of the largest banks in Iceland have collapsed, since their CSR was directed toward noncore business operations such as philanthropy and public relations (Sigurthorsson, 2012). Furthermore, a multiple cross section study conducted by Stanwick and Stanwick in 1998 for a length of 5 years (1987-1992) using the fortune survey of Corporate Reputation for measuring CSR, concluded that CSR affects positively the FP of banks. According to Soana (2009), firms with good financial performance will have better social performance; since companies who are more profitable, will have more profits for allocating resources in programs concerning corporate social responsibility.

Moreover, a financially sound bank will always be looking for a good image and an outstanding reputation; therefore, it would be obvious that a bank capable of incurring some costs on CSR in order to gain this needed brand image. Furthermore, according to Chen, Chen, and Wei (2009), "firms with strong shareholder equity rights tend to have a lower cost of equity capital than competing firms, which supports the idea that reducing the agency problem between stakeholders and management improves financial performance". According to a study done by Marcia, Otgontsetseg, and Hassan (2013) on U.S banks, banks who had higher ROA and ROE relative to their size achieved significantly greater CSR scores (Cornett, Erhemjamts, & Tehranian, 2014). Despite some findings from the literature on possible causal relation between financial performance of banks and engaging more as a result in CSR activities, the direction of this causal relationship is doubtful, especially when it comes to banks.

4. Research methodology

4.1. Data collection

This research paper is conducted to study the causal relation between CSR and FP in banks. Raw data are collected from seven banks active on the Lebanese soil, namely, Audi, BLC, FRANSABANK, BLF, BLOM, FNB, and SGBL. These data are obtained from the annual reports of four consecutive years 2012 to 2015. This type of data is called panel data.

4.2. Variable measurement

Financial performance is the dependent variable and is measured by return on assets ROA and return on equity ROE. CSR is the independent variable and is measured by economic developments (in million \$), community development (in million \$), environmental development (in million \$), and human development (in million \$).

Two panel data regression models will be estimated, one with ROA as dependent variable and the other with ROE as dependent variable. Panel data regressions are sought herein to evaluate fixed bank effects, i.e. whether or not the causality associating CSR to FP significantly differs between the seven banks (Hsiao). Also, it is used to evaluate fixed period effects, i.e. whether or not the aforementioned causality differs significantly between the four years (2012 to 2015). Panel data regressions follow the equation:

$$y_{it} = \beta_0 + \beta_A X_{Ait} + \sum_k \alpha^k D_i^k + e_{it}$$

Here y_{it} represents the dependent variable (ROA and ROE), X_{Ait} represents independent variables (economic, community, environmental, and human developments), D_i^k represent dummy variables created for banks (6 dummy variables with Audi bank taken as reference) and periods (3 dummy variables with year 2012 taken as reference), e_{it} represent residual errors. β_0 , β_A , and α^k are estimated coefficient by the least square method pertaining to the intercept, the slope of each independent variable, and the coefficients of the dummy variables, respectively.

4.3. Results discussions

Quantitative analysis is performed using SPSS[®] 23. Two panel regressions are obtained, one explaining Return on Assets (ROA) and the other Return on Equity (ROE) based on economic, community, environmental, and human developments. ROA and ROE are accounting ratios which shows how effective and efficient the management is while using corporate's assets and equity to earn profit.

4.4. Results for ROA

The following tables report the result for ROA. It is clearly evident that the model has a good global fit, $F_{0.05(13,14)}=10,120.395$ and $p<0.05$. The coefficient of determination indicates that 92.2% of the variability of ROA can be explained by the independent variables.

Model summary.				
Model	R	R square	Adjusted R square	Std. error of the estimate
1	.960 ^a	.922	1.000	.00314

^a Predictors: (Constant), SGBL, Year 2015, EnvironmentalProtection, FRANSA, BLF, BLC, FNB, Year 2013, BLOM, EconomicDevelopment, HumanDevelopment, Year2014, CommunityDevelopment.

ANOVA ^a						
Model		Sum of squares	df	Mean square	F	Sig.
1	Regression	1.295	13	.100	10,120.395	.000 ^b
	Residual	.000	14	.000		
	Total	1.295	27			

^a Dependent variable: ROA.
^b Predictors: (Constant), SGBL, Year 2015, EnvironmentalProtection, FRANSA, BLF, BLC, FNB, Year 2013, BLOM, EconomicDevelopment, HumanDevelopment, Year2014, CommunityDevelopment.

Coefficients ^a						
Model		Unstandardized coefficients		Standardized coefficients	t	Sig.
		B	Std. error			
1	(Constant)	.004	.008		.459	.654
	EconomicDevelopment	6.953E-5	.000	1.215	104.079	.000
	CommunityDevelopment	.002	.001	.037	1.842	.087
	EnvironmentalProtection	.000	.000	.026	1.468	.164
	HumanDevelopment	.078	.001	1.353	80.229	.000
	Year2013	-.007	.009	-.014	-8.27	.422
	Year2014	.013	.009	.026	1.421	.177
	Year2015	.010	.009	.019	1.120	.282
	BLC	.001	.003	.001	.194	.849
	FRANSA	.000	.002	.001	.154	.880
	BLF	.001	.002	.002	.544	.595
	BLOM	.008	.004	.013	1.862	.084
	FNB	-.003	.003	-.005	-.966	.350
	SGBL	.001	.003	.001	.260	.799

^a Dependent variable: ROA.

The equation of the regression is:

$$ROA = 0.004 + (6.953 \times 10^{-5}) \text{Economic development} + (0.002) \text{Community development} + (0.000) \text{Environmental development} \\ + (0.078) \text{Human development} - (0.007) \text{Year 2013} + (0.013) \text{Year 2014} + (0.010) \text{Year 2015} + (0.001) \text{BLC} - \\ + (0.000) \text{FRANSA} + (0.001) \text{BLF} + (0.008) \text{BLOM} - (0.003) \text{FNB} + (0.001) \text{SGBL}$$

Economic, community, and human developments have significant positive impact on ROA at both 0.05 and 0.1 levels of significance. Environmental development has no significant effect on FP, $p>0.05$. Dummy variables related to the banks show no significant difference between Audi (taken as reference) and other banks to the exemption of BLOM who exhibits an enhancement over Audi by 0.008 point for the impact of CSR on FP. Dummy variables related to periods show no significant change during the four years of the positive effect of CSR on FP.

4.5. Results for ROE

The following tables report the result for ROE. It is clear that the model has a good global fit, $F_{0.05(13,14)}=14.082$ and $p<0.05$. The coefficient of determination indicates that 92.9% of the variability of ROE can be explained by the independent variables.

Model summary.				
Model	R	R square	Adjusted R square	Std. error of the estimate
1	.964 ^a	.929	.863	1.31875

^a Predictors: (Constant), SGBL, Year 2015, EnvironmentalProtection, FRANSA, BLF, BLC, FNB, Year 2013, BLOM, EconomicDevelopment, HumanDevelopment, Year2014, CommunityDevelopment.

ANOVA ^a						
Model		Sum of squares	df	Mean square	F	Sig.
1	Regression	318.377	13	24.491	14.082	.000 ^b
	Residual	24.348	14	1.739		
	Total	342.725	27			

^a Dependent Variable: ROE.
^b Predictors: (Constant), SGBL, Year 2015, EnvironmentalProtection, FRANSA, BLF, BLC, FNB, Year 2013, BLOM, EconomicDevelopment, HumanDevelopment, Year2014, CommunityDevelopment.

Coefficients ^a						
Model		Unstandardized coefficients		Standardized coefficients	t	Sig.
		B	Std. error	Beta		
2	(Constant)	9.859	3.232		3.050	.009
	EconomicDevelopment	.001	.000	.566	1.875	.082
	CommunityDevelopment	.173	.480	.184	.359	.725
	EnvironmentalProtection	-.034	.068	-.235	-.505	.621
	HumanDevelopment	.097	.411	.103	.236	.817
	Year2013	2.128	3.577	.263	.595	.561
	Year2014	3.264	3.788	.404	.862	.403
	Year2015	1.102	3.616	.136	.305	.765
	BLC	-3.680	1.203	-.368	-3.059	.008
	FRANSA	-2.216	.948	-.222	-2.339	.035
	BLF	-2.872	1.012	-.287	-2.837	.013
	BLOM	.959	1.753	.096	.547	.593
	FNB	-2.673	1.267	-.267	-2.110	.053
	SGBL	5.292	1.068	.529	4.954	.000

^a Dependent Variable: ROE.

The equation of the regression is:

$$\begin{aligned} \text{ROE} = & 9.859 + (0.001) \text{Economic development} + (0.173) \text{Community development} - (0.034) \text{Environmental development} \\ & + (0.097) \text{Human development} + (2.128) \text{Year 2013} + (3.264) \text{Year 2014} + (1.102) \text{Year 2015} - (3.680) \text{BLC} \\ & - (2.216) \text{FRANSA} - (2.872) \text{BLF} + (0.959) \text{BLOM} - (2.673) \text{FNB} + (5.292) \text{SGBL} \end{aligned}$$

Only economic development has a significant positive impact on ROA, $p<0.1$. Environmental development has no significant effect on FP, $p>0.05$. Dummy variables related to the banks show a significant difference between Audi (taken as reference) and other banks to the exemption of BLOM. BLC exhibits a decrease over Audi by 3.680 points for the impact of CSR on FP. FRANSABANK exhibits a decrease of 2.216 points over Audi. BLF exhibits a decrease of 2.872 points over Audi. FNB exhibits a decrease of 2.673 points over Audi. SGBL exhibits and enhancement of 5.292 points over Audi. Dummy variables related to periods show no meaningful change during the four years of the positive effect of CSR on FP.

5. Conclusion

Going from the analysis of the results, the latter shows an existence of linear relations between the two constructs. However, an issue, at this level, can be highlighted. Even though a positive correlation exists between CSR and the CFP, it is important to consider the to the direction of influence of CSR on PFE or inversely.

The present results have shown a positive relation between CSR and financial performance. That type of association between the two constructs confirms the advancements of the Stakeholder Theory. That implies that Lebanese banks attempts to adopt volunteer actions that promotes social responsibilities as for their legitimacy and their interest for the human, economic, community development and the environmental protection.

However, Lebanese banks with high profit are socially responsible companies that strive for social commitment, while other banks, even if they are earning a high profit, the lack of being socially engaged is explained by the absence or the reluctance to contribute for the social sector.

A socially responsible bank is expected to earn above-average profits to be able, successfully, to solve environmental and social problems and to achieve that mission through a credible and quality management measure. CSR would therefore improve financial performance, lower operating costs, improve brand image and reputation, increase sales and consumer loyalty, achieve better quality and productivity, improve the ability to attract and retain employees, reduce regulatory control, and increase access to the capital market.

Conflict of interest

There are no conflicting interest.

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