EFFECT OF CORPORATE SOCIAL RESPONSIBILITY ON FINANCIAL PERFORMANCE OF BANKS IN SRI LANKA

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Abstract:

Corporate social responsibility (CSR) is not a new concept in the banking sector, but nowadays, it becomes highly typical since the crisis has significantly highlighted the need for integration of moral principles in the banking business. CSR describes as "Doing all those activities which are not forced by law of those countries in which they are running their business and which are not for the primary benefits of the business but for the benefits of the society." This study examined the effect of corporate social responsibility for the financial performance of selected Licensed Commercial Banks in Sri Lanka. The objective of this study is to examine the impact of corporate social responsibility on financial performance for the period of 2010 to 2014 in selected Commercial Banks of Sri Lanka. They are Amana Bank PLC, People's Bank, Commercial Bank of Ceylon PLC, Hatton National Bank, Nations trust Bank, Bank of Ceylon, DFCC Bank PLC, National Development Bank PLC, Pan Asia Banking Corporation and Sampath Bank PLC. This study utilizes the secondary data. The data were collected from annual reports of the selected banks and Directors' reports. Other sources such as newsletters, news articles, journals and websites were also used. The data were analyzed using correlation, regression analysis and hypothesis testing by SPSS 20.0 software. In addition, the regression model shows that there is a positive impact between CSR and the dimensions of financial performance (ROA, ROE, EPS and Net Profit). The finding of this study shows that there is a positive and significant relationship between corporate social responsibility and financial performance, which demonstrates that there is positive impact of corporate social responsibility for the financial performance of selected Licensed Commercial Banks of Sri Lanka. This study concludes that CSR for the success of Commercial Bank since it helps to improve financial performance. The study recommends that banks may portray themselves as socially responsible firms it will lead to improve the overall financial performance of the Banks. Government should play its role to motivate the banks to spend for the welfare of the societies, nations and environment where banks operate their businesses and earn profits.

Keywords: *Corporate Social Responsibility, Financial Performance, Licensed Commercial Banks*

1. INTRODUCTION

Corporate social responsibility (CSR) is an important concept in the banking industry, but in the current economic situation, it has become the best solution for integrating moral principles in banking activity. There is no universally accepted definition of corporate social responsibility (CSR). It is described as an instrument, a concept or even a business model that requires companies to apply a radical change in attitude. Corporate social responsibility has been defined by different researchers in different ways. Mcwilliams and Siegel (2001) describe corporate social responsibility as "Doing all those activities which are not forced by law of those countries in which they are running their business and which are not for the primary benefits of the business but for the benefits of the society."

Given the lack of consensus on the CSR definition among academicians and practitioners (Abagial McWilliams et al., 2003) it is obvious that CSR can bring many advantages for the banking sector. The most important is to enhance the banks' reputation and financial performance because, for the bank, its reputation is a determining factor to retain old clients and attract new ones, which eventually enhances the bank's financial status. Besides, if a bank pays attention to social responsibilities, the bank can get profits for themselves through better risk management, employee loyalty and higher reputation. The CSR concept includes economic, legal, ethical and philanthropic expectations that a society has in relation to a company (Classon and Dahlstrom, 2006). One broad framework used for categories CSR initiatives includes actions under the domains of employee relations and diversity programs, ethical materials sourcing, product design, marketing programs, the environment, human rights, and corporate governance (KLD, 2006). CSR differs from place to place, from industry to industry and over time (Richard Welford et al., 2007). Corporate Social Responsibility affects the Financial Performance of the firms. Financial performance means measuring and analyzing the financial objectives of the firms to see whether they are accomplished or not. (Kotler et al., 2005)

Financial performance can be defined as the measurement of 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. (Shoukat Malik, Muhammad Nadeem, 2014). In the last decades, scholars discussed the existence of a link between CSR and financial performance, without ever reaching an agreement. There are two main schools of thought: the neo-classical view and the behavioral view. The first started with Milton Friedman around the '70s: he was a convinced upholder that firms, and in particular managers, how to maximize shareholders' value and that practices like CSR would just push them away from this goal (Friedman, 1970). The relationship between CSR and financial performance represents the least understood area of CSR (Angelidis, Massetti and Magee–Egan, 2008). The Sri Lankan banking sector has been evolving time to time huge and deep understanding in almost all fields not only by Industry experts but also by academics. Prior studies have focused mainly on developed countries. There is less work done on measuring the impact of corporate social responsibility for financial performance in less developed countries like Sri Lanka. In less developed countries, most of the firms are not yet quite familiar with the importance of corporate social responsibility and thus do not pay much attention on the corporate social responsibility. Previous study examined on Corporate Social Responsibility (CSR) in selected local Commercial Banks (SLCB) of Sri Lanka (Ismail, 2013).

Further, a number of researches had been done in many countries such as Kenya, Pakistan, and Romania. However, no such research has been done in the Sri Lankan context. Therefore, in order to fill this research gap, this study is aimed to investigate the effects of corporate social responsibility on the financial performance in selected licensed Commercial Banks in Sri Lanka. This study searched to identify the relationship between CSR and financial performance, and also this study examines the effect of CSR on the financial performance of selected Commercial Banks in Sri Lanka.

2. STATEMENT OF THE PROBLEM

This study states the problem by previous empirical findings. Generally a corporate social responsibility impacts on financial performance of the banking sector. According to Robins (2005), managers of banks are often faced with the challenge of determining how socially responsible their banks are, particularly with the increased competition in the banking industry. Therefore, promoters of CSR have argued that organizations should integrate economic, social, and environmental concerns into their business strategies, their management tools, and their activities going beyond compliance and investing more on human, social and environmental capital (Belal & Momm, 2009; Perrini, 2006). Empirical evidence on the effect of CSR on a firm's financial performance has yielded mixed results. Gariga and Mele (2004) observe that a number of studies have yielded a positive correlation between CSR and financial performance. Studies by Erhemjamts et al., (2011) have also yielded a positive correlation between CSR and financial performance. Another Study that has provided a positive relationship was done by Tsoutsoura (2004) in California. A study by Abiodum (2012) however, returned an inverse relationship between CSR and financial performance in Nigeria. Ngwakwe (2009) found a positive relationship between CSR and financial performance.

Locally, most studies focused on the strategic aspects of CSR. Similar findings were obtained in the banking sector by Auka (2006), Anyona (2005), Ominde (2004), Odhiambo (2006) and Kweyu (1993). Very few studies however have been carried out on the effect of CSR on the financial performance of Commercial Banks. Moreover, the few studies that have been done have yielded mixed results. Studies by Mutuku (2004) found no relationship between CSR and financial performance of firms listed on the NSE (Nairobi Securities Exchange). Kipkemoi (2010) found a positive relationship between CSR and ROA and a significant negative relationship between CSR and growth in sales. Despite the vast empirical evidence that firms use CSR as a strategic tool to grow their financial performance, there is not much research that has been done to establish the effect of CSR on financial performance in the banking sector. One fundamental limitation of these studies is that they used listed companies. This implies that the number of firms sampled from the banking sector is not adequate to draw a conclusion on the effect of CSR on the financial performance of Commercial Banks in Sri Lanka. Therefore, this study examined the effect of CSR on financial performance in selected licensed Commercial banks in Sri Lanka.

3. RESEARCH OBJECTIVE

The main objective of the study is to examine the impact of corporate social responsibility on financial performance for the period of 2010 to 2014 in selected Licensed Commercial Banks of Sri Lanka. Furthermore, the secondary objectives of this study are to identify the relationship between CSR and financial performance and also to examine the effect of CSR on the financial performance of selected Licensed Commercial Banks in Sri Lanka.

4. LITERATURE REVIEW

4.1. Corporate social responsibility

The concept of Corporate Social Responsibility is an abstract one. In the literature, there is no uniformity in the proposed definition, so there are a number of approaches. In the view of Classon et al., the CSR concept includes economic, legal, ethical, and philanthropic expectations that a society has in relation to an organization. In another vision, companies are perceived as human communities using social practices in order to achieve common goals (Rendtorff and Mattsson, 2012). Holmes and Watts (1999) defined CSR as the continuing 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 of the local community and society at large. Some researchers argue that, corporations make longer term profits by operating with a CSR perspective, while others argue that CSR distracts from the economic role of businesses. The initial definitions of the concept showed that, CSR refers to problems: economic, political, social, and ethical (Bowen, 1953). European Commission defines CSR (2001) in the Green Paper as "a concept according to which companies voluntarily decide to contribute to the attainment of a better society and a cleaner environment". In 2004, it was proposed that the numerous theories present be classified into groups: instrumental, political, integrative, and ethical (Garriga and Melè, 2004). Since 2010, this concept began to take a social aspect, thus the difference between voluntary practices and moral obligations was presented in the study of Maon et al., (2010).

4.2. Financial Performance

Financial performance can be defined as the measurement of 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. (Shoukat Malik, Muhammad Nadeem, 2014). Financial performance can also be defined as measuring and analyzing the financial objectives of the firms to see whether they are accomplished or not. (Kotler et al., 2005). As for the banking industry, the relation between Corporate Social Responsibility and Financial Performance has not been examined extensively, and the few existing studies offer conflicting evidence. For example, Chih et al., (2010) investigated a total of 520 financial firms in 34 countries over 2003-2005 and concluded that CSR and financial performance are not related. In contrast, Wu and Shen (2013) analyzed 162 banks in 22 countries over 2003-2009 and reported that CSR is positively associated with financial performance in terms of Return on Assets, Return on Equity, net interest income, and non-interest income. Differences in the results could be related to measurement issues, differences in the sample as well as sample period.

McGuire et al., (1988) have on the basis of previous research been able to sort the relationship between CSR usage and financial performance into three main viewpoints. In the first viewpoint, it is argued that CSR investments put these companies into an economic disadvantage compared to less responsible companies. The second viewpoint is that explicit CSR investment costs are minimal and that companies investing in CSR actually gain benefits from this in terms of employee morale and productivity. In the third viewpoint, costs of CSR investments are significant; they are, however, offset by the reduction in other company costs. It is also suggested that companies should satisfy all stakeholders, not just the shareholders of a company. Most of the scholars investigating corporate social responsibility and financial performance have argued for a positive association. Several authors have cited improved employee and customer goodwill as an important outcome of social responsibility (Davis, (1973); Soloman & Hansen, (1985)). Researchers started to empirically analyze the relationship between CSR and financial performance. The results found in the empirical studies are heterogeneous: some researchers found a positive correlation (e.g. Barnett & Salomon, 2006; Ruf et al., 2001; Graves & Waddock, 1999; Preston & O'Bannon, 1997); some other stated that the correlation is negative (e.g. Brammer et al., 2006; Boyle et al., 1997; Aupperle, Carroll & Hatfield, 1985) and others sustain that there is no correlation at all (e.g. Moore, 2001; McWilliams & Siegel, 2000; Guerard, 1997).

5. CONCEPTUAL FRAME WORK

After the study of literature review, the following conceptual model is formulated to illustrate the relationship between corporate social responsibility and financial performance.

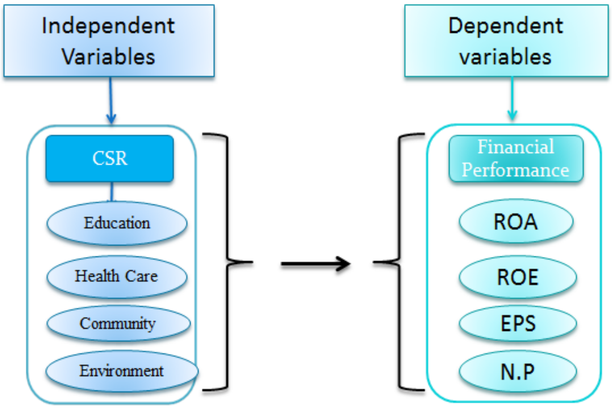

Figure 1.1: Formulation of conceptual framework
Source: M. Shoukat Malik, Muhammad Nadeem (2014)

Where,

- ROA - Return on Asset
- ROE - Return on Equity
- EPS - Earning Per Share
- N.P - Net Profit

The above conceptual model shows the relationship between corporate social responsibility and financial performance of selected licensed Commercial banks in Sri Lanka.

5.1. Hypothesis Development

On the basis of the above literature review, these hypotheses are developed:

H_0: There is no relationship between Corporate Social Responsibility (CSR) and Financial Performance.

H_A: There is a relationship between Corporate Social Responsibility (CSR) and Financial Performance.

H_{A1}: There is a positive and significant relationship between CSR and ROA (Return on Asset).

H_{A2}: There is a positive and significant relationship between CSR and ROE (Return on Equity).

H_{A3}: There is a positive and significant relationship between CSR and EPS (Earning per Share).

H_{A4}: There is a positive and significant relationship between CSR and N.P (Net Profit).

6. METHODOLOGY

6.1. Population & sample selection

This study makes use of the annual report of selected Licensed Commercial Banks in Sri Lanka, as the sources of sample data, for the sample period from 2010 to 2014. There are a total of 24 conventional banks and 1 Islamic bank the licensed

Commercial Banks under the regulation of the Central Bank of Sri Lanka. Selected licensed Commercial banks of Sri Lanka are taken as the sample. They are Amana Bank PLC, People's Bank, Commercial Bank of Ceylon PLC, Hatton National Bank, Nations trust Bank, Bank of Ceylon, DFCC Bank PLC, National Development Bank PLC, Pan Asia Banking Corporation PLC and Sampath Bank PLC.

6.2. Data & Data collection method

Data were collected from secondary source mainly from the sustainability report of annual report on the selected banks for the sample period from 2010 to 2014. Furthermore, this study was focused on the Directors' reports, balance sheets, and income statements in their annual reports. Other sources such as newsletters, news articles, journals and websites were also used. Further, researchers read some books and lot of research papers to have broad knowledge regarding the study.

6.3. Data Analysis

The collected data were calculated and verified according to the mathematical formulas, Microsoft Excel software and SPSS 20.0 software which were presented and analyzed with figures and tables. Those figures and tables were helpful for testing the correlation, hypothesis and regression analysis to reach a correct conclusion. Correlation analysis was also applied in the study to identify if a change in the value of one variable is accompanied by changes in the value of another variable. In addition to that, regression analysis was run to describe the nature of the relationship between variables in terms of a mathematical equation.

7. DISCUSSION AND FINDINGS

The findings of this study suggest that, there is positive and significant relationship between corporate social responsibility and the financial performance, which demonstrates that there is positive impact of corporate social responsibility for the financial performance of selected Commercial Banks in Sri Lanka. This positive relationship between corporate social responsibility and the financial performance reveals social behavior of selected Commercial Banks. Sri Lankan Commercial Banks are contributing as much as banks can contribute to the social well-being of society, improving the living standards by promoting education and better health facilities as well as protecting the environment from hazardous changes. Banks are taking good care of their employees and stakeholders in order to build their trust and confidence. On the other hand, people of developing countries like Sri Lanka are not much aware about the concept of CSR. They do not have information about the firm's contribution to the well-being of society and the environment.

7.1. Financial spending on CSR and financial performance for selected Licensed Commercial Banks

The relationship between financial spending on CSR and financial performance of selected licensed Commercial Banks is summarized in the table below.

Year	CSR (Rs.in million)	Average ROA	Average ROE	Average EPS	Average N.P
2010	202.55	1.50	16.86	137.67	18,233
2011	261.77	2.59	24.03	247.41	36,832
2012	185.63	1.97	21.32	309.87	22,358
2013	344.96	1.36	16.10	256.49	41,136
2014	298.44	1.35	15.83	272.48	14,196

Table 1.1: Analysis of financial spending on CSR and financial performance

The findings in table 1.2 indicate that, the selected licensed Commercial Banks were spending the highest amount on CSR in the year 2013 and the last in 2012. Rs. 298.44 million was spent in 2014, Rs.261.77 million in 2011, Rs. 202.55 million in 2010. Financial Performance of the selected licensed Commercial Banks was measured using ROA, ROE, EPS and N.P. The study found that the highest ROA of 2.59 % was recorded in 2011 while the lowest ROA of 1.35% was recorded in 2014. The highest ROE of 24.13 % recorded in 2011 while the lowest ROE of 15.83% recorded in 2014. The highest EPS of Rs. 309.87 was recorded in 2012 while the lowest EPS of Rs. 137.67 recorded in 2010. Finally, the highest N.P of Rs. 41,136 was recorded in 2010 while the lowest N.P of Rs. 14,196 recorded in 2014.
Table 1.2 shows the average value of each variable presented as mean. The median is the value that comes in the middle of the data series after arranging it in either ascending or descending order. The standard deviation denotes the variation or dispersion from the average value. A lower standard deviation signifies that the values are closer to mean, whereas a higher standard deviation means that the value are far away from the mean value.

Variables	Return On Asset (ROA)	Return On Equity (ROE)	Earnings Per Share (EPS)	Net Profit (N.P)	Corporate Social Responsibility (CSR)
Mean	1.75	18.82	244.78	26551.00	258.67
Median	1.50	16.86	256.49	22358.00	261.70
Std. Deviation	0.53	3.65	64.46	11809.29	66.18
Minimum	1.35	15.83	137.67	14196.00	185.63
Maximum	2.59	24.03	309.87	41136.00	344.96

Table 1.2: Descriptive Statistic of the Variables

According to this table 1.2 the results show that the average Return on Assets and Return on Equity are 1.75 percent and 18.83 percent respectively. The average Earnings per Share and Net Profit are million Rs. 244.78 and million Rs. 26551.00 respectively. The highest Return on Assets is at 2.59 percent, while the lowest is 1.35 percent. It could be observed that 0.53 percent of the dispersion reported from the average Return on Assets. The highest Return on Equity during the research period is 24.30 percent, while 15.83 percent reported as the lowest. The highest Earnings per Share is million Rs. 309.87, while the lowest is million Rs. 137.67 and the highest Net Profit during the research period is million Rs. 41136.00, while million Rs. 14196.00 reported as the lowest. The selected licensed commercial banks were spending the million Rs.258.67 the average amount of corporate social responsibility. The median is million Rs.261.77 the highest expenditure of the bank is million Rs. 344.96 while the lowest is million Rs. 185.63. The standard deviation indicates a variation million Rs. 66.18 from average amount of expenditure on corporate social responsibility.

7.2. Result of Correlation Analysis

R & P Value	Research Hypothesis	Results
R = 0.064 P = 0.046	**H_{A1} =** There is a positive and significant relationship between CSR and ROA (Return on Asset).	Supported / Significant
R = 0.723 P = 0.048	**H_{A2} =** There is a positive and significant relationship between CSR and ROE (Return on Equity)	Supported / Significant
R = 0.798 P = 0.030	**H_{A3} =** There is a positive and significant relationship between CSR and EPS (Earning per Share).	Supported / Significant
R = 0.603 P = 0.028	**H_{A4} =** There is a positive and significant relationship between CSR and N.P (Net Profit).	Supported / Significant

Table 1.3: The summarized correlation results in the study

Above the data shows that, CSR significantly correlates with all indicated dimensions of financial performance and hypothesis also supported.

7.3. Result of Regression Analysis

Independent Variable	Simple linear regression
Corporate social responsibility	ROA = 2.477 + 0.003 CSR

(CSR)	
Corporate social responsibility (CSR)	ROE = 24.882 + 0.023 CSR
Corporate social responsibility (CSR)	EPS = 194.92 + 0.193 CSR
Corporate social responsibility (CSR)	N.P = 3341.8 + 89.725 CSR

Table 1.4: The summarized regression results in the study

Above the data shows that, there is a positive and significant impact of corporate social responsibility and financial performance.

8. CONCLUSIONS AND RECOMMENDATIONS

8.1. Conclusions

The study intended to examine the effect of corporate social responsibility on the financial performance of selected licensed commercial banks in Sri Lanka. The researcher used quantitative research design and a regression model and found that, CSR has a positive and significant effect on ROA, ROE, EPS and N.P for selected licensed commercial banks. This study concludes that CSR for the success of a commercial bank since it helps to improve financial performance. 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 cause. 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.

8.2. Recommendations

The purpose of this study was to determine the effect of corporate social responsibility on the financial performance of selected licensed Commercial Banks in Sri Lanka. The study found that CSR is good for the financial performance of all Commercial institutions. In agreement with the argument of Friedman (1970) that the social responsibility of business is to grow its profits, it is in the interest of shareholders, for Commercial Banks engage in CSR activities as doing so improves their financial performance. Based on Following findings and conclusion, the following recommendations are made:

- The researchers recommend that institutions should partner with other institutions that offer varying services to jointly invest in common CSR activities as doing so leads to cost reduction while achieving similar goals. Financial institutions can partner with telecommunication industries, manufacturing industries, commercial, academic institutions or hospitals to spearhead similar CSR objectives

- Other recommends that small firms would rather engage in strategic marketing activities other than CSR in order to improve on their Financial Performance. However, it is worth noting that small banks have a small client base and market segments whose interests they can monitor. In this regard, the strategic CSR activities undertaken should appeal to the interests of these market segments.

- This study recommends that, the Central Bank of Sri Lanka and its capacity as the regulator of commercial banks designs a uniform reporting format for commercial banks engaged in CSR activities. This will not only make it easier for future researchers to find data, but will also enable shareholders to evaluate the extent to which the firm is engaged in promoting corporate citizenship and its benefits. The Central Bank of Sri Lanka could also consider including and its database, not only the amount commercial banks spends on CSR annually, but also CSR performance index for all the commercial banks. As Commercial Banks revealed that, CSR has a positive effect on their financial performance, the motivation to engage in CSR purely for the sake of improving company performance may begin to take shape.

- The researchers recommends that, the Central Bank of Sri Lanka, being the regulator of commercial banks, consider developing, publishing and implementing guidelines and procedures of engaging in CSR activities. Finally, the researchers recommend that, the input of shareholders be taken into account regarding how much the firm intends to spend on CSR annually, and where the activities will be undertaken. Furthermore, management should carry out a cost benefit analysis of the CSR projects they have initiated and avail such reports to shareholders. This will help to ensure that as much as firms are socially responsible, shareholders'' wealth is not run down in the interest of the general public.

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