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The Impact of Financial Performance on Corporate Social Responsibility: An Empirical Analysis of Conventional and Islamic Banks of Pakistan

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Abstract

The study explores how financial performance (FP) affects the corporate social responsibility (CSR) of the banking sector of Pakistan. Further, it also elaborates the comparison between FP and CSR of Islamic and conventional banks of Pakistan. The study is based on the annual reports of banks listed at Pakistan Stock Exchange (PSE) for the years 2010-2016. The study used several panel data diagnostic tests and three regression models to check the relationship between FP and CSR of Islamic and conventional banks of Pakistan, while taking leverage and size as control variables. The results indicate that in case of conventional banks the relationship between ROE and CSR is negative. Here, the results are consistent with the agency theory which states that investment in CSR related activities is a waste of resources. While return on asset (ROA) is depicting negative and insignificant relationship with CSR, which depicts that FP does not have any impact on the investment in CSR initiatives. In the case of Islamic banks, the relationship between return on equity (ROE) and CSR is positive and significant. Here, the results support social contract and stakeholder theories. The research has important practical consequences that will help the banking industry managers to adopt optimal investment strategies about CSR related activities. The study provides guidelines to conventional banks to invest more in CSR in the same way Islamic banks are doing. The findings of the study lay some foundations upon which a more detailed analysis of CSR of banks could be based.

***Keywords**:* banking sector, corporate social responsibility, financial performance

1. Introduction

CSR is a business approach that contributes to sustainable development (SD) by delivering economic, social and environmental benefits to all stakeholders. World Business Council for Sustainable Development 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.” CSR activities are divided into four significant parts *i.e.* workplace, market, environment, and community. These activities are used to increase customer attraction, profit level, and productivity. CSR is based on four important types of principles which define the responsibilities of the organizations and the expectations that the society has from them including economic, legal, ethical, and philanthropic principles. Many references support the evolution of CSR in 1930s and 1940s, but the beginning of the concept is dated with Bowen in 1950s (Carroll, 1979). In 1977, Carroll defined CSR as "economic, ethical, and philanthropic concerns - also includes collaboration with stakeholders." The definition states that in order to meet the concept of social responsibility, enterprises "should have in place a process to integrate social, environmental, ethical, human rights and consumer concerns in their business operations and core strategy in close collaboration with their stakeholders."

In the contemporary world, business environment has increased the demand of CSR initiatives which maximize shareholders' wealth, as reflected in the market price of the firms' stocks. Nejati, Quazi, Amran and Ahmad (2017) raised the question that whether these initiatives lead to better FP by an organization? Their answer concluded that a company is socially responsible to invest its profit from the corporate side (corporate social responsibility) as well as the investor side (socially responsible investing) in the capital market.

CSR is important to a business because it demonstrates to both consumers and the media that the company takes an interest in wider social issues that have no direct impact on profit margins. These issues may be local, national or global. Indeed, a concern shown for the health and wellness of others that does not involve sales if handled well can be seen as commendable. The concept of CSR gives a chance to all the employees of an organization to contribute towards society, environment, country and so on. Hopkins (2012) stated that CSR is a matter of concern for all stakeholders. Contribution in CSR initiatives gives an employee a feeling of unparalleled satisfaction. The progress of CSR continued during 1970s and 1980s and transformed CSR towards a more regulated practice carried out in a business institution. It now covers aspects such as stakeholders' relationship with management, corporate citizenship, corporate reputation, stakeholders' rights and other obligations. Finally, from 1990s till the 21st century due to formation of international CSR standers; intensive competition has increased legislative requirements made on the government and in consequence, CSR strategies started playing their role for the better survival and effectiveness of an organization.

The FP of a company influences its CSR activities and consequent make a good impact on the society. Social activities improve the market image of the company and engender profit. McWilliams and Siegel (2000) explained that investment in CSR shows a firm's interest and its compliance with the legal restrictions to promote a good social environment. In the banking industry CSR takes many forms, from compliance with the conditionality of financing certain principles to the banks' own social programs. After the international financial crisis, many banks changed the way they used to operate by changing their business philosophy, the focus moved from making big profits towards finding sustainable methods both for the banks and for the society to work in a comfortable environment. Community involvement is the basis of all accomplished CSR policy initiatives and extends far beyond the standard charitable measures. Banks normally introduce innovative CSR schemes such as permanent learning programs for less developed sectors of the society, educational sponsors for young entrepreneurs, provision of academic scholarships, research grants, support for environmental issues such as recycling and waste management, community support programs, health support programs and financial support. The concept of CSR is important for the banks that have well-designed and successful CSR strategies, due to the obvious and real gains it contributes. CSR and FP have a dual relationship with each other. For instance, the allotted funds in CSR activities play a vital role in the banking sector as they lead to increase in owners' welfare, ensure profitability and growth (Decker & Sale, 2009). While Rehman, Baloch and Sethi (2015) posited that FP plays an integral role in defining investment in CSR activities, which means that the more financial status of the bank is the more it can actively participate in fulfilling its obligations towards society.

A company should invest proactively in CSR activities. However, CSR can incur extra cost and may reduce profit. For instance, Freeman, Harrison, Wicks, Parmarand and Colle (2010) suggested that CSR activities produce numerous benefits for shareholders. Hiller and Raffin (2017) believe that CSR initiatives increase the FP of a firm. Thus, the researchers are ambivalent about the relationship between FP and CSR. Whether it is positive, negative or neutral is debatable since different studies show different results keeping in view firms and banks of different countries. It is also not clear which variable affects the other, that is if firms with high profitability should be involved in CSR or CSR is the source of the firms' profit. This study explores the impact of FP on CSR of Islamic and conventional banks of Pakistan. It extends the work of (Rehman et al., 2015) and is organized as follows. Section two comprises the review of literature that covers the previous studies on the current subject. Section three overarches the research methodology followed by the results and discussion. Finally, section four comprises the conclusion and recommendations.

1.1. Objectives of the Study

The broader objectives of the study are as follows.

- To investigate the impact of FP on CSR activities of the conventional banks of Pakistan listed at PSE.
- To explore the influence of FP on CSR activities of the Islamic banks of Pakistan listed at PSE.
- To compare the impact of FP on CSR activities of the Islamic and conventional banks of Pakistan.

2. Review of Literature

In the contemporary business organization, the concept of CSR is gaining wider acceptance both in developed and developing countries. Both medium sized and large organizations are encouraged to invest in socially responsible activities for the better satisfaction of stakeholders. However, in the business sector, the definition of CSR and its implementation is still unclear, especially in the developing countries. According to Murillo and Martinek (2009), CSR activities of a firm require a sense of responsibility towards its stakeholders, specifically its customers, employees and community at large in addition to its profit maximization goal. These activities include donations or commitments on the behalf of the firm regarding environmental protection, social wellbeing projects, and for providing a healthy and safe workplace for its employees. Studies conducted about the relationship between CSR and FP have generally focused on the issue that socially responsible organizations achieve higher, lower, or the same FP relative to comparable firms that are not socially responsible (McWilliams & Siegel, 2001). CSR activities engender profitability and in the long run develop competitive advantage. Since the government is not able to solve every problem, the business enterprises ought to play their part in solving many burning social issues.

Mecaj and Bravo (2014) found that the social impact of big and small corporations has become a significant issue in business administration. A “bad” social impact may increase a firm’s risk, and may lead to weak relationships with its many stakeholders and may affect its reputation adversely. Hence, CSR is becoming an important task, but the problem is to understand whether CSR is compatible with value creation or not? Pletsch, Silva and Hein (2015) were of the view that CSR is a social obligation. Mcwilliams and Siegel (2001) concluded that CSR is the action that results in social welfare, thus CSR activities are not conducted for the benefit of the business but for the benefit of the society.

Numerous theories explicate how firms should respond towards CSR initiatives. Some of those theories include the social contract theory, the agency theory and the stakeholder theory. Social contract theory describes that every business has an obligation towards the community to be socially responsible. According to the theory, it should involve in CSR in order to fulfill its contractual duty to the community. Agency theory views CSR as a waste of resources which could have been used for other projects. The stakeholder theory argues that a company owes responsibility to a broader group of stakeholders other than just financial stakeholders. Therefore, they should participate in CSR in order to enhance performance.

Murtaza, Akhtar, Ijaz and Sadiqa (2014) found a positive relationship between CSR and corporate financial performance (CFP). Javed, Saeed, Lodhi, and Malik (2013) also concluded a positive and significant effect of a firm's donations on its profitability. To illustrate historically, Carroll (1979) concluded that those firms which are more involved in CSR activities earn more as compared to the firms which are not involved. Chen (2011) enumerated that CSR captures the company's better resources, highly skillful employees, and better market products and services. Dunn and Sainty (2009) concluded that CSR activities increase the reputation of the company and create a positive relationship between management and employees. Aupperle, Carroll and Hatfield (1985) concluded that CSR activities have a positive effect on the FP of a company and also found a positive correlation between a firm's profit and its CSR activities. There is a positive relationship between CSR and performance (Oyewumi, Ogunmeru & Oboh, 2018; Platonova, Asutay, Dixon, & Mohammad, 2018; Maqbool & Zameer, 2018; Okegbe, & Egbunike, 2016; Greening & Turban, 2000). There is a positive relationship between CSR and FP of pharmaceutical companies in Peshawar (Aga, Khan, Wasim, & Shah, 2012). Kiran (2015) discovered a positive relationship between CSR and CFP of the cement sector firms of Pakistan.

Some researchers report a positive relationship while others report a negative significant relation between CSR and performance (Davidson, & Worrell, 1988). Bird, Hall, Momente and Reggiani (2007) elucidated that CSR and CFP have a negative relationship because the firms bear an additional cost. The second group of theorists are of the view that the relationship between CSR and firm performance does not exist. Das, Dixon, and Michael (2015) found a negative relationship between CSR and performance. There was no statistical relationship found between CSR and firm performance (Yip, Staden & Cahan, 2011; Michelberger, 2016). Various studies discovered a mixed relationship between CSR and performance. For instance, Peloza (2006) reviewed 128 empirical studies and reported that 59%

of them found a positive relationship between CSR and FP, 14% found a negative relationship and 27% found no relationship at all. Selcuk and Kiymaz (2017) argued for a positive but minute effect of CSR on FP. FP might play an essential role in enhancing investment in CSR activities. The listed Bangladeshi banking companies exhibited a positive significant relationship between profitability and CSR (Das et al., 2015; Malik, Ali, & Ishfaq, 2015). On the contrary, CSR was negatively associated with non-performing loans (Wu & Shen, 2013).

Pakistan is a developing country. In the Pakistani business sector, it is imperative to practice CSR activities due to the society's needs. Different researchers studied the FP-CSR relationship and found mixed results. This research covers the banking sector of Pakistan. It describes the impact of FP on CSR activities of the banking sector of Pakistan. Data was extracted from the annual reports of the selected banks for the period 2010-2016. Eight banks were selected for the study; including 4 conventional banks (Allied Bank, United Bank, Punjab Bank and National Bank) and 4 Islamic banks (Dubai Islamic Bank, Meezan Bank, Bank Islamic and Al Baraka Bank).

2.1. Hypotheses

H_1: FP positively enhances investment in CSR activities of the conventional banks of Pakistan.

H_2: FP positively enhances investment in CSR activities of the Islamic banks of Pakistan.

The main purpose of developing these hypotheses is to measure the impact of FP on CSR activities of conventional and Islamic banks of Pakistan, and to compare the impact of FP on CSR of Islamic and conventional banks of Pakistan.

3. Data Collection and Methodology

The study is based on a quantitative research paradigm and it utilized secondary data sources describing CSR practices of the conventional and Islamic banks of Pakistan. Data was collected from the annual reports and "Financial Statement Analysis of State Bank of Pakistan" for the years 2010-2016 of 4 conventional banks (National Bank of Pakistan, Allied Bank Ltd, United Bank Ltd. and Punjab Bank Ltd.) and 4 Islamic banks (Bank Islamic, Meezan Bank, Al Baraka Bank and Dubai Islamic Bank). There were two reasons behind the selection of these banks. Firstly, there are only four Islamic banks listed at PSE. Secondly, the study selected banks that provided data on their CSR activities in their annual reports from 2010-2016. Two accounting based measures were used to depict FP (ROA, ROE). The description of the sample size of the study is given below in Table 1.

Table 1
Total Listed Banks of Pakistan

Sector	No of Listed Banks
Total conventional banks	28
Total Islamic banks	4
Selected conventional banks	4
Selected Islamic banks	4
Total selected banks	8

3.1. Measurement of Study Variables

Table 3 shows the variables used in the study and how they are operationalized.

Table 2
Measurement of the Study Variables

Variables	Measurements	Notation
Dependent Variable		
Corporate Social Responsibility	Donations, Charity, Funds etc.	CSR
Independent Variables		
Return on Assets	Net profit after tax /Total assets	ROA
Return on Equity	Net profit after /Total shareholders' equity	ROE
Control Variables		
Leverage	Total liabilities/Total assets	LEV
Size	Total no. of assets	SZ

3.2. Conceptual Framework

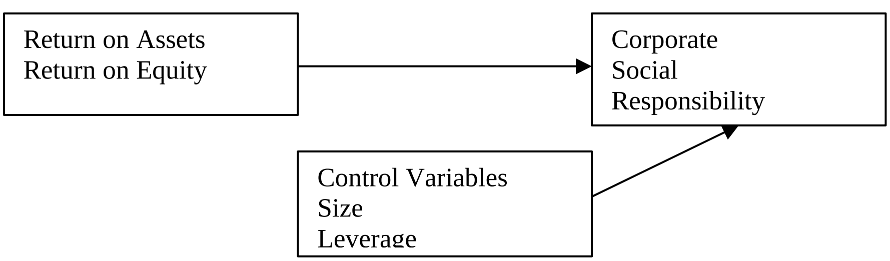

Figure 1. Relationship between CSR and FP

3.3. Data Analysis

The study was based on panel data which involved both cross-sectional data and time-series data. The study selected 4 conventional and 4 Islamic banks listed at PSE (cross-sectional data). The time frame of the research was 7 years (time-series data). Total number of observations were 28 each for the Islamic and conventional banks. The study used multiple regression model to analyze the impact of CSR on FP of the banks of Pakistan.

3.4. Empirical Model Specification

$$CSR_{it} = \beta_0 + \beta_1 ROA_{it} + \beta_2 ROE_{it} + \beta_3 LEV_{it} + \beta_4 LNSZ_{it} + \mu_{it}$$

where

ROA_{it} = return on Assets
ROE_{it} = return on Equity
β_0 = intercept term
β_i= negative or positive coefficients of independent variables
μ_{it} = is the error term
LEV = leverage
LNSZ = size

4. Results and Discussion

4.1. Descriptive Analysis

Table 3
Descriptive Statistics of Conventional Banks

	LNCSR	ROA	ROE	LEV	LNSZ
Mean	11.10704	0.191114	0.182802	0.816862	19.88107
Median	11.34677	0.018950	0.196150	0.896942	20.33567
Maximum	13.76970	1.820000	1.516750	0.970000	21.40708
Minimum	7.082103	0.001000	-0.569100	0.090000	14.79104
Std. Dev.	1.730384	0.470648	0.318819	0.219334	1.580501
Skewness	-0.578706	2.814297	2.130630	-2.035020	-2.221604
Kurtosis	2.894609	9.573514	13.14457	6.086074	7.569253
Probability	0.454793	0.000000	0.000000	0.000000	0.000000
Observations	28	28	28	28	28

Source: Author's own calculation

Tables 3 and 4 provide the descriptive analysis of the selected conventional and Islamic banks, and demonstrates the CSR investment in the context of percentage, mean, medium, maximum, minimum, standard deviation, skewness and kurtosis. The selected conventional and Islamic banks are more inclined towards education, health, relief disaster recovery, water purification, collaboration with government etc. Put simply, we can observe that each bank is participating in social welfare projects and shows environmental concerns by undertaking activities related to environmental awareness.

Table 4

Descriptive Statistics of Islamic banks

	LNCSR	ROA	ROE	LEVERAGE	INSZ
Mean	10.00888	0.043071	0.243480	0.765139	18.56953
Median	9.907607	0.006350	0.052100	0.920000	18.36310
Maximum	12.40083	0.560000	7.100000	0.942639	20.31763
Minimum	7.649693	-0.120000	-9.700000	0.045986	16.97096
Std. Dev.	0.917553	0.126925	2.626469	0.337579	0.835398
Skewness	0.132578	2.902844	-1.027912	-1.663546	0.539928
Kurtosis	4.197616	11.53995	10.34076	3.792722	2.830354
Probability	0.415747	0.000000	0.000000	0.001088	0.498074
Observations	28	28	28	28	28

Source: Author's own calculations

4.2. Correlation Matrix

Table 5

Pearson Correlation Matrix of Conventional Banks

	LNCSR	ROA	ROE	LEVERAGE	INSZ
LNCSR	1.000000	0.175247	-0.015211	-0.087293	-0.205803
ROA		1.000000	0.024572	-0.436135	-0.899989
ROE			1.000000	0.058189	-0.010767
LEVERAGE				1.000000	0.283877
INSZ					1.000000

Source: Author's own calculations

Table 6

Pearson Correlation Matrix of Islamic Banks

	LNCSR	ROA	ROE	LEVERAGE	INSZ
LNCSR	1.000000	-0.017463	0.184832	0.353333	0.314280
ROA		1.000000	0.709590	0.155941	0.071021
ROE			1.000000	0.041899	0.140754
LEVERAGE				1.000000	0.321300
INSZ					1.000000

Source: Author's own calculations

The overall results reveal that the study variables have a positive correlation with each other, except CSR and ROA, which are negatively correlated. It depicts that a small ratio of ROE reduces investment in CSR activities.

4.3. Panel Data Diagnostic Tests

Table 7

Panel Unit Root Test of Islamic and Conventional Banks

	Levin, Lin, and Chu Test		lm, Pesaran and Shin W-stat		ADF-Fisher Chi square		PP-Fisher Chi-squar	
Variable	Statistic	P-value	Statistic	P-value	Statistic	P-value	Statistic	P-value
INSZ	-2.57484	0.0050	1.88412	0.9702	10.0485	0.8641	13.8612	0.6091
LEV	-8.42180	0.0000	0.41346	0.0660	22.3906	0.1310	17.3584	0.3628
CSR	-8.69624	0.0000	-2.13394	0.0164	32.9393	0.0075	31.0406	0.0133
ROA	-1.12579	0.1301	-0.66222	0.0539	27.8635	0.0328	30.7311	0.0146
ROE	-3.93291	0.0000	-1.68484	0.0460	31.1090	0.0130	24.1349	0.0866

Source: Author's own calculations

The results in Table 7 describe that the main variables of the study are stationary and fulfil the assumptions of the classical linear regression model.

Table 8

Cross-section Dependence Test of Conventional Banks

	ROA		ROE	
	Statistic	P-value	Statistic	P-value
Breusch-Pagan LM	20.63489	0.0021	8.441242	0.0075
Pesaran scaled LM	4.224728	0.0000	0.704726	0.4810
Pesaran CD	-1.280804	0.2003	-1.393871	0.0634

Source: Author's own calculations

Table 9

Cross-section Dependence Test of Islamic Banks

	ROA		ROE	
	Statistic	P-value	Statistic	P-value
Breusch-Pagan LM	8.408930	0.2096	11.35760	0.0779
Pesaran scaled LM	0.695398	0.04868	1.546605	0.1220
Pesaran CD	-0.511738	0.9900	-0.420902	0.0738

Source: Author's own calculations

The results in the Tables 8 and 9 enumerate that there is no issue of cross-sectional dependence in the data of both conventional and Islamic banks.

4.4. Panel-Level Heteroscedasticity Test

When the variance of the residuals does not remain constant then there is an issue of heteroscedasticity. The Breusch-Pagan test was adopted to measure panel level heteroscedasticity. The specified empirical model was first estimated by ordinary least squares (OLS) and then by applying the heteroscedasticity test in contrast to the null hypothesis of homoscedastic (constant) error variance (Torres, 2007). The conclusion was drawn through the comparison of LM-critical and LM-statistical. The result signifies that there is no issue of heteroscedasticity in the data.

Table 10

Regression Analysis of Conventional Banks

Variable	OLS	FE	RE
Constant	0.1376	0.0020	0.1838
	17.62484	35.22994	17.62484
	0.8505	0.0361**	0.8667
ROA	-0.364018	-3.531985	-0.364018
	0.0503*	0.0422**	0.9557
ROE	-0.069974	-0.397616	-0.069974
	0.8345	0.5394	0.8523
LEVERAGE	-0.394432	1.295503	-0.394432
	0.5698	0.1097	0.6125
INSZ	-0.307491	-1.228981	-0.307491
No. of observation	28	28	28
No. of cross-section	4	4	4
R-squared	0.45010	0.62103	0.45010

Source: Author's own calculations

Significance level *p < 0.10, **p < 0.05 and ***p < 0.01

Table 10 defines the influence of ROA and ROE on CSR while considering LEV and INSZ as control variables. The results indicate that in case of conventional banks the relationship between ROE and CSR is negative and significant (Fiori, di Danato, & Izzo, 2010; Jackson & Hua, 2009). Here, the results are consistent with the agency theory which states that investment in CSR related activities is a waste of resources. While as, ROA is depicting negative and insignificant relationship with CSR, which depicts that FP does not have any impact on the investment in CSR initiatives. Moreover, there is an insignificant relationship between CSR and LEV, which depicts that more debt portion in the capital structure limit its investment in CSR activities. The relationship between INSZ and CSR is insignificant, depicts that the size of a conventional bank does not have any imapct on its investment in CSR activities (Gitundu, Kisaka, Kiprop & Kibet, 2016). The overall results of the study reject the null hypohesis (H_1).

Table 11

Regression Analysis of Islamic Banks

VARIABLE	OLS	FE	RE
C	0.1403	0.3713	0.0011***
	5.836056	3.241984	5.836056
	0.1635	0.0456***	0.0000***
ROA	-2.713152	1.503702	2.713152
	0.0264***	0.0003***	0.0000***
ROE	0.144092	0.102089	0.144092
	0.0939*	0.2290	0.1822
LEVERAGE	0.920459	0.919715	0.920459
	0.3755***	0.0082***	0.0633**
INSZ	0.191191	0.328662	0.191191
No. of observation	28	28	28
No. of cross-section	4	4	4
R-squared	0.57152	0.54443	0.45715

Source: Author's own calculations

Significance level *p < 0.10, **p < 0.05 and ***p < 0.01

Table 11 describes that the relationship between ROA and CSR is positive and significant, here the results are consistent with the findings of (Babalola, 2013). It describes that a higher ratio of ROE encourages investment in CSR activities, which consequently increases the agency problems. Moreover, the influence of ROE on CSR activities is positive and significant (Malik et al., 2015). Here, the results are consistent with the social contract and stakeholder theories. The relationship between CSR and LEV is insignificant (Farooq, Ullah, & Kimani, 2015), depicts that more debt in capital structure does not have any impact on the investment in CSR activities by an Islamic bank. The relationship between CSR and INSZ is positive and significant (Rehman et al., 2015), which illustrates that large size induces an Islamic bank to fulfils its social responsibilities efficiently. The overall results of three models accept null hypohesis (H_2).

5. Conclusion and Recommendations

The study describes the effect of FP on CSR activities of banks (both conventional and Islamic) of Pakistan. Eight different banks were considered and the data was extracted from the annual reports of the banks for seven years. The overall results depict that CSR is a very common practice in both types of financial institutions. There is little difference between Islamic and conventional banking. However, the Islamic banking sector works under the value system of the *Shariah*. Due to the age and size of the conventional banking sector, the conventional banks are able to invest more in CSR practices. The results of the study are mixed, which depicts that FP has both significant and insignificant relationships with CSR activities of Islamic and conventional banks of Pakistan.

The results of the study lead to the conclusion that Islamic banks are investing more in CSR practices in Pakistan due to their higher FP. It also depicts that Islamic banks are following Islamic ethical principles which provide a broader framework for CSR. Similarly, conventional banks should also focus on corporate governance and ethical values in order to perform effectively. If conventional banks experience higher FP, they should invest their budget in CSR practices for the purpose of upgrading the social and economic conditions of the country. In the case of conventional banks, the overall results have rejected the null hypothesis and express a negative relationship between FP and CSR activities. On the contrary, in the case of Islamic banks the results of the study lead to the acceptance of the null hypothesis and illustrate the fact that the higher FP of Islamic banks boosts their investment in CSR activities. Future researchers can do further analysis by expanding the number of banks used in the study. Various other sectors of the economy may also be selected for data collection and analysis. Data from multiple countries on FP and CSR initiatives can be used by future researchers to expand the current research.

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