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The Nexus between Corporate Social Responsibility and Financial Performance of Commercial Banks: A Modelling and Conceptual Perspective

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Abstract: *This study investigated the nexus between corporate social responsibility and financial performance of commercial banks based on a modelling perspective. This study concludes that banks should focus more on employee and customers in order to obtain higher return and therefore increase the performance. Government should play its role to motivate the banks to spend for the welfare of the societies, nations; environment where they operate their businesses and earn profits also the governments should mandate certain aspects of corporate societal engagement. Government should have regulations that determine a specific level or type of corporate societal investment for commercial banks.*

I. Introduction

Corporate social responsibility (CSR) is defined as the responsibility of an organization towards its stakeholders. Bowen (1953) defined CSR as businessmen obligations to pursue those policies, to make those decisions or to follow those lines of action which are desirable in terms of the objectives and value of the society. Carroll (1979) argued that the definition of CSR, if it is to fully address the entire range of obligations business has to society; must embody the economic, legal, ethical and discretionary categories of business performance. Carroll (1991) later suggests that these categories might be depicted as a pyramid. This means that firms are expected to generate profit, to obey the law, operate in harmony with the unwritten social rules and to voluntarily support societal programs even if society does not expect such support. Recent definition of CSR focuses on firm's responsibilities towards its various stakeholders. In July 2001, the Commission of the European Union presented a green paper entitled promoting a European Framework for corporate social responsibility; the green paper defined CSR as a concept whereby companies integrate social and environment concerns in their business operations and in their interaction with their stakeholders on a voluntary basis (Sweeney, 2009). This represents one of the most common definitions of CSR and is consistent with the most recent academic literature. CSR as a term is often used interchangeably in these studies with such concept as corporate responsibility, corporate citizenship, social enterprise, sustainability, sustainable development, triple-bottom line, and corporate ethics and in some cases corporate governance (Ofori, Nyuur & Darker, 2014).

Corporate social responsibility has received increasing attention as a complementary to financial statements for evaluating financial performance. Recently, the use of financial metrics only, as the measure of a firm's performance is criticized by many scholars and stakeholders due to different reasons. Internally to the firms, use of financial metrics is urged to be backward oriented as they do not consider the future performance of the firm. It is also argued that if firm's management do not care about the needs and expectation of the stakeholders in the community, it will not be competitive hence its survival is questionable (Yeung, 2011). Externally, there is increasing awareness among the managers, stakeholders and communities that business firms are part of the society hence should be responsible for the surrounding societies in which it operates (Yeung, 2011). Meanwhile, an increasing number of shareholders, analyst, regulators, activist, labour unions, employees, community organizations and news media have started to ask companies to be responsible for ever changing set of CSR issues. Accordingly, there is increasing demand for transparency and growing expectations that corporations measure, report and continuously improve their social, environment and economic performance.

The concept of social responsibility is being embraced by companies with wide recognition all across the globe, especially in developing and underdeveloped countries. In recent years, a growing number of companies are adopting CSR initiatives for the sake of meeting the needs and expectations of a range of stakeholders. CSR has generally centred on voluntarily actions, policies, and practices undertaken by the business firms that are related to the firm business ethics, community involvement and investment, social and environment concerns and sustainability, human relations-especially treatment of its employees and its overall business practices. CSR is considered as a response of social pressure, relative to stakeholders' demands and expectations, environmental concerns and social demands which characterise the dimensions of CSR. The stakeholder dimension relates to how the firm interacts with its employees, suppliers, customers and general public. The environmental dimension refers to how business operations worries about natural environment. And the social dimension is related to how the enterprise contributes to a better society by integrating its business practices with social concerns (Crisostomo, Freire & Vasconcedos, 2011). Consumers expect goods and services to reflect socially and environmentally responsible business behaviour at competitive price. General public now has high expectations of the private sector for responsible behaviour. Shareholders also search for enhanced financial performance that integrates social and environmental consideration (Cheung & Mark, 2010).

Behaving in a socially responsible manner is increasingly seen as essential to the long term survival of companies. The current situation of the world and new business environments requires managers of the companies take good governance and establish a balance between social, economic and environmental sectors of the business. That means being responsible to all stakeholders. The recent scandals of companies attracted attention of good corporate governance such as, trust, accountability and ethical economic performance (Amir & Amini, 2015). However, the role and governance power are not considered seriously and only net profit and its increase are emphasized mostly. Hence, with Corporate Social Responsibility, managers in business firms are required to make decisions and actions that recognize the relationship between the business and society. According to World Business Council for Suitable Development CSR is a continuing commitment by business to behave ethically and contribute to the economic development while improving the quality of life of work force and their families as well as local community and society at large. Business can use ethical decision making to secure their business by making decisions that allow for government agencies to minimize their involvement in the corporation.

Commercial banks performance

In the literature on bank performance, operational expenses efficiency is usually used to assess managerial efficiency in banks. Poor expenses management is the main contributor to poor profitability in the banking sector (Okwoma, 2010). There are factors that determine financial performance of commercial banks. Bank specific factors are those factors within the direct control of managers and can be best explained by the CAMEL framework. That is Capital adequacy, Asset quality, Management efficiency, Earning performance and Liquidity. Capital adequacy can be defined as the sufficiency of the amount of equity to absorb any shocks that the bank may experience. The capital structure of the bank is highly regulated. This is because capital plays a crucial role in reducing the number of bank failures and losses to depositors, when a bank fails as highly leveraged firms are likely to take excessive risk in order to minimize shareholder value at the expense of finance providers (Kamau, 2009).

The importance of liquidity goes beyond the individual bank as a liquidity shortfall at an individual bank can have systemic repercussions. It is argued that when banks hold high liquidity, they do so at the opportunity cost of some investment, which could generate high returns (Kamau, 2009). Commercial banks can also diversify their revenue by engaging in off balance sheet activities. The decline in interest margins, has forced banks to explore alternative sources of revenues, leading to diversification into trading activities, other services and non-traditional operations. Market structural factors such as ownership structure of a bank and market concentration have been found to influence profitability of banks (Okwoma, 2010). Foreign banks bring better know how, and exerts competitive pressure on local banks leading to efficiency.

According to Kusemererwa (2010), primary business activity of commercial banks is lending and therefore the loan portfolio represents one of the largest assets and predominate source of risk to a bank's soundness. Whether due to lax credit standards, poor portfolio risk management, or weakness in the economy, loan portfolio problems have historically been the major cause of banks losses and failures. While annual audits of loan portfolios may address these risks, experience has revealed that continuous monitoring of the portfolio is the preferred approach. Identifying control breaches, anomalies, and high risk activities early and employing a firm remediation strategy often prevents and certainly minimizes the impact of any potential impairment of the portfolio. Commercial banks provide valuable services in the economy, performance are the primary concern of management and investors; this is because the profit will make them to survive and hence economic development. Management will be in the position to hedge on all possible events which may result to losses and capitalize on all possible profits. Commercial banks exist due to various services which they offer to the community it includes information services, liquidity services, transaction cost services, maturity intermediation services, and alike. Failure to provide this services in effectively and efficient manner can be costly to both users as well as the economy.

The link between CSR and financial performance

The examination of relationship between CSR and Firm financial performance have been highly developed and researched in modern literature. No definite consensus exists on the empirical CSP and financial performance associations. Other empirical evidence suggests conflicting results about the direction of CSP and financial performance linkage. Various studies have found a positive relationship between CSR and financial performance. The study of Muhamad, Saleh and Zulkifli (2011), reveals that CSR and all its dimensions are positively related to corporate financial performance. Palmer (2012), carried out a study to determine CSR and financial performance, they found significance positive relationship. Tsoutsoura (2004) carried out a study to determine the relationship between CSR and financial performance in California he found a positive and significant relationship between CSR and financial performance. While other study found neutral or no relationship. Cheung & Mak (2010), conducted the study to investigate the relationship between CSR disclosure and financial performance in commercial banks in Canada, they found that no definite relationship exists, neither positive nor negative between CSR and financial performance in commercial banks. Aras, Aybars and Kutlu (2009), investigated the relationship between CSR and financial performance in emerging markets in Turkey. They found no link between CSR and financial performance. Meanwhile others came out with negative relationship. For example Crisostomo et al (2011) and Kamau (2013), Carried out the study of CSR and financial performance in banking sector they found negative correlation between CSR dimensions and banks profitability.

Those who found positive relationship suggest that CSR improves firm value. This group's assertions is based on stakeholder theory, suggesting that an organization's survival and success is attributed to the achievement of its economic (profit maximization) and non-economic (corporate social performance) objectives in the interest of their stakeholders (Singh, 2014). Scholars argued that an increase in the expenditure on social activities improves the stakeholder relationships which reduces firm's transaction costs and increases the market opportunities and pricing premiums, which further leads to higher net financial performance.

Those who found negative relationship adopt the idea that firm must use its resources only to maximize its profit and otherwise it will have adverse results. This group supports Friedman's viewpoint that the only obligation of business is to utilize its resources in a way which helps to increase the profit and share of the owners of firm. It is believed that indulging in CSR is an extra cost to the firm, thus the net financial performance goes low (Singh, 2014). Cochran and Wood (1984) argued, if certain actions that are classified as socially responsible are negatively associated with the firm's financial performance, and then the managers are advised to be cautious. On the contrary, if the relationship exhibits a positive association, the managers are encouraged to pursue such activities with enthusiasm (Cochran & Wood, 1984).

Those who found neutral relationship, suggests that there are many factors that can prevent researchers from secure results. Neutral association can be explained if CSR is perceived as pure marketing strategy (Karagiorgos, 2010). This group of scholars partially argues for the existence of too many confusing parameters, advising no precise relationship between CSR activities and the financial performance (Singh, 2014).

According to Singh, (2014), even if CSR is viewed as a significant cost, the firms with profitable performance might be more willing to absorb these costs in the future. However, less profitable firms are reluctant in undertaking socially responsible activities. Majority of studies abide by the idea that a high level of social indulgence helps to build good relationships with its stakeholders, thus enhancing the firm's financial performance. CSR activities also build good relationships with the firm's external stakeholders such as customers, community, and prospective employees. The stakeholders weigh the firm's CSR involvement positively, thereby increasing their demand or paying premium prices for the products of CSR active firms. CSR involved firms attract better quality of workforce as these firms are perceived as attractive by job seekers.

The link between CSR and commercial banks

The commercial banks have a great contribution in the economy. Banking is considered as one of the major contributing sectors behind economic stability and growth, and it is highly visible to public evaluation. It has a wide spectrum of stakeholders which include owners, borrowers, depositors, regulators and managers (Cheung & Mak, 2010). Banks provides necessity in nature to the society and whose policies and decisions can largely affect public interest. It follows that CSR is the obligation of the banks to manage their social, economic and environment activities at local and global level. This involve the bank considering not only their profitability and growth, but also the interests of society and the environment by taking responsibility for the impact of their activities on stakeholders, employees, shareholders, customers, suppliers and civil society represented by NGO. Banks manage financial risk, monitor borrowers and organize payment system, which helps to improve market efficiency.

Financial institutions are not left behind in the issues of CSR, also they need to develop different strategy which would show that they are responsible to the community and society concerns at large and therefore CSR of banks is expected to develop a voluntary trend in the banking industry. Banking industry realized that CSR activities have a significant impact on their Performance and survival (Decker, 2004).

These days, competition in the banking sector has a non-price nature. Many banks offer similar conditions in the same market. The necessity of searching for additional benefits is got mainly through the promotion of new products and brand development. It should be taken into account that to maintain the uniqueness in the market within the introduction of innovations is not possible in the long term financial engineering does not stand still, and competitors can always offer something similar, if the product is successful. That is why the development of brand of the bank by creating a positive image in front of the main groups of stakeholders is an important aspect of the performance in a high competitive environment. To achieve this target, tools of socially responsible business are often used and the choice is determined by financial possibilities of banks, the level of development of the whole system and the requirement of regulators.

In today's business, financial institutions are under pressure from different stakeholders concerning responsible business they are required to carry out while doing their businesses. As stipulated by Cheung & Mak (2010), investors raised their awareness towards the importance of transparency of banks, as well as the threat of environment and social risk. Instead of merely focus on maximizing the benefit of stakeholders, banks are expected to care the wellbeing of the whole society when they make their decisions, as impact of a wrong decisions can be disastrous to the society.

II. Literature Review

Carroll's Three Dimensional Model

Carroll's pyramid of corporate social responsibility is perhaps the most famous example of early models. This model's graphical representation implied a hierarchy of responsibilities moving from economic legal through to more socially oriented ones of ethical and philanthropic responsibilities (Carroll, 1991). Carroll's foundation article on social performance provided a three-dimensional model presented as follows;

First dimension: Category of responsibility that organisations must undertake on CSR.

Economic Responsibility; a company's first responsibility is its economic responsibility. It needs to be primarily concerned with earning a profit, this is for the simple fact that, if a company doesn't make any money it will not last, employees will lose jobs and the company will not even be able to think of taking care of its social responsibilities. Before a company think about being a good corporate citizen, it first needs to make sure that it can be profitable.

Legal; a company's legal responsibility is a requirement that is placed on it by the law, next to ensuring that the company is profitable. Legal responsibility can range from securities regulations to labour law, environment law, and even criminal law.

Ethical Responsibility; economic and legal responsibilities are the key obligations of the company after a company has met these basic requirements a company can involve itself with ethical responsibilities. Ethical responsibilities are responsibilities that a company puts on itself because its owners believe it is the right thing to do, not because they have an obligation to do so. This could include being environmental friendly, paying fair wages, etc.

Philanthropic Responsibility; philanthropic responsibilities are responsibilities that go above and beyond what is simply required or what the company believes to be right. They involve making an effort to benefit society for example by donation services to community organisations, engaging in projects to sustain the environment.

Second Dimension: Attitude towards corporate social responsiveness

The reactive attitude means that organization reacts to external forces that oblige them to act and defensive attitude, a way of escape for organization towards other external forces also the well-off attitude, means that an organisation act on CSR because they know it exists but they do it without caring for the results and finally pre active or productive attitude, organization try to anticipate with the right strategies of CSR without being forced by any institution or other interest group.

Third Dimension: Range of social issues Third dimension concerns issues organization take to become a responsible organization (corporate social performance).Consumption, Environmental, Product security and Shareholder security.

Acknowledging problems inherent in visual representation of this scheme as implicit hierarchy Schwarz and Carroll (2003) have replaced the pyramid with a Venn diagram and also abandoned philanthropic category as not justifiable as a social responsibility due to its discretionary nature. This later revision updates the model to correspond more closely to a contemporary notion of CSR as integrated to the business system and exemplified in concepts such as the triple bottom line and social auditing (Meehan, Meehan & Richards, 2006).

These early model of CSR (often termed as CSR one when responsiveness is emphasized, and CSR two) are normative and descriptive in nature, they singularly fail to provide any tool or guidance on how to operationalize the responsibilities they would have managers embraced Meehan at al. (2006). Generally Carroll's model has been criticized that, the model does not approach environmental issue as responsibilities (Jose and Chillida, 2009). To solve the problem John Elkington (1998), coined the Triple Bottom line, with the aim to formulate strategies to achieve the economic results throughout economic social and environmental sustainability, the actual baseline for today's conception of CSR (Jose and Chillida, 2009).

Wartick and Cochran (1985), presented their evolution of the CSP model, which extended Carroll's model recasting the three dimensions of responsibility, responsiveness and social issues into a framework of principles (using Carroll's four-part definition of CSR), processes (social responsiveness-the general means to the ends of satisfying corporate social obligation) and policies (social issues management) (Geva, 2008), as presented in table 2.1 below.

Table 2.1: Corporate Social Performance Model of Wartick and Cochran

Principles	**Processes**	**Polices**
Corporate Social Responsibility • Economic • Legal • Ethical Directed At The Social Contract of Business Philosophical Orientation	Corporate Social Responsiveness • Reactive • Defensive • Accommodative Directed At • The capacity to respond to changing societal condition • Managerial Approaches to developing responses Institutional Orientation	Social Issues Management • Issues Identification • Issue Analysis • Responsive Development Directed At • Minimizing Surprises • Determining effective corporate social policies Organizational Orientation

Source: Wartick and Cochran (1985)

Wood (1991) acknowledged Wartick and Cochran's definition of CSP represented a conceptual advance in researchers' thinking about business and society. She also stressed that some problem were left unaddressed (Wood, 1991). Pierick, Beekman, Weele, Meeusen and Graaff, (2004) assert that, the term performance speaks of action and outcomes, not of interaction or integration. The definition of CSP model which integrates the various concepts, could not define CSP itself unless an action component was added. Second, there is a problem with addressing social responsiveness as a single process rather than a set of processes. Third the final component of CSP model is too restrictive.

Addressing these problems, Wood (1991), building on Wartick and Cochran's model, integrated much of the previous theoretical developments in an acknowledged definition of CSP as the configuration of the principles of social responsibility, process of social responsiveness and policies, programs and observable outcomes as they relate to the firm's societal relationships (Geva, 2008). Following her definition as a guide, Wood (1991) constructed the CSP model as outlined in table 2.2 below.

Table 2.2: Wood Corporate Social Performance

Principles of corporate social Responsibility
Institutional Principle: legitimacy
Organizational Principle: Public responsibility
Individual Principle: Managerial discretion
Process of corporate social responsiveness
Environmental assessment
Stakeholder management
Issue management
Outcome of corporate social behaviour
Social policies
Social programs
Social impacts

Source: wood (1991)

This definition permits corporate social performance to be seen as an assessment tool, a guiding framework that provide an outline of what needs to be considered (policies, programs, processes, and social outcomes) in evaluating corporate social responsibility (Geva, 2008). Wood (1991), considered that the basic idea of corporate social responsibility is that business and society are interwoven rather than distinct entities therefore society has certain expectation for appropriate business behaviour and outcome (Branco & Rodrigues, 2008).

Discussing on the element of the model, Wood retained Carroll's categories and identified how they relate to corporate social responsibility principles (the principle of legitimacy, the principle of public responsibility and the principle of managerial discretion). The principle of legitimacy operates on an institutional level and is based on company's overall responsibilities to the society in which it operates, specifying what is expected of all companies (Branco & Rodrigues, 2008). The principle of public responsibility function on an organization level, stating that companies are responsible for solving problems they have caused, and they are responsible for helping to solve problems and social issues related to their business operations and interest.

The principle of managerial discretion functions on an individual level and emphasizes managerial responsibilities to behave as moral actors and make choices about activities designed to achieve socially responsible outcome (Branco & Rodrigues, 2008). Wood (1991) suggests companies use three main kinds of processes to bring these principles into practice. She meant the process by which the organisation identifies and frames responses to threats and opportunities presented by environmental factors and managerial processes that generates internal copying mechanisms. Specifically content includes environmental factors (think, PESTEL, DEPICTS, etc.), stakeholders demands and ad hoc issues relating to public relations, crises, political lobbying etc. Internal copying mechanisms take the form of internal policies, codes of conduct, ethics and values (Meehan, Meehan & Richards, 2006).

The outcome of corporate behaviour is the only observable and assessable element of the model, and designed in conjunction with the principles and processes allowing for improved pragmatic assessment of social impacts (benefit or negative), social programs (which refers to the actions companies take to manage their social impacts in favourable manner), and social policies (which emerge to guide decision making) (Branco & Rodrigues, 2008).

Although the corporate social performance model does integrate much of the earlier work into coherent model for assessing an organisations social responsibility standing, it does not fully consider the significance of stakeholder impacts (Meehan at al. 2006).Therefore the CSP model offers greater theoretical integration and more emphasis on strategic and process considerations but little guidance on how to actually develop appropriate strategies and instruments for realising its stated aims (Meehan at al. 2006).

Wood and Jones (1995) use stakeholder framework to modify wood's definition of CSP as principles, processes and outcomes. They defined the outcomes as; internal stakeholder effects, external stakeholder effects and external institutional effects (Branco & Rodrigues, 2008).They argue stakeholder has three roles: first, they are the sources of expectations about what constitutes desirable and undesirable company performance defining the norms for corporate behaviour. Secondly, they experience the effects of corporate behaviour and they evaluate outcomes of company's behaviour in terms of how they have met expectations and have affected the groups and organisations in their environment. Third, from stakeholder perspective, CSP can thus be assessed in terms of a company meeting the demands of its multiple stakeholder groups, and companies must seek to satisfy their demands as an avoidable cost of doing business (Branco & Rodrigues, 2008). The CSP is considered to refer to the ability of the company to meet or exceed stakeholder expectations regarding social issues. Clarkson (1995) holds that stakeholder management framework is more useful to the analysis and evaluation of CSP than models and methodologies based on concepts of social responsibilities and responsiveness.

Shareholder Model

Shareholder model is centred on the shareholder as the most important stakeholder, with the goal of maximizing wealth for investors and owners. From economic perspective such point of view makes sense. Business cannot survive without making a profit even high visionary companies like Safaricom and Equity bank cannot pursue their mission and goals if they do not earn to turn these goals in reality. Friedman (1970), argued that a business manager's responsibility is to maximize profit for shareholders while conforming to the laws and ethical customs of the society, Friedman (1970) also points out that managers who choose to use their capacity as an agent to pursue social responsibility at the expense of the organization are basically using the money of the shareholders to pursue goals that will not help them financially. In doing so, the manager is neglecting her responsibility towards the owners which is unethical and disadvantageous to the organization. Shareholder model gained much attention among corporations, managers begun to be offered stock in the company in order to align their objectives with those of the firm to help shareholder keep track of whether management was pursing the best interest of the company, pubic corporations report quarterly earnings to provide shareholders with a snap shot of how the organization is doing financially. If managers are not increasing profits, they may be terminated for being unable to maximize shareholders' value. Advocates of shareholder model believe having this one goal helps a business become more competitive, helps managers prioritize their responsibilities and helps create transparency in allowing investors to monitor the company performance.

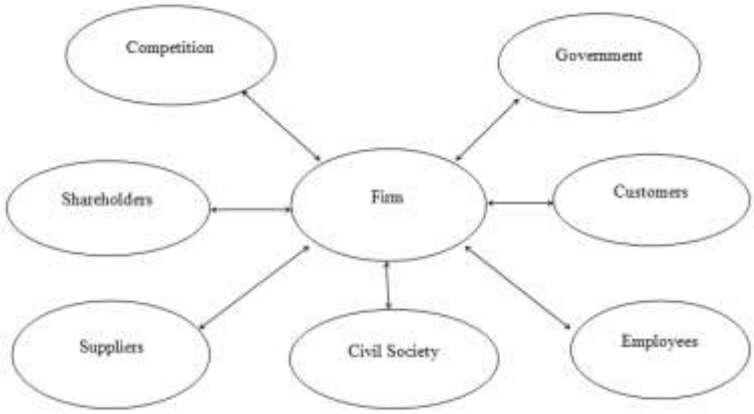
Problems of shareholder model; Due to the pleasures to meet performance expectations, managers are often tempted to take short term perspective of the organization. Managers focus on maximizing value on the short term rather on the long term. This can have negative effect on the firm. Studies have supported the idea that a short term emphasis on the shareholder value harms long term value creation.

Stakeholder Model

Freeman (1984) considers a new managerial model which goes beyond the traditional shareholders view with the new incorporation of other internal and external stakeholders. Freeman stakeholder analysis improves the frameworks of corporate performance model of Carroll (1979), Wartick & Cochran (1985) and Wood (1991), because by managing the wants and needs of all the stakeholders, the required dynamism is accomplished as stakeholder theory focuses on what the organisation should act upon (Jose & Chillida, 2009).
Stakeholder model is an alternative to shareholder model, managers that adapt stakeholder model they are responsible to other stakeholders including consumers, suppliers, employees, communities, regulatory authority,

and environment. Waddock & Grave (2006) classified stakeholders in primary and secondary. Primary stakeholders are owners, employees, customers and suppliers; and those without whom, the organisation could not survive. Secondary stakeholders include the non-governmental organisations (NGOs), activists, communities and governments; those who can affect the firm or be affected by it. They also include independently general societal trends and institutional forces (Jose & Chillida, 2009).
Model of the stakeholder theory included the following stakeholders:

Figure 2:1: Stakeholder Model



Source: The original stakeholder Model Freeman (1984).

Freeman (1984) works from this basis, having defined and identified the possible stakeholders of the firms, and presents a method and reasoning for how and why relationships between the firm and these stakeholders may be managed. He therefore provides a new perspective on how firms may operate, where the focus is always on interdependency between the firms and its environment. Carroll (2003) and Freeman (1984) theorize that by taking the interests of all the firm stakeholders into account the firm could do better (achieve greater performance) than by simply focusing on shareholder interest. Carroll and Freeman believe that if a firm create value for its stakeholders, it will create value for its shareholders as well (Pfarrer, 2010).Unlike the assumption of classical economics and shareholder theory (that a firm can only maximize value on one dimension) stakeholder theorists believe that taking all constituent group into account is the better way to maximize overall firm performance.

While managers with this view point acknowledge the importance of all stakeholders, they also recognise that firms must prioritize these stakeholders for instance some firm may choose to prioritize employees while other could choose to focus on customers. This allows the firm to tailor its goals to best meet the needs of its chosen stakeholder rather than trying to meet the needs of every stakeholder (Sawayda, 2013).

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