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# Impact of Corporate Social Responsibility on Corporate Financial Performance: Commercial Banks of India and Priority Sector Lending

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**Structured Abstract:**

**Purpose:** Corporate Social Responsibility is now mandatory rather than a voluntary approach. This has triggered a controversy relating to rationale behind convergence of CSR and profit making objectivity of a firm. The reviews of past studies reveal mixed and conflicting results with regard to the relationship between social responsibilities of firms with their financial performance. In this paper attempt is made to analyze the impact of social responsibility of public and private sector banks in India on their financial performance.

**Design / Methodology / Approach:** In this paper panel data regression analysis is used to study the impact of corporate social responsibility of commercial banks in India on their financial performance, taking priority sector lending by the banks as a proxy for CSR .This is an annual study conducted on 36 commercial banks in India, covering a period of 8 years, starting from 2008-09 to 2015-16.

**Findings:** This empirical analysis reveal negative impact of CSR on accounting based measures of financial performance - ROA, ROE and EPS. While corporate social responsibility has a positive impact on price to book value of the firm, but the result is not statistically significant.

**Originality / Value:** In Indian perspective, very few studies explored the relationship between CSR and CFP, especially in regard to Indian banking industry. Inadequacy of empirical study regarding significance of corporate social responsibility of the Indian banking industry prompted to provide empirical evidence on the relationship between CSR and CFP in Indian banking Industry so as to add further to the existing perception.

**Keywords:** Corporate Social Responsibility (CSR), Corporate Financial Performance (CFP), Commercial Banks, Priority Sector Lending, Panel Data Analysis.

**Paper Type:** Research Paper.

## Introduction

Corporate Social Responsibility (CSR) is a buzzword in every corporate house. All forms of organization are focusing on integration of CSR into their operational activities. Impact of global influences, need for ecological environment protection prompted legal adoption of social responsibilities by the firms in India as well. National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business issued by Government of India in 2011 and guidelines issued by Companies Act 2013 relating to adoption and incorporation of Corporate Social Responsibility Practices into business activities, led to compulsory adoption of social responsibilities by the firms in India. The Banking sector in India also incorporated social responsibility practices into their traditional activities of accepting of deposits and lending of money. In this paper attempt is made to study the impact of corporate social responsibility of commercial banks in India on their financial performance, with special reference to implication of priority sector lending.

## Concept of Corporate Social Responsibility (CSR)

CSR creates an obligation on the firm to be good to the people, society, and ecological environment and continue to make enough profit which can contribute to growth of economy.CSR aims at integrating philanthropic, legal, ethical, economic responsibility into business operation so as to forge a strong relationship between firms and the society. Firms being a part of the society have a commitment towards the society and are expected to address the social evils and problems that are either caused by their own operation or by others. Social responsibility of firms took different dimensions overtime from the traditional philanthropic approach that is spending part of business income on charitable activities to societal and environmental approach.

European Union (EU) (2011) describes CSR as accountability of the firm for its action and decision towards all its stakeholders.

The World Business Council (2001) defined CSR as "the commitment of business to contribute to sustainable economic development, working with employee, their families ,local community and society at large to improve their quality of life."

According to Kotler and Lee (2005) "Corporate social responsibility is a commitment to improve community well-being through discretionary business practices and contributions of corporate resources."

According to Kotler and Lee (2005) "We all want a better world and are convinced that communities need corporate support and partnership to make it happen."

CSR activities aim at converging social, financial and economic performance.

Advocating Corporate Social Responsibility, Kofi Annan, United Nations' Secretary General, commented "a happy convergence between what your shareholders want and what is best for millions of people the world over" (Annan, 2001).

**Corporate Social Responsibility of Banking sector in India**

Banking sector plays an important role in strengthening and development of an economy. The banks are entrusted with the responsibility of managing the funds of the general public in an effective and prudent manner and are expected to integrate social and environmental concerns in their business operation. Banks have shifted from their narrow traditional objectives of maximizing profit to maximizing the interest of every member of society who is directly or indirectly associated with the firm.

Financial inclusion introduced in India in 2005 was the first step of social responsible practices by the banking sector. In a notice circulated by RBI to all Scheduled Commercial banks in India entitled "Corporate Social Responsibility ,Sustainable Development and Non Financial Reporting –Role of Banks" on 20th December 2007, explained the concept of Corporate social responsibility, sustainable development and non-financial reporting and highlighted its growing importance and global initiatives in this regard and suggested integration of economic ,social and environmental concerns in their business operations to achieve sustainable development.

Keeping in view the national priorities certain functions of banks like priority sector lending, agricultural lending, lending to MSE, weaker section , minority community, women beneficiaries, MSME, establishing self help groups, Kisan Credit Card forms a part of CSR strategy of Commercial Banks in India.

The other social issues that are addressed by banks in India include child welfare, community welfare, education, environment protection, healthcare provision, poverty eradication, rural development, vocational training for youth and women , women empowerment, unemployment problem.

Like other business organizations banks are linking their functional areas with social and environmental issues to survive in the long run by establishing long term relationship with the society at large.

**Priority Sector Lending**

According to RBI (2014), "Priority sector refers to those sectors of the economy which may not get timely and adequate credit in the absence of this special dispensation. Typically, these are small value loans to farmers for agriculture and allied activities, micro and small enterprises, poor people for housing, students for education and other low income groups and weaker sections"

Priority sector lending aims at removal of poverty through equitable distribution of income by uplifting the poorer section of society. Domination of unorganised financial system and existence of unscrupulous moneylenders in the economy impedes the credit system in the country and hampers economic growth. In Indian economy, sectors like agriculture, micro, small and medium enterprises, education for poor, women and girl child education and empowerment, rural development, employment opportunities for unemployed youth requires a lot of attention and financial support for development of the society and overall economic development. The Government of India and the Reserve Bank of India took initiative to extend credit facility to these sectors on easy terms.

**Literature Review**

The relationship between corporate social responsibility (CSR) and corporate financial performance (CFP) is a matter of concern for the firms and researchers and authoritative bodies. In recent years different guidelines prescribed compulsory adoption of CSR activities by the firms. This has triggered a controversy relating to rationale behind coexistence of CSR and profit making objective of a firm. This gave birth to a controversial issue regarding the impact of CSR performance of the firms on its financial performance and whether resources spent on CSR activities is an investment for reaping future profit or its is an added expenditure on the firm pushing it towards an economically disadvantaged position. Some theories reflect unilateral relationship while some theories reflect bilateral relationship between CSR and CFP, while some theories question the adoption of CSR activities advocating that CSR expenditure puts the firm in economically disadvantaged position.

Unilateral Relationship provides that CSR activities have a positive impact on CFP (Belkaoui 1976, Graves & Waddock 2000, McGuire, Sundgren & Schneeweis 1988, Waddock & Graves 1997) or CSR activities may have a negative impact on CFP (Wright & Ferris 1997, Friedman (1970), Cerdeiro & Sarkis (1997). On the other hand improved CFP may lead to increased adoption of CSR activities by the firms (McGuire, Sundgren & Schneeweis 1988, Waddock & Graves 1997), or fall in CFP will have a negative impact on CSR activities.

Bilateral Relationship suggest that increased CSR activities leads to improved CFP which in turn has a positive impact on firms CSR activities thus forming a virtuous cycle. Conversely increased CSR activities may have a negative impact on CFP which results in reduced CSR activities forming a vicious cycle of CSR.

Sharma (2011) provided a picture of CSR practices and strategies that has been incorporated into normal banking operations and CSR reporting by the Indian banking sector and highlighted the inadequacy of norms regarding CSR reporting system. The study revealed no significant difference between the public and private sector banks with regard to corporate social performance though private banks scored more as compared to public banks.

Singh et al. (2011) documented a linkage between ownership, number of employees, and number of years of incorporation with the CSR orientation of Indian Banks and on the other hand opined that financial performance of banks has little impact on CSR of banks.

Banerjee and Mandal (2014) made a comparative analysis of the impact of societal and marketing expenditure on the profitability of the scheduled commercial banks in India and observed a positive impact of societal expenditure on the profit of the top–performers and that societal expenditure of banks increased although not significantly post the issue of RBI notice on 20th Dec, 2007 titled "Corporate Social Responsibility, sustainable Development and Non-Financial reporting" to incorporate social and environmental concern in their business operation to achieve sustainable development.

## Research Gap

The review of past studies reveals mixed results with regard to the relationship between social responsibilities of firms with its financial performance. Some studies provide a strong positive association between CSR and CFP while some reveal a negative impact of CSR on firm's financial performance. In Indian perspective, very few studies have been conducted to explore the relationship between CSR and CFP, especially in regard to Indian banking industry. Inadequacy of empirical study regarding significance of corporate social responsibility of the Indian banking industry prompted to provide an empirical evidence of relationship between CSR and CFP in Indian banking Industry, with special reference to priority sector lending which forms an important social responsibility initiative by the Indian banks.

**Objective of Study**

The study aims -

> **To analyze the impact of social responsibility of public and private sector banks on their financial performance.**

**Hypothesis:** CSR activities of public and private sector commercial banks significantly contribute towards financial performance.

**Methodology**

Initially the dataset included all 39 commercial banks in India, 21 public and 18 private sector commercial banks (excluding their Associates and subsidiaries). Subsequently the banks that are not listed on stock exchange before April 2016 were excluded from the sample. Hence the final balanced sample consists of 36 commercial banks in India. This is an annual study covering a period of 8 years, starting from 2008-09 to 2015-16. Panel Data regression analysis is used to study the impact of social responsibility of the commercial banks in India on their financial performance.

**Data Collection**

The study is based on secondary data. The data is collected from the annual reports of the banks under study and data provided by the reports of the Reserve Bank of India.

**Dependent Variable**

In this study the financial performance is the dependent variable. Financial performance is measured using historical accounting based measures- Return on Equity (ROE), Return on Asset (ROA) and Earning per Share (EPS) which provides a picture of efficiency of the management in utilizing the assets and capital to generate return. In contrast to historical accounting based measure of financial performance, market based measures - Price Earnings

Ratio (PER) and Price to Book Value (PBV) ratio are used. The market based financial performance measures are forward looking and reflect shareholder's perception towards impact of social responsibility of the firm on its earning.

**Independent Variable**

Corporate Social Responsibility (CSR) of bank is the independent variable in this study.

In the present study priority sector lending by the individual commercial banks in India is considered as a measure of corporate social responsibility. Priority sector lending is a significant social performance of banks which integrates social issues with the core lending function of the banking business.

The set of voluntary Guidelines on CSR for corporate sector, issued by The Ministry of Corporate Affairs, Government of India, in 2009, emphasize on inclusiveness, sustainability, improvement of quality of life of people and all round development of the economy. The following three principles provided in the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business issued in 2009 emphasize integration of social, environmental issues into the business functions, policies and strategies:

**"Principle 4: Businesses should respect the interests of, and be responsive towards all stakeholders, especially those who are disadvantaged, vulnerable and marginalised.**

**Principle 5: Businesses should respect and promote human rights.**

**Principle 8: Businesses should support inclusive growth and equitable development."**

In accordance with the above guideline, Priority Sector Lending (PSL) by the banks is an important socially responsible practices of the bank and hence used as an independent variable to represent corporate social responsibility practices by the banks.

**-----------------------------------**Insert Table 1 about here**--------------------------------------------**

**Panel Data Analysis**

The panel data regression model is used to analyze the impact of corporate social responsibility (CSR) on financial performance.

Simple panel data regression model of the following form is used.

$Y_{it} = \alpha + \beta' X_{it} + u_{it}$, i = 1, 2, ...., N ; t = 1, 2, ..., T , ( 1)

Where i denote the 36 banks included in the study and t denotes the time series dimension, which is from 2009 to 2016.

Yit is a dependent variable, α is a scalable, β is a [Kx1] vector of the regression coefficient, Xit is an observation on the *i*th individual in *t*th time period on K explanatory variables, $u_{it}$ is an error component of the model, which is usually either a one-way form or a two-way form. Most of the panel data applications utilise a one-way error component models for the disturbances. It is of the form:

$u_{it} = \mu_i + \nu_{it}$ , where $\mu_i$ denotes the unobservable individual-specific, time-invariant effect and $\nu_{it}$ denotes the remaining disturbances (Baltagi, 2005).

The above model (1) can be divided as either fixed effects model or random effects model based on the terms of error component of the model that can be assumed as a fixed constant or as having random variation.

There are five models; every model contains CSR as an independent variable and financial performance as dependent variable. The five models are as follows:

**Model 1:** EPS= $\beta_0 + \beta_1$LOGPSL

**Model 2:** ROA= $\beta_0 + \beta_1$LOGPSL

**Model 3:** ROE= $\beta_0 + \beta_1$LOGPSL

**Model 4:** PER= $\beta_0 + \beta_1$LOGPSL

**Model 5:** PBV= $\beta_0 + \beta_1$LOGPSL

We hypothesise the following:

$H_0$: CSR has a positive impact on Financial Performance.

$H_1$: CSR has a negative impact on Financial Performance.

The analysis is executed using statistical software package EVIEWS 7 version.

**Analysis and Findings**

**Descriptive Statistics**

**-----------------------------------**Insert Table 2 about here**-------------------------------------------**

**Table 2** shows the descriptive statistics of the all the variables used in this study. The mean value of EPS is 31.25 with a very high standard deviation of 42.04.The mean value of ROA is

0.835521 with a very low standard deviation of 0.687870.The independent variable LOGPSL has a mean value of 1.07337 and low standard deviation of 1.13258.

**Correlation Analysis**

**-----------------------------------**Insert Table 3 about here**--------------------------------------------**

**Table 3,** the correlation matrix presents the association among all the dependent and independent variables used in the present study. The priority sector advance has a positive correlation with the dependent variable EPS. The association between LOGPSL and EPS is 29%.There exists negative correlation between LOGPSL and ROA, ROE, PER and PBV.

**Panel Data Regression Analysis**

In this study fixed effect model and random effect model is used.

$CFP_{it} = \beta_0+\beta_1\, LOGPSL_{it} + e_{it}$

CFPit = financial performance in $t^{th}$ year measured by ROA, ROE, EPS, PER and PBV in five individual models.

$B_0$ = constant

$\beta_1$= regression coefficients

$LOGPSL_{it}$ = a proxy for corporate social responsibility

$e_{it}$ = unobserved error component of firm i at year t,

**-----------------------------------**Insert Table 4 about here**--------------------------------------------**

**Table 4** presents the panel least squares analysis of the study. The table presents the coefficient value of the constant and the independent variable LOGPSL with corresponding value of t-statistic and p-value. In the above table the $R^2$ value represents variation in the dependent variables EPS, ROA, ROE, PER and PBV caused by independent variable LOGPSL. The F value with corresponding significant probability value at 5 % level of significance; indicate that the value of $R^2$ is statistically significant for all models and that the independent variable is good predictors of the dependent variable. The result of the analysis is as follows:

**Model 1:** EPS= 177.2547 -14.49874LOGPSL

**Model 2:** ROA= 5.165290 -0.429823LOGPSL

**Model 3:** ROE=110.7874 -9.797426LOGPSL

**Model 4:** PER= -5.182538+ 1.469197LOGPSL

**Model 5:** PBV= 1.110052+ 0.013169 LOGPSL

**-----------------------------------**Insert table 5 about here**--------------------------------------------**

**Table 5** presents the panel EGLS cross section random effect analysis. The table presents the coefficient value of the constant and the independent variable LOGPSL with corresponding value of t-statistic and p-value. In this study F statistic greater than 1 and significant at p<=0.01 which indicates significance of the model in predicting the outcome variable. The result of the analysis is as follows:

**Model 1:** EPS= 41.03824-0.976310LOGPSL

**Model 2:** ROA= 3.192161-0.233948LOGPSL

**Model 3:** ROE=41.48662-2.917820LOGPSL

**Model 4:** PER= 24.61389-1.488744LOGPSL

**Model 5:** PBV= 1.167220+0.007494 LOGPSL

**Analysing appropriateness model**

**-----------------------------------**Insert Table 6 about here**--------------------------------------------**

Hausman test is used to ensure selection of appropriate panel data technique. **Table 6** presents the result of Hausman test; the chi-square statistic and corresponding probability value for each model. In the study the p-value=0.0000 for model 1, model 2 and model 3 suggest appropriateness of fixed effect model , while p-value of 0.0769 in case of model 4 and p-value for model 5 of 0.8304 suggest random effect model is appropriate.

**Overall Analysis**

The overall empirical results reveal negative coefficient of LOGPSL for almost all models, thus indicating a negative relationship between corporate social responsibility and corporate financial performance. Model 5 reveals that corporate social responsibility has a positive impact on price to book value of the firm, but the result is not statistically significant. Thus we reject the hypothesis that CSR has a positive impact on Financial Performance.

**Conclusion**

Corporate social responsibility is becoming mandatory now for all firms. Whether CSR is an investment for the firm to achieve profit in long run or an added expenditure with no benefit will require more research to establish the fact. The relationship between CSR and CFP has been addressed by many researchers mostly in the developed countries, while very few relates to Indian context. Corporate social responsibility in Indian banking industry is in embryonic stage. An inadequacy is noticed with regard to socially responsible practices by the banks and its reporting of such practices. Lack of reliable measure of CSR for evaluating the social responsibility practices for banks in India acts as a constraint.

**Limitation**

The present study is not free from certain undesirable factors. The panel data analysis was conducted on a relatively small number of sample -36 commercial banks of India and period of study was 8 years. This is a small data set to establish a relation between CSR and CFP.

**Suggestion for Future Research**

This study reveals a negative impact of CSR on financial performance in Indian banking industry. Thus more empirical works are required to add further to the existing perception on the impact of corporate social responsibility. The researchers are required to explore more extensively the other causal mechanisms linking CSR to profitability.

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## Tables

**Table 1: Description of Variables**

| Variables | Definition and computational formula | Symbols |
|---|---|---|
| | **Accounting Based Measure** | |
| **Return on assets ratio** | Computed by dividing net income by total assets. | **ROA** |
| **Return on equity ratio** | Computed by dividing net income by shareholder's equity. | **ROE** |
| | **Market Based Measure** | |
| **Earnings per share ratio** | Computed by dividing the net income by the total number of capital stock shares. | **EPS** |
| **Price/earnings ratio** | Computed by dividing the market value price per share by the earnings per share. | **PER** |
| **Price/book value ratio** | Computed by dividing the market value of equity to the book value of equity. | **PBKV** |
| | **Independent Variable** | |
| **CSR** | Log of Priority Sector Advances is taken as a proxy of CSR | **LogPSL** |

**Table 2: Descriptive Statistics**

| | EPS | LOGPSL | ROA | ROE | PER | PBV |
|---|---|---|---|---|---|---|
| **Mean** | 31.20351 | 10.07337 | 0.835521 | 12.09434 | 9.617222 | 1.242708 |
| **Median** | 18.34000 | 10.22127 | 0.865000 | 13.82500 | 7.300000 | 0.905000 |
| **Maximum** | 243.9200 | 12.70245 | 2.020000 | 28.26000 | 197.9000 | 7.170000 |
| **Minimum** | -83.01000 | 7.045446 | -1.840000 | -35.56000 | -19.00000 | -0.070000 |
| **Std. Dev.** | 42.04553 | 1.132558 | 0.687870 | 10.34724 | 13.93693 | 1.078400 |
| **Sum** | 8986.610 | 2901.130 | 240.6300 | 3483.170 | 2769.760 | 357.9000 |
| **Sum Sq. Dev.** | 507366.2 | 368.1310 | 135.7983 | 30727.75 | 55746.28 | 333.7659 |
| **Observations** | 288 | 288 | 288 | 288 | 288 | 288 |

**Table 3: Correlation Matrix**

| | EPS | LOGPSL | ROA | ROE | PER | PBV |
|---|---|---|---|---|---|---|
| **EPS** | 1.000000 | | | | | |
| **LOGPSL** | 0.290427 | 1.000000 | | | | |
| **ROA** | 0.448726 | -0.043034 | 1.000000 | | | |
| **ROE** | 0.470329 | -0.019855 | 0.880987 | 1.000000 | | |
| **PER** | -0.001202 | -0.147984 | 0.140787 | 0.051736 | 1.000000 | |
| **PBV** | 0.138837 | -0.020145 | 0.579074 | 0.300737 | 0.304498 | 1.000000 |

**Table 4: Panel Least Squares Analysis**

| | Dependent variables | | | | |
|---|---|---|---|---|---|
| | **Model 1** | **Model 2** | **Model 3** | **Model 4** | **Model 5** |
| | **EPS** | **ROA** | **ROE** | **PER** | **PBV** |
| **Constant** | 177.2547 | 5.165290 | 110.7874 | -5.182538 | 1.110052 |
| **t-stat (P-value)** | 4.205308 (0.0000) | 7.477367 (0.0000) | 9.378308 (0.0000) | -0.271858 (0.7860) | 1.623345 (0.1058) |
| **LogPSL** | -14.49874 | -0.429823 | -9.797426 | 1.469197 | 0.013169 |
| **t- stat (P-value)** | -3.467859 (0.0006) | -6.272996 (0.0000) | -8.361362 (0.0000) | 0.776981 (0.4379) | 0.194156 (0.8462) |
| **$R^2$** | 0.585029 | 0.583575 | 0.461804 | 0.227453 | 0.833979 |
| **Adj $R^2$** | 0.525511 | 0.523848 | 0.384613 | 0.116649 | 0.810168 |
| **F-stat (P- value)** | 9.829494 (0.000000) | 9.770813 (0.000000) | 5.982579 (0.000000) | 2.052755 (0.000762) | 35.02387 (0.000000) |
| **Durbin Watson stat** | 0.965172 | 0.796051 | 1.020295 | 2.738174 | 1.537419 |

**Table 5: Panel EGLS Cross Section Random Effect Analysis**

| | Dependent variables | | | | |
|---|---|---|---|---|---|
| | **Model 1** | **Model 2** | **Model 3** | **Model 4** | **Model 5** |
| | **EPS** | **ROA** | **ROE** | **PER** | **PBV** |
| **Constant** | 41.03824 | 3.192161 | 41.48662 | 24.61389 | 1.167220 |
| **t-stat (P-value)** | 1.316986 (0.1889) | 6.005560 (0.0000) | 5.668406 (0.0000) | 2.747262 (0.0064) | 1.792519 (0.0741) |
| **LogPSL** | -0.976310 | -0.233948 | -2.917820 | -1.488744 | 0.007494 |
| **t- stat (P-value)** | -0.319308 (0.7497) | -4.490838 (0.0000) | -4.051131 (0.0001) | -1.685529 (0.0930) | 0.120019 (0.9046) |
| **$R^2$** | 0.000331 | 0.062143 | 0.045995 | 0.009764 | 0.000051 |
| **Adj $R^2$** | -0.003164 | 0.058864 | 0.042659 | 0.006302 | -0.003446 |
| **F-stat (P- value)** | 0.094832 (0.758346) | 18.95064 (0.000019) | 13.78869 (0.000246) | 2.820006 (0.094188) | 0.014453 (0.904394) |
| **DurbinWatson stat** | 0.792992 | 0.658597 | 0.755230 | 2.383285 | 1.353988 |

**Table 6: Hausman Test Summary**

| | **Chi-Sq. Statistic** | **Chi-Sq. d.f** | **Prob.** |
|---|---|---|---|
| **Model 1** | 22.488659 | 1 | 0.0000 |
| **Model 2** | 19.366556 | 1 | 0.0000 |
| **Model 3** | 55.404741 | 1 | 0.0000 |
| **Model 4** | 3.129941 | 1 | 0.0769 |
| **Model 5** | 0.045889 | 1 | 0.8304 |