

The relationship between Corporate Social Responsibility and Financial performance in the banking sector in Zimbabwe

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Abstract – The study critically assessed a causal relationship between Corporate Social Responsibility (CSR) and firm's Financial Performance (FP) in the banking sector in Zimbabwe. Data was collected from annual reports and CSR score was obtained using content analysis. Pooled ordinary least squares model was used to analyse the relationship between CSR and FP. Company size and capital adequacy ratios were used as the control variables in the regression model. The study revealed that there is an insignificant negative relationship between CSR and FP (-0.0017: 0.193) at the 5% level of significance. The research findings also reveal that both capital structure and company size have a positive significant relationship with financial performance. CSR should be viewed as a philanthropic activity, not as a marketing strategy in the banking sector.

Keywords: Corporate Social Responsibility, Banking sector, Financial Performance, Return on Assets, Return on Equity, and Tobin's Q.

1.0 INTRODUCTION

Over the past three decades, numerous studies have been done on identifying the relationship that exists between CSR and FP. According to Margolis and Walsh (2003), from 1971 to 2001, more than 122 empirical studies have been reported on the relationship between CSR and FP. Empirical evidence provides conflicting results in the study area, other are saying there is a negative relationship (Cordeiro & Sarkis, 1997; Moore, 2001; Nelling & Webb, 2009) others a showing a positive relationship between the two variables (Ruff et al., 2001; Van der Laan et al., 2008; Waddock & Graves, 1997; Cheruiyot, 2010) whilst others say the is relationship a neutral one (Soana, 2011; Lioui and Sharma, 2012; Trang & Yekini, 2014). There are few studies on the relationship between CSR and FP in Zimbabwe, previously published studies on CSR have focused more on the effects of CSR on sustainable development (Kakava, et al. 2013) on reporting (Nyahunzvi, 2012), on company image (Mandina, et al. 2014), on profitability (Dlamini, 2016).

Lynes & Andrachuck (2008) noted that shareholders demand profits in pursuit of wealth maximization, hence entities are torn between social awareness and profit maximization. CSR practice can be viewed as a cost that reduces profit and shareholder value (Waddock & Graves, 1997), in such instance, CSR involvement will be insignificant. Those who are involved in CSR do so as a marketing strategy and those who are not involved believe it's a high cost that reduces profitability (Emilsson, Classon and Bredmar, 2012). Many banks have increased their spending on CSR activities in the past decade and much is being invested in social welfare. It remains unclear on the motivation behind CSR involvement, as this has become part of the bank's strategy. The question is; are banks involved in CSR as a marketing strategy or they actually care for social welfare? Different CSR activities have a different effect on the FP of the firm (Johansson, 2015). It is from the above background that the study sought to establish the causal relationship between CSR and FP in the banking sector in Zimbabwe. The findings and recommendations of the study will assist the banking sector in Zimbabwe on how CSR and FP related to each other. The paper is organized as follows; it gives the objectives of the study and briefly explains

CSR and its principles. It reveals the relationship between CSR and FP. Conclusions were made grounded on the findings of the study followed by recommendations.

2.0 LITERATURE REVIEW

CSR is a concept that integrates environmental and social issues in enterprise operations with voluntary consultation with stakeholders. This entails ameliorating the quality of your employees' welfare, society and the local community. Enterprises have economic responsibilities towards societies that endorsed their formation and sustenance. As enterprises operate, they should take cognisance of laws and regulations. According to Carroll (1991), ethical responsibility entails societal expectations over and above legal and economic expectations. Philanthropic responsibility involves enterprises participating in societal actions that are not obligatory by regulation and engrosses public giving.

2.1 Stakeholder Theory

According to Donaldson and Preston (1995), there are benefits to be obtained by participating in an enterprise as there lacks priority of one set of interest over the other. The stakeholder theory advocates the needs of stockholders and shareholders as interrelated. Thus the needs of shareholders (profit maximisation) cannot be attained by divorcing an entity from the society in which it operates. Companies are affected by stakeholder relationships that include environmental and social issues (Russo & Perini, 2010). Therefore, the success of organisations entails competent management of relationships with providers of finance, customers, employees, shareholders and societies (van Beurden and Gossling, 2008)

2.3 Friedman Theory

According to Freidman (1970), management responsibility lies with profit maximization for its owners. He propagated that management are not properly skilled in social capital but managerial capitalism hence divergence of objectives. Social issues are not the concern of business people. Freidman advocates a free market system with the Gross National Product (GNP) being the measure of social wealth. He states that in the event the free market system is unable to solve social issues, the government should cater to the needs of society.

2.4 Corporate Financial Performance (CFP)

Cochran and Wood (1984), argued that there is no best agreed way of measuring corporate financial performance. A study that was carried out by Orlitzky, Schmidt, and Rynes (2003), revealed that there are basically three forms of measuring financial performance, namely, market, survey and accounting measurements. There are various ratios that are used in measuring FP, this study will only consider tobin q, return on assets and return of equity.

2.4.1 Tobin Q

According to Wang et.al. (2014), Tobin Q is a measure of an entity's market based financial performance that evaluates the effectiveness of an entity in exploiting its net assets. It's computed as the firm's market value plus loans divided by its total assets. If the output equals 1, the firm's market value equals the replacement cost of assets. If the output is greater than 1, the market value exceeds the replacement cost of an entity's assets hence indicating that the business is overvalued. If the output is less than 1, the replacement cost of the entity's assets is lower than the market value, hence indicating the entity is undervalued (Wang et al, 2014).

$$\text{Tobin's } Q = (MVE + PS + DEBT) / TA$$

Where:

MVE = the firm's share price multiple of its common shares outstanding.

PS = the firm's liquidating value of the outstanding preferred stock.

DEBT = the firm's short – term liabilities and net short – term assets + the value of the long – term debts.

TA = the firm's total assets.

2.4.2 Return on assets

Return on Assets (ROA) is a frequently adopted measure for approximating an entity’s profitability as well as economic performance (Belu & Manescu, 2013). This is an indicator how profitable an entities is in relation to its utilisation of assets. ROA provides an indication on how efficient are the assets used in the generation of earnings. If the ROA is high it indicate that the entity efficiently utilise its assets.

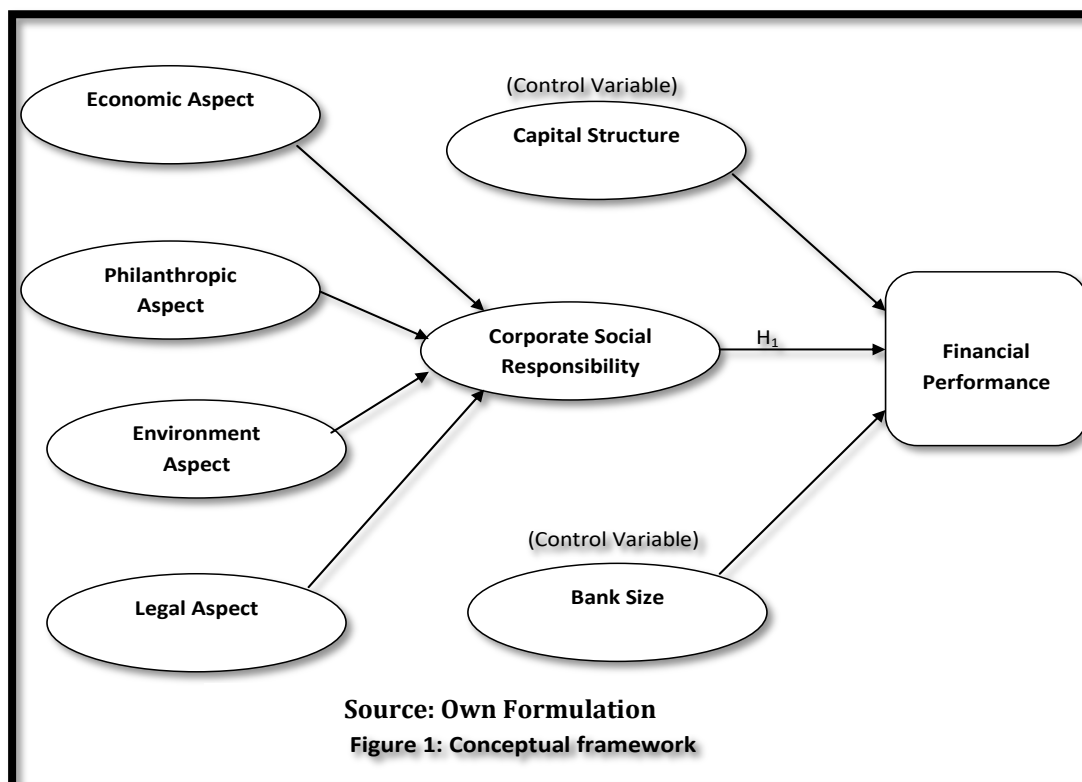
$$ROA = (\text{Net Profit} / \text{Total Assets}) * 100$$

2.4.3 Return on Equity

Return on Equity (ROE) measures an entity’s profitability that reflects profit generated taking into consideration shareholders’ funds. This ratio reveals the profit generated by an entity using the funds invested by the shareholder. ROE measures both profitability and efficiency, if the ratio rise, this is an indicator on how well the entity’s management is efficient on the utilisation of shareholders’ funds. It is however important to note that if the shareholders’ funds value goes down, return on equity goes up. A higher ROE is preferable, hence, a fall in the ratio is always a problem to the entity.

$$ROE = (\text{net profit} / \text{shareholders equity}) * 100$$

Figure 3: Conceptual model



H₁ - There is a positive relationship between CSR and FP

2.5 Relationship between CSR and FP

Researchers have sought to understand the relationship between CSR and FP, with positive implications outweighing the negative. Margolis and Walsh (2003) as well as Beurden and Gossling (2008) attest to CSR being positively correlated with CFP. Ofori, Nyuur and Darko (2014) studied Ghanaian banks and revealed CSR as being positively correlated with CFP although CFP depended on control variables such as growth, origin debt

ratio and size. Weshah et.al (2012) postulates a positive relationship between CSR, bank size, risk and CFP in Jordanian Banks. According to Malik and Nadeem (2014), a positive relationship exists between profitability utilising earnings per share, ROE, ROA and net profit with CSR. Ketocho (2015) discloses CSR expenditure as positively related to bank deposits, loans & advances and profit for the year of CRDB Bank in Tanzania. According to Ahmed, Islam and Hasan (2012), there is an insignificant positive correlation between CSR and CFP from sampled Bangladesh banks. Mosaïd and Boutti (2012) studied 8 Islamic banks from 2009 to 2010 and unearthed an insignificant statistical relationship involving performance indices (ROA & ROE) with CSR. Rahman, Rashid and Haque (2014) assert CSR as having no significant impact on profit after tax of Jamuna Bank Limited (Bangladesh). Madugba and Okafor (2016) establish earnings per share and dividends per share as having a significant negative relationship with CSR, while positively related with CSR on return on capital employed in their study of Nigeria Listed banks from 2010 to 2014.

3.0 METHODOLOGY

The annual reports and audited financial statements from 2014 to 2018 for five listed banks in Zimbabwe were used in the study. The use of annual reports on data collection for CSR is identical with prior studies (Guthrie & Parker, 1990; Hackston & Milne, 1990; Christopher, et al., 1997; Thompson and Zakaria, 2004; Saleh, et al., 2008; Abiodun, 2012; Bolanle, et al., 2012; Dlamini, 2016). The content analysis was used in the evaluation of textual data so as to derive the CSR score on components reported by the bank on corporate social responsibility (Tesch, 1990); (Hsieh and Shannon, 2005) (Saleh, et al., 2008) (Mwangi and Jerotich, 2013). Nyahunzvi (2013); Holcomb et al., 2010; Maphosa, (1997); Mwanza and Mugumisi (2014) used content analysis in their studies and this is worth noting especially on the measure of CSR score.

Random effects model versus pooled ordinary least squares was tested using a Lagrange multiplier test; p-value = 1. For the fixed effects model the F-test was used, p-value = 0.2657 which is greater than 0.05, as a result the two were dropped. Pooled ordinary least squares model was estimated using Stata to determine the relationship between CSR and FP where the following variables were used; ROA, ROE, market to book ratio (Tobin's Q). Two control variables; company size and capital adequacy ratios (as determined by RBZ) were also introduced in the regression model. Previous studies on the relationship between CSR and FP; ROA and ROE are commonly used as the measure for financial performance (Waddock & Graves, 1997; Griffin & Mahon, 1997; Simpson and Kohres, 2002; Tsoutsoura, 2004). Tobin's q was also used by Elsayed and Paton (2004), in examining the environmental disclosure on the firm's financial performance. McGuire *et al.*, (1988); Yoshikawa and Phan, (2003); Saleh, et al., (2008); Cavaco & Crifo, (2009); Hirigoyen and Poulain-Rehm, (2015); used both accounting ratios and the market to book ratio to measure financial performance.

Model:

$$F_p = \beta_0 + \beta_1 CSR + \beta_2 Co.Size + \beta_3 Cap.Stru + \varepsilon$$

Where:

F_p : Financial performance

CSR: Corporate social responsibility

Co.siz: Company size

Cap.stru: capital structure

3.0 RESULTS AND DISCUSSIONS

The regression equation established was as follows:

$$F_p = -2.9425 - 0.0017CSR + 0.3696Co.Size + 1.5038Cap.Stru$$

Results summary

Table 1: Regression Statistics

Root MSE	R Square	Adjusted R Square	Prob> F
0.12452	0.844	0.8014	0.0001

Table 2: Regression co-efficient

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t- Stat</i>	<i>P-value</i>
Co Size	0.3696305	0.0992128	3.73	0.003
CSR	-0.0017437	0.0012564	-1.39	0.193
Cap Struct (adequacy ratio)	1.503763	0.4309781	3.49	0.005
Constant	-2.942475	0.8367622	-3.52	0.005

The pooled ordinary least squares regression model results as shown in Table 1 above were used to evaluate the relationship between CSR and FP, capital structure and company size and in the banking sector in Zimbabwe. The results revealed ($p < 0.0005$, adjusted R-squared=0.8014). The model was therefore found to be significant at 5%. The model reveals that corporate social responsibility has an insignificant negative relationship with financial performance (-0.0017: 0.193) at 5% level of significance. The model also revealed that capital structure and company size has a positive significant relationship with financial performance (1.5038:0.005), (0.3696:0.003) respectively. These results are consistent with the findings by Cordeiro & Sarkis, 1997; Nelling and Webb, 2009; Makni *et al.* 2009; Mwangi *et al.*, 2013; Hirigoyen and Poulain-Rehm, 2015 who found that there is a negative insignificant relationship between CSR and FP.

4.0 CONCLUSIONS AND RECOMMENDATIONS

From the findings, it can be concluded that corporate social responsibility has an insignificant negative impact on financial performance. The results suggest that financial advantage in the banking sector is not derived by investing more in CSR but being ethically in CSR without sacrificing financial performance is critical in the sector. CSR should be compulsory for all banks and should be viewed as a philanthropically activity, not as a way to enhance financial performance or a marketing strategy in the banking sector. The research findings also reveal that both capital structure and company size have a positive significant relationship with FP. Future studies should be conducted on other sectors so that a conclusion can be drawn about how companies relate to CSR in Zimbabwe.

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