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Corporate social responsibility expenditures and its impact on financial performance variables of listed commercial banks in Nepal

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ABSTRACT

Financial institutions, such as banks, hold significant position in the economy and are subject to increasing expectations from shareholders. As a result, it is crucial to understand how CSR influences the financial aspects of banking operations. Corporate social responsibility (CSR) is often viewed as a self-regulatory approach that is incorporated into the business models of companies and organizations. The primary objective of this research is to evaluate the impact of CSR on the financial performance of various commercial banks in Nepal. The study utilizes data from all commercial banks in Nepal over a three-year timeframe, spanning from 2020 to 2022. For many businesses, CSR serves as a forward-thinking business strategy and marketing tool that aids in achieving a competitive edge. Research results have demonstrated a notable and substantial influence of CSR on ROA and EPS. However, we found no relationship of CSR expenses on commercial banks' ROE. Most of the research on corporate social responsibility focuses on established companies and countries, while developing nations like Nepal receive minimal attention. The findings of this study significantly add to the existing knowledge and provide crucial insights for policy makers and governance of financial sector.

KEYWORDS: CSR, Financial Performance, Commercial Banks, Financial indicators

1. INTRODUCTION

Corporate Social Responsibility (CSR) is a business approach that involves companies voluntarily regulating themselves in order to maintain transparency and be held accountable to the broader community The connection between businesses and society/environment has been a topic of discussion since the mid-twentieth century (Zhang et al., 2019). The concept of corporate social responsibility (CSR) was initially introduced in 1953 by HR Bowen in his book "Social Responsibilities of the Business". Bowen provided an initial explanation of the social responsibilities of businessman, which refers to their obligation to pursue policies, make decisions, or take actions that align with the objectives and values of society as a whole (Khatun, 2014). The European Commission defines CSR as "a concept by which companies integrate social and environmental concerns in their operations and in their interaction with stakeholders on a voluntary basis" (Khong, Yeoh & McCabe, 2019). When a company engages itself in CSR, it takes responsibility for its actions to improve environment, the community in which it operates, and the society at large. Corporate Social Responsibility (CSR) is a multifaceted concept that encompasses not just economic aspects, but also non-financial elements, including community engagement and employee relations (Saeidi et al., 2015). CSR has four fundamentals layer in a pyramid structure: economic responsibilities, legal responsibilities, ethical responsibilities, and philanthropic responsibilities (Carroll, 1991).

Many developing nations, including Nepal, rely heavily on their banking industry to drive economic growth. Nepal is situated between the emerging economies of China and India, with a diverse geography that ranges from high mountain ranges to flat plains. The majority of Nepalese citizens (over 80%) are engaged in agriculture, with the remaining working in service and manufacturing industries. Banks are the main contributors to government tax revenue in Nepal and provide most of the funding to private sector borrowers.

Banks, much like other major corporations, have a substantial influence on various aspects of society and play a vital role in maintaining the stability of the financial system. Beyond simply safeguarding funds, financial institutions also invest them to create income and ensure that resources are utilized efficiently to encourage economic development. However, the impact of bank deposits and investments can have both positive and negative consequences for society. Therefore, CSR is relevant within the financial system. The objective of this research is to examine how CSR is linked to the financial performance of banking sector in Nepal. This research attempts to understand the influence of corporate social responsibility on the profitability of commercial banks within the Nepalese context.

2. OBJECTIVES OF THE STUDY

The aim of this study is to investigate the effect of CSR spending on the financial performance of commercial banks in Nepal. Consequently, the study's objectives are as follows:

- To understand the present state of CSR in Nepal.
- To ascertain whether CSR expenditures influence the overall financial performance of the commercial banks in Nepal.

3. REVIEW OF LITERATURE

3.1 CSR in Nepal

Nepal is currently facing numerous social and economic issues, including political and economic instability, insufficient healthcare and education resources, corruption, substandard living conditions, pollution of water sources resulting from improper disposal of industrial waste, and deforestation. As a result, it is crucial to encourage research on CSR in Nepal to raise awareness and emphasize the significance of CSR to the general public and regulatory entities. Although businesses in Nepal have traditionally addressed some CSR issues through philanthropy, the formal concept of CSR is relatively new (Shrestha, 2005). In Hinduism, the concept of philanthropy is deeply ingrained, as evidenced by references to philanthropic kings and sages in ancient scriptures. The religion recognizes that giving and sharing bring happiness. There is a word daan in Nepali which is translated as philanthropy in English. Daan is deeply rooted in Hinduism. Traditional community development practices of social responsibility and volunteerism are deeply rooted in Nepalese society (Biggs & Messerschmidt, 2005). In earlier times, the business community in Nepal strongly believed that their business should be beneficial not only to themselves but also to the buyers and the society as a whole. This was reflected in various philanthropic acts such as constructing wells for drinking water, providing rest areas for travelers and porters, establishing lodges for pilgrims, donating land and money for schools, hospitals, orphanages, and old age homes, and performing traditional rituals of giving to the poor. The concept of maintaining a philanthropic account, known as Dharmadi Khata, was also prevalent in their accounting system (Kharel, 2005:33). As a result, even today, charitable donations continue to be an integral part of Nepalese businesses.

Despite being regarded as voluntary, CSR has become mandatory in many countries through the enactment of laws with different provisions. These laws can pertain to labor, environment, consumer protection, human rights, and other areas (Lin, 2021). Tamvada (2020) maintains that a regulatory framework is necessary to ensure effective CSR since voluntarism has not produced the intended results, and this framework should be based on legal theories of morality. Nepal Rastra Bank (NRB) implemented a CSR directive in the financial year 2016/17, marking its first introduction. Under the most recent NRB guidelines, Bank and financial institutions must establish a CSR fund and allocate at least 1% of net profit to be spent on designated CSR initiatives in the following fiscal year. Additionally, they must disclose details about the CSR fund and expenditures from it in their yearly financial statements.In Nepal, except for Banking and financial institutions regulated by NRB, CSR is not mandatory, so most Nepalese companies do not disclose their CSR activities in their yearly reports, although some exceptions exist. However, certain joint ventures and foreign multinational corporations disclose their CSR practices as a requirement from their parent companies. In present, it has been observed that Nepalese companies have started disclosing their CSR activities more frequently than before, particularly after Nepal joined the World Trade Organization (WTO).

CSR in Nepal in general is characterized by the low level of awareness. CSR is perceived primarily as charitable giving and considered as after profit add-on activity. Nepali entrepreneurs view CSR as a luxury exclusive to large and wealthy corporations, deeming it unattainable for small and medium-sized businesses. They perceive CSR as supplementary activities or pursuits undertaken after generating profits, rather than an integral component of daily business operations or the manner in which businesses function. Rather than genuinely addressing social concerns, businesses aim to gain media exposure through charitable contributions. In Nepal, it is not uncommon for companies to engage in various unethical practices while simultaneously donating to social causes. In Nepal, there is a noticeable lack of expertise in the field of CSR. Research studies are scarce, and there is a minimal number of training programs, discussions, seminars, and workshops available. Furthermore, business colleges seldom offer courses focused on CSR.

3.2 Financial performance (FP)

According to Mutende et al. (2017), FP refers to the capacity of a company to attain its projected financial outcomes in comparison to its desired outcomes. According to the literature, there are two main perspectives for evaluating financial performance: accounting and market. These two approaches are widely recognized as important economic measures of a company's performance. Researchers have concluded that these measures are not closely related statistically and represent two different dimensions of a company's FP (Gentry & Shen, 2010). Market-based measures reflect stockholders' perceptions and do not necessarily reflect a company's intrinsic value, whereas accounting returns represent short-term profitability that is specific to the company (Inoue & Lee, 2011; Richard et al., 2009).

Efficient use of resources and increased revenue are the criteria used to evaluate a bank's financial performance. The performance of both companies and banks can be measured using financial statements and annual reports as fundamental tools. While net income is the primary indicator of a company's overall performance, other factors can also be used to assess its financial health. Metrics such as Return on Assets (ROA), Return on Equity (ROE), Earnings per Share (EPS), Net profit margin (NPM), Price Earnings Ratio (PER), Tobin’s Q, market value, invested capital, and earnings before interest (EBITDA) are some of the measures used to evaluate FP (Khan & Tariq, 2017).

ROA serves as a key measure of a company's performance, as noted by Al-Matari et al. (2014). This metric assesses the effectiveness and application of a firm's assets and acts as a reference point for gauging the returns generated from new asset investments. The metric employed to evaluate a firm's effectiveness in generating earnings for its stockholders is known as ROE. A favorable ROE is considered to be above 12%, indicating a strong rate of return. Earnings per share (EPS) denotes the segment of a corporation's profits, after deducting taxes and preferred stock dividends, apportioned to each unit of common stock

3.3 CSR and financial performance

The contemporary literature extensively investigates the relationship between CSR and FP. The significance of the relationship between FP and CSR practices lies in its ability to guide businesses and companies in deciding whether to adopt CSR practices or not (Matten and Moon, 2020). Researchers have examined whether the connection between CSR and FP is neutral, positive or negative, but there is no agreement among scholars (Ullmann, 1985). Three schools of thought have emerged in the CSR literature. The first school believes that there is a positive correlation between CSR and FP (Murtaza et al., 2014; Fu and Shen, 2015; Yusoff and Adamu, 2016). Uadiale and Fagbemi (2012) analysis of the effect of CSR in developing countries demonstrates a substantial and favorable correlation between CSR and FP. Implementing CSR practices positively impacts a company's overall efficiency and competitiveness, subsequently leading to better FP for the organization (Kang, Germann and Grewal, 2016). The second group found that there was a negative relationship between CSR and FP, and they support the idea of maximizing a company's profits by utilizing its resources. They do not support the idea of allocating resources towards CSR (Babaloba, 2012; Hirigoyen and Poulain- Rehm, 2014). In their research, Oyewumi et al. (2018) examine the link between corporate philanthropy and the FP of businesses in the banking sector. They use FP as the dependent variable and expenditures on CSR as the independent variable, and at the same time, they also consider firm size and tangibility as controlling factors. Their findings suggest that CSR negatively affects the financial performance of banks. The third perspective examined the neutral correlation between CSR and FP, identified a variety of relationships, and recommended taking into account several other factors that could hinder researchers from reaching a definitive conclusion (Allen, 2014; Adeneye and Ahamad, 2015).

As the literature presents conflicting findings regarding the correlation between CSR and FP, the hypothesis being examined is as follows:

- *H1: Banks in Nepal exhibit a positive and significant relationship between their CSR expenses and their ROA.*
- *H2: Banks in Nepal exhibit a positive and significant relationship between their CSR expenses and their ROE.*
- *H3: Banks in Nepal exhibit a positive and significant relationship between their CSR expenses and their EPS.*

Research theoretical framework

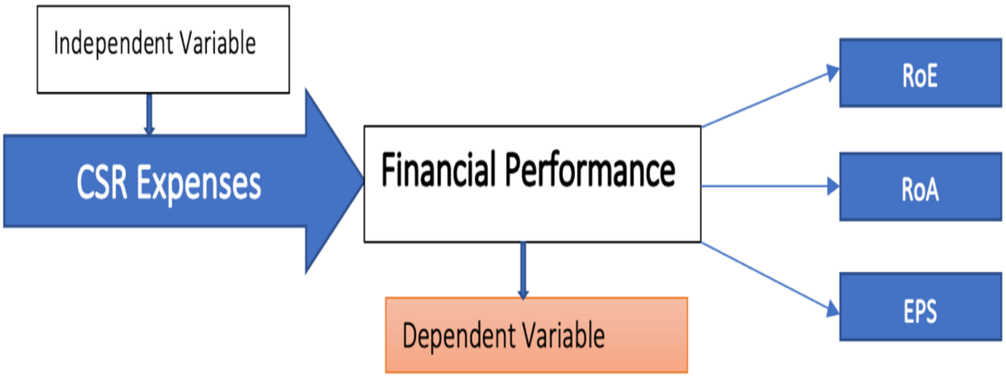

Figure 1: Proposed theoretical framework

Figure 1 displays a framework concerning the suggested conceptual model employed in this study. It can be asserted that the investment in CSR initiatives is viewed as the independent variable, while the financial performance of an organization serves as the dependent variable. ROE, ROA, and EPS are the proxies in measuring FP.

4. RESEARCH METHODOLOGY

There are various proxies used in literature for the measurement of CSR. Some researchers rely on corporate donations and actual spending on CSR activities to serve as proxy variables for assessing CSR (Brammer and Millington, 2008; Joseph et al., 2016; Oyewumi et al., 2018). La Rosa et al. (2017) employs a social score to measure CSR, while Jin et al. (2017) uses a social capital index. The MSCI KLD 400 Social Index is another commonly used proxy to measure CSR (Zhou et al. 2015). In order to assess the effects of CSR expenditures on the FP of banks, financial indicators from all the listed commercial banks in Nepal were taken. We chose to use a census approach as opposed to a sampling approach due to the relatively small number of commercial banks in Nepal.

The data, gathered from respective bank's annual reports for the period 2020 to 2022, included CSR spending and financial indicators such as return on assets (ROA), return on equity (ROE), and earnings per share (EPS). Descriptive statistics were employed to evaluate companies' CSR expenditures, while a regression model was utilized to determine the relationship between CSR spending and financial variables. The regression model illustrated the significance of CSR investments on these financial indicators. Lastly, a correlation analysis was conducted to determine if the selected financial variables had a positive or negative association with the CSR spending of companies over the past three years, from 2020 to 2022. In the study, a 95% confidence level has been adopted to determine the outcome.

Based on the study's characteristics and research goals, the subsequent econometric model is utilized to assess the hypothesis:

$$FP_{i,t} = \beta_0 + \beta_1 CSR_{i,t} + \vartheta_{i,t}$$

In order to operationalize the research objective, the regression equation is further broken down into three distinct equations, each corresponding to a different proxy of FP. FP stands for Financial Performance, with ROA signifying returns on assets, ROE representing return on equity, and EPS indicating earnings per share. These variables are considered dependent, while CSR serves as the independent variable. The error term in the regression equations is denoted by $\vartheta_{i,t}$.

$$RoE_{i,t} = \beta_0 + \beta_1 CSR_{i,t} + \vartheta_{i,t}$$
$$RoA_{i,t} = \beta_0 + \beta_1 CSR_{i,t} + \vartheta_{i,t}$$
$$EPS_{i,t} = \beta_0 + \beta_1 CSR_{i,t} + \vartheta_{i,t}$$

The data for CSR and its impact on financial performance of commercial banks in Nepal varies across three different years comprising of 21 different commercial banks. Thus, the data used in the analysis will be both cross sectional and times series in nature which is called as Panel data. We will be applying pooled ordinary least squares regression for analyzing the impact of CSR fund on financial performance. In the above equations, i represents different banks and t represents different time period in annual terms. $\vartheta_{i,t}$ represents error term in the model.

We pool all 63 observations and estimate one big OLS for each FP indicators. As the data used comprises of total population of "A" class commercial banks and these banks share similar characteristics, certain assumptions are made which are listed as below.

- Regression coefficient are same for all Commercial banks. Thus, we believe no likelihood of heterogeneity exists i.e., each commercial bank has same characteristics in terms of CSR spending as it is a regulatory mandate dictated by the central bank of Nepal, NRB.

- Regressors are non-stochastic i.e., errors are not corelated with explanatory variables.

$$CoV\ (\vartheta_{i,t}, CSR_{i,t}) = 0$$

- Error term has a zero mean and constant variance.

5. RESULTS AND DISCUSSION

Table 1 shows that Banks in Nepal spend an average Rs. 30.2 million towards CSR in the last three years. The average minimum spending of the Banks was 8.83 million and the maximum average spending was 79.7 million.

Table 1: Corporate Social Responsibility Spending Descriptive statistics (2020-2022)

CSR(x) Descriptive Statistics	
Mean	30.2114494
Standard Error	2.1944728
Median	26.3617874
Standard Deviation	17.4180879
Sample Variance	303.389785
Kurtosis	0.70046741
Skewness	1.05668583
Range	70.8353149
Minimum	8.88349987
Maximum	79.7188147
Sum	1903.32131
Count	63

Amount in Million

The p-value in Table-2 is less than 0.05 ($P\ value_{ROA}$=0.00560704) which indicates that there is significant relationship between CSR expenses and ROA of commercial banks of Nepal. Hypothesis H1 is supported. However, a R^2 value of 11.9% indicates that not much of the variability in ROA is explained by the CSR expenses and there is a great deal of unexplained variance in the proposed model.

Table 2: Impact of CSR on ROA

$$RoA_{i,t} = \beta_0 + \beta_1 CSR_{i,t} + \vartheta_{i,t}$$

ANOVA						
	df	*ss*	*MS*	*F*	*Significance F*	
Regression	1	0.468557054	0.46855705	8.24671768	0.005607041	
Residual	61	3.465861373	0.0568174			
Total	62	3.934418426				
	Coefficients	*Standard Error*	*t stat*	*P-value*	*Lower 95%*	*Upper 95%*
Intercept	1.07289432	0.060488281	17.7372262	9.2845E-26	0.951940531	1.19384812
CSR	0.00499097	0.001737978	2.87170989	0.00560704	0.001515667	0.00846627

Regression Statistics	
Multiple R	0.34509683
R Square	0.11909182
Adjusted R Square	0.1046507
Standard Error	0.23836401
Observations	63

The p-value in Table-3 is greater than 0.05 ($P\ value_{ROE}$=0.7448057) which indicates that there is no relationship between CSR expenses and ROE of commercial banks of Nepal. Hypothesis H2 is rejected. However, a R^2 value of 0.01% indicates no variability in ROE is explained by the CSR expenses and there is a great deal of unexplained variance in the proposed model. The results are opposite to the study done by Asatryan and Březinová (2014) which states that CSR expenses improves the ROE of commercial banks. These results are at the same time are in line with those produced by García-Castro et al. (2010).

Table 3: Impact of CSR on ROE

$$RoE_{i,t} = \beta_0 + \beta_1 CSR_{i,t} + \vartheta_{i,t}$$

ANOVA						
	df	*ss*	*MS*	*F*	*Significance F*	
Regression	1	1.35299323	1.3529932	0.106913	0.744805697	
Residual	61	771.959804	12.655078			
Total	62	773.312797				
	Coefficients	*Standard Error*	*t stat*	*P-value*	*Lower 95%*	*Upper 95%*
Intercept	13.21245	0.90274063	14.635937	1.2669E-21	11.4073144	15.017597
CSR	0.0084810	0.02593797	0.3269756	0.7448057	-0.04338515	0.06034728

Regression Statistics	
Multiple R	0.0418283
R Square	0.00174961
Adjusted R Square	-0.0146152
Standard Error	3.55739775
Observations	63

The p-value in Table-4 is less than 0.05 ($P\ value_{EPS}$ =0.01518004) which indicates that there is significant relationship between CSR expenses and EPS of commercial banks of Nepal. Hypothesis H3 is supported. However, a R^2 value of 9% indicates small variability in EPS is explained by the CSR expenses and there is a great deal of unexplained variance in the proposed model. The findings also align with the outcomes of earlier research (Murtaza et al., 2014; Kiran et al., 2015; Jie and Hasan, 2016).

Table 4: Impact of CSR on EPS

$$EPS_{i,t} = \beta_0 + \beta_1 CSR_{i,t} + \vartheta_{i,t}$$

ANOVA						
	df	*ss*	*MS*	*F*	*Significance F*	
Regression	1	332.287521	332.28752	6.2427682	0.015180039	
Residual	61	3246.88311	53.227592			
Total	62	3579.170636				
	Coefficients	*Standard Error*	*t stat*	*P-value*	*Lower 95%*	*Upper 95%*
Intercept	17.5451957	1.851394534	9.47674598	1.3367E-13	13.84310353	21.2472879
CSR	0.13291093	0.053195156	2.49855323	0.01518004	0.02654064	0.23928122

Regression Statistics	
Multiple R	0.30469534

R Square	0.09283925
Adjusted R Square	0.07796776
Standard Error	7.29572423
Observations	63

Table 5 displays the correlation between the CSR expenditures of Nepalese commercial banks and financial performance metrics like ROA, ROE, and EPS. In order to examine the association between these factors, financial data from 2020 to 2022 was gathered, as well as the CSR expenditures of the companies. The average of each financial variable over the three-year period was computed, together with the average CSR spending by the firms.

Table 5: Correlation Analysis

	CSR(x)	*RoE(Y)*	*RoA(Y)*	*EPS(Y)*
CSR(x)	1			
RoE(Y)	0.0418283	1		
RoA(Y)	0.34509683	0.450972131	1	
EPS(Y)	0.30469534	0.71777669	0.48366024	1

6. CONCLUSION

Corporate social responsibility (CSR) encompasses various dimensions and has seen an increasing level of attention in recent years. Businesses implementing corporate social responsibility (CSR) strategies have recognized the significance of establishing and safeguarding their corporate image by employing CSR practices, moving away from the conventional notion of a company that solely concentrated on financial results. While CSR is typically viewed as a voluntary endeavor, an expanding number of nations have implemented legislation related to CSR initiatives, characterized by diverse elements. In most cases, CSR provisions are integrated into corporate law. Over the past three years, banks have, on average, allocated more than one percent of their net profits to their CSR funds. As a result, the banking sector has exceeded the minimum contribution requirements for CSR funds established by the NRB. Concurrently, the overall size of CSR funds has grown and is expected to continue expanding. If properly utilized and safeguarded against misuse, these CSR funds can substantially contribute to the socio-economic advancement of Nepalese communities.

In the study, the various financial performance indicators examined display different impacts on CSR. We conclude that CSR expenses have positive relationship with ROA and EPS but doesn’t show any relationship with ROE. The relationship between CSR and FP has been thoroughly researched. This expands the body of knowledge on the connection between CSR and the performance of business, supporting stakeholder theory, which promotes the positive impact of CSR on business performance.

Nonetheless, the findings remain inconclusive, potentially due to the negligence of the effects of mediating variable. It is crucial to conduct research and experimentation on the topic of a company's social responsibility, given the ongoing discussions about its impact. As businesses shift their focus from solely maximizing profits, they are recognizing the significance of Corporate Social Responsibility (CSR). It is necessary to quantify and evaluate the advantages of CSR. This study aims to establish a connection between CSR and financial performance.

This study investigated the potential link between investments in CSR and financial performance among banks. The findings could provide valuable insights to both bank executives and researchers interested in CSR's impact on strategic decision-making. The study's outcomes could also aid bank leaders from Nepal in their ongoing efforts to create positive social impact within their communities. It makes sense because CSR could play a crucial role in addressing developmental challenges in Nepal, such as high joblessness, inadequate healthcare services, poverty, inadequate education quality, lack of access to clean and safe drinking water, and insufficient social amenities in disadvantaged communities across the nation.

7.LIMITATIONS

A primary limitation of the current study is its reliance on secondary research. Another significant constraint is the data's time frame, as the researcher only considered information from a three-year period up to 2022. A more extensive investigation might have included data spanning 10 years, but the researcher has chosen to limit their analysis to a 3-year timeframe. The researcher has opted to focus on a small number of variables like ROA, ROE and EPS despite the presence of other potentially relevant factors, including inventory turnover, current ratio, quick ratio and more. This, too, serves as another limitation in the research.

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