Importance of Corporate Social Responsibility in the Banking Industry of Pakistan

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Abstract

The main purpose of this study is to examine the relationship of corporate social responsibility (CSR) with financial performance (FP), financial inclusion (FI), and financial stability (FS) of conventional banks of Pakistan. The study used a structural equation modeling (SEM) technique on panel data for the period 2008-2020 using 18 conventional banks listed in the Security and Exchange Commission of Pakistan (SECP). SEM is considered as one of the best tools to identify multilevel relations. The result shows that CSR initiatives lead to an increase in financial performance, financial inclusion, and financial stability in conventional banks. The empirical findings further suggest that banks with higher CSR spending and disclosure have higher financial performance, financial stability and financial inclusion. Therefore, the banking industry may need to use CSR as an effective tool to improve financial inclusion, financial performance, and financial stability. The findings prove that corporate social responsibility initiatives are important to increase financial inclusion within economies. In addition, it also helps to improve workplace behaviors of banking industry as well.

Keywords: Corporate Social Responsibility, financial inclusion, financial performance, financial stability, banks, structural equation modeling.

1. Introduction

The banking sector is a vital component of economic development. Banks are assisting in enhancing productive investments and encouraging the effective channelization of scarce resources to boost productive industries. However, the crucial concern for any firm including banks is sustainability. In a recent study, Ahmad (2021) highlighted the importance of incorporating sustainability and stability in their operations. Similarly, with an increase in globalization, the pressure on the banking sector has increased to maintain high financial performance, enhance financial stability, and ensure financial inclusion. This means banks need to concentrate on doing ways that will enable them to gain and maintain a competitive edge and ensure survival in the dynamic and ever-changing environment.

On the other hand, for any firm including bank, corporate social responsibility (CSR) is gaining a prominent position. It not only includes philanthropic activities, but is also concerned with ethical, moral, and legal aspects that a firm may take care of while operating (Liu, Zhen, Changhui, Tao, & Wan, 2020). It has been observed that the banks involved in CSR activities are preferred by customers because of their positive image in minds of stakeholders. Previous study of Gerda and Dalia (2020) highlighted a significant and positive relationship between CSR and financial performance. Similarly, banks increase and improve their services leading to more customer satisfaction which in return positively affect the financial performance of the banks (Nguyen, Kim-Duc, & Freiburghaus, 2020). Financial performance works as a barometer for the investor while making their investment decisions. In the banking sector, performance is used as a basis for future growth making. It is essential for banks to have stable financial standing and efficient and effective procedures.

CSR spending leads to more deposits that reduce the default risk of the banks. This increases financial inclusion and financial stability of banks (Hasanul, Kabir, Rubi, & Rabiul, 2021). Similarly, CSR incorporated into the decision-making process help to improve the good brand image of the bank (Contini, Annunziata, Rizzi, & Frey, 2020). Furthermore, banks incorporate green practices, fulfill regulatory requirements, take care of employees and society, avoid unethical, illegal activities and participate in philanthropic activities. All these activities and actions are part of CSR initiatives. Similarly, if a bank is not financially stable, it may not be able to perform activities at its full potential. Unstable banks cannot survive in a dynamic and turbulent environment. Financial stability enables banks to capitalize on opportunities. It also enables banks to survive even in the economic downturn. Likewise, CSR is one of the important factors that lead to an increase in financial stability. Therefore, banks incorporate CSR activities in their operations to become financially stable.

Financial inclusion leads to the provision of financial services to everyone equally. This increases financial inclusion and financial stability (Hasanul, & Rabiul, 2021). It helps financial institutions including banks to attract and retain more customers leading to increasing deposits and serving more customers. It involves opening more branches leading to better access of customers to the facility. According to Van et al (2020), wider financial inclusion means easily accessible financial services like more branches. This leads to increased financial stability and increases financial performance.

On the other hand, financial stability is also crucial for banks for the smooth and effective running of concerning operations, overcoming any discrepancies in the economic environment, and enhancing the chance of survival in the dynamic environment. However, financial inclusion refers to the provision of availability of financial services to everyone equally leading to more customers which leads to increased performance of the financial institutions. Financial stability, financial performance, and financial inclusion are positively affected by CSR initiatives.

Banks always strive to make strategies that can help them enhance their financial performance and stability. In the modern era, banks also make efforts to increase the well-being of the public through different CSR activities (Hasanul, & Rabiul, 2021). Banks are also making strategies to increase financial inclusion. Banks that are not involved in CSR initiatives are unable to reach their full potential. However, less evidence is available in the literature to study the impact of CSR on financial performance, inclusion, and stability in the banking sector of Pakistan. Therefore, this study aims to fill this gap. The main objective of the current research is to find out the impact of CSR on the Financial Performance, Financial Stability, and Financial Inclusion of banks of Pakistan. Structural Equation Modeling (SEM) technique is used to achieve the objective of the study. The control variables used in the study are age of the bank, size, and leverage. The findings of the study indicate that banks involved in CSR have better financial performance, financial stability, and financial inclusion.

After explaining the introduction in the first section, second section includes literature review consisting of various literatures available on the relevant variables and research hypotheses. The third section consists of the research methodology consisting of the econometric equation, data collection methods, and data collection techniques. Forth section consists of empirical results that incorporate data analysis and results. The fifth section consists of the conclusion and recommendations of the study.

2. Literature Review

The aim of this chapter is to shed a light on existing research that supports and contradicts the topic of this research. CSR governance is necessary for implementing good strategies for the enhancement of financial performance (Zhihong, & Joseph, 2017). The aim of CSR is to have a positive contribution towards external factors, by doing this firm increase financial and non-financial outcome (Akisik, & Gal, 2011). Old theories of financial perspective focus on the maximization of profit of the firms whereas modern theories focus on stakeholder orientated approach to firms (Paltrinieri, Dreassi, Migliavacca, & Piserà, 2020). Less literature is available on the aforesaid relationship in the past. It is important to shed light on this relationship to increase the financial performance of the banks.

2.1 CSR and Financial Performance

Firms can reduce costs (Barnett & Salomon, 2012) and increase the satisfaction of the customers (Servaes & Tamayo, 2013), employee's commitment and productivity (Youn, Lee, & Lee, 2018) through CSR. The impact of SCR on financial performance is talk of the time in finance (Cuypers, Koh, & Wang, 2016). Banks improved their services leading to more customer satisfaction which in return positively affected the financial performance of the banks.

According to Chen & Wang (2011), CSR has a positive and significant impact on the financial performance of firms. It is observed in Greek firms that the connection of CSR without the performance of financial institutions is dependent on the size, type, and nature of financial institutions (Karagiorgos, 2010). A firm's fintech philanthropy development generates an ecosystem that is digital enabling financial stability via a culture of financial inclusion (Gabor & Brooks, 2016). A firm's biggest motivation to participate in CSR is corporate social responsibility itself (Wu & Shen, 2013). CSR in banks also results in increasing the financial stability of banks (Elizabeth, Christopher, & Andrew, 2019). Therefore, first hypothesis of the study is:

H_1: CSR has a positive effect on the Financial Performance of banks.

2.2 CSR and Financial Stability

As discussed previously, the actual objective of financial institutions is to enhance financial stability. The integration of globalization and capital market via financial institutions results in an increase in financial stability. It was concluded that financial institutions with positive social performance have more financial stability (Chollet, & Sandwidi, 2018). Therefore, the banking sector increases CSR spending leading to increased deposits enabling financial institutions to survive the crisis situation resulting in more financial stability and financial inclusion.

H_2: CSR has a positive effect on the Financial Stability of banks.

2.3 CSR and Financial Inclusion

As discussed previously, inclusive growth, financial strength, and economic development are the main advantage of financial inclusion. Financial inclusion provides access to savings, credit, transactions, payments, and insurance to unbanked adults. Financial stability is increased by the increasing level of FI by enabling avilablity of financial products and services to many people. Reduced cost, increased revenue, and expansion of market share are some factors resulting from financial inclusion (Duc, Nhan, & Loan, 2021).Financial inclusion leads to increasing saving and deposits leading to an increase in the financial stability of financial institutions. Morgan and Pontines (2014) examined the relationship between financial inclusion and financial stability with CSR. Their results proved a positive and significant relationship between financial stability, financial inclusion, and CSR. This literature supports the importance of CSR to increase financial stability. Therefore, it is important to study the relationship of CSR with the financial stability of banks. Financial inclusion is certainly related to stability and equal income (Neaime, & Gaysset, 2018). When low income people have access to financial services which improves their economic condition. It mitigates equality in income levels (Linyang, 2018). Similarly, wider financial inclusion means easily accessible financial services like more branches. This leads to increased financial stability and increases financial performance indicating the importance of incorporating CSR as it increases FI, FS, and FP. From above arguments, our last hypothesis is:

H_3: CSR has a positive effect on the Financial Inclusion of banks.

2.4 Resource-based View

The underpinning conjecture that impacts concerned topic is resource-based view. The resource-based view is deeply rooted in internal firm resources, competitive advantage, and firm performance (Gaurav, Kevin, Yaw, & Cynthia, 2018). This study uses the theoretical lens of a resource-based view to reach the hypotheses. Resource-based review analyses internal sources of the firm and puts emphasis on resources and capabilities in designing a strategy to attain sustainable competitive advantages through activities that are effective as well as efficient. Following the same school of thought, the current study investigates the impact of CSR activities on the financial performance, financial stability, and financial inclusion on the banking industry of Pakistan using the structural equation modeling.

According to Ahmad et al., (2021), as banks are homogenous in nature, creating loyal customers in banking industry is challenging. Therefore, banks that participate in CSR activities have a competitive edge over banks that ignore CSR. It helps in gaining a good public image and results in increasing the profit of the bank. Gerda, & Dalia, (2020) found that firm's financial performance has a positive relationship with the CSR activities conducted by the firm. In another study Yadong et al., (2021) explained the effect of CSR on Financial Institution's Financial

Performance using fintech as moderating variable in China. When endogeneity issues were addressed, it was found that there is a positive association between CSR and Financial Performance, financial stability, and financial inclusion (Wei, Xuefeng, Macro, & Wen, 2020).

Relatively less literature is available that discusses how CSR impacts financial performance, financial stability, and financial inclusion together in the banking sector of Pakistan. So this study clarifies the effect of CSR on Financial Institution's Financial Performance, Financial Stability, and Financial Inclusion in Pakistan using control variables such as age, size, as well as leverage. On the basis of the previous studies following conceptual framework is established for this research.

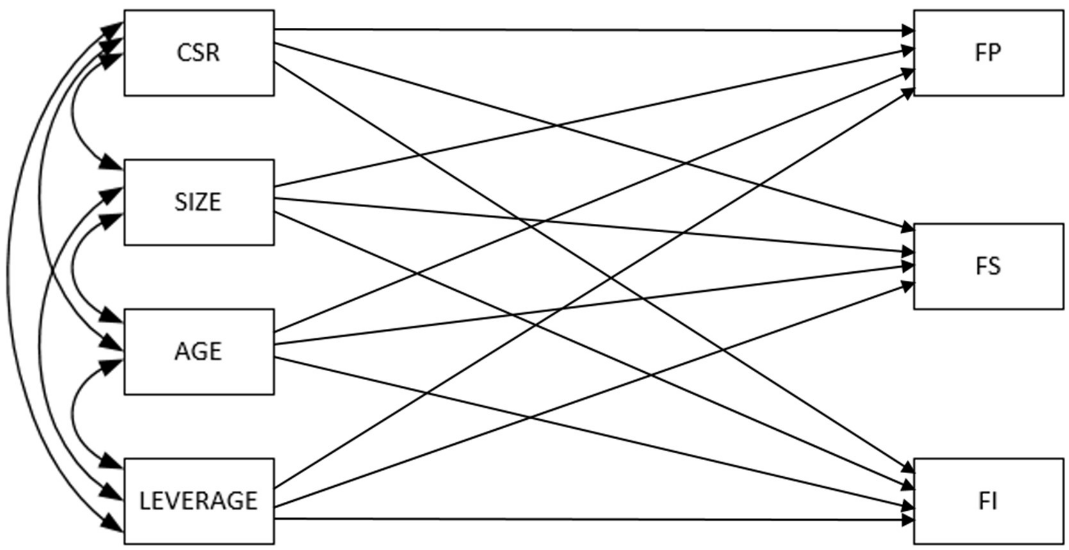

Figure 1 - Conceptual framework

In the figure, CSR stands for corporate social responsibility, FP is financial performance, FS stands for financial stability, and FI is financial inclusion.

3. Research Methodology

The study used a structural equation modeling (SEM) approach on panel data for the period 2008-2020. This time period is taken because of the lack of availability of CSR disclosure and reporting for previous years to examine the relationship of corporate social responsibility (CSR) with financial performance (FP), financial inclusion (FI) and financial stability (FS). 234 observations were made considering 18 banks listed in the Security and Exchange Commission of Pakistan (SECP). Data related to the variables used in the study were taken from the websites of the respective banks or SECP.

According to Rebecca & Paul (2006), the SEM is the best to approach to analyzing multilevel relationships. This model enabled the analysis of all variables at once increasing the accuracy of the findings as it is more advance than simple regression analyses. It studies the linear causal relationship of independent variables with dependent variables. Stata 14 was used to interpret data by using SEM panel regression to analyze and summarize data to report the results and suggest conclusions. It is best suited for this study as it can analyze the multi-level relationship of variables simultaneously. The structural equation model is a multivariate statistical analysis technique in which structured relationships are analyzed. It measures all relationships among variables and latent constructs at the same time.

The study uses an advanced method structural equation model (SEM) while analyzing the impact of corporate social responsibility on Financial Institution's Financial Performance, Financial Stability as well as Financial Inclusion including the current time frame in order to observe the effect of above-stated relationship.

3.1 Econometric equation

Following econometric models are developed for this research:

1 $FP_{it} = \beta + \beta 1 \log CSR_{it} + \beta 2 \log Leverage_{it} + \beta 3 \log Age_{it} + \beta 4 \log Size_{it} + e_{it}$

2 $Z\text{-}score_{it} = \alpha + \alpha 1 \log CSR_{it} + \alpha 2 \log Leverage_{it} + \alpha 3 \log Age_{it} + \alpha 4 \log Size_{it} + e_{it}$

3 $FI_{it} = \gamma + \gamma 1 \log CSR_{it} + \gamma 2 \log Leverage_{it} + \gamma 3 \log Age_{it} + \gamma 4 \log Size_{it} + e_{it}$

In the above equations, FP stands for Financial Performance. The proxy used for financial performance is is the return on equity as it shows financial performance of the financial institution. FS stands for Financial Stability measured by Z-score, and FI stands for Financial Inclusion. The proxy used for financial inclusion is the number of bank branches, CSR stands for corporate social responsibility and e is error term.

3.2 Data collection methods

Data was collected using secondary sources including annual reports, financial statements, balance sheets, and websites of banks. Variables used in this study have the following description and measurement.

Following Table 1 shows the descriptions of variables and their measurement:

Table. 1 Description and measurement of variables

Variable nature	Variables	Proxy
Independent variable	Corporate Social Responsibility	CSR spending and donations
Dependent variables	Financial performance	ROE
	Financial stability	Z-score
	Financial inclusion	Number of branches
Control variables	Size	Log of total assets
	Age	Number of operating years
	Leverage	Division of total debt from total assets

CSR can be measured in different ways like social score, social capital index, MSCL KLD 400 social index, and corporate donation and spending on CSR. In Pakistan, CSR-related disclosure is inadequate as it is still not commonly practiced. Disclosure is still in the developmental stages as there is voluntary nature of disclosure. Therefore, in the Pakistan context, corporate donation and actual spending is the best measure for CSR.

3.3 Data analyses techniques

Statistical analysis (mean, median, mode, standard deviation, maximum value, minimum value, skewness, and kurtosis), Correlation analysis and SEM regression analysis are also conducted on secondary panel data.

4. Discussion and Analysis

4.1 Data analysis and results

Following Table 2 shows the summary statistics of the data being analyzed:

Table.2 Summary statistics

	MEAN	STD. DEV.	MIN	MAX	SKW	KURT
Corporate Social Responsibility	.643	0.077	0.451	.789	-.479	2.71
Financial Inclusion	547.50	520.58	20.00	1751	.905	2.32
Financial Performance	.087	.24	-1.99	9.64	6.39	48.18
Z-score	11.10	9.55	-1.99	.57	-4.13	31.77
Size	19.80	1.28	16.80	23.06	-.072	2.70
Age	40.78	34.83	1.00	158	1.77	6.16
Leverage	.88	.22	0.09	1.57	-1.61	9.18

CSR captures the initiatives taken by banks to contribute toward the betterment of society. CSR is calculated by taking the log of actual corporate spending and donations. The maximum value of CSR is 1 whereas the minimum value may be zero. CSR mean is = .643 whereas standard deviation is .077. Financial inclusion is calculated by taking the total number of branches indicates the total branches of each financial institution for the concerned period. The mean of the number of branches is 547.5 whereas the standard deviation is 520.58. Skewness and kurtosis is .905 and 2.32 respectively. Skewness is near zero showing data is symmetrical and is slightly right-skewed. Financial performance (FP) provides insights to investors about the efficiency of the bank in spending shareholders' money. The skewness value shows that the data is highly right-skewed. Kurtosis value is leptokurtic and highly peaked

The correlation matrix is reported in Table 3, which indicates the value of the correlation coefficient (r) and tells us about the strength of the relationship and the directions of the relationship. CSR and FI indicate the positive relationship with the strength of .56 which is statistically significantly different from zero. This relationship between CSR and the FI is significant which shows that 95% of data shows this relationship. The correlation of CSR with Z score is reported as .05 which is also positive showing that with the increase in CSR the financial stability of a financial institution is increased. The relationship is also significant. FP has a significant negative relationship with Z-score with strength of .14. Z-score has a positive relationship with age with the strength of .18 and is significant. Size and age have a positive significant relationship with each other with the strength of .47.

Table. 3 Correlation matrix

Correlation matric of the research is shown in following Table 3:

	CSR	FI	FP	Z-score	Size	Age	Leverage
Corporate Social Responsibility	1						
Financial Inclusion	0.56*	1					
Financial Performance	0.13*	-0.029	1				
Z-score	0.05*	0.086	-0.14*	1			
Size	0.70*	0.79*	0.046	-0.073	1		
Age	0.51*	0.39*	-0.048	0.18*	0.47*	1	
Leverage	0.067	-0.086	0.024	0.094	-0.12	0.0014	1

**indicate significant at level 0.10*

Following Table 4 shows a regression analysis of the data under analysis:

Table. 4 Regression analysis

	Coef.	Std.Err.	Z	P>z	[95%Conf.	Interval]
Financial stability						
CSR	12.169	5.623	2.164	0.010	-10.611	34.949
Size	-1.886	0.689	-2.740	0.006	-3.236	-0.536
Age	0.069	0.020	3.370	0.001	0.029	0.108
Leverage	2.550	2.834	0.900	0.368	-3.005	8.104
_cons	35.591	11.038	3.220	0.001	13.957	57.225
Financial Inclusion						
CSR	0.995	0.494	2.014	0.007	-0.170	2.159
Size	0.074	0.035	2.090	0.037	0.005	0.143
Age	-0.003	0.001	-2.700	0.007	-0.005	-0.001
Leverage	-0.491	0.145	-3.390	0.001	-0.775	-0.207
_cons	0.946	0.564	1.680	0.094	-0.160	2.052
Financial Performance						
CSR	0.970	0.271	3.580	0.000	0.438	1.501
Size	0.019	0.016	1.150	0.249	-0.013	0.050
Age	-0.000	0.000	-0.020	0.985	-0.001	0.001
Leverage	-0.141	0.066	-2.130	0.033	-0.270	-0.011
_cons	-0.778	0.257	-3.020	0.003	-1.282	-0.273

LR test of model vs. saturated: chi2(15) = 463.04, Prob > chi2 = 0.0000

The findings of the SEM analysis show that there is a significant and positive impact of CSR on financial performance where the coefficient of regression is .970, and the standard deviation is .271. A value of Z-score more than 1.96 is considered acceptable for significant impact. In the case of Z-score value, Z-score is 3.580 which is significant. The value of probability is .000 which is less than 0.05. This supports the finding of Ramzan et al. (2021), Ofori et al. (2014), and Fu &

Shen, (2015) who suggested that increased CSR leads to increased financial performance. It is also in line with the results of (Chung et al., 2019; Fauzi & Idris, 2009; Rhou et al., 2016) that support positive effect of CSR in FP. Findings indicate that banks spending more on CSR have higher financial performance. The results imply that banks that need to increase their financial performance may achieve that by increasing CSR spending. Customers will have positive perceptions of these banks and in return, their financial performance will increase. This result also encourages regulators to take initiatives to increase the CSR activities of the banking industry. Financial performance has a significant negative relationship with age and leverage which indicates that with more operating years financial performance decreases as banks are unable to maintain quality operating standards as well as a higher levels of debt decrease the financial performance of the bank. Whereas it has a significant positive relationship with the size of the bank which means when size increases financial performance also increases because banks are able to achieve higher performance by serving more customers due to the increase in their size. The findings of this study support H1, which says that CSR has a positive effect on the financial performance of the financial institution. The results are also consistent with the findings of (Mallin et al., 2013; Uadiale et al., 2012; Adewale & Rahmon 2014).

There is a significant and positive relationship between financial stability and CSR. When CSR spending is high customer trust organization leads to the stable financial standing of the firm due to loyal customers. The results support the findings of (Chollet & Sandwidi, 2018; Orazalin et al., 2019; Visser, 2008; Saidane & Abdallah, 2021). The results indicate that financial institutions with higher CSR spending are more financially stable. Financial inclusion has a negative relationship with the age of the bank. Financial stability has a significant and positive relationship with age and leverage implying that when the size and leverage of a financial institution increase financial stability also increases as the bigger the size the spending on CSR initiatives leads to making the financial institutions more financially stable. The finding supports H2, which stated that CSR has a positive effect on the financial stability of the financial institution. Banks can improve their financial stability by increasing CSR initiatives and spending. The results of this study are also consistent with the findings of (Lev et al., 2010; Goun & Ho, 2018), which proved that with the increase in social spending the financial risk decreases.

The relationship of CSR with financial inclusion (number of branches) is significant and positive where the coefficient of regression is .995, the standard deviation is .494. This finding supports the results of Van der Werff et al., (2013), Ullah (2013), Srinivasan, (2021), Bhattacharyya & Wright, (2021) and Halder et al., (2016) who observed that CSR has a significant positive relationship with financial inclusion. This indicates that banks with more spending on CSR activities have a higher level of financial inclusion. The number of branches has a significant positive relationship with CSR and the size of the financial institution implying that with more branches financial inclusion will increase which is facilitated by higher spending on CSR initiatives. Similarly, number of branches has a negative relationship with the size and leverage of the banks. The number of employees has a positive and significant relation with CSR. These findings encourage regulators to make policies deporting procedures to increase CSR spending and disclosure in the banking sector in order to achieve higher financial stability, financial performance, and financial inclusion. Finally, the finding supports H3, which stated that CSR has a positive effect on the financial inclusion of the financial institution. Results are in line with the study conducted by (Campbell 2000; Halder et al., 2016; Bihari & Pradhan, 2011; Mukherjee, 2012) in which the positive effect of CSR spending on financial inclusion was explained for firms.

5. Discussion

The findings of this study suggest that CSR has a significant positive relationship with FP. The findings show that CSR creates a favorable image of the financial institution in the mind of the potential and existing customers with enables a financial institution to attract them leading to an increase in the financial performance of the bank. Banks that are spending more on corporate social activities and making more donations can develop strong relationships with their customers. Increased CSR activities result in the reduction of financial risk which leads to an increase in the financial stability of the bank. As more people are encouraged to trust those banks having higher CSR initiatives leading to more financial stability as compared to banks ignoring this aspect.

The current study also shows that CSR has a significant impact on financial inclusion. Banks having a large number of branches are better able to serve customers and are capturing more customers leading to an increase in their deposits leading to an increase in the financial inclusion of the bank. This research will contribute to the existing literature by highlighting the importance of CSR activities and initiatives in the banking sector as well. It will enable us to better understand how CSR can improve financial stability, financial inclusion, and financial performance of the banking sector. Future researchers can expand the topic by studying the same variables in different sector and comparing it with the banking sector. Different controlled variables can be used to study their impact on the given relationship. Moreover, CSR's impact on other variables like bank liquidity, credit risk, customer loyalty, and employee job satisfaction can be studied in the banking sector and other financial institutions.

5.1 Implications

The findings of this study have various implications. The results may help the regulatory body to understand the importance of CSR in order to encourage the banking sector to increase its participation in CSR activities. The results demonstrate that CSR initiatives are key ingredients to enhancing financial performance, financial stability, and financial inclusion in the banking sector. The findings of the study are helpful for the banks as well as it highlight the means to gain a competitive edge over competitors and gain loyal customers. It helps shareholders to invest in the firm that are good corporate citizens. It also encourages concerned firms to invest more in CSR to gain trust and a good image in society in order to increase the organization's goodwill.

5.2 Limitations of Study

The results of the study suggest banks having higher CSR spending have higher financial stability, performance, and inclusion. In light of the results, it is recommended that the central bank, and legislative and regulatory bodies may monitor the bank's CSR activities and disclosure. Along with this proper mechanism should be developed to report CSR spending. It is also recommended to make proper CSR compliance reports with a standard reporting structure that may be monitored by stakeholders especially shareholders before investing in the stocks to encourage banks to make CSR activities part of their operations. It is recommended that government may monitor and encourage banks to provide their services in rural and underprivileged areas to increase financial inclusion. By offering rewards and certificates banks can be encouraged to involve in CSR activities more than they already do. Data is the main limitation of the study. In future study maybe repeated by adding macroeconomic control variables.

5.3 Conclusion

Firms have to incorporate CSR in their operations to achieve a higher level of financial performance, financial stability, and financial inclusion. CSR includes fulfilling ethical, legal, and economic duties. Firms need to incorporate green practices, fulfill all regulatory requirements, take care of employees and society, work on employee and society wellbeing, avoid unethical as well as illegal activities and participate in philanthropic activities to fulfill the CSR aspects. The firms incorporating CSR have a competitive edge in terms of FP, FS as well as FI over firms that are neglecting CSR initiatives.

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