

**THE EFFECT OF CORPORATE SOCIAL RESPONSIBILITY ON  
FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN  
KENYA**

**KIPRUTO DANIEL**

**D63/60179/2013**

**A RESEARCH PROJECT SUBMITTED IN PARTIAL  
FULFILLMENT OF THE REQUIREMENT FOR THE AWARD OF  
THE DEGREE OF MASTER OF SCIENCE IN FINANCE, SCHOOL  
OF BUSINESS, UNIVERSITY OF NAIROBI**

**OCTOBER, 2014**

## **DECLARATION**

This research project is my original work and has not been submitted for examination in any other University or institution of higher learning. No part of this research project can be reproduced without prior written permission of the author and/ or University of Nairobi.

Signature .....

Date .....

**Kipruto Daniel**

**D63/60179/2013**

This research project has been submitted for examination with my approval as the supervisor.

Signature .....

Date .....

**Mirie Mwangi**

## **ACKNOWLEDGEMENT**

I am grateful to God for the gift of good health, strength and ability to complete this project. My gratitude goes to my supervisor, Mirie Mwangi, for his time in guiding me through this exercise. I also acknowledge my workmates, Moris Avusah and Stephen Kabiru, for the role they played in collecting data. I also acknowledge Lecturers in School of Business, University of Nairobi for the role they played towards the success of this research project. May God bless you abundantly.

## **DEDICATION**

This work is dedicated to my grandfather, the late Rev. Nashon Lijondo Kihima, for mentoring and instilling in me the spirit of hardworking and the importance of education from my tender age. May his soul rest in eternal peace. I also dedicate this work to my mother Mebo Kangahi, my lovely wife Faith Chebet and my beloved son Abel Kimaru. May this work inspire you to great achievements.

## TABLE OF CONTENTS

Declaration.....	ii
Acknowledgement.....	iii
Dedication.....	iv
List of Tables .....	viii
List of Figures .....	ix
Abbreviations .....	x
Abstract.....	xi

### CHAPTER ONE

INTRODUCTION.....	1
1.1. Background to the Study.....	1
1.1.1. Corporate Social Responsibility.....	2
1.1.2. Financial Performance.....	3
1.1.3. Corporate Social Responsibility and Financial Performance.....	4
1.1.4. Commercial Banks in Kenya.....	6
1.2. Research Problem.....	7
1.3. Objective of the Study.....	10
1.4. Value of Study.....	11

## CHAPTER TWO

LITERATURE REVIEW.....	12
2.1. Introduction.....	12
2.2. Theoretical Review.....	12
2.2.1. The Theory of Social Costs.....	12
2.2.2. Agency Theory.....	14
2.2.3. Stakeholder Theory.....	15
2.2.4. Relational Theory.....	17
2.3. Determinants of Financial Performance of Commercial Banks.....	19
2.4. Empirical Literature.....	20
2.5. Summary of Literature Review.....	27

## CHAPTER THREE

RESEARCH METHODOLOGY.....	28
3.1. Introduction.....	28
3.2. Research Design.....	28
3.3. Target Population and Sample Design.....	28
3.4. Data Collection Procedures.....	29
3.5. Data Analysis .....	29

## CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION.....	30
4.1. Introduction.....	30
4.2. Response Rate.....	30
4.3. Descriptive Statistics.....	31
4.4. Correlation Analysis.....	33
4.5. Regression Analysis and Hypothesis Testing.....	33
4.6. Discussion of Research Findings.....	36

## CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS.....	37
5.1. Introduction.....	37
5.2. Summary of the Findings.....	37
5.3. Conclusion.....	39
5.4. Recommendations.....	40
5.5. Limitations of the Study.....	42
5.6. Suggestions for Further Research.....	43
REFERENCES.....	44
APPENDIX I: Commercial Banks in Kenya.....	52
APPENDIX II: Representative Offices of Foreign Banks.....	53
APPENDIX III: Data Used for Study.....	54

## **LIST OF TABLES**

Table 4.1: Descriptive statistics for overall CSR

Table 4.2: Descriptive statistics for investments

Table 4.3: Descriptive statistics for overall financial performance

Table 4.4: Descriptive statistics for overall financial performance, CSR and investments

Table 4.5: Analysis of variance



## **LIST OF FIGURES**

Figure 4.1: Correlation matrix between the variables

Figure 4.2: Coefficient of determination

Figure 4.3: Standard error, t-ratio and P- Values

## **ABBREVIATIONS**

ANOVA	Analysis of Variance
CBK	Central Bank of Kenya
CEO	Chief Executive Officer
CFP	Corporate Financial Performance
CSP	Corporate Social Performance
CSR	Corporate Social Responsibility
Df	Degrees of freedom
GDP	Gross Domestic Product
KBA	Kenya Bankers Association
MBA	Master of Business Administration
Min	Minimum
Max	Maximum
NPBT	Net Profits Before Tax
NPM	Net Profit Margin
NSE	Nairobi Securities Exchange
ROA	Return On Assets
ROE	Return On Equity
ROI	Return On Investment
SCB	Standard Chartered Bank
SCSR	Strategic Corporate Social Responsibility
Sig	Significance
SME	Small and Medium Enterprises
Std	Standard deviation
UK	United Kingdom
US	United States of America

## **ABSTRACT**

The study intended to determine the effect of corporate social responsibility on financial performance of commercial banks in Kenya. Financial performance was measured by use of net profits before taxes obtained from audited statements of comprehensive income. For uniformity purposes, net profits before taxes was chosen since some commercial banks had treated expenses on CSR as tax exempt while others had not. Investments were measured by considering loans to customers (except to other banks and corporations), investment in treasury bonds and government securities, investment in shares for trading purposes and investment in subsidiaries. Investment in CSR was measured using monetary spending on social activities. Data was obtained from commercial banks audited financial statements, websites, publications and annual reports. Commercial institutions that did not participate in CSR activities or that had not kept data pertaining to CSR were excluded. Secondary data from the year 2009 to 2013 was used for analysis. Using descriptive research design, the study tested for linear relationship between financial performance and corporate social responsibility. The study used multiple regression analysis and the five years secondary data to analyze the effect of corporate social involvement on financial performance. Financial performance was the dependent variable while corporate social responsibility and investments were the independent variables in the multi linear regression. The study revealed that not all commercial banks report their CSR involvement. Out of the 44 commercial banks studied, only eight provided the necessary and complete data that was appropriate for the study. The study findings were that expenses on social course have an effect on financial performance of commercial banks in Kenya.

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1. Background to the Study**

Corporate social responsibility has become a common practice among most financial institutions in Kenya. It is one of the newest management strategies where companies try to create a positive impact on society while doing business. Holme and Watts (2000) defined CSR as the continuous commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as the local community and society at large. Businesses can use ethical decision making to secure their businesses by making decisions that allow for government agencies to minimize their involvement in the corporation. Several reasons have been advanced to explain why commercial institutions voluntarily engage in social activities. Most companies practice social activities to satisfy their primary needs of presenting themselves as legitimate members of society (Bowen, 1953). This legitimacy has led companies to pursue their primary purpose of seeking sustainable profitability.

Leaving aside the fact that the corporate sector provides significant economic benefits to society, there are growing concerns that larger society provides great opportunities for companies to use public resources to operate their businesses (Carroll, 1979). Some experts are of the idea that most rules and regulations are formed due to public outcry, which threatens profit maximization and therefore the well-being of the shareholder and that if there were no outcry, there would be little regulation (Carroll, 1999). A firm is not socially responsible if it merely complies with the minimum required of the law, because

this is what a good citizen would do. Eilbert and Paret (1973) tried to make a better understanding as to what social responsibility really meant by using the expression “good neighborliness”. They explained that “good neighborliness” entailed two meanings. First, “not doing things that spoil the neighborhood” and second, “the commitment of business in general, to an active role in the solution of board social problems, such as racial discrimination, pollution, transportation, or urban decay”.

### **1.1.1. Corporate Social Responsibility**

CSR is an ethical theory that an entity has an obligation to act in a way that benefits the society. It is a duty that every individual has to perform so as to maintain a balance between the economy and the ecosystems. A trade-off always exists between economic development, in the material sense, and the welfare of the society and environment. Social responsibility means sustaining the equilibrium between the two. It pertains not only to business organizations but also to everyone whose action impacts the environment (Bowen, 1953). CSR activities can be grouped into four main categories: economic, legal, ethical and philanthropic. Such classification assumes abiding by the CSR principles, where company’s responsibility towards the society is based on normal profit maximization, following the legal rules, and moral responsibility as well as philanthropic activities. CSR as a concept is based on relationship between business world and society, and on behaviour of company’s towards its main interest groups such as: employees, buyers, investors, suppliers, local community and special interest groups (Carroll, 1991).

In order for organization to be sustainable it must be financially secure, decrease its negative environmental impact and act in conformity with the expectations of society. Although the prime focus of business is generating profits, corporations can contribute to social and environmental goals by applying corporate social responsibility as a strategic line in their core business practices, corporate governance, and management instruments (Waddock and Graves, 1997). According to Carroll (1979), businesses encompass economic, legal, ethical and discretionary expectations that society has of organization at any given time. Businesses can use ethical decision making to secure their businesses by making decisions that allow for government agencies to minimize their involvement with the corporation. The best definition of CSR is that by Bowen (1953) where corporate social responsibility is described as achieving commercial success in ways that honour ethical values and respect people, communities, and the natural environment.

### **1.1.2. Financial Performance**

The term “financial performance” is a composite of an organization’s financial health, its ability and willingness to meet its long term financial obligations and its commitments to provide services in the foreseeable future. Long-term objectives represent the results expected from pursuing certain strategies which represent actions to be taken to accomplish long-term objectives. The time frame for objectives and strategies should be consistent, usually from two to five years (Weber, 2008). Financial performance refers to the act of performing financial activity. In broader sense, financial performance refers to the degree to which financial objectives being or has been accomplished. It is the process of measuring the results of a firm's policies and operations in monetary terms.

Accounting based indicators such as ROA, ROE and ROI capture a firm's internal efficiency. These indicators are used to measure firm's overall financial health over a given period of time and can also be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. ROA is used to measure the efficiency of assets in producing income while ROE measures the performance of the firm relative to shareholder investment (Marshall, 1920). Some of the limitations of accounting measures are that they only capture historical aspects of the firm's performance, are subject to bias from managerial manipulation and the differences in accounting procedures (McGuire, Schneeweis and Hill, 1986). Accounting measures are also inward looking since they largely reflect the efficiency of internal decisions and therefore do not reflect external market responses to organization (Branch, 1983). Despite the limitations of Accounting based measures, accounting based measures are better predictors for CSR than market based measures (Moore and Spence, 2006).

### **1.1.3. Corporate Social Responsibility and Financial Performance**

Some researchers have argued that CSR can improve the competitiveness of a company in the long run, implying a positive relationship between the CSR involvement of a company and its financial success (Weber, 2008). The relationship between CSR and financial performance represents the least understood area of CSR (Angelidis, Massetti and Magee-Egan, 2008). While studies suggest a mild positive relationship (Orlizky, 2003), this connection has not been fully established and the mechanisms through which firm's financial performance can be enhanced through CSR is not well understood (Jawahar and McLoughlin, 2001). Most researchers argue that good corporate reputations

have strategic value for firms that possess them (Rumelt, 1987). Firms with assets that are valuable and possess a competitive advantage may expect to earn superior returns (Neville, Bell and Menguc, 2005). Those whose assets are difficult to imitate may also achieve sustained superior financial performance (Barney, 1991).

The viewpoint for positive correlation between CSR and CFP suggest that a company's explicit costs are opposite of the hidden costs of stakeholders (Briloff, 1972). Therefore, this viewpoint is proposed from the perspective of avoiding cost to major stakeholders and considering their satisfaction (Cornell and Shapiro, 1987). Commitment to CSR would result to increased costs to competitiveness and decrease the hidden cost of stakeholders. Bowman and Haire (1975) pointed out that some stakeholders regard CSR as a symbol of reputation and the company reputation was improved by actions to support the community resulting in positive influence on revenue. Jensen and Meckling (1976) had an opinion that businesses can turn a social problem into long term economic opportunity and economic benefits, productive capacity, human competence, well paid jobs and wealth.

Bowman and Haire (1975) realised that companies devoting a medium amount of resources to CSR reported highest ROE indicating, an inverted "U" shape relationship between CSR and financial performance. Theoretically, CSR is expected to improve a firm's financial performance in the long run. A firm is expected to gain entry into new but volatile markets, stay competitive, maintain its customers apart from increased revenue, and maintain a better brand image in the eyes of its customers, better



understanding of customers' wants and how to turn those wants into needs. Consumers have responded in ways that have undeniably shifted CSR from 'trend' to 'expectation'.

#### **1.1.4. Commercial Banks in Kenya**

There are 44 commercial banks in Kenya out of which 31 are locally owned, while 13 are foreign owned. Three of the locally owned banks are publicly owned by shareholders while twenty eight are private. Nine of the foreign owned banks are locally incorporated. In addition to the forty four financial institutions, there are seven representative offices of foreign banks (CBK, 2014).

Commercial Banks have taken keen interest in CSR in the last few years. This is evident from their annual reports and websites where they provide a statement on their CSR involvement. In most of their end of year financial reports, they dedicate pages highlighting their contributions to CSR. These institutions have engaged in activities that include education and leadership development, financial literacy and access, entrepreneurship, agriculture, Health, innovation, environmental sustainability, enterprise development, humanitarian intervention, business ethics, community development and corporate governance and workplace issues.

Commercial banks in Kenya commit their resources to treasury bills and bonds, loans and advances, securities, foreign currencies as their major investments apart from owning subsidiaries and joint associations with other organizations. These are considered as the major sources of income for commercial banks. The banking act requires all commercial

banks not to advance loans in excess of 80% of deposits while at the same time deposit a minimum amount with central bank of Kenya. The minimum deposit is determined by CBK. Deposit protection act requires all commercial banks to insure all cash held by them. Every bank is required to have a minimum capital of Ksh 250 Million and must retain a core capital of at least 8% of total deposit liabilities (CBK, 2014).

## **1.2. Research Problem**

Literature has attempted to explain the economic benefits of having a sound long term financial success and has explored its effect on real sector outcomes, including national economic growth and income distribution. Financial institutions with good operating results and strategies can reduce screening and monitoring costs and diversify risk across different projects and overcome liquidity risks which ultimately provide savers with high return. Having long term financial success can attract investment in long-term projects while allowing investors access to their savings at short-term notice (Levine, 1991). These institutions allow cross-sectional diversification across projects, allowing risky innovative activity while guaranteeing contracted interest rate to savers (King and Levine, 1993). Financial institutions can boost the rate of technological innovation by identifying the entrepreneurs with most promising technologies. Successful institutions can help reduce liquidity risk and enable long-term investment (Diamond and Dybvig, 1983). Banks with sound long term performance can offer job security to its employees, create new employment opportunities, assure government of continuous revenue apart from satisfying their shareholders' expectations. Goldsmith (1969) demonstrated empirically the positive correlation between sound long term financial performance and

GDP per capita. Reduced control problems of investors, owners and managers of enterprises through improved corporate governance can also increase savings and capital accumulation.

Even though the banking industry is one of the most profitable within the economy, higher performance could be achieved by engaging in social activities (Grant, 1991). There is no reason to believe that shareholders are willing to tolerate an amount of corporate non-profit activity which appreciably reduces either dividends or the market performance of the stock (Hetherington, 1973). Therefore, when a company increases its costs by improving CSR in order to increase competitive advantage, such CSR activities can enhance company reputation, thus, in the long run CFP can be improved by sacrificing the short term CFP (Balabanis, Philips and Lyall, 1998). Today, businesses that embrace CSR continue to see positive results such as; enhanced reputation, increased sales and customer loyalty, Competitive edge, Strengthened relationships and expanded market share. This drives the bottom line as people care about how an organization conducts business. All organizations have an impact on society and the environment through their operations, products and services and through their interaction with key stakeholders (Fox, Mumo and Kavwanga, 2005). Institutions can enhance CSR as part of marketing strategy. As such CSR is important in all firms (Moore and Spence, 2006). Research points to a positive relationship between CSR and financial performance. Investment in CSR can attract customers, enable a firm to penetrate a hostile market and attract highly competitive staff who will help the firm attain its mission. A business should operate in a way that the society does not feel unappreciated

as it strives to maximize its profits (Hetherington, 1973). Managers should therefore put in place measures to address issues that affect communities who live in their areas of operation.

In a competitive market, customers associate themselves with products and services from organizations in accordance to their own perceptions towards such institution and institutions were becoming socially responsible to have good perceptions from their customers (Marcia, Otgontsetseg and Hassan, 2013). Largest institutions appeared to be rewarded for being socially responsible. Lorraine (2009) realized that a firm size was directly proportional to the firm's CSR investment. The more a firm invested in CSR, the more profitable it become. A firm was considered socially responsible only if it took into account the social needs of its stakeholders. Implementation of CSR strategy and firm size are crucial in determining ROE of a firm (Carmen-Pilar, Rosa and Lisa, 2011). Kitzmuelery and Shimshack (2012) realized that firms could use CSR to maximise profits while not for profit firms could use CSR to satisfy its shareholders. Margolis, Elfenbein and Walsh (2007) found out that CSR has, indeed, an effect on firm financial performance. The key finding from these studies is that CSR is important in achieving customer satisfaction and community appreciation.

Studies in Kenya have proved that there is a link between CSR and firm profitability. Okoth (2012), during his study on effect of CSR on financial performance of commercial banks in Kenya, realized that CSR has an effect on ROA and ROE. Gichana (2004) realized that all firms listed at NSE had incorporated CSR in their mission statements.

This was during a study on a survey of CSR practices by Kenya companies listed at NSE. According to Okiro, Omoro & Kinyua (2013) commercial banks can use CSR to create a platform for improving their brand value and to promote themselves. The link between CSR and corporate performance can only be clear if the components of the CSR programs in an organization are clearly identified before the relationship of the joint and several functions can be established (Gathungu and Ratemo, 2013). Institutions that have remained competitive and that have experienced steady growth have been embracing CSR activities for a long time. This has enabled them to flourish in competitive markets where sellers sell similar goods at similar prices (Ong'olo, 2012). This demonstrates that CSR plays a critical role in a firm's financial success.

The aforementioned empirical studies have demonstrated that there is an association between CSR and firm's financial performance. The studies have shown that there is a close relationship between CSR and firm's long run profitability. However, these studies have failed to tell how a firm's financial performance would improve per shilling spent on CSR. Therefore, these studies have failed to tell the effects that CSR has on a firm's financial performance; hence there exists a knowledge gap. This study is therefore aiming at filling this gap by posing the question: "Does investing in corporate social responsibility activities have an effect on a firm's financial performance?"

### **1.3. Objective of the Study**

To determine the effect of corporate social responsibility on financial performance of commercial banks in Kenya.

#### **1.4. Value of Study**

The study will enable company executives understand that engaging in social activities can help in managing emerging social risks as an offshoot of their operating activities. The study will highlight a better way of marketing for a firm and its management. The study will help a firm attract, motivate and retain competent employees who will enable it realize its objectives. Social activities help companies to be known as responsible corporate citizens with sensitivity towards social and environmental issues (Carroll, 1979).

By understanding the effect of corporate social responsibility activities on financial performance, investors will determine how to allocate their portfolio so as to maximise returns and thereafter change their assessment of companies' performance and will be making decisions based on criteria that will include ethical concerns (Carroll, 1991). Furthermore, this study will add knowledge to previous studies on corporate social responsibility by adding the component of its effect on long term financial performance. Analysts will find this study helpful when trying to understand the effect that engaging in social activities has on a firm's long term financial performance.

Finally, by investigating the effect of CSR on CFP, the study findings will enrich the discussions on CSR and contribute to the existing theories and literature on their association. Other scholars can also use the information gathered to expound on areas not yet addressed in CSR, corporate strategy and CFP. The study's findings will act as reference material for them while replicating the study elsewhere.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1. Introduction**

This chapter highlights various theories on CSR, the empirical studies on CSR, theoretical framework and a conclusion from literature review.

#### **2.2. Theoretical Review**

In spite of the variety and complexity of approaches related to CSR, there are some proposals which have become mainstream theories on normative Corporate Social Responsibility. Among the theories are; the theory of social costs, agency theory, stakeholder theory and relational theory.

##### **2.2.1. The Theory of Social Costs**

The focus on corporate non-economic effects on the socio-economic system is the basis for responsibility allocation Marshall (1920). In other words, problems of modern corporate responsibility deal with the fair allocation of social costs. Moreover, the social costs literature influences indirectly attempts at measuring social performance. The terms 'social cost' point out, at a very basic level of analysis, the same concept. Problems arise in the literature with regard to the study of 'external economies'. According to Marshall (1920), external economies have to be secured by the concentration of many small businesses of a similar character in particular localities or by the localization of industry. The location of small enterprise is thought of as a matter of exogenous advantage when they can be placed among a cluster of similar enterprises. There is always some part of

the enterprise's activities that affects the environment. A transition from 'external' to 'social' is a short logical passage, in fact social forces here co-operate with economic. There are often strong friendships between employers and employees but neither side likes to feel that in case of any disagreeable incident happening between them, they must go on rubbish against one another (Marshall, 1920).

Pigou (1920) starts out from Marshall's intuitions in order to introduce the problem of the firm's social costs, or the 'real' theoretical basis of social responsibility. This difference assumes importance in welfare economics, as it can be social revenues or losses. The fact that we can distinguish between social and private profits or losses implies a series of problems in terms of evaluation. The issue of social costs relates to the organization originating the costs and to their coverage. Of the two, the latter produces a huge debate (Meade, 1973). Based on the fact that the problem is of justifying state intervention in the economy and making it easier to reach a 'natural' equilibrium, this assumption has important consequences in terms of social responsibilities.

The state's role in the economic system aims to cover social costs and may be intended as the state assuming responsibilities in order to preserve the national product and citizens' welfare. Thus, its natural counterpart should be that of leaving no responsibilities to the corporation that produces the cost even if indirectly or involuntarily. This issue makes it clear that paying for social costs is a matter of contracting and that it has to be assumed by either the firm or by the state (Coase, 1960). From a different perspective, Coase (1960) tries to shift the issue to corporate production factors. The main thesis is that the



costs of the transaction between citizens and government determine whether the state intervenes in the economy or not (Coase, 1988). Paying for social costs is a matter of contracting.

### **2.2.2. Agency Theory**

Generally, 'shareholder value-oriented' goes along with the agency theory, which has been dominant in many business schools in the last decades (Ross, 1973). In this theory, owners are the principals and managers are their agents. The manager bears fiduciary duty towards the owners and is generally subject to strong incentives in order to alienate their economic interests with those of the owners, and with the maximization of shareholder value. Today, it is commonly accepted that under certain conditions the satisfaction of social interests contribute to maximizing the shareholder value and most large companies pay attention to CSR particularly in considering the interests of people with a stake in the firm. In this respect, Jensen (2000) has proposed what he calls 'enlightened value maximization'. This concept specifies long-term value maximization or value-seeking as the firm's objective which permits some trade-offs with relevant constituencies of the firm.

To distinguish profitable CSR from others which are not, Burke and Logsdon (1996) proposed the concept of SCSR to refer to policies, programs and processes which yield substantial business related benefits to the firm, in particular by supporting core business activities, and thus contributing to the firm's effectiveness in accomplishing its mission. From this perspective, there is an ideal level of CSR determinable by cost-benefit

analysis and depending on several factors (McWilliams and Siegel, 2001). This requires a careful calculation of the optimal level of social output in each situation for maximizing shareholder value.

### **2.2.3. Stakeholder Theory**

In stakeholder theory, the purpose of the firm is to create wealth or value for its stakeholders by converting their stakes into goods and services (Clarkson, 1995) or to serve as a vehicle for coordinating stakeholder interests (Evan and Freeman, 1988). Stakeholder theory was first presented as managerial theory. Accordingly, the corporation ought to be managed for the benefit of its stakeholders: its customers, suppliers, owners, employees and local communities, and to maintaining the survival of the firm (Evan and Freeman, 1988). The decision making structure is based on the discretion of the top management and corporate governance, and frequently it is stated such governance should incorporate stakeholder representatives. Stakeholder theory of CSR is related to the belief that corporations have an obligation to constituent groups in society other than stockholders and beyond that prescribed by law or union contract (Jones, 1980). Thus, stakeholder theory takes into account individuals or groups with a stake in the company including shareholders, employees, customers, supplier and local community.

According to Freeman (1984) the stakeholder concept provides a new way of thinking about strategic management. By paying attention to strategic management, executives can begin to put a corporation back on the road to success. However, it is also a normative theory which requires management to have a moral duty in order to protect the

corporation as a whole and, connected with this aim, the legitimate interests of all stakeholders (Friedman, 1970). Evan and Freeman (1988) stated that management, especially top management, must look after the health of the corporation, which involves balancing the multiple claims of conflicting stakeholders. The term stakeholder was meant by Friedman (1970) to generalize the notion of stockholder as the only group to whom management need to be responsible. 'Stakeholder' can be taken in two senses. In a narrow sense, the term stockholder includes those groups who are vital to the survival and success of the corporation (Freeman and Reed, 1983). In a wide sense, it includes any group or individual who can affect or is affected by the corporation (Freeman, 1984). Thus, stakeholders are identified by their interests in the affairs of the corporation and it is assumed that the interests of all stakeholders have intrinsic value (Donaldson and Preston, 1995).

The base legitimacy of the stakeholder theory is on two ethical principles; principle of corporate rights and principle of corporate effects (Freeman and Reed, 1983). Both principles take into account the Kant's dictum respect for persons. The former establishes that the corporation and its managers may not violate the legitimate rights of others to determine their future. The latter focused on the responsibility for consequences by stating that the corporation and its managers are responsible for the effects of their actions on others. There is the problem of solving conflicting interests between stakeholders. Several authors, accepting the basic stakeholder framework, have used different ethical theories to elaborate different approaches to the stakeholder theory, and specifically to solve conflicting stakeholder demands. It has been proposed, among

others, the following theories: Feminist Ethics (Burton and Dunn, 1996), the Common Good Theory (Argandoña, 1998), the Integrative Social Contracts Theory (Donaldson and Dunfee, 1999) and the Doctrine of the fair Contracts (Freeman, 1994). Freeman accepted these pluralistic ethical approaches by presenting stakeholder model as a metaphor where different ethical theories find room.

#### **2.2.4. Relational Theory**

Relational theory has its root from the complex firm-environment relationships. Corporate citizenship of the relational theory strongly depends on the type of community to which it is referred. It is a path that a corporation may take to behave responsibly. Fundamentally, it is about the relationship that a corporation develops with its stakeholders, and therefore, the former has to continuously search for engagement and commitment with the latter. Corporate citizenship, according to Garriga and Mele (2004), is an approach used under the integrative and political theories and this is supported by Swanson (1995) and Wood and Lodgson (2002). This theory is sub-divided into four categories namely business and society, stakeholder approach, corporate citizenship and the social contract.

Business and society implies business in society where CSR is the interacting factor between the two. It is necessary that the Social responsibility of the business need to reflect social power that the business possesses. The approach is both within the interactive and ethical theories, where the former emphasizes the integration of social demands and the later focuses on the right thing to achieve a good society (Garriga and

Mele, 2004). Corporations are proactive in publishing reports on economic, social and environmental performance following the idea of triple-bottom line (Elkington, 1998).

Stakeholder approach is one of the strategies of improving the management of the firm. Corporate relationship of relational theory depends on the type of community it refers to while the social contract theory explains the fundamental issue of justifying the morality of economic activities in order to have a theoretical basis of analyzing social relations between the corporation and the society. In the stakeholder approach, the purpose of the firm is to create wealth or value for its stakeholders by converting their stakes into goods and services (Clarkson, 1995), or “to serve as a vehicle for coordinating stakeholder interests” (Evan and Freeman, 1988). Stakeholder approach has been developed as one of the strategies in improving the management of the firm. It is a way to understand the reality in order to manage socially responsible behavior of a firm.

The term ‘corporate citizenship’ was introduced into the business and society relationship mainly through practitioners (Vidaver-Cohen and Altman, 2000). Since the concept of corporate or business citizenship is increasingly associated with a global sense of business and with a notion of citizenship which go beyond national boundaries, Wood and Logsdon (2002) suggested using the expression ‘business citizenship’ and ‘global business citizenship’ instead of ‘corporate citizenship’ to make clear that this term is not limited to corporate involvement and philanthropy and to present a global sense for citizenship. A firm is not socially responsible if it merely complies with the minimum required of the law (Eilbert and Parket, 1973). Meade (1973) argues that a society is a

series of social contacts between members of society and society itself. He states that the business does not act in a responsible manner because it is in its commercial interest but because it is part of how society implicitly expects business to operate.

### **2.3. Determinants of Financial Performance of Commercial Banks**

The determinants of commercial bank's financial performance can be categorized into two namely those that management can control and those that are beyond management control (Linyiru, 2006). The factors that management can control are classified as internal determinants while those that are beyond their control are referred to as external determinants. According to Williams, Molyneux and Thornton (1994), the internal determinants basically reflect on the differences in bank management policies and decisions in regard to sources and uses of funds management, capital and liquidity management and expenses management. The management induced effects on profitability can be analyzed by examining the comprehensive income statement and statement of financial position of these institutions. Statement of financial position items would illustrate the bank's management policies and decisions in relation to the sources, composition and use of funds (Bourke, 1989).

According to Molyneux and Thornton (1992), management efficiency in generating revenues and controlling costs would be reflected in the statement of comprehensive income. Management controllable internal determinants include capital ratios, liquidity ratios, asset and liability portfolio mix and overhead expenses. On the other hand, external determinants of commercial bank profitability can be sub-classified as either

environment related factors or firm related factors. Environment related factors as considered by Short (1979), Bourke (1989) and Molyneux and Thornton (1992) includes market structure, regulation, inflation, interest rate and market growth. Firm specific factors include firm size and ownership.

## **2.4. Empirical Literature**

The study by Marcia, Ogtongsetseg and Hassan (2013) investigated whether US commercial banks in aggregate were taking substantive steps at being socially responsible, if their socially responsible activities had changed since the financial crisis, and whether they were being rewarded for their actions. The study used publicly available data on CSR to analyze CSR strengths and CSR concerns. It found out that the largest banks consistently had higher CSR strengths and CSR concerns during the sample period. Further, this group saw a steep increase in CSR strengths and a steep drop in CSR concerns as the worst of the financial crisis passed. The study also found that more profitable banks, banks with higher capital ratios, and banks that charged lower fees on deposits had significantly higher CSR strengths. The researchers found out that banks with more females and minorities on the board of directors had significantly higher CSR strengths. Examining the relation between CSR and bank performance, the researchers realized that the largest banks appeared to be rewarded for being socially responsible as both size adjusted ROA and ROE were positively and significantly related to CSR scores. Thus, after the financial crisis, the biggest banks that had been accused of putting their own interests ahead of their customers and the financial system as a whole worked to repair their reputations by turning to more socially responsible activities. For these banks,

the increased participation in socially responsible activities was related to improved financial performance.

Lorraine (2009) studied the relationship between CSR and financial performance using structural equation modeling. His findings were that; all respondents had knowledge of the term CSR, however, not all respondents used the term CSR and others such as “corporate citizenship” and “corporate responsibility and sustainability” were offered as alternatives. It was noted that some SMEs felt the word “Corporate” alienates small firms and implies CSR is more complicated than it is in reality, while some large firm respondents felt the word “Social” confined their CSR activities to those of a social nature. With regard to the management of CSR, all large firms interviewed had devoted persons or departments to CSR, while no SME had a separate CSR department, the management of CSR was assumed by senior management, in most cases the CEO. It was also noted that CSR was more formal, strategic and integrated into all aspects of the business in large firms than in SMEs. While definitions of CSR differed from firm to firm, Lorraine (2009) realized that a commonality among them was that CSR was generally defined by reference to stakeholder theory in that a firm was socially responsible if it took into account the interests and needs of its group of stakeholders. CSR activities are positively correlated with firm size.

Carmen-Pilar, Rosa and Lisa (2011) aimed at analyzing the effect exerted by CSR on short-term and long-term corporate financial performance of European companies listed in the Stoxx Europe 600 index and Stoxx Europe Sustainability index from 2007 to 2010.



Results revealed that the implementation of a CSR strategy, the level of economic development of the country and firm size determine the ROE of the firm. The CSP variable is positively and significantly related to the ROE of companies. Thus, companies with more socially responsible activities improve the shareholders' return by realizing higher CFP. Thus, firms in more developed countries obtain significantly better financial performance than other companies situated in less developed countries. In contrast, there was a negative and significant relation between firm's volume of total assets and ROE which could be due to larger firms having a more complex organizational structure that is more formal and centralized than those of smaller firms. The results for ROA showed that the estimators obtained using the different models also presented differences in terms of size and level of significance, as was the case for the ROE specification. The study found a positive and significant relationship between the ROA variable and CSP and the classification of the country in which the company's headquarters were situated, while the relationship between ROA and firm size was negatively significant. The results showed a positive and significant relationship between CSR, CSP and the level of development of the country where their headquarters were located.

Kitzmuellery and Shimshack (2012), while studying economic perspectives on CSR, realized that individual preferences were the ultimate driving force behind any form of CSR. In the presence of social stakeholder preferences, firms may use strategic CSR to maximize profits, while not-for-profit may use CSR to satisfy shareholders' social ambitions. Only if managers take CSR beyond strategic levels or shareholder preferences does CSR constitute moral hazard. The study revealed that when people make donations

or privately provide public goods, such as charity, there may be many factors influencing their decision other than altruism. Social pressure, guilt, sympathy or simply a desire for a "warm glow" may all be important. Within this framework two opposing perspectives on CSR can be taken. First, CSR may constitute a special form of investment into innovation that may result in negative costs (net benefits) over time. Secondly, shareholder value maximization in general, as well as profit maximization in particular, can motivate CSR. Stakeholders may be endowed with respective social, environmental or ethical preferences. CSR treats the existence of social or environmental preferences as exogenously given and focuses on the interactions between firms and stakeholders. The study considered such impure altruism formally and developed a wide set of implications. In particular, the study discussed the invariance proposition of public goods, the sufficient conditions for neutrality to hold, the optimal tax treatment of charitable giving and calibrates the model based on econometric studies in order to consider policy experiments.

Margolis, Elfenbein and Walsh (2007), while carrying out a meta-analysis of the results from 167 studies, found that 27% of the analyses showed a positive relationship, 58% showed a non-significant relationship, and 2% showed a negative relationship between CSR and CFP. Building up on the view of CSR as a resource, the CSR-CFP relationship is influenced by both the company's social performance and institutional norms of CSR in the firm's industry. In support of the view that CSR is a valuable resource for firms, they found that CSR-related shareholder proposals that were adopted led to superior financial performance as compared to firms whose CSR-related shareholder proposals

were rejected. The researchers realized that adopting the proposal led to an increase in ROA by 0.7% to 0.8%, and an increase in NPM by 1.1% to 1.2% in the two fiscal years following the adoption of CSR. They also found that the stock market reacted positively to the passage of close-call CSR proposals in the two-day event window following the announcement of the vote. A CSR proposal that passed yielded a positive cumulative abnormal return of 1.9% compared to a proposal that failed.

A study by Gathungu and Ratemo (2013) revealed that disclosure of the CSR activities by organizations was used as a measurement tool of performance in the sense that the investment in CSR activities was an indication of the level of resources available and more especially the value that the organization had ascribed to the beneficiaries of the programs. Though CSR was considered part of the operations of an organization, its impact on the organization's financial performance was slightly different from that of other functions such as production, finance, selling and distribution. Therefore, if it would not be possible to establish a clear relationship between CSR and corporate performance, the social and environmental responsibility of the organization was likely to remain at the level of empty mission statements and isolated add-on activities which in turn would affect the performance of the organization. The study revealed that CSR practices were aligned with the strategic intent and that generally the CSR programs met the expectations of employees, investors and local communities.

Ongolo (2012) investigated the relationship between CSR and market share of supermarkets in Kisumu City for the period 2006 to 2010. He sought to determine the

factors that motivated the practice of CSR amongst supermarkets in Kisumu City. The findings revealed that there was a strong relationship between CSR and market share. Institutions that had invested more on CSR had high sales revenue. The researcher also realized that there was a positive correlation coefficient between market share index and CSR. Larger supermarkets preferred education, water and sanitation while the other supermarkets preferred to support to the less fortunate in society as their CSR activities.

Okiro, Omoro and Kinyua (2013) tested the relationship between investment in CSR and sustained growth of commercial banks in Nairobi County. The researchers sought to establish the relationship between banks sustained growth and CSR. The findings revealed an increasing positive attitude towards CSR in terms of investment. There was a general agreement that CSR was essential for the success of the firm. Since commercial institutions work to generate profits by offering the best services to customers, they would provide proper care to retain its customers. The researchers found out that investment in CSR activities had a positive effect on a banks' sustained growth. The findings indicate that there was a weak positive relationship between the variables and that only 11% of bank sustained growth could be explained by investing in CSR activities.

A survey by Gichana (2004) on CSR practice by Kenyan companies sought to identify social responsibility practices by firms listed in the NSE and the factors that explain the kind of CSR practices adopted by these firms. The study found out that all the companies practiced long term planning and had strategies or social responsibility in place. It was

observed that majority of these firms focused on health and education in their practice and were responsible to their employees by offering them medical, housing and pension schemes. It was also observed that water conservation and management was poorly addressed with most of the respondents focusing on internal implications or their activities rather than the water situation as a whole on factors that drive companies to adopt CSR. The recognition of CSR as a core value was the most cited explanation. Other factors include: giving back to the community as a way of meeting government requirement on degradation and as a medium of advertisement.

Okoth (2012) found out that CSR was good for the financial performance of large and medium size banks and had no effect on the ROA of small banks. The researcher realized that CSR had a positive and significant effect on ROA and ROE for all commercial banks when aggregated. However, when classified on the basis of market size, the study revealed that CSR improved financial performance of large and medium size banks while the effect on ROA of small banks was insignificant. This study concluded that CSR had a positive effect on financial performance of large and medium size banks and no significant effect on the financial performance of small banks. The researcher concluded that it was not in the interest of shareholders for small banks to engage in CSR activities as doing so could only drain their wealth without any return.

## **2.5. Summary of Literature Review**

Studies that have been conducted are based on the belief that a responsible institution is rewarded for its good reputation and have failed to arrive at the same conclusion. Some of these studies show a positive correlation, others a negative correlation while others have shown no correlation at all. A closer examination of these studies reveals variations on data sources, measures used on both dependent and independent variables and control variables. The researchers have not been conclusive as to what is the relationship between corporate social responsibility and financial performance.

The aforementioned empirical studies have demonstrated that there is a link between CSR and financial performance. Most of the early studies attempting to identify the relationship between CSR and financial performance have focused on subjective techniques to measure CSR. These studies have not, however, demonstrated how a firm's financial performance would be affected by investing in CSR activities. The studies have not explained the motive for commercial institutions to aggressively invest in CSR activities despite the fact that there is no requirement for them to do so. This constitutes a research gap which this study is seeking to breach.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1. Introduction**

This chapter begins by describing the research design adopted. It then identifies the target population from which the sample was selected and the sampling techniques used in identifying the firms that were subjected to the study. The chapter ends by describing the data analysis techniques used in analyzing the data and the models applied in data analysis.

#### **3.2. Research Design**

The research design used in this study was the descriptive design. The descriptive design leads to the discovery of associations among the different variables. An explanatory case study was used to explore causation in order to find underlying principles. The design was found appropriate for carrying out a holistic, in depth and comprehensive investigation where much emphasis was placed on the analysis of the effect of CSR on financial performance of Kenyan commercial banks.

#### **3.3. Target Population and Sample Design**

The study targeted commercial banks in Kenya that had invested in CSR from the year 2009 to 2013. A non probabilistic sampling design was used since the data was only from those firms that have incorporated CSR in their activities from the year 2009 to 2013. Investment in CSR was tested against net profits before tax for the same period.

### **3.4. Data Collection Procedures**

The study used secondary data for analysis which included data from the company's annual reports to shareholders. The nature of data used included statement of financial position, statement of comprehensive income and annual reports to stakeholders. The study covered a period of five years from 2009 to 2013.

### **3.5. Data Analysis**

The study used Statistical Package for Social Sciences to determine the relationship between firm's CSR investment and profitability. The strength of the relationship between CSR and performance was tested using covariance correlation coefficient. Regression analysis was used to determine the relationship between CSR and firm's financial performance at 5% level of significance. The regression equation took the form;

$$\text{NPBT} = \alpha + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$$

Where NPBT is the net profits before tax,  $X_1$  represents investment on CSR,  $X_2$  represents total investments, while  $\varepsilon$  is the error term.  $\beta_1$ ,  $\beta_2$  and  $\alpha$  are constants to be determined.

Investments includes investment in government securities, investment in subsidiary, securities held for trading purposes and loans and advances to customers. CSR investment considered only monetary expenses towards social course. Net profits before taxes (NPBT) were used to measure financial performance.



## **CHAPTER FOUR**

### **DATA ANALYSIS, RESULTS AND DISCUSSION**

#### **4.1. Introduction**

This chapter presents response rate, descriptive statistics, correlation analysis, regression analysis and a test of statistics. The chapter ends with a discussion from the research findings.

#### **4.2. Response Rate**

This study analysed 44 commercial banks out of which only eight provided the complete and necessary data for this research. Commercial banks studied had government securities, investment in subsidiaries, securities held for trading purposes and loans and advances to customers as their main source of income. Most financial institutions analysed, even though they participated in CSR activities, had failed to keep proper data to reflect what they had spent on CSR. Some of these companies had treated CSR as part of marketing expenses. Data on investments was readily available from all the 44 Kenyan commercial banks. Since this study was mainly concerned with the effect of CSR on financial performance, data on only investments could not be of any help. Data obtained from the eight financial institutions was analyzed using Excel to determine each of the firm's CSR expenses, investments and net profits before taxes.

### 4.3. Descriptive Statistics

The study used two types of data analysis; descriptive analysis and inferential analysis. The study used Pearson correlation, regression analysis and t-ratio for inferential analysis and means, averages and standard deviation for descriptive analysis. Commercial institutions with large capital base had invested significantly large amounts on CSR compared to those with low capital base. The study also revealed that commercial banks that invested the largest amounts of money on CSR realized the highest returns. Table 4.1 presents the descriptive statistics of the overview of CSR investment during the 2009 to 2013 period. The results revealed that on average, commercial banks studied had spent Ksh 73 Million in 2009, Ksh 124 million in 2010, Ksh 96 million in 2011, Ksh 115 Million in 2012 and Ksh 207 Million in 2013 on CSR.

Year	Min	Max	Mean	Variance	Standard deviation
2009	14,500	160,000	73,140	2318533635	48151.15404
2010	30,500	362,400	124,426	11413103049	106832.1255
2011	26,160	175,800	96,801	2666168416	51634.95343
2012	29,632	235,000	115,264	5104196152	71443.65719
2013	29,700	555,311	207,816	33448757103	182890.0137

Table 4.1: Descriptive statistics for overall CSR

On the other hand, these banks had invested between Ksh 8.7 million and Ksh 273 million on government securities, subsidiaries, securities held for trading purposes and loans and advances to customers during the 2009 to 2013. Table 4.2 presents a summary of the descriptive statistics of total investments for the years under review.

Year	Min	Max	Mean	Standard Deviation
2009	8,759,532	137,404,000	72,654,815	41939327.52
2010	16,172,710	154,823,728	94,824,081	48859935.15
2011	24,470,836	208,297,358	110,811,206	59465770.34
2012	37,765,343	230,504,366	130,409,019	66081887.28
2013	46,214,995	273,184,115	156,005,750	75899410.04

Table 4.2: Descriptive statistics for investments

Commercial banks studies recorded varying financial results depending on their mode of operation and investments. Table 4.3 is a statistical illustration of financial performance for the years 2009 to 2013 while table 4.4 is a statistical illustration for investments, CSR and financial performance for the entire period covered by the study.

Year	Min	Max	Mean	Std
2009	318,137	9,002,000	4,430,264	2936869.52
2010	535,083	13,553,000	6,494,736	4334011.18
2011	1,147,408	15,129,374	7,771,435	5182162.54
2012	1,147,408	17,420,000	9,501,834	6525775.39
2013	1,812,168	20,123,759	10,621,879	6929475.12

Table 4.3: Descriptive statistics for overall financial performance

	Mean	Min	Max	Std
NPBT	7,746,725.20	318,137	20,123,759	5550376.033
CSR	119,255	14,500	555,311	106503.0113
Investments	112,756,284	8,759,532	273,184,115	63440278.15

Table 4.4: Descriptive statistics for overall financial performance, CSR and investments

#### 4.4. Correlation Analysis

Correlation analysis provides a measure of degree of association between variables in a regression model. Linear regression used in this study estimates the relationship between financial performance, investment and CSR. The statistical package for social Sciences (SPSS) version 20 was used to find the statistical relationship between financial performance, investment and corporate social responsibility at 5% level of significance. A correlation matrix was used to determine multi-collinearity between the variables. If there is a strong correlation between two predictor variables, the correlation coefficient is close to 1.0. In a situation where two predictor variables have a correlation coefficient of 1.0, then one of them has to be dropped from the model. As shown in figure 4.1, none of the variables is strongly correlated with each other.

		NPBT	CSR	Investments
Pearson Correlation	NPBT	1.000		
	CSR	0.717	1.000	
	Investments	0.962	0.643	1.000

Figure 4.1: Correlation matrix between the variables

#### 4.5. Regression Analysis and Hypothesis Testing

Coefficient of determination (the percentage variation in the dependent variable being explained by the changes in the independent variables) and P-value were used to determine the overall significance of the model. As shown in figure 4.2, Correlation coefficient of 0.970 indicates a very strong correlation between the dependent and independent variables. On the other hand coefficient of determination ( $R^2 = 0.941$ )

indicates that 94.1% of the variation in the firm financial performance is explained by the changes in CSR and investments while only 5.9% is unexplained. Both investments and CSR have a direct relationship with firm financial performance. The correlation coefficient (r) determines the magnitude and direction of the relationship between the independent and dependent variables. Figure 4.3 shows the coefficients, standard errors, t-ratio and P- Values for each of the variables used in the model.

Model	R	R <sup>2</sup>	Adjusted R <sup>2</sup>	Std. Error of the Estimate	Change Statistics	
					R <sup>2</sup> Change	F Change
1	0.97	0.941	0.938	1383010.915	0.941	295.571

Figure 4.2: Coefficient of determination

Model	Unstandardized Coefficients		t	Significance
	Coefficient	Std. Error		
(Constant)	-1717925.720	450328.532	-3.815	0.001
CSR	8.702	2.716	3.204	0.003
Investments	0.075	0.005	16.391	0.000

Figure 4.3: Standard error, t-ratio and P- Values

Analysis of Variance (ANOVA) consists of calculations that provide information about levels of variability within a regression model and forms a basis for tests of significance. ANOVA was used to determine the level of variability from the mean. It provides a

statistic for testing the hypothesis that  $\beta_1 \neq 0$  (there is a significant relationship between the response and predictor variables), against the null hypothesis that  $\beta_1 = 0$  (there is no significant relationship between the response and predictor variables).

A predictor variable is linearly related with the response variable if its P-Value is less than the level of significance. Using P-Values to test on the individual significance, this study shows that financial performance is affected by both investments and firms engaging in social course. If P-value is found to be less than the level of significance, a correlation exists between the response and predictor variables. As shown in Table 4.5, P-Value of 0.000 is less than 0.05, suggesting that there is a significant relationship between the dependent and independent variables used in the study. This clearly indicates that CSR and investments determine financial performance of commercial banks in Kenya.

	Sum of Squares	Df	Mean Square	F	Sig.
Regression	1130689680193080.00	2	565344840096541.00	295.571	0.000
Residual	70770610082003.50	37	1912719191405.50		
Total	1201460290275080.00	39			

Table 4.5: Analysis of variance

Figure 4.3 illustrates that P-Value for CSR is 0.003. This being less than 0.05 suggests that there is enough evidence to support the alternative hypothesis ( $\beta_1 \neq 0$ ) that CSR has an effect on financial performance at 5% level of significance. This suggests that there is a significant linear relationship between financial performance and corporate social responsibility.

#### **4.6. Discussion of Research Findings**

The study found that CSR is good for the financial performance of commercial banks in Kenya. The study findings are that  $\alpha = -1,717,925,720$ ,  $\beta_1 = 8.702$  and  $\beta_2 = 0.075$  suggesting that CSR has a positive and direct effect on firm's financial performance. The regression coefficients illustrate that if a commercial bank does not invest or engage in CSR, it would incur a loss of Ksh 1,717,925,720. The model also shows that, for every unit increase in CSR investment, firm's financial performance increases by 8.702 units and by 0.075 for every unit increase in investment on income generating activities.

Therefore, a model of two predictor variables (CSR and investments) can be used in forecasting financial performance of a commercial bank in Kenya for the period 2009 to 2013. The adjusted R square of 93.8% shows that the model is a fair estimate of the relationship between financial performance, investment and corporate social responsibility. It is therefore reasonable to state that CSR helps to improve firm's financial performance and that the model below can be used to fairly determine financial performance of a commercial bank during the period 2009 to 2013.

$$\text{NPBT} = 8.702 \text{ X CSR} + 0.075 \text{ X Investments}$$

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

#### **5.1. Introduction**

This chapter provides a summary of the study, conclusion, recommendations, limitations of the study and suggestions for further research.

#### **5.2. Summary of the Findings**

The study used a cross-sectional research design and covered the period from 2009 to 2013. Financial performance was measured by use of net profits before taxes obtained from audited statements of comprehensive income. Investments were measured by considering loans to customers (except to other banks and corporations), investment in treasury bonds and government securities, investment in shares for trading purposes and investment in subsidiaries. Investment in CSR was measured using monetary spending on social activities. A multiple regression model was then used to analyze data. The study revealed that CSR has a positive and significant effect on firm's financial performance. The nature of CSR activities also determines the level of profitability.

The findings of this study agree with those of Okoth (2012) only that this study reveals that CSR improves financial performance of all commercial banks irrespective of their size. The study fully supports the findings of Ongolo (2012) and those of Gathungu and Ratemo (2013). CSR enables a firm to penetrate the market, remain competitive in a stiff and volatile market and generate profits for a foreseeable future. Commercial banks that started as small have had their profitability improve over a long period to the extent that



they are outshining their “large” counterparts. Banks that have reported highest profits have highest Strategic CSR investment compared to those that report very low profits. This study’s findings deviate from the findings of Okiro, Omoro and Kinyua (2013). The slight variation is mainly brought about by methodology used to measure CSR and location of the study.

Holme and Watts (2000) defined CSR as a continuous commitment by businesses to behave ethically and contribute to economic development while improving the quality of life of the local community and the society at large. The objective of this study was to determine the effect of CSR on financial performance of commercial banks in Kenya. Bowen (1953) specifically stated that companies practice CSR to satisfy their primary needs of improving their financial performance while presenting themselves as legitimate members of the society. Instrumental theories recommend that firms should engage in CSR activities since it helps them enter new markets, attract cheap and competitive labor, build their brand name and grow revenues. This in return maximizes shareholder value in terms of earnings per share, performance of company shares in the market and overall firm growth. When an organization recruits the unemployed and inexperienced youth in a society, there is usually a relationship that develops between the organization and the society.

The satisfaction of society’s social interests contributes to maximizing shareholder value. Burke and Logsdon (1996) proposed the concept of SCSR in which case, as revealed by this study, educating a poor bright child, setting up a health facility where there is none,

starting an irrigation plant in arid areas and donating food to the starving will add more value than collecting garbage, planting trees or maintaining a garden. A CSR activity that affects the majority in the society has a higher effect than those that favours few individuals. Therefore, a firm can strategically choose a CSR activity that will help it build a strong relationship with its customers.

### **5.3. Conclusion**

The study intended to determine the effect that CSR has on financial performance of commercial banks in Kenya. The researcher used cross-sectional research design and a regression model and found that CSR has a positive and significant effect on financial performance. This study concludes that CSR is for the success of a commercial bank since it helps to improve financial performance. It is, therefore, a noble practice for commercial banks to engage in CSR as part of their operating activities and set aside funds annually towards a social course. CSR should therefore be considered as part of daily operating activities and that for a firm to grow and realize its dreams, it has to engage itself morally and commit itself at improving the society's social and living standards.

The study reveals that highly profitable institutions have heavily invested in CSR activities for many years while those that have always reported losses have been considering CSR as unnecessary expenses. Therefore, commercial institutions should operate outside their normal business activities to support the community. Improving the livelihood of a community attracts volunteers, investors and sponsors who will help a commercial institution achieve its objectives towards community needs. In return, the

financial institution will spend less on CSR while at the same time achieve high returns from being a good corporate citizen. Being a good corporate citizen attracts new and unexpected customers, new capital, tax exemptions, government favors and in the end achieving greater profitability. This study justifies the reason why successful Kenyan commercial banks have been aggressive towards investing on CSR activities than towards marketing.

#### **5.4. Recommendations**

The study found that CSR is good for the financial performance of all commercial institution. In agreement with the argument of Friedman (1970) that the social responsibility of business is to grow its profits, it is in the interest of shareholders, for commercial banks to engage in CSR activities as doing so improves their financial performance. The researcher recommends that institutions should partner with other institutions that offer varying services to jointly invest in common CSR activities as doing so leads to cost reduction while achieving similar goals. Financial institutions can partner with telecommunication industries, manufacturing industries, commercial academic institutions or hospitals to spearhead similar CSR objectives.

This study recommends that the Institute of Certified Public Accountants of Kenya, being a professional accounting body, designs a uniform reporting framework for all institutions to use while reporting their CSR involvement. This will not only make it easy for future researchers to collect research data, but will also enable shareholders to evaluate the extent to which the firm has invested in promoting their company's

corporate citizenship. Commercial banks in Kenya do not have a common platform or procedure for reporting their CSR investment. One has to read through their annual reports to determine the approximate amount invested in CSR. Kenyan commercial banks follow International Financial Reporting Standards, International Accounting Standards, Generally Accepted Accounting Standards and Generally Accepted Accounting Procedures that fail to address CSR investments. Commercial banks have also formed independent companies dubbed “foundation” to spearhead their CSR activities and have published CSR information on several pages of their annual reports, their websites and their newsletters. These reports, however, lack uniformity across the industry hence making it difficult to determine with precision what an institution has invested on CSR.

Finally, the researcher recommends that shareholders views be considered regarding how much the firm should invest on social course annually and the nature of CSR activities to be undertaken. Shareholders, being spread all over the country, have vital information on what the society needs and what will make them associate with a brand name. Management should also carry out a cost benefit analysis for projects they intend to initiate so as to determine if the firm will fully achieve its objectives without constraining finances for other core activities of the organization. This will help ensure that in as much as the firm is socially responsible, shareholders’ funds are not run down meeting the interests of the society.

## **5.5. Limitations of the Study**

In this study, CSR was measured by considering monetary spending on social activities. However, CSR has various dimensions, some monetary while others non monetary. To determine a linear relationship, numerical values are required in which case it becomes difficult to capture non monetary measures. Non financial CSR activities such as man hours spent in planting trees, sanitary pads donated to school girls, free financial literacy, fair employment practices, time and resources spent in cleaning the environment and food items donated to starving communities and school going children were not captured in this study due to difficulties in their measurement. There is a possibility that the results of this study would be different if such aspects were considered.

Some commercial institutions had charged their CSR expenses under office expenses, marketing expenses or general expenses and reflected the totals in their statements of comprehensive income. Notes to the financial statements, however, did not disclose this fact. This in turn interferes with the net profits before tax that was used in the study. Commercial institutions should adequately report on their CSR items individually without generalizing it with other expenses. Furthermore, some institutions treated CSR expenses as tax exempt while others considered it otherwise. Investments only considered loans to customers, investment in treasury bonds, investment in shares for trading purposes, investment in foreign currencies and investment in subsidiary. These are not the only investments affecting profit levels that a commercial bank can engage in.

## **5.6. Suggestions for Further Research**

This study sought to determine the effect of CSR on financial performance of commercial banks in Kenya. The study found that CSR has a positive and significant effect on financial performance of commercial banks and that it drives profit levels. The researcher suggests that the possible effect of CSR on financial performance be extended to other industries. A study can be conducted to determine if CSR has any effect on the financial performance of telecommunication industry, private hospitals, insurance companies, non bank financial intermediaries, micro finance institutions, manufacturing industry, SMEs among others.

The findings of this study were based on CSR monetary spending being regressed on the financial performance of commercial banks for the same accounting period. In practice, however, the benefits of CSR may spread over to the forthcoming accounting periods. The researcher suggests that a study be conducted to determine if monetary spending on CSR in the current financial year has an effect on the financial performance for the subsequent financial years. By engaging in CSR activities, a bank establishes a strong relationship with its environment. One would expect that as a bank increases its engagement in CSR activities, non performing loans would reduce as a result of goodwill from customers. The researcher therefore suggests that a study be conducted to determine the effect of CSR on lending by commercial banks, or the effect of CSR on loan repayment by commercial bank's customers or better still, the effect of CSR on commercial banks loan book or loan portfolio.

## REFERENCES

- Angelidis J. P., Massetti, B. L. & Magee-Egan, P. (2008). Does Corporate Social Responsibility Orientation Vary by Position in the Organizational Hierarchy? *Review of Business Spring*, 28(3), 23-32.
- Argandoña, A. (1998). The Stakeholder Theory and the Common Good. *Journal of Business Ethics*, 17, 1093-1102.
- Balabanis, G., Philips, H. & Lyall, J. (1998). Corporate Social Responsibility and Economic Performance in the Top British Companies: Are they Related? *European Business Review*, 98(1), 25-44.
- Barney, J. B. (1991). Firm resources and sustained competitive advantage. *Journal of Management*, 17, 99 – 120.
- Bourke, P. (1989). Concentration and other determinants of bank profitability in Europe, North America and Australia. *Journal of Banking and Finance* 13, 65-79.
- Bowen, H. R. (1953). *Social Responsibilities of the Businessman*. New York: Harper & Row.
- Bowman, E. & Haire, M. (1975). A Strategic Posture toward Corporate Social Responsibility. *California Management Review*, 18(2), 49-58.
- Branch, B. (1983). *Misleading Accounting: The Danger and the Potential*. Working paper. Amherst, USA: University of Massachusetts.
- Briloff, R. (1972). *Unaccountable Accounting*. New York: Harper & Row.
- Burke, L. & Logsdon, J. M. (1996). How Corporate Social Responsibility Pays Off. *Long Range Planning*, 29(4), 495-502.

- Burton, B. K. & Dunn, C. P. (1996). Feminist ethics as moral grounding for stakeholder theory. *Business Ethics Quarterly*, 6(2), 133-147.
- Carmen - Pilar, M. B., Rosa, R. M. & Lisa, G. J. D. (2011). Do the Best European Socially Responsible Companies Perform Better Financially? Unpublished project, University of Barcelona.
- Carroll, A. B. (1979). A Three Dimensional Conceptual Model of Corporate Social Performance. *Academy of Management Review*, 4, 497–505.
- Carroll, A. B. (1991). The pyramid of corporate social responsibility: Toward the moral management of organizational stakeholders. *Business Horizons*, 39–48.
- Carroll, A. B. (1999). Corporate Social Responsibility: Evolution of a Definitional Construct. *Business & Society*, 38(3), 268-295.
- Central Bank of Kenya website <http://www.centralbank.go.ke/>
- Clarkson, M. B. E. (1995). A stakeholder framework for analyzing and evaluating corporate social performance. *Academy of Management Review*, 92, 105-108.
- Coase, R. H. (1960). *The problem of social cost*. Chicago, Ill: University of Chicago Law School.
- Coase, R. H. (1988). *The firm, the market, and the law* (pp. 95-156). Chicago: University of Chicago Press.
- Cornell, B. & Shapiro, A. C. (1987). Corporate Stakeholders and Corporate Finance. *Financial Management* 16, 5-14.
- Diamond, D. W. & Dybvig, P. H. (1983). Bank Runs, Deposit Insurance and Liquidity. *Journal of Political Economy* 91, 401–419.



- Donaldson, T. & Dunfee, T. W. (1999). *Ties that bind: A social contracts approach to business ethics*. Boston, Mass: Harvard Business School Press.
- Donaldson, T. & Preston, L. E. (1995). The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications. *Academy of Management Review*, 20, 65-91.
- Eilbert, H. & Parket, I. R. (1973). The practice of business: The current status of corporate social responsibility. *Business Horizons*, 16(4), 5-14.
- Elkington, J. (1998). *Cannibals with forks: The triple bottom line of 21<sup>st</sup> century business*. Gabriola Island, BC: New Society Publishers.
- Evan, W. M. & Freeman, R. E. (1988). Ethical Theory and Business. A stakeholder theory of the modern corporation. *In Kantian capitalism* (pp. 75-93). Englewood Cliffs, Prince hall.
- Fox, T., Mumo, K. & Kavwanga, Y. (2005). How can Corporate Social Responsibility Deliver in Africa? *Perspectives on corporate responsibility for environment and development*.
- Freeman, R. E. & Reed, D. L. (1983). Stockholders and stakeholders: A new perspective on corporate governance. *California Management Review*, 25(3), 93-94.
- Freeman, R. E. (1984). *Strategic Management. A Stakeholder Approach*. Marschfield, MA: Pitman.
- Freeman, R. E. (1994). The Politics of Stakeholder Theory: Some Future Directions. *Business Ethics Quarterly*, 4 (4), 409-421.
- Friedman, M. (1970). The Social Responsibility of Business is to increase profits. *New York Times*, 13<sup>th</sup> September, pp. 122-126.

- Garriga, E. & Mele, D. (2004). Corporate Social Responsibility Theories: Mapping the Territory. *Journal of Business Ethics*, 53, 51- 71.
- Gathungu, J. M. & Ratemo, N. Z. (2013). An Assessment of the Impact of Corporate Social Responsibility on the Strategic Intent at Standard Chartered Bank Kenya Limited. *International Journal of Education and Research*, 1(5) 1-16.
- Gichana, O. B. (2004). A Survey of Corporate Social Responsibility Practice by Kenyan Companies: A Case for Companies Listed in the Nairobi Stock Exchange. An unpublished MBA Research project, University of Nairobi.
- Goldsmith, R. W. (1969). *Financial Structure and Development*. New Haven: Yale University Press.
- Grant, R. M. (1991). The resource-based theory of competitive advantage: implications for strategy formulation. *California Management Review*, Spring, 114 – 135.
- Hetherington, J. A. C. (1973). *Corporate Social Responsibility Audit: A Management Tool for Survival* ; London; The Foundation for Business Responsibilities.
- Holme, R. & Watts, P. (2000). *Corporate social responsibility: Making good business sense*. Conches-Geneva, Switzerland: World Business Council for Sustainable Development.
- Jawahar, I. & McLaughlin, G. (2001). Toward a Descriptive Stakeholder Theory: An Organizational Life Approach. *Academy of Management Review*, 26(3), 397-414.
- Jensen, C. M. (2000). Value Maximization and Corporate Objective Function. *Journal of Applied Corporate Finance*. Harvard Business School.

- Jensen, M. C. & Meckling, W. H. (1976). Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*,3(4), 305-360.
- Jones, T. M. (1980). Corporate Social Responsibility, Revisited, Redefined. *California Management Review*. 22(3), 59-67.
- Kenya Bankers Association website <http://www.kba.co.ke/>
- King, R. G. & Levine, R. (1993). Finance, Entrepreneurship and Growth: Theory and Evidence. *Journal of Monetary Economics* 32, 513–542.
- Kitzmueller, M. & Shimshack, J. (2012). Economic Perspectives on Corporate Social Responsibility. *Journal of Economic Literature*, 50(1), 51–84.
- Kombo, D. & Tromp, D. (2006). *Proposal and thesis writing: An Introduction. (2<sup>nd</sup>Ed.)*. Nairobi: Pauline’s publications Africa.
- Levine, R. (1991). Stock Markets, Growth, and Tax Policy. *Journal of Finance* 46, 1445–1465.
- Linyiru, B. M. (2006). Survey of Corporate Governance Practices in Banks in Kenya. An unpublished MBA Research project, University of Nairobi.
- Lorraine, S. (2009). *A Study of Current Practice of Corporate Social Responsibility and an Examination of the Relationship between CSR and Financial Performance using Structural Equation Modeling*. Dublin Institute of Technology.
- Marcia M. C., Otgontsetseg, E. & Hassan T. (2013). Corporate Social Responsibility and its Impact on Financial Performance: Investigation of U.S. Commercial Banks. Unpublished research paper, Department of Finance, Bentley University, Waltham, US.

- Margolis, J. D., Elfenbein, H. A. & Walsh, J. P. (2007). Does it pay to be good? A meta-analysis and redirection of research on the relationship between corporate social and financial performance. Working paper, Harvard Business School, Cambridge.
- Marshall, A. (1920). *Principles of Economics*, (8<sup>th</sup> ed.). London.
- McGuire, J., Schneeweis, T. & Hill, J. (1986). An analysis of alternative measures of strategic performance. In Lamb, R. & Shrivastava, P. (1986). *Advances in strategic management. Research annual,4*, 107-153.
- McWilliams, A. & Siegel, D. (2001). Corporate social responsibility. A theory of perspective. *Academy of Management Review*, 26 (1), 117-127.
- Meade, J. E. (1973). *The Theory of Economic Externalities. The Control of Environmental Pollution and Similar Social Costs*. Leiden: Sijthoff.
- Molyneux, P. & Thornton, J. (1992). Determinants of European bank profitability. *Journal of Banking and Finance*, 16, 1173-1178.
- Moore, G. & Spence, L. (2006). Editorial: Responsibility and Small Business. *Journal of Business Ethics*, 67(3), 219-226.
- Neville, B., Bell, S. & Menguc, B. (2005). Corporate Responsibility, Stakeholders and the Social Performance – Financial Performance Relationship. *European Journal of Marketing*, 39(10), 1184-1198.
- Okiro, K., Omoro, N. & Kinyua, H. (2013). Investment in Corporate Social Responsibility and Sustained Growth In Commercial Banks In Kenya. *Journal of Emerging Issues in Economics, Finance and Banking. An Online International Monthly Journal*,3(2), 1057-1064.

- Okoth, D. O. (2012). The Effect of Corporate Social Responsibility on the Financial Performance of Commercial Banks in Kenya. An unpublished MBA Research project, University of Nairobi.
- Ong'olo, P. B. (2012). Relationship between Corporate Social Responsibility Practices and Market Share among Supermarkets in Kisumu Town. An unpublished MBA Research project, University of Nairobi.
- Orlitzky, M. (2003). Does firm size confound the relationship between corporate social performance and firm financial performance? *Journal of Business Ethics*, 33, 167–180.
- Pigou, A. C. (1920). *The Economics of Welfare*, (4<sup>th</sup> ed.). London: Macmillan.
- Pivato, S., Misani, N. & Tencati, A. (2008). The impact of corporate social responsibility on consumer trust: The case of organic food. *Business Ethics: A European Review*, 17(1), 3–12.
- Ross, S. A. (1973). The Economic Theory of Agency: The Principal's Problems. *American Economic Review*, 62, 134-139.
- Rumelt, R. P. (1987). Theory, Strategy and Entrepreneurship. *The Competitive challenge: Strategies for industrial innovation and renewal*. Cambridge, Mass: Ballinger Publishers, 137 – 157.
- Short, B. K. (1979). The Relation between Commercial Bank Profit Rates and Banking Concentration in Canada, Western Europe and Japan. *Journal of Banking and Finance*, 3, 209-219.
- Swanson, D. L. (1995). Addressing a Theoretical Problem by Reorienting the Corporate Social Performance Model. *Academy of Management Review*, 20(1), 43-64.

- Vidaver-Cohen, D. & Altman, B. W. (2000). Corporate Citizenship in the New Millennium. *Business and Society Review*, 105(1), 145-169.
- Waddock, S. A. & Graves, S. B. (1997). The corporate social performance - financial performance link. *Strategic Management Journal*, 18 (4), 303-319.
- Weber, E. J. (2008). *A short history of derivative security markets*. Crawley, W.A: University of Western Australia, Business School, Economics Program.
- Williams, D. M. L., Molyneux, P. & Thornton, J. (1994). Market structure and performance in Spanish banking. *Journal of Banking and Finance*, 18, 433-443.
- Wood, D. J. & Lodgson, J. M. (2002). Business citizenship: From individuals to organizations. *Business Ethics Quarterly, Ruffin Series*, 3, 59-94.

## **APPENDIX I: Commercial Banks in Kenya**

African Banking Cooperation (Kenya)	Guaranty Trust Bank / Fina Bank
Bank of Africa	Guardian Bank
Bank of Baroda	Gulf African Bank
Bank of India	Habib Bank
Barclays Bank (Kenya)	Habib Bank AG Zurich
CFC Stanbic Bank	I&M Bank
Chase Bank (Kenya)	Imperial Bank Kenya
Citibank	Jamii Bora Bank
Commercial Bank of Africa	Kenya Commercial Bank
Consolidated Bank of Kenya	K-Rep Bank
Cooperative Bank of Kenya	Middle East Bank Kenya
Credit Bank	National Bank of Kenya
Development Bank of Kenya	NIC Bank
Diamond Trust Bank	Oriental Commercial Bank
Dubai Bank Kenya	Paramount Universal Bank
Ecobank	Prime Bank Limited
Equatorial Commercial Bank	Stanbic Bank
Equity Bank	Standard Chartered Bank Kenya
Family Bank	Trans National Bank
Fidelity Commercial Bank Limited	United Bank for Africa
First Community Bank	Victoria Commercial Bank
Giro Commercial Bank	

## **APPENDIX II: Representative Offices of Foreign Banks**

Bank of China

Bank of Kigali

Central Bank of India

FirstRand Bank

HDFC Bank Limited

Hong Kong and Shanghai Banking Corporation

Nedbank



### APPENDIX III: Data Used for Study

<b>Bank</b>	<b>Year</b>	<b>Total Investments Ksh “000”</b>	<b>CSR Ksh “000”</b>	<b>NPBT Ksh “000”</b>
Barclays Bank	2009	137,404,000	76,800	9,002,000
Barclays Bank	2010	143,143,000	56,400	13,553,000
Barclays Bank	2011	136,671,000	64,300	12,013,000
Barclays Bank	2012	152,015,000	31,200	13,020,000
Barclays Bank	2013	165,921,000	212,700	11,134,000
Chase Bank	2009	8,759,532	79,500	318,137
Chase Bank	2010	16,172,710	22,000	535,083
Chase Bank	2011	24,470,836	63,500	830,171
Chase Bank	2012	37,765,343	65,000	1,331,252
Chase Bank	2013	46,214,995	64,000	2,287,074
Cooperative Bank	2009	66,690,994	70,000	3,735,695
Cooperative Bank	2010	111,311,254	87,000	5,642,641
Cooperative Bank	2011	131,452,789	85,200	6,208,618
Cooperative Bank	2012	149,105,003	89,600	9,610,140
Cooperative Bank	2013	162,424,706	95,540	10,507,075
Equity Bank	2009	76,725,000	80,300	5,278,000
Equity Bank	2010	111,547,000	83,049	9,045,000
Equity Bank	2011	145,692,000	109,200	12,834,000
Equity Bank	2012	178,250,000	235,000	17,420,000
Equity Bank	2013	219,509,000	555,311	19,004,000
I&M Bank	2009	42,958,752	14,500	1,794,833

<b>Bank</b>	<b>Year</b>	<b>Total Investments Ksh “000”</b>	<b>CSR Ksh “000”</b>	<b>NPBT Ksh “000”</b>
I&M Bank	2010	54,685,021	30,500	3,004,482
I&M Bank	2011	63,540,238	26,160	4,457,331
I&M Bank	2012	81,444,886	29,632	4,721,540
I&M Bank	2013	118,080,066	57,000	6,059,818
Kenya Commercial Bank	2009	106,296,558	70,000	6,425,558
Kenya Commercial Bank	2010	154,823,728	78,600	9,797,971
Kenya Commercial Bank	2011	208,297,358	157,000	15,129,374
Kenya Commercial Bank	2012	230,504,366	151,000	17,208,143
Kenya Commercial Bank	2013	273,184,115	172,000	20,123,759
National Bank	2009	39,838,588	17,800	2,159,441
National Bank	2010	50,521,712	60,000	2,697,823
National Bank	2011	54,829,152	49,100	2,443,850
National Bank	2012	55,247,965	55,659	1,147,408
National Bank	2013	67,123,657	29,700	1,812,168
Standard Chartered	2009	102,565,095	100,680	6,728,447
Standard Chartered	2010	116,388,222	133,860	7,681,884
Standard Chartered	2011	121,536,275	108,446	8,255,135
Standard Chartered	2012	158,939,591	107,020	11,556,191
Standard Chartered	2013	188,200,846	143,400	13,354,965