

**THE IMPACT OF CORPORATE SOCIAL RESPONSIBILITY ON  
FIRMS RISKS AMONG QUOTED COMMERCIAL BANKS IN  
KENYA**

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AWARD OF THE DEGREE OF MASTER OF BUSINESS  
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OF NAIROBI.**

**OCTOBER, 2012**

## DECLARATION

This is to declare that this management project report is my original work and has not been submitted for a degree in any other university or institution of higher learning for examination or for any other purpose.


Signed  .....

Date  .....

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This management project report has been submitted for examination with my approval as the university Supervisor.

Signed  .....

Date  .....

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## **DEDICATION**

To God, almighty ..... From whom all good things come.

## **ACKNOWLEDGMENT**

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## ABSTRACT

This research was undertaken in order to understand the impact of corporate social responsibilities on firm risks amongst quoted banks in Kenya. The objective of the study was to investigate how CSR impacts on firm risks. A number of studies have been done in Kenya regarding the relationship between CSR and financial performance but none has been carried out to establish the relationship between CSR in relation to firm risks. Specifically, it was expected that by pursuing a series of nominated objectives, this study will help assess consumers, community, employee and other stake holders reactions towards the perceptions of banks as socially responsible entities, in the context of CSR principles

The researcher used a descriptive survey by administering a questionnaire to the targeted respondents. Data was analyzed using SPSS software and presented using bar graphs, pies charts and frequency tables. Secondary data was also obtained from Banks to obtain accounting measures of risks. The results show that the firms with CSR did suffer less stock price declines in negative events. Additionally, this study also finds the CSR has greater protection effect for firms with higher intangible assets, and has significant contribution in the safety-related negative events but not in the integrity-related negative events.

CSR is not about free goodies. It is an effort by organizations to deploy their resources in a way that helps the organizations build a mutually productive and sustainable business relationship between them and the communities with which they do business. It's thus recommended that banks should adopt portfolio mitigating strategies before investing heavily in CSR activities which are capital intensive to establish the risk return trade off.

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## ABBREVIATIONS

CEP	Control for Environmental pollution
COM	Community Relations
CSF	Corporate Financial Performance
CSP	Corporate Social Performance
CSR	Corporate Social Responsibility
DIV	Diversity Issues
DY	Dividend Yield
EMP	Employee Issues
ENV	Environmental Issues
KLD	Kinder, Lydenberg, Domini
MIMS	Main Investment Market Segment
MTBV	Market to Book value
MV	Market Capitalization
NSE	Nairobi Securities Exchange
PRO	Product Issues
TDCE	Total debt to common equity ration
ROA	Return on Assets
ROE	Return on Equity
ROS	Return on Sales

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of the Study

In the world of business, the main responsibility for corporations has historically been to make money and increase shareholders wealth. In other words corporate financial responsibility has been the sole bottom line driving force. Friedman (1962).

However, the sovereignty of the shareholder view has come under attack from management and strategy researchers who argue that the firm has multiple stakeholders, including employees, suppliers, and the larger community in which it operates and that the proper goal of management must be to meet the objectives of all stakeholder groups simultaneously. Jones (1995).

According to advocates of the stakeholder view, corporate social responsibility goes beyond simply staying within the rules of the game, and has been defined as actions that appear to further some social good, beyond the interest of the firm and that which is required by law. McWilliams & Segal (2000).

In the field of Accounting, CSR falls under the subject of Social Accounting. The key features of Social Accounting are the measurement and communication of information concerning the effect of business and its activity towards society and environment. Belkaoui (2000). In essence, Social Accounting provides a framework for identifying, measuring and reporting firm's social and environmental impacts to their stakeholder. Social Reporting is one of the branches of Social Accounting as such firms will use communication mediums such as annual reports, social reports, promotional material, and web sites, to report their CSR activities. These reports are important to other users such as employees, consumers, community, government and NGOs, other than solely for financial analysts and fund managers. However, the extent of CSR information appearing in the annual report is varied over time and regions. Gray, Kouhy and Lavers (1995), and countries economic development status. Belkaoui & Karpik (1989) and Hackston & Milne (1996), emphasized that business is under pressure from their stakeholders to report its social activities because these parties want to protect their long-term interests in the firms. The whole notion of Corporate Social responsibility of business was problematic from the very beginning of the field and the subsequent language about social responsiveness; social

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performance and the ethical obligations of the business perpetuate this fundamental problem. Muriu (2010).

Each company differs in how it implements corporate social responsibility, if at all. The differences depend on such factors as the specific company's size, the particular industry involved, the firm's business culture, stakeholder demands, and how historically progressive the company is in engaging CSR. Some companies focus on a single area, which is regarded as the most important for them or where they have the highest impact or vulnerability, human rights, for example, or the environment while others aim to integrate CSR in all aspects of their operations. For successful implementation, it is crucial that the CSR principles are part of the corporations values and strategic planning, and that both management and employees are committed to them. Furthermore, it is important that the CSR strategy is aligned with the company's specific corporate objectives and core competencies. Roberts (1992).

Recently the practice of Corporate Social Responsibility (CSR) initiatives by Kenyan companies seems to have increased over the past few years. Although majority of Kenyan companies express their social responsibility through support of communities, they are also expected to take responsibility of the impact of their activities on other stakeholders including customers, employees, shareholders, and the environment in all aspects of their operations. This obligation, which is often voluntary, should result in an improvement in the quality of life of these stakeholders. However, it is still argued that in most countries in Africa, CSR is still in its embryonic phase. Visser (2006).

According to instrumental stakeholder theory perspective by Donaldson & Preston (1995) Jones (1995) CSP is expected to decrease firm financial risk. Surprisingly a small number of researchers have taken up this study. The researcher of the study aims to bridge this gaps that currently exist by conducting a study to prove that investing in CSR can actually decrease firm risks among quoted banks in Kenya.

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### **1.1.1 Corporate Social Responsibilities in Commercial Banks**

Financial institutions, such as banks, do not produce hazardous chemicals or discharge toxic pollutants into the air, land or water and thus apparently they might be viewed as uninvolved with environmental issues. Cowton and Thompson, (2000). But through their financing practices they are supporting commercial activity that ultimately degrades the natural environment. Smith, (1993). They act as facilitators by supplying the fund to support the production process which ultimately causes environmental degradation. Sarokin and Schulkin (1991). Thus banks should admit the responsibility of indirect involvement in environmental damages and recognize their environmental responsibility,

which is a part of their CSR, to strike a balance between economic and social goals to encourage the efficient use of resources. It is not just philanthropy and obeying the laws, rather an attempt to ensure their own sustainability and profitability. Wanless (1995).

Involvement in environmental degradation will not only invite public criticism and negative customer reaction, but also might make regulations more stringent which can impair the bank responsible for their clients' environmental impacts. Thus banks have strong prudential reasons for trying to avoid lending in ways that expose them to environmental risk and have clear incentive to incorporating environmental criteria into the lending decision making process. Wood (1991).

In Kenya the Banking industry is governed by the Companies Act, the Banking Act, the Central Bank of Kenya Act and the various prudential guidelines issued by the Central Bank of Kenya (CBK). The banking sector was liberalized in 1995 and exchange controls lifted. The commercial banks and non-banking financial institutions offer corporate and retail banking services but a small number, mainly comprising the larger banks, offer other services including investment banking. Currently only 10 banks have been listed on the Nairobi security exchange markets. It is generally observed that many banks are getting involved in the practice of Corporate Social Responsibility. This is one of the strategies commercial banks are adopting so as stay competitive in the market and improve on their financial performance. Mandu ,( 2010).

### **1.1.2 Risks in Commercial Banks**

Risks as defined by Knechel (2002) is the likelihood that the outcome from a process will not meet expectations. Risks associated with implementing corporate social responsibility (CSR) initiatives into strategic and operating plans need to be closely controlled and monitored, These is because Investments in CSR involve relatively irreversible commitments, which can easily backfire in the form of negative effects on the company's competitiveness and competitive positioning. Rugman and Verbeke (1998).

Companies are in especially grave danger when they adopt a low-effort CSR profile Stevens et al. (2005), when they do not free up sufficient managerial capacity to manage CSR activities rigorously, Bansal (2005) or when their investment triggers the interest of previously dormant stakeholder groups. Buysse and Verbeke (2003).

In financial institutions such as banks and insurance companies, the management of financial risk or hazard risk is the firm's core business therefore they may be categorized as core risks, together with strategic risk and operational risk.

Strategic risk arises from a firm's inability to adapt to changes in the environment such as changes in consumer preferences, market competition and social developments. This risk is associated with the compatibility of a firm's goals, the business strategies to achieve those goals, and the quality of implementation. Strategic risk may result from changes in market, technology, brand, competitor, and customer. For example, brand perception is subject to customers from service and product quality, and the risk of brand erosion could seriously hurt firm's value. Alt (2000).

Operational risk usually is related to losses from operational errors that affect the earnings of a firm. It can happen in many aspects of business operations, including systems, processes and people. Operational risk arises from issues such as succession planning, human resources, information technology, control systems and compliance with regulations. For example, the typing errors in deposit transactions are made by employees in the bank. Alt (2000).

Financial risk refers to all kinds of uncertainties in corporate finance of a firm, such as volatility in interest rates, exchange rates, asset-liability mismatch.

Financial risks generally are categorized into market risk, credit risk, and liquidity risk. Market risk is the fluctuation of asset values due to changes in interest rate, exchange rate, and commodity and equity prices. Credit risk arises from uncertainty in counterparty's ability to pay its financial obligations. Liquidity risk results from unbalanced cash inflows and outflows such that a firm cannot afford the immediate payments. Alt (2000).

Hazard risk refers to losses related to natural hazards or man-made accidents which traditionally managed through insurance. Today businesses are required to assess and disclose environmental liabilities and risks that are material. If a firm fails to comply with regulations and does not take step to protect the environment in which they operate, it may face the risks of resistance and decreased reputation from society and local government. Alt (2000).

## **1.2 Statement of the Problem**

Despite a vast and growing body of research on corporate social responsibility (CSR), there have been ongoing debates on its key elements and meanings. Wood (1991). describes CSR as the construction of three major components. The first component is the level of corporate social responsibility legitimate within society and public within the organization. The second component is the processes of corporate social responsiveness which includes environmental assessment and stakeholder management.

The third component is the outcomes of corporate social behavior which includes charity support and community development. McWilliams and Siegel (2001) suggests CSR as actions that appear to further some social good, beyond the interests of the firm and that which is required by law. Others, such as Bakker et al. (2005) argue that CSR indicates societal expectations of corporate behavior that is alleged by a stakeholder to be expected by society or morally required and is therefore justifiably demanded of a business.

In either academic or actual practice, CSR may be interpreted in terms of societal or stakeholder expectations. Different social groups or stakeholders may place different expectations on business at different periods. These expectations may also differ according to different sectors of the economy the activities of the business operate in. Issue of whether social responsibilities should be addressed through instruments of public policy or through some form of voluntary,



ethical requirements remains ambiguous. This lack of consensus over CSR reflects the complexity and evolving nature of CSR itself across place and time. Consequently, it should come as no surprise that there exists no universally accepted definition of CSR. Vance (1995).

Firm risks arise from transactions that are likely to result into a loss. It could be argued that a company which is consistently socially and environmentally responsible should in the course of time reap the fruits of this strategic posture by experiencing fewer downward adjustments and less volatility in its share price compared to less socially responsible firms or, equivalently, that firms having been shown to be involved in controversial, socially and or environmentally irresponsible activities would be exposed to a higher degree of stock market risk. Bansal (2005).

High levels of CSP can be associated with low financial risk, among other things, lower probabilities of suffering legal prosecutions and fines, less stringent regulatory controls, more stable relations with the government and the financial community. McGuire et al. (1988) customer loyalty and a supportive environment on the parts of employees and communities during times of crisis. All of these beneficial implications can lead to reductions of the various operational risks that a company faces in terms of its profitability and overall viability. Also, high firm social performance may be considered to be a sign of superior management skills the so called good management hypothesis. Waddock and Graves (1997) study indicated that a firm which is likely to be characterized by more effective business and financial planning consequently, results to improved financial stability.

In a view to justify the emergence of this new concept into our Kenyan banks, these study aims to investigate the impact of CSR activities on organizational risks and whether banks should spend more on CSR activities because it impacts on the firms risks thus diluting shareholders Value. Pelozo (2006) suggests that CSR may have a function to mitigate risk. The function of risk mitigation means that the CSR done by a firm in the past may secure the financial impairments when negative events of the firm take place in the future. That is, the performance of CSR can create certain value for the firm in managing risk. However Orlitzky and Benjamin (2001) in their study concluded that the true score correlation coefficient between CSP and risk is negative.

According to Bessis (2005) risk management is important to bank management because banks are the “risk machines”, they take risks, transform them and embed them in banking products and services. Risks are uncertainties resulting in adverse variations of profitability or in losses.

A number of studies on CSR Kamau (2001), Kiarie (1997), Kweyu (1993), Mulwa (2002), and Gichana (2004) have carried out research in Kenya. Most of these studies Kamau (2001), Kiarie (1997), Kweyu (1998) and Mulwa (2002) focused on managers attitudes towards CSR. Ominde (2006) focused on how social responsibility actions are linked to corporate strategy. Odhiambo (2006) focused on CSR as a strategic tool for stakeholder management. Gichana (2004) focused on CSR practices among companies listed at the NSE.

Studies in Kenya have only focused on the relationship between CSR and firm performance with no specific study considering the risks involved in investing in CSR activities. Given the gap poised by the above empirical studies, this study will attempt to bridge the gap that currently exists of identifying the relationship between CSR activities and on the firm risks of quoted commercial banks in Kenya

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

The objective of the study is to determine the relationship that exists between corporate social responsibility and firm risks of commercial banks quoted on the NSE.

#### **1.4 Importance of the Study**

This study is justified on the basis that corporate social responsibility issues form major concerns to any business. It will be quite useful for future researchers who may want to conduct similar or related studies in the area.

The management of Commercial banks in Kenya have recently embraced the concept of CSR into their strategic plans, it will be very beneficial for them as they will be able to understand the relationship between CSR activities on a firm risks of the banks.

The government of Kenya will be enlightened in a bid to make policies relating to corporate social responsibility. Knowledge on the existing relationship between corporate social responsibility and financial performance will assist in ascertaining the appropriate guidelines to be put in place for governing quoted bank in the NSE. The government will also be informed on how it can protect the investors and encourage more investments for the growth and development of the national economy.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter highlights the major issues relating to the relationship between corporate social responsibilities and financial risks of commercial banks. Financial risk and will cover the theoretical framework and empirical studies. It will also review literature on relationship between legitimacy theory, Economic agency theory and as well as stakeholder theory.

#### **2.2. Theoretical Framework**

The theoretical framework helps to make logical sense of the relationship of the variables and factors that have been deemed relevant/important to the problem. It provides definitions of relationships between all the variables so that the theorized relationship between them can be understood. The theoretical framework will therefore guide the research, determining what factors will be measured, what statistical relationship the research will look for.

##### **2.2.1. Legitimacy Theory**

Legitimacy theory is derived from the concept of organizational legitimacy, which has been defined by Dowling and Pfeffer (1975) as a condition or status which exists when an entity's value system is congruent with the value system of the larger social system of which the entity is a part off. When a disparity, actual or potential, exists between the two value systems, there is a threat to the entity's legitimacy.

Legitimacy theory posits that organizations continually seek to ensure that they operate within the bounds and norms of their respective societies. In adopting a legitimacy theory perspective, a company would voluntarily report on activities if management perceived that those activities were expected by the communities in which it operates. Deegan (2000), Deegan, Rankin and Voght (2000), Cormier and Gordon (2001).

Legitimacy theory relies on the notion that there is a social contract between a company and the society in which it operates. Deegan (2000), Deegan (2002), Mathew (1993), Patten (1991-1992).

The social contract is used to represent the myriad expectations society has, about how an

organization should conduct its operations. Deegan (2000), Mathew (1993). Specifically, it is considered that an organization's survival will be threatened if society perceives that the organization has breached its social contract. Deegan (2002). Where society is not satisfied that the organization is operating in a legitimate manner, society will revoke the organization's contract to continue its operations. Deegan and Rankin (1997). Deegan (2002) provides examples of how this may be done.

Consumers may reduce the demand for the organization's products, factory suppliers may eliminate the supply of labour and financial capital to the business, or constituents may lobby government for increased taxes, fines or laws to prohibit those actions which do not conform to the expectations of the community. Deegan (2000).

The social contract is difficult to define because it can be explicit or implicit and not permanent. Therefore, the 'terms' of the social contract cannot be known with any precision, and different managers will have different perceptions about these various terms. Deegan (2000), O'Donovan (2002). Gray, Owen and Adams (1996) indicate that legal requirements provide the explicit terms of the contract, while other non-legislated societal expectations embody the implicit terms of the contract. It is in relation to the implicit terms of the contract that managers' perceptions may vary greatly. Deegan (2002).

Additionally, societal expectations are not permanent, but rather change over time, hence, the conditions under the social contract on which social approval is conferred, change over time. This requires organizations to be responsive to the environment in which they operate. Deegan (2000). Because community expectations can change over time, the organization needs to make disclosures to show that it is also changing. Given the impacts of perceived breaches of the social contract for organizational survival, it is important to examine the remedial actions that organizations might engage in.

To this end, legitimacy theory offers the notions legitimacy gap and legitimacy strategies. Lindblom (1994), refers to a 'legitimacy gap as the difference between the expectations of the 'relevant publics' relating to how an organization should act, and how the organization does act. Lindblom (1994), suggests that when a legitimacy gap occurs, there is a threat to the entity's

legitimacy and when a disparity, actual or potential, exists between the two value systems, there is a threat to the entity's legitimacy.

Where managers perceive that the organization's operations are not commensurate with the 'social contract' then, pursuant to legitimacy theory, organizations may take remedial action to become legitimate. Dowling and Pfeffer (1975). Because the theory is based on perceptions, for remedial action to have an effect on external parties, it must be accompanied by publicized disclosure. Cormier and Gordon (2001). Hence the importance of publicized corporate disclosures, such as those made within annual reports and other publicly released documents. Deegan (2002), Deegan, Rankin and Voght (2000), Cormier and Gordon, (2001).

Several studies have directly or indirectly examined for legitimacy theory and its applicability to the CSR disclosure practices of companies for example, 'Adams, Hill and Roberts (1998), Campbell, Craven and Shrides (2003), Deegan, Rankin and Voght (2000). The results of these studies generally tend to acknowledge the applicability of legitimacy theory to understanding voluntary CSR disclosure practices of companies.

Further, a number of studies have identified the nature of a company's industry as a factor affecting CSR disclosure. Prior studies in both literatures for example, Bozzolan Favotto and Ricceri (2003), Patten (1991), Roberts (1992), have found industry type influences the amount of voluntary disclosure. It has been argued that this may be because companies in different industries have differing motivations towards legitimation owing to the different perceptions that society has with regard to their activities, and how the management of the companies themselves perceive opinions about them 'Campbell, Craven and Shrides (2003). Two studies, by Roberts (1992) and Campbell, Craven and Shrides (2003) attempted to examine for variations in CSR practices between industries with different profiles.

A positive relationship was found between industry type and level of disclosure and Roberts (1992) concluded that corporations with a high profile are more likely to disclose social responsibility activities.

Campbell, Craven and Shrides (2003) examined the extent to which voluntary disclosures represent an attempt to close a perceived legitimacy gap. They contended that the level and patterns of disclosure by a company may vary depending on whether the company's main

product has mainly negative connotations that is, the organization is, in the eyes of some constituencies, structurally illegitimate, such as tobacco companies, or whether the company's main product is an essentially desirable product which may give rise to some undesirable by products . Specifically, they argued that, in the case of structurally illegitimate companies, it is likely that legitimacy can never be attained in the eyes of some constituencies and the objective cannot be to restore something they never had. In such cases, the aim of disclosure might simply be to limit damage or to convince society that they are 'not all that bad'. Their findings were inconsistent with legitimacy theory and concluded that companies who are expected to disclose more because of society's perceptions do not always do so and companies with a lesser apparent legitimacy gap sometimes disclose more.

Hence, there is mixed evidence that companies from high profile industries will report more than those with low profiles. However, as previously noted, an important consideration in examining CSR is the need to recognize industry-specific factors and issues. Indeed, failure to do so might be one explanation for the findings of Campbell, Craven and Shrides (2003).

### **2.2.2. Economic Agency Theory**

The relationship of agency is one of the oldest and commonest codified modes of social interaction. Ross (1973). Agency relationship arises between two or more parties when one, designated as the agent, acts for, on behalf of, or as representative for the other, designated the principal, in a particular domain of decision problems.

Jensen and Meckling (1976) presented the first detailed theoretical exposition of agency theory, defining the managers of the company as the "agents" and the owners of the company as the "principals". The authors argue that if both principals and agents are aiming at utility maximization, the agents will not always act in the best interest of the principal, resulting in agency costs of various kinds.

Agency theory became a popular rationale for CSR disclosure since its emergence as an explanatory model for corporate financial reporting Watts and Zimmerman (1986).

The theory is developed based on Adam Smith's classical school of thought. It views the firm as a nexus of contracts between various economic agents who act opportunistically within efficient markets Reverte (2008). Gray et al. (1996), offered the idea that managers use company's information to satisfy or manipulate influential stakeholders in order to gain their support which

is required for survival. Cowen et al. (1987), suggested that consumer-oriented firms are expected to concern more about their corporate images, which in turn would ultimately improve their turnover.

However, Cormier et al. (2005) pointed out that agency theory tends to focus only on firm's monetary or wealth considerations. In fact, many potential users of Corporate social responsibilities information may not act in these markets at all e.g. pressure groups. Reverte (2008), Yamak and Suer (2005) suggests that the application of principle-agent theory in financial industry is not adequate to explain their social responsibility practices because the banking sector has larger number of major stakeholders and subjected to heavier regulations.

### **2.2.3. Stakeholder Theory**

One of the cornerstones of CSR is the concept of stakeholder management Davidson (2006). Stakeholder theory has evolved as academics and practitioners have looked beyond the notion that a for-profit, listed company, there primarily goal is to serve its shareholders. While this broadened view is not new Freeman (1984) definition of stakeholders has become known as the broad conceptualization, defining a stakeholder as any group or individual who can affect or is affected by the achievement of the firm's objectives.

Donaldson and Preston (1995), on the other hand drew together the work on stakeholder theory and divided it into three aspects: descriptive, instrumental and normative. They explained descriptive stakeholder theory as basically describing how a corporation deals with stakeholders. Instrumental theory was seen as the connection between how an organization manages its stakeholders and the achievement of organizational goals. While, normative stakeholder theory is interested in how a company should act towards its stakeholders. Donaldson and Preston (1995) were explicit as to which strand they felt was the most crucial to be studied and followed in business, linking their justification to the theory of property rights. Taking this argument further, it has been posited that stakeholder status should be extended even to non-human entities such as the environment. Starik (1995).

However Gioia (1999) was critical of the academic approach which favors the normative view of stakeholder theory arguing that it is an academic form of admonishing business. Gioia (1999)



went on to exhort academics to get off the veranda by doing research and grounding stakeholder theory in more data.

It has also been suggested that Donaldson and Preston's Stakeholder Model is still too simplistic for the complexity of relationships both within and outside the corporation. Rowley (1997), Frooman (1999), Neville and Menguc (2006). Rowley (1997) used concepts from social network analysis to examine characteristics of stakeholder structures. He argued that, since stakeholder relationships do not occur in a vacuum of dyadic ties, but rather in a network of influences, then a firm's stakeholders are likely to have relationships with each other.

Clarkson (1995) linked stakeholder research with studies on corporate social performance, suggesting that CSP could be analyzed more effectively by using a framework based on the management of a corporation's relationships with its stakeholders. His definition of primary stakeholders included the "usual suspects" of shareholders and investors, employees, customers and suppliers. However, Clarkson also suggested that the public stakeholder group should also be considered primary by a firm – the governments and communities whose laws and regulations must be obeyed and to whom taxes and other obligations may be due. Clarkson suggested that the media and special interest groups should be classed as secondary stakeholders, believing that the corporation is not dependent for its survival on these groups but that they can cause significant damage to it.

In conclusion stakeholder theory implies that a company has responsibilities not only to their shareholders but also to all stakeholders. Garriga and Melé (2004).

Managers perceptions of three key stakeholder attributes including power to influence the company, legitimacy of the relationship with the company, and urgency of the claim on the company would significantly affect the degree to which managers give priority to competing stakeholder claims. Mitchell et al. (1997). Compare to Legitimacy Theory, Stakeholder Theory suggests that firms tend to focus only on their stakeholders, instead of the whole society. Deegan (2002) states that both theories conceptualize the organization as part of a broader social system wherein the organization impacts, and is impacted by, other groups within society.

### **2.3 Relationship between CSR and Firm Risks**

The relationship between CSP and firm risk carries considerable potential importance for managers and investors alike. Managers seeking to reduce the uncertainty to which their businesses fortunes are subject would find it useful to know whether improved CSP is likely to increase or decrease the variability of future firm performance. This is especially true if one accepts the claim of Cox et al. (2004) that there is a broad consensus in the conceptual literature that many financial gains from improved social performance accrue in the long run also applies to the effects of CSP on financial risk.

Spicer (1978) was amongst the first to conduct such a study. He used the Controls for Environmental Pollution (CEP) reports as a CSP measure and finds negative correlations between it and measures of total and systematic risk, thus providing some early empirical support for a risk-reducing effect of strong CSP.

Aupperle et al.(1985) in his study found no measure of financial performance significantly related to factors like the employment of social forecasting or having a social responsibility committee, but all of the latter are significantly and negatively related to total financial risk and insignificantly negatively associated with long-term beta. Building on this paper, Aupperle and Pham (1989) aggregate the non-economic components of CSP and use a variety of accounting (ROA, ROE, ROS) and market stock price growth, total return to investor measures of CFP. They found no significant relationship between CSP and any measure of financial performance or even financial risk. Somewhat similarly McGuire et al. (1988) in his study sampled a of large number of US firms rated in Fortune's 'America's'. They used multiple CFP measures (total return, asset growth, alpha and others) and risk measures (operating leverage and beta) and run regressions for different time windows. They find that CSP is positively and strongly related to CFP and negatively and less strongly related to both prior and subsequent systematic risk.

More recently, the study of Salama et al. (2009) provides some evidence on the nature of the link between Community and Environmental Responsibility (CER) rankings and systematic firm risk in the British context, they found a negative and statistically significant relationship between the two variables, with CER being a pioneer of financial risk. In summary, the extant literature on

the effect of CSP on financial risk is sparse and problematic, and this study seeks to address a number of the substantive limitations of previous work.

## **2.4. Empirical Studies**

Within the rapidly evolving research area of Corporate Social Responsibility (CSR), a significant portion of the relevant theoretical and empirical literature has concentrated on studying the specificities of the relationship between the corporate social performance (CSP) and measures of the corporate financial performance (CFP) of the firm. For many researchers, managers and investors, the question of whether there is a business case for CSR is of key importance. Perceptions of a positive (or negative) direct or indirect relationship between a corporation's social responsibility and its bottom line promote the implementation of CSR principles in both corporate and investment strategies. The academic debate concerning the nature of the link between CSP and CFP is a persistent and controversial one. Due to a variety of definitional, measurement and methodological issues, there is no consensus in the relevant literature, either at the firm or portfolio level of analysis, with results often in sharp conflict Griffin and Mahon (1997) Margolis and Walsh (2003) some studies indicate a positive CSP–CFP relationship. Hillman and Keim (2001), others point to a negative link. Brammer et al. (2006) and others indicate no significant association between the two. Renneboog et al. (2008), Bauer et al. (2005). Among these studies, the common denominator is the use of measures of financial performance that focus on firm profitability (accounting measures) or on stock returns market measures, sometimes using risk either accounting or market risk, respectively only as an adjustment factor. The inherent assumption in these papers is that CSP can influence CFP solely through a front door mechanism. Under the stakeholder management perspective, CSP is expected to contribute to the creation of sustainable comparative advantages that will enhance firm profitability and lead to an overall positive CSP–CFP relationship. Jones (1995). In contradiction to this, there are those who view CSR practices as a misappropriation and misallocation of valuable corporate resources which are detrimental to firm performance. Friedman (1970). The final possibility is that there are so many intervening variables between CSP and CFP that identifying a consistent, statically significant relationship between the two is prohibitively difficult. Ullmann (1985).

In this study, we attempt to offer an alternative empirical pathway in relation to the CSP and CFP connection by investigating the possibility of the existence of a back door mechanism between

the two so that CSP has a wealth protective instead of wealth enhancing effects that are captured in the corporations' stock market valuations. To investigate such effects, we will focus our analysis upon the relationship between CSP and financial risk rather than profitability or returns on share ownership) at the firm level. Thus, in a substantive departure from previous studies of the CSP and CFP link, risk will be employed as a key dependent variable.

In Kenya, Mutuku (2004) did a study on the relationship between CSR and Financial performance of quoted companies in Kenya. The results of the regression analysis showed no relationship between CSR and Financial performance of all companies listed at the NSE, Mwangi (2011), also did a study on relationship between CSR and Financial performance of quoted companies in Kenya and concluded that investment in CSR do not significantly influence the performance of firms. Auka (2006) did a study on Factors influencing the practice of CSR by financial Institutions in Kenya and noted that Corporate image, moral obligation and solving societal problems are the main reasons why financial institutions invest in CSR activities.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction.**

This chapter sets to explain the research design, the population of interest, the basis of sample selection, the sources of data, the techniques of analysis that was used and the data analysis.

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

The research design adopted was a descriptive survey. Descriptive survey was preferred for it is used to obtain information concerning the current status of a phenomena and purposes of these methods was to describe what exists with respect to situational variables i.e. it looks at relationships between and among variables. (Mugenda (2003).

This study was carried out through the use of both primary and secondary data. Primary data was obtained through the use of structured questionnaires. Secondary data was obtained from listed banks annual reports. Through the use of the listed banks in the NSE, the researcher was able to obtain the data for various variables included in the study from the financial statements in the annual report of the listed banks. This data was then analyzed through the use of descriptive and Meta-analysis to determine the effect and direction of the various factors identified on the level of CSR activities and its effect on the firm's risks.

#### **3.3 Popultaion of Study**

The population of interest in this study was composed of all publicly quoted banks at the Nairobi Securities Exchange between 2007 and 2011. Unlisted banks were excluded as their annual reports will not easily available. Currently, there are 10 listed firms at the NSE in the Main Investment Market Segment (MIMS) that constituted the requisite population (Appendix I). The reason as to why these markets were chosen is primarily due to the availability and the reliability of the financial statements in that they are subject to the mandatory audit by internationally recognized audit firms. Furthermore, firms listed on the stock exchange have an incentive to present profits in order to make their shares more attractive. Lazaridis and Tryfonidis (2006) and also from the fact that the number of firms in this market had not materially changed over the study period.

### 3.4 Sample and Sampling Procedures.

In order to obtain a representative sample from the population, a number of filters were applied. Observations of firms with anomalies such as negative values in their total assets, current assets, fixed assets, capital, depreciation or the interest paid will be eliminated. In addition, only firms that will have continuously traded over the period 2007 to 2011 will be considered in the study. Further, observations of items from the balance sheet, and profit and loss accounts showing signs contrary to reasonable expectations will be removed. Subject to the foregoing, the study was a census survey in which all banks listed at the NSE were studied, due to the manageable numbers involved.

### 3.5 Data Collection

Data was collected from annual reports submitted to the NSE and Capital Markets Authority. Annual reports of the firms were obtained between 2007 and 2011 which were the study period. The company's annual accounts were obtained from the NSE library and the Capital Markets Authority. All banks in the bourse that were continually listed between 2007 and 2011 were included to ensure that the sampling frame is current and complete

#### 3.5.1 Dependent Variable Description

The dependent variable in the study was firms' risks. Firm Risks were measured using accounting variables namely the MV (Market capitalization), MTBV (Market to book value ratio), DY (dividend yield), TDCE (total debt to common equity ratio).

$$RM_{it} = \alpha_i + \sum_{j=1}^{10} \beta_j COMP_{jit-1} + \beta_{11} MV_{it-1} + \beta_{12} MTBV_{it-1} + \beta_{13} DY_{it-1} + \beta_{14} TDCE_{it-1} + \epsilon_{it}$$

where  $RM_{it}$  is the risk measure for firm  $i$  in year  $t$ ,

$\alpha_i$  is the time invariant intercept for firm  $i$ ,

$\beta$  is are the slope coefficients of the respective factors,

$COMP_{jit-1}$  is the individual  $j$  components (strengths and concerns of Community, diversity issues, employee programs, environment issues, product safety and quality),

$MV_{it-1}$  is the market capitalization,

$MTBV_{it-1}$  is the market to book value ratio,

$DY_{it-1}$  is the dividend yield, (dividend per share to price per share)

$TDCE_{it-1}$  is the total debt to equity ratio, all referring to firm  $i$  in year  $t-1$  and

$\epsilon_{it}$  it is the respective disturbance term

### **3.5.2. Independent Variable Description**

CSR measures were the independent Variable. To construct measures for CSR, the study similarly used the procedure adapted by Coombs and Gilley (2005), and construct a measure of the firms CSR performance using the KLD categories of employee relation (EMP), diversity issues (DIV), product issues (PRO), community relations (COM) and environmental issues (ENV). Each dimension was measured using a scoring system of 0,1,2,3 based on the extent to which the company adopts and implements the indicated policy.

### **3.6 Data Analysis**

The techniques used to analyze the data and interpret the data collected were descriptive statistics i.e. cross tabulation. The statistics were used to generate frequency tables and proportions or percentages, and graphs.

Meta-analysis was employed to analyze data. This is a quantitative method of research integration Cooper (1989). Increasingly, it has replaced the narrative literature review as a technique of summarizing a research area. The meta-analytic guidelines provided by Hunter and Schmidt (1990) were followed. Their meta-analytic techniques correct the observed sample statistics for methodological distortions due to sampling error and measurement error. Each observed correlation must be weighted by the sample size of the primary study to calculate the observed mean weighted correlation across all of the studies involved in the analysis. The standard deviation of the observed correlations was then computed to estimate the variability in the relationship between the variables of interest. Such as population, variation due to sampling error, and variation due to other artifacts e.g., lack of reliability in measures.

## CHAPTER FOUR

### DATA ANALYSIS, PRESENTATIONS AND FINDINGS.

#### 4.1 Introduction

This chapter presents the research findings. The research presented in the sections that follow is based on the research objective focused on by the study. The objective of the study is to determine the relationship that exists between corporate social responsibility and firm risks of commercial banks quoted on the NSE.

Whereas the study had targeted a total of 50 respondents from the listed banks in Kenya only 31 respondents, 30 respondents were considered valid and adequate for analysis stage. This represents 60%. This responses formed the basis for the analysis presented in this chapter. The chapter is guided by the study objectives. The analysis of the data was done using proportions and percentage and the finding were presented using graphs, pie charts and tables.

#### 4.2 Data Analysis and Presentation

##### 4.2.1 Policy & Employees

##### 4.2.1.1. CSR Mission Statement & Corporate Responsibility

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Disagree	1	3.3	3.3	3.3
Neutral	3	10.0	10.0	13.3
Agree	4	13.3	13.3	26.7
strongly agree	22	73.3	73.3	100.0
Total	30	100.0	100.0	

Source: Research data

From the table above, 86.6% of respondents agree that the financial institution they work for has a corporate social responsibility statement and values showing business principles and or vision



of corporate responsibility. Only a small portion of 3.3% who disagree and 10% who are not sure if the organization they work for do have a corporate social responsibility statement. From the sample there was no instances of strongly disagree on the issue.

#### 4.2.2.2. Environmental standard policy.

The table below summaries the frequency, percentages and cumulative percentages at which banks work towards undertaking a standard environmental standard policy of CSR.

##### **This financial institution applies an environmental standard policy.**

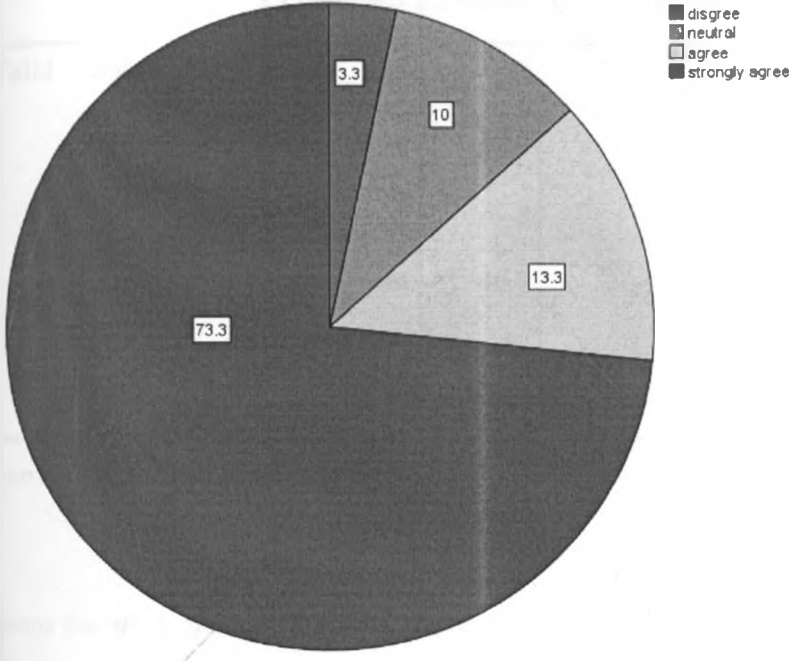
	Frequency	Percent	Valid Percent	Cumulative Percent
disagree	2	6.7	6.7	6.7
Valid neutral	6	20.0	20.0	26.7
disagree	13	43.3	43.3	70.0
strongly agree	9	30.0	30.0	100.0
Total	30	100.0	100.0	

**Source: Research data**

From the table above, 73.3% do agree that the financial institution they work for do have standard environmental policy for corporate social responsibility. Only a small portion of the respondents' disagree being represented by 6.7 % and 20% neutral about the presence of standard environmental policy.

The pie chart below shows the level of strongly agree creates the strong perception entities have towards corporate social responsibility in their organization.

**This financial institution has a CSR mission statement & values showing a business principles and for vision of corporate responsibility**



**Source: Research data**

From the pie chart above the indications of 86.6% indicates how well organization have entrenched CSR mission statement and values showing a business principles and/or vision of corporate responsibility. A very small proportion of the sampled population 3.3% disagrees and hence this is insignificant.

#### 4.2.2.3. Responsibility towards Corporate responsibilities issues.

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid disagree	2	6.7	6.7	6.7
neutral	5	16.7	16.7	23.3
agree	9	30.0	30.0	53.3
strongly agree	14	46.7	46.7	100.0
Total	30	100.0	100.0	

Source: Research data

From the table above, 76.7% of respondents agree there are manager responsible for ethics or corporate responsible issues .This mean that organization appreciate the need and value attached corporate social responsibility. Managers will Endeavour to maintain corporate social responsibility in a move to increase shareholders value i.e. profit maximization and increase the overall profit generation of the company.

#### 4.2.2.4. Employee human Rights.

The Banks employees are key resources in achieving the firm's objectives including implementation of CSR objectives. The table below highlights the frequency the percentage and cumulative percentage at which the banks human right policy is implement to safe guard employees interests.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Disagree	6	20.0	20.7	20.7
	Neutral	8	26.7	27.6	48.3
	Agree	6	20.0	20.7	69.0
	strongly agree	9	30.0	31.0	100.0
	Total	29	96.7	100.0	
Missing	System	1	3.3		
Total		30	100.0		

**Source: Research data**

Human right is one of broad issue catered under the consumption of products and services. From the table above 50% of respondents agree that the organizations support the human rights of the employees with 20% disagree with the statement.

#### 4.2.2.5. Summary on Policy and Employees Standards.

	N	Minimum	Maximum	Mean	Std. Deviation
This financial institution has a CSR mission statement & values showing a business principles and /or vision of corporate responsibility	30	2.00	5.00	4.5667	.81720
The code of ethics is distributed to Employees	30	2.00	5.00	4.4667	.81931
This financial institution publishes a social report and /or has an ethical audit	30	2.00	5.00	3.8000	.96132
This financial institution applies an environmental standard policy.	30	2.00	5.00	3.9667	.88992
Staff behave in ways that reinforce the institutions' code of conduct	30	2.00	5.00	4.1667	.94989
It develops innovative products and Services	30	2.00	5.00	4.3000	.74971
I trust this financial institution	30	2.00	5.00	4.1000	.80301
There is a manager responsible for ethics or corporate responsibility issues.	30	2.00	5.00	4.1667	.94989
I have a good feeling about this financial institution	30	2.000	5.000	4.06667	.827682
It offers high quality products and Services	30	2.00	5.00	4.2000	.76112
Valid N (list wise)	30				

**Source: Research data**

From the table above, out of sampled population a mean of 3.80 believes that their organization publishes reports on corporate social responsibility report and has an ethical audit. Since these organizations operate in controlled environments, pollution levels and reduced energy consumption are some of the issues covered by these management reports. The table also indicates that the minimum mean of 3.80 implies that majority of respondents agree that the

above factors are well covered in their organizations. From the data, Companies are offering high products and services with a mean of 4.20 and standard deviation of 0.76.

#### 4.2.2. Organizational Culture

The table below shows the minimum, maximum mean and standard deviations of opportunities that the banks were interested in pursuing.

**Bank Opportunities**

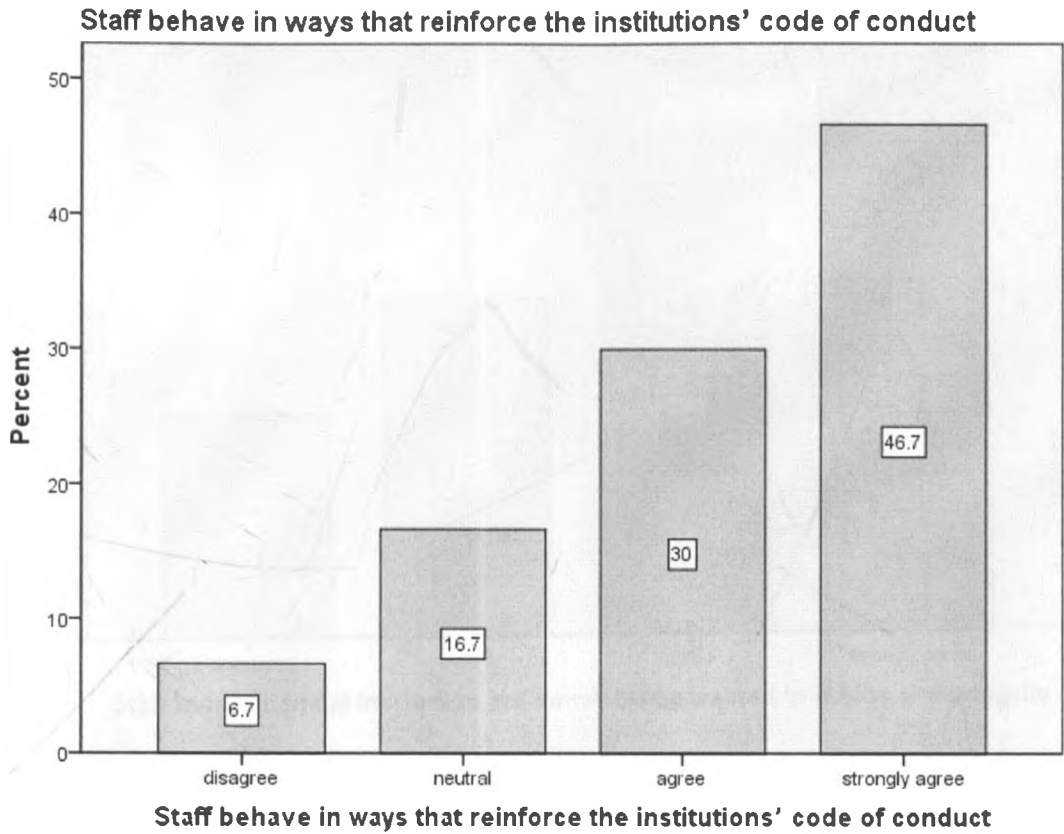
	N	Minimum	Maximum	Mean	Std. Deviation
This financial institution is an aggressive competitor and takes advantage of opportunities	30	3.00	5.00	4.3000	.79438
Valid N (list wise)	30				

**Source: Research data**

From the table above financial institutions are in great competition will always take advantages of opportunities available in the market. Market share is of great concern. from the respondents, a mean of 4.30 agree to this with a standard deviation of 0.794.

### 4.2.3. Ethical Citizenship

#### 4.2.4.1. Code of Conduct.

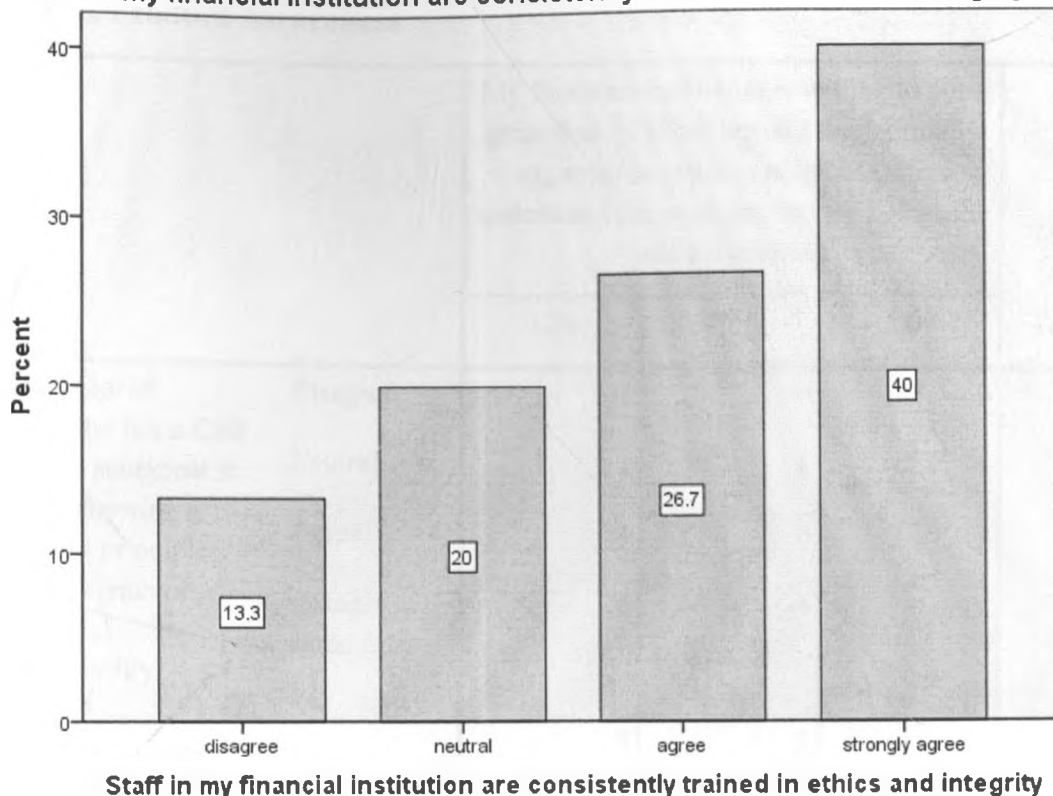


**Source: Research data**

From the table above, staffs behave in ways that reinforce the institutions' code of conduct with 76.7% agreeing to it, 6.7% disagree and 16.7% being neutral. The staff of an institution can create a good image of the organizations or badly damage the same.

#### 4.2.4.2. Ethics Training

Staff in my financial institution are consistently trained in ethics and integrity



**Source: Research data**

From the diagram above it indicates that staff in these organizations are consistently trained in ethics and integrity issues. This cultivates the culture of working together with their stakeholders and efficient working relationships with their clients this is represented by 66.7% of the respondents, with only 13.3% disagree and 20% neutral on the whole issues. Staff did not strongly disagree signing negative response of 13.3% as not being strong.



#### 4.2.4. Reputation

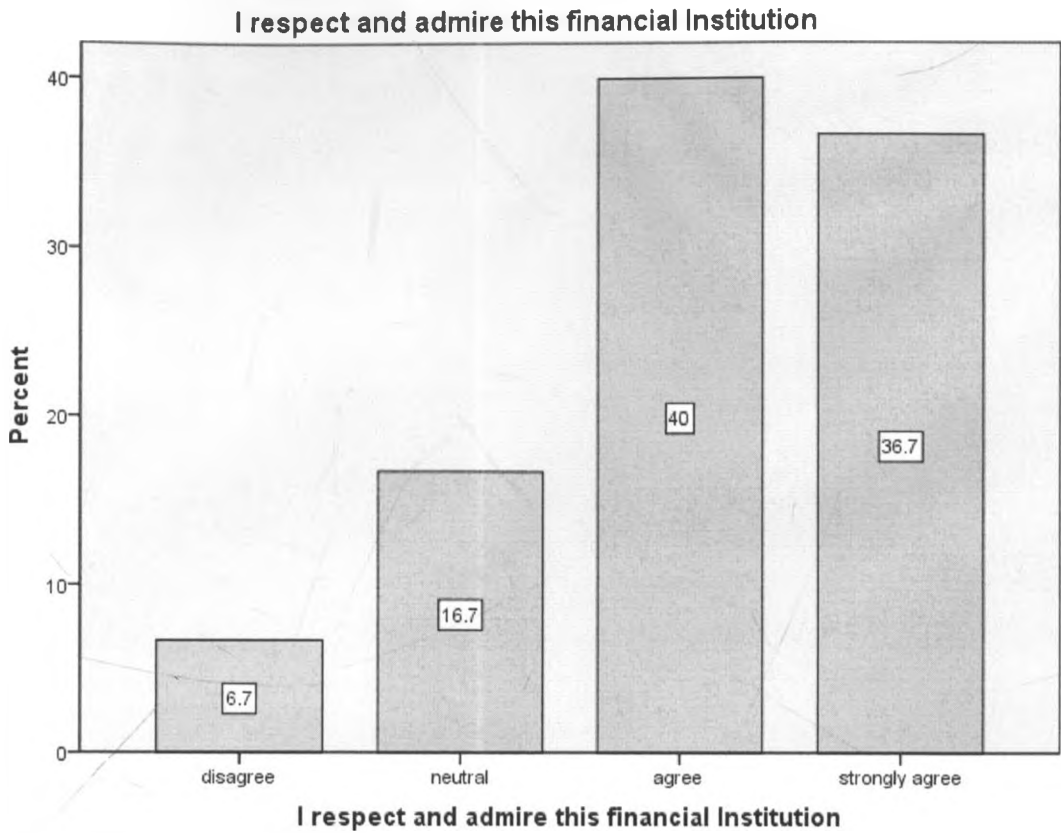
##### 4.2.4.1. Product Awareness

		My financial institution is willing to put a great deal of effort beyond that normally expected in order to help customers understand the products/service before the make a decision			Total
		3.00	4.00	5.00	
This financial institution has a CSR mission statement & values showing a business principles and /or vision of corporate responsibility	Disagree	1	0	0	1
	Neutral	1	1	1	3
	Agree	1	0	3	4
	strongly agree	6	4	12	22
Total		9	5	16	30

**Source: Research data**

From the table above, a cross tabulation between if the financial institution has a CSR mission statement and values showing a business principles in comparison with if the financial institution is willing to put up a great deal of effort beyond that normally expected in order to help customers understand products and services before the make a decision, 26 out of possible outcome of 30 agree and this is equivalent to 87%.this means that the two variables are in line with helping reduce the risks levels associated with corporate social responsibility in these institutions .only 1 out of possible 30 disagree and this is insignificant while only 3 out of possible 10 representing 10% being neutral

#### 4.2.4.2. Employee Perceptions to a bank.



**Source: Research data**

From the graph above, 76.7% of respondents agree that they respect and admire the institution they work for. This highlights the importance attached to institution and their employees as one of the stakeholders and the chief marketer of their products and services. 6.7% of respondents disagree and 16.7% are neutral in regard having respect and admiration of these institution.

### 4.2.4.3. Quality of Products and Services



Source

: Research data

From the graph above 86.7% of respondents agree that high quality products and services is part of their institution dedication. 3.3% of respondents disagree while only 10% are neutral. This indicates the importance attached quality as the organization try to promote their products and services and attached corporate social responsibility in maximization of shareholders wealth.

Stakeholders in an organization include employees, providers of finance, government, community and environment, consumers of the organization's products and special interest organizations or groups

## 4.3 Regression Analysis

### 4.3.1 Descriptive Statistics

Descriptive Statistics			
	Mean	Std. Deviation	N
Market Capitalization	16103.9250	10179.53196	40
Market / Book value	6.2582	5.65151	40
Dividend Yield	2.3092	3.58067	40
Debt to Equity	6.5565	2.08290	40

The Average Mean market capitalization for quoted banks from the period 2007 to 2011 is 16,103.9 the standard deviation is 10,179.5. The average firm's years observations have a market to book value ratio of 6.2 a dividend yield of 2.3% and a leverage ratio of 6.5. All the beta measures are very close to unity as they ought to be. They do not exactly equal to one because of the nature of the unbalanced data. This means that the mean utility measures are negatively lower as a risk aversion increases. This is to say that any average positive utility effects coming from reaping positive returns are increasingly offset by the respective values of the volatility returns.

### 4.3.2 Correlations

		$\beta$ coms / $\beta$ comc	Market Capitalization	Market to book value	Dividend yield	Debt to Equity ratio
Pearson Correlation	$\beta$ coms / $\beta$ comc	1.000	.454	.411	-.186	.584
	Market Capitalization	.454	1.000	.210	-.236	.445
	Market to book value	.411	.210	1.000	-.48	.344
	Dividend yield	-.186	-.236	-.48	1.000	.266
	Debt to Equity ratio	.584	.445	.344	.266	1.000
<b>Sig. (1-tailed)</b>	$\beta$ coms / $\beta$ comc	.	.023	.038	.365	.011
	Market Capitalization	.023	.	.127	.351	.026
	Market to book value	.038	.127	.	.281	.065
	Dividend yield	.355	.341	.271	.	.126
	Debt to Equity ratio	.011	.026	.065	.126	.
N	$\beta$ coms / $\beta$ comc	40	40	40	40	40
	Market Capitalization	40	40	40	40	40
	Market to book value	40	40	40	40	40
	Dividend yield	40	40	40	40	40
	Debt to Equity ratio	40	40	40	40	40

The Pearson Correlation table above shows correlations between various market risk measures and the corporate social strengths. There is a high but not positive correlation between the conventional risks metrics 0.454, 0.411 and .584 market capitalization, market to book value and leverage ratio and a negative correlation with the dividend yield -0.186 of a firm.

### 4.3.3 Model Summary

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.549 <sup>a</sup>	.302	.243	8854.85489	.302	5.181	3	36	.004

a. Predictors: (Constant), Debt to Equity, DY, market to Book value

ANOVA<sup>b</sup>

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1.219E9	3	4.062E8	5.181	.004 <sup>a</sup>
	Residual	2.823E9	36	7.841E7		
	Total	4.041E9	39			

a. Predictors: (Constant), Debt to Equity, DY, Market to Book value

b. Dependent Variable: Market Capitalization

Coefficients<sup>a</sup>

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	32757.542	4709.991		6.955	.000
	Mrkt to Bkt	-666.232	443.808	-.370	-1.501	.142
	DY	1022.003	686.410	.359	1.489	.145
	Debt to Equity	-2264.048	705.049	-.463	-3.211	.003

a. Dependent Variable: Market Capitalization

#### 4.4 Summary and Interpretation of Findings.

From the analysis of data above, there appears to be a negative but insignificant relationship between the various corporate social strengths and systematic financial risk. The results are very similar when certainty equivalents of stock returns are used as dependent variables, with the findings being largely insignificant, the exception being employment strengths which are negatively associated with investor utility for average and high levels of risk aversion.

When looking at the correlation tables 4.3.2 the individual concerns components and risk is stronger than the respective link between their strength counterparts and market risks that is (.023, .038, .355, .011). This observation provides stronger that the effects CSP concerns on financial risk would have a greater impact than that of CSP strengths. This findings are confirming the conclusions made by Lankoski (2009), findings that the economic impacts were more positive for CSP issues that reduce negative externalities (KLD concerns in this case) than for those that generate positive externalities (KLD strengths in this study).

This weak negative (Moderate positive association between the individual KLD strengths verify the findings of the Salama et.al (2009) study that focuses on longitudinal data sample of firms

from the UK. The results are also consistent with those of previous research with the same purpose but very differently data sets and methodologies such as Spicer 1978, Aupperle et al. (1985), Mc Guire et.al (1988), Orlitzky and Benjamin (2001).

This last finding could be rationalized by observing that some of the indicators of employment strengths have a financially ambiguous nature since they lead to immediate costs for the company with the expectation of medium- to long-term economic benefits. For example, significant cash profit sharing and strong retirement benefits are characteristically supportive of this line of reasoning and both are used by KLD, as can be seen. Such practices are obviously costly for the firm but are expected to cause an easier attraction of superior quality employees, higher personnel retention ratios, decreased costs of staff training and improved employee loyalty.

This result is also in contrast to the conclusions of Edmans (2011), who found a positive relationship between employee satisfaction and risk adjusted returns. However, Edman used the "100 Best Companies to Work for in America" as his CSP measure which does not escape the criticism of halo effects and risk adjusted returns as a performance metric which makes the results of the two studies somewhat incomparable.

Previous literature also suggests that CSR may have a function to mitigate risk, and is empirically confirmed by the research based on the data of the US firm by Godfrey, Merrill, and Hansen (2009). The results show that the firms with good CSR did suffer less stock price declines than the firms without CSR when they encounter negative reports.

From the data collected, it's evident that most banks are eager to gain a large market share, one of the strategies adopted is implementing CSR activities in the market.

The respondents mean score of 4.3 is a clear indicator of this fact. Environmental standard policies are another contributor to achievement of CSR activities.

Only 6.7% of respondents felt that the organization they work for do not have any Standard policies relating to CSR implementation. Most banks appear to have mission statement incorporating CSR policies and expected outcomes. This serves as guidance to all staff of what is expected of them.



Quite a number of banks have appointed specific management to spear head activities. Equity bank and Kenya commercial banks have registered foundations to implement its CSR activities this evidenced by 86% of respondents who confirmed that the institutions they work for have departments established to implement CSR activities.

It is important for banks to identify communities that actual need support from them ethically, and not because they have different interests. Ethics training to staff is such mechanisms that are adopted by banks to ensure these standards are maintained.

Reputation risk is one of the challenges the banks are likely to be faced with and to minimize this risk quality products and services is ad effort every bank undertakes to ensure that all customers are informed in this regard 87%. of respondents agree that their institutions ensure customers are given quality products and services .this means that the two variables are in line with helping reduce the risks levels associated with corporate social responsibility in these institutions .only 1 out of possible 30 disagree and this is insignificant while only 3 out of possible 10 representing 10% being neutral.

Human rights policies are implemented quite a number of institutions under this research. 50% of respondents agree that actually their institutions have this policy.

In Conclusion if the return-inducing effects of CSP also enhanced financial risk, managers would face a strategic dilemma (risk-return trade-off). In this article, we Showed that, risk is negatively correlated with CSP. In fact, among all risk measures, high CSP appears to be most highly negatively correlated with total market risk. Furthermore, the better a firm's CSP reputation, the lower is its risk. Thus ,a firm that is socially responsible and responsive may be able to increase interpersonal trust between and among internal and external stake holders ,build social capital, lower transaction costs, and, therefore, ultimately

## CHAPTER FIVE

### DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

#### 5.1 Summary

Today people have more concerns on a firm's social performance than before.

The businesses which take into account of the interest of stakeholders in addition to Shareholders usually earn a better public image in the society. Many researches have Contributed to investigating the relationship between CSR and financial performance, but cannot make conclusive suggestions. This study intended to find out the need of corporate social responsibility in quoted banks and the risk levels. The findings indicated that most of the individual social concerns such as Community, Employment, environment, product safety and quality are negatively but insignificantly associated with firm risks .When urging companies to adopt CSR activities, it's important to advise them the likely effect of CSR investments on overall business performance.

This study contributed to identification of seven commonly occurring CSR risks, of which four principally play out at the level of the organization and three others at the level of the inter organizational relationship. We urge managers to implement CSR activities with care, and to always use a portfolio of mitigation strategies. Our findings suggest that CSR involvement is not an innocent activity, and that experimenting with it in the hope to contribute to the social good or to gain standing in the eyes of others can be dangerous for the competitiveness of business In general the study was able to deduce many of the organizations favor setting up corporate social responsibility boards or committee and statements. Managers will Endeavour to maintain corporate social responsibility in a move to increase shareholders value i.e. profit generation and increase the overall profit generation of the company.

In consideration of this study, it's clearly evident that investing in CSR can significantly mitigate the risks levels of quoted banks in Kenya, however it's rather important for managers to be advised of the implications of CSR investment activities and the overall corresponding impacts on business performance and stock prices in the long run.

## **5. 2. Conclusions**

The conclusion drawn from this study is that programmatic CSR activities eventually cultivate loyal partners and a grateful clientele thereby developing a highly productive and sustainable relationship between the initiating organizations, partner donors both individual and corporate as well as beneficiaries in the community. Such a relationship should be the target of any organization with CSR programs.

Based on the results from data analysis and findings of the study individual social concern components are significantly positively related to measures of systematic risks. It appears that the risk return tradeoff is such that no clear utility gain or loss can be realized by investing in firms characterized by different levels of social and environmental performance.

It has become more visible that in times of moderate levels of volatility of returns, firms that engage in socially responsible behavior are characterized by lower levels of market risk while during times of high volatility, firms that are socially irresponsible are associated with high levels of financial risks.

The findings that corporate social performance affects the ability of a firm to cope with adverse economic down times should be considered by firm managers when they make strategic business decisions and private or institutional investors when they trying to identify the optimal asset allocation of their wealth. The latter is especially true for those institutional investors such as pension funds who have significantly predictable outflows to beneficiaries and want to invest in share that are not very volatile.

Managers will thus endeavor to maintain corporate social responsibility in a move to increase shareholders value i.e. profit maximization and increase the overall profit generation of the company. Corporate social responsibility which in essence a corporate activity, inevitably brings up the issue of the motivations of the organizations practicing it. In essence CSR, is about “doing good”, and thus intertwined with notions of benevolence, which run contrary to the profit motive.

### **5.3. Policy Recommendations**

According to majority of the respondents there is need of more corporate social responsibility in their organization. The need for the same cannot be under estimated in marketing the products and services of the organization and thus minimizing the costs associated with marketing. For these organizations to fully meet their social responsibility enterprises should have in place a process to integrate social, environmental, ethical and human rights concerns into their business operations and core strategy.

Stakeholders in an organization include employees, providers of finance, government, community and environment, consumers of the organization's products and special interest organizations or groups. CSR demands that good corporate leadership and governance should therefore strive to maintain a balance between the organizational interests and those of stakeholders in order for the organization's business to be conducted in a profitable and sustainable manner.

Organizations require implementing partners for their CSR programs since the activities are often not within the company's core competence. Many organizations such as the Kenya Commercial Bank (KCB), Co-operative bank of Kenya and Equity bank have formed foundations to help them implement their respective CSR programs. Not all organizations may have the resources to set up foundations and in any case, successful CSR programs essentially have to have community implementing partners. Communities should therefore form their own credible structures to partner with organizations in their implementation of CSR projects and programs.

CSR activities are likely to be more effective both to the target beneficiaries and the initiating organization when carried out either as high impact projects, timed or open ended programs than when done as one off events. Some organizations carry out one time or many uncoordinated high media profile events erroneously believing that the members of the public will remember the events, hold the organization in high esteem and increase their business transactions with the company. Unfortunately, such events are a waste of resources because their impact is like a grass fire- quick, short-lived and quickly forgotten. They neither effectively benefit the organization nor the targeted beneficiaries.

## **5.4 Limitations of the study**

It's not possible to have a perfect research situation, it is logical to expect some research limitations that evolved during the research assignment.

Owing to time and resource limits the study drew its sample only from listed banks at the Nairobi security Exchange. The Excessive transport costs of visiting supervisors offices for guidance, the communications costs of calling and following up on respondents.

Another challenge encountered was the time limits and complexity of access to information. The researcher is a full time employee and getting time to meet with the respondents proved to be quite a challenge.

Most respondents who were to participate in the research were not freely giving information. In addition very few banks accepted to authenticate the respondent's questionnaires by stamping them, it's a bank policy not to stamp non-banking documents.

The study was limited to the banking sector only having in mind the bigger service industry in the country and the challenges facing the service industry where the services cannot be quantified. ❖

## **5.5. Recommendations for further research**

The study had focused on the need of corporate social responsibility in quoted banks and the risk levels. Further research need to be undertaken on the investing in corporate social responsibility to enhance customer value as well as returns to shareholders value.

Employees have also emerged as key players in enhancing CSR activities there is need to conduct a study to establish the relation that exists between employee relations and CSR activities.

The reputation risk of firms is highly affected if CSR impacts negatively, there is need to understand the relationship that exists between reputation risks and CSR.

Corporate social activities are under scrutiny, board and shareholders are increasing demanding that outcomes from these investments be measured to understand if and how they positively impact on profitability of the firm.

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**APPENDIX 1:  
LETTER OF INTRODUCTION**

Dear respondent,

**RE: MBA Research Project**

I am a post graduate student at the School of Business, University of Nairobi, doing a research on how corporate social responsibility relates to firm risk as part of the requirements for the award of a degree of Master of Business Administration (MBA).

Kindly spare some of your time to fill in the questionnaire to enable me finalize my studies.

The information collected will be used only for academic purposes and will be treated with strict confidence. Your name will not be mentioned in the report. Where possible a copy of the research report will be availed to you on request.

Your assistance and cooperation will be highly appreciated.

---

**Judy Stanley**

**MBA student**

## APPENDIX 2 QUESTIONNAIRE

### The Relationship between Corporate Social Responsibility and Firm Risks.

Kindly take a few minutes to complete this questionnaire. Your specific answers will be treated in strict confidence and no organizations /respondents names will be disclosed without full consent of the concerned.

#### A. RESPONDENTS BACKGROUND.

Name of the Respondent.....

Position in the Organization.....

Name of the Bank.....

B.	<b>POLICY &amp; EMPLOYEES</b>	Strongly Agree (5)	Agree (4)	Neutral (3)	Disagree (2)	Strongly Agree (1)
1.	This financial institution has a CSR mission statement & values showing a business principles and /or vision of corporate responsibility					
2.	This financial institution has code of Ethics					
3.	The code of ethics is distributed to Employees					
4.	There is a manager responsible for ethics or corporate responsibility issues.					
5.	This financial institution publishes a social report and /or has an ethical audit					
6.	This financial institution has a policy to support the human rights of its employees					
7.	This financial institution been fined for false advertising.					
8.	This financial institution applies an environmental standard policy.					
9.	This financial institution has been involved in corruption law suits within the past five years					
10.	This financial institution has an anticorruption or bribes policy					
11.	This financial institution has an anti discrimination policy in recruiting, promoting and training					
12.	This financial institution has a form of employee					

	participation to profits					
13.	This financial institution's Board of Director's actions are transparent (such as comply with Cadbury code, OECD3 corporate governance Guidelines					
14.	This financial institution's staffs are trained on the corporate code of ethics					
15.	This financial institution requires its suppliers to adhere or comply with its code of ethics					
16.	This financial institution tries to have a continuing dialogue with the internal and external stakeholders of the financial institution on social responsibility issues.					
17.	This financial institution contributes to projects for the local community					
18.	This financial institution creates jobs Every year.					
19.	This financial institution takes risks, is innovative, and is open to experimenting with different ways of doing things					
20.	This financial institution pays attention to details, strives for precision, and stresses the importance of analytical skills					
<b>C.</b>	<b>ORGANIZATION CULTURE</b>					
21.	This financial institution is achievement-oriented, has high expectations and demands results from its employees					
22.	This financial institution is an aggressive competitor and takes advantage of opportunities					
23.	This financial institution is supportive of its employees, shares information with them and praises their performance					
24.	This financial institution is noted for its high pay for performance and offers opportunities for professional growth					
25.	This financial institution has a team oriented work environment and encourages collaboration					
26.	This financial institution's decision making process is decisive, and entails little Conflict					
<b>D</b>	<b>ETHICAL CITIZENSHIP</b>					
27.	Staff behave in ways that reinforce the institutions' code of conduct					
28.	Staff in my financial institution are consistently trained in ethics and integrity					

29.	My financial institution follows good motives and intentions when evaluating its employees					
<b>E.</b>	<b>REPUTATION</b>					
30.	My financial institution is willing to put in a great deal of effort beyond that normally expected in order to help customers understand the products / service before they make a decision					
31.	I have a good feeling about this financial institution					
32.	I respect and admire this financial Institution					
33.	I trust this financial institution					
34.	It offers high quality products and Services					
35.	It develops innovative products and Services					

Any Additional Comments .....

.....

.....

Thank You!

### APPENDIX 3

## LIST OF QUOTED COMMERCIAL BANKS

#### BANKING

Barclays Bank Ltd Ord 2.00

CFC Stanbic Holdings Ltd ord.5.00

Diamond Trust Bank Kenya Ltd Ord 4.00

Housing Finance Co Ltd Ord 5.00

Kenya Commercial Bank Ltd Ord 1.00

National Bank of Kenya Ltd Ord 5.00

NIC Bank Ltd Ord 5.00

Standard Chartered Bank Ltd Ord 5.00

Equity Bank Ltd Ord 0.50

The Co-operative Bank of Kenya Ltd Ord 1.00

