The Role of Corporate Social Responsibility (CSR) in the Egyptian Banking Sector

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<u>Abstract</u>

Given the global recognition of *Corporate Social Responsibility (CSR)* of the financial institutions in developed countries and the lack of interest in the relevance of this concept in Egypt, it is essential to investigate the relation between Corporate Social Responsibility and Financial Performance (i.e. CSR-FP link) in the Egyptian banking sector. This paper explores, empirically, this association. The results imply a negative and statistically significant relationship between CSR-dimensions and banks' profitability. This empirical evidence is consistent with the neoclassical economists' point of view that practicing CSR by an organization is associated with competitive disadvantages.

Keywords: Corporate Social Responsibility (CSR), Egypt, Banking Sector, Profitability.
JEL classification: E50, G0.

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1. Introduction:

In the early 1990s, the Egyptian government implemented *the Economic Reform and Structural Adjustment Program (ERSAP)* in order to amend the structural imbalances in the economy and allow the private sector to lead economic growth. (Subramanian, A., 1997).

This program aimed at liberalizing the financial markets, reforming the banking sector and supporting the role of Egyptian banks as partners in achieving economic development. Furthermore, several banking reform plans implemented in the last twenty years by the Central Bank of Egypt (CBE, *hereafter*) ended up by the plan (spanning from January 2009 till present) to improve the soundness of the Egyptian banking sector and upgrade its competitiveness and risk management ability.[1]

In accordance with its obligatory role, the CBE declared in August 2011, a circular on *Banks' Governance* in order to adapt the international governance standards to the Egyptian banking sector. It included clear governance rules, information system efficiency and appropriate competency criteria for officials and managers of banks' key sectors. [2] Unfortunately, there was no *Corporate Social Responsibility Code or Index* to assess the degree of involvement of the Egyptian banking sector in socio-economic aspects of the economy.

Reviewing the relevant literature implied that due to the problem of data limitation; there was no empirical research to analyze the direct relation between practicing CSR in the Egyptian banking sector and its finical performance. Therefore, it was crucial to find a way to investigate *the role of Corporate Social Responsibility (CSR, hereafter)* of Egyptian banks.

Accordingly, this paper contributes to the existing studies as it represents the first study that provides an empirical assessment of practicing the principles of CSR in the Egyptian banking sector.

This study is structured as follows: section 2, deals with the conceptual framework of CSR. Section 3, reviews the relevant studies. Section 4, discusses the methodology and data issues. Section 5, indicates the empirical results. Finally, section 6 concludes.

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[1] Central Bank of Egypt, "Annual Report for Fiscal Year 2009/2010".

[2] Central Bank of Egypt, "Circular Dated 23 August 2011 Regarding the CBE's BOD Decree Dated 5 July 2011 on Banks' Governance". The official website of the Central Bank of Egypt: http://www.cbe.org.eg/public/Banks_Governance.pdf

2. The Conceptual Framework:

(Garriga and Melé, 2004, p.51) demonstrated that once Bowen (1953) wrote his seminal book '*Social Responsibilities of the Businessman*', the recognition of the CSR of organizations evolved.

(Carroll, 1979; 1991) contributed in framing the CSR concept through building on Bowen's work and highlighted the conceptualization of CSR as a pyramid comprising *economic*, *legal*, *ethical*, and *philanthropic* responsibilities of the business.[3]

The *economic* responsibilities were related to the objective of business to produce goods and services to gain profits. In this context, (Lantos, 2001, p.600) described CSR as "*the organization's obligation to maximize its positive impact and minimize its negative effects in being a contributing member to the society, with concern for society's long-term needs and wants*".

The *legal* responsibilities were considered as the second layer of the pyramid where organizations are obliged to operate within the boundaries of laws. (McWilliams and Siegel, 2001, p.117) defined CSR as "*actions that appear to further some social good, beyond the interest of the firm and that which is required by law*".

The third level of the pyramid was *Ethical* responsibilities. Those were related to the nature of the organizational operations that should be moral, fair and just. Finally, *Philanthropic* responsibilities were relevant to directing the financial and other resources of the organizations to the benefit of the community. In this regard, (Edmondson and Carroll, 1999; Hill *et al.*, 2007) suggested that a key indicator to determine the true worth of modern organizations was their ability to give back to the society part of their earnings through CSR initiatives.

The other conceptual framing for CSR in the literature was the model by Wood (1991). She introduced important refinements to Carroll's Pyramid by going beyond an identification of the different types of *responsibilities*. She examined the degree to which *principles* of social responsibility motivate actions taken by the organization, the degree to which the firm makes use of socially responsive *processes*, and the existence and nature of policies and programs designed to manage the firm's social impacts (i.e. the observable outcomes) of its CSR performance.

Recently, other concepts began to appear such as the '*triple bottom line*' principle. This concept was widely used in the literature to reflect that organizations (including banks) had to extend their reporting to incorporate their *economic* performance as well as the *social* and *environmental* aspects of their activities. (Sharma, 2011).

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[3] This was based on the investigation of the American business environment. Depending on a similar conceptualization, (Visser, 2008) addressed it in developing countries.

In addition, CSR of banks addressed issues such as employees' rights and security, education and leadership development, resources management and stakeholders' rights.[4] Banks nowadays relate their social and environmental responsibilities to the corporate sphere by choosing other terms such as: '*Corporate Duty*'; '*Corporate Responsibility*'; '*Corporate Sustainability*'; and '*Business Ethics*'. (Viganò and Nicolai, 2006).

Such concepts were used to reflect the crucial responsibility of banks in contributing to sustainable economic development while it was striving towards achieving profit maximization.

In conclusion, despite the previous mentioned efforts by researchers to conceptualize CSR, it could be considered as a controversial term. A universally accepted definition of CSR did not exist. This was attributed to the differences in culture, economic development, legal and political environment, organizational ethical climate, and gender. (Jamali and Mirshak, 2007).

Nevertheless, a definition of CSR that a number of researchers referred to was that '*CSR could be defined as the commitment of business to contribute in sustained economic development, working with employees, their families, local community and society to improve their quality of life*'.(World Business Council for Sustainable Development, 2001, p. 6).

3. Review of the Relevant Studies:

An obvious feature of the literature on CSR-FP link was the concentration on the role of companies as drivers of CSR (e.g. Waddock and Graves, 1997; McWilliams and Siegel 2001). Furthermore, the directional influence of the dimensions of CSR to financial performance of companies was investigated (e.g. Makni et al., 2009). However, the role of the banking sector was rarely investigated (e.g. Soana, 2009; Simpson and Kohers, 2002).

Furthermore, there is no consensus regarding the CSR-FP relation in empirical studies. This was attributed to the several variables used as proxies for financial performance and CSR. The mixed findings of the literature indicated that the CSR-FP relation could be positive, negative, or neutral. (Amole *et al*., 2012; Griffin and Mahon, 1997).

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[4] The Egyptian Banking Institute (EBI), "Corporate Social Responsibility (CSR)", Issue 14, the official website of the EBI, http://www.ebi.gov.eg/Admincp/ App_Upload/file/Info%20Fourteen_CSR_English(1).pdf

- The *negative relation* as argued by the neoclassical economists (e.g. Friedman 1970) could be explained as socially responsible firms have a competitive disadvantage, because they incur costs that reduce profits and shareholders' wealth. (Waddock and Graves, 1997). Hence, firms tend to reduce expenses on CSR dimensions to increase short-term profits.

  On the contrary, (Hopkin and Cowe, 2003) discussed the empirical evidence of a weak inverse relation between the CSR rank of the organization and the price of its shares. This implies another way of illustrating the CSR-FP link.

- The *positive CSR-FP* implied that practicing CSR principles by banks could help them earning trust, reputation and confidence of stakeholders. This in turn would increase their profits. (Amole *et al.*, 2012; Simpson and Kohers, 2002).

- The *no CSR-FP relation* implied that the interrelations between the financial institution and the society were so complex that a simple, direct CSR-FP relationship did not exist. Other variables could intervene. (Soana, 2009).

Moreover, the CSR-FP link had been investigated in the Jordanian banking sector (Sulaiman, *et al.*, 2012) and in the Nigerian banks (Amole *et al.*, 2012). However, there was no study of the CSR-FP relation in the Egyptian banking sector.

4. Methodology and Data Issues:

In order to measure the relationship between CSR in the Egyptian banking sector and its performance, the paper utilized the following multiple-regression equation:

$$
\begin{aligned}
Earnings\ =\ &\alpha + \beta_1(Capital\ Adequacy) + \beta_2(Liquidity\_1) + \\
&\beta_3(Liquidity\_2) + \beta_4(Liquidity\_3) + \\
&+\ \beta_5(Asset\ Quality\_1) +\ L\,L\,L\,L\,L\,L\,L\,L\,L\,L\ Equ.(1) \\
&\beta_6(Asset\ Quality\_2) + \beta_7\big(Finance\,to\,Private\ Sector_{CSR}\big) \\
&+ \beta_8\ Banking\ Density_{CSR}\ + \varepsilon_i
\end{aligned}
$$

The ratio of net profit to assets was used as the dependent variable.

The following independent variables were incorporated into the analysis:

- The ratio of equity capital to assets was used as a proxy for capital adequacy.

- Three proxies for liquidity were utilized; the ratio of loans and discount balances to total deposits with banks (Liquidity_1); the ratio of securities to the average of assets (Liquidity_2) and the ratio of deposits to the average of assets (Liquidity_3).

- Two measures for the quality of assets were included in the analysis (The ratio of loan provisions to total loans (Asset Quality_1) and the ratio of provisions to the average of assets (Asset Quality_2)).

- The ratio of claims on the private business sector to the Growth Domestic Product (GDP) indicates the role of the banking sector in providing finance to the private sector. This variable was considered as one-dimension of the CSR of banks towards the society.

- The banking density was calculated as the population in thousands for each banking unit. This variable was used as another dimension for the CSR of banks.

Testing the parameters β_7; β_8 attached to the CSR-dimensions would reflect the impact of CSR on banks' profitability. Moreover, joint test hypotheses were utilized as follows:

1- The Separate Hypotheses:

The null hypothesis

H_0: β_7; β_8; separately are $= 0$ (i.e. the relationship between CSR dimensions and banks' profitability is neutral).

Against the <u>alternative hypothesis</u>;

H_1: β_7; β_8; separately are $\neq 0$ (i.e. the relationship between CSR and banks' profitability could be positive or negative).

2- The Joint Hypotheses:

The null hypothesis

H_0: $\beta_1 = \ldots = \beta_8 = 0$ (i.e. the independent variables do not affect the dependent variable, jointly).

Against the <u>alternative hypothesis</u>;

H_1: $\beta_1 \neq \ldots \neq \beta_8 \neq 0$ (i.e. the independent variables affect the dependent variable, jointly).

Furthermore, this paper utilized the Granger-causality test to assess the directional influence of the dimensions of CSR to profitability. The approach was simply the following:

The variable X is a cause of *Y* (i.e. $X \Rightarrow Y$). *The variable X* is able to increase the accuracy of the prediction of Y with respect to a forecast, considering only past values of *Y*. (Granger, 1969).

3- The Pairwise Granger Causality Test Hypotheses:

The null hypothesis

H_0: The two CSR-dimensions do not Granger-cause profitability.

Against the alternative hypothesis;

H_1: The two CSR-dimensions do Granger-cause profitability.

Accordingly, the interpretation of the results would depend on:

- The signs of the coefficients attached to the variables representing the two dimensions of CSR as well as the overall significance of the estimated model.

- The Granger-causality test would indicate the directional influence of the dimensions of CSR to profitability.

Concerning the data used in the analysis, the variables were collected for banks operating in Egypt (except the Central Bank of Egypt (CBE)) on monthly basis. The sample covered the period from January 1999 to July 2011. The data were collected from the publications of the CBE that aggregate the financial positions of banks.[5] Three variables were available on monthly basis from the data source. They were the ratio of loans to deposits, the ratio of claims on the private business sector to growth domestic product, and capital adequacy.

However, due to the non-availability of the other six variables on monthly basis, they were disaggregated from quarterly frequency using statistical methods. In addition, some of the series were corrected for the seasonality problem using the appropriate statistical methods.[6]

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[5] The publications and data are available at the official website of the Central Bank of Egypt (CBE), *http// www.cbe.org.eg.*

[6] The adjusted variables were the ratio of securities to the average of assets (liquidity_2) and the ratio of deposits to the average of assets (liquidity_3), the ratio of claims on the private business sector to growth domestic product, capital adequacy and the banking density.

5. *The Empirical Outcomes:*

Table (1) indicates the correlation matrix of the independent variables. It reflects the high correlation between the two dimensions of CSR (e.g. banking density and finance to the private sector). The value of the correlation coefficient is 0.97. It shows, also, a correlation between the dimensions of CSR and liquidity.

Table (1): The Correlation Matrix of the Independent Variables

	Capital Adequacy	*Liquidity 1*	*Liquidity 2*	*Liquidity 3*	*Asset Quality_1*	*Asset Quality_2*	*Finance to the Private Sector (the 1st dimension of CSR)*	*Banking Density (the 2nd dimension of CSR)*
Capital Adequacy	**1.00**	-0.27	0.58	0.34	-0.17	-0.68	-0.61	-0.57
Liquidity 1	-0.27	**1.00**	-0.62	-0.81	-0.77	0.67	0.86	0.84
Liquidity 2	0.58	-0.62	**1.00**	0.59	0.23	-0.69	-0.73	-0.65
Liquidity 3	0.34	-0.81	0.59	**1.00**	0.56	-0.52	-0.67	-0.67
Asset Quality_1	-0.17	-0.77	0.23	0.56	**1.00**	-0.08	-0.55	-0.56
Asset Quality_2	-0.68	0.67	-0.69	-0.52	-0.08	**1.00**	0.79	0.75
Finance to the Private Sector (the 1st dimension of CSR)	-0.61	0.86	-0.73	-0.67	-0.55	0.79	**1.00**	0.97
Banking Density (the 2nd dimension of CSR)	-0.57	0.84	-0.65	-0.67	-0.56	0.75	0.97	**1.00**

Source: The researcher's calculations.

Table (2) shows the results from the estimation of equation (1). The value of t-statistic suggests the significance of each variable. The results show that there is an inverse and statistically significant relation between the two dimensions of CSR and banks' profitability (at 5 percent significance level).

This empirical evidence is consistent with the neoclassical economists' point of view that practicing CSR by an organization is associated with competitive disadvantages.

A high value of F-statistic that equals 83.27 implies the overall significance of the model. Furthermore, the high value of R^2 of 0.83 suggests that for a successful assessment of the link between profitability and CSR-dimensions, it is essential to include all the relevant variables. (Diagram (b) in the Appendix shows the research model). In addition, the high correlation between the two-dimensions of CSR does not affect the overall results.

Table (2): Results from the Estimation of Equation (1)
The sample covers the period from 1999:M₁ to 2011:M₇

The Independent Variables	The coefficient	t-Statistic	Probability
Capital Adequacy	0.1805	0.4657	0.6421
Liquidity 1	-0.1168	-2.1534	0.0330
Liquidity 2	-0.0071	-0.1627	0.8710
Liquidity 3	-0.9082	-11.9328	0.0000
Asset Quality_1	-0.9927	-4.6210	0.0000
Asset Quality_2	2.9033	6.2103	0.0000
Finance to the Private Sector	-0.2768	-5.0846	0.0000
Banking Density	-1.1550	-4.6405	0.0000
Constant	113.8973	11.4932	0.0000
R^2	0.8253		
Adjusted R^2	0.8154		
F-statistic	83.2684		
Probability (F-statistic)	0.0000		
Durbin-Watson Statistic	0.4527		

Source: The researcher's calculations.
The dependent variable is the ratio of net profit to equity.

Finally, the test for the causality direction has to be performed using stationary series. Hence, applying the Augmented Dickey-Fuller (ADF) test on the three variables (finance to the private sector, banking density, and profitability) indicates that they are non-stationary. Table (3) highlights the pairwise Granger-causality test applying 6 lags on the first differences of the three variables. This represents the appropriate lag length for the stability of the estimated equations. It shows *a unidirectional causality* from finance to the private sector to both profitability and banking density.

Table (3): Pairwise Granger Causality Tests

Null Hypothesis	Number of Observations	F-Statistic	Probability
Finance to the Private Sector does not Granger Cause Profitability	144	3.4697	0.00325*
Profitability does not Granger Cause Finance to the Private Sector	144	0.78343	0.58439
Banking Density does not Granger Cause Profitability	144	0.97118	0.44741
Profitability does not Granger Cause Banking Density	144	0.06023	0.99911
Banking Density does not Granger Cause Finance to the Private Sector	144	0.45075	0.84337
Finance to the Private Sector does not Granger Cause Banking Density	144	4.77641	0.00020*

Source: The researcher's calculations.
The sample spans over the period from 1999: M₁ to 2011: M₇.
* Implies the rejection of the null hypothesis at 5% significance level.

6. Concluding Remarks

• The linkage between CSR and firms' financial performance had received considerable research attention. The empirical findings concerning the relationship between the two variables were mixed. However, the similar investigation for the banking system was rare.

• Using data for banks operating in Egypt (except the CBE) showed that there was a negative and statistically significant relation between the two dimensions of CSR in the banking sector and its profitability.

• The negative signs of the coefficient attached to CSR dimensions were consistent with the competitive disadvantages argument by the neoclassical economists in explaining the CSR-FP link.

• The empirical outcomes showed a unidirectional causality from finance to the private sector to both financial performance and banking density.

• The results could be sensitive to the empirical method and the variables incorporated in the estimation. This could be a scope for further research.

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Appendix

Table (a): The Main Variables

The Variable	How to Measure It
Earnings as the Dependent Variable	The ratio of net profit to equity
Independent Variables	
Capital Adequacy	The ratio of equity capital to assets
Liquidity _1	The ratio of loans to deposits
Liquidity _2	The ratio of securities to the average of assets
Liquidity _3	The ratio of deposits to average assets
Asset Quality_1	The ratio of loan provisions to total loans
Asset Quality_2	The ratio of provisions to the average of assets
Finance to the Private Sector	The ratio of claims on the private business sector to GDP
Banking Density	This variable is computed as the population in thousands for each banking unit.

Note: The variables were collected for banks operating in Egypt (except the Central Bank of Egypt (CBE)) on monthly basis. The sample covered the period from January 1999 to July 2011.

Diagram (b): The Research Model and Variables

Independent Variables

Dependent Variable
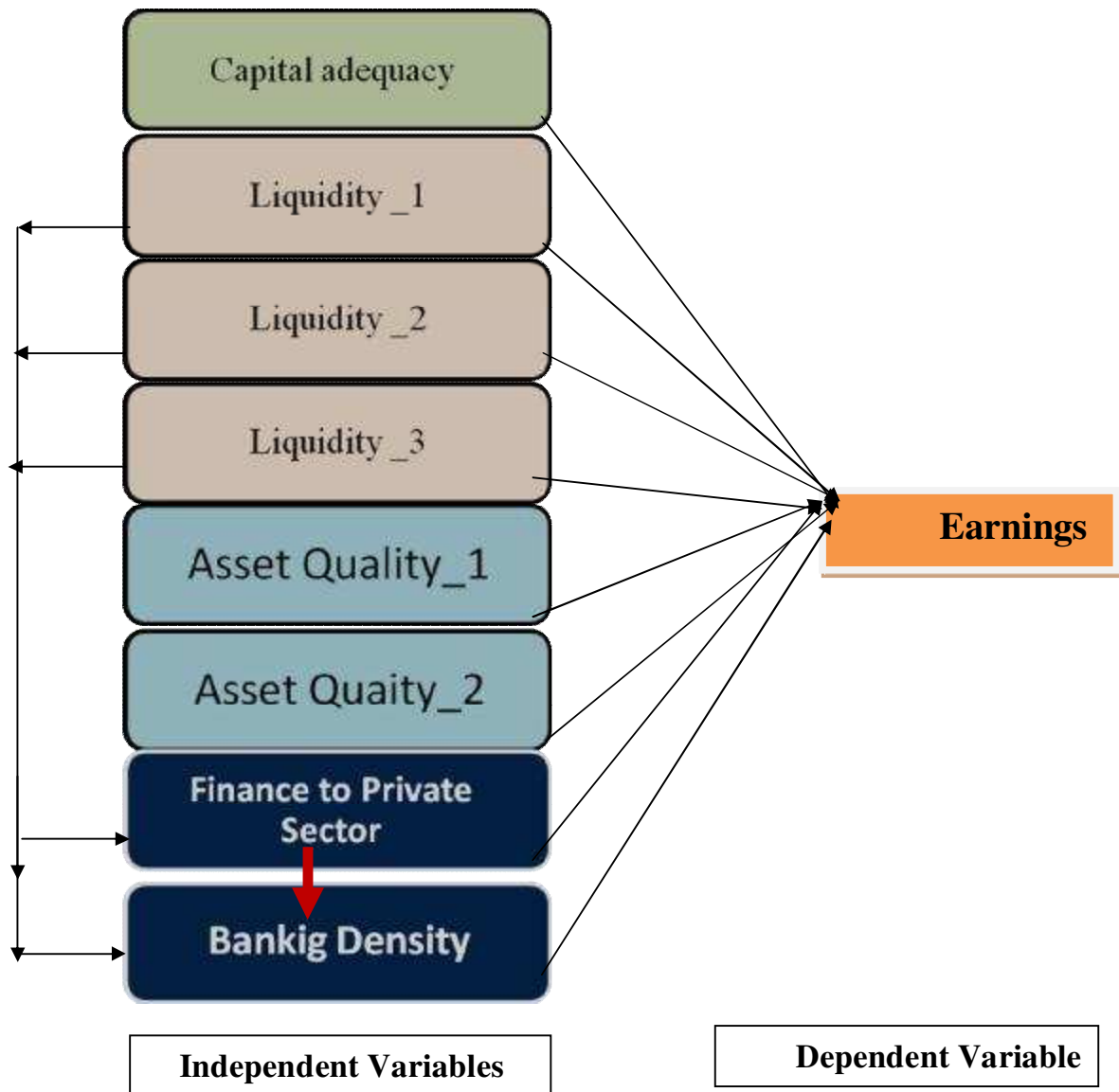
Source: This diagram represents my point of view regarding the relation between the variables using Egyptian data. It suggests that the eight independent variables affect profitability jointly. Moreover, there is a logical relation between the various definitions of liquidity and the ability of the banking sector to provide finance to the private sector and extend banking units. In addition, there exists a unidirectional causality from finance to the private sector to banking density.

Diagram (c): The Direction of the Causality between the Main Variables Depending on the Results of the Causality Test

Finance to the Private Sector (Dimension of CSR)	⇄	Profitability
Banking Density (Dimension of CSR)	↔	Profitability
Banking Density (Dimension of CSR)	⇄	Finance to the Private Sector (Dimension of CSR)