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A Study of Relationship between Corporate Governance, CSR and Firm Performance: Empirical Evidence from Indian Banking Industry

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Banking industry envisages the flow of finance in the country. In a developing nation like India, the banks play a crucial role in providing the funds for infrastructural development and upliftment of the industries. Thus, working memorandum of the banks should depict application of corporate governance in association with the corporate social responsibility (CSR) initiatives to build a social connect with the citizens. This in turn is likely to have a significant impact on their performance. The purpose of this paper is to analyze the relationship among corporate governance, CSR initiatives and performance of the commercial banks in India. The hypothesis that corporate governance, CSR activities and firm performance are inter related, has been tested empirically, extracting facts and figures from the annual reports of the banks for the year 2014-15. The research methodology involves the application of Pearson's Correlation Coefficient and Multiple Regression to conduct the statistical investigation among the three parameters. The parameters depicting significant correlation and further used to develop regression models. Model fit is then tested using R square. The study offers significant managerial implications for decision making and improving firm performance by establishing connect between the above stated parameters. The generalisations are limited to ten banks under study and are also period specific. The study may be extended by enhancing the scope of research to other significant industries. Further research may be conducted taking all Indian banks and increasing the span of time.

Key Words: IndianBanking Industry, Corporate Governance, Corporate Social Responsibility, Firm Performance, Commercial Banks.

Introduction

CSR has become one of the most debated topics in the business world. The buzz around CSR is associated with the globalisation process, which stimulates economic and social development in emerging economies. (Christmann and Taylor, 2001)CSR is a response to modern day circumstances of globalisation, in which capitalism is expected to play a social or productive role rather than merely making profits for business owners. If CSR is put in plain words it can be described as social or moral responsibility towards a civilisation.Not only the attention towards CSR has grown these days but corporate governance also seems to have an important linkage with CSR. For almost every organisation in India working on a large scale transparent disclosure of the information has become mandatory. Therefore corporate governance has become an integral part of organisations to disclose their information on CSR practices. Most of the companies include corporate governance in their CSR practices these days. CSR and Corporate governance not only depict a firm's ethical behaviour but also show the financial progress of a firm. Good corporate governance in India has contributed majorly towards building confidence among organisations and foreign investments. SEBI has also taken measures to construct a rigorous regulatory regime that has ensured fair practices, especially in the financial institutions. Due to these stricter norms, banks also have ensured fair corporate governance towards society and have always been showing improvements in their performance. Banking Industry contributes majorly towards the regulation of a country's economy and GDP. Indian Banks have reached a way ahead in fetching the rural masses towards banking awareness and also have gone a long way in bringing banking at the door step of the rural people. Awareness about CSR, Sustainable development and Non-financial reporting (NFR) all these things have been brought in force by RBI in the Indian Banking sector. CSR (Almona, 2005)in Indian Banking sector also aims at roping in the financial services to the untouched areas of country, covering the areas that demand a socio-economic

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development like poverty eradication, education, computer training programmes, health care and financial literacy trainings, environment protection etc. CSR has become the basic fundamental duty of an organisation these days. The institutions especially like banks need not to evaluate only the financial performance but also need to check in the CSR performances. The society at large in India has been feeling to improve the quality of their life over past two decades. The purpose of this study is to add our understanding of relationship among corporate governance, CSR initiatives and performance of banks in India.

Review of Literature

The notion of CSR (Carroll, 1999) is not new in the global era. CSR (Amran et al, 2013) can vary from business to business and also according to the social needs of time and society. All the organisations have various kinds of responsibilities including, legal, ethical, economic etc.

Davis (1973), CSR can be defined as a firm's responsibility to various issues of the society. These issues can revolve around the economic, legal and technical requirements of the organisation.

According to Holmes and Watts (1999), CSR is a commitment to improve the ethical behaviour continually towards society and also improve the lives of employees at work, so that the organisation can achieve the social and organisational goals together.

World Business Council for Sustainable Development (2001), explained that CSR can help the management be more committed towards business and help understand the economic development to make it more sustainable.

According to Michael Hopkins (2003), getting involved in CSR activities keeps internal and external stakeholders together, bound in an ethically and socially. The broader scope of being involved in a CSR is that it contributes towards improving the standards of living of weaker sections of the society along with preserving the profitability of the corporation, for its stakeholders.

According to Friedman (2006), says that a firm's only social responsibility is to carry out business activities which can multiply its profits. As long as a firm plays ethically, the more are the chances to stay in competition in market.

Sharma and Mukta (2013), explained that banks are making an effort to help a society grow by fulfilling their social responsibilities but still the efforts need to be more aggressive in order to meet the requirements.

The relation between CSR and financial performance has not been extensively examined in the banking industry, the existing few studies offer conflicting evidence (e.g., Chih et al., 2010; Wu and Shen, 2013).

Given the mixed results of previous studies and the incentive for banks to improve their reputations after the financial crisis, an examination of bank CSR activities surrounding the crisis would be of particular interest for assessing banks' efforts at being more socially responsible (Cornett et al., 2014)

Contribution of banking sector towards improving the literacy levels in the society and by providing scholarships and making people understand the importance of education in weaker sections of the society has been of greater importance. In the tough competition times, if the banks need to survive long term among the stakeholders they need to go an extra mile and that can be done by contributing towards CSR.(Singh et al., 2015)

Corporate Governance & Firm Performance

Shleifer and Vishny (1997) define corporate governance as "the ways in which suppliersof finance to corporations assure themselves of getting a return on their investment." Given this,much of the governance literature has focused on studying the different ways suppliers of capitalcan monitor their investments. While there are numerous plausible proxies for corporategovernance, in most corporations, the board of directors' explicit purpose is to serve as theliaison between shareholders and managers. As such, the relationship between boardindependence and firm performance is one of the most studied relationships in the corporategovernance literature.

Bhagat and Black (2002) document that firms with moreindependent boards do not perform better, using a variety of performance measures. They alsofind that poorly performing firms are more likely to increase the number of independent directors, but that this does not improve performance.

More recently, Bhagat and Bolton (2008)find a negative relationship between board independence

and operating performance. Theoverwhelming majority of work finds that having a more independent board of directors does notlead to better performance and may actually lead to worse performance.

In a study conducted on Pakistani listed firms, a significant relationship between ROE and profit margin was found. The board size should be limited to a sizeable limit and board must be a right mixture of executive and non-executive directors. (Yasser et al, 2015, Velnampy, 2013)

According to John et. al. (2015), board independence does not affect the firm performance whereas the board size and board accounting positively affect the performance of the firm. The diligence of the board members towards the board meetings is also said to affect the performance of the firm.

Research Methodology

The study is based on descriptive research. A sample of ten banks has been taken from the Indian banking industry. The data pertaining to the following ten commercial banks has been extracted from their annual reports for the year 2014-15:

- State Bank of India
- Punjab National Bank
- Bank of Baroda
- Andhra Bank
- Canara Bank
- Axis Bank
- IDBI Bank
- HDFC Bank
- Yes Bank
- IndusInd Bank

The hypothesis formulated is mentioned hereunder:

There is significant relationship between corporate governance and firm performance in banking industry.

For testing of hypothesis, the data has been analyzed using the statistical techniques viz. Karl Pearson's Coefficient of Correlation and multiple regression analysis.

Variables

The study has been incorporated with three kinds of variables i.e. dependent, independent and control variables.

The three variables depicting the firm performance are Return on Assets, Return on Equity and Earnings Per Share which are taken as dependent variables. The independent variables are represented by Board size, Board Meetings and Expenditure on CSR Initiatives which act as significant drivers of corporate governance.

Return on Assets, Return on Equity and Earnings Per Share values are extracted from the annual reports of the companies. Board size has been measured as the natural algorithm of the total strength of the board members in the respective companies. Board meetings are also measured as the logarithm of the number of board meetings in a year. The expenditure on CSR initiatives comprises of the expenditure made by the companies on healthcare, education, sanitation, rural development, environment sustainability, promoting entrepreneurship, poverty alleviation, cleanliness and livelihood.

Figure 1: Dependent and Independent Variables

Firm Performance (Dependent Variables)	Corporate Governance (Independent Variables)
• Return on Assets • Earning Per Share • Return on Equity	• Board Size • Board Meetings • Expenditure on Corporate Social Responsibility (CSR) initiatives

Correlation Analysis

Correlation Analysis has been used to analyze the degree of relationship between the variables representing corporate performance and corporate governance. Nine permutations for three parameters each for Firm Performance and Corporate Governance were made to find Karl Pearson's Coefficient of Correlation. Only 2 sets of combinations were found to be significantly correlated.

Table 1: Correlation Table

Parameters Analyzed	r	Type of Correlation	Significant/ Not Significant
CSR Expenditure and Return on Assets	.722	High degree of positive correlation	Significant
CSR Expenditure and Return on Equity	.686	High degree of positive correlation	Significant

Source: Created by authors using SPSS

Regression Model

This study employs multiple regression model to examine the relationship between firm performance and Corporate Governance variables. Mashayekhi and Bazaz (2008), Singh et al (2013) and Mcknight and Weir (2006) supported the regression model as a method for analyzing the relationship between variables. The following regression model is used to test the hypotheses

EPS/ ROA / ROE BSIZE + BM ECSR

Model I (CSR Expenditure and Return on Assets)

The correlation between CSR expenditure and return on assets is found to be significant. They have high degree of positive correlation of 0.722. The following regression model is developed to express the nature of relationship between them.

$Y = 0.716 + 0.468X$

Model II (CSR Expenditure and Return on Equity)

The correlation between CSR expenditure and return on equity is found to be significant. They have high degree of positive correlation of 0.686. The following regression model is developed to express the nature of relationship between them.

$Y = 10.118 - 0.362X$

Testing Model Fit

Coefficient of determination is analyzed to test the model fit.

Model - I

Table 2: Model-I Summary.

Model	R	R Square
I	.899	.573

Source: Created by authors using SPSS

Model - II

Table 3: Model-II Summary

Model	R	R Square
II	.676	.436

Source: Created by authors using SPSS

The specification of the two variables i.e. Return on Assets and Return on Equity in the model indicates the ability to predict performance. In model I the value of R Square is 0.573 and in model II the value of R Square is 0.436 which indicates that variability in performance can be explained by the differences in both the independent variables namelyReturn on Assets and Return on Equity. Remaining 42.7% and 56.4% of the variance in performance is related to other variables which are not depicted and explained in the model. R Square values of 57.3% and 43.6% indicate that there may be number of variables which can have an impact on performance that need to be studied. Hence this area is indicated as a scope for future research.

Dhingra& Mittal (2014), had focused on the significant role and impact of CSR in the Indian Banking Sector.

Discussion and Conclusion

The study has explained the influence of Corporate Governance variables such as Board Size Board meetings and CSR initiativeson firm performance. EPS, ROA, and ROE are used as measures of firm performance. To test these hypotheses, the study used the data from annual reports of Indian Banks for the financial year 2014-15. The correlation results suggest that expenditure on CSR initiatives is positively associated with Return on Assets as well as Return on Equity. The regression models developed indicates that majority of the variance in the firm performance is due to expenditure on CSR but there are other significant factors which have an impact on the firm performance. Expenditure on CSR activities of the Indian Banks has started playing a pivotal role in the performance of the bank. After the involvement of RBI the CSRhas becomethe important part of Banking Sector but still more regulations and new policies are required to implement the concept of CSR in Indian Banking Sector.

Scope for Future Research

The study provides a clear picture of the degree and direction of association between corporate governance, CSR and firm performance. Further research may be done wherein association between these parameters may be studied with respect to other industries like Software industry, Pharmaceutical industry. Also the scope of current research may be widened by expanding the time horizon and a comparative study may be conducted between public sector and private sector banks.The study may be extended to uncover more variables affecting firm performance apart from corporate governance and CSR.

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