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Impact of Corporate Social Responsibility on Firm's Financial Performance

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The Impact of Corporate Social Responsibility on Firm's Financial Performance

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ABSTRACT

Over the past decade, sustainability has emerged as one of the foremost issues faced by corporations across all sectors and corporate social responsibility has gained much momentum in the past two decades. This research investigates whether corporate social responsibility has an impact on the financial performance of in selected banks in Ethiopia. The aim was to ascertain whether or not a correlation exists between CSR and financial performance of Ethiopian banking sector. This paper specifically investigates the relationship between the financial performance and corporate social responsibility on the banking sector using an empirical approach from a compiled panel data. The findings reveal that there are observable differences in the financial performance of firms for a positive corporate social responsibility. The findings also reveal that all the data's follow the third hypothesis which dictates that there is a positive relationship between the two variables. The research has opened up the avenue for future studies to investigating the purported link between CSR and financial performance in the context of emerging economies like Ethiopia.

Key Words: - Corporate Social Responsibility

Financial Performance





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Acronyms

AAU	Addis Ababa University
AIB	Awash International Bank
ACFN	Accounting and Finance
BITC	Business in the Community
BoA	Bank of Abyssinia
BSR	Business for Social Responsibility
CBB	Construction and Business Bank
CBE	Commercial Bank of Ethiopia
CEO	Chief Executive Officer
CFP	Corporate Financial Performance
CSP	Corporate Social Performance
CSR	Corporate Social Responsibility
DB	Dashen Bank
IBLF	International Business Leaders Forum
KLD	Kinder, Lydenberg, Domini & Co. Inc



MBA	Masters of Business Administration
NBOUC	Number of Branches Opened Up Country
NGO	Non-Governmental Organizations
NIB	Nib International Bank
ROA	Return on Asset
ROE	Return on Equity
TOVR	Employee Turnover Ratio
WB	Wegagen Bank
WBCSD	World Business for Sustainable Development
WEF	World Economic Forum

CHAPTER ONE

1. INTRODUCTION

The field of corporate social responsibility has grown exponentially in the last decade. More than half of the Fortune 1000 companies issue corporate social responsibility (CSR) reports. A larger number of companies than at any time previous are engaged in a serious effort to define and integrate CSR into all aspects of their businesses. An increasing number of shareholders, analysts, regulators, activists, labor unions, employees, community organizations, and news media are asking companies to be accountable for an ever-changing set of CSR issues. There is increasing demand for transparency and growing expectations that corporations measure, report, and continuously improve their social, environmental, and economic performance.

The definition of corporate social responsibility is not abstruse. According to *Business for Social Responsibility* (BSR), corporate social responsibility is defined as “achieving commercial success in ways that honor ethical values and respect people, communities, and the natural environment.” McWilliams and Siegel (2001:117) describe CSR as “actions that appear to further some social good, beyond the interest of the firm and that which is required by law.” A point worth noticing is that CSR is more than just following the law (McWilliams & Siegel, 2001). Alternatively, according to Friedman (1997:227), the definition of what would exemplify CSR is the following: “An action by a firm, which the firm chooses to take, that substantially affects an identifiable social stakeholder’s welfare.”



A socially responsible corporation should take a step forward and adopt policies and business practices that go beyond the minimum legal requirements and contribute to the welfare of its key stakeholders. CSR is viewed, then, as a comprehensive set of policies, practices, and programs that are integrated into business operations, supply chains, and Decision-making processes throughout the company and usually include issues related to business ethics, community investment, environmental concerns, governance, human rights, the marketplace as well as the workplace.

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 demand, 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. Even if corporations need to incorporate social responsibility in their day to day performances most of the corporations keep their social responsibility in the dark.

There is no reports issued regard to CSR except some of them, so it makes it difficult for the evaluators to measure their contribution to the society. The case that they don't prepare reports of CSR to the stakeholders makes these corporations vulnerable to critics and judgments.

1.1 BACK GROUND OF THE STUDY

The field of corporate social responsibility (CSR) has grown exponentially in the last decade. Nevertheless, there remains a protracted debate about the legitimacy and value of corporate responses to corporate social responsibility concerns. There are different views of the role of the firm in society and disagreement as to whether wealth maximization should be the sole goal of a corporation. Living in the world of competition and fast social, environmental and cultural deterioration adapting corporate social responsibility principles is becoming crucial in surviving in a competitive environment. In most developed countries in the world like US, UK, China, Japan etc it's becoming customary to corporations issue CSR reports along with the Annual report. Corporations in these developed countries are also ranked on multiple CSR dimensions by number of firms that rate and rank companies (such as KLD and ASSET4 (Thompson Reuters) among others).

When we come to Africa the most under developed continent in the world CSR is a new concept for most of the countries. In Ethiopia currently the economy is growing fast and the attention and investment of International Corporations brings the concept of CSR to the attention of the society and also the society is developed in different aspects and asks a lot of questions one of which is corporate social responsibility.

An increasing number of shareholders, analysts, regulators, labor unions, employees, community organizations, and news media are asking companies to be accountable for an ever-changing set of corporate social responsibility issues. There is increasing demand for transparency and growing expectations that corporations measure, report, and continuously improve their social, environmental, and economic performance. It's very difficult to find research findings on the subject especially here in Ethiopia the researcher explore the Addis Ababa university data base and there was no single research paper on the topic mentioned above but it doesn't mean that there is no paper in this topic. So it's the researcher's opinion that it's important to study the impact of corporate social responsibility on financial performance in the Ethiopian banking industry context.

This paper identifies the CSR and its impact on the financial performance of some selected banks in Ethiopia from two dimensions the employee and the customers. It evaluates the relationship and the dimension of the relationship between CSR and financial performances of the corporations.

1.2 STATEMENT OF THE PROBLEM



The fast growing economy in Ethiopia has been tremendous scoring double digit economic development for the past seven or six years makes the country one of the resting place for foreign investors in Africa. In collaboration globalization and the economic development brings new concept to the minds of consumers, CEO's, managers, owners. Medias etc.... but what does CSR bring to the firm? This is the question that ever corporation would ask when they are thinking about CSR. So what effect does corporate

social responsibility will have on the firm's financial performance? Is the first and for most question that will be raised. This paper will demonstrate what impact CSR will have on firm's financial performance.

1.3 OBJECTIVE OF THE STUDY

1.3.1 General objective

The general objective of this research is to determine whether socially responsible corporations will exhibit improved financial performance or not. So the major objective of the study will be determining whether corporate social responsibility will have a positive, negative or no effect on the firm's financial performance.

1.3.2 Specific objective

Measuring the impact of CSR is complicated by its nature because of the difficulties in measuring CSR accurately and it's easy to see that there are no firms in Ethiopia which evaluate and rank corporations in CSR perspective or either the corporations issue CSR reports. Even if this is the case this research has the following specific objectives;

- ✦ Determine the impact of CSR on banks financial performance; whether it positive, negative or no impact.
- ✦ Examining which CSR dimension has a greater impact on the financial performance.
- ✦ Observing the benefits of CSR whether its short term or long term.

1.4 THEORIES AND HYPOTHESIS

In this study, the sign of the relationship between corporate social responsibility and financial performance is tested. The sign may imply negative, neutral or positive linkages. The argument for a negative relationship follows the thinking of those such as Friedman (1970) and other neoclassical economists. According to their view, socially responsible firms have a competitive disadvantage (Aupperle et al., 1985), because they incur costs that fall directly upon the bottom line and reduce profits, while these costs could be avoided or borne by individuals or the government. On the other hand, many empirical results reveal no significant relationship between CSR and financial performance. According to this line of thinking (e.g., Ullman, 1985), there are so many variables that intervene between the two that a relationship should not be expected to exist. The third view proposes that there is a positive linkage, since the actual costs of CSR are covered by the benefits.

A firm that attempts to decrease its implicit costs by socially irresponsible behavior—by, for example, neglecting to take measures against pollution—will eventually incur higher explicit costs. Socially responsible companies have less risk of negative events. It is less likely for these companies to pay heavy fines for excessive polluting, to have costly lawsuits against them, or to experience socially negative events that would be destructive to their reputation.



Theoretically, if there could be two identical companies, where the one is socially responsible and the other is not, it should be expected that the former would have less downside risk for value and encounter fewer events which would be detrimental to its line of profit. In the present study, empirical techniques will be used to identify the sign of the relationship. The major concept in the above paragraphs can be summarized by the following hypotheses.

Hypothesis 1. CSR will have a positive impact on the financial performance of the firm.

Hypothesis 2. CSR will have a negative influence on the financial performance of firms.

Hypothesis 3. CSR and financial performance have no relation at all.

1.5 OPERATIONAL DEFINITION

In order to reach at a common contentious operational definition is required. The concepts that are listed in this research paper may be new for some readers or may be perceived in different way therefore in order to clarify the concepts that are listed the following operational definition is required.

Corporate Social Responsibility (CSR) is defined as “achieving commercial success in ways that honor ethical values and respect people, communities, and the natural environment.” There are a lot of dimensions of measuring corporate social responsibility social, people, environmental, customer, employee etc for the purpose of this paper I use the two dimensions the social and employee.



The social responsibility is measured in terms of the percentage of branches opened outside of Addis Ababa to the total branches that the firm operates and the employee dimension is measured by employee turnover rate.

Number of branches opened up country (NBOUC) as mentioned above NBOUC is calculated by dividing the number of branches opened outside of Addis Ababa by the total branches that the firm operates. We only consider branches opened outside of the capital because the ratio of branches to number of customers is very low in the capital and unbelievably very high in upcountry.

Ability to select and retain employee measured by employee turnover (TOVR) employee turnover is calculated as a ratio of employees hired to employees left the company. Employees leaving the company don't include those who left because of retirement.

Return on Asset (ROA) This ratio is generally considered the best overall measure of a company's profitability and it is calculated by dividing operating income by average total asset of the corporation.

Return on Equity (ROE) This measure indicates how well the company employed the owners' investments to earn income. It's calculated by dividing operating income by average stockholders' equity.

1.6 EXPECTED RESULTS

As mentioned in the hypothesis and theories part there are obvious results for the research questions raised and the hypostasis listed. After the study the researcher expects three outcomes first the outcome can be positive which implies corporations which follow the principles of corporate social responsibility have benefited from their act and their financial performance have been positively impacted. The second outcome can be negative impact which implies corporate social responsibility only sucks up corporate costs no effect on the financial performance and last but not least indifference; meaning all the corporate costs on social responsibility will be returned from the benefits without any additional financial advantages. Most of previous outcomes revealed that there is a positive impact but it doesn't mean it is always true because some others have found a negative and indifference impact of corporate social responsibility on financial performance. Therefore the research will try to see the impacts of corporate social responsibility on firm's financial performance in the Ethiopian context by taking eight commercial banks and the outcomes can be one of the above mentioned options.

1.7 SIGNIFICANCE OF THE STUDY

Studying CSR new in the country it's discussed only in recent times without great emphasis in its impact on corporations. Even if it's discussed most of the time the discussions focused on the environmental dimension of CSR but there are number of dimensions in which we can see CSR. CSR and its impact on the financial performance of corporations have a great significance for countries which are in the verge of great economic development.

So the concept of CSR plays a vital role to the growth of companies. The study will open a new way of looking at CSR with regard to financial performance and CSR. The study will also be a footstep to others who need to study further on this area.

1.8 LIMITATION OF THE STUDY

The scope of this paper is to the study the impact of CSR on the financial performance of firms in the financial sector. As the study only considers the banking sector the data of other industry isn't included in the analysis. The data is limited to the thirteen years of annual report seven banks. The study did not compare the results with the same data set by other countries besides; the study data is limited to banks, in addition, for a comprehensive picture about corporate social responsibility and its impact on the financial performance it would have been more valuable if the study considered all sectors of industries in the country.

1.9 ORGANIZATION OF THE PAPER

The research paper on the impact of corporate social responsibility on firm's financial performance is organized in to five chapters the first chapter will be the introduction part in which the paper discuss the reason why this research is necessary; the research questions that are needed to be answered, limitations of the study and the methodology that is deployed to reach at a conclusion. The second part which is chapter two of the research paper is dedicated to review previous research papers and scholars point of view on the topic raised.



The second chapter literature review discusses in depth previous researches on the topic of corporate social responsibility and its impact on the financial performance of a firm. Chapter three which is the third part of the paper is full dedicate to methodology, research design, sample design and statistical model of the research under study. In order to help the analysis and interpretation the researcher will use e'views statistical software.

Chapter four of this paper is all about data interpretation and analysis. Which is the interpretation of the data collected using the statistical software mentioned above. In this chapter detailed analysis will be carried out to support the last chapter which is recommendation and conclusion. The final chapter will be conclusion and recommendation based on the analysis performed on the fourth chapter of the paper. The conclusion and recommendation will solely base on the data collected, analyzed and interpreted in the previous chapters. The paper also include reference papers listed at the end of the paper which will enable readers grasp further knowledge on the research topic and other related topics.

CHAPTER TWO

2. LITERATURE REVIEW

The field of corporate social responsibility (CSR) has grown exponentially in the last decade. More than half of the Fortune 1000 companies issue corporate social responsibility (CSR) reports. A larger number of companies than at any time previous are engaged in a serious effort to define and integrate CSR into all aspects of their businesses. An increasing number of shareholders, analysts, regulators, activists, labor unions, employees, community organizations, and news media are asking companies to be accountable for an ever-changing set of CSR issues. There is increasing demand for transparency and growing expectations that corporations measure, report, and continuously improve their social, environmental, and economic performance.

In now a day's globalization has brought different concepts and ideas in to the minds of corporate stakeholders and managers one of this concepts is corporate social responsibility which have been raised as long as trade and commerce itself. Commercial logging operations for example, together with laws to protect forests, can both be traced back almost 5,000 years. In Ancient Mesopotamia around 1700 BC, King Hammurabi introduced a code in which builders, innkeepers or farmers were put to death if their negligence caused the deaths of others, or major inconvenience to local citizens. In ancient Rome senators grumbled about the failure of businesses to contribute sufficient taxes to fund their military campaigns, while in 1622 disgruntled shareholders in the Dutch East India Company started issuing pamphlets complaining about management secrecy and "self enrichment".

Even if the idea of corporate social responsibility is as old as the beginning of trade and commerce it reaches its pick in the last four decades specially the recent September 11 terrorist attacks added a greater attention for corporate social responsibility. Starting from this incidents corporations start incorporating corporate social responsibility activities in their annual report even more they start issuing CSR reports separately. When we come to Ethiopian context CSR is one of the least talked and reported issues in the country. Corporations do not incorporate reports on corporate social report in their annual report nor do they issue corporate social responsibility report. With regard to researches concerning CSR or its impact on the financial performance of a firm it's difficult to find one research in the country. Fact that the non existence of research paper in this concept supports the idea that CSR is new in the country.

2.1 DEFINITION OF CSR

The definition of Corporate Social Responsibility itself has already generated numerous articles and publications. Various definitions have been debated and taken place for more than five decades now. There is an impressive history associated with the evolution of the concept and definition of corporate social responsibility (CSR). Definitions expanded during the 1960's and grew during the 1970's. In the 1980's, there were fewer new definitions, more empirical research, and alternative themes began to mature. These alternative themes included corporate social performance (CSP), stakeholder theory, and business ethics theory. In the 1990's CSR continues to serve as a core construct but transformed into alternative thematic frameworks.

According to *Business for Social Responsibility* (BSR), corporate social responsibility is defined as “achieving commercial success in ways that honor ethical values and respect people, communities, and the natural environment.” McWilliams and Siegel (2001:117) describe CSR as “actions that appear to further some social good, beyond the interest of the firm and that which is required by law.” A point worth noticing is that CSR is more than just following the law (McWilliams & Siegel, 2001).

Alternatively, according to Freeman (1997:227), the definition of what would exemplify CSR is the following: “An action by a firm, which the firm chooses to take, that substantially affects an identifiable social stakeholder’s welfare.” A socially responsible corporation should take a step forward and adopt policies and business practices that go beyond the minimum legal requirements and contribute to the welfare of its key stakeholders. CSR is viewed, then, as a comprehensive set of policies, practices, and programs that are integrated into business operations, supply chains, and decision-making processes throughout the company and usually include issues related to business ethics, community investment, environmental concerns, governance, human rights, the marketplace as well as the workplace. Bowen (1953) defined CSR as the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society.

Some academics even argue that CSR goes against the basic notion of a free economy in which the main task of the corporation is to seek economic profits. Maybe the biggest opponent of CSR, Milton Friedman, wrote in 1970 that business as a whole cannot be

said to have responsibilities (Friedman, 1970). Furthermore, he denies the existence of CSR in the capitalist world. His basic argument against social responsibilities is the fact that the CEO, or any other manager for that matter, spends the money of the owners of the company. If investors want to contribute to society they can do that with their private money and they do not need a manager spending their money.

Furthermore, he indicates that corporations can make philanthropic contributions as long as they will lead to long term returns for the shareholders and provided that these corporate social initiatives are approved by the stockholders. Maignan and Ralston (2002) define the CSR policy of a firm as the principles and processes present to minimize its negative impacts and maximize its positive impacts on selected stakeholder issues. This idea is shared by the Commission of European Communities (2001) of the European Union, who defines CSR as a concept whereby companies voluntarily integrate social and environmental concerns in their business operations and in their interactions with their stakeholders.

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.

2.2 KEY CHARACTERISTICS OF CSR

CSR refers to the obligations of the firm to society or, more specifically, the firm's stakeholders—those affected by corporate policies and practices. Paternalistic capitalism reveals three important characteristics of CSR. First, it is not a new idea, the hype surrounding it today notwithstanding. Second, firms engaging in CSR often have mixed motivations the “business case” and the “normative case” for CSR. Third, while there is substantial agreement that CSR is concerned with the societal obligations of business, there is much less certainty about what these obligations might be or their scope.

2.3 DIMENSIONS OF CSR PRACTICE

Although CSR seems a single concept it encompasses a lot of dimensions in which it can be measured. These dimensions can be generally divided in to four large groups.

Environmental Dimension

- Good waste and recycle policy
- Energy conservation
- Ensuring products do not harm environment
- Undertake initiative to promote environmental responsibility.



Human Resource Dimension

- Protecting in health and safety
- Treat employees fairly in terms of wage, working hours etc.
- Promoting equal opportunity
- Investing in education and training

Human rights dimension

- Promoting human right
- Ensuring operation respect human rights
- Refrain lending to oppressive regime or companies violating human rights.

Philanthropic Dimension

- Help solve social problem
- Supporting charities and community projects
- Participate in management of public affairs
- Play a role on society goes beyond profit maximization

The lists above, although they are not exhaustive, may provide a general overview of the meaning of CSR and serves as a framework for conducting research on it. The countless example of activities and dimensions of CSR of the aforementioned lists are adopted in much literature in CSR.

2.4 HISTORY OF CORPORATE SOCIAL RESPONSIBILITY

The history of social and environmental concern about business is as old as trade and business itself. Commercial logging operations for example, together with laws to protect forests, can both be traced back almost 5,000 years. In Ancient Mesopotamia around 1700 BC, King Hammurabi introduced a code in which builders, innkeepers or farmers were put to death if their negligence caused the deaths of others, or major inconvenience to local citizens. In Ancient Rome senators grumbled about the failure of businesses to contribute sufficient taxes to fund their military campaigns, while in 1622 disgruntled shareholders in the Dutch East India Company started issuing pamphlets complaining about management secrecy and “self enrichment”.



With industrialization, the impacts of business on society and the environment assumed an entirely new dimension. The “corporate paternalists” of the late nineteenth and early twentieth century’s used some of their wealth to support philanthropic ventures. By the 1920s discussions about the social responsibilities of business had evolved into what we can recognize as the beginnings of the “modern” CSR movement. In 1929, the Dean of Harvard Business School, Wallace B. Donham, commented within an address delivered at Northwestern University:

'Business started long centuries before the dawn of history, but business as we now know it is new - new in its broadening scope, new in its social significance. Business has not learned how to handle these changes, nor does it recognize the magnitude of its responsibilities for the future of civilization.'

Almost seventy five years later, these words ring just as true. Although today we face some novel concerns about the role of business in society, from internet “spam” to genetically modified foods, many of the issues under discussion are not very different to those being raised in the 1920s. *There is a danger that social and environmental concern about business is an issue which, like sex, every new generation thinks that it has discovered.*

2.5 PROMINENCE OF CSR

CSR has never been more prominent on the corporate agenda than it is today, its historical origins and the uncertainty about the societal obligations of business notwithstanding. CSR has been one of the leading topics at recent World Economic Forum (WEF) meetings. A report from the WEF observes that the three key pressures of “corporate competitiveness, corporate governance and corporate citizenship, and the linkages between them, will play a crucial role in shaping the agenda for business leaders in the coming decade.”

It elaborates on corporate citizenship, as follows:

In the face of high levels of insecurity and poverty, the backlash against globalization and mistrust of big business, there is growing pressure on business leaders and their companies to deliver wider societal value. This calls for effective management of the company’s wider impacts on and contributions to society, making appropriate use of stakeholder engagement.

Similarly, the World Business Council for Sustainable Development (WBCSD), a coalition of 120 international companies, refers to the increasing calls for business to assume wider responsibilities in the social arena and claims that CSR “is firmly on the global policy agenda.” Among the many other organizations that are advocating greater attention to CSR are the International Business Leaders Forum (IBLF), Business for Social Responsibility (BSR), and Business in the Community (BITC).

2.6 THE RISE AND FALL OF CSR

Corporate social responsibility (CSR) has been debated and practiced in one form or another for more than 4,000 years. For example, the ancient *Vedic* and *Sutra* texts of Hinduism and the *Jatakas* of Buddhism include ethical admonitions on usury (the charging of excessive interest).

The modern concept of CSR can be more clearly traced to the mid-to-late 1800s, with industrialists like John H. Patterson of National Cash Register seeding the industrial welfare movement and philanthropists like John D. Rockefeller setting a charitable precedent that we see echoed more than a hundred years later with the likes of Bill Gates.

Despite these early variations, CSR only entered the popular lexicon in the 1950s with R. Bowen’s landmark book, *Social Responsibilities of the Businessman*. The concept was challenged and strengthened in the 1960s with the birth of the environmental movement, following Rachel Carson’s critique of the chemicals industry in *Silent Spring*, and the consumer movement off the back of Ralph Nader’s social activism, most famously over General Motors’s safety record.

The 1970s saw the first widely accepted definition of CSR emerge – Archie Carroll’s 4-part concept of economic, legal, ethical and philanthropic responsibilities, later depicted as a CSR pyramid- as well as the first CSR code, the Sullivan Principles. The 1980s brought the application of quality management to occupational health and safety and the introduction of CSR codes like Responsible Care. In the 1990s, CSR was institutionalized with standards like ISO 14001 and SA 8000, guidelines like GRI and corporate governance codes like Cadbury and King. The 21st century has been mostly more of the same, spawning a plethora of CSR guidelines, codes and standards (there are more than 100 listed in *The A to Z of Corporate Social Responsibility*), with industry sector and climate change variations on the theme.

Why is all this potted history of CSR important in a discussion about the future? Well, first, it is to realize that CSR is a dynamic movement that has been evolving over decades, if not centuries. But second, and perhaps more importantly, it is to acknowledge that, despite this seemingly impressive steady march of progress, CSR has failed. Furthermore, we are witnessing the decline of CSR, which will continue until its natural death, unless it is reborn and rejuvenated.

That is a bold claim, so it deserves substantiation. CSR has undoubtedly had many positive impacts, for communities and the environment. Yet, its success or failure should be judged in the context of the total impacts of business on society and the planet. Viewed this way, on virtually every measure of social, ecological and ethical performance we have available, the negative impacts of business have been an unmitigated disaster, which CSR has completely failed to avert or even substantially moderate.

A few facts will suffice to make the point: our global ecological footprint has tripled since 1961; WWF's Living Planet Index shows a 29% species decline since 1970; and 60% of the world's ecosystems have been degraded, according to the Millennium Ecosystem Assessment. We do not fare much better on social issues: according to the UNDP, 2.5 billion people still live on less than \$2 a day; 1 billion have no access to safe water; and 2.6 billion lack access to sanitation.

What about ethical issues? Not much good news there either. In 2007, 1 in 10 people around the world had to pay a bribe to get services. Before Enron collapsed in fraudulent disgrace in 2001, *Fortune* magazine had voted it one of the '100 Best Companies to Work for in America' in 2000. More worrying still, Enron had all the CSR codes, reports and practices you would expect from a socially responsible company.

2.6.1 THE FAILURE OF CSR

Why has CSR failed so spectacularly to address the very issues it claims to be most concerned about? This comes down to three factors – the Triple Curse of Modern CSR, if you like:

Curse 1: Incremental CSR

One of the great revolutions of the 1970s was total quality management, conceived by American statistician W. Edwards Deming, perfected by the Japanese and exported around the world as ISO 9001. At the very core of Deming's TQM model and the ISO standard is continual improvement, a principle that has now become ubiquitous in all



management system approaches to performance. No surprise, therefore, that the most popular environmental management standard, ISO 14001, is also built on the same principle.

There is nothing wrong with continuous improvement *per se*. On the contrary, it has brought safety and reliability to the very products and services that we associate with modern quality of life. But when we use it as the primary approach to tackling our social, environmental and ethical challenges, it fails on two critical counts: speed and scale.

The incremental approach of CSR, while replete with evidence of micro-scale, gradual improvements, has completely and utterly failed to make any impact on the massive sustainability crises that we face, many of which are getting worse at a pace that far outstrips any futile CSR-led attempts at amelioration.

Curse 2: Peripheral CSR

Ask any CSR manager what their greatest frustration is and they will tell you: lack of top management commitment. This is 'code-speak' for saying that CSR is, at best, a peripheral function in most companies. There may be a CSR manager, a CSR department even, a CSR report and a public commitment to any number of CSR codes and standards. But these do little to mask the underlying truth that shareholder-driven capitalism is rampant and its obsession with short-term financial measures of progress is contradictory in almost every way to the long-term, stakeholder approach needed for high-impact CSR.



The reason Enron collapsed, and indeed why our current financial crisis was allowed to spiral out of control, was not because of a few rogue executives or creative accounting practices, it was because of a culture of greed embedded in the DNA of the company and the financial markets. Joel Baken goes so far as to suggest that companies are legally bound to act like psychopaths. Whether you agree or not (and despite the emerging research on 'responsible competitiveness'), it is hard to find any substantive examples in which the financial markets reward responsible behavior.

Curse 3: Uneconomic CSR

If there was ever a monotonously repetitive, stuck record in CSR debates, it is the one about the so-called 'business case' for CSR. That is because CSR managers and consultants, and even the occasional saintly CEO, are desperate to find compelling evidence that 'doing good is good for businesses, i.e. CSR pays! And indeed, the lack of sympathetic research seems to be no impediment for these desperados endlessly incanting the motto of the business case, as if it were an entirely self-evident fact. The more 'inconvenient truth' is that CSR sometimes pays, in specific circumstances, but more often does *not*. Of course there are low-hanging fruit – like eco-efficiencies around waste and energy – but these only go so far. Most of the hard-core CSR changes that are needed to reverse the misery of poverty and the sixth mass extinction of species currently underway require strategic change and massive investment. They may very well be lucrative in the long term, economically rational over a generation or two, but we have already established that the financial markets don't work like that; at least, not yet.



2.7 THEORIES UNDERLYING CSR

Concepts and theories of corporate social responsibility (CSR) have been examined and classified by scholars since the mid-1970s. However, due to the evolving meaning of CSR, numerous efforts are needed to understand new developments. Since there is a great diversity of theories and approaches, the task remains a very hard one, mainly because no uniformity could be arrived. In discussing CSR, western research will normally adopt several theories such as ethical, economic, legal, charity or stewardship. Each theory will lead to different perceptions on CSR. The ethical theory suggests that business must be carried out in accordance to the ethical principles such as fair and justice. As for the economic theory, it suggests that CSR could be implemented through a successful company and therefore, the responsibility of a company is to maximize its wealth. A well performed company could assist the society through providing jobs, basic amenities and contribute to thriving economy. A company according to the legal theory is a nexus of contract.

Therefore, companies are required to operate in a legal manner within the stipulated law. The charity theory suggests that companies make voluntary contributions to society and in return it will enhance their reputation. Contrary to that, the stewardship theory suggests that companies are trustees and must ensure that the benefits will be returned to the society. The existence of a company according to the stewardship theory should lead to a better condition for the society and not otherwise. However in this context, three theories are further explained and explored; namely Stakeholder Theory, Carroll's CSR and Agency Theory.

Firstly, an important approach to CSR stems from a book by Freeman (1984) called —Strategic Management: A Stakeholder Approach. In another words, the real pioneer in the field of stakeholder responsibility is Freeman. The stakeholder theory developed by Freeman (1984) focuses on the interactions between firms and society. Over the years the stakeholder theory has been recognized as an integral part of CSR by many authors (Harrison and Freeman, 1999; Clarkson, 1995).

It is argued that through effective stakeholder, management social and ethical issues can be resolved and the demands of society and shareholders will be accounted for (Harrison & Freeman, 1999). Clarkson's (1995) differentiates between social and stakeholder issues, stating that social issues are furthered by local institutions and adopted in regulation and legislation, while stakeholder issues are not concerned with legislation and regulation. The obligation towards every stakeholder needs to be identified and the company needs to assume responsibility for meeting their obligations towards their stakeholders.

Whether the stakeholders are employees, stockholders, customers or Non-Governmental Organizations (NGOs) all the issues they feel are important need to be taken into consideration by the company to a certain extent. It is important for companies to identify all their stakeholders, because stakeholders that might not be recognized still have expectations of the corporation. These expectations refer again to Carroll's (1979 and 1991) approach towards the definition of CSR, because expectations focus on all levels of responsibility, economic, legal and ethical (Carroll, 2006). There are many different stakeholders a company has to take into account. They range from stockholders to NGOs

and from customers to suppliers. The company has responsibilities towards each of these stakeholders and these responsibilities can be qualified according to Carroll's approach using the economic, legal and ethical responsibilities. This will lead to an overview of the type of stakeholders, their possible priorities and the consequential responsibilities. It should be noted that every company has slightly different stakeholders with different expectations. Some stakeholders expect more than others, while other stakeholders may be more important or have a more direct influence on the company.

Secondly, a famous viewpoint on the concept of CSR is provided by famous Carroll's (1979, 1991). He uses Pyramid of Corporate Responsibility to identify a spectrum of obligations that companies have toward society. He defines CSR using a four responsibilities approach known as economic, legal, ethical and philanthropic (discretionary). The main focus of any organization has always been on the economic responsibilities, which implies that companies have to produce goods and services for the public to gain profit. Businesses have responsibility towards the shareholders to increase their wealth. Even though, making lots of money is surely central to why corporations exist, but these days it appears that corporations are being challenged to do more and, to be more. Businesses are also accountable on their legal responsibility.

Legal responsibilities require business to operate within the boundaries of laws and national policies. The companies' activities need to be regulated in order to prevent them from abusing their power. According to Carroll this legal responsibility is seen as part of the social contract between society and business. On the other hand, ethical responsibilities demand that firms operate morally, fairly and justly (Tan and Komaran, 2006).

However, broadening accountability beyond shareholders to include employees, customers, suppliers, competitors and the community have shifted the board's role in overseeing this accountability beyond philanthropy. Philanthropic responsibilities oblige companies to contribute financial and other resources for the welfare, making charitable donations and contributing to human wellbeing. These responsibilities are not expected by the public, so when a company does not take discretionary responsibilities it will not be perceived unethical, and will therefore not be punished by the society (Cochius, 2006).

Thirdly, the agency theory is the relationship between the principals and agents which involves the nature of costs of resolving conflict of interests between principals and agents (Jensen and Meckling, 1976). This theory infers that the precipitators of these conflicts incur agency costs in which they have the incentive for possible reduction (Morris, 1987). Recent study done by Brown, et al. (2006) indicates that agency costs play a prominent role in explaining corporate donation, which is part of CSR.

2.8 THE POINT OF TENSION

There is a protracted debate about the legitimacy and value of corporate responses to CSR concerns. As CSR comes into contact with many of the issues traditionally addressed by government, like human rights and community investing, there is strong criticism that societal problems are best solved by freely elected governments. The resources of a corporation are poorly suited for addressing those social problems, and therefore, it is argued, they should not be misallocated.

According to Friedman (1970), in a free society, “there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.” He prefers that the state address social problems, arguing that an executive, by taking money and resources that would otherwise go to owners, employees, and customers, and allocating them according to the will of the minority, fails to serve the interests of her or his principal. In this way, the executive imposes a tax and spends the proceeds for “social” purposes, which is intolerable, since she or he has neither the skills nor the jurisdiction to do so. On the other hand, there are many appeals by others for corporate adoption of the CSR principles. Although the government is mainly responsible for addressing those issues, the contribution of private firms can be substantial.

There is also the argument of the shifting balance of power. According to the OECD, of the 100 largest global economies, as measured by GDP, 51 of them are US corporations, and only 49 are nation states. So economic power has shifted to the corporations; they, therefore, should have an increasing role in and responsibility for addressing social problems. For example, the government sets the regulations and the minimum standards for the workplace, but a company can further improve the work environment and the quality of living of its employees. A firm cannot ignore the problems of the environment in which it operates.



The poverty of a nation state's citizens, political unrest, and the exhaustion of natural resources can have destructive effects for a corporation. For example, resources which are inputs in the production process and which, at the beginning of the industrial revolution, were abundant are now in many regions of the planet scarce, polluted, or diminishing.

Naturally, this imposes an extra cost to the corporations and may force them to relocate or to cease operations. From one perspective, companies may be poorly equipped to address some of the social or environmental problems, but from another perspective, no matter how poorly equipped, companies may still be best positioned to ameliorate the problems

Certainly, adopting the CSR principles involves costs. These costs might be short term in nature or continuous outflows. These costs might involve the purchase of new environmentally friendly equipment, the change of management structures, or the implementation of stricter quality controls. Since being socially responsible involves costs, it should generate benefits as well in order to be a sustainable business practice. A corporation could not continue a policy that constantly generates negative cash flows. The shareholders invest their money in a corporation, expecting the highest possible risk adjusted return. Therefore, being socially responsible should have bottom-line benefits in order to be sustainable.



Socially responsible corporate performance can be associated with a series of bottom-line benefits. But in many cases, it seems that the time frame of the costs and benefits can be out of alignment—the costs are immediate, and the benefits are not often realized quarterly. Nevertheless, many benefits can be identified. Firstly, socially responsible companies have enhanced brand image and reputation. Consumers are often drawn to brands and companies with good reputations in CSR related issues.

A company regarded as socially responsible can also benefit from its reputation within the business community by having increased ability to attract capital and trading partners. Reputation is hard to quantify and measure; it is even harder to measure how much it increases a company's value. But since companies have developed methods to measure the benefits of their advertisement campaigns, similar methods can and should be able to be applied in the case of corporate reputation. Socially responsible companies also have less risk of negative rare events. Overlooking negative social and environmental externalities when valuing a company might be equal to ignoring significant tail risk. The risks related to CSR could be grouped into three categories: corporate governance, environmental aspects, and social aspects. Companies that adopt the CSR principles are more transparent and have less risk of bribery and corruption.

In addition, they may implement stricter and, thus, more costly quality and environmental controls, but they run less risk of having to recall defective product lines and pay heavy fines for excessive polluting. They also have less risk of negative social events which damage their reputation and cost millions of dollars in information and advertising campaigns. The scandals about child-labor and sweatshops that affect the clothing

industry are two fine examples. Thus, socially responsible businesses should have more stable earnings growth and less downside volatility. Since companies that adopt the CSR principles carry less risk, when valuing those companies, a lower discount rate should be used. In the company valuation this lower tail risk should be taken into account.

There are also other cases in which doing what is good and responsible converges with doing the best for the particular business. Some CSR initiatives can dramatically reduce operating costs. For example, reducing packaging material or planning the optimum route for delivery trucks not only reduces the environmental impact of a company's operation, but it also reduces the cost. The process of adopting the CSR principles motivates executives to reconsider their business practices and to seek more efficient ways of operating.

Companies perceived to have a strong CSR commitment often have an increased ability to attract and to retain employees (Turban & Greening 1997), which leads to reduced turnover, recruitment, and training costs. Employees, too, often evaluate their companies CSR performance to determine if their personal values conflict with those of the businesses at which they work.

There are many known cases in which employees were asked, under pressure of their supervisors, to overlook written or moral laws in order to achieve higher profits. These practices create a culture of fear in the workplace and harm the employees' trust, loyalty, and commitment to the company.

Companies that improve working conditions and labor practices also experience increased productivity and reduced error rates. Regular controls in the production facilities throughout the world ensure that all the employees work under good conditions and earn living wages. These practices are costly, but the increased productivity of the workers and improved quality of the products generate positive cash flows that cover the associated costs. Thus, firms may actually benefit from socially responsible actions in terms of employee morale and productivity (Moskowitz, 1972; Parket & Eibert, 1975; Soloman & Hansen, 1985).

As mentioned earlier, although it is rather straightforward to identify the above benefits as being socially responsible for businesses, it is an arduous task to quantify and measure them. Since CSR is integrated into the business practices, it is by definition complicated to try to measure its effects separately. Ideally, it should be possible to keep all other factors constant and measure a company's financial performance and volatility of cash flows before and after adopting the CSR principles. As this is not possible, however, empirical methods are used to identify the relationship between a company's socially responsible conduct and its financial performance.

2.9 CSR AND BUSINESS ETHICS

Although the CSR movement is at the crest of a well-established tradition of business ethics, it represents a new perspective on traditional notions of morality in the business world. CSR draws on the above justifications, but it proposes behavioral expectations of businesses that go beyond the conventional idea that businesses' sole moral obligation is to comply with legal regulations and to act honestly. The contention that there is

“something more” to business ethics is the source of both praise and criticism from experts in the field.

A generally accepted definition of CSR was recently discussed in December 2005 edition of *The Wall Street Journal*'s “Big Issues” forum series. In it, Benjamin W Heineman, a senior vice president for law and public affairs at General Electric Co., describes three elements of CSR: “Strong, sustained economic performance. Rigorous compliance with financial and legal rules Ethical and other citizenship actions, beyond formal requirements, which advance a corporation’s reputation and long term wealth”. The ambiguity and length of the third criterion implicitly conveys the difficulty that proponents have in articulating and integrating complex notions of CSR into a single sentence. Many business ethicists flatly reject the third claim while concurring that the first two aspects of CSR are an indisputable standard. Such a view of CSR was adopted by the skeptical editorial board of *The Economist*, which published a symposium on CSR in its January 22, 2005 edition:

To say that CSR reflects a mistaken analysis of how capitalism serves society is certainly not say that managers can be left to do as they please, nor to say that the behavior of firms is nobody’s concern but their own. There is indeed such a thing as “business ethics”: managers need to be clear about that, and to comprehend what it implies for their actions. The first two aspects of CSR are an obvious goal for any legitimate business. “Strong, sustained, economic performance” benefits not only shareholders, but a firm’s employees and their dependants as well. Further, people have a tendency to take it for granted that an economically vibrant corporation is *by definition* providing a public

service. As Adam Smith famously wrote in *The Wealth of Nations*, “it is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.” If the firms weren’t selling goods and services that the public desires, then it wouldn’t enjoy “strong, sustained, performance.”

The value that people attach to the goods and services they buy from companies is shown by what they are willing to pay for them. The costs of producing those goods and services are a measure of what society has to surrender to consume those things. If what people pay exceeds the cost, society has gained—and the company has turned a profit.

In this way, private business is a win-win situation: the firm makes money while the public satisfies its wants. This principle assumes, however, that commodities will be priced in a way that accurately reflects cost. Oftentimes, costs known as externalities are left unaccounted for, thus compromising the above standard. Former Vice President Al Gore stresses that “externalities are costs created by industry but paid for by society” (The Wall Street Journal).

The most obvious type of externality is pollution. Unless a firm takes care to account for the environmental damage resulting from engaging in production in the price of its products, it is promoting a market failure that may require remedy. Such remedies would be endorsed by traditional ethicists who believe that a company ought to account for the full economic cost it incurs. The second aspect of Mr. Heineman’s definition is also supported by prominent business ethicists. Just as average citizens are expected to comply with all criminal statutes, so should companies take special care to comply with



their own legal guide lines? It would be rare to find a person who would assert corporate exceptions' to the law. If anything, most business ethicists would be comfortable with the notion that companies ought to exhibit *greater* commitment to rules and regulations than the average person, for the damage done to society and the market by flagrant violators of business standards is much greater than the damage done to society by solitary criminals.

A major argument made by CSR proponents as well as those generally interested in advancing business ethics is that being "merely legal" is not enough for a firm to be considered socially responsible: Some businessmen appear to believe that anything which is not outright illegal, however unethical, can be regarded as proper business conduct. But without ordinary decency (which goes a long way beyond what the law requires of firms), business could not be carried on.

Firms that lie and cheat cannot be expected to stay in business very long, even if their actions are allowed by the law. Dishonest companies will be unable to borrow, to obtain working capital, or to form stable business relationships with suppliers and customers. Decency in this sense is not just good for business, it is essential. When it comes to maximizing long-term owner value, honesty is not just the best policy; it is the only feasible policy.

Businesses that fail to engage in honest, transparent, and legal practice will ruin their credibility, which, in a competitive market, is a precious resource. Therefore, businesses must follow legal guidelines not only to avoid formal penalties from the government, but also to preserve the state of public opinion. "This pressure of outsiders' perceptions is an

indispensable force. Without it, companies in a private-enterprise system would be nasty, brutish, and very short-lived.” Trust-building CSR practices are considered to have merit in-themselves. Public trust is an asset that is hard to foster and maintain but easy to tarnish.

“These include not lying to your employees, for instance...establishing a reputation for dealing honestly with employees, suppliers, and customers....and looking farther ahead than the next few weeks.”It is the product of good management, which, as recent auto industry layoffs indicate, may unfortunately be in short supply (The Wall Street Journal).

One of the participants in *The Wall Street Journal*'s forum on CSR—who is actually harshly critical of Heineman's “progressive” opinion—elaborated on this view: Business must, of course, be attentive to those groups whose trust and good will are essential to its economic success. These include shareholders but also employees, customers, suppliers, and neighbors ... They own, work for, buy from, sell to or live by your plans and their good will is useful to minimize the costs of doing business. Bad relations with any or all of these groups can (and will) impact the bottom line. The slough of scandals among large corporations shows that it is imperative for proponents and opponents of CSR alike to show solidarity in confronting such lapses. It is a sad indicator of the sorry state of business ethics among many major firms that, in 2002, Forbes magazine was able to publish a “Hall of Shame” listing many firms who have disgraced themselves with fraudulent accounting practices that harmed their shareholders (Corporate Scandal Sheet).

The major accounting firm Arthur Andersen drowned itself in the Enron case, “losing much of its business, and two thirds of its once 28,000 strong workforce” (BBC News). Four years later, Enron executives are still on trial for their role in what has become one of the most notorious crimes in the history of corporate America, and to this day at least one of them still asserts that Enron was “as good as it gets” (CNN Money). These problems aren’t just a symptom of “American capitalism.” Such legal abuses are rife in Chinese companies, have appeared in Europe’s infamous Parmalat scandal (The Wall Street Journal), and have backfired against executives at the Korean automaker Hyundai, where in 2003 the Hyundai Asian chairman committed suicide while in early April two Hyundai executives were arrested on corruption charges (The Wall Street Journal).

Recently, retired senator Bob Dole visited Kansas City and commented on CSR, among other topics, lamenting that “these corporate scandals have really gotten out of hand; it’s essential to do what we can to address such crimes.” Nobody would label Forbes magazine or the distinguished Republican presidential nominee as an enemies of big business—let alone of capitalism—and yet even they assert the absolute importance of corporations’ commitment to CSR reasoning with respect to ethical business practice.

2.10 CSR AND BANKING SECTOR

According to literature the banking sector has been quite slow in considering the consequences of the issue of sustainability, despite of the fact of their exposure to risk. Referring to the relevant literature from 1990 to 2000, banks began addressing the issue of sustainability by considering firstly environmental and then social issues and attempting to incorporate them by established policies for the environment and society.

It is possible to recognize that most studies focus on 'banking and the environment' or 'environmental risk' and consequently, in terms of banks' activities, 'environmental risk assessment', 'risk management', 'product developments' (special funds), 'new markets', 'communication and organization'.

As a consequence of the emphasis on banking and the environment, research interests focused initially on the 'direct risks' banks were running, i.e. the risks of banks being held liable for polluting activities. Only in the later years the 'indirect risks', such as reputation and responsibility of banks related to lending activities (client's solvency/continuity or collateral) were taken up and investigated in the sector.

Risk management which was usually focused on the potential financial risks, involves nowadays also the environmental and social consequences of lending money to clients with dubious sustainability performances.

2.11 THE RELATIONSHIP BETWEEN CSR AND FINANCIAL PERFORMANCE

In recent years, the number of companies practicing CSR is growing and many argued that it is linked to sustainability and ensuring long term profit. Whether or not to practice CSR could be answered by reviewing the empirical studies done on this area that examine the link between CSR and financial performance. A significant body of CSR research has been centered on the debate over whether there is a relationship between good CSR and strong financial performance, and what kind of relationship there is.

The link between these two variables has been investigated over the last few decades. However, as yet there are no conclusive findings as to the direction or strength of this link. The findings on this issue are not conclusive. Some researchers found a positive correlation between CSR and profit, others found negative and also no relationship at all between these two (Carroll and Buchholtz, 2006). One of the main problems is that it is not clear whether social responsibility leads to increased financial performance or whether better profits lead to more funds being available to devote to CSR. However, most of the findings could be summarized under three categories: positive, negative and neutral.

Chand (2006) investigated the relationship between CSR and financial performance. The study used industry type as a boundary condition. Accordingly, by controlling the industry types will eliminate all the environmental differences that tend to hide the link between these CSR and performance. He found that by controlling for industry, a clear positive link can be shown between CSR and performance.

Cochran and Wood (1984) examined the relationship between CSR (Moskowitz's ranking) and Corporate Financial Performance (the ratio of operating earnings to assets and the ratio of operating earnings to sales, asset age and excess market valuation). The conclusion of their study was that within industry groups, the financial variable that most strongly correlated with CSR was asset age. However, they claimed that the causality between these two variables was left uninvestigated.

Curran (2005) summarized 34 papers on the effects of CSR on indicators of financial performance and to assess the quality of the studies. She indicated that 24 of the 34 studies (70%) were positive. They showed a positive and statistically significant relationship between CSR and financial performance. Two studies (5.8%) showed a negative and statistically significant relationship between CSR and financial performance. Out of the eight studies (23%) with neutral outcomes, some of these were genuinely neutral and others were positive results but not statistically significant. She concluded that the relationship between CSR and financial performance is mostly positive, a quarter of all studies were not able to demonstrate a positive or a negative relationship (termed neutral here) and negative relationships were in the minority. Heinze et al. (1999) used Fortune reputation index and arranged into 22 manufacturing industry groups. The main finding is that there is a relationship between CSR and profit but the strength of the relation between CSR and profits varies considerably from one manufacturing industry to another.

Aupperle (1985) revealed no relationship between CSR and Corporate Financial Performance (CFP). This survey adopted the questionnaire survey method to measure CSR which assessed the attitude of the CEO as a CSR variable. However, it failed to measure CSP in terms of actual behavior or performance. McGuire et al. (1988) conducted a correlation analysis on this relationship and found that prior financial performance indices have a stronger correlation with CSR than concurrent financial performance indices. They measure CSR by Fortune magazine's rating of corporate reputation, and assessed financial performance by stock market returns (i.e., total return,



alpha or risk-adjusted return) and accounting-based indices (i.e., ROA, total assets, and sales growth).

Interesting study by Waddock and Graves (1997) reported that CSP was positively associated with prior and future CFP. They concluded that not only the relationship exists between CSR and CFP but also CSP drives CFP. In this study, they measured CSP by a constructed index provided by a rating firm Kinder, Lydenberg, Domini & Co. Inc (KLD), based on five factors related to the stakeholder and three factors with responsiveness to significant external pressure.

Another study that used KLD index as one of the CSR measurements is Griffin and Mahon (1997). They focused on the chemical industry and did not only use KLD but used other reputation index such as the Fortune reputation index and other performance-based indices as CSR variables. They argued that the use of CFP measures might predetermine the relationship outcome. Another notable issue was that different industries have different social pressures that affect CSP which indirectly affected the reliability of the cross-sectional analysis.

Wu (2006) conducted meta-analysis of 121 empirical studies to investigate the relationships among CSR, CFP and size. The paper revealed positive relationship between CSR and CFP and supports the view that the cost of having high level of corporate social responsibility is minimal and that firms may actually benefit from socially responsible actions in terms of employee morale and productivity. The study further argued that profitability, asset utilization and growth were better predictor of CSR

compared to market-based measures. Additionally, reputation index had the strongest measures with CFP and perceptually based measures will report a stronger CSR-CFP relationship than studies using performance based measures.

The linkage between corporate social responsibility and firm financial performance has received considerable research attention especially in the area of socially responsible investing (SRI). The global study by Hill et al. (2006) examined corporate social responsibility through a comparison of SRI to the broader stock markets in the United States, Europe, and Asia. In their findings show that only the European fund outperformed the larger equity market in the short term (3 years). None of these statistics was significant in the medium term (5 years); however, both the United States and European portfolios outperformed their comparison markets in the long term (10 years).

They further argued that taken together, these results suggest that being viewed as socially responsible by investors may impact positively the valuation of firms over the long run, providing them with the opportunity to do well while doing good“. European investors appear to value CSR in the short term as well as the long-term, and Asian investors may have the tendency to mirror the US investors. They concluded from the findings, the value of CSR activities to global enterprises may continue to grow in importance.

2.12 THEORY AND HYPOTHESES

The controversy about corporate social financial performance relationships involves two different empirical issues, in addition to the inevitable problems of measurement. One of these issues is the direction of the relationship :are social and financial performance positively or negatively associated, or not associated at all?(a positive social-financial performance relationships is, of course, a critical implication of the stakeholders theory of the corporation.) the other issue is the casual relationship involved: does social performance influence financial performance; does financial performance influence social performance ;or is there a synergistic relationship(either positive or negative) between the two? Combining these two dimensions of variation yields the six possible cause and directional hypotheses briefly discussed in the following paragraphs.

Social impact hypothesis

Some adherents of the stakeholder theory appear to believe that favorable social performance_ that is, meeting the need of various corporate stakeholders _will ultimately lead to favorable financial performance, and vice. Cornell and Shapiro (1987) argue that failure to meet the expectation of various no shareowner constituencies will generate market fear, which, in turn, will increase a company's risk premium and ultimately result in higher costs and /or lost profit opportunities. According to their analysis, serving the implicit claims of major stakeholders (e.g., employees, customers) enhances a company's reputation in a way that has positive impact on its financial performance; conversely disappointing these groups may have negative financial impact.

This “social impact” version of the stakeholder theory implies a lead-lag relationship between social and financial performance; external reputation (favorable or unfavorable) follow. Previous statistical tests of this hypothesis have not produced supportive results (McGuire et al., 1988; Preston, sapienza, and Miller, 1991). Nevertheless, we retain the hypothesis here for completeness.

Hypothesis 1: higher (lower) levels of social performance lead to higher (lower) levels of financial performance.

Trade-off hypothesis

The trade-off hypothesis asserts that social performance is the independent variable and that social accomplishments involve financial costs. This hypothesis reflects the classic friedman position and is supported by the well known early finding of Vance (1975) that corporations displaying strong social credentials experience declining stock prices relative to the market average.

More recently, the trade-off hypothesis has been carefully articulated by Aupperle et al. (1985). They point out that socially responsive activities (e.g., charity, environmental protection, community development, etc.) may siphon off capital and other resources from the firm, putting it at a relative disadvantage compared to firms that are less socially active. Hence, a firm’s higher level of social performance may lower its financial performance as compared to competitors and/or other norms.

Hypothesis 2: higher (lower) level of social performance lead to lower (higher) level of financial performance.



Available fund hypothesis

A third possibility is that social and financial performances are, indeed, positively associated, but that the casual or lead-lag relationship is from financial to social performance. Although firms may wish to follow the normative rules of good corporate citizenship at all times, their actual behavior may depend on the recourses available.

Hence, profitability in one time period may increase a firm's ability to fund discretionary projects, including social performance projects, subsequently.

Again, a lead-lag relationship, this time with financial performance leading social performance, would provide a relevant test of this proposition. In the previous lead-lag studies, McGuire et al. (1988) found a stronger positive relationship when financial performance was viewed as the leading variable, and their results were partially supported by preston et al. (1991), Kraft and Hage (1990) found that the availability of slack resources (i.e., previous profits), as well as the values and goals of managers, strongly influenced the level of community services undertaken by corporations.

Hypothesis 3: higher (lower) level of financial performance lead to higher (lower) levels of social performance.

Managerial opportunism hypothesis

It is frequently argued in the literature that corporate managers may pursue their own private objectives, to the detriment of the both shareowners and other stakeholders (weidenbaum and Vogt, 1987; Williamson, 1967, 1985). Recent surveys support the view

that top managers consider their own interest of primary importance, or second only those of customers, in corporate decision making (posner and Schmidt, 1992; Alkhafaji, 1989).

The “managerial opportunism” hypothesis, which we believe to be original here, states that pursuit of private managerial goals, in the context of compensation schemes closely linked to short term profit and stock price behavior, might lead to a negative relationship between financial and social performance.

The reasoning is as follows: when financial performance is strong, managers may attempt to “cash in” by reducing social expenditures in order to take advantage of the opportunity to increase their own short term private gain. Conversely, when financial performance weakens, managers may attempt to offset, and perhaps appear to justify, their disappointing results by engaging in conspicuous social programs.

Hypothesis 4: higher (lower) level of financial performance lead to lower (higher) level of social performance.

CHAPTER THREE

3. RESEARCH DESIGN AND METHODOLOGY

3.1 RESEARCH DESIGN

The research design take a quantitative and descriptive approach examining the relationship between corporate social responsibility and financial performance and attempt was made to establish causality between the two variables.

In order to serve the objective of reaching an objective the following stages of research stapes are used:-

1. A list of all commercial banks in the country obtained.
2. A list of commercial banks selected for this research based on the criteria is selected.
3. Measures for the two variables (employee turnover ratio, number of branches opened in up country, return on equity and return on asset) are calculated from the annual report of the banks for the sample period.
4. Outcome of the third stage are compiled in to panel data.
5. The panel data is used to perform statistical analysis to determine whether there is a significant relationship or not.
6. At last the conclusion and recommendation is drown from the analysis of the panel data.

3.2 METHODOLOGY

The research design is quantitative analysis which involves analyzing the annual report and records of sample studies. The study included all banks in the country as a population out of which eight banks are selected based on the availability of the necessary research data. After collection of the data only seven banks are left in the study because one of the sample banks was not willing to give information regarding one of the research questions so we are left with only seven banks (see table 1). This study is based on the annual report of the sampled companies for the year 1999-2011 G.C. Some researchers excludes financial institutions from the study which evaluates the impact of corporate social responsibility their justification is due to the argument that banks and other financial institutions are not directly impacting negatively on their environment and also due to their specific core business and risk profile, they would have altered the average results (Singh and Davidson, 2003).but the researcher believes that there are other dimensions in which we can measure the corporate social responsibility. So it's the researcher strongly agrees that we need to measure the corporate social responsibilities in this service industries.

Dependent variable of the study is financial performance which is represented by ROE (measured as a proportion of Profit after tax to issued share capital) and ROA (measured as the proportion of Profit after tax to total assets). The independent variables/parameters are number of branches opened in upcountry and employee turnover.

Annual reports are used in this research paper to collect the data. The exclusive use of annual reports for this type of research is in agreement with the majority of researchers for several reasons. Annual reports are the most widely read of any corporate documents issued by firms. Annual reports are read by a range of different stakeholders so the information contained in the annual reports has the most impact on readers (Deegan and Rankin 1997). "Annual reports are highly useful sources of information, because managers of companies commonly signal what is important through the reporting mechanism." A number of companies in most of the developed countries produce specialty CSR reports but unless these are included in the annual reports they are unlikely to be read by a large audience. "Our acceptance of the social importance of the corporate annual report stresses its potential (rather than fact) to be influential. Annual reports are the most accessible medium (they are readily available on a number of databases) and as every registered company produces an annual report they provide the most reliable source of information (Gray *et al.* 1995).

3.3 MEASURING CORPORATE SOCIAL RESPONSIBILITY

Determining how social and financial performances are connected is further complicated by the lack of consensus of measurement methodology as it relates to corporate social performance. In many cases, subjective indicators are used, such as a survey of business students (Heinze, 1976), or business faculty members (Moskowitz, 1972), or even the fortune rankings (McGuire, J. B., A. Sundgren, and T. Schneewis 1988; Akathaporn McInnes, 1993; Preston and O'Bannon, 1997). Significantly, it is unclear exactly what these indicators measure.

In other cases, researchers employ official corporate disclosures-annual reports to shareholders, CSR reports, or the like. Despite the popularity of these sources, there is no way to determine empirically whether the social performance data revealed by corporations are under-reported or over-reported. Few companies have their SCR reports externally verified. Thus, information about corporate social performance is open to questions about impression management and subjective bias. Still other studies use survey instruments (Aupperle, 1991) or behavioral and perceptual measures and perceptual measures (Wokutch and McKinney, 1991). Waddock and Graves (1997) drew upon the Kinder Lydenberg Domini (KLD) rating system. Where each company in the S and P 500 is rated on multiple attributes considered relevant to CSP. KLD uses a combination of surveys: financial statements, articles on companies in the popular press, academic journals (especially law journals), and government reports in order to assess CSP along eleven dimensions.

All such things are not present in most of under developed countries including the country under study in this regard it was very difficult to measure corporate social responsibilities especially in the banking industry so the researchers uses two measures of corporate social responsibility ratio of Number of Branches Opened in UP Country (NBOUC) and Employee Turn Over Ratio (TOVR).

NBOUC is calculated by dividing the number of branches opened in up country to the total branches in the same fiscal year. While TOVR is calculated dividing the total number of employees who left the company by the total number of employees of the company in a specific year.



The reason that the researcher is using these variables is first the availability of this data second as per the National Bank of Ethiopia regulation each bank is obliged to open new branches in order to serve new customers found in remote areas where there is no such facility and as per the ration (branch to number of customers) the ration is very high in up countries than the capital and some few towns around the capital so if banks open new branch in the up countries it will serve as their corporate social responsibility response as well as profitability approach. The second measure employee turnover ratio is one of the dimensions in which the company measures the company's response to employees. The higher the ration the lower the response of the company towards its employee's needs and demands which is counted as one of corporate irresponsibility's one thing must be clear employee turnover doesn't include those fired, retired, and dead.

3.4 MEASURING FINANCIAL PERFORMANCE

The financial performance measure has a significant impact on the comparability and reliability of the results. In the 51 papers empirically examining the relationship between CSR and financial performance published prior to 1995, there have been 80 different measures for financial performance used, and 57 of these were used by only one researcher (Griffin and Mahon1997). This inconsistency has caused comparability issues, which has caused a weakness in the case for a relationship between CSR and financial performance (Cochran and Wood 1984). This paper uses two measurements, return on assets (ROA) and return on equity (ROE).

These are the two most commonly used measures for financial performance and will therefore provide the most comparable results (Griffin and Mahon 1997). Larger firms have the resources to make larger profits. The Adams and Harte (1998) use of ROA and ROE controls this problem by providing a firm's financial return in relation to total assets (ROA) or total equity (ROE) which are generally accepted measures of size. Size is a problem as it moderates the relationship as discussed previously in this Chapter and must be adequately controlled to provide reliable results. ROA and ROE were calculated from relevant figures from a company's annual report from 1999-2011 G.C. The Formulas used to calculate ROA and ROE are:

$$ROE = \text{Net Operating Income} / \text{Total Equity}$$

$$ROA = \text{Net Operating Income} / \text{Total Assets}$$

3.5 HYPOTHESIS

In this study, the sign of the relationship between corporate social responsibility and financial performance is tested. The sign may imply negative, neutral or positive linkages. The argument for a negative relationship follows the thinking of those such as Friedman (1970) and other neoclassical economists. According to their view, socially responsible firms have a competitive disadvantage (Aupperle et al., 1985), because they incur costs that fall directly upon the bottom line and reduce profits, while these costs could be avoided or borne by individuals or the government. On the other hand, many empirical results reveal no significant relationship between CSR and financial performance.

According to this line of thinking (e.g., Ullman, 1985), there are so many variables that intervene between the two that a relationship should not be expected to exist. The third view proposes that there is a positive linkage, since the actual costs of CSR are covered by the benefits.

A firm that attempts to decrease its implicit costs by socially irresponsible behavior—by, for example, neglecting to take measures against pollution—will eventually incur higher explicit costs. Socially responsible companies have less risk of negative events. It is less likely for these companies to pay heavy fines for excessive polluting, to have costly lawsuits against them, or to experience socially negative events that would be destructive to their reputation. Theoretically, if there could be two identical companies, where the one is socially responsible and the other is not, it should be expected that the former would have less downside risk for value and encounter fewer events which would be detrimental to its line of profit. In the present study, empirical techniques will be used to identify the sign of the relationship.

3.6 POPULATION

A population is defined as “a complete group of entities sharing some common set of characteristics” (Zikmund, 2003: 739). The population of relevance for this study is commercial banks in Ethiopia. All banks in the country are considered as population of the research. The research considers both private and governmental banks in the country but only commercial ones.

3.7 SAMPLE METHOD AND SIZE

The sampling method that we used to determine the relationship between corporate social responsibility and financial performance the researcher takes criterion sampling. First the researcher developed a criterion by which banks are selected out of the population in the way that they will fulfill the objectives set at the beginning of the research.

So the first criterion was the number of years that the banks operate. This was the first criterion because the second one is directly dependent on it. The second criterion is availability of financial data for the expected number of years so if the company doesn't operate for longer period of year the company may not have the required data available. Based on the above two criteria the paper selected eight banks later reduced to seven because one of the samples totally refused to cooperate.

The banks selected are:-

Table 1:- Banks selected for study

Bank Name	Abbreviation
Abyssinia bank	BoA
Awash bank	AIB
Construction and Business bank	CBB
Commercial bank of Ethiopia	CBE
Dashen bank	DB
Nib bank	NIB
Wegangen Bank	WB

The above banks are selected because one they have stayed in the industry for long period of time; two they have available data for the research period which is 1999-2011. Beyond that they were open and cooperative as its mentioned above one of the original eight banks were left out from the research because of the reason that they total denied any information so the research only used the available data for this research paper.

3.8 DATA COLLECTION

After selecting the sample firms the researcher directly proceeds with collecting data. As it has been mentioned in the proposal and above all data's are secondary. So we exclusively used annual reports of the firms in order to collect data for the two variables of financial performance for each and every bank at each every specific year.

To gather employee turnover data this research used personnel (human resource) records of the firms. Number of branches opened in upcountry data was collected from the marketing department of the banks. All the data's that are have used in this paper are attached at the end of this paper in the appendix part. The data's were not in the proper and organized manner so the researcher has done some manipulations and calculations to reach at the required data quality. The way data's are organized will be discussed next.

3.9 DATA ORGANIZATION

After data's are collected for each and every firm at each research period the mean data was calculated for the sample firms in each specific period. Then the data was compiled into panel in spread sheet it means that the data for each and every variable is the mean of that same variable taken from the all sample at a given year.

The data that is compiled in to panel is used to do the analysis for determining the standard of the two models used in this research. The statistical analysis tool that is used in this paper as mentioned above is eview's. So using this tool the researcher performed descriptive statistics, regression and correlation analysis on the models to determine whether or not the models fit the data presented; to determine whether or not the models are appropriate or not for the data and to determine whether the research questions are answered or not. So as it has been mentioned above the calculation of the two dependent and the independent variables follows the standards set at the beginning of the research.

3.10 STATSTICAL MODEL

Based on the four variables that we identified we try to modify the models that was developed by *Olayinka Marte Uadiale* and *Temitope Olamide Fagbemi*, in their paper called "Corporate Social Responsibility and Financial Performance in Developing Economies: The Nigerian Experience" in their paper the researchers measure financial performance by Return on Equity and Return on Asset just like we did but the corporate social responsibility measures differ they used community performance, environment management system and employee relations which is somewhat different than this research what they have done is they take each CSR measure dimension generally whereas what we have done is we tried to identify variables that will measure the dimensions of corporate social responsibility. So what we do is that we used our independent variables and fit them in to the model.



The regression model is represented as follows:

$$Y_{ROE} = \alpha_0 + \alpha_1 NBOUC + \alpha_2 TOVR$$

$$Y_{ROA} = \beta_0 + \beta_1 NBOUC + \beta_2 TOVR$$

Where:

β_0, α_0 = Intercept coefficients

NBOUC = Number of Branches Opened in Up Country

TOVR = Employee Turnover Ratio

ROE = Return on Equity

ROA = Return on Asset

CHAPTER FOUR

4. DATA ANALYSIS AND PRESENTATION

This section of the study is devoted to presenting the results of the analysis performed on the data collected to test the propositions made in the study and answer the research questions. Analyses were carried out with the aid of the Eview's 6.0.

A group descriptive analysis is the first analyses which the researcher performed on the data as we can see in Table:-2 the descriptive analysis shows that average of ROE is 62.4308% which mean out of the total net income that the banks generate approximately 62.5% belongs to the total equity with the standard variation of plus and minus 5.7% in both direction with 0.722 and 0.494 being the maximum and minimum respectively. It skewed towards the left with a probability of 0.60 approximately.

As to the ROA the mean for the seven banks in the observed 13 years is 0.059692 which expresses that out of the net income that the banks collected about 6% is generated by the assets that the company manages. The maximum of ROA is 0.078 and the minimum is 0.046. Which may seem significantly low this is because most of the incomes that the firms generate come from interest and other service related incomes. The Skewness is 0.456021 which has a probability of 58% for the 13 year observation.

The turnover ratio is 10.8% which explains on average 10% of the total employees left their company which will not include those retired, fired or left the company for further educational purpose or any other reason include as mentioned on the metrology part the data only include those employees which left the company because of their own reasons its skewed towards the right end of the normal distribution curve with a measure of 2.306912.

The mean for number of branches opened in up country is less than half percent which states that only 37% of the total branches opened in specific year are opened in upcountry for the banks under consideration for the given 13 year period. It's negatively skewed by 0.25 approximately with a probability of 0.752305. At last the residual has a mean value of 5.34E-18 with a standard deviation of 0.049106 and it's negatively skewed with the probability of 0.97 approximately.

We need to mind some point's here the above descriptive statistics works only for the last thirteen years of observations and the seven banks that are selected if other banks were considered the figures might have been different. Not also the number of banks but the number of observations might make the result different.

Table 2:- Group Descriptive Analysis

	ROE	ROA	TOVR	NBOUC	RESID
Mean	0.624308	0.059692	0.108154	0.374846	5.34E-18
Median	0.632000	0.059000	0.093000	0.357000	-0.003296
Maximum	0.722000	0.078000	0.253000	0.521000	0.090538
Minimum	0.494000	0.046000	0.076000	0.190000	-0.097025
Std. Dev.	0.057650	0.010078	0.048081	0.099375	0.049106
Skewness	-0.652955	0.456021	2.306912	-0.249633	-0.143767
Probability	0.596743	0.585132	0.000012	0.752305	0.976135
Observations	13	13	13	13	13

Source: - Eview's output

Correlation between Profitability and Corporate Social Responsibility Measures

The correlation analysis was done to examine the relationship of profitability with corporate social responsibility variables. This part starts by analyzing the correlation between the profitability and corporate social responsibility measures then the paper tries to analyze and developed the models that are presented above at the beginning of this chapter. To look at the relationship among these variables, Pearson correlation coefficients were calculated. After running each of the following regression models, the test for the assumptions of Classical Linear Regression Models (CLRM) has done. According to Chris Brooks (2008); there are five assumptions of CLRM, the first assumption says the errors have zero mean ($E(u_t) = 0$).

The second assumption says the variance of the error must be constant ($\text{Var}(u_t) = \sigma^2 < \infty$). The third assumption is about the errors are linearly independent of one another ($\text{cov}(u_i, u_j) = 0$). The fourth assumption says There is no relationship between the error and corresponding X variant ($\text{cov}(u_t, x_t) = 0$). Finally, the last assumption said that the error term u_t is normally distributed.

Due to the fact that, all the regression model has contain a constant term, the entire regression models satisfy the first assumption of CLRM. In addition, without making a test for the third assumption (test for auto correlation), we can say that all the regression models satisfied it. This is because, the data analysis technique is pooled cross sectional analysis the researcher can mitigate the problem by ignoring the time effect.

The test for the remaining assumptions of CLRM, the identified problems and the mitigation method used to deal with the problem with the respective regression models is presented next. In addition, this section of the study also presents the regression or econometrics analysis of the effect of corporate social responsibility on firms' financial performance. In this section of the study the results of correlation study among the variables are presented and analyzed.

Model Analysis for ROE as dependent variable

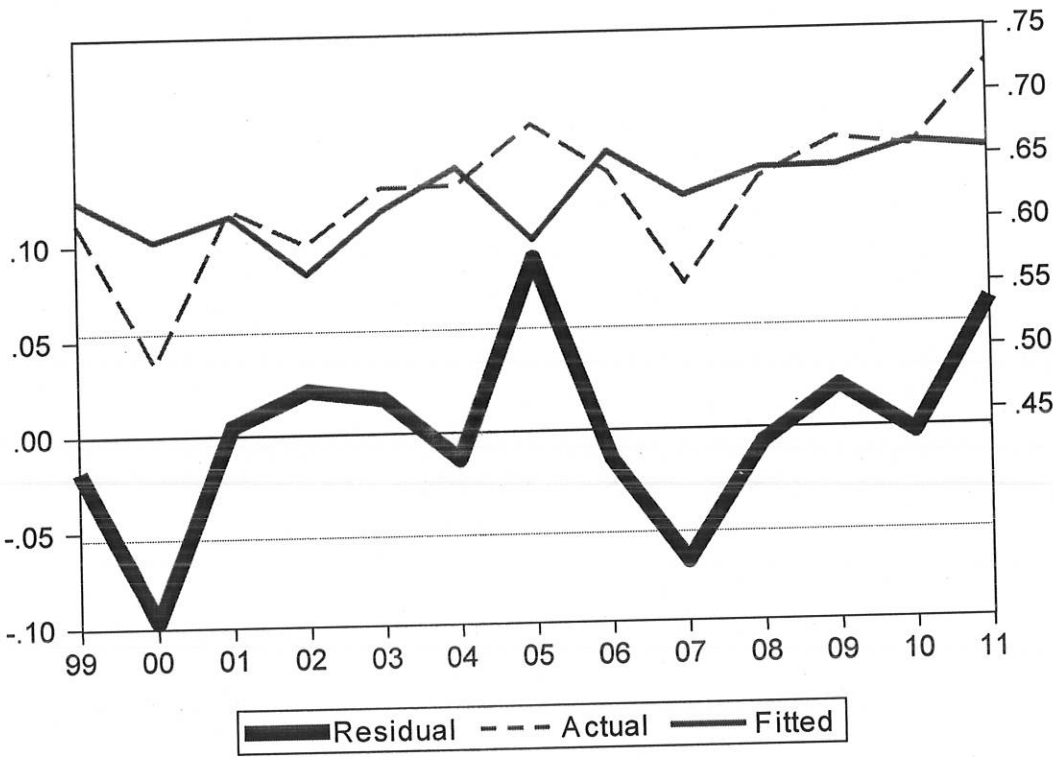


Figure 1:- Actual, Fitted and Residual graph for the first model

Source: - Eview's output

The graph above shows the residual, actual and fitted graphs of the first model. Except the two outliers at 2000 and 2007 in the actual the fitted line more or less is similar with the actual data. The residuals in the contrary the residual terms run here and there in different direction having outliers at 2000, 2005, and 2007. So the outliers in the first model happen at 2000, 2005, and 2007.

Table 3:- Correlation analysis of ROE with corporate social responsibility measures

	ROE	NBOUC	TOVR
ROE	1.000000	0.412168	-0.360210
NBOUC	0.412168	1.000000	-0.092780
TOVR	-0.360210	-0.092780	1.000000

Source: - Eview's Output

As it can be seen from the above table the correlation analysis shows as there is a positive and more or less strong relationship with number of branches opened up country. The correlation between employee turnover and the profitability measures turn out to be negative as expected. As most literatures mentioned employees turnover ratio will have a negative impact on the profitability of the company this is because most employees who left the company will have a negative attitude towards that same company and as it have been listed in most marketing literatures negative words spread faster than the positives so the negative attitudes spread through potential customer and reduce their number which in turn reduce the profitability of the company. It's expected turnover to have a negative impact the higher the employees turnover rate the lower the result of the dependent variable (ROE). The correlation analysis also shows that the impact of employee turnover has negative and insignificant impact on the number of branches opened.



The correlation analysis follow the third theory as mentioned in the theory and hypothesis part one of the paper which suggested that there is a positive relationship between corporate social responsibility and profitability measures unlike the negative theory which suggested that the costs of corporate social responsibility will outstand and the company will incur loss positivists believes that companies response to corporate social responsibility will decrease the risk of responding to negative deeds which will have a greater impact than the cost of corporate social responsibility response.

4.1 THE REGRESSION ANALYSIS FOR ROE AS THE DEPENDENT VARIABLE

The regression analysis for the first model is shown in the table below regressions were run to analyze the effect of employee turnover and number of branches opened upcountry on return on equity. When the models were tested for the CLRM assumptions, the problems of heteroscedasticity were found. The log value of the variables was used to minimize the problem of heteroscedasticity. Below as we can see the regression equation can be expressed as:-

$$\text{ROE} = 0.583345 + (-0.389400) \text{TOVR} + (0.221631) \text{NBOUC}$$

(0.07278) (0.32436) (0.15694)

The regression analysis shows that Return on Equity is positively related with the number of branches opened in up country. In the contrary the employee's turnover ratio has a negative impact on the company's corporate social responsibility.

The above model shows that keeping other things constant a ratio of 1(one) change in employees turnover ratio will have a -0.3894000 change in the company's corporate social responsibility on the other side a zero change in the employee's the employees turnover ratio will add 0.4 on the company's corporate social responsibility. On the contrary number of branches opened in up country has a positive relationship with the dependent variable if we express it with the a number a 100% change in the number of branches meaning if the company opens all its branches in upcountry it will add 0.221631 to the company's corporate social responsibility value. But the latter case is rare and hard to find because of many reasons banks prefer to open in the capital and major cities of the country to mention few of the reasons:-

- More capital is accumulated in the capital
- The saving culture of the society is low in upcountry
- Technological and other infrastructure facilities etc.

At last the constant term explain that companies which have zero ratio with respect to the two corporate social responsibility measures will have some value added to its profit because other variables that are not considered in this model will contribute for the profitability of the company.

Table 4:- The Regression Analysis for ROE as a dependent variable

Dependent Variable: ROE				
Method: Least Squares				
Sample: 1999-2011				
Included observations: 13				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
α_0	0.583345	0.072781	8.015029	0.0000
TOVR	-0.389400	0.324368	-1.200487	0.2576
NBOUC	0.221631	0.156942	1.412188	0.1882

Source: - Eview's Output

To further strongly judge the model whether it aligns with the objectives that are set at the beginning or not we used table three below which specifically explains the significance level and their respective probability. The significance level determine at what percent is the results are determinant and significant.

Table 5:- Casual relationship b/n corporate social responsibility Measures and return on equity

	C		TOVR		NBOUC	
	Coef.	t-value	Coef.	t-value	Coef.	t-value
	(Std. Err.)	(P-value)	(Std. Err.)	(P-value)	(Std. Err.)	(P-value)
ROE	0.58334 (0.07278)*	8.01502 (0.000)***	-0.389400 (0.324368)*	-1.200487 (0.2576)*	0.221631 (0.15694)*	1.412188 (0.1882)*
Number of obs	13		13		13	
*** significant at 1% level						
** significant at 5% level						
* significant at 10% level						

Source: - Eview's output

Above table 3, reveals the results of the regression model in which the impact of corporate social responsibility measures (employees turnover ratio and number of branches opened in upcountry) have on return on equity (ROE) the result shows that employee turnover ratio has a strong negative impact on ROE at 10% significant level while number of branches opened in upcountry has more or less a lower level of impact on ROE when compared with TOVR (employees turnover ratio) and the impact is significant at 10%.



Table 6:- Summary of Regression Model Result

Model	R Square	Adjusted R Square	Std. Error of the regression	F-statistic	Prob (F-statistic)
1	.274447	.129336	0.053793	1.891293	0.201070

Source: - Eview's output

Table 4 presents summary of regression model result. The R Square value, which indicates the explanatory power of the independent variables, is 0.27 approximately. This means that 27% of the variation in ROE is explained by the independent variables (number of branches opened upcountry and employee turnover). It can therefore be concluded that the R Square value is quite low since about 73% of the variation in the dependent variable is unexplained by the model, denoting a weak relationship between the explanatory variables and the explained variable.

The fitness of the model can also be explained by F-ratio (F) in Table 4. The F-ratio is 1.89 approximately, which is significant at $p < 0.05$. This means that there is significant evidence to infer that at least one of the explanatory variables is linearly related to ROE. This confirms the existence of the relationship between ROE and employee turnover ratio or number of branches opened in upcountry.

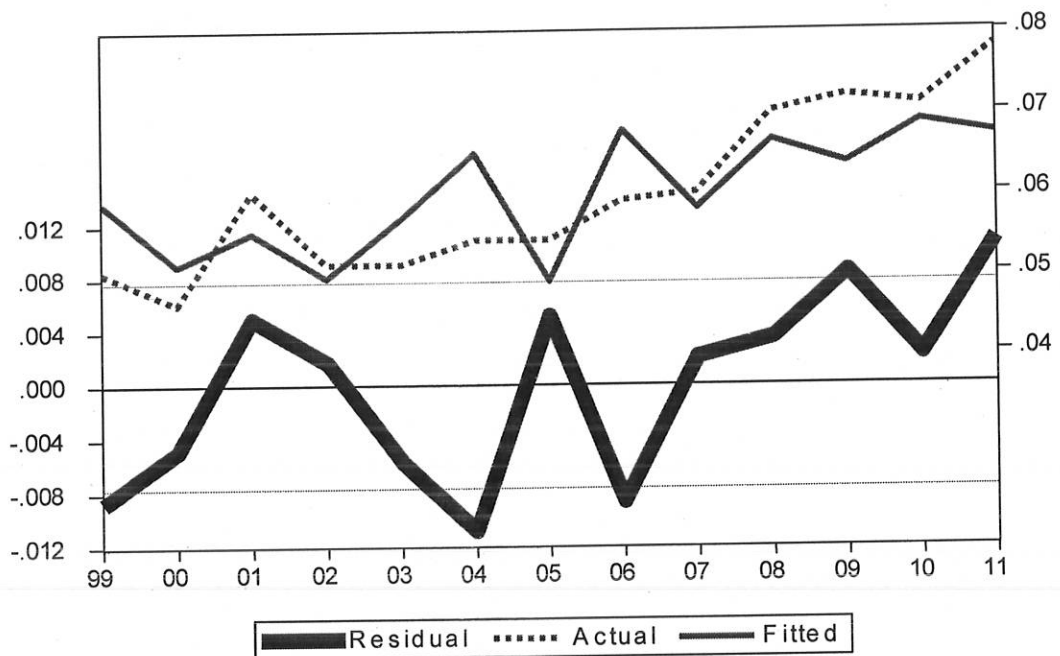


Figure 2:- Actual, Fitted and Residual graph for the first model

Source: - Eview's output

The fitted, actual and residual graph for the second model is somewhat disturbed than the first model. The fitted line continually runs up and down while the actual run smooth for continues periods having no extreme outliers in the actual and fitted data but the residual have its outliers at 2001, 2004, 2005, and 2006. We are going to see in detail about the model but based on the graph below it seems that the first model fitted the data than the second model.

Table 7:- Correlation analysis of ROA with corporate social responsibility measures

	ROA	NBOUC	TOVR
ROA	1.000000	0.650981	-0.363456
NBOUC	0.650981	1.000000	-0.092780
TOVR	-0.363456	-0.092780	1.000000

Source: - Eview's output

Table five above shows that there is a positive and strong above average relationship with number of branches opened up country. Just like the first model the relationship between the second explanatory variable (employee turnover) and return on asset become negative. As it is mentioned above and in the literature part of this paper good employee relation will add a great deal of impact on the corporate social responsibility measure of the company. So the higher employee turnover ratio means the lower the return on asset. The second correlation explains the relationship between numbers of branches opened in upcountry and return on asset. As it has been said here and there opening branches in areas where there is no financial service will add some value and attract new customers who are potential and interested in getting the service but don't have the facility around them. Beyond increasing the profitability and corporate social responsibility opening new branches in areas where there is no such facility over all will contribute to the countries ratio on number per branch.

Once again the correlation analysis carried out on the second model follows the third theory as mentioned in the theory and hypothesis part one of the paper which suggested that there is a positive relationship between corporate social responsibility and profitability measures unlike the negative theory which suggested that the costs of corporate social responsibility will outstand and the company will incur loss positivists believes that companies response to corporate social responsibility will decrease the risk of responding to negative deeds which will have a greater impact than the cost of corporate social responsibility response.

4.2 THE REGRESSION ANALYSIS FOR ROA AS THE DEPENDENT VARIABLE

The regression analysis that we are performing here is almost similar with the one that we have performed earlier first we tried to determine how the second model which considered ROA as the dependent variable will look like with the estimated value of the coefficients of the independent variables. So given the estimated values of the coefficients for the dependent variables the second model ROA as the dependent variable will look like what we see below but we must give big emphasis on the point that this estimations may not work for other industry or firms other than what we considered in the sample. The most important thing that we consider is the direction of the relationship rather than the magnitude. As it's mentioned in the objective of this paper determining the direction of the relationship is the first objective that this paper is concerned with.

Because of the reason that we take the mean of each variable for different period and it's better to consider only the direction. So the equation with the estimates will look like:-

$$\text{ROA} = 0.042954 + (-0.064073) \text{ TOVR} + (0.063142) \text{ NBOUC}$$

(0.010387) (0.046292) (0.022398)

As we can see above the relationship between the explanatory variable and the explained the dimension of the relationship is similar with the first model that is explained above. So the negative coefficient of the employee's turnover ratio explains that given other things constant a 100% change in the ratio of employee's turnover will have a -0.064073 change on the ROA with a standard error of 0.046292. It seems that employee turnover ratio has a negative impact on ROA but when combined with the other corporate social responsibility it has a positive impact because literatures suggested that lower employee turnover the higher company's attitude towards employee relation which is a positive relation.

The relationship between number of branches opened upcountry and ROA is also similar with the first model in dimension but it's obvious to differ in magnitude. So the coefficient in NBOUC explains that if no branch is opened in upcountry the company that follows this model will loss 0.063142 value of its return on asset which the company would have gotten if branches were opened in upcountry.

At last the constant term explains the amount that the firm may add to its ROA without satisfying or doing anything to the two explaining variables. The value 0.042954 explains that given a value of the two independent variables zero still the company maintains to add 0.042954 on the ROA of the company as the paper tried to explain earlier this will happen because of the reasons that are mentioned above.

Table 8:- The Regression Analysis for ROE as a dependent variable

Dependent Variable: ROA				
Method: Least Square				
Sample: 1999 2011				
Included observations: 13				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
β_0	0.042954	0.010387	4.135327	0.0020
TOVR	-0.064073	0.046292	-1.384099	0.1964
NBOUC	0.063142	0.022398	2.819093	0.0182

Source: - Eview's output

The above description and model formulation does not explain the relationship between the explanatory and the explained variables by itself. So we need further in-depth analysis and table three below which specifically explains the significance level and their respective probability helps to satisfy the objective.

Table 9:- Casual relationship b/n corporate social responsibility Measures and return on equity

	C		TOVR		NB OUC	
	Coef.	t-value	Coef.	t-value	Coef.	t-value
	(Std. Err.)	(P-value)	(Std. Err.)	(P-value)	(Std. Err.)	(P-value)
ROA	0.042954 (0.01038)	4.135327 (0.0020)***	-0.064073 (0.04629)	-1.384099 (0.1964)*	0.063142 (0.02239)	2.819093 (0.0182)**
Number of obs	13		13		13	
*** significant at 1% level						
** significant at 5% level						
* significant at 10% level						

Source: - Eview's output

The above table (table 8), explains that the constant coefficient takes a value of 0.042954 which is significantly lower than the first model which takes ROE as independent variable. The value is significant at 5% level. The third column in the table shows clearly shows the negative relationship between the explanatory and the explained variable. So the value -0.064073 is significant at 95% level of confidence interval with a probability of 20% approximately.

The last but not the least is 0.063142 for the coefficient value of number of branches opened upcountry which indicate the positive relation of the variable with return on asset. The coefficient of NBOUC has a standard error of 0.02239 so the probability of the variable is 0.0182.

Table 10:- Summary of Regression Model Result

Model	R Square	Adjusted R Square	Std. Error of the regression	F-statistic	Prob (F-statistic)
1	.516417	.419700	0.007677	5.339488	0.026446

Source: - Eview's output

Table 9 presents summary of regression model result. The R Square value, which indicates the explanatory power of the independent variables (TOVR and NBOUC) on the dependent variable meaning R square determines what percent of the change in the dependant variable is explained by the change in the dependent variable. As we can see the result of R square for the second model is 0.52 approximately. This means that 52% of the variation in ROA is explained by the independent variables (number of branches opened upcountry and employee turnover). The variation or the change in the dependent variable ROA is caused by the change in the explanatory variables. It can therefore be concluded that the R Square value is high since about 52% of the variation in the dependent variable is explained by the model, denoting a strong relationship between the explanatory variables and the explained variable.

The fitness of the model can also be explained by F-ratio (F) in Table 4. The F-ratio is 5.34 approximately which is somewhat larger than one because it's mentioned above that the larger the f ratio the better, it's also significant at $p < 0.05$. This means that there is significant evidence to infer that at least one of the explanatory variables is linearly related to ROA. This confirms the existence of the relationship between ROA and employee turnover ratio or number of branches opened in upcountry. The relationship between the two variables may be affected by other variables like industry, size, policy etc but the this paper is only consider in finding the relationship and find whether the independent variable will affect the outcomes of the explained variable.

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CHAPTER FIVE

5. CONCLUSION AND RECOMMENDATION

5.1 CONCLUSIONS

Corporate Social Responsibility (CSR) has assumed increasing importance in the practitioner as well as in the academic community. The debate on whether CSR is financially rewarding however remain a contentious issue. To address this issue, prior research has examined the effect of CSR on firm performance with mixed results. In this study, the impact of corporate social responsibility on financial performance was studied taking employee turnover and number of branches opened up country as a corporate social responsibility measure and return on equity and return on asset for financial performance. The study takes a quantitative approach in examining the relationship. In order to come up with a valid result the researcher modified a model that was developed by Olayinka Marte Uadiale, Temitope Olamide Fagbemi, for tasting the same relationship but they used different variables.

Our results indicate that the mean of the two financial performance measures are significantly different from one another so this may not be the most important analysis in this paper but it tells as some important points. Return on asset is important in the discussion of efficient asset utilization (the return on the total investment in the firm) and return on equity discusses the profitability, efficiency and leverage. So the value 0.059692 shows that the average asset utilization level of the firms. The later value 0.624308 shows a good leverage and profitability of firms in the sample.

In the regression analysis of the first model results revealed that return on equity is positively and significantly related with one of the corporate social responsibility measure which is number of branches opened up country. It's also negatively and significantly related with employee turnover ratio. The coefficients of the two explanatory variables show that CSR have a good impact on the financial performance of the firm measured by return on equity.

In determining the goodness of the model fitting the data the result of the analysis shows as the model has 0.275 R square which explains that only 27.5% of the time the difference in the dependent variable is explained by the change in the explaining variable. The result is low and put a lot of questions on the appropriateness of the model developed so what we can say is that there may be a relationship between the variables but this model falls to explain that relationship.

The second model results are somewhat different and strong results shows that there is a positive and strong above average relationship with number of branches opened up country. Just like the first model the relationship between the second explanatory variable (employee turnover) and return on asset become negative. The results of the second model also show a strong R square which explain the degree of fitness of the model and like the first model the second model have a 51.6% R square.

The value explains that more than half of the time the change in the explained variable is occurred because of the change in the explanatory variable meaning 51.64% of the time the change in ROA is caused by the change in employee turnover and number of branches opened in upcountry.

Coming to the general hypothesized theories from the results of the two models there were three possible outcomes expected out of the analysis. The results of this analysis follow stakeholder theory as mentioned in the literature review that favorable social performance_ that is, meeting the need of various corporate stakeholders _will ultimately lead to favorable financial performance, and vice. Cornell and Shapiro (1987) argue that failure to meet the expectation of various no shareowner constituencies will generate market fear, which, in turn, will increase a company's risk premium and ultimately result in higher costs and /or lost profit opportunities. According to their analysis, serving the implicit claims of major stakeholders (e.g., employees, customers) enhances a company's reputation in a way that has positive impact on its financial performance; conversely disappointing these groups may have negative financial impact.

Theoretically, if there could be two identical companies, where the one is socially responsible and the other is not, it should be expected that the former would have less downside risk for value and encounter fewer events which would be detrimental to its line of profit.

From the two models analyzed it's easy to see that employee turnover ratio is negatively related with both Return on Asset (ROA) and Return on Equity (ROE) which means that the higher the ratio of employee turnover the lower the financial performance of the firm. Whereas number of branches opened in up country is positively related with both financial performance measures which reveals that the higher number of branches opened in up country the higher will be the financial performance of the firm.

From the findings of our analysis it's possible to say that there is a positive relationship between corporate social responsibility and financial performance. So firms that spend much effort in retaining employees and opening branches in upcountry will have a higher result in their financial performance than those who do the opposite.

The result on the analysis of the two models shows as that coefficient of employee turnover which measures employee dimension of corporate social responsibility is higher in both models than the customer dimension measured by number of branches opened in up country. So based on the impact of the two variables in both models it's easy to say that employee dimension of corporate social responsibility has a higher impact of corporate financial performance than customer dimension of CSR. It's because the willingness, motivation, sense of belongingness and creativity of employee will attract more customers. Branches opened in upcountry but without a good service from employees will further divert customers to other options than attracting them. So it can be concluded that the impact of employee dimension is greater than the impact of customer dimension in financial performance of the firms in this study.

The impact of corporate social responsibility on financial performance is long-term in its nature because we have used the mean value of the variables all the ups and downs of each variable is considered. So once the firm does in either dimensions of corporate social responsibility its impact extends through the study period so it can be concluded that the impact of corporate social responsibility is long term in its nature.

5.2 RECOMMENDATION

It's unarguable to conclude that doing good thing is important for the financial performance, corporate reputation as well as public image of the company but the impact of CSR on financial performance has been giving contradicting outcomes as we have observed above analysis of this paper gives a positive relationship between the two variables under consideration so based on the analysis carried out and the behavior of the firms under consideration we recommend the following points.

- Firms which consider and incorporate corporate social responsibility measures in their strategy happen to perform high in their financial performance. So it's recommended that firms acknowledge the existence of corporate social responsibility and act towards implementing in their day to day operation.
- Firms which operate under the command of corporate social responsibility not only help themselves in achieving their financial goal but also help the country meet international standards in giving financial services.

- Studied should be conducted over a long period of horizon and under normal economic conditions (i.e. without the effect of the global financial crises) to obtain reliable data related to the financial performance of the firms under consideration.
- The impact of corporate social responsibility on financial performance using accounting based measurements, should be investigated. This would investigate another dimension of the financial performance.
- Also there are seven dimensions of corporate social responsibility the study only considered two of them but it's recommended for further researches to consider as many dimensions as possible.
- The study doesn't consider new and emerging banks but the result of the study would have been applicable for all the firms in the industry if it had also include the firms which are new and emerging ones.
- Studies should be conducted on the relationship between the corporate social responsibility and financial performance in industries where CSR issues are more sensitive than the financial sector.

“What you give you get, ten times over”

Yoruba proverb

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Appendix

Abyssinia Bank (ABB)

Year	Return on Asset (ROA)	Return on Equity (ROA)	Employee Turnover ratio (TOVR)	Ratio of Number of Branches opened upcountry (NBOUC)
1999/2000	0.064	0.634	0.041	0.667
2000/2001	0.049	0.285	0.056	0.160
2001/2002	0.069	0.426	0.094	1.000
2002/2003	0.040	0.298	0.098	0
2003/2004	0.037	0.358	0.112	0.450
2004/2005	0.057	0.491	0.090	0.450
2005/2006	0.053	0.468	0.097	0
2006/2007	0.059	0.447	0.074	0.750
2007/2008	0.057	0.512	0.062	0.200
2008/2009	0.056	0.604	0.054	0.500
2009/2010	0.053	0.563	0.044	1
2010/2011	0.054	0.583	0.051	0.75
2011/2012	0.062	0.687	0.060	0.416



Awash International Bank (AIB)

	Return on Asset (ROA)	Return on Equity(ROA)	Employee Turnover (TOVR)	Ratio of Number of Branches opened upcountry (NBOUC)
1999/2000	0.061	0.612	0.075	0.333
2000/2001	0.078	0.695	0.072	0.250
2001/2002	0.084	0.728	0.059	0
2002/2003	0.063	0.646	0.074	0
2003/2004	0.061	0.729	0.069	0.500
2004/2005	0.056	0.686	0.083	0
2005/2006	0.060	0.750	0.074	0.333
2006/2007	0.077	0.830	0.075	0.400
2007/2008	0.083	0.791	0.081	0
2008/2009	0.089	0.861	0.079	0.5
2009/2010	0.100	0.939	0.087	0.333
2010/2011	0.076	0.715	0.089	1.000
2011/2012	0.083	0.694	0.093	0.833

Construction and Business Bank (CBB)

Year	Return on Asset (ROA)	Return on Equity (ROE)	Employee Turnover (TOVR)	Ratio of Number of Branches opened upcountry (NBOUC)
1999/2000	0.032	0.494	0.100	0
2000/2001	0.029	0.422	0.121	0.500
2001/2002	0.031	0.471	0.080	0
2002/2003	0.043	0.522	0.418	0.500
2003/2004	0.036	0.519	0.126	0
2004/2005	0.045	0.550	0.084	0.650
2005/2006	0.040	0.704	0.080	0.500
2006/2007	0.056	0.741	0.098	1
2007/2008	0.064	0.710	0.095	0
2008/2009	0.073	0.679	0.200	0
2009/2010	0.067	0.643	0.075	0.333
2010/2011	0.065	0.640	0.050	0.667
2011/2012	0.081	0.926	0.075	0.818



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Commercial Bank of Ethiopia (CBE)

Year	Return on Asset (ROA)	Return on Equity (ROE)	Employee Turnover (TOVR)	Ratio of Number of Branches opened upcountry (NBOUC)
1999/2000	0.065	1.092	0.047	0.333
2000/2001	0.062	1.023	0.049	0
2001/2002	0.057	1.034	0.047	0
2002/2003	0.045	1.212	0.055	0.455
2003/2004	0.066	1.198	0.041	0.500
2004/2005	0.052	1.012	0.048	1
2005/2006	0.052	1.217	0.049	0.500
2006/2007	0.036	0.862	0.059	0.500
2007/2008	0.039	0.406	0.040	0.667
2008/2009	0.078	0.869	0.050	0
2009/2010	0.094	1.110	0.056	0
2010/2011	0.087	1.171	0.042	0.75
2011/2012	0.091	1.187	0.042	0

shen Bank (DB)

Year	Return on Asset (ROA)	Return on Equity (ROE)	Employee Turnover (TOVR)	Ratio of Number of Branches opened upcountry (NBOUC)
1999/2000	0.041	0.574	0.096	0
2000/2001	0.020	0.244	0.142	0.333
2001/2002	0.029	0.412	0.106	0.500
2002/2003	0.025	0.310	0.400	0
2003/2004	0.026	0.402	0.113	1
2004/2005	0.028	0.437	0.084	0.250
2005/2006	0.021	0.299	0.110	0
2006/2007	0.027	0.323	0.070	0
2007/2008	0.027	0.306	0.095	0.667
2008/2009	0.031	0.341	0.286	0.800
2009/2010	0.032	0.353	0.075	0.333
2010/2011	0.038	0.428	0.104	0.853
2011/2012	0.046	0.485	0.075	0.667

Nib International Bank (NIB)

Year	Return on Asset (ROA)	Return on Equity (ROE)	Employee Turnover (TOVR)	Ratio of Number of Branches opened upcountry (NBOUC)
1999/2000	0.020	0.137	0.221	0.548
2000/2001	0.023	0.113	0.313	0
2001/2002	0.078	0.500	0.173	0.051
2002/2003	0.076	0.462	0.288	0.500
2003/2004	0.065	0.528	0.237	0
2004/2005	0.066	0.539	0.121	0.500
2005/2006	0.078	0.609	0.160	0
2006/2007	0.078	0.554	0.120	0.175
2007/2008	0.079	0.488	0.152	0.400
2008/2009	0.086	0.529	0.109	1
2009/2010	0.088	0.584	0.118	0.273
2010/2011	0.093	0.607	0.128	1
2011/2012	0.092	0.560	0.112	0.493

Wegagen Bank (WB)

Year	Return on Equity (ROE)	Return on Asset (ROA)	Employee Turnover (TOVR)	Ratio of Number of Branches opened upcountry (NBOUC)
1999/2000	0.069	0.693	0.092	0.548
2000/2001	0.063	0.680	0.100	0.500
2001/2002	0.073	0.739	0.093	0.444
2002/2003	0.065	0.664	0.436	1
2003/2004	0.072	0.685	0.100	0
2004/2005	0.080	0.711	0.084	0.500
2005/2006	0.079	0.711	0.095	0
2006/2007	0.082	0.731	0.084	0.500
2007/2008	0.076	0.656	0.110	0.400
2008/2009	0.082	0.562	0.243	0.250
2009/2010	0.076	0.464	0.075	0.556
2010/2011	0.085	0.465	0.074	0.509
2011/2012	0.091	0.515	0.075	0

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