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Corporate Sustainability Practices Impact on Firm Financial Performance: Evidence from the Banking Sector of Pakistan

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A B S T R A C T

This study examines Corporate Sustainability Practices (CSP) impact on Firm Financial Performance (FFP) of the Top public listed commercial banks of Pakistan. This study observes the annual reports of the top 10 Pakistani public listed commercial banks by focusing on their market capitalization. Content analysis technique which is used for data collection from their respective annual reports for five years from 2012 to 2016 (both inclusive). Fixed Effect (FE) and Random Effect (RE) model is utilized. Results indicates that CSP have positive and significant impact on FFP. No significant impact of firm size and age was found on FFP while leverage has significantly negative impact on FFP (ROA). These findings suggest that in order to boost financial performance of commercial banks in Pakistan CSP can be considered. These outcomes propose that Pakistani commercial banks should be involved constantly in their CSP; as the result shows that financial performance in commercial banks of Pakistan can be improved with higher sustainable practices. Although there is scarcity of CSP impact on FFP related studies; still the existing studies on CSP in Pakistan relate to the study of such motivations of managers toward CSP and its reporting. A wide-ranging empirical research on the CSP impact on FFP in top public listed commercial banks of Pakistan is compartmented by this study.

INTRODUCTION

For the last few years, corporate sustainability practices (CSP) reporting has emerged as an area of interest for many researchers (Mathews, 1997). In the year of 2002 a survey was carried out by Price Water House Cooper's International (PWC) reported that the global executives whose percentage are said to be more than a whopping 70% considered CSP to be at the forefront of their firm's growth & survival (Bhatia & Chander, 2014; Simms, 2002; Sharif & Rashid, 2014). Educated and healthy community is an indispensable aspect of the firm's overall business objective. However, this ideal situation can only be attained if relationship amongst the corporate entities and the communities are influential and equally beneficial. It is a common understanding that the primary growth of a firm is associated directly with the welfare of the overall society, Businesses cannot flourish in segregation and it needs to give something in return to the societies and communities it operates in. Additionally, it

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should be a part of their strategic & business objective. CSP has become a permanent force and an essential aspect of the corporate governance (CG) concern in order to satisfy the social responsibilities. There is a great number of research studies conducted on demystifying the relationship between the CSP activities and efforts of a firm in regards to the main economic indicators like a firm's market position, risk management, industry relationship, market response, size, environmental impacts both micro and macro, and goodwill of the company (Herremans, Akathaporn, & McInnes, 1993; Newson & Deegan, 2002; Roberts, 1992; Tilt, 1994). With these benefits and plenty more, corporate managers are quite motivated and intrigued to practice and implement CSP programs across the organization (C. A. Adams, Hill, & Roberts, 1998; Deegan & Gordon, 1996; Deegan & Rankin, 1996; Donaldson, Preston, & Preston, 1995; Guthrie & Parker, 1989; Neu, Warsame, & Pedwell, 1998; Patten, 1992; Roberts, 1992). The studies conducted earlier were targeting specific characteristics of a firm. There were a very few organizations who considered the Corporate Governance attributes of CSP and its positive and lasting relationship with CSP activities.

Across the broad-ranging research studies in this field, it is found that research scope of CSP in developed countries is limited to the non-financial sector. This resulted in an ignorance of the banking sector in the CSP related research (Deegan, Rankin, & Tobin, 2002). Furthermore, CSP related research studies in the developing countries are inadequate due to limited attention to this segment in the developing countries. Pakistan, being a developing country is not exception to this fact (Sharif & Rashid, 2014). This research is intended to add to the knowledge body of CSP related research studies in the context of Pakistan and explore the impact of CSP on FFP amongst the top 10 public listed commercial banks in Pakistan.

In addition to objective of finding the impact of CSP in FFP, this paper further reviews the existing literature associated to legitimacy theory (LT) to authorize the legitimacy of CSP by different companies. It also explores the actual and potential practices conducted by different commercial banks in Pakistan in contrast with global indicators of CSP as per the sustainability reporting framework (Global Reporting Initiative (GRI), 2011) which is applicable globally. These guidelines which is globally applicable are voluntary in nature and not legally binding (C. Adams & Narayanan, 2010). This study is focused at exploring the CSP reporting system within the commercial banking system of Pakistan to identify and evaluate CSP related knowledge variables on annual reports.

LITERATURE REVIEW

Theocratical Framework: Legitimacy theory (LT) and banks' CSP

Legitimacy Theory (LT), within the CSP domain, stresses on the optimistic response to different social expectation deemed by the society from the corporate management (Deegan et al., 2002; Campbell, 2000; Patten, 1992). The infamous LT theory is something used by organizations frequently in the recent years (Deegan & Gordon, 1996; Milne & Patten, 2002; Moerman & Van Der Laan, 2005; Murthy & Abeysekera, 2008; O'Donovan, 2002; O'Dwyer, 2002; Patten, 1992).

Although, the banking sector offers a beneficial and dynamic product/service to the society, it is still in the need to hunt for legal authority in the eyes of community regarding its social value (Oliver, 1991). Pakistan is no stranger to such norms and regulations where the banking sector is held liable for reporting all information related to the social activities of the banks with a purpose that in the country it will resolve the multidimensional social problems (Sharif & Rashid, 2014). With this in prospect, all banks are formalized to duly report such information in their annual reports. Amongst many other, some of the core areas of social work mostly comprise of fighting against illiteracy, health & hygiene, poverty alleviation, protection of human rights and provision of employment of the women and children (Lindblom, 1994).

Since the organizations are motivated to display their organizational legitimacy, they are encouraged to report CSP voluntarily and therefore corporate governance reports such social activities (Guthrie & Parker, 1989). Similarly, a positive relation between reporting CSP information and re-usability of organizations in the society has been found by (Branco & Rodrigues, 2008). The LT theory, in this context plays a pivotal role in bridging the gap between organizational legitimacy and rationale disclosure. As an example, if the firm is faced with an exception disaster where the concerned department is highlighted, the organization is compelled to change their CSP reporting (Deegan, Rankin, & Voght, 2000; Patten, 1992). Some researchers also believe that the legitimacy of different companies remain doubtful for the society about the CSP (Barako & Brown, 2008; Deegan et al., 2002, 2000). One of the reasons why this happens is due to the communication gap between the society and the company. However, one way of countering such instances for a firm is to guarantee that it is keeping a close check on the essential legitimacy by practicing the right thing whilst circumventing the wrong things (Buhr, 1998). In order to affirm this practice, the LT emphasizes on using CSP reporting as an optional mode of communication with the stakeholders (Branco & Rodrigues, 2008).

Hypotheses development

Amongst many other, two core questions that require a deliberate and comprehensive explanation about the financial institutions are 'what makes them special and understanding the need to study their activities independently? To begin with, financial institutions are unique in many different ways starting from their role in the retail services to their ability of processing an economic activity for the companies. Similarly, their uniqueness is evident from the changes that occurred in the mainstream financial services over the recent few decades. Historically, the financial sector of U.S in the early 80's accounted for nearly 4% of its GDP which has jumped up to 8% by the year of 2005 (Philippon, 2007).This growth is largely credited to the commercial banks and traditional depository institutions in the U.S market (Philippon, 2007). Moreover, there are a few other factors that contributed to the boom of American GDP which are deregulations (e.g. The 1999 Act of Gramm-Leach-Bliley) and the subsequent innovation by financial institutions that created securities like credit default swaps and collateralized debt obligations. Initially, these products were aimed at helping the corporations in hedging balance sheet exposures or the likes of diversifying portfolio holdings, but the during the early 2000, the same products were used by banks proprietary trading departments for increasing profits by speculation. The same process contributed to the financial crisis of 2007-2008 where the American economy went into recession and people suffered tremendous losses worth in Trillions of dollars. Considering all this, we can observe the significance of the finance sector to a country's economy and therefore it is of high importance to study the factors which impact the financial sector. Corporate governance failure can be seen if there is financial crisis, and in general if financial institutions are underperforming. Andrei Shleifer & Vishny (1997) are of the opinion that CG is a set of mechanism that empower businesses to deliver a return on capital to the capital suppliers.
In the event that the CG environments were not ideally intended to profit the institutions' partners, a legitimate augmentation is to inquire as to whether different parts of the Institutions' Corporate

environments were appropriately structured. Shouldn't something be said about their CSP structures? Carroll (1979) characterizes CSP as incorporating the legitimate, moral, financial and other optional obligations that organizations need to society. At the point when connected to singular firms, this is reliable with (Freeman, 1984) theory of stakeholder, which recommends that organizations have a duty to various diverse interests' groups, including employees of the firm, clients, suppliers, and society everywhere – notwithstanding stakeholders. Given this, diverse firms may have distinctive targets and guidelines for execution, contingent upon who their partners are. These diverse partners should compel firms to give the best conceivable return to the particular capital that they have invested.

Since this will incorporate return to investors, concentrating on monetary execution of firms, which is the most promptly quantifiable wellspring of profits, ought to give the best proxy to the firm's overall performance. A lot of research has considered the connection among CSP and performance of the firm. The outcomes demonstrate a positive connection among CSP and firm performance; see (Griffin & Mahon, 1997) for an overview of the pre-2000s research. All the more as of late, (Orlitzky, Schmidt, & Rynes, 2003) play out a meta-analysis of CSP and firm performance studies and demonstrate this positive relationship. Deckop, Merriman and Gupta (2006) give a rundown of a great part of the CSP-firm performance literature and furthermore demonstrate for most of the part, positive connection between CSP quality and performance of the firm. Shen and Chang (2009) demonstrate that organizations with solid CSP culture don't perform awful, and for the most part perform better than firms with feeble CSP culture over an assortment of money related measurements. Examined in the CSP research context, this paper is of pivotal importance because of the selected country focus and industry. Although, prior research studies were conducted in this domain, it often excluded Banking/Financial institution due to the rigid regulation and strict requirements of this sector (Alsaeed, 2006; Ismail & Chandler, 2005; Leung & Horwitz, 2004; Hossain, Tan, & Adams, 1994).

This paper intends to link the long-drawn-out gap by studying and gaining a deep insight into CSP of this essential sector. furthermore, this paper focuses on Pakistan in the milieu of a developing country research & contributes to the practical disclosure research on developing economies (Alsaeed, 2006; Barako, Hancock, & Izan, 2006; Owusu-Ansah, 1998). On the basis of literature and discussion above, the Following hypothesis are developed.

H1: CSP have significantly positive impact on FFP.

RESEARCH METHODS

Population

Currently there are 20 public listed commercial banks on Pakistan Stock Exchange and hence this will be considered as population of the study.

Data and Sample

This paper considers sustainability related information which is publicly available; thus, solely information that's accessible to any or all stakeholders (Van der Ploeg & Vanclay, 2013). Therefore, information assortment for the sustainability index depends on company annual, CSR and CSP reports as sources of data. Previous studies used this approach for data collection, for example (Clarkson, Li, Richardson, & Vasvari, 2008; Herbohn, Walker, & Loo, 2014). This study investigated annual reports of top 10 commercial banks of Pakistan listed on Stock Exchange as a sample for the period of 2012-2016 (both years inclusive). It is likewise the self-evident actuality that companies don't disclose any data in regards to reporting their CSP separately (Sharif & Rashid, 2014).The selection of banks from the sector is based on their highest market capitalization. As indicated by (Tsang, 1998) medium sized and expansive firms having bigger obligation and standards unveiled CSP data to a higher extent in contrast to small firms who tries to expand its business activities (Gardiner, Rubbens, & Bonfiglioli, 2003). Annual reports are used for this paper in order to collect data while using the content analysis procedure. In research on accounting disclosures content analysis is the most common and extensively used method (Boesso & Kumar, 2007).

Variable Measurements

Dependent variable

FFP is dependent variable in this paper. ROA and ROE has been extensively considered as profitability measures (Athanasoglou, Delis, & Staikouras, 2006; Hassan & Bashir, 2005). In this study a 1-year lag of ROA and ROE in our model is used in order to express that CSP is a strategic concept (Fischer & Sawczyn, 2013; Porter & Kramer, 2006.). Therefore, effects do not take place in the same year but in the following period.

Independent Variable

CSP index (CSPI)/ GRI Reporting Index

CSP is independent variable in this study. The numbers "1" and "0" were assigned to code an item in this paper. 1 implies that a CSP item is reported and 0 implies that a CSP item isn't reported in their respective annual report. All the items score are added and summation of all the reported items are utilized for further procedure (Wang & Choi, 2013). The CSP total score for a particular bank by CSP disclosures model calculated as follows.

$CSPI = \sum di$ …. (1)

where, CSPI= Corporate Sustainability Performance index while di is 1, if the item di is reported in the annual report and 0 if the item di is not reported.

Control Variables

Some of the corporate characteristic factors are controlled in this study, including firm’s size by the proxy logarithm of total assets, firm’s age by proxy the age of the firm since its enlisting on Pakistan Stock Exchange, whereas leverage of firm is measured as proxy of total liabilities over total assets. These variables will be normalized with a logarithmic transformation (Lee, 2012; Slater & Romi, 2013).

Model Specification

Model 1

$$FFP(ROA)_{it} = \beta_0 + \beta_1 CSP_{it} + \beta_2 AGE_{it} + \beta_3 SIZ_{it} + \beta_4 LEVG_{it} + \beta_5 LAGROA_{it} + \varepsilon_{it}$$

Model 2

$$FFP(ROE)_{it} = \beta_0 + \beta_1 CSP_{it} + \beta_2 AGE_{it} + \beta_3 SIZ_{it} + \beta_4 LEVG_{it} + \beta_5 LAGROE_{it} + \varepsilon_{it}$$

Whereas;
FFP is Firm Financial Performance.
β is Beta.
CSP is Corporate Sustainability Practices.
ROA is Return on Assets.
ROE is Return on Equity.
AGE is Firm Age.
SIZ is Firm Size.
LEVG is Firm Leverage.
LAGROA is Lag of ROA
LAGROE is Lag of ROE
it is i^{th} firm at time t and
ε is Error term.

RESULTS

Descriptive statistics

Results of descriptive statistics are stated in Table 1 below. Mean and standard deviation are reported in column four and five respectively in table 1. Mean value and standard deviation as shown in the table 1 are positive for all variables. For example, median value of two variables are above one while the rest of them have median value below one. In case of this sample the mean value of ROA is 1.3 % with standard deviation of 0.7% while the mean value for ROE is 17.6% with standard deviation of 10.7%.

Table 1 Descriptive statistics

	Minimum	Maximum	Mean	Std. Deviation
ROA	-0.014	0.027	0.013	0.007
ROE	-0.329	0.273	0.176	0.107
CSP	0.000	1.000	0.420	0.499
Firm's Age	15.000	75.000	43.600	22.539
Firm's Size	274437	2400000	893015	529690
Firm's Leverage	0.881	1.019	0.934	0.025

Notes: Return on Assets (ROA), net operating income/total assets for firm *i* period t; Return on Equity (ROE), net income/ shareholder's equity for firm *i* period t; Corporate Sustainability Practices (CSP), summation of CSP item reported for firm *i* period t; Firm's Age, proxy logarithm the age since its enlisting on Pakistan Stock Exchange for Firm *i* period t; Firm Size, proxy logarithm of the total assets for firm *i* period t; Firm's Leverage, total debt to total assets for firm *i* period t.

Correlation Analysis

CSP is significantly positively correlated with ROA and ROE as it is revealed in the correlation matrix labeled as table 2. Which satisfies hypothesis H1 that there is significantly positive impact of CSP on FFP. ROA and ROE are the representation of Firm Financial Performance. Secondly the correlation matrix revealed that two control variables (Firm's Age and Firm's Size) are also positively correlated with ROA while Firm's Leverage which is also a control variable is negatively correlated with ROA. The matrix of correlation of the variables in Table 2 illustrates that all variables with each other have low correlation coefficients, which means that none of the variables indicates genuine multicollinearity.

Table 2: Correlation Matrix

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
ROA (1)	1							
ROE (2)	.692**	1						
CSP (3)	.478**	.427**	1					
Firm's Age (4)	.489**	.299*	0.135	1				
Firm's Size (5)	.366**	0.240	-0.027	.821**	1			
Firm's Leverage (6)	-.796**	-0.232	-0.206	-.407**	-.362**	1		
Lag ROA (7)	.731**	.464**	.498**	.335*	0.235	-.674**	1	
Lag ROE (8)	.487**	.560**	.433**	.312*	0.268	-.288*	.689**	1

- **. Correlation is significant at the 0.01 level (2-tailed). *. Correlation is significant at the 0.05 level (2-tailed).
- **Notes:** Correlation is significance at: * 0.05 and **0.01 levels (two-tailed); Return on Assets (ROA), net operating income/total assets for firm i period t; Return on Equity (ROE), net income/ shareholder's equity for firm i period t; Corporate Sustainability Practices (CSP), summation of CSP item reported for firm i period t; Firm's Age, proxy logarithm the age since its enlisting on Pakistan Stock Exchange for Firm i period t; Firm Size, proxy logarithm of the total assets for firm i period t; Firm's Leverage, total debt to total assets for firm i period t.

Regression Results

Table 3 shows regression results. When ROA and ROE are used as dependent variables in order to measure financial performance both Model 1 & Model 2 represents that Random Effect (RE) model is more precise than Fixed Effect (FE) model as the Hausman test is insignificant. The regression results show that CSP has significantly positive impact on FFP (ROA) at 5% of confidence level while CSP has negative impact on ROE but the results are insignificant. These finding is consistent with the study of (Janamrung & Issarawornrawanich, 2015; Waddock, Sandra A; Graves & Samuel, 1997). Firm age illustrates positive while firm size illustrates negative relationship with FFP (ROA & ROE) but aren't statistically significant. The result related to firm size having no significant impact matches the result of (Niresh & Velnampy, 2014; Waddock, Sandra A; Graves & Samuel, 1997). Firm leverage has significantly negative impact on ROA at 5% confidence level. The finding of this study related to firm leverage impact on ROA is consistent with the findings of (Al-Matari, Al-Swidi, Fadzil, & Al-Matari, 2012) who found out that at the selected level of significance firm leverage is negative and significant. Firm leverage has negative relation with ROE too but that is of no significance. R-Square indicates that FFP is strongly explained by the CSP and other explanatory variables in which the overall estimation is very good at 80%.

Table 3: Regression results

	Model 1			**Model 2**		
	OLS Model	***RE Model***	**FE Model**	**OLS Model**	***RE Model***	**FE Model**
	ROA	***ROA***	ROA	ROE	*ROE*	ROE
CSP	0.212**	0.212**	-0.903***	0.117	-0.136	-1.945***
	(0.091)	(0.091)	(0.297)	(0.135)	(0.258)	(0.447)
Firm Age	0.184	0.184	1.769**	0.044	0.210	1.632
	(0.135)	(0.135)	(0.833)	(0.209)	(0.435)	(1.300)
Firm Size	-0.083	-0.083	-0.672	0.014	-0.054	-0.515
	(0.142)	(0.142)	(0.419)	(0.219)	(0.429)	(0.645)
Firm Leverage	-0.595***	-0.595***	-0.421**	-0.058	-0.229	-0.347
	(0.113)	(0.113)	(0.197)	(0.137)	(0.239)	(0.304)
Lag ROA	0.179	0.179	-0.071			
	(0.115)	(0.115)	(0.111)			
Lag ROE				0.509***		
				(0.136)		
Year 1 (2012)		0.044		0.164	-0.134	-1.068
		(0.253)		(0.392)	(0.472)	(0.696)
Year 2 (2013)	-0.246	-0.203	-0.462*	0.131	-0.378	-1.521***
	(0.218)	(0.236)	(0.230)	(0.372)	(0.445)	(0.530)
Year 3 (2014)	0.036	0.080	-0.042	0.619*	0.074	-0.679*
	(0.224)	(0.226)	(0.334)	(0.360)	(0.369)	(0.342)
Year 4 (2015)	0.202	0.245	0.150	0.905***	0.640**	
	(0.243)	(0.210)	(0.469)	(0.331)	(0.326)	
Year 5 (2016)	-0.044		-0.096			-0.604*
	(0.253)		(0.600)			(0.336)
_cons	-0.004	-0.047	0.083	-0.392	-0.040	0.781**
	(0.170)	(0.162)	(0.322)	(0.257)	(0.361)	(0.290)
Obs.	49	49	49	49	50	50
R-squared	0.800	0.800	0.386	0.493	0.800	0.517
Hausman Test X^2	-	13.27	-	-	9.89	-

Notes: Standard errors are in parenthesis *** p<0.01, ** p<0.05, * p<0.01; Return on Assets (ROA), net operating income/total assets for firm *i* period t; Return on Equity (ROE), net income/ shareholder's equity for firm *i* period t; Corporate Sustainability Practices (CSP), summation of CSP item reported for firm *i* period t; Firm's Age, proxy logarithm the age since its enlisting on Pakistan Stock Exchange for Firm *i* period t; Firm Size, proxy logarithm of the total assets for firm *i* period t; Firm's Leverage, total debt to total assets for firm *i* period t.

CONCLUSION AND RECOMMENDATIONS

This study found out the overall impact of Corporate Sustainability Practices (CSP) on Firm Financial Performance (FFP) of the top public listed commercial banks of Pakistan. It observed the annual reports of the top 10 Pakistani public listed commercial banks by focusing on their market capitalization. Results indicated that CSP have positive and significant impact on FFP (ROA). Firm size and age have no significant impact on FFP while leverage has significantly negative impact on FFP (ROA). These findings suggest that if the commercial banks along with other public listed companies in Pakistan wants to improve its financial performance they must consider CSP. Although there is scarcity of CSP impact on FFP related studies; still the existing studies on CSP in Pakistan relate to the study of such motivations of managers toward CSP and its reporting. A wide-ranging empirical research on the CSP impact on FFP in top public listed commercial banks of Pakistan is compartmented by this study. These outcomes propose that Pakistani commercial banks should be involved constantly in their CSP; as the result shows that financial performance in commercial banks of Pakistan can be improved with higher sustainable practices. The results of this study shouldn't be considered similar for other sector of public listed companies or privately-owned businesses. Further studies can be carried out for a more drawn out timeframe on a larger sample in financial and non-financial firms whether manufacturing or non-manufacturing sector practicing corporate sustainability.

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