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Social Sustainability and Financial Performance: A Comparative Analysis of the Conventional and Islamic Banks of Pakistan

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ABSTRACT

This study investigates the impact of Social Sustainability (SS) on the financial performance of the banking industry of Pakistan. Also, the study compares the nexus of SS and financial performance between conventional and Islamic banks. The study employs Ordinary Least Square with Panel Corrected Standard Errors (OLS- PCSEs) to data of 23 banks from Pakistan for 7 years from 2013 to 2019. The findings revealed that SS improves banks' financial performance measured by ROA and ROE. The findings also showed that Islamic banks are comparatively more active than conventional banks in SS; hence they have better financial performance than their conventional counterparts. The study provides important insights for the practice and action of the conventional and Islamic banks in a developing country like Pakistan. The findings motivate the conventional banks to follow the footsteps of the Islamic banks in perusing SS for improving their financial performance.

INTRODUCTION

CS is the capability of an organization to meet the needs of its direct and indirect stakeholders without compromising its ability to satisfy their needs in the future (Dyllick et al., 2002). It is suggested that every firm should perform morally and contribute to the economic welfare and civilizing the life of the employees and individuals in society. The subject of CS has mostly been investigated in relationship with FFP in the developed countries and produced mixed results – positive, negative, and neutral (Gangi et al., 2019; Sroufe & Gopalakrishna-Remani, 2019). Moreover, it has also been investigated as a

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combined construct focusing on its environmental, economic, and social aspects (Dinç, 2020; Andania & Yadnya, 2020). However, these studies overlooked focusing on the society alone that could be an important factor, especially in developing countries like Pakistan, where the public looks towards NGOs and firms for their social responsibility (Das & Bhunia, 2016). It is also important as the increased public awareness and government focus on SS have made it difficult for organizations to ignore it in developing their business strategies. In the epoch of globalization, firms are now expected to be engaged more with the community where they operate for strengthening social license, and improving public image (Deegan & Rankin, 1996; Govindan et al., 2020). SS not only requires firms to increase their current or existing betterment for the society but also needs them to pay attention to the well-being of future generations or the quality of their life (GRI, 2013). Furthermore, it also requires firms to increases social values, social identity, and social relations with all their stakeholders. Firms enrich SS by integrating it into their business operations and increasing active participation in community welfare programs (Moldan et al., 2012; Yam, 2013). Among others, these exert positive effects on firms' financial performance by increasing their positive image in the market and society. However, on contrary, few studies also found that SS is an expenditure or cost that has negative or no positive impact on FFP (Galbreath, 2013; Grewatsch & Kleindienst, 2017; Nizam et al., 2019; Zahid et al., 2018).

Keeping in view the incongruence of prior studies mostly carried out in the non-financial sectors of the developed countries, this study investigates the impact of SS on FFP in a sample of 23 banks from a developing country like Pakistan from 2013 to 2019. Besides, the study also compares the SS-FFP nexus between conventional and Islamic banks as the latter might be more actively involved in SS due to following Islamic/Sharia laws which strictly require societal welfare or individuals' well-being (Amran et al., 2017). The study contributes in numerous ways. Firstly, the majority of the prior studies on SS were carried out in developed countries. Secondly, most of these studies investigated corporate sustainability in non-financial firms while the financial sector, or more specifically the banking industry is important as it has a crucial role in promoting green financing (Sharif & Rashid, 2014). Thirdly, most of the prior studies in the context of Pakistan have focused on inquiring about the level of CSR or sustainability and not its impact on FFP. Fourthly, the rarely available literature in the context of banks has either focused on conventional or Islamic banks and produced mixed results.

LITERATURE REVIEW

The stakeholder theory assumes that firms are supposed to maximize value for all the stakeholders. Hence, firms that meet the expectancy of a broader spectrum of stakeholders improve their financial performance (Steurer et al., 2016). Stakeholders which include employees, shareholders, suppliers, customers, the government and local communities, etc. have certain or diverse expectations from firms with a claim or analogy that firms should payback for the use and wastage of natural resources, creating pollution, and health hazardous, among others (Misopoulos et al., 2019). Maignan and Ralston (2002) argued that social changes or highlighting social issues are the output of stakeholders' pressure on the firms. In short, the stakeholder theory assumes stakeholders are important and thus requires managers to value them for improving FFP (Rahman et al., 2021).

Many empirical studies also authenticate these theoretical postulations by documenting that SS has a significant positive impact on FFP. For instance, Chieh and Hou (2018) noted that firms good in SS have better financial performance than others, or those having weak SS. Lin et al., (2015) found a significant positive impact of SS on FFP in a sample of 500 largest companies from the S&P 500. Zahid et al., (2015) validated the findings in a sample of 113 companies from REITs and property sectors for a period from 2010 to 2013. Garcia et al., (2019) found that ESG including the societal aspect exerts a positive impact on FFP in BRICS. Fijałkowska et al., (2018) found that corporate social-environmental performance has a positive impact on FFP in a study of twenty European banks from 2012 to 2016. Siueia et al., (2019) also documented that social disclosures have a significant positive impact on the financial performance of the banking industry of Sub-Saharan countries. Several other studies also found similar results for the relationship between SS and FFP in the USA (Vidal et al., 2018), Taiwan (Chieh & Hou, 2018), Vietnam (Tran & Beddewela, 2020), and China (Weber, 2017). However, on contrary, Xiao et al., (2018) noted that environmental and social sustainability negatively affect FFP. Buallay, (2019) also found a significant negative effect of SS on FFP for 235 European banks. Summing up, the incongruent findings of the prior literature with a low focus on the banking industry of developing countries necessitates further inquiry of the subject. Hence, it is hypothesized that:

H1: SS has a significant positive impact on the ROE of the banks in Pakistan.

H2: SS has a significant positive impact on the ROA of the banks in Pakistan.

Regarding SS, Allah SWT states in Al-Quran: “And when he turns his back, his objective is to extend discomforts all over and destroy crops and cattle, but Allah loved not annoyance (Chapter No. 2, verse number 205). At another place Allah SWT states in Al-Quran: “If anyone saved a life, it would be as if he saved the life of the whole humanity” (Chapter No. 5, verse number 32). Allah will not be merciful to those who are not merciful to mankind (Sahih Al-Bukhari, Book 73, Hadith number 42). The sample of the current study also includes Islamic banks which follow or claim to adhere to the principles of Islamic accountability. Hence, they are supposed to be more active in SS that would have positive implications for their financial performance. Many empirical studies also noted that SS of Islamic banks has positive impacts on their financial performance (Hanif & Arshed, 2016; Platonova et al., 2018). Jan et al., (2019) investigated the impact of SS on FFP in the Islamic banking industry of Malaysia. They found that SS significantly boosts the financial performance of Islamic banks. Nofianti, (2019) also documented that CS including SS has a positive effect on the financial performance of Islamic banks in Indonesia. However, on contrary, it is noted that SS has a significant negative effect on the financial performance of 13 listed banks of UAE (Nobanee & Ellili, 2016).

H3: The relationship between SS and ROE is more pronounced in Islamic banks as compared to conventional banks.
H4: The relationship between SS and ROA is more pronounced in Islamic banks as compared to conventional banks.

RESEARCH DESIGN

This study selected the banking industry as a population since it has largely been overlooked in the past, especially for the relationship between SS and FFP. Besides, the study also focused on the banking industry of Pakistan due to the availability of the required data. The study selected a sample of twenty-three (23) banks in which nineteen (19) were non-Islamic and four (4) were full-fledged Islamic banks for a period of 7 years from 2013 to 2019. Among these, the Islamic banks included Meezan Bank, Al Baraka Bank, Bank Islami, and Dubai Islamic Bank. The conventional banks included Allied Bank, Askari Bank, Bank Alfalah, Bank of Khyber, First Women Bank, Bank Al Habib, Standard Chartered Bank, Faysal Bank, Habib Metropolitan Bank, Habib Bank, JS Bank, Khushali Bank, Muslim Commercial Bank, National Bank of Pakistan, Silk Bank, Sindh Bank, Soneri Bank, United Bank, and Zarai Taraqiati Bank. The required data were collected through content analysis like many previous similar studies (Rahman et al., 2021; Rahman et al., 2020) on an adapted index (Appendix A) from the

official websites and annual/sustainability reports of the sample banks. The factors of SS selected from previous studies with some addition as provided in Appendix A (Sharif and Rashid, 2013; Zahid et al., 2015). Each indicator/item of the index is treated as a binary variable having a value of 1 for the disclosure and 0 otherwise (Rahman et al., 2021; Rahman et al., 2020). The index calculated the total disclosure score of SS for a particular bank as

$$\text{CSRI} = \sum_{i=1}^{mj} \text{dj/N}$$

Where dj is 1 if the item is disclosed and 0 otherwise while N is the greatest number of items ($N \leq 27$) for nth firms. The score of each item is divided by the maximum likely score and multiplied by a hundred to obtain the percent scores to calculate the score of a particular bank. The maximum possible disclosure score is 27 items for a bank. FFP is measured by ROA (net profit/total asset) and ROE (net profit/owner equity). Besides, the study used control variables of age, size, and leverage of the sample firms. Firms' age is calculated as the number of years since a bank is listed and firms' size is gauged as a natural logarithm of the total assets. Firms' leverage is calculated by the ratio of total debt to total equity (Galant & Cadez, 2017; Rahman et al., 2021).

Following is the econometric model of the study.

$FFP\ (ROA/ROE)_{it} = \beta_0 + \beta_1 Xit + \beta_2 FAGit + \beta_3 FSIZit + \beta_4 FLEVit + \varepsilon it$ ……Model 1

$FFP\ (ROA/ROE)_{it}$ = ROA/ROE of the *ith* firm at a time *t*

$\beta 0$ = intercept of the model

$\beta 1$ = change co-efficient for X_{it} variables

Xit = social sustainability score of a firm i at a time t

FAG*it* = firm age of the *ith* firm at a time *t*

FSIZ*it* = firm size of the *ith* firm at a time *t*

FLEV*it* = firm leverage of the *ith* firm at a time *t*

i = number of the firms i.e. i = 1, 2, 3…., 23

t = time period i.e. t= 1, 2, 3…, 7 (in present study t = 7 years)

ε = the error term.

RESULTS & DISCUSSION

The statistics reported in Table 1 show that ROA has a mean value of 0.02 and ROE has an average value of 0.14. Similarly, SS has a mean value of 16.69 in a combined sample having both the

conventional and Islamic banks. By dividing the sample into Islamic and conventional banks, it is revealed that the former has a mean value of 19.19 while the latter has an average value of 16.27 for SS.

Table 1: Descriptive Statistics

Variables	Minimum	Maximum	Mean	Standard Dev
ROA	-0.02	0.07	0.02	0.01
ROE	-0.17	0.49	0.14	0.11
SS (Combined Sample)	10	25	16.69	3.56
SS (Islamic Banks)	16	25	19.19	3.03
SS (Conventional Banks)	10	23	16.27	3.47
FAG	1	76	31.76	20.19
FSIZ	10	12	11.46	0.62
FLEV	0.02	0.27	0.13	0.05

The comparison clearly shows that Islamic banks have good or higher SS than their conventional counterparts. Likewise, firm age has a mean value of 31.76 while firm size has an average value of 11.46. The mean value of firm leverage is 0.13. Overall, the data was not normal. Also, it has outliers. Hence, by using the Van der Waerden data distribution method, the data was normalized before further analysis (Rehman et al., 2020; Zahid et al., 2019).

Table 2 shows the Pearson correlation matrix. The reported statistics show the correlation between any two variables. The statistics provide evidence that all the correlations between explanatory variables are less than 0.80; hence there is no multicollinearity in the data (Zahid et al., 2019; Sharif et al., 2013).

Table 2: Pearson's Correlation Matrix

Variable	ROA	ROE	SS	FAG	FSIZ	FLEV	LROA	LROE
ROA	1							
ROE	0.77**	1						
SS	-0.20*	-0.15	1					
FAG	0.19*	0.09	0.25**	1				
FSIZ	-0.01	0.29**	0.39**	0.45**	1			
FLEV	0.40**	0.42**	0.22**	0.51**	0.47**	1		
LROA	0.73**	0.59**	-0.13	0.29**	0.06	0.45**	1	
LROE	0.58**	0.76**	-0.07	0.18*	0.33**	0.48**	0.76**	1

**. Correlation is significant at the 0.01 level (2-tailed). *. Correlation is significant at the 0.05 level (2-tailed).

Before regression estimation, the data was diagnosed for heteroscedasticity. The findings showed that all models of the study were suffering from heteroscedasticity. Thus, the study used Ordinary Least Squares (OLS) with Panel Corrected Standard Errors (PCSEs) which is a preferred estimator over OLS and GLS, especially in the presence of heteroscedasticity. As the estimator is sensitive for autocorrelation, therefore, the study used one year lag of both the outcome variables i.e. ROA (LROA) and ROE (LROE) in the relevant regression estimations (Beck & Katz, 1995; Rahman & Zahid, 2021).

Table 3: Ordinary Least Squares with Panel Corrected Standard Errors (OLS-PCSEs)

Variables	Combined-ROA	Combined ROE	Islamic Banks - ROA	Conventional Banks - ROA	Islamic Banks -ROE	Conventional Banks - ROE
SS	-0.14**	-0.17**	0.98*	-0.19**	0.51*	-0.24***
	(0.652)	(0.623)	(0.462)	(0.662)	(0.458)	(0.639)
FAG	0.03	-0.04	-0.03	0.06	0.33	-0.03
	(0.002)	(0.002)	(0.001)	(0.002)	(0.001)	(0.002)
FSIZ	0.01	0.15**	-0.30	-0.02	0.34	0.13
	(0.062)	(0.061)	(0.059)	(0.061)	(0.062)	(0.059)
FLEV	-0.03	-0.001	-0.21	-0.10	0.08	-0.10
	(0.047)	(0.049)	(0.041)	(0.039)	(0.042)	(0.042)
LROA/ROE	0.71***	0.71***	-0.002	0.64***	0.45	0.64***
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
Const.	-0.15**	-0.02	0.05	-0.16**	-0.03	-0.04
	(0.036)	(0.043)	(0.037)	(0.039)	(0.042)	(0.049)

***p< 0.01, **p < 0.05, *p < 0.10

The findings show that SS has a negative relationship with ROA and ROE in the combined analysis or sample having both the Islamic and conventional banks. The findings which reject hypotheses H1 and H2 of the study suggest that SS is a cost that directly affects the profitability of the banks by increasing their expenses. The findings also have a plausible explanation that firms' efforts for social welfare require time to exert positive implications for their financial performance. The findings not aligned with the postulations of stakeholder theory are consistent with many previous studies showing that SS has a significant negative impact on ROA and ROE of the banks (Buallay, 2019; Xiao et al., 2018). To probe the matter further, the nexus of SS and FFP is estimated separately for the Islamic and conventional banks as reported in Table 3. The findings show that SS has a significant positive impact on the ROA in the case of Islamic banks. However, the relationship converted into a significant negative when it comes

to conventional banks. Likewise, SS has a significant positive impact on the ROE of Islamic banks, but the relationship became significantly negative in the case of conventional banks. The findings which accept H3 and H4 of the study explain that the relationship between SS and FFP (ROA and ROE) is significantly positive and more pronounced in the case of Islamic banks as compared to their conventional counterparts. The findings indicate that Islamic banks follow Islamic rules and Sharia principles which push them towards more societal welfare or higher SS that exerts positive impacts on their financial performance. This explanation is aligned with the statistics reported in Table 1 showing that SS has a mean value of 19.19 in Islamic Banks as compared to the average value of 16.27 in conventional banks. Overall, the findings of the study validate many previous studies showing that SS has a significant negative impact on the financial performance of the conventional banks (Buallay, 2019) but the relationship is significant and positive in the case of Islamic banks (Nofianti et al., 2019; Jan et al., 2019). The findings also endorse the prior research showing that the relationship between SS and FFP is more pronounced in the case of Islamic banks (Chintaman, 2014). The findings for H3 and H4 also provide an additional explanation to H1 and H2 that the significant positive relationship between SS and financial performance of the Islamic banks has been dominated by the conventional banks and turned the association into a significant negative.

Table 4: Model Summary

Models		R	R Square	Adjusted R-Square	Std. Error of the Estimate
1	Combined Sample - ROA	0.757[a]	0.573	0.555	0.652
2	Combined Sample - ROE	0.779[a]	0.607	0.590	0.623
3	Islamic Banks - ROA	0.847[a]	0.718	0.587	0.462
4	Conventional Banks - ROA	0.735[a]	0.541	0.517	0.662
5	Islamic Banks - ROE	0.926[a]	0.858	0.792	0.458
6	Conventional Banks - ROE	0.741[a]	0.549	0.527	0.639

The R-square value for combined ROA is 0.573 which shows that SS along with all other predictors bring 57% variation in ROA and the remaining 43% variation comes through other factors. The R-square value for combined ROE is 0.607 which indicates that all predictors including SS bring a 61% variation in ROE and the remaining 39% variation comes through other factors. The value of R-square for ROA in Islamic banks is 0.718 which shows that all predictors bring a 72% variation in ROA, and the remaining 28% variation comes through other factors. The value of R-square for ROA in commercial banks is 0.541 which explains a 54% variation in ROA due to the independent variables

used in the estimation. For ROE in Islamic banks, the R-square of 0.858 explains 86% variation in ROE due to the employed predictors in the model. For ROE in commercial banks, the R-square of 0.549 suggests a 55% variation in ROE due to the independent variables in the estimation.

CONCLUSION & RECOMMENDATIONS

Unlike most of the prior literature focused on the level of CSR or its impact on FFP in the manufacturing sector of the developed countries, this study focused on SS in relation to FFP (ROA and ROE) of the banking industry of Pakistan. Hence, the study contributes to the literature, policy, and methodology in many ways. First, the study contributes to the scarce and incongruent literature especially in the context of the banking industry of a developing economy like Pakistan. The findings inform the stakeholders that SS has a significant negative impact on FFP (ROA and ROE) in a combined sample of conventional and Islamic banks of Pakistan. Second, the study also contributes to the literature, policy, and practice by comparing the subject in conventional and Islamic banks. The findings unveiled that Islamic banks contribute more in terms of SS; hence they have better financial performance as compared to conventional banks. The findings also explain that Islamic banks are more aware and committed to SS than conventional banks in Pakistan. In nutshell, the study provides important empirical insights for the regulators, State Bank of Pakistan, practitioners, the Pakistan Stock Exchange, and all other key stakeholders regarding the importance of SS for improving FFP. The study is not free of limitations as it has a purely quantitative approach. Therefore, future studies may consider the qualitative aspect of the study. Besides, these studies may also search or explore some potential moderation or mediation in the nexus of SS and FFP. The subject could also be explored in other sectors and countries for further robustness of the current findings.

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Appendix A

Social Sustainability Measurement
1. Donation to hospitals for medical support to AIDS patients
2. Donation to hospitals for poor Thalassemia patients
3. Internship facility for universities students
4. Scholarships for physical disabled students
5. Part time job facilities for students
6. Donation for book and other equipment's
7. Donation to affected people from flood and earthquake
8. Donation of employees for affected people
9. Donation for street children's improvement
10. Donation to the victims of terrorists' attacks
11. Health care center establishment for rural people
12. Staff engagement programs
13. Employee's training cost
14. Employees benefits
15. Employees' health care center
16. Career development
17. Employees' compensation
18. Employees' children's facilities
19. Cost of employees' safety measures
20. Employees categories by function
21. Improvement of product/service quality
22. Shelters for Workers & Others
23. Customer Satisfaction
24. Safety of customers
25. Drinking Water on Workplace
26. Amount/Descriptive

27. Annual Report/Stand Alone