CORPORATE SOCIAL RESPONSIBILITY IN BANKING SECTOR

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Abstract

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After popularity increase of the concept of Corporate Social Responsibility over last century in the USA, with the 21st century the concept comes into the European Union as well, actually into Czech Republic. For the European Union, the concept of social responsibility becomes one of the tool for achieving the most competitive and dynamic knowledge-based economy (Lisbon Strategy, 2000). With the start of the financial and economic crisis, the European Commission sees in the Corporate Social Responsibility a way how to cope with the crisis. Also scientific studies (Ghoul, 2011; Gruz, 2009) indicate the positive influence of Corporate Social Responsibility on financial performance of the company. In the Czech Republic, the implementation of the concept is especially for multinational corporations. For example, Corporate Social Responsibility is very popular in financial sector, which the financial crisis did not damage so perceptible as in other countries of developed economies (Singer, 2009).
This article defines on a theoretical level the concept of Corporate Social Responsibility, its development, its present form and the influence on financial performance of the company. Another part of the article focuses on three czech banking subjects (Česká spořitelna, Komerční banka a Československá obchodní banka), which regularly take the leading positions of the official corporate donors chart „TOP Filantrop“. The article explores the evolution of corporate donations and finds the connection between corporate donations and corporate profit and financial and economic crisis.

Corporate Social Responsibility, stakeholders, banking sector, financial and economic crisis

The concept of corporate social responsibility (CSR) has evolved over the past decades from a marginal, and often neglected, area of interest, into a comprehensive area of specialisation, which has become increasingly relevant in decision making processes in firms and enterprises. In fact, CSR used to be discussed only by a small group of academics (Cochran, 2007). Despite the increasing interest by professionals and academia, to this day there is no universally accepted definition of CSR. A paper written by Archie B. Carroll in 1979, *A Three-Dimensional Conceptual Model of Corporate Performance*, is generally accepted as the most relevant analysis of CSR. In his paper, Archie B. Carroll proposes a fourfold definition of CSR: "Corporate social responsibility involves *economical, legal, ethical and voluntary* expectations that the society has towards enterprises or firms at any given time" (Carroll, 1979).

In 1991 Carroll has redefined the term "voluntary actions" as "philanthropic actions" (Carroll, 1991). Carroll's definition has been expanded in the following years (Wartick and Cochran 1985; Wood, 1991; Carroll 1999) and is still appreciated for its relevance.

Following the works of Carroll, Lantos (2001) classified CSR into three categories, i.e. ethical, altruistic and strategic responsibility. Bloom and Gundach (2000) define social responsibility as the obligation of an enterprise towards its stakeholders, i.e. individuals and groups who have influence on the firm, or are directly impacted by the firms' policies and practices. Such obligations exceed the framework of legal requirements. The fulfilment of these requirements is meant to minimise damage and maximise long term positive impact of the firm on the society.

The European Commission (EC) has a clear policy concerning CSR. The EC contribution to the CSR discussion was summarised in the Lisbon Strategy Document, published in March 2000. At the EU summit in year 2000, an ambitious goal was set – by 2010 the EU should become *the most competitive and most dynamic knowledge based economy, capable of sustained growth, with more and better work opportunities, together with a strengthened social cohesion.* It was actually the first time that the positive contribution of enterprises for reaching this goal has been discussed. In its Lisbon Strategy Document, the EC appealed, for the first time, on corporations and their sense of social responsibility (Franc *et al.,* 2006). A key document concerning CSR was published in 2001 as the "Green Book". According to the EC definition, *social responsibility implies a voluntary integration of social and ecological issues in the firms' daily dealings and interaction with its environment* (Green Paper, 2001). The EC Green Book further indicates that to be "socially responsible" implies not only fulfilling legislative requirements, but also investing more in human capital, environment and into bettering relations with business stakeholders. According to the European Competiveness Report, published in 2008, the significance of CSR cannot be overstressed, particularly in times of financial crisis. The Vice-President of the European Commission, Günther Verheugen (in Trapp 2009), added, that socially responsible firms will have a better position in the future than those that have not yet adopted a CSR policy, because they will enjoy more profits, including loyalty of employees, which they can rely on. *Our Report shows that CSR is good when times are good; in troubled times it something that seems to be indispensible, if one at all wants to cope with difficulties.*

In 2003, Bowd, Harris and Cornelissen formulated their own definition of CSR (May *et al.* 2007, 121), based on EC Reports (2001, 2002) and on key papers by authors such as Carroll, Wood, Freeman and Friedman. According to Bowd *et al., social responsibility of a firm means rigidly adhering to social contracts with internal and external stakeholders, adhering to the laws and directives given by the government and managing the firm according to ethical standards, which go beyond prescribed legal obligations.* The term "ethical standards" is of course rather vague. Bowd et.al included concrete examples of ethical behaviour, i.e. active participation in the life of the community where the firm is situated, philanthropy, transparent management of the firm, and protection of the environment. Amongst the most recent definitions of CSR we could mention the definition formulated by Sandler and Lloyda (2009). They defined CSR as the notion that companies should accompany the pursuit of profit with good citizenship within a wider society.

Despite the lack of a generally accepted definition of previous corporate social responsibility, Hedige (2010) comprehended CSR as a program where firms act such as to maximize profits and at the same time to improve the welfare of other stakeholders.

Stakeholders in Corporate Social Responsibility Concept

The concept of social responsibility puts emphasis on the role of stakeholders, stressing the fact that a firm cannot function independently from its surroundings (Bearle and Meanse, 2002). Falck and Heblich (2007), state that CSR can be strategically applied in dealings with claims of each particular interest group. The firms' management can use CSR as a normative instrument in planning strategies which satisfy shareholders as well as other interest groups.

Social responsibility represents an important "exchange" between the firm and its public domain or interest groups. This exchange, the only transaction where the firm offers something of value – typically social profits or public service – presupposes the approval and support by key individuals and/or social-political interest groups (Murray, Vogel, 2007).

Corporate Social Responsibility and financial performance

Several research studies realized in recent years proved a positive relationship between CSR and financial performance. The research realized by Ghoulou *et al.* (2011) proved that investment in employee relations, environmental policies, and product strategies contribute to lowering firms' cost of equity. Not only do such activities contribute to society at large, but they also benefit the firm by their lowering financing costs. Scholtens (2008) finds a positive and significant interaction between financial and social performance. More specifically, it appears that financial performance (both risk and return) in general terms precedes social performance (both strengths and concerns) much more often than the other way around. The research results of Cruz (2009) show that investment in previous social responsibility activities is capable of increasing profit, reducing risk and environmental impacts. CSR can potentially decrease production inefficiencies, reduce cost and risk and at the same time allow companies to increase sales, increase access to capital, new markets, and brand recognition. As a result of lower cost, lower risk and increase in sales, companies are more profitable. Influence of CSR on business performance was discussed also by Lin *et al.* (2009). Their findings suggest that even if positive CSR activities do not increase immediate profitability, they may be instrumental in reducing the risk of damage to brand evaluations in the long run.

Corporate Social Responsibility in Banking Sector

The issue of social responsibility in the banking sector was dealt with in a study by Brancoa and Rodrigues (2008) and Couplanf (2005), published in journals which are listed in the SCOPUS database. The Brancoa and Rodrigues (2008) study examined

social responsibility disclosure (SRD) on the Internet by Portuguese banks in 2004 and 2005 and compared these disclosures with those made in annual reports in 2003 and 2004. The results suggest that banks with higher visibility attribute greater importance to SRD as part of their reputation management strategies when compared with banks with lower visibility. These banks exhibit greater concern to improve the corporate image through SRD. Coupland (2005) analyzed five reports of banking groups operating in the UK. The aims of the study were; to locate and make visible how distance is created between CSR issues and accounting practices in the web-based literature of these organizations; to examine how CSR is constructed as a concern of the organizations and to investigate how this is legitimated, in part, through accounting terms.

The goal of this paper is to evaluate development of financial donations from specific banking institutions (i.e. Česká spořitelna, Komerční banka and Československá obchodní banka) between years 2005 and 2010 with the emphasis on period of financial crisis. Consequently, the relationship between the volume of financial means allocated for philanthropic purposes, and profits before taxation is identified.

METHODS AND RESOURCES

To obtain a general overview of the investigated issues, the literature focusing on the concept of Corporate Social Responsibility in general and studies dealing with Corporate Social Responsibility and Corporate Performance were surveyed.

The above mentioned banking institutions were selected on the basis of their position in the "Top Philanthropic Firm" ranking. The "Top Philanthropic Firm" is the only ranking system of its kind in the Czech Republic. Since 2004 it assesses donor firms according to the volume of their distributed funds. The ranking is established and subsequently published by the Donors Forum in cooperation with Czech TOP 100. The allocated funds will be compared with the earnings, which are published by banking institutions in their Annual Reports. Profits before taxations were chosen for the purpose of objective comparison of economic results, due to the possibility of declaring a lower tax base by donor institution. The gross profits and total volume of donated funds time series from Česká spořitelna and Československá obchodní banka will cover the years 2005–2010. Komerční banka was not listed in the 2010 "Top Philanthropic Firm" ranking. The volume of its donations is therefore not available, and the time series cover only the years 2005–2009.

The measure of interdependency of the total volume of donated funds in relation to gross profits will be determined by the correlation of time series. Correlation of time series will be established using the statistics software application STATISTIKA 10.

Each time series will be processed through a simple nonlinear regression, wherein the relevant trend function is established on the basis of a correlation index.

In case that the values of the correlation index do not reach a satisfactory level, the time series in question will be balanced by means of simple exponential alignment, where a function will be considered as appropriate if its mean absolute percentage of estimation error will have a value which is inferior to 10. Once the basic regression results of the selected trend functions are available a residual analysis will be carried out. If none of the above mentioned methods can be used, the residues will be calculated as the difference between real values of an indicator and the average of a specific time series. By applying a residual analysis, residues will be determined and subsequently correlated (Hindls *et al.*, 2002). Hindls (2004) states, that the correlation coefficient acquires values from –1 to 1. According to Hindls, as the absolute value of the correlation coefficient *r* approaches 1, the dependence gets stronger.

The basic methods used in this research were analysis, synthesis and comparison.

RESULTS AND DISCUSSION

Three banking institutions are being assessed in this article. All are part of multinational banking corporations. Česká spořitelna (CS) is member of the Erste Group since 2000. Erste Group is one of the largest provider of financial services in Central and Easter Europe. Currently it serves 5.3 million clients. Komerční banka (KB), with 1.59 million clients, is a member of the International Group Société Generale, since2001. Since 1999, the majority ownership of the Československá obchodní banka (ČSOB) is in the hands of the Belgium based KBC Bank, member of the KBC Group. ČSOB has 3.086 million clients.

Amongst the above mentioned banking institutions Česká spořitelna (CS) may be seen as the most socially responsible. Altogether, during the assessed period 2005–2010, CS was ranked amongst the top ten firms in the "Top Philanthropic Firm" ranking six times (4th in 2005; 4th in 2006; 2nd in 2007; 2nd in 2008, 3rd in 2009; 3rd in 2010;). During the same period, KB was ranked amongst the top ten institutions five times (10th in 2005; 9th in 2006; 8th in 2007; 5th in 2008 and 4th in 2009) and ČSOB three times (10th in 2006; 6th in 2009 and 7th in 2010).

Financial crisis and banking sector in Czech Republic

It is a generally accepted fact, that the main cause for the current financial crisis was the American sub-prime mortgage crisis (Marek, 2008) The sub-prime mortgage crisis started to manifest already in the mid 2007, when insecurity from the real estate market indicators started to spread (Musílek, 2008). In September 2008, the problems on the world

financial markets reached a level where they could be described as a global financial crisis. The crisis caused a dramatic deterioration in the value of most financial indicators. The global financial system was confronted with a serious liquidity deficit, a wide spread financial insolvency of financial institutions, growing volatility in the scales of financial instruments, important fall of the value of financial and non-financial assets and a significant decrease of the volume of allocated savings in the entire system (Musílek, 2008).

The Czech Republic was not impacted as heavily by the financial crisis as other countries with developed economies. According to the Governor of the Czech National Bank (CNB), M. Singer (2009), the financial system in the Czech Republic was less vulnerable than in other countries and the impact of the financial crisis was therefore not as serious.

Data indicated in Fig. 1. seem to confirm the conclusions of the Governor of CNB. From all assessed banking institutions only ČSOB reported a significant deficit in gross profits.

In 2007–2008 their gross profits declined from 1 263 788 900 CZK to 374 000 CZK. However, ČSOB had announced the downfall in its profits already ahead. The ČSOB portfolio included structured stocks and bonds (so called CDO) with an overall nominal value approaching 430 billion EUR. ČSOB decided to adopt the most prudent attitude and reviewed these assets to nil. According to its Management Board, in the upcoming years the CDO portfolio will not have a negative impact on the economic outcomes of the ČSOB group (Králíček, 2009). In 2009 ČSOB registered a significant growth and produced the highest volume of gross profits (15 338 000 000 CZK) amongst all assessed banking

institutions in that year. On the other hand, in 2009 and 2010 the CS reported a deficit of its gross profits.

However, gross profits figures for the period between 2005 and 2010 indicate that during this period gross profits have not fallen under the level reached in 2005 and 2006. The growth of gross profit in 2008 only shows variations in the time series. The development of the gross profits of KB is comparable to the developments at CS. A fall in gross profits was observed in 2009. In 2010 the volume of gross profits rose. Results from 2010 have show that the financial crisis did not significantly impact banking institutions described in this paper.

According to R. Holman (2008), member of CNB Board, the main reason why the financial crisis had a relatively low impact on the Czech Republic, is to be found in the difference between real estate mortgage policies in the USA and in the Czech Republic. In the Czech Republic, the growth of the real estate market was based on an equally strong economic growth. The credit policy standards in the Czech Republic were very strict before the outbreak of the financial crisis, and have become even more restrictive in the past years. Currently, there is no significant secularisation of mortgages and transfer risks out of the banking sector. Banks have their mortgage credit policy firmly under control. The Czech banking system disposes of sufficient capitalisation and remains profitable. Bank performance evaluations carried out by the CNB for assessing the resilience of the banking sector as a whole towards eventual negative impacts have shown that despite relatively high losses from depreciated credits the banking sector remains stable and has made provisions against eventual economic downturn (Singer, 2011).
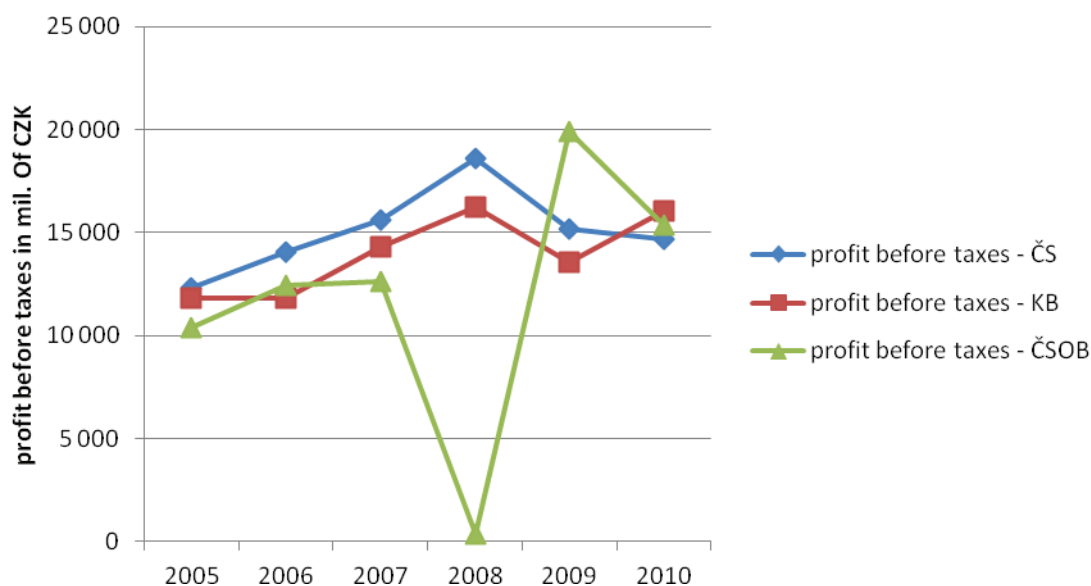
1: *Profit before taxes of Česká spořitelna, Komerční banka and Česká obchodní banka*
Source: adapted by authors on the basis of information provided in the Annual Reports of CS, KB and ČSOB
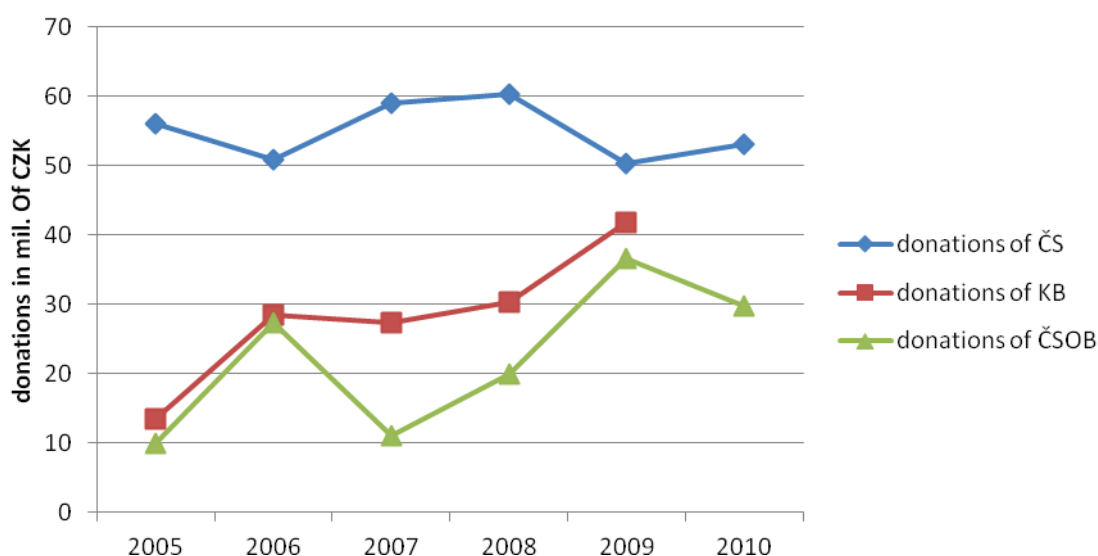
2: *Donations of Česká spořitelna, Komerční banka and Česká obchodní banka*
Source: adapted by authors on the basis of information provided in the Top Firemní Filantrop ranking

The evolution of the overall volume of donated funds for philanthropic purposes by the assessed banking institutions is shown in Fig. 2. The results indirectly confirm the view of the Vice-President of the EC, Mr Günter Verheigen (in Trapp, 2009), who sees in the concept of social responsibility an opportunity for effectively dealing with the crisis. The overall sum of donated funds given by the KB and ČSOB after 2008 is higher than before 2008. According to assessed time series, CS registered a decrease of overall donated funds during the years of the crisis. Nevertheless, with a total of 53 130 091 CZK for 2010 it was in 3rd position in the Top

Philanthropic Firms ranking, which evaluates firms and companies throughout the Czech Republic.

The current situation does not show any dramatic developments in the Czech banking system. However, it is impossible to predict if the financial and economic crisis will not impact the Czech banking sector in a more severe way in the future. According to M. Singer (2011), financial stability in the next two years depends on the evolution of world economy. The main risk scenario for the Czech economy in the next two years would be a serious decline in economic growth of Germany and other countries, which have important
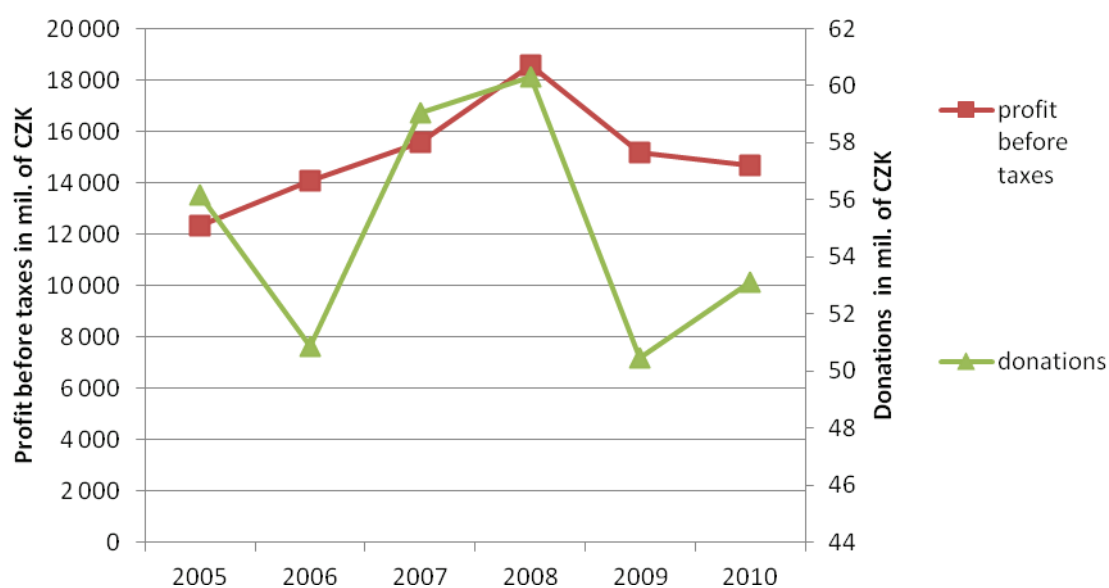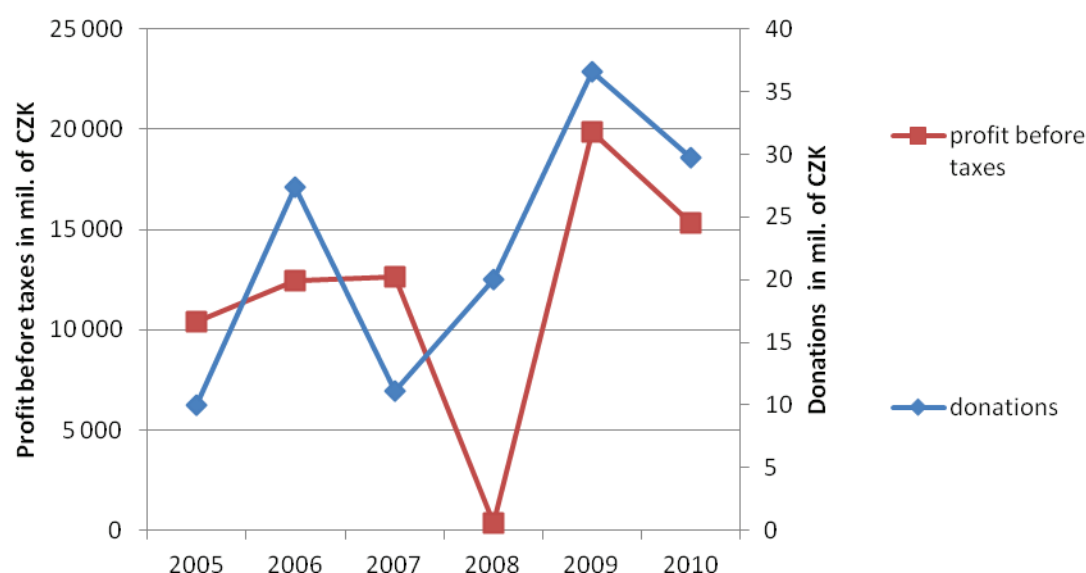

3: *Evolution of the overall volume of donated funds and gross profits of the CS bank, between 2005 and 2010*
Source: own research
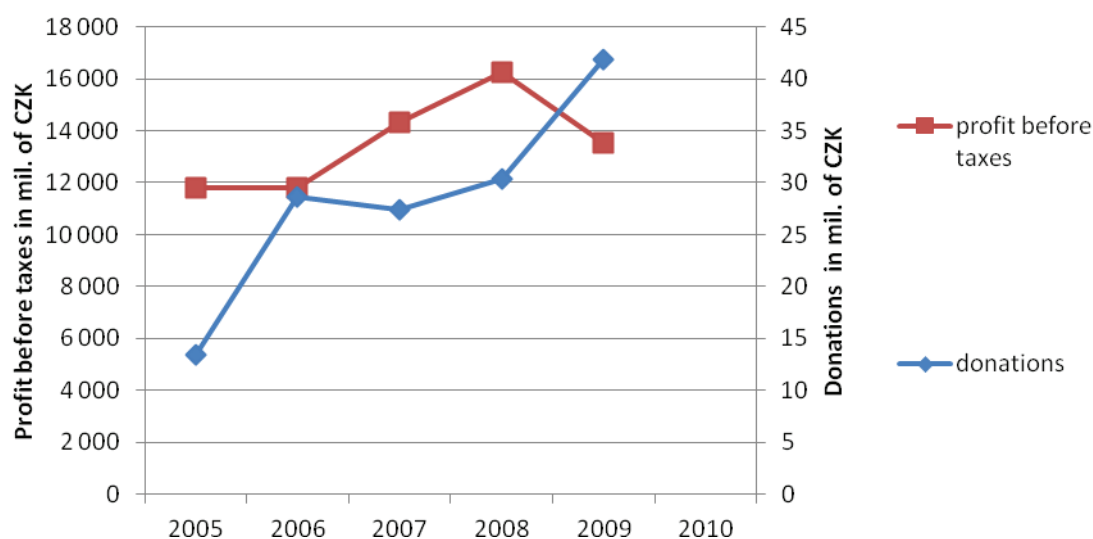
4: *Evolution of the overall volume of donated funds and gross profits of the KB, between 2005 and 2010*
Source: own research

5: *Evolution of the overall volume of donated funds and gross profits of the ČSOB, between 2005 and 2010*
Source: own research

commercial ties with firms and companies in the Czech Republic. An import source of risk for Czech financial institutions would be a downturn in the volume of domestic income of households. Such downturn would negatively impact their budgets and concomitantly their capacity of paying back previously contracted obligations.

Due to the evolution of the crisis abroad, with problems of indebted economies in the Euro zone culminating, an optimistic prognosis for the future would be irresponsible. Furthermore, the current economic indicators for the Czech Republic do not support the statements that the crisis is coming to an end. In order to ensure stability in the Czech financial system it is imperative that the local financial institutions maintain capital and liquidity reserves which were created during the crisis.

The dependence of the volume of donated funds on gross profits

The development of the profit volumes before taxation, and the overall volume of donated funds which banks allocate for philanthropic purposes, is illustrated in Fig. 3. to 5. The dependence of the overall volume of donated funds on the profits before taxation has been statistically tested.

The CS correlation coefficient r, with a value of 0.65, shows that CS overall value of donated funds

has a medium strong level of dependence on the overall volume of gross profits.

KB correlation coefficient r, with a value of 0.52, indicates a medium strong level of functional dependence between donated funds and gross profit.

Finally, ČSOB correlation coefficient r, with a value of 0.42, shows a medium level of dependence between these indicators.

At present, the financial sector in the Czech Republic seems to be stabilised. In the past few years, assessed banks in the Czech Republic have not registered important downturns in their profit volumes as well as in the values of donated funds, allocated in the framework of social responsibility for philanthropic purposes. Of course, the question of future development remains open. The instable situation of the Euro zone and a further deepening of the economic downturn in the upcoming years, which will probably strongly impact the financial sector, due to the negative development in the strongly indebted countries of the EU, such as Greece, Spain or Portugal, will surely shape any future development.

SUMMARY

The purpose of this paper was to assess the development of the volume of allocated funds for philanthropic purposes at selected banking institutions between 2005 and 2010, with emphasis on the period of financial crisis. These banking institutions (i.e. Česká spořitelna, Komerční banka and Československá obchodní banka) have been selected because of their ranking in the Top Philanthropic Firms. Financial funds allocated for philanthropic purposes were compared with the economic outcomes of these institutions, as published in Annual Reports. The level of dependence of the overall volume of donated funds on gross profits was subsequently determined by means of correlation of time series, using the statistics software STATISTIKA 10. Results have shown that the financial crisis did not seriously affect the above mentioned banking institutions. An important downturn in profits was observed at the CSOB, in 2008. This downturn was caused by a revaluation of risk assets by the CSOB, with a nominal value of about 430 million EUR, to a nominal value equal to zero. All other banking institutions reported a higher profit before taxation in 2010, than in the years 2005 and 2006. Even in the matter of social responsibility, there has been no serious impact of the financial crisis on the selected banking institutions. An actual dependence of the overall volume of donated funds on gross profits has been assessed at the CS and at the ČSOB.

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