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Impact of Corporate Social Responsibility (CSR) spending on Financial Performance of selected Indian Banks

A Check on selected Indian Banks for Responsible Investment

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Abstract: The Indian banking industry is playing an important role in the economy. In the past few years it is seen that the banks are showing more interest in Corporate Social Responsibility and it has been made mandatory to spend atleast 2% of firms earnings on CSR activities *(as per Companies Act, 2019).* According to the EU Commission (2002), integration of environmental and social concerns by the companies in the operation of the business and in their interactions with stakeholders voluntarily to mandatory now is called Corporate Social Responsibility. The main purpose of the study is to identify the impact of CSR spending on the financial performance of banks measured by earnings per share, return on assets, return on equity, price to sales ratio, and price to book value. The study is focused mainly on 3 public sector banks operating in India for the period of three financial years starting from 2017-18 to 2019-20. The methodology used in this study is panel data analysis. The result shows that ROE, ROA and EPS have a positive relation with CSR. CSR has a negative impact on price to sales and price to book value.

Index Terms – corporate social responsibility, financial performance, public sector banks

I. INTRODUCTION

The concept of CSR rests on the ideology of *'GIVE AND TAKE'*

Corporate social responsibility (CSR) is a self-regulating business model that helps a company be socially accountable—to itself, its stakeholders, and the public. By practicing corporate social responsibility, also called *corporate citizenship*, companies can be conscious of the kind of impact they are having on all aspects of society, including economic, social, and environmental. To engage in CSR means that, in the ordinary course of business, a company is operating in ways that enhances society and the environment, instead of contributing negatively to them. Corporate social responsibility is a broad concept that can take many forms depending on the company and industry. Through CSR programs, philanthropy, and volunteer efforts, businesses can benefit society while boosting their brands. As important as CSR is for the community, it is equally valuable for a company. CSR activities can help forge a stronger bond between employees and corporations, boost morale, and help both employees and employers feel more connected with the world around them. For a company to be socially responsible, it first needs to be accountable to itself and its shareholders. Often, companies that adopt CSR programs have grown their business to the point where they can give back to society.

Thus, CSR is typically a strategy that's implemented by large corporations. After all, the more visible and successful a corporation is, the more responsibility it has to set standards of ethical behavior for its peers, competition, and industry. CSR is a concept whereby companies not only consider their profitability and growth, but also the interest of society and the environment by taking the responsibility for the impact of their activities on stakeholders, environment, consumers, employees, communities, and all other members of the public sphere. The basic premise is that when the corporate get bigger in size, apart from the economic responsibility of earning profits, there are many other responsibilities attached to them that are more of a non-financial /social nature**.**

CSR IN INDIA AND ITS LEGAL FRAMEWORK

India is the first country in the world to make corporate social responsibility (CSR) mandatory for corporate and CSR has become an integral part of business philosophy after its introduction as a statutory obligation under Section 135 of the Companies Act, 2013. Through Corporate Social Responsibility (CSR) has been a key area for various corporate in India; it formally became a part of Corporate Governance in 2013. Ministry of Corporate Affairs has notified Section 135 and Schedule VII of the Companies Act as well as the provisions of the Companies (Corporate Social Responsibility Policy) Rules, 2014 (CRS Rules) which have come into effect from 1 April 2014.

The Companies Act, 2013 requires companies with-

- A net worth of Rs. 500 Cr or more, OR
- An annual turnover of Rs. 1000 Cr or more, OR
- Net profit of Rs. 5 Crore or more,
- *Spend at least 2% of their three-year annual net profit towards CSR activities (specified in SCH VII) in a financial year*

SCHEDULE VII

Activities which may be included by companies in their Corporate Social Responsibility Policies Activities relating to:

i. Eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation and making available safe drinking water.
ii. Promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly and the differently able and livelihood enhancement projects.
iii. Promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups.
iv. Ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water [including contribution to the Clean Ganga Fund]
v. Protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional art and handicrafts;
vi. Measures for the benefit of armed forces veterans, war widows and their dependents, Central Armed Police Forces (CAPF) and Central Para Military Forces (CPMF) veterans, and their dependents including widows
vii. Training to promote rural sports, nationally recognised sports, Paralympic sports and Olympic sports
viii. Contribution to the prime minister's national relief fund or Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund (PM CARES Fund) or any other fund set up by the central govt. for socio economic development and relief and welfare of the schedule caste, tribes, other backward classes, minorities and women;
ix. (a) Contribution to incubators or research and development projects in the field of science, technology, engineering and medicine, funded by the Central Government or State Government or Public Sector Undertaking or any agency of the Central Government or State Government; and
x. (b) Contributions to public funded Universities; Indian Institute of Technology (IITs); National Laboratories and autonomous bodies established under Department of Atomic Energy (DAE); Department of Biotechnology (DBT); Department of Science and Technology (DST); Department of Pharmaceuticals; Ministry of Ayurveda, Yoga and Naturopathy, Unani, Siddha and Homoeopathy (AYUSH); Ministry of Electronics and Information Technology and other bodies, namely Defense Research and Development Organization (DRDO); Indian Council of Agricultural Research (ICAR); Indian Council of Medical Research (ICMR) and Council of Scientific and Industrial Research (CSIR), engaged in conducting research in science, technology, engineering and medicine aimed at promoting Sustainable Development Goals (SDGs).
xi. Rural development projects
xii. Slum area development.
xiii. Disaster management, including relief, rehabilitation and reconstruction activities.

ACTIVITIES NOT COVERED UNDER CSR:

The CSR projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities.

i. One-off events such as marathons/ awards/ charitable contribution/advertisement/sponsorships of TV programs etc. would not be qualified as part of CSR expenditure.
ii. Expenses incurred by companies for the fulfillment of any Act/ Statute of regulations (such as Lab our Laws, Land Acquisition Act, etc.) would not count as CSR expenditure.
iii. Contribution of any amount directly or indirectly to any political party shall not be considered as a CSR activity.
iv. Any activity undertaken by the company outside India except for training of Indian sports personnel representing any State or Union territory at national level or India at international level
v. Activities are undertaken by the company in pursuance of its normal course of business

[Provided that any company engaged in research and development activity of new vaccine, drugs and medical devices in their normal course of business may undertake research and development activity of new vaccine, drugs and medical devices related to COVID-19 for financial years 2020-21, 2021-22, 2022-23 subject to the conditions that-

(a) such research and development activities shall be carried out in collaboration with any of the institutes or organisations mentioned in item (ix) of Schedule VII to the Act;

(b) details of such activity shall be disclosed separately in the Annual report on CSR included in the Board's Report.]

COMPANIES (CSR POLICY) AMENDMENT RULES, 2021

Some of the amendments will actually be relevant from 1st April, 2021; some of them will have immediate compliance implications-

Changes in Definition: Certain changes came out in the Companies (CSR Policy), amendment rules, 2021

Rule 2(1) (b) Now it clearly incorporated in the revised definition of 'Administration overhead' It is clearly mentioned that administration overhead means the expenses incurred for general management and administration of CSR functions in the company and explicitly excludes any expenses incurred for the designing, implementation, monitoring, and evaluation of a particular Corporate Social Responsibility project
Rule 2(1) (d) Earlier the definition defined what includes under CSR in reference to SCH VII, but the amended definition changed the concept from included to exclude. (Revised definition has provided the list of exclusion from CSR, there are 6 exclusion mentioned in revised rules.)
Rule 2(1) (f) The amended rules defined the CSR policy means a statement containing the approach and direction given by the board of a company, taking into account the recommendations of its CSR Committee and includes guiding principles for selection, implementation, and monitoring of activities as well as the formulation of the annual action plan
Rule 2(1) (g) International Organization in the framework of India's CSR. It allows corporates to take a call on the appointment of any outside organization for designing, monitoring, and evaluating their CSR projects and in assisting them with capacity building of their personnel under Rule 4(3) of New Rules.
Rule 2(1) (i) This amendment defined the term 'Ongoing Project" means a multi-year project undertaken by a Company in fulfillment of its CSR obligation having timelines not exceeding three years excluding the financial year in which it was commenced, and shall include such project that was initially not approved as a multi-year project but whose duration has been extended beyond one year by the board based on reasonable justification;

OTHER IMPORTANT POINTS & CHANGES TO BE TAKEN CARE

Penal Provisions (Earlier Vs New)

Earlier	New *Companies (Amendment) Act, 2020 & 2021*
Sub-section (7) to section 135 provided for penal provisions for Non-Compliances of the provisions Fine on company *Min. Rs. 50 Thousand* *Max. Rs. 25 Lakh*	Sub-section (7) substituted in Companies (Amendment) Act, 2020 and amended the penal provision as Fine on company *Up to twice the amount required to be transferred to fund specified in Schedule VII or Unspent CSR A/c* OR *Rs. 1crore* *(whichever is lower)*
Fine to Office in default *Min. Rs. 50 Thousand* *Max. Rs. 5 Lakh* *Imprisonment-Max 3 years* Earlier corporates had the chance to avoid the fine by explaining the reason of not spending the CSR fund within the stipulated time frame with expanding the same by that time. In other terms, we can say corporates had a chance to avoid the fine.	Penalty on Office in default *1/10 of the amount required to be transferred to fund specified in Schedule VII or Unspent CSR A/c* OR *Rs. 2 lakhs* *(whichever is lower)* After amendments to Rules 2020 &2021, it was shifted from explanation to pay the penalty. The Penalty mentioned in sec. 135 (7) is payable Not only for failure to spend the target CSR amount but also for failure to transfer the money to Unspent CSR Account within the stipulated time limit.

MANDATORY SPENDING & ITS CONSEQUENCES OF NOT SPENDING

Second provision to sec. 135 (5), read with sec. 135 (6), elaborates the mandatory spending requirement in the particular financial year.

- If the company fails to spend the CSR target
- The board shall still explain the reasons for the same.
- If not spend and it pertains to 'Ongoing project', Transfer the fund to 'Unspent CSR Account' within 30 days of the end of FY.
- If any other reason, transfer the unspent amount National Unspent Fund, within 6 months from the end of FY.

II. HYPOTHESIS DEVELOPMENT

In this study the common measures used for calculating the financial performance are return on equity, return on asset, price to book value, earnings per share, P/E ratio.

Hypothesis for this study are:

1. H_1: There is positive relation between CSR and ROE
2. H_2: There is positive relation between CSR and ROA
3. H_3: There is positive relation between CSR and EPS
4. H_4: There is positive relation between CSR and Price to Earnings
5. H_5: There is positive relation between CSR and Price to Book Value

Return on Equity
Return on equity tells the profit created by the company with the money invested by shareholders.

ROE= Net Income/Shareholder's Equity

Return on Asset
The efficiency of management in using its assets to generate earnings can be understood by ROA. It shows the relation between profitability and total assets.

ROA= Net Income/Total Assets

Price to earnings ratio
The relation between company's share price and the earnings per share is P/E ratio.

P/E= Market Value per Share/EPS

Price to Book Value
Comparison of the company's stock value to its book value is Price to Book ratio

P/B ratio= Stock Price/ (Total Assets-Intangible Assets and Liabilities)

Earnings per Share
The portion of profit given to each outstanding share is EPS. It is a sign of company's profitability.

III. RESEARCH METHODOLOGY

The study is based on 3 public sector banks operating in India for three consecutive years starting from 2017-18 to 2019-20.

A. Data Source

The data for this study is collected from the annual reports, business responsibility reports of the banks and from moneycontrol.com database. The CSR spending, percentage of CSR spending on net profit, ROA, ROE, P/E, price to book value, EPS of 3 banks from the year 2017-18 to 2019-20 are collected. CSR spending and the percentage of CSR spending on the net profit is collected from the respective bank's annual report/business responsibility report. The other variables are taken from moneycontrol.com database. Banks selected for study incurred a loss in the financial year 2017-18. But they have contributed to CSR activities. For these banks the percentage of CSR spending on net profit is taken as negative.

B. Sample Data

	CSR Scores *(amount in Rs. crores)*					
Banks	**2017-18**	**% of profit**	**2018-19**	**% of profit**	**2019-20**	**% of profit**
State Bank of India	112.96	1.72	16.46	1.90	27.47	0.18
Punjab National Bank	2.91	1.99	17.24	1.44	26.35	4.07
Canara Bank	28.53	0.67	23.62	6.80	20.49	0.91

The above table shows the sample data of CSR spending and percentage of CSR spending on the net profit of each bank from the year 2017-18 to 2019-20.

	2017-18		**2018-19**		**2019-20**	
Banks	**ROE**	**ROA**	**ROE**	**ROA**	**ROE**	**ROA**
State Bank of India	-3.37	-0.18	0.39	0.02	6.95	0.36
Punjab National Bank	-32.85	-1.60	-24.20	-1.28	0.58	0.04
Canara Bank	-14.51	-0.68	1.16	0.04	-6.78	-0.30

The above table shows the sample data of the ROE and ROA of the banks for three years starting from 2017-18 to 2019-20.

Since the nature of the data is panel, the panel data analysis was used. Fixed effects and Random effects model were performed on the data and Hausman test was used to find the better fitting model. After performing the Hausman test, the Random effects was shown to have a better fit on the data. The results are summarized below.

IV. RESULTS AND DISCUSSIONS

The results are listed below in the order of the hypothesis:

Dependent variable: ROE

Model	**Unstandardized Coefficients**		**Standardized Coefficients**	**t**	**Sig.**
	B	**Std. Error**	**Beta**		
(Constant)	-11.931	6.414		-1.860	0.105
CSR	0.126	0.149	0.303	0.842	0.427

The above result shows that the CSR has an impact on the return on equity (at 5% significance). When CSR increases ROE also increases and vice versa. ROE is positively affected by CSR.

Dependent variable: ROA

Model	**Unstandardized Coefficients**		**Standardized Coefficients**	**t**	**Sig.**
	B	**Std. Error**	**Beta**		
(Constant)	-0.585	0.322		-1.817	0.112
CSR	0.006	0.007	0.294	0.813	0.443

CSR impacts the return on assets also (at 5% significance). When CSR increases ROA also increases. CSR is positively affecting return on assets.

Dependent variable: EPS

Model	**Unstandardized Coefficients**		**Standardized Coefficients**	**t**	**Sig.**
	B	**Std. Error**	**Beta**		
(Constant)	-24.920	14.582		-1.709	0.131
CSR	0.202	0.340	0.220	0.595	0.570

From the results one more variable has a positive impact. When CSR spending increases EPS also increases. This represents that CSR has a positive impact on the earnings per share.

Dependent variable: Price to Sales

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.536	0.150		3.572	**0.009**
CSR	0.004	0.003	0.364	1.035	0.335

Dependent variable: Price to Book Value

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.684	0.163		4.187	**0.004**
CSR	0.004	0.004	0.330	0.924	0.386

The result shows that price to earnings and price to book value has a negative relation with CSR. However they are insignificant. Hypothesis 1, 2 and 3 were supported by the analysis. However hypothesis 4 and 5 were not supported and were also not statistically significant. So based on the results, return on equity, return on assets and earnings per share are positively affected by CSR.

V. CONCLUSION

As per Companies Act, 2013 all banks selected for the study need to spend on CSR activities; and now with further amendment in Companies Act, 2013 in the year 2019, it has been made mandatory for the company to spend on CSR activities. From the annual reports it is found that all the banks are allocating 2% of their net profit towards CSR. But most of the banks are not utilizing the full amount allocated towards CSR.

This paper examined the impact of CSR on return on equity, return on asset, price to book value, earnings per share, P/E ratio. By using panel data analysis and generating a random effects model, it was shown that not all of them were influenced by CSR. Only ROA, ROE and EPS were influenced which shows that the companies' key financials will be affected if there is a change in CSR spending. However price to sales and price to book ratios were not significant in the results which should be investigated further. An important sector such as banking could look at spending and allocating more towards CSR activities while future research can also examine the influence of CSR spending in other important sectors of the economy.

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