

**THE EFFECT OF CORPORATE SOCIAL RESPONSIBILITY (CSR) ON
PROFITABILITY OF COMMERCIAL BANKS IN KENYA**

ONGWAE ELKANAH MUMA

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DECLARATION

I hereby declare that this project is my own work and effort and it has not been presented in any other university anywhere for an academic award.

ONGWAE ELKANAH MUMA

D61/79084/2015

SIGN..... Date.....

This research project has been submitted for examination with my approval as the candidate's university supervisor.

Signed..... Date.....

Dr. Duncan Elly Ochieng (PhD, CIFA)

Lecturer,

Department of Finance & Accounting, School of Business

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DEDICATION

This job is dedicated to my grandmother, the late Rhoda Kerubo, for instilling in me the culture of hard work and the significance of learning from a young age. May her soul rest in peace. I also dedicate this work to my mother Franciscah Kwamboka, my supportive sister Carol Ongwae and my guardian Naftali Okong'o. May this work motivate you achieve great accomplishments.

Table of Contents

DECLARATION	ii
ACKNOWLEDGEMENT	iii
DEDICATION	iv
LIST OF TABLES	viii
ABBREVIATIONS	x
ABSTRACT.....	xi
CHAPTER ONE: INTRODUCTION.....	1
1.1 Background to the Study.....	1
1.1.1 Corporate Social Responsibility.....	2
1.1.2 Profitability of Firms	2
1.1.3 Corporate Social Responsibility and Profitability	3
1.1.4 Commercial Banks in Kenya.....	3
1.2 Research Problem.....	4
1.3 Research Objective.....	6
1.4 Value of the Study.....	6
CHAPTER TWO: LITERATURE REVIEW.....	7
2.1 Introduction.....	7
2.2 Theoretical Review	7
2.2.1 Stakeholder Theory.....	7
2.2.2 Competitive Advantage Theory.....	8
2.2.3 Social Cost Theory	8
2.2.4 Agency Theory	9
2.3 Determinants of Profitability of Firms	10
2.3.1 Liquidity	10
2.3.2 Size	10
2.3.3 Share Capital Ratio.....	11

2.4 Empirical Literature Review	11
2.4.1 International Empirical Studies	11
2.4.2 Local Empirical Literature.....	13
2.5 Conceptual Framework	14
2.6 Summary of the Literature Review	15
CHAPTER THREE: RESEARCH METHODOLOGY	16
3.1 Introduction	16
3.2 Research Design.....	16
3.3 Target Population	16
3.4 Sample Design.....	16
3.5 Data Collection Procedures	16
3.6 Diagnostic Tests	16
3.7 Data Analysis	17
3.7.1 Inferential Statistics	17
CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION	18
4.1 Introduction	18
4.2 Descriptive Statistics	18
4.3 Diagnostic Statistics	19
4.4 Correlation Analysis.....	19
4.5 Regression Analysis	20
4.6 Summary and Interpretation of Findings	22
CHAPTER FIVE: SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS	24
5.1 Introduction	24
5.2 Summary of Findings	24
5.3 Conclusions	25

5.4 Recommendations	26
5.5 Limitations of the Study	27
5.6 Suggestions for Further Research	27
APPENDICES	32
APPENDIX 1: DATA COLLECTION FORM	32
APPENDIX 2: LIST OF COMMERCIAL BANKS IN KENYA.....	35

LIST OF TABLES

Table 4.1: Descriptive Statistics for the Kenyan Banking Industry.....	19
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LIST OF FIGURES

Figure 2.1: Conceptual Framework.....	14
Figure 4.1: Correlation Matrix.....	20
Figure 4.2: Regression Analysis Summary Output.....	21
Figure 4.3: Analysis of Variance (ANOVA).....	22
Figure 5.1: Revised Conceptual Framework.....	25

ABBREVIATIONS

ANOVA – Analysis of Variance

CSR - Corporate Social Responsibility

ROA - Return on Assets

SCR – Share Capital Ratio

ABSTRACT

The purpose of this research is to determine the relationship between corporate social responsibility and profitability for commercial banks in Kenya. Corporate social responsibility consisted of expenditures on healthcare, scholarships, environment, and recreation and sports. Profitability consisted of Return on Assets obtained from financial statements. This study uses a sample of firms which participated in CSR activities and made data public. It excludes firms that either did not participate in CSR or did not release CSR data. Data for the five year period from 2009 to 2016 was analyzed. The study conducted multiple regression analysis on the data to determine the effects of CSR on profitability. The independent variables consisted of CSR and Bank Size while the dependent variable was ROA. The results show that size and CSR have strong correlation with ROA. With values close to zero, the correlation of both liquidity and share capital ratio with ROA is weak. The study therefore finds no significant relationship between liquidity and share capital ratio with ROA. The study supports theoretical evidence by demonstrating that a high liquidity ratio limits funds available for investment. It does not support the idea that commercial banks in Kenya gain substantially by maintaining a very high liquidity to pay depositors and creditors on demand. The findings support theoretical evidence by demonstrating a weak and negative relationship between share capital ratio and ROA. It indicates that banks that take up more debt increase ROA due to tax savings. The study findings support the competitive theory as it indicates a strong and positive relationship between CSR and profitability. There is enough evidence to show that commercial banks in Kenya make more profit by responding to stakeholder demands. Most firms invest in similar CSR programs which are scholarships, healthcare, environment, and recreation and sports. This is a clear indication that they respond to the most demanded areas of responsibility but still increase profitability by 6.5 % for every shilling invested. The research also identified limitations and gave suggestions for further research. As the current study did not seek to establish the relevant timelines for which a company returns profit for a particular set of CSR expenditures, further research should be conducted to establish the correct period in which profitability relates to. For the reasons that current research cannot identify and capture the correct CSR practices, further research should focus on only commercial banks which report their CSR expenditures and a structured manner. Finally, further study should incorporate more stakeholders as this research only included the main dimensions of CSR.

CHAPTER ONE: INTRODUCTION

1.1 Background to the Study

Companies, especially those with a diverse institutional ownership, have embraced Corporate Social Responsibility (CSR). Activities within CSR are many, and diverse. According to Alawiye-Adams & Afolabi (2014), the wide spectrum of activities involved makes it difficult to determine the effects of Corporate Social Responsibility (CSR) on profitability. To make matters worse, empirical research findings are inconclusive. Alawiye-Adams & Afolabi (2014) holds that 53% of studies show a positive CSR-profitability relationship while 24% show a negative relationship. The remaining 23% of studies show no relationship. Therefore, due to inconclusiveness of results, it is important to identify CSR elements so as to understand how they translate to profitability.

The stakeholder, competitive advantage, and social cost theories seek to establish effects of CSR on profitability. According to Argandoña (1998), the stakeholder theory holds that there are several groups of people who are affected by the CSR investment programs of an organization. They include employees, customers, and investors. The theory holds that fulfilling interests of different stakeholders attracts more funds for investment leading to higher total profits. The competitive theory holds that an organization conducts CSR as a way of creating more value than its competitors. In the long run CSR develops proper relations with the community and minimizes costs of friction. The social cost theory is of the view that managers invest to show their desire to achieve CSR. Sometimes they may spend more than necessary leading to less profits and higher risks.

Commercial banks in Kenya, just like all other local companies, participate in CSR mainly as a way of giving back to the society. They aim at creating a good image and adhering to corporate policies. Many commercial banks have not had a department for CSR. This shows that CSR has not been a major consideration in strategic planning. The firms do not have a defined way of establishing a relationship between CSR and profitability. In addition, they are only reactive to societal demands. They act responsibly after instigation by environmentalists, consumers, and governments.

1.1.1 Corporate Social Responsibility

Corporate Social Responsibility (CSR) encompasses a range of investment outcomes, activities, and business processes. According to the stakeholder theory, CSR consists of diverse outcomes resulting from responsible behavior Roman, Hayibor, & Agle (1999). For a company with stakeholders such as employees, governments, customers, society, and investors, CSR with respect to every stakeholder, will be rewarding good performance, paying taxes, delivering superior products, providing jobs, and maximizing investment. The costs of CSR are, therefore, diverse in nature.

Shareholders and other stakeholders often have conflicting perspectives which tend to dictate how CSR will be achieved (Argandoña, 1998). Argandoña's views suggest that there will always be shortcomings at every level of CSR, considering that companies do not have unlimited resources. Managers have to balance CSR expenditure with available funds. The balancing act may not be acceptable to some stakeholders. To appease different stakeholders, firms should rank their importance depending on their contribution to long-term sustainability.

1.1.2 Profitability of Firms

Profitability refers to the financial health of an organization. It is the capacity of an organization to provide services in the immediate future (Aupperle, Carroll & Hatfield 2005). Profitability reflects the ability of a company to discharge its mandate to stakeholders. A company should perform activities to fulfill objectives that are quantified in monetary terms. Profitability is the degree to which a corporate entity achieves its objectives.

According to Roman, Hayibor, & Agle (1999), profitability can be defined by cumulative quantification measures that include accounting-based profitability measures, risk measures, growth of sales, and realized stock returns. Accounting-based profitability measures are the cornerstone for previous research in determining CSR and profitability relationship. However, they only lead to a myopic way of evaluating performance. To

redress this literature shortcoming, researchers recommend the use of net profit to total asset ratio to preempt any possibility of managers adjusting net income figures.

1.1.3 Corporate Social Responsibility and Profitability

According to Aupperle, Carroll & Hatfield (2005), CSR will have a negative relationship with accounting measures of profitability in the short-term due to initial investments. On the other hand, it will reduce business risk. As managers invest in CSR activities, they inspire confidence in stakeholders. In the long-term, companies profit from CSR investment. The relationship between CSR and accounting measures of performance will be positive.

According to Carroll (1979) CSR can have a positive, negative, or no effect on profitability, depending on expenditure to achieve CSR. The same findings demonstrate that some CSR investments are crucial for sustainability. Therefore, corporate management of CSR budget is crucial in determining the optimal effects CSR has on profitability. Aupperle, Carroll & Hatfield (2005) demonstrate that CSR costs are justified if they can recover hidden costs of not seeking CSR. Companies sacrifice short-term profitability for long-term returns to attain a competitive edge. In consideration of previous empirical research studies and theories, this study will demonstrate a positive CSR-profitability relationship in the long-term.

1.1.4 Commercial Banks in Kenya

Currently there are 42 commercial banks and 7 representative offices of foreign banks. These financial institutions in total are 49. Among the 42 commercial banks, 13 have foreign ownership, while 31 banks have local ownership. Among the 31 banks with foreign ownership, 9 of them were incorporated locally. Only 4 were incorporated in foreign countries. Local banks are mostly owned by private investors, with 3 out of the 31 banks having public ownership. There is a strong regulatory framework that guides their investment policies. Banks are prohibited from advancing loans which amount to over 80% of total deposits. The Central Bank of Kenya regulates the deposits held by a bank. Banks are required to insure their deposits. They are also required to have a minimum of 250 million Kenya Shillings. The legal framework guides companies in formulating CSR policies as they protect all stakeholders' interests.

Commercial firms have embraced CSR as a concept of strategic importance (Okoth, 2012). For a long time, CSR had been considered to be a public relations undertaking with no positive impact on profitability. However, commercial banks have changed this concept. Initially, CSR was under the marketing department. Today, most of the commercial banks have created a distinct department for CSR. The department, just like finance and marketing departments, is ranked highly during corporate planning. Companies devote sufficient funds for CSR activities. They create policies with the public at heart, and do not act solely for the purpose of increasing visibility.

Profitability of local commercial banks can be analyzed using growth, ROA, and market risk methods. Recently, the commercial bank sector has generally recorded increased profit, and growth. However, market risk analysis has recorded mixed results. Top lenders such as Equity, Kenya Commercial Bank, and Barclays Bank achieve double digit growth in profitability. Currently, growth is expected to be maintained as the economy remains supportive. Market risk is, however, very high. Many companies are relying heavily on banking technologies, such as mobile banking. This, coupled with government interventions, could cause major swings in profits for different firms.

1.2 Research Problem

The corporate world is interested in CSR as most studies indicate a CSR effect on profitability of firms. Some studies show that there is a positive CSR-profitability relationship while others indicate a negative relationship. Others show no CSR-profitability relationship. The main reason why this study is important is because most studies show that CSR affects profitability in a positive way. CSR improves measures of profitability and the cumulative effect is an increase in ROA. Carroll (1979) implies a contradiction to the positive CSR-profitability hypothesis by stating that firms' profitability reduces as the community coerces them to be socially responsible. However, studies done earlier by Eilbert and Paret (1973) discuss the idea of good neighborliness which refutes the coercion aspect by stating that firms have the will to solve community problems as they are part of a community. This study supports this point of view because

the firms that solve problems attract different stakeholders who perceive the firm to improve their situation.

The study identifies a positive CSR-profitability for commercial banks in Kenya. The banks achieve long-term financial success by implementing CSR policies. Such successful banks operate with low costs. They diversify risks by investment in different projects. Investors receive high returns. The banks benefit from higher reinvestments, which they use to expand their scale of operations. After studying several commercial banks, Kinyua (2013) found out that investors invest more in companies which are socially responsible. Gichana (2004) after conducting a survey on social responsibility found out that most listed company provided employees with medical and housing benefits. The banks that successfully translate CSR into strong profitability invest in entrepreneurs who have innovative ideas. Such partnerships help the government to raise more revenue through taxation. The banks and technological entrepreneurs all benefit from business relationships. Ongolo (2012) in his studies on supermarkets in Kisumu demonstrates a strong relationship between diversification through innovation and market share. The supermarkets have attained a large market share as a result of funding innovative entrepreneurs.

Global studies have presented arguments and evidence showing positive negative or neutral relations between CSR and profitability. Using CSR as a collection of independent variables, global studies seek to identify if it has an effect on profitability. If the study identifies a linkage, then it seeks to establish the nature of the relationship. According to Kotler (2008) 53% of the global empirical studies indicate a positive CSR-profitability relationship. Orlitzky et al. (2015) supports the views of Kotler's study in his research which shows a strong and positive relationship between environmental awareness, and profitability. However, Arya (2009) conducts a research which factored in social pressure as an independent variable. The studies showed that the inclusion of social pressure resulted in negative profits for many international firms. As most of the global studies indicate a positive CSR-profitability relationship, international businesses stand to benefit from the contribution makes to international research.

Obado (2007) sought to investigate the effect of donations to short-term profits of commercial banks in Kenya. The study discovered that net profit growth declined in the first year but increased annually after 2 years. In his research, Okoth (2012) discovered that CSR expenditure had a positive financial implication on banks with a large capital base. The research, thus, concluded that it made no sense for shareholders of small banks to spend on CSR. Ongolo (2012) in his study on relationship between CSR and market share of supermarkets in Kisumu City found out that there existed a strong relationship between CSR expenditure and market share. Supermarkets that had invested heavily on CSR activities produced more sales revenues. From local empirical evidence, none of the studies has managed to focus on the mechanism through which CSR activity expenses translate to profitability, leave alone how they are selected. There is a knowledge gap characterized by occurrence of positive, negative, and neutral profitability in different studies. Hence this study uses the stakeholder approach to establish the profitability achieved from carefully selected CSR expenditure. The research will use the question: What are the effects of CSR expenditure on profitability?

1.3 Research Objective

This study sought to identify the effects of Corporate Social Performance on profitability of commercial banks in Kenya.

1.4 Value of the Study

The research will add value to the companies as this would allow them to determine whether to practice corporate social responsibilities to improve on their financial performance or not. It will also help corporate managers in the decision making process, because they will be in a position to determine whether there is a relationship between the CSR and profitability of their respective organizations. The outcome of this research will help the employees to identify institutions which are environmentally and socially responsible when looking for prospective employers. Finally, the study will help the society in finding firms with strong CSR practices to support.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

The main purpose of this section is to identify how stakeholder theory can guide CSR practices. In order to motivate firms to become socially responsible, we need to understand how different stakeholders perceive corporate social responsiveness and how organizations can change stakeholders' perceptions of a firm's CSR practices. This section also investigates studies that have been conducted to address any research gaps from theories proposed in previous literature.

2.2 Theoretical Review

The theoretical framework that is used to model CSR investment decisions are derived from the stakeholders' theory and competitive advantage theory. The organization can balance stakeholders' needs and still remain profitable in the long-term. The stakeholder theory and competitive advantage theories are discussed in detail below.

2.2.1 Stakeholder Theory

Bruno & Nichols (1990) defines stakeholders as a collection of individuals whose actions affect a firm's policies, processes, and procedures. The theory holds that different stakeholder groups have unique interests and expectations from a business perspective. The degree of fulfillment of stakeholder's desires defines future relationships. On one hand failure by a firm to meet expectations leads to loss of valuable resources in stakeholders. On another hand, meeting stakeholders' demands enables a firm to consolidate resources which translate to profitability. Clarkson (1995) demonstrates that a business organization has to incorporate stakeholder management into its strategic plan. He explains that CSR practices are too complex to be left to business units plans and must be defined by top levels of management.

Freeman (1984) gives a general definition of stakeholders by inclusion of the whole collection of individuals that interact with an organization. Davis (1975) lists stakeholders as constituting of employees, managers, investors, the society, and the government. His views mean that stakeholders are integrated into any functioning organization. According to studies by Davis (1975), stakeholders affect profitability indirectly through social interactions. Clarkson (1995) breaks down stakeholders into

primary and secondary stakeholders. He views primary stakeholders, who include investors, employees, and creditors, as core resources for a business organization. His views seem to relegate secondary stakeholders, such as the government and the society, to a lesser influential position on business matters. This paper primarily uses stakeholder theory to determine the effect of fulfilling CSR expectations on profitability of commercial banks in Kenya.

2.2.2 Competitive Advantage Theory

Competitive advantage is the capacity of a firm to create more value than the next inefficient firm that manages to break even. Harrison et al. (2007) demonstrates a more inward looking definition by viewing competitive advantage as going beyond value creation and avoiding opportunity costs. He focuses on the ability to amass more resources from the desire of stakeholders to keep them interacting with a firm. These resources consist of capabilities which other firms cannot rival. The role of CSR is to enable a firm to create internal strengths which will help a firm to adapt to changes in the best way possible.

CSR is used as a tool to increase the reputation of a firm in a given social context. Ultimately, it helps attract more customers, creditors, and investors. Carmen-Pillar, Rosa and Lisa (2011) hold that social responsibility generates loyalty through a continuous process of reevaluating relationships between organizations and factors which define their internal strengths. Harrison (2007) claims that firms that conduct CSR activities collectively have a big impact on individual firm's returns.

2.2.3 Social Cost Theory

The social cost theory is based on the idea that challenges of the current CSR concern the equitable apportionment of social costs. The social cost literature attempts to estimate the magnitude of social costs. The terminology social costs refer to almost the same costs but issues arise when externalities are brought into consideration. According to Crowther & Aras (2008) externalities have to be consolidated under one concept which could be locality or creating a location for industries. The locality of a business is thought to have advantages if they are operating alongside other similar businesses. The proximity creates amplifies the cause and effect relationship between the environment and the firm. Consequently external forces transform into social forces. The forces interact with one

another through cooperation and symbiosis. An example of such cooperation is the warm relationship that an employer builds with new employees from the society or even rival companies.

The state can either have an unlimited role in social welfare or one limited by responsibility. The main purpose why the state exists is to cater for the social needs of the society (Crowther & Aras, 2008). It covers the social costs of all citizens which mean that the corporate entities have their work cut out. The state and the society have no expectations of firms to pay for social costs. The other perspective on state intervention in social responsibility holds that the state enters into a contract with corporate entities. It demands that businesses take part in paying for some social costs. The extent of their involvement is mainly based on their extent of interaction with the society. This criterion is used because the activities which a firm engages in have an influence on the immediate society and the magnitude depends on level of engagement.

2.2.4 Agency Theory

In the agency theory, principles are owners and agents are managers (Clarkson, 1995). The role of managers is to maximize the wealth of the owners. The owners, who are shareholders, empower managers to increase efficiency of operations by all means. However, managers have to report back to shareholders on their progress and before making huge and risky decisions. However, it is not only shareholders who have legitimate interests to company. There are other stakeholders some who have even spent much more money in firms operations than most shareholders. An example is creditors who loan a company funds to support operations.

Managers as agents minimize costs of friction between different stakeholders by facilitating operations which serve to protect their interests. According to Crowther & Aras (2008) the role of managers is to distinguish between profitable CSR and non-profitable CSR. Profitable CSR does not compromise core activities and register reduced net profits and growth. Negative CSR, on the other hand, increases costs of friction and compromises core activities. Managers should achieve optimal CSR results at every level of maximizing shareholder value.

2.3 Determinants of Profitability of Firms

According to Crowther and Aras (2008), both controllable and non-controllable factors affect the profitability of a firm. A change in at least one of the factors presents opportunities or problems to performance of important activities. These factors are liquidity ratio, amount of deposits, market share, and bank ratio.

2.3.1 Liquidity

Regulators often demand a certain level of liquidity which has a direct impact on profitability of a firm. They demand certain amount of assets to be liquid so as to avoid bank runs (Clarkson, 1995). However, this requirement limits funds available for investment. The higher the liquidity ratio, the fewer funds a bank has to invest. Consequently, the less the investment projects, the less profit a company makes.

On the flipside, liquidity ratios might improve profitability by saving costs of lawsuits and loss of reputation. Companies that comply with legal liquidity requirements often have enough funds to pay creditors when payments are required as per a signed contract. In addition, a company gets to preserve its reputation. According to Clarkson (2005), reputation plays a big role in keeping loyal depositors. Therefore a firm that maintains sufficient liquidity levels makes payments when due and retains loyal depositors. In the long run they remain profitable.

2.3.2 Size

According to Kotler & Lee (2008) the size of a bank is described its market share. The larger the market share, the larger the bank. Large banks can use their size and scale of operations to enjoy a competitive edge over their rivals. They also have many customers and deposits available are high. Such bank can mobilize resources to invest in new projects which have high returns. Consequently, the ratio of net profit to total assets is high.

A large market share enables a company to diversify its projects to reduce risks. A lower risk profile increases profitability as cost of capital is perceived to be lower (Clarkson, 1995). In addition profits can be optimized by investing risky projects with high returns.

These are projects which smaller firms avoid as they may face liquidity problems due to the fact that large risky projects use up the few available resources.

2.3.3 Share Capital Ratio

Share capital provides a source of funds for companies. The availability and capital ratio used affects performance. Firms which are restricted from borrowing or have a lower capacity to access loans raise funds through issuing shares (Clarkson, 1995). The more share capital a bank can access, the more projects it can accommodate. Therefore share capital availability has large increases profitability.

Conversely, for a large company with a large borrowing capacity, using more capital reduces profitability. According to Clarkson (1995), the use of more debt capital increases net profit as a result of tax relief of debt capital. Ideally, companies should keep capital ratio as low as possible to minimize cost of capital, and maximize profitability.

2.4 Empirical Literature Review

This section includes empirical studies regarding the effect of CSR on profitability. It presents 5 local studies and 5 international studies in a chronological order.

2.4.1 International Empirical Studies

Carmen-Pillar, Rosa and Lisa (2011) sought to determine the effect of CSR on profitability within short and long periods of time. The research consisted of listed European firms and the period for the study was the four year duration preceding 2010. The research hypothesized that CSR has a strong and positive relationship within short time horizons but increases profitability in long time horizons. The results showed that companies' performances increased markedly in the long-term and only increased in a short-term period of less than 18 months. The study included large companies and it is recommended that the same study be conducted to include small companies to improve validity.

Arya (2009) supports the idea that CSR has a positive correlation with profitability through a study which sought to investigate the manner in which CSR affects share price. The study included companies around Soweto Township which had embraced social

responsibility with short-term and long-term strategies in place. The studies conducted during the 10 year period preceding 2005 found out that 80% of companies recorded sharp increases in profitability attributed to long-term strategies. The short-term strategies did not affect performance in a significant way.

Aragandona (1998) compared a business focusing on cost reduction for CSR and implications on well being. She found out that CSR, even though they led to expenditures, help to minimize costs. The findings indicate that organizations use CSR to minimize costs of friction between different stakeholders. The result is maximum shareholder value for investors and optimal profit for the organization. Aragandona classified stakeholders into exogenous factors for which a firm must respond to in order to remain competitive. The research supported the view that being social responsible has far reaching impacts on profitability.

Kotler (2012), sought to determine the drivers of CSR while studying socio-economic perspectives on CSR in an attempt to establish a relationship between CSR and profitability. An interview was conducted with similar questions structured for corporate, governmental, and non-governmental organizations. It was postulated that corporate social responsibility was driven by only individual preferences. The findings indicated that social pressures forced organizations to become socially responsible. Response to social pressures leads to poor profitability in the short-term and long-term. The same can be attributed to lack of control on CSR on the part of the organization.

Alawiye-Adams and Afolabi (2014) sought to determine long-term profitability of a firm, without which, there is no survival. The study included firms in Nigeria which had spent the least funds for CSR. The research used a survey which collected data on what organizations understood about CSR. It was noted that 69 firms did not seem to have a clear strategy on implementation of CSR. Non participation in CSR eventually impacted negatively on their performances leading to financial losses in 48 firms and closure of 12 more firms. From the high percentage of affected firms, it is clear that CSR input is directly related to profitability in Nigeria. I recommend that the government steps in with its vast resources to partner with managers in CSR programs.

2.4.2 Local Empirical Literature

Gichana (2004) in his survey on CSR practices on public limited companies sought to determine the nature of CSR activities and their impact on profitability. The study used a questionnaire which was distributed to a sample of 35 firms. Results showed that most firms spent CSR money on health, education, and housing programs. The similarity in investments accounts for the reason why many Kenyan firms show a substantially big sensitivity to CSR.

Obado (2007) sought to investigate the effect of donations to short-term profits of commercial banks in Kenya. He engaged in distribution of questionnaires. He then compared the net profit to money spent and realized a loss in the first year. However, the company broke even after two and a half years.

In his research, Okoth (2012) discovered that CSR had a positive financial implication on banks with a large marketshare but it had no effect on those with a small market share. The research also highlighted that CSR had a positively significant effect on ROA and ROE for commercial banks in aggregate. Analysis based on market size showed that CSR improved profitability of larger banks. It had no significant effect on return on assets for smaller banks. Researcher concluded that it made no sense for shareholders of small banks to practice CSR activities as doing so only drained their wealth without realizing any returns.

Ongolo (2012) in his study on relationship between CSR and Market share of supermarkets in Kisumu City found out that there existed a strong relationship between CSR and Market share. Supermarkets that had invested heavily on CSR activities produced more sales revenues. He also found out that there was a strong link between market share index and CSR. Most Supermarkets tended to be more on contributing to the society through education, water and environmental sanitation, while others preferred in giving back to society through the less fortunate.

Kinyua, (2013) carried out a study to establish the relation between investment in CSR and sustained growth in commercial bank in Kenya. In their findings they revealed that there was an increasing positive attitude towards CSR in Investment, It was noted that

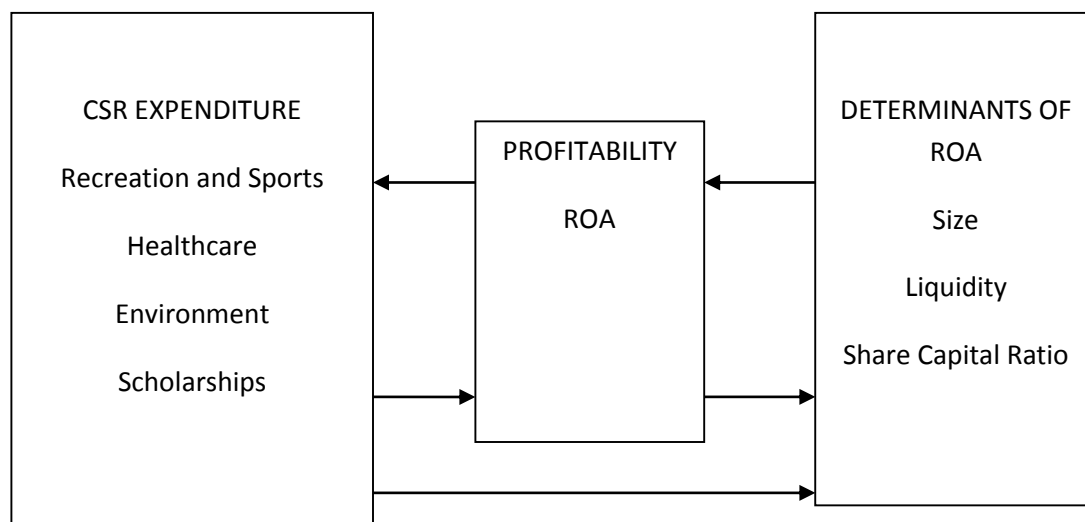
CSR as critical for success of the banks. Commercial banks work to create wealth for its shareholders by offering the best competitive services to its customers. It was revealed that, banks which had invested heavily on CSR activities it had a positive impact on their growth.

2.5 Conceptual Framework

Figure 2.1, shown below, describes the relationship between CSR and profitability. The process starts with investment of resources in different activities. This creates an expenditure whose amount depends on the desired CSR outcome. A firm's CSR is defined by the firm for the purposes allocation of funds. Different stakeholders such as, employees, society, investors, and depositors, are ranked according to their impact on profitability. Management allocates funds accordingly and successful CSR leads to an increase in market share, deposits, liquidity, and security.

The CSR-profitability relationship is cyclical and stabilizes with time. After the first cycle, which ranges between 2-5 years, firms use some of the extra accounting profit and expands its CSR activities. It increases salaries, employs more people, and provides higher returns to depositors. In this second cycle, improved CSR in terms of motivated employees and more deposits greatly improves profitability.

Figure 2.1: Conceptual Framework



2.6 Summary of the Literature Review

Corporate Social Responsibility focuses on ethic, employees, environment, and the society at large. The effect of CSR on profitability is inconclusive. Research shows both positive and negative relationships. Some demonstrate n relationship at all. This view is held by Monalish and Walsh (2002) who concluded that research studies indicate a positive CSR-profitability relationship while 24% indicate a negative relationship.

Despite the contradictory results, the CSR concept has developed due to the fact that an organization is part of the society it operates in. Depending on the level of engagement with the immediate community, an organization can tap valuable resources. There is a tradeoff which affects profits in the long-term because CFR requires resources to satisfy the needs of different stakeholders. This study, guided by relevant literature, investigates the relationship between CSR and profitability for commercial Banks in Kenya.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the research design, the population of the study, the sample design, data collection procedure, and finally data analysis technique.

3.2 Research Design

The descriptive research design was used in order to discover associations between various research variables. An explanatory case helped discover underlying principles by enabling the exploration of causation. The descriptive research design was appropriate for this study as it facilitates an in depth analysis.

3.3 Target Population

The population consisted of licensed commercial banks in Kenya. A total of 42 firms operated in Kenya between the period 2009 and 2013. In addition, 7 registered offices for foreign banks formed part of the population.

3.4 Sample Design

As there are 42 commercial banks all with head offices in Nairobi, a small sample was selected after giving all the firms an equal chance for selection. Simple random sampling method was used on firms which have all the CSR attributes readily available. The sample provided net profit and CSR investment figures for the 5 year period between 2009 and 2013.

3.5 Data Collection Procedures

Secondary data was obtained from websites of commercial banks in Kenya. The data included statements of comprehensive income, statements of financial position, and annual reports.

3.6 Diagnostic Tests

The study conducted normality and heteroskedasticity of data. It eliminated serial correlation and heteroskedasticity in data used. Reorganization of part of the data that is

not normal was conducted and adjustments were done to make data suitable for the model.

3.7 Data Analysis

The study used multiple linear regression to determine the relationship between CSR expenditure and Profit Before Tax. The regression equation took the form:

$$ROA = a + b_1CSR_t + b_2\ln SIZE + b_3SR + b_4LIQ + e$$

Where:

ROA is return on annuity measured by calculating the ratio of net profit to total assets

a and b are constants

e is the error term

SIZE is the size of a firm measured by natural logarithm of total assets

CSR_t is an annual cumulative total for CSR expenditure at consisting of: Scholarship expenditure, recreation, health, and sports

3.7.1 Inferential Statistics

Analysis of Variance (ANOVA) was used to test significance of the model at 95% confidence interval and 5% level of significance.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents descriptive statistics, diagnostic statistics, correlation analysis, and regression analysis. It concludes with a discussion and Interpretation of research findings.

4.2 Descriptive Statistics

The study employed descriptive statistics consisting of totals, means, standard deviation, skewness, and Kurtosis to present the data. Average values for the 5 year period from 2009 to 2013 were computed. They show that the average for the ROA is 0.043 with a standard error of 0.0048, skewness of -0.23, Kurtosis of -0.64, and standard deviation of 0.013. The average for InSIZE is 25.65 with a standard error of 0.19, skewness of 0.076, Kurtosis of -1.53, and standard deviation of 0.50. The average for Liquidity is 0.41 with a standard error of 0.016, skewness of 0.42, Kurtosis of -0.54, and standard deviation of 0.042. The average for CSR expense is 0.24 with a standard error of 0.043, skewness of 0.54, Kurtosis of 0.35, and standard deviation of 0.11. The average for share capital ratio is 0.22 with a standard error of 0.0077, skewness of -0.10, Kurtosis of -0.50, and standard deviation of 0.020. Table 4.1 shows descriptive statistics for the data.

Table 4.1: Descriptive Statistics for the Kenyan Banking Industry

	Mean	Standard Error.	Skewness	Kurtosis	Standard Deviation
ROA	0.043	0.0048	-0.23	-0.64.	0.013
InSize	25.65	0.19	0.076	-1.53	0.50
Liquidity	0.41	0.016	0.42	-0.54	0.042
CSR Expense	0.24	0.043	-0.54	0.35	0.11
Share Capital Ratio	0.22	0.0077	-0.10	-0.50	0.020

4.3 Diagnostic Statistics

The study tested the normality of the data. The excel software was used to determine the normality of data. The method yielded a value below 2 which indicated that there is no evidence to deny that the research data is not normal. The ROA Kurtosis of -0.64 is between the allowed +/- 2 interval and this indicates a normal distribution. The distribution of ROA showed that the data distribution is negatively skewed. The skewness value of -0.23 indicates normal distribution. The confidence interval is 0.012, a level for which the results are accepted. As ROA has the lowest standard deviation, we are confident that data is clustered around the mean and are reliable.

4.4 Correlation Analysis

This study employed correlation analysis using Microsoft excel to establish and quantify the relationship between investment expenditures and CSR expenditures. It also estimated the relationship between total expenditures and profitability. A correlation magnitude close to one indicates a strong relationship. Figure 4.1 below shows a correlation matrix for the study variables.

Figure 4.1: Correlation Matrix

	<i>ROA</i>	<i>SIZE</i>	<i>Liquidity</i>	<i>CSR Expenses</i>	<i>Share Capital Ratio</i>
<i>ROA</i>	1				
<i>SIZE</i>	0.822004	1			
<i>Liquidity</i>	-0.12057	-0.23585	1		
<i>CSR Expenses</i>	0.873506	0.728501	-0.04081	1	
<i>Share Capital Ratio</i>	0.125921	0.006014	0.19126	-0.06399	1

The results indicate a strong correlation between ROA and the independent variables size and CSR expenses. Therefore, an increase in each of the independent variables leads to an increase in profitability. Similarly, a decrease in the independent variables leads to a decrease of the independent variable ROA. The variables liquidity and capital ratio have a weak relationship with the independent variable. They are eliminated from the model.

4.5 Regression Analysis

The study used Microsoft excel to do a regression analysis and then test the research hypothesis. It included bank size and CSR expenses as X variables and ROA as the independent variable. From the regression analysis, we obtained the correlation coefficient (r) and the coefficient of determination (r^2). The correlation coefficient gives the magnitude of relationship between variables. The research identified a strong correlation coefficient of magnitude 0.91. The correlation coefficient ($r^2=0.84$) explains 84 percent of the variation. Regression analysis also provides p values to test significance.

Figure 4.2: Regression Analysis Summary Output

SUMMARY OUTPUT					
<i>Regression Statistics</i>					
Multiple R	0.914581				
R Square	0.836458				
Adjusted R Square	0.754688				
Standard Error	0.006258				
Observations	7				

ANOVA					
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	2	0.000801	0.000401	10.22931	0.026746
Residual	4	0.000157	3.92E-05		
Total	6	0.000958			

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>
Intercept	-0.02978	0.037469	-0.7949	0.471173	-0.13381
SIZE	0.01127	0.008409	1.340299	0.251213	-0.01208
CSR Expense	0.065345	0.032953	1.982969	0.118399	-0.02615

RESIDUAL OUTPUT			PROBABILITY OUTPUT	
<i>Observation</i>	<i>Predicted ROA</i>	<i>Residuals</i>	<i>Percentile</i>	<i>ROA</i>
1	0.032158	0.001842	7.142857	0.023
2	0.054073	0.005927	21.42857	0.034
3	0.024767	-0.00177	35.71429	0.035
4	0.046596	0.000404	50	0.046
5	0.040156	0.005844	64.28571	0.047
6	0.057447	-0.00445	78.57143	0.053
7	0.042803	-0.0078	92.85714	0.06

Analysis of variance (ANOVA) provides a statistic to help test the null hypothesis; there is no significant relationship between CSR expenditures, and profitability. The findings indicated a p-value of 0.027 which is less than the 0.05 level of significance. This is an

indication that there is a relationship between variable (CSR expenditure) and dependent variable (profitability). Figure 4.3 summarizes results of analysis of variance.

Figure 4.3: Analysis of Variance (ANOVA)

ANOVA					
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	2	0.000801	0.000401	10.22931	0.026746
Residual	4	0.000157	3.92E-05		
Total	6	0.000958			

4.6 Summary and Interpretation of Findings

After conducting regression analysis and hypothesis testing, we obtained coefficients for our research paper. They are a , b_1 and b_2 with magnitudes -0.02978, 0.01127, and 0.065325 respectively. The constant which is -0.02978 represents the billion shillings profitability loss for an average commercial bank that does not invest in CSR. The coefficient b_1 , with a value of 0.011, shows that an increase in 1 unit of natural logarithm of size (measured by natural logarithm of total assets) increases profitability by 0.11 times. The coefficient b_2 , with a value of 0.065, shows that an increase by 1 unit of CSR increases ROA by 0.065 times. The model for predicting profitability of individual banks within the Kenyan Banking industry is as follows:

$$ROA = -29,780,000 + 0.65CSR + 0.11\ln SIZE$$

Where CSR is the cumulative CSR expenditure and $\ln SIZE$ is the natural Logarithm of size (measure by total assets). The model drawn using data between the years 2009 to 2013 can be used to predict changes in ROA in the year 2014 onwards.

The results show that size and CSR have strong correlation with ROA. With values close to zero, the correlation of both liquidity and share capital ratio with ROA is weak. The study therefore finds no significant relationship between liquidity and share capital ratio with ROA. The study supports theoretical evidence by demonstrating that a high liquidity ratio limits funds available for investment. It does not support the idea that commercial banks in Kenya gain substantially by maintaining a very high liquidity to pay depositors

and creditors on demand. The findings support theoretical evidence by demonstrating a weak and negative relationship between share capital ratio and ROA. It indicates that banks that take up more debt increase ROA due to tax savings.

According to the competitive advantage theory, the higher the investment in CSR, the higher the ROA and in the long-term, the more competitive can become. The study findings support the theory as it indicates a strong and positive relationship between CSR and profitability.

The positive CSR-profitability relationship agrees with Carmen-Pillar, Rosa, and Lisa (2011) who demonstrated similar findings in the long-term. The same applies to Arya (2009) who demonstrated a sharp increase in profit for 80% South African companies which engaged in CSR. The study, however, deviates from Kotler (2012) findings which indicate that investing in CSR due to social pressure leads to reduction of profits. There is enough evidence to show that commercial banks in Kenya make more profit by responding to stakeholder demands. Most firms invest in similar CSR programs which are scholarships, healthcare, environment, and recreation and sports. This is a clear indication that they respond to the most demanded areas of responsibility but still increase profitability by 6.5 % for every shilling invested. The findings also agree with results for Obado (2007) which indicated a longer period for companies that spent funds on donations, a less common CSR practice for commercial banks in Kenya. Alawiye-Adams and Afolabi (2014) showed a high percentage of closure of firms that were not socially responsible.

CHAPTER FIVE: SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS

5.1 Introduction

This chapter presents summary of findings, conclusions, recommendations, and limitations of the study. It concludes with suggestions for further research.

5.2 Summary of Findings

The study used a descriptive research design for the five year period from 2010 to 2014. The independent variables used were cumulative CSR expenditures, liquidity, natural logarithm of assets (InSIZE), and share capital ratio. The dependent variable was profitability measured by Return on Annuity (ROA). ROA is used to measure the efficiency with which a business uses its assets to generate net profit. It is employed to give a reliable profitability measure which is not prone to manipulation by bank managers. It is also a good general measure for big and small banks which have a large deviation on profitability from the average mean. It enables us to use form and use a common linear regression model for predicting profitability.

Findings for the five year period for dependent and independent variables were collected from corporate financial statements and reports. A data collection form (check appendix) was used to record the data for seven select banks that contained all the useful statistics. A descriptive research design was used to present data in order to give deeper information on variables. The information showed that the average for the ROA is 0.043 with a standard error of 0.0048, skewness of -0.23, Kurtosis of -0.64, and standard deviation of 0.013. The data was collected from a normal population as indicated by kurtosis and skewness values that were within the allowed -2 to 2 limits. Liquidity and share capital were eliminated as they had correlation coefficients that were close to zero. Linear regression and analysis of variance resulted in a highly accurate prediction model that took the form:

$$\text{ROA} = -29,780,000 + 0.65\text{CSR} + 0.11\text{InSIZE}$$

Okoth (2012) holds that CSR expenditures lead to higher profits in medium to large banks. This study supports this view as large banks invest more in CSR. The more a firm incurs CSR expenditure the higher the returns. The findings also support the results for

Kinyua (2013) who held that continued CSR expenditure leads to growth in the long-term. The findings show that average CSR expenditures increase from one year to another as does ROA. This is an indication of growth.

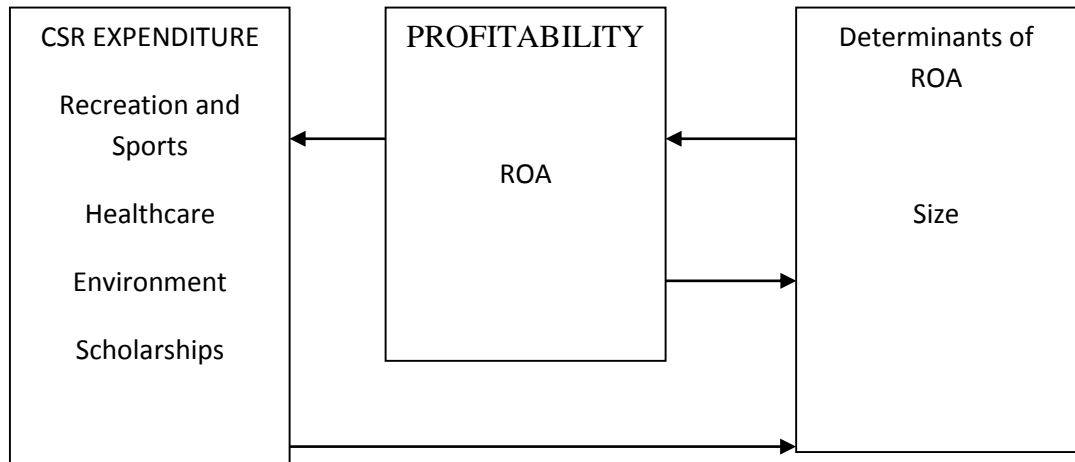
The findings support the stakeholder theory which holds that several stakeholders have conflicting interests which if all fulfilled will lead to improved performance. This research includes the multiple stakeholder approach to determine the independent variables. The competitive advantage theory is supported as results show that firms which invest in CSR are able to enjoy increased long-term growth and market-share. Clarkson (1995) established that companies which were socially responsible have a low risk profile from a large market share which enables them to operate competitively.

5.3 Conclusions

The main objective of the study was to determine the effect of CSR on profitability of commercial banks in Kenya. The study demonstrates that all commercial banks in Kenya stand to benefit from being socially responsible. The descriptive research methodology was used to identify expenditures on several stakeholders. The findings show that CSR has a strong positive relationship with profitability. An increase in CSR expenditure increases annual profits. It is to the advantage of commercial banks in Kenya to consider creating a department for CSR. On the other hand, commercial institutions do not benefit much from increasing liquidity and share capital ratio. Both have a weak relationship on a bank's ROA and a new conceptual framework shown below captures the effects of CSR on profitability better.

Commercial institutions that invest more in CSR achieve higher profits. Those that invest less either achieve lower profits or incur losses. Large commercial institutions have more resources and can impact the lives of more people. They can easily attract investors and sponsors for being socially responsible. Similarly, they can attract more depositors who are loyal hence guarantee availability of more funds to invest in wider CSR practices and projects. This study therefore justifies the idea that commercial banks in Kenya should spend more funds on CSR.

Figure 5.1: Revised Conceptual Framework



5.4 Recommendations

The study is in agreement with Friedman (1970) who held that companies participate in CSR so that they can maximize their profits. An increase in profit results in increased shareholders wealth. Therefore companies seek to maximize shareholders wealth through CSR expenditures. The study recommends commercial banks in Kenya to invest more in CSR so as to achieve long-term growth in shareholder wealth. For smaller companies that cannot raise enough funds to participate in CSR, it recommends that they partner with other institutions in the manufacturing and service fields so as to increase their outreach.

The study recommends that commercial banks understand stakeholder views on the types of CSR they can undertake. Stakeholders have a national outlook and their inclusion in CSR planning will help address the needs of all citizens at a national level. The firms will profit from avoiding costs of conflict between stakeholders and between stakeholders and the firm. However, investment in many different stakeholders should not be done at the expense of core activities. Managers in commercial banks should carry out a cost-benefit analysis to establish the effect of CSR on core activities.

Finally the study recommends professional bodies to recognize the impact CSR has in business profits and design a framework for reporting CSR expenses. Future researchers and shareholders will be the biggest beneficiaries. Future researchers will collect relevant data within a shorter period by checking companies' financial statement figures for CSR.

As at now, CSR information can only be found by reading numerous different reports to obtain an estimate of expenditures. Shareholders, the other beneficiaries, will understand how funds have been spent so as to establish their future engagement with a company in terms of investments.

5.5 Limitations of the Study

Commercial banks participated in CSR activities whose expenses and returns are difficult to measure because of their non-monetary nature and the use of profitability figures which relate to other periods of time. The commercial banks educated people on financial literacy, raised awareness on health matters, and chose to undertake ethical practices. There is a lot of subjectivity involved in quantifying time spent on CSR activities. Similarly, what that can be regarded as ethical to some stakeholders may not be perceived to be ethical by others and this creates a cost of friction which cannot be estimated with accuracy.

The other equally important limitation is the slightly inaccurate identification of CSR practices. Currently there is no standard classification of CSR expenditures. Commercial banks do not have a distinct CSR department and sometimes classify CSR practices under their marketing departments. The inability to capture the correct CSR activities makes it difficult to establish profitability for a given set of CSR expenditures. Therefore the strength and magnitude of CSR-profitability relationship might be higher or lower than this research obtained.

The final limitation of the study is the use of a limited number of stakeholders to compute CSR. The study used the main stakeholders who consist of the immediate society to come up with only four CSR dimensions namely recreation and sports, environment, healthcare, and scholarships. These are the main areas for CSR investment by firms to day. However, for the purposes of corporate research, more dimensions should be included so as to create a model which is inclusive and more accurate in predicting profitability outcomes for certain amounts of CSR investment.

5.6 Suggestions for Further Research

As the current research did not seek to establish the relevant timelines for which a company returns profit for a particular set of CSR expenditures, further research should

be conducted to establish the correct period in which profitability relates to. This research assumes that profits are earned in one year. Studies should show that profits extend beyond the 12 month period that is used in current research. Similarly, research can compare growth for firms that invest in CSR and those that do not invest in CSR to establish a benchmark by way of variance of Profit Before Tax.

For the reasons that current research cannot identify and capture the correct CSR practices, the study further research should focus on only commercial banks which report their CSR expenditures and a structured manner. The studies should ensure that for the companies they research, it should be explicitly be spelt out that money spent was for CSR activities. Researchers should be cautious enough to prevent mixing marketing expenditures and CSR expenditures.

Further study should incorporate more stakeholders as this research only included the main dimensions of CSR. Commercial banks are large institutions which affect the lives of many people as opposed to only sportsmen, learners, the sick, and people living in the immediate environment. Other stakeholders that should be include are employees and the government. The research should be able to find a link between these additional stakeholders to CSR so as to make the current model more effective at predicting profitability of firms based on their level of investment.

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APPENDICES

APPENDIX 1: DATA COLLECTION FORM

2009 Bank Codes	ASSETS ‘000	ROA	Liquidity	CSR Expense	Capital Adequacy
1	60026	0.053	0.308	0.073	0.233
2	133891	0.071	0.41	0.603	0.280
3	62553	0.049	0.436	0.0073	0.200
4	153985	0.037	0.395	0.2621	0.166
5	142881	0.055	0.56	0.073	0.144
6	223026	0.053	0.308	0.259	0.233
7	107140	0.025	0.369	0.0166	0.163
2010 Bank Codes	ASSETS	ROA	Liquidity	CSR Expense	Capital Adequacy
1	68666	0.047	0.345	0.1	0.146
2	176912	0.069	0.375	0.208	0.279
3	76904	0.043	0.384	0.0122	0.293
4	167773	0.073	0.273	0.199	0.165
5	164183	0.038	0.345	0.078	0.316
6	282495	0.055	0.314	0.186	0.208
7	140088	0.065	0.379	0.3144	0.144
2011 Bank Codes	ASSETS	ROA	Liquidity	CSR Expense	Capital Adequacy
1	67155	0.011	0.35	0.176	0.285

2	215829	0.0515	0.465	0.3495	0.302
3	91519	0.0368	0.355	0.0238	0.174
4	199664	0.0368	0.359	0.3	0.239
5	195494	0.0412	0.395	0.176	0.259
6	304112	0.0366	0.356	0.365	0.228
7	133378	0.0234	0.465	0.2415	0.256
2012 Bank Codes	ASSETS	ROA	Liquidity	CSR Expense	Capital Adequacy
1	92,000	0.037	0.425	0.238	0.233
2	238,194	0.055	0.340	0.365	0.224
3	141,000	0.070	0.3402	0.0303	0.247
4	231215	0.060	0.326	0.241	0.209
5	173,000	0.058	0.380	0.269	0.238
6	225,000	0.077	0.333	0.427	0.222
7	180,000	0.041	0.679	0.3804	0.241
2013 Bank Codes	ASSETS	ROA	Liquidity	CSR Expense	Capital Adequacy
1	107112	0.0217	0.6205	0.385	0.140
2	276115	0.0550	0.5652	0.286	0.185
3	137087	0.0294	0.3790	0.1164	0.274
4	282689	0.0296	0.4834	0.246	0.178
5	226118	0.0372	0.5159	0.28	0.217
6	376969	0.0422	0.4645	0.574	0.215

7	175808	0.0216	0.4986	0.2981	0.225
Code	List of Banks in the Sample				
1	National Bank of Kenya				
2	Equity Bank				
3	I&M Bank				
4	Cooperative Bank of Kenya				
5	Standard Chartered Kenya				
6	Kenya Commercial Bank				
7	CfC Stanbic Holdings				

APPENDIX 2: LIST OF COMMERCIAL BANKS IN KENYA

	Licensed Commercial Banks
1	ABC Bank (Kenya)
2	Bank of Africa
3	Bank of Baroda
4	Bank of India
5	Barclays Bank of Kenya
6	CfC Stanbic Holdings
7	Charterhouse Bank Limited
8	Chase Bank Kenya (In Receivership)
9	Citibank
10	Commercial Bank of Africa
11	Consolidated Bank of Kenya
12	Cooperative Bank of Kenya
13	Credit Bank
14	Development Bank of Kenya
15	Diamond Trust Bank
16	Ecobank Kenya
17	Equitorial commercial bank
18	Equity Bank
19	Family Bank
20	Fidelity Commercial Bank Limited
21	First Community Bank
22	Giro Commercial Bank
23	Guaranty Trust Bank Kenya
24	Guardian Bank
25	Gulf African Bank
26	Habib Bank
27	Habib Bank AG Zurich
28	I&M Bank

29	Imperial Bank Kenya (In receivership)
30	Jamii Bora Bank
31	Kenya Commercial Bank
32	Middle East Bank Kenya
33	National Bank of Kenya
34	NIC Bank
35	Oriental Commercial Bank
36	Paramount Universal Bank
37	Prime Bank (Kenya)
38	Sidian Bank
39	Standard Chartered Kenya
40	Trans National Bank Kenya
41	United Bank for Africa
42	Victoria Commercial Bank