

# RELATIONSHIP BETWEEN CORPORATE SOCIAL RESPONSIBILITY DISCLOSURE AND FINANCIAL PERFORMANCE IN SRI LANKAN DOMESTIC BANKING INDUSTRY

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## Abstract

*The purpose of this study is to examine the relationship between corporate social responsibility (CSR) disclosure and financial performance in domestic commercial banks in Sri Lanka. The researcher selected six high performance domestic commercial banks as a sample for a period of five years starting from 2009 to 2013. CSR disclosures and firm size have been identified as independent variables and financial performance identified as the dependent variable in this study. The researcher used secondary data for the purpose of analysis. This study employed return on equity to identify the financial performance (FP), GRI index G3 guidelines to identify the CSR disclosure level of the banks and firm size measured by logarithm of total assets of the banks. Through the result of the research it has been concluded that the null hypothesis can be rejected since there is a negative relationship between CSR disclosures and financial performance of selected domestic commercial banks. Researcher identified FP will not be totally depended on CSR disclosure. Bank performance varies with the different time periods, economic condition and other macro factors. The researcher further identified that CSR disclosure level in private banks is higher than the state banks even though the firm size of private banks are smaller than the state banks.*

**Keywords:** CSR disclosure, Financial Performance, Return on equity, GRI index

## 1 INTRODUCTION

A company is not only an economic entity but also social and political entity. Because decision taken by the company not only affect the business but affect the stakeholders who are directly or indirectly interested in company also. Because of that, in modern concept of corporate social responsibility (CSR), it is stated that business enterprises in usual process of decision making should pay due consideration to the social interest of the people in the society (Wijesinghe and Senaratne, 2011). According to the Mc Williams and Siegel (2001), CSR is an action that appear to further some social good and it is going beyond complying with the law. Even though there is no specific definition of CSR, most of the companies are doing CSR activities and communicate those activities through their annual reports. It is because that CSR disclosure is an instrument by which stakeholders use to evaluate corporate social performance. Over the years, CSR has become an issue of emergent interest in the business world and, because of that now a days this CSR disclosure is not only voluntary disclosure but also mandatory .

Today, the banking industry is considered as one of the key contributing sectors behind economic solidity and growth, and it is highly observable to public evaluation. So general public now has high expectations of the government and private sector for responsible behavior. Matching with recent corporate disasters, CSR disclosure has received increasing concentration as a complementary to financial statements for evaluating financial

performance. Because of that shareholders search for improved financial performance that integrates social and environmental considerations. A better understanding of the corporate social responsibility (CSR) disclosure and financial performance (FP) link is very useful to managers, stockholders, and other employees of the corporation as social issue of today can evolve into financial issue of future. Today's banking business environment is too competitive and dynamic where Challenges are updated day by day. In order to face for these new challenges firms should build good bond economically, environmentally and socially. Therefore, most of the companies engage with the CSR activities and try to build their corporate image through the disclosure of those activities in annual reports and other publications.

Many researchers extract into this matter in order to find any empirical relationship between corporate social responsibility disclosure and financial performance. Previous studies have identified different kinds of relationships (positive, negative, no relationship) between firm financial performance and firm social responsibility. According to the Wijesinghe and Senaratne (2011), overall level of the disclosure in the actual scenario is at a very lower level with compared to global standard. It is clear that the relationship between CSR disclosure and FP is still questionable and open area for further researches. Through this research, researcher gives a clear idea about relationship between corporate social responsibility disclosure and financial performance in domestic commercial banks in Sri Lanka.

### **1.1 Research Problem**

There are number of studies which highlight the improvement of CSR reporting worldwide (Boessoand Kumar, 2006; Enquist, Damayanthi and Rajapaksha, 2009). According to the Damayanthi and Rajapaksha. (2009), there is growing trend to report on listed companies in Sri Lanka and that in the banking and finance , insurance ,plantation, food and beverage and tobacco sector the CSR reporting is mostly common. Because of that identifying the relationship between CSR disclosure and financial performance is most important in current condition. According to this research, researcher's focus is to identify the relationship between CSR disclosure and financial performance in domestic commercial banks in Sri Lanka.

### **1.2 Objective of the Study**

As mentioned earlier Since CSR is about satisfying current social expectations rather than traditional objective of satisfying narrower expectations of shareholders, still there are unsolved questions about how disclosure of CSR affect to FP.

So the main purpose of this research is to identify the relationship between corporate social responsibility disclosure and financial performance in domestic commercial banking industry. Financial performance would be measured using return on equity (ROE). Under this research, corporate social responsibility disclosure is measured through identifying different corporate social responsibility activities performed by the banks base on the GRI index G3 guide lines. Accordingly, research objectives are as below.

1. To identify the relationship between CSR disclosure and financial performance in banking industry.
2. To identify and understand the current level of CSR disclosure in banking industry.
3. To identify and examine the new CSR activities being practiced in banking industry.

## **2. LITERATURE REVIEW**

### **2.1 Corporate Social Responsibility (CSR)**

Business generates wealth in a society and with this wealth comes power that shapes the culture and the morals of the society. This power and influence can be used positively to support the achievement of long-term development goals of the country. According to the different researchers, CSR identified different aspects and it defines through the different findings and observations of the research studies. Some researchers defined CSR as a concept which companies incorporate social and environmental concern in business operations and in interaction with stakeholders on a voluntary basis (Sheham and Jahfer, 2011). According to those researchers, CSR is an umbrella term for a mixture of practices which include: (a) a responsibility for the organization's impact on society and the natural environment, sometimes beyond legal compliance and the liability of individuals; (b) a responsibility for the behavior of others with who do business (e.g. within supply chains); and that (c) management of its relationship with wider society, whether for reasons of commercial viability, or to add value to society.

### **2.2 Measure of Corporate Social Responsibility and Corporate Social Responsibility Disclosure**

Difference research studies are used different model to measure the CSR according to the research model. Most of the researchers used content analysis for measure the CSR. According to Cheung and Mak (2010), content analysis can measures either qualitatively or quantitatively and the extent of the reporting of particular variables in a broad array of firm publications such as annual report, sustainability report, and corporate websites. That variables including in analysis are CSR activities, and the assessment of these variables is quite mechanical and objective. Fauzi (2007) used content analysis to measure CSR and that CSR activities identified through Mahoney and Robert (2007) study. Tsoutsoura (2004) and article release 2013 regarding CSR and bank performance , used Kinder Lydenberg Domini (KLD) rating system for measure the CSR and where each company in the S& P 500 is rated on multiple attributes considered relevant to corporate social performance. KLD consist more than 80 different qualitative pointers in 7 major categories including community issues, governance issues, diversity issues, employee relations, environmental issues, human Rights and Product issues. Some researcher used CSR expenditure for measure the CSR (MahbubaandFarzana, 2013). Cornett, Erhemjamtsa and Teranianb (2014) used ESG (Economic, Social and Governance) index for the studies of identifying the relationship between CSR and financial performance. KLD index also known as ESG index and ESG refer as economic, social and governance indicators which includes in KLD index.

A Sri Lankan researcher has developed a framework for CSR relevant to the Sri Lankan companies (Thilakasiri, 2012). It consist six categories including employee relationship, customer relationship, educational, health related, community related and environment relations activities. These disclosure criteria gathered through pilot test using 10 listed companies of the Colombo Stock Exchange (CSE) in different sectors including banking, finance and insurance, manufacturing and plantations. Other than that conducted the questionnaire and interviewed with industry experts. This framework is the first framework for developed relate to the CSR.

### **2.3 Corporate Social Responsibility Disclosure**

As to Gray, Owen and Adams (1996) defined CSR disclosure is as the process of communicating the social and environmental effects of organizations' actions such as

economic, to relevant interest groups within society and to society at large. When considering the CSR disclosures, most of the company's disclosure the CSR activities for various purposes. According to the Damayanthi and Rajapaksha (2009), there are two Reasons Company motivating the CSR disclosures. First one is creating authenticity through reporting the quality and reputation of its products and operations, being a communication media, stay away from stakeholder challenges, proactively winning the assurance of stakeholders, informing the stakeholders on organizational changes and changing the perception of the public reflecting the legitimization through the factors leading to CSR reporting. Second, CSR reporting is due to: requirement to ensure the competitive position in the industry, maintain the trend in the industry, the influence by the professional bodies which provide guidelines, the organizational growth and its' profitability, influence of leaders on CSR reporting, and the impact of organization specific culture reflecting the institutionalization through the factors leading to CSR reporting.

#### **2.4. Corporate Social Responsibility Disclosure and Financial Performance**

A significant amount of research has studied the relationship between CSR and firm financial performance. The relationship may be positive, negative or neutral and it base on the researchers' research scope and limitation.

Some studies emphasize the benefits obtainable from disclosing CSR information to the stakeholders to include, being an instrument for stakeholders to evaluate corporate social responsibility activities of the firm and it help to increasing transparency and credibility of a firm to society (Cheung & Mak,2010). Empirically, the study of Wijesinghe and Senaratne (2011) test the relationship between CSR disclosure and CFP using evidence from banks, finance and insurance sector in Sri Lanka and reported a positive and significant relationship between CSR disclosure and both return on assets (ROA) and return on equity (ROE). Same time researchers argued considering level of disclosure, overall level of disclosure was at low when comparing global standards and most of the information provided regarding CSR so far in the annual reports is mandated by authorities. It emphasize still Sri Lankan companies are given more priorities figures appears in the financial statement rather current global changes in reporting.

#### **2.5 Corporate Social Responsibility Disclosure in Banking Industry**

Financial institutes are exclusive in many ways and the retail services provide to firms role in facilitating economic activity for corporations. Those firms are also unique in how they have altered over the last few decades. When considering the Sri Lankan economy, service sector play vital role and high portion support from banking and financial institutions. The finance sector had become so important to the Sri Lankan economy; problems within the finance sector can impact so many other aspects of the economy. Studying the factors that can impact the finance sector is of critical importance.

According to the Damayanthi and Rajapaksha (2009), there is growing trend to report on listed companies in Sri Lanka and that in the banking and finance, insurance, plantation, food and beverage and tobacco sector the CSR reporting is mostly common.

#### **2.6 CSR in Sri Lanka**

Low numbers of researchers have focused on this area in Sri Lankan contest. The findings of the Thilakasiri, (2012) identified different organizations used different methods to disclose their CSR activities, although they had all adopted international CSR standards and principles to practice them. Some organizations performed philanthropic activities, while other companies practiced a combination of philanthropic activities, and compliance with legal and

economic responsibilities. According to that researcher Sri Lanka's CSR is still in its infant stage. The benefits of CSR are an important study for developing countries. Mandatory requirements are needed to improve the implementation of activities related to environmental, employee and customer constructs. As a CSR framework has yet to be identified in the developing countries, the framework developed in this study provides a useful model that could be employed to facilitate the discussion of CSR in other developing countries. In addition, other Sri Lankan organizations which have not yet implemented CSR programmes will become aware of the ideas and expectations of their stakeholders in relation to CSR activities.

### 3. RESEARCH METHODOLOGY

This chapter discusses the methodology of research and it includes research design, population and sample selecting, concept and variables, hypothesis development, data collection techniques, data analysis and model specification to reach the objectives of this study.

#### 3.1. Research Design

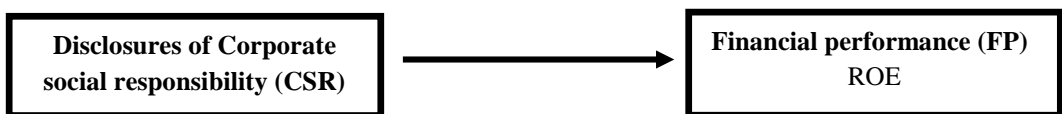
This research study consists of identifying the relationship between CSR disclosures and financial performance in domestic commercial banks in Sri Lanka. Researcher uses both qualitative and quantitative data collected in a sequential time in order to achieve the establish objectives. CSR disclosures are quantitative and cannot directly identify the quantitative figures for analysis. Researcher has used GRI guideline to identify the criteria of disclosure and accordingly identified the level of disclosures. Other variables are quantitative and measured by referring banks annual reports.

#### 3.2. Population and Sample Selection

The research population consists with 12 domestic commercial banks in Sri Lanka for a period of five years starting from 2009 to 2013. From those banks; the research concern is 06 licensed commercial domestic banks in Sri Lanka. This sample banks are different size and selected based on the high performance of the domestics' banks.

#### 3.3. Conceptual model

As per the variables identified, the conceptualization for the study can be developed as follows,



**Notes:** Control variable is Firm size

#### 3.4. Hypothesis Development

Relationship between CSR disclosure and financial performance can be positive or negative. According to the literature review different researchers build different hypothesis to achieve the ultimate objective of the research. Cheung and Mak, 2010 researchers used two hypothesis to identify the relationship between CSR disclosure and financial performance evidence from commercial banking industry and this study follow up that hypothesis. Those hypotheses are,

**H0:** There is no relationship between CSR disclosure and financial performance.

**H1:** There is relationship between CSR disclosure and financial performance.

### 3.5. Data Analysis and Model Specification

Researcher identifies CSR disclosure as independent variable and financial performance as a dependent variable. In this study, financial performance measured through ROE. Firm size is identified as a control variable and measuring using natural logarithm of total assets. According to that researcher use a multiple regression model developed by Thilakasiri (2012) to identify the relationship between CSR disclosure and financial performance. Accordingly regression can be shown as follows,

$$Y_{it} = \alpha_i + \beta_1 X_{1it} + \beta_2 X_{2it} + U_{it}$$

Two equations can develop for ROA and ROE using above regression model,

$$ROE_{it} = \alpha_i + \beta_1 CSR_{1it} + \beta_2 Firm\ Size_{2it} + U_{it}$$

**ROE** = Return On Equity bank *i* at the end of the year *t*

**CSR** = Corporate Social Responsibility Disclosure bank *i* at the end of the year *t*

**Firm Size** = Firm size using natural logarithm of assets bank *i* at the end of the year *t*

## 4. RESULTS

### 4.1 Descriptive Statistics

Descriptive statistics used to describe the data set of the observation. It includes minimum, maximum, mean and the standard deviation of the each variable in the model.

**Table 1: Descriptive Statistics**

	N	Minimum	Maximum	Mean	Std. Deviation
ROE	30	.06	.43	.2020	.08592
GRI	30	.23	.91	.5647	.20010
Firm Size	30	18.77	20.84	19.7213	.60372
Valid N (list wise)	30				

*Source: Survey analysis data*

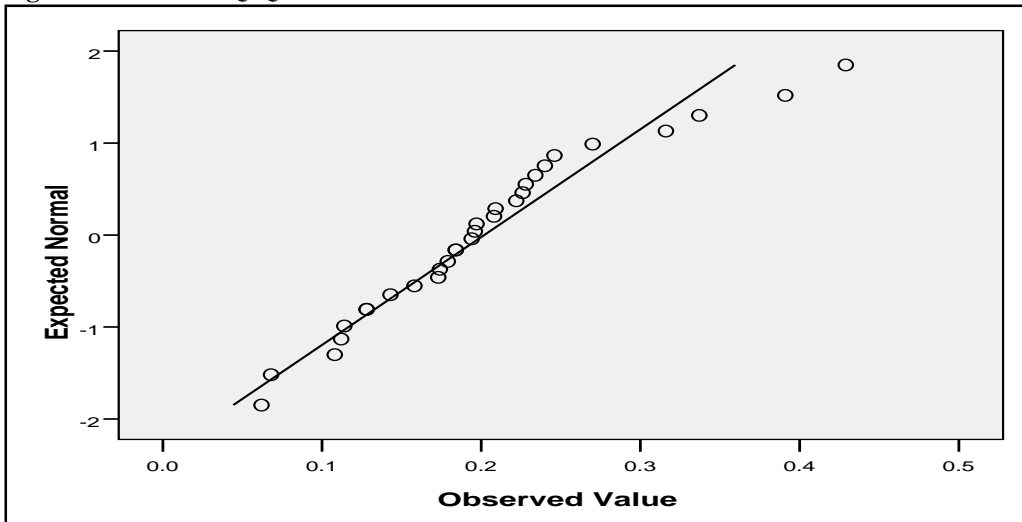
As in the table above (Table 1) the number of observations included in the regression analysis is thirty observations with a dependent variable; return on equity and two independent variables; GRI index and firm size. The minimum value is the lowest value with relate to the variables and maximum is the highest value of stated variables. The mean value is measurement of central tendency where it represents the average value of the above variables. According to the statistics it can be summarized that the minimum return on equity is 0.06 whereas the maximum is 0.43. The standard deviation measures the spread of the observations. The higher the value of standard deviation, the spread of the observations is

also higher. Accordingly spread of the ROE is 0.0859. The GRI disclosure level is having 0.23 of minimum with the average 0.5647. When consider the firm size it recorded 18.77 minimum and 20.84 maximum with the 0.6037 high spread.

#### 4.2 Testing the Normality of the Sample

In order to identify the observations that have the unusual values in the dependent variables, the study has tested the normality and according to the testing, identified that the ROE of some of the banks has the abnormal ratio when compared to the ROE of the other banks. The sample size is less than the 50 the Shapiro-wilk more appropriate to test of normality. The sample is normally distributed means the Shapiro-wilk statistic value should be approximately one and the significant value is greater than the 0.05. Shapiro-wilk value of the selected sample for this research is 0.943 and significant value is 0.112. It is indicating that the sample is normally distributed. In order to determine the normality graphically, researcher used normal Q-Q plot. If the data are normality distributed, data points close to the diagonal line. As per the below normal Q-Q plot (Figure 4.1), the data is normally distributed.

**Figure 4.1: Normal Q-Q Plot of ROE**



*Source: Survey analysis data*

### 4.3 Correlations

**Table 2: Correlation between the variables**

		ROE	GRI	Firm Size
ROE	Pearson Correlation	1	-.501(**)	.622(**)
	Sig. (2-tailed)		.005	.000
	N	30	30	30
GRI	Pearson Correlation	-.501(**)	1	-.383(*)
	Sig. (2-tailed)	.005		.037
	N	30	30	30
Firm Size	Pearson Correlation	.622(**)	-.383(*)	1
	Sig. (2-tailed)	.000	.037	
	N	30	30	30

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

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

Source: Survey analysis data

Study identified the correlation between variables using Pearson correlation (Table 2). Study has performed a correlation analysis using SPSS to find out the interrelationships between the variables explained in the paper such as return on equity, CSR disclosure level through the GRI index and the firm size. The correlation between ROE and GRI index moderate negative correlation is -0.501 and significant at 1% level, 2- tailed. Accordingly there is strong positive correlation between ROE and firm size is 0.622 and correlation significant at 1% level, 2 –tailed. The correlation score between GRI index and firm size was founded -0.38 and significant at 5% level, 2- tailed. It is weak negative correlation.

### 4.4 Regression Analysis

This research study performed multiple regression analysis as discussed previous chapter. Results obtained from the regression analysis are given below. Through the model summary researcher identified how well regression model fit or did not fit the observed data. Model summary is revealing essential information regarding that.

**Table 3: Model Summary (b)**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.684a	.468	.429	.06494

Source: Survey analysis data

In the above model summary table 3 can see R square = 0.468 that indicate the explanatory power of the independent variables to the dependent variable. It means 46.8% variation in performance of the domestic commercial banks is explained through the selected independent variables; GRI index which is represent the CSR disclosure level and firm size. The adjusted R square represent when another one variable is added to the model, how far it will explained the dependent variable. Adjusted R square = 0.429 in this model and when added to new variable in this model, it will explain 42.9% of the performance of the bank. The standard error of the estimate is a measure of the accuracy of prediction. Standard error of the estimate is 0.0649 means and it simply the standard deviation. This explains how far the mean of the



selected sample deviates from the actual mean of the population. According to this model actual mean only have variance of 6. 49 percent from the sample mean.

**Table 4: ANOVA (b) table**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.100	2	.050	11.885	.000(a)
	Residual	.114	27	.004		
	Total	.214	29			

a. Predictors: (Constant), Firm Size, GRI

b. Dependent Variable: ROE

Source: Survey analysis data

The regression sum of square or explain sum of square obtained from the regression model developed in this study is 0.100 (Table 4).It means how much variability is accounted for by the regression model, which is the fitting of the least squares line. The residual sum of square is how much variability uncounted for by the regression model. According to this study residual sum of square is 0. 114. The sum of both regression and residual variability called total sum of squares. The extent to which the regression sum of squares is lower relative to the residual sum of squares is the extent to which variability is accounted for by research model.

The degree of the freedom regression is equal to the number of predictors in the model. According to this study it is equal to the two and degree of the freedom residual is twenty seven which is the amount obtained from the deducting number of total observations. When it comes to the means squares, those are arrived by dividing sum of squares from the degree of the freedom.

F value is the measure of the overall significance of the model that is obtained by taking the ratio of the mean square regression to mean square residual. As such for result of the study, it is equal to 11.89 and the significant at the 1% level. Accordingly it can be conclude as the overall model is significant at the 1% level and 99% confidence.

**Table 5: Coefficients (a) table**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta	B	Std. Error
1	(Constant)	-1.139	.442		-2.576	.016
	GRI	-.132	.065	-.308	-2.027	.053
	Firm Size	.072	.022	.504	3.319	.003

a Dependent Variable: ROE

Source: Survey analysis data

The coefficient of each of variable in the model with the beta value and the standard error value is mentioned in the coefficient table 5. Regression model coefficient table contain

essential information for interpreting the regression analysis. The table includes the significant level of each of the dependent variables and independent variable. The interpretation has indicated as above table 5.

According to table 5 the constant is -1.139 it shows that the least square line touches the ordinate axis at the value of -1.139. Furthermore it says that the given value of independent variable zero, the value of expected return on equity is -1.139.

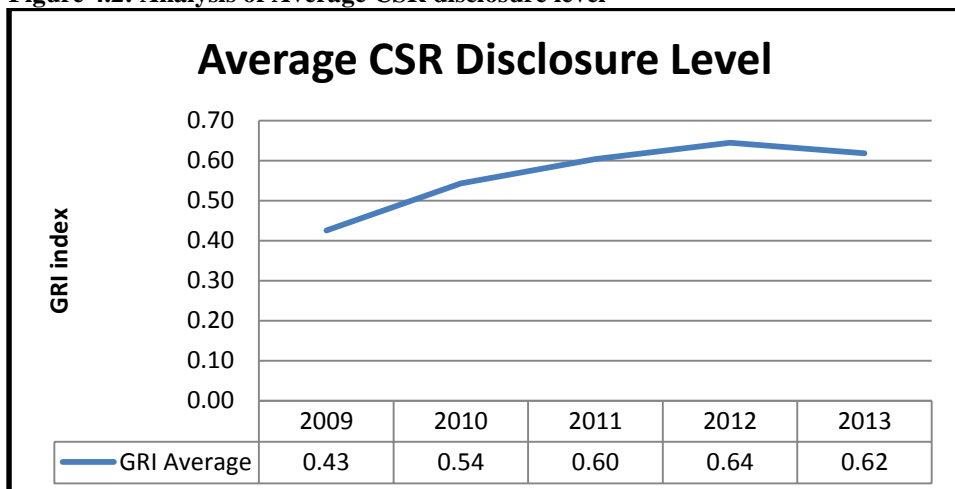
Further, it can be explained as in model one, for one unit of increase in the independent variables; GRI the return on equity that mean the performance of the banks has reduced by 0.132. Standard error provide a measure of how much should expect the given the sample coefficient to vary under the assumption of the null hypothesis. According to the standard error mentioned in the table 5 GRI index which is representing the disclosure level of the corporate responsibility was 6.5 percent and firm size was 2.2 percent. The study result has shown that the standard errors are smaller as it indicates smaller variance in the repeated samples.

“T-Value indicates the individual significant to the regression model from the independent variables. According to the result of the study, GRI index is having absolute t-value of -2.027 where it is more than two which is the bench mark value. When it is comes to the firm size, it has absolute t-value of 3.319 and that also higher value than the benchmark value. As per the result of the t- value for independent variables, both GRI index and firm size are significant to the regression model.

#### 4.5 Graphical Representation of the Results

According to the research result there is increasing trend to the corporate social responsibility disclosure level. Average CSR disclosure has been increased from 43% in 2009 to 62% in 2013. It shows below figure 4.2. There is a tendency to increase the level of CSR disclosure. Positive increasing may be due to recently experienced corporate scandals such as Golden key, Ceylinco etc, improved awareness of state holders on global trends, introduction of awards and introduction of code of best practices by Institute of chartered accounted Sri Lanka.

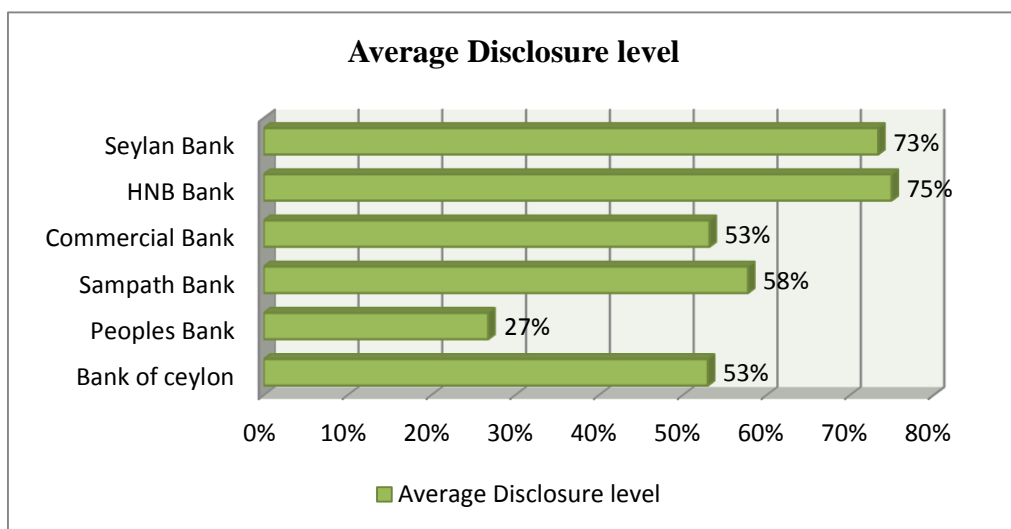
**Figure 4.2: Analysis of Average CSR disclosure level**



Source: Survey data

Banking sector in Sri Lanka is highly competitive and risky sector and banks need to maintain and increase the market share within that environment. Due to that banks use CSR activities and high level of CSR disclosures in the publication as a promoting instrument. According figure 4.3 research result, it proved that HNB bank recorded highest CSR disclosure level and Peoples’ bank recorded lowest CSR disclosure level. Accordingly private domestic bank in research sample more disclosed the CSR and in line with the GRI index rather than the state banks. Study shows even though the state banks have high assets basis do not more disclosures the CSR compared to the private domestic banks. It proves negative correlation between GRI index and firm size. Due to the less market share and high risk in private banks, they do more CSR activities and disclosure those activities in the annual reports to sustain the banking business.

**Figure 4.3: Analysis of Average disclosure level Banks wise**



*Source: Survey data*

**Figure 4.4: Analysis of Disclosure level Category wise**

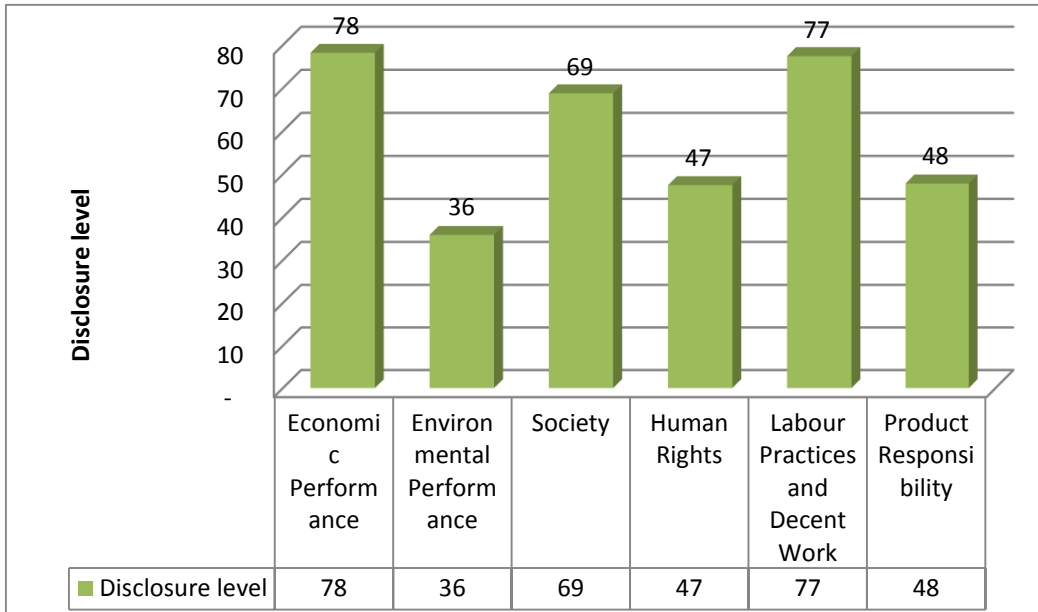


Figure 4.4 shows average level of CSR disclosure according to the GRI index. Accordingly there is high disclosure level in Economic performance and labour practice and descent works categories respectively 78% and 77% from the total number of disclosure in sub categories. There is low disclosure level in environmental performance and it represents 36% level. Most of the environment performance disclosures not relate in to the banking sector and total number of environmental performance disclosures according to the G3 guide lines are 30 and 10 disclosures are not relate in to the banking sector. Because of that study performed base on 20 environmental performance disclosures. Selected disclosures are showed in the appendix 01, GRI compliance index G3.

#### 4.6 CSR Activities of the Banks

Considering the current trends of the banks, most of the banks improve their reporting level relate to the CSR activities. Through the content analysis researcher identified i banks were less in line with GRI guidelines and level of disclosure is less in year 2009 compare with year 2013. Researcher identified sustainability reports not only check by management of the banks but also third party such as independent auditors. Considering level of CSR disclosure HNB bank recorded high disclosure level of CSR activities compared to the other banks and got the A<sup>+</sup>GRI application level check from the deputy chief executive GRI. It means banks in line with global standards of sustainability reporting and high level of CSR disclosure.

When considering content of the annual reports and sustainability reports of the selected banks researcher identified, most of the banks currently give priority for environment performance disclosure compare to year 2009. Banks focus green banking, green procumbent, waste management and resource efficiency. Under green banking, banks build green buildings which are eco-friendly and actively promoting projects that invest in renewal energy and alternate source of energy. Other than that banks introduce new policies and disclose those in line with the Economic performance, social performance and labor practice and works compare to the year 2009 and 2010.

#### 4.7 Hypothesis Testing

The hypothesis of this study is as follows:

**H<sub>0</sub>:** There is no relationship between CSR disclosure and financial performance.

**H<sub>1</sub>:** There is relationship between CSR disclosure and financial performance.

There is negative correlation and negative  $\beta$  values in the analysis of corporate social responsibility disclosures which represent GRI index with banks performance which represent ROE (According to the table 4 ). But the p values of the model less than 0.05 (Table 4). Therefore this study is rejecting the null hypothesis and accept the hypothesis **H<sub>1</sub>** which is there is relationship between CSR disclosure and financial performance.

#### 4.8 Relationship between CSR Disclosure and FP in Domestic Commercial Banks in Sri Lanka

According to the correlation of the table 2, there is 1% significant negative relationship between GRI index which is represent CSR disclosure level and banks performance which represent to the ROE. According to previous researchers, research results suggest a negative relationship exists between CSP and financial performance. Cheung and Mak (2010) argued (as cited in Waddock and Graves, 1997; Preston and O'Bannon, 1997) the relationship is consistence with the neoclassical economist's argument that the increase of firm's social activities reduces firm's profit and shareholder wealth. Furthermore Cheung and Mak (2010) explained (as cited in Aupperle, Carroll and Hatfield, (1985) that firms perform responsibly would incur extra cost compare to their rivals which incurs them a competitive disadvantage. Meanwhile, Agency Theory suggests that managers would only interest in activities that can increase company's profit. Putting both arguments together would reach to the conclusion that a firm would spend less on CSR to increase their profit. This argument can also apply to the relationship between CSR disclosure and financial performance, as firms have to incur extra cost to make higher quality disclosure. As a result, a negative relationship between CSR disclosure and FP is expected. As Wijesinghe and Senaratne (2011) noted (as cited in Bragdon and Marlin, 1972; Vance, 1975) high responsibility results in additional costs that put a firm at an economic disadvantages compared to others, less socially responsible firms. Furthermore costs may result from actions like making extensive charitable contributions, promoting community development plans, maintaining plants in economically depressed location and establishing environmental protected procedures. In additions, concern for social responsibility may limit a firm's strategic alternatives.

CSR disclosure is the most direct way for a company to let the public knows about their contribution to the well-being of the society. Within this five year period CSR disclosure level increase and ROE decrease. Other than the above result findings there are some specific reasons for decline the CSR disclosure is not the only factor that decides the banks financial performance. Economic situation of the country at that period and government rules and regulations mainly affect to the bank performance.

**Figure 4.5: Sri Lankan bank performance**



*Source: Central Bank of Sri Lanka, 2013*

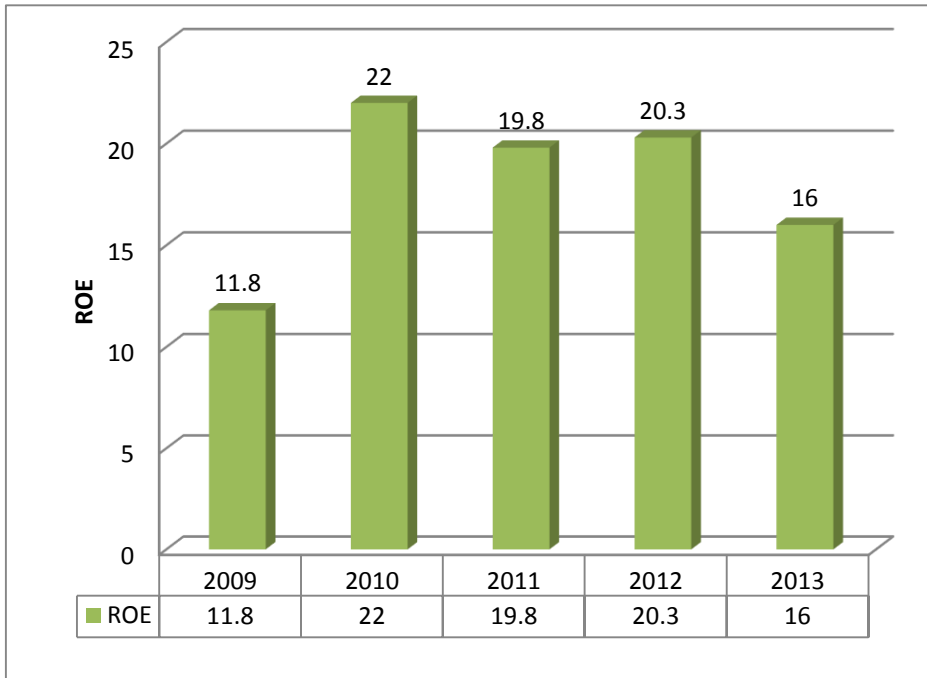
When analyze the data, study identified there is huge decline in bank performance in year 2013. It clearly mentioned in central bank financial system stability report 2013. It is shows in figure 4.5. But consider the CSR disclosure there is increasing trend from the year 2009 to 2013 which period research analyze the data set figure 4.2. Other than the CSR disclosures below reasons affected to decide the ROE in the banks. This research measured banking performance using ROE and it calculated total assets divide in to average total share holders' equity. The amount of net income returned as a percentage of shareholders equity. It reveals how much profit a company earned in comparison to the total amount of shareholder equity found on the balance sheet. According to the central bank statistics profit after tax decline in year 2013 (Table 6) but shareholders' equity increase rapidly. In order ROE of the banking sector in Sri Lanka declined year 2013 (figure 4.6).

**Table 6: Profit after Tax in Banking Sector**

	2009	2010	2011	2012	2013
Profit After Tax	27	59	66	83	75

*Source: Central Bank of Sri Lanka, 2013*

**Figure4.6: ROE in Banking Sector**



*Source: Central Bank of Sri Lanka, 2013*

According to the central bank financial system stability review 2013 bank profits moderated as reflected by the decline in both the Return on Assets (ROA) and the Return on Equity (ROE) and amounted to 74. 6 billion in 2013 compared to 82. 7 billion recorded in 2012. Several factors contributed to the decline in banking sector profits. While interest earned from credit granted is the main source of income for the banking sector, credit growth moderated in 2013. An increase in the share of high cost time deposits in total deposits; an increase in the provisions and write offs; and an increase in the share of lower yielding assets also contributed to the moderation in profits during the year.

However asset quality deteriorated while profitability declined during 2013 as a result of the deceleration in credit growth and an increase in non-performing loans, which also led to deterioration in the Return on Assets (ROA), the Return on Equity (ROE) and the net interest margins in the banking sector.

## **5. CONCLUSION**

Banking industry is highly competitive and risky industries which simultaneously face the Challenges being updated day by day. Nevertheless, this is one of the key economic contribution sectors in Sri Lanka. Therefore, banking industry is highly observable to public sector. Considering those factors, responsible parties of the bank more consider market share and profitability while trying to face dynamic competitive environment with different perspectives. Accordingly most of the bank move to corporate social responsibility activities to promote the corporate image and to face the competitive environment. Then corporate social responsibility activities disclose through using firm annual report and other

publications as a tool of communication. Gray et al. (1996), defined CSR disclosure as the process of communicating the social and environmental effects of organizations' actions such as economic, to relevant interest groups within society and to society at large. But as a decision maker of the company need to know impact of the CSR disclosures to the firm financial performance. According to that managers can identified that CSR disclosures are becoming progressively necessary for the long term wellbeing of firms or whether it effect towards facing new challenges or help to build good bond with economically, environmentally and socially. A better understanding of the corporate social responsibility (CSR) disclosure and financial performance (FP) link is very useful to managers, stockholders, and other employees of the corporation to get the decisions with dynamic banking business environment.

The evidence provided in this study indicated that the relationship between CSR disclosure and financial performance of the domestic banking industry in Sri Lanka. Researcher gathered evidence relates in to this research area from previous research through literature review and showcase low number of research have focused on this area of the study. This study conducted base on content analysis of the six domestic banks annual reports and sustainability reports for five year time period from 2009 to 2013. Total number of domestic commercial banks in 2013 is 12 and sample selected on the high performance basis. Secondary data in banks annual reports and sustainability reports are used for data analysis. Researcher used ROE to measure the financial performance and GRI index G3 guide lines to measure the level of CSR disclosure. Other than that firm size are measured through logarithm of total assets. GRI index G3 guide lines introduced 2006 and it includes general standard disclosures and specific standard disclosures. This research consider the specific standard disclosures which include economic, environmental and social (Labour practice and decent work, human rights, society and product responsibility) disclosures.

Main objective of this study is to identifying relationship between CSR disclosure and financial performance in domestic banking industry in Sri Lanka. Research used regression analysis, Pearson correlation matrix, Descriptive statistics, Scatter Plots and charts to achieve the stated objectives from the beginning.

## **6. RECOMMENDATIONS AND DIRECTIONS FOR FURTHER RESEARCHER**

As per the research there is a high consideration on CSR disclosure. This research focused how current year CSR disclosure affects to the current year financial performance and identified as a negative. But in long term CSR disclosure can affect to the different way than this result. As per study most of the banks promote to do CSR activates and disclose through publications to inform the customer even though the financial performance and CSR disclosure have negative effect. It proves from the study there is increasing trend of CSR disclosure level.

Because of that future research can focus the identifying the relationship between CSR disclosure and domestic banking performance for long term. This study only focus on secondary data and future research can use both secondary and primary data. Results only focus for domestic banking industry in Sri Lanka and result identified relate to this industry. But different industry focus in different CSR dimensions and through apply this model in various industry can specifically identified what are the major disclosure dimension level. As well as future research could compare the results with developed and developing nations.



Finally, the results of the study are very much important to identify the relationship between CSR disclosure and FP in domestic banking industries in Sri Lanka which is negative relationship. However banks disclose the CSR voluntarily and there is increasing trend to CSR disclosure as well in line with GRI index which is global standard for sustainability reporting. This GRI guidelines are indicate of moving towards the sustainability.

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