

# **CORPORATE SOCIAL RESPONSIBILITY AND FINANCIAL PERFORMANCE: A STUDY OF INDIAN BANKING SECTOR**

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## **ABSTRACT**

*Corporate social responsibility (CSR) has the potential to make positive contribution to the development of society and businesses. In 2007, the Reserve Bank of India suggested the banks to pay special attention towards integration of social and environment concerns in their business operations to achieve sustainable development. RBI also pointed out to start non financial reporting (NFR) by banks which will cover the work done by banks towards the social, economic and environmental betterment of society. The CSR in Indian banking sector aimed towards addressing the financial inclusion, providing financial services to the untapped areas of the country, the socio-economic development of the country by focusing on the activities like poverty eradication, health and medical care, rural area development, self employment training and financial literacy trainings, infrastructure development, education and environment protection, etc. So the banks are beginning to see the benefits from setting up strategic CSR agendas. The increasing attention to CSR is based on its capability to influence firms' performance. From a long time several studies have reported unpredictable impact of corporate social responsibility on financial performance. Therefore it is important to study the relationship between social and financial performance of a company. Using a sample of twenty banks, this study has tried to examine the impact of CSR activities on financial performance measured in terms of return on equity and return on assets. The study concluded that financial performance may get affected by CSR to some extent but on the other hand it can be drawn from the results that if the banks start following CSR practice to the desired extent then these may have significant impact on their financial performance.*

**Key Words : Corporate Social Responsibility, Financial Performance, Community Welfare, Employee welfare, Environment Protection and Financial Literacy**

## **INTRODUCTION**

Corporate social responsibility (CSR) is the latest buzz word to which increasingly more and more companies are getting attentive, especially after the passing of new Company Act of 2013. It is the responsibility, which has been recognized by the companies to act in a socially responsible manner. There is no single universally accepted definition of CSR, it is usually accepted as business decision making linked to ethical values, legal compliance, and respect for people, community, and environment. CSR expects the companies to go an extra mile and conduct its operations with integrity and in an ethical manner in all its business dealings with customer, suppliers, lenders, and others, treat its employees in a fair manner and contribute towards their growth and development, respect human rights, sustain the environment for future generations and be a responsible neighbour in the community and a good 'corporate citizen'. The importance of CSR has been realized by our government also and as a result it has been made mandatory for a specified category of companies as per the New Company Act of 2013. Before the passing of this act it was voluntarily taken up by the companies as a deliberate inclusion of public interest into corporate decision making. It is an important component in public affairs program because of a number of reasons but the primary one is because of a need to maintain a good reputation and trust among the stakeholders, whether it is the customers, employees, government or society at large. It needs no argument to claim that CSR practices adopted by the companies pay them off in managing their image. Since the beginning of the 1990s, companies are changing their business practices under ethical frame work in order to incorporate the concept of CSR.

The contribution of financial institutions including banks to sustainable development is paramount, considering the crucial role they play in financing the economic and development activities of the economy. In this context, the urgency for banks to act as responsible corporate citizens in the society, especially in a developing country like India, need be hardly overemphasized. Their activities should reflect their concern for human rights and environment. Studies over the recent times have revealed that organizations involved in CSR activities have sustained for much longer duration in comparison to those not involved in such activities. As a result various organizations across sectors are increasingly getting involved in CSR activities. It can be identified as a tool to contribute directly or indirectly to the company's bottom line and also ensure its long term sustainability. CSR is not merely a charity or philanthropy, but it is a means through which companies develop a sense of responsibility towards different stake holders.

## **The possible relationship between CSP and CFP**

Various authors in India and abroad have tried to test the relationship between Corporate Social Performance and Corporate Financial Performance but no consensus could be built on this relationship, that is whether investment in CSR leads to any competitive advantage for the firms or it simply adds to additional cost incurred by the firms. The results of various empirical studies showed mixed results. In a meta-study on the relation between CSR and firm performance, Margolis and Walsh (2003) reviewed 109 studies, where CSR was taken as the independent variable, predicting firm performance. They conclude that out of these 109 studies, 54 indicated a positive relationship, 20 showed mixed results, 28 studies reported non-significant relationships, and 7 studies reported a negative relationship between corporate social performance and corporate financial performance. They pointed out that the impact of CSR on financial performance is a long-standing but still an unresolved question. They further concluded that a possible reason for the lack of consensus was limitations related to measurement of CSR, and model misspecifications. On the basis of literature review, four possibilities can be identified to study the relationship between CSP and CFP.

### **Negative Relationship**

In line with the notion of Milton Friedman, which prevailed few decades back, a company that opts for social responsibility would produce costs decidedly superior to profits and this would cause deterioration in financial-economic indicators. In Friedman's point of view, the managers have the obligation to increase the values of shareholders, because their principal duty is to maximize the values of the company. According to Friedman (1970), the commitment towards the needs and interests of the society does not give the profit, and therefore the commitment should not always be done. Those, not in favour of CSR contend that by expending limited firm resource on this discretionary activity, its competitive position is compromised and it takes away wealth from the firm's owners or shareholders.

### **Positive Relationship**

Some researchers believe that there is a positive relationship between CSP and CFP. Freeman (1984) concluded that CSR helps to minimize the expense of transaction and potential conflict with the stakeholders; hence it is an effective tool to improve the reputation of the company and reduce the risk of the politic at interest and law action. Husted (2003) concluded that CSR helps to build up competitive advantage for a company, which further enhances and protects the values of various stakeholders. He further emphasized that implementation strategy of social activities should be in line with the vision and mission of the company. Mc William, Siegel & Wright (2001) stated that firms engage in "Profit Maximizing" CSR, which means they take up social

activities in anticipation of various benefits in the form of enhanced reputation, ability to charge a premium price for their product and attract and retain quality work force. These benefits go a long way to offset the cost incurred in pursuing social activities. However the causal relationship is not established and is still doubtful. It cannot be concluded from the extant research that whether good social performance leads to good financial performance or it is other way around that more profitable companies, in the light of allocated profits, would have more resources for programs concerning corporate social responsibility.

### **Mixed Relationship**

The extant research also explains that the connection between CSP and CFP could not be constant in time and the relationship between the two variables could assume the form of a “U” or of an “Inverted U”. The relationship to “U” could be explained by the hypothesis that for a company the implementation of a CSR program could initially result in an increase in cost resulting in decrease in financial performance, a tendency that gets reversed in the medium and long run. Researchers, who talk of “Inverted U” relationship between CSP and CFP, presuppose the existence of an optimum level of corporate social responsibility, beyond which to be “socially responsible in the long run would be no longer advantageous.

### **No Relationship**

According to this hypothesis CSP and CFP would be two uncorrelated variables and therefore corporate social responsibility would have no impact on the profitability of the companies.

## **LITERATURE REVIEW**

Vance (1975) found an inverse relationship between the corporate social responsibility and the profitability of the companies in short run. McDonald and Thiele (2007) in their study on the relationship between CSR and customer outcomes found that the CSR strategies and customer satisfaction have a positive relationship. Narwal (2008) conducted a study to highlight the CSR initiatives taken by the Indian Banking Industry. The findings suggest that banks have an objective view-point about CSR activities. They are concentrating mainly on education, balanced growth, health, environmental issues and customer satisfaction as their core CSR activities. Mulyadi and Anwar in (2011) using panel data model from responsibility and corporate governance rating of listed companies in Indonesia, concluded that there is no significant impact of corporate responsibility on stock's return (corporate financial performance/firm value). Choi, Kwak and Choe (2010) tried to examine the empirical relation between corporate social responsibility and corporate financial performance from 2002-2008 in Korean

companies and found that financial performance of sample companies, measured by ROA, ROE and Tobin's Q had a positive and significant impact on their social performance. Sharma (2011) analyzed the CSR practices and its reporting in Indian banking sector and concluded that although Indian banks have integrated sustainability into their business model but reporting of these practices is still far from satisfaction. Ahmed et al. (2012) suggested that the CSR can increase both long term profitability and sustainability of the banks as well as enhance the reputation of the banks.

## **Research Gap**

The literature review shows that a lot of studies have been conducted to assess the level of CSR in banking industry and to identify the relationship between CSR and CSP worldwide but very few studies have been conducted to study the level of CSR in Indian Banking Industry and its impact on corporate performance. As the New Company Law (2013) has made CSR mandatory for certain specified category of companies and many banking companies operating in India fall in that category so through this paper, an attempt has been made to assess the level of CSR in banking sector before the implementation of New Companies Act, in other words an attempt has been made to know how the banks were voluntarily undertaking Corporate Social Responsibility and to study the impact of CSR on Corporate Financial Performance over a period of four years, immediately before the passing of new Companies Act, i.e. from 2010 to 2014 for a sample of 20 banking companies, which include ten public sector banks and equal number of private sector banks.

## **OBJECTIVES**

The present study aims to evaluate the divergent corporate social responsibility practices in Indian Banking sector (both private as well as public sector banks). However the specific objectives of this paper includes

1. To study the CSR Practices comparatively in Public and Private Sector Banks.
2. To analyze the impact of CSR variables on financial performance indicators.

## **METHODOLOGY**

**Corporate Social Performance:** CSP score of the banks was calculated from the Annual Reports of the sample banks. To find out their contribution in societal development and its disclosure a Social Responsibility Disclosure Index (SRDI) have been calculated taking into consideration nature of social responsibility assumed by individual bank and its disclosure in annual reports. After going through the existing available literature on CSR, four variables namely financial literacy, community

welfare, employee welfare and environment protection were identified and all social activities were categorized under these headings.

**Calculation of CSR Score :** On the basis of the actual activities done and disclosed in the annual reports, the banks have been assigned points using following criterion:

Number of activities	0	1 to 2	3 to 4	5 to 6	Above6
Points	0	1	2	3	4

**Corporate Financial Performance:** Since one of the objectives of the study is to determine the impact of corporate social responsibility disclosure on company's financial performance, a sample size of top 20 banks was taken. Dependent variable of the study is financial performance represented by ROE (measured as a proportion of profit after tax to issued share capital) and ROA (measured as the proportion of profit after tax to total assets). The independent variables/parameters are community welfare, environment protection, employee welfare and financial literacy.

**Sample:** Sample for the paper consist of 20 top performing Banks taken in equal number from both public and private sector banks and the time period for the study is four years, 2010-11, 2011-12, 2012-13 and 2013-14. The top 10 banks each from public and private sector have been selected on the basis of their ranking in ROA during 2012-13. Extent of social activities was determined by SRD Index on the basis of four social variables and the impact of CSR on financial performance of the sample banks was determined through Regression Equation.

**The Regression Model is represented as follows:**

$$Y_{ROE} = \alpha_0 + \alpha_1 CW + \alpha_2 EW + \alpha_3 EP + \alpha_4 FL$$

$$Y_{ROA} = \beta_0 + \beta_1 CW + \beta_2 EW + \beta_3 EP + \beta_4 FL$$

Where:

$\alpha_0, \beta_0$  = Intercept Coefficient

$\alpha_1, \beta_1$  = Coefficients for each of the Independent Variables

CW = Community Welfare

EW = Employee Welfare

EP = Environment Protection

FL = Financial Literacy

### **Development of Hypothesis**

Reserve Bank of India through a notification issued in December, 2007, directed Indian banks to adopt CSR for the sustainable development and to report on non financial matters also especially those related to social and environmental issues. As a result most of the Indian banks have adopted CSR as a part of corporate management strategy.

They have implemented it as image building tool and marketing tool to retain existing customers and attract potential customers. So following null hypothesis has been developed on the basis of literature reviewed and objectives of the paper.

$H_{01}$  = *There is no significant difference in the CSR activities taken up by public sector banks and private sector banks.*

$H_{02}$  = *There is no significant relationship between Corporate Social Performance and Corporate Financial Performance in Indian Banking Sectors.*

The source of data is Annual Reports of selected banks, Directors' Reports and Statistical Tables Relating to Banks in India of four years i.e. 2010-11 to 2013-14. The data has been analyzed with the help of SPSS version 17.0.

Correlation, t-test and regression model are the statistical tools applied to achieve the objectives.

## **DATA ANALYSIS AND INTERPRETATION OF RESULTS**

On the basis of data collected from various annual reports, directors' reports of the selected banks and Statistical Tables of Indian Banking, RBI publication, various results have been drawn and interpreted in this section.

Table 1 shows an increasing trend in CSR activities conducted by the selected banks though the average lies between 5 and 15. But it is the PNB having average 23 activities during these four years followed by SBI, ICICI and Syndicate Bank whereas others have very low score. Out of 20 banks only 9 banks show higher score than average mean score i.e. 10.68 where only three are public sector banks SBI, PNB and Syndicate Bank and six are private banks J&K, Axis, HDFC, ICICI, IndusInd and Kotak Mahindra Bank.

**Table 1: CSR Score of Selected Banks for four years**

<b>Banks</b>	<b>2010-11</b>	<b>2011-12</b>	<b>2012-13</b>	<b>2013-14</b>	<b>Average</b>
<b>Public Sector Banks</b>					
State Bank of India	14	13	16	20	15.75
State Bank of Hyderabad	7	8	8	10	8.25
State Bank of Bikaner & Jaipur	6	7	6	8	6.75
Andhra Bank	6	6	7	8	6.75
Bank of Baroda	8	8	7	8	7.75
Corporation Bank	4	5	6	6	5.25
Dena Bank	4	5	5	6	5
Indian Bank	5	6	6	8	6.25
Punjab National Bank	25	20	23	25	23.25
Syndicate Bank	16	11	15	19	15.25
<b>Private Sector Banks</b>					
City Union Bank	8	10	10	10	9.5

Jammu & Kashmir Bank	15	18	17	18	17
Karur Vysya Bank	10	8	10	10	9.5
Tamilnadu Mercantile Bank	2	3	3	3	2.75
Axis Bank	10	12	12	15	12.25
HDFC Bank	14	11	15	18	14.5
ICICI Bank	18	13	15	16	15.5
IndusInd Bank	10	12	12	12	11.5
Kotak Mahindra Bank	9	13	14	15	12.75
Yes Bank	6	8	8	10	8
Average Score	9.85	9.85	10.75	12.25	10.68

$H_{01}$  = There is no significant difference in the CSR activities taken up by public sector banks and private sector banks.

**Table 2: Summary of Independent Sample t-Test for CSR performance of Public and Private Sector Banks**

CSR	t	df	Sig (two tailed)	Mean Difference	Std. Error Difference
Equal Variance assumed	-0.656	18	0.520	-1.50	2.286

Note: Significance level is 5%

The mean score of CSR of public sector banks is 10 whereas the mean score of private sector banks is 11.50. To compare the CSR score of public sector and private sector banks, independent sample t-test was performed. The results indicated that there was no significant difference between the mean CSR score of public sector and private sector banks. Thus null hypothesis is accepted as CSR score of public sector banks and private sector banks witness insignificant difference. (Table 2)

Table 3 demonstrates that average score for Community Welfare is high i.e. 3.25 for which PNB, J&K, HDFC, ICICI & SBI contributes the maximum. Employee Welfare and Financial Literacy have equal average score for which PNB, SBI, HDFC & ICICI contribute the maximum. Whereas Environment protection related activities are very less in all the banks having just 1.45 average activities per bank.



**Table 3: Average CSR Score in terms of four factors (2010-11 to 2013-14)**

Banks	CW	EW	EP	FL
<b>Public Sector Banks</b>				
State Bank of India	4	4	3	5
State Bank of Hyderabad	3	2	1	3
State Bank of Bikaner & Jaipur	2	2	1	2
Andhra Bank	3	2	1	3
Bank of Baroda	2	2	1	3
Corporation Bank	2	3	1	3
Dena Bank	2	2	1	3
Indian Bank	2	3	1	2
Punjab National Bank	6	5	4	6
Syndicate Bank	4	3	2	5
<b>Private Sector Banks</b>				
City Union Bank	3	3	1	2
Jammu & Kashmir Bank	5	3	2	4
Karur Vysya Bank	3	3	1	2
Tamilnadu Mercantile Bank	1	1	0	1
Axis Bank	4	3	2	3
HDFC Bank	5	4	1	4
ICICI Bank	5	4	2	4
IndusInd Bank	3	4	2	2
Kotak Mahindra Bank	4	5	1	2
Yes Bank	2	3	1	2
Average Score	3.25	3.05	1.45	3.05

$H_{02}$  = There is no significant relationship between Corporate Social Performance and Corporate Financial Performance in Indian Banking Sectors.

Table 4 statistics show that ROA is positively but insignificantly correlated with Community welfare and Employee welfare score while negatively with Environment protection and Financial Literacy score. Only financial literacy has significant impact on ROA though negative at 5 percent significance level. It means community welfare and employee welfare activities positively contribute to improve financial performance.

**Table 4: Correlations between CSR and ROA**

		ROA	CW	EW	EP	FL
<b>Pearson Correlation</b>	ROA	1.000	.151	.204	-.265	-.411
	CW	.151	1.000	.743	.746	.766
	EW	.204	.743	1.000	.653	.469
	EP	-.265	.746	.653	1.000	.816
	FL	-.411	.766	.469	.816	1.000

<b>Sig. (1-tailed)</b>	ROA	.	.262	.194	.129	.036
	CW	.262	.	.000	.000	.000
	EW	.194	.000	.	.001	.018
	EP	.129	.000	.001	.	.000
	FL	.036	.000	.018	.000	.

Table 5 presents summary of regression model results. The R value of 0.842 represents the correlation between ROA and CSR where R Square with 0.709 values indicates the explanatory power of the independent variables (CW, EW, EP, FL). It means that 70.9 per cent of the variation in ROA is explained by the independent variables which is quite good and denotes strong relationship between the explanatory variable and ROA. The standard error of the estimate is 0.21538, which explains how representative the sample is likely to be of the population.

**Table 5: Summary of Regression Model**

Model	R	R Square	Adjusted R Square	Std Error of the Estimate
1	.842 <sup>a</sup>	.709	.631	.21538

a. Predictor: Constant FL, EW, EP, CW

F-ratio explains the fitness of the model (table 6) which is 9.135 and significant at  $p < 0.005$ . This means that there is significant evidence to infer that one or more of the explanatory variables are linearly related to ROA.

**Table 6: Summary of ANOVA**

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	1.695	4	.424	9.135	.001 <sup>a</sup>
	Residual	.696	15	.046		
	Total	2.391	19			

a. Predictor: Constant FL, EW, EP, CW

Dependent: ROA

Table 7 shows the results of the coefficients of regression model with ROA as dependent variable. The t-value for community welfare, employee welfare, environment protection an financial literacy are 4.057, -0.006, -0.773, -3.880 respectively.

**Table 7: Summary of Coefficients of Regression Model**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	1.403	.190		7.388	.000
CW	.317	.078	1.193	4.057	.001
EW	.000	.081	-.001	-.006	.995
EP	-.088	.114	-.220	-.773	.452
FL	-.318	.082	-1.145	-3.880	.001

Dependent: ROA

Hence the hypothesis is rejected and a model has best fit with 70 % variations due to independent variables. Especially Financial literacy has significant impact though negative on ROA.

Table 8 statistics show that ROE is negatively and insignificantly correlated with all four variables of CSR where only Employee welfare has a significant relationship with ROE. It means that employee welfare activities significantly affect the financial performance in terms of ROE.

**Table 8: Correlations between CSR and ROE**

		ROE	CW	EW	EP	FL
<b>Pearson Correlation</b>	ROE	1.000	-.262	-.416	-.352	-.329
	CW	-.262	1.000	.743	.746	.766
	EW	-.416	.743	1.000	.653	.469
	EP	-.352	.746	.653	1.000	.816
	FL	-.329	.766	.469	.816	1.000
<b>Sig. (1-tailed)</b>	ROE	.	.132	.034	.064	.078
	CW	.132	.	.000	.000	.000
	EW	.034	.000	.	.001	.018
	EP	.064	.000	.001	.	.000
	FL	.078	.000	.018	.000	.

Summary of regression model (Table 9) presents that R value is 0.509 which represents the correlation between ROE and CSR where R Square with 0.259 value indicates the explanatory power of the independent variables (CW, EW, EP, FL). It means that only 25.9 per cent of the variation in ROE is explained by the independent variables which is quite low and denotes poor relationship between the explanatory variable and ROA. It means that 74 per cent variations are unexplained by the model. The standard error of the estimate is 2.87113, which explains how representative the sample is likely to be of the population.

**Table 9: Summary of Regression Model**

Model	R	R Square	Adjusted R Square	Std Error of the Estimate
1	.509 <sup>a</sup>	.259	.062	2.87113

a. Predictor: Constant FL, EW, EP, CW

Table 10 presents the summary of ANOVA where F-ratio explains the fitness of the model. F-ratio is 1.312 and insignificant at  $p < 0.005$ . This means that there is insignificant evidence to infer that at least one of the explanatory variables is linearly related to ROE.

**Table 10: Summary of ANOVA**

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	43.270	4	10.817	1.312	.310 <sup>a</sup>
	Residual	123.651	15	8.243		
	Total	166.920	19			

a. Predictor: Constant FL, EW, EP, CW  
Dependent: ROE

The statistics of table 7 shows the results of the coefficients of regression model with ROE as dependent variable. The t-value for community welfare, employee welfare, environment protection and financial literacy are 1.130, -1.614, 0.118 and -1.042 respectively and all are insignificant at 5% significance level.

**Table 11: Summary of Coefficients of Regression Model**

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
1 (Constant)	23.170	2.532		9.150	.000
CW	1.179	1.043	.530	1.130	.276
EW	-1.733	1.074	-.614	-1.614	.127
EP	.179	1.514	.053	.118	.908
FL	-1.139	1.093	-.491	-1.042	.314

Dependent: ROE

The hypothesis is accepted because all variables of CSR have insignificant impact on ROE where EW and FL are negatively affecting the ROE but CW and EP affecting the ROE positively. The statistical analysis witnessed a poor relationship between ROE and independent variables.

## CONCLUSION

Despite, mass acceptance of the concept of CSR reporting by banking sector around the globe, Indian banks are not responding in the expected manner. According to some critics, Indian financial institutions are concerned to the exclusion of all other considerations about the ecology of their balance- sheets and, therefore, focused on ever-greening their assets. From the results of this study it can be concluded that CSR activities are not more than 10 per year except few banks and among all activities focus on Community welfare is highest, followed by employee welfare and financial literacy where environment protection activities are negligible or just 1 or 2 per year. Except PNB, SBI and Syndicate Bank from public sector and ICICI & HDFC from Private sector others are not doing well in CSR practices. But collectively private sector banks are performing better than the public sector banks in community development, employee welfare and environment protection but as far as financial literacy is

concerned, it is public sector banks which are performing better through credit counselling of masses in rural areas by opening financial literacy and Credit Counselling Centres. There is negative relationship between CSR variables and ROA & ROE but in case of ROA community and employee welfare have positive impact. There are again mixed results because in case of ROA some CSR variables have significant impact while in case of ROE no variable witness significant impact. Hence it can be concluded that financial performance may get affected by CSR to some extent but on the other side it can be drawn from the results that if the banks start following CSR practice to the desired extent then these may have significant impact on their financial performance.

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