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IMPLICATIONS OF CSR ON NON-PERFORMING LOANS IN THE ASEAN BANKING INDUSTRY

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Abstract

Banks with good reputation are linked to better financial performance and creditworthiness. Their incentives to achieve that should be directed toward a more strict pre-loan evaluations of borrowers. This research examines whether there is any link between corporate social responsibility (CSR) and non-performing loans (NPLs) in the ASEAN banking industry. The sample in the study consists of 60 publicly listed banks from Singapore, Malaysia, Indonesia, Thailand, Philippines, and Vietnam with a time period of 6 years from 2011-2016. A cross-sectional approach is applied to assess the relationship between NPLs and CSR and other selected control variables. The study employs multiple regression analysis to determine the relationship between variables. The results indicate that there is no significant link between NPLs and CSR in the ASEAN banking industry. Notwithstanding that, the findings exhibit a significant negative relationship for profitability and firm size with NPLs. The findings also show an insignificant impact of banking ownership toward NPLs.

INTRODUCTION

Business enterprises have traditionally been conceived as a part of economy with the major responsibility to produce goods and provide services competently. With the approach of sustainable development, firms began to shift away from the narrow economic perception of responsibility and make an alteration in acknowledging the changing of society's expectations and environmental conditions (Robinson, 2000). Corporate Social Responsibility (CSR) is a concept that has captured worldwide attention.

The concern of CSR has developed from the presence of globalization and international trade, in which are reflected new demands for transparency and corporate citizenship. In general, corporate social responsibility is defined as a positive contribution from a business enterprises to society by going beyond a conservative focus on maximizing profit (Jamali, 2006). Particularly, McWilliams, Siegel, and Wright (2006) address CSR as a situation where companies are involved in actions that seem to be ethical and responsible to society and environment. The motive of companies to adopt corporate social responsibility could be its positive contribution to the company's performance, such as better reputation, recruiting and maintaining highly qualified employees, environmental improvement, and decreasing social inequality (Wu & Shen, 2013).

This study focuses on CSR activities of the banking industry, which has an important role as a financial intermediary since banks price and value financial assets, observe debtors, manage financial risk, and arrange the payment system (Scholtens, 2009). Furthermore, Wu and Shen (2013) mention that CSR is related to bank reputation which is revealed to be a major incentive for banks to engage in more severe evaluations of loan borrowers. They established that good reputation banks are linked with better profitability and solvency. Therefore, banks performing CSR are able to choose and attract more creditworthy borrowers, which can reduce the level of non-performing loans (NPLs).

Non-performing loans are one of the key indicators to assess the performance of financial institutions as they indicate how banks manage their credit risk. In general, non-performing loans are loans in which the borrower fails to make a repayment for at least ninety days (Bhattarai, 2016). For reputable banks to be trusted, their level of non-performing loan would affect the perception of stakeholders about their reliability.

The sample of this study covers publicly-listed banks from Indonesia, Singapore, Malaysia, Thailand, Philippines, and Vietnam over the period of 2011 to 2016. This paper aims to establish whether corporate social responsibility is influencing non-performing loans. This study should benefit the banking industry since its findings may provide insights about the interaction of CSR and NPLs and enable them to manage their CSR and loan portfolios' quality. The results may contribute to academics and researchers by expanding the existing literature, especially the banking industry in ASEAN where limited studies are available in this specific area. This study enables researchers to go beyond the widely-focused financial performance and CSR, and might serve as a groundwork for academics and researchers who wish to explore the topic deeper in the future.

The remainder of this study is organized as follows. Section 2 highlights the literature review of the theoretical foundations on CSR. Methodology is outlined in Section 3. Section 4 elaborates the findings of the analysis while Section 5 presents the conclusions on the paper.

LITERATURE REVIEW

Corporate Social Responsibility

Corporate social responsibility is defined as a circumstance in which organizations are involved in ethical and responsible activities toward society and environment (McWilliams et al., 2006). The Triple Bottom Line, known as the theory of CSR, is a model in which organizations accomplish a balance of economic, environmental, and social practices that also fulfil stakeholders' expectations. It is also known as the three Ps, namely people, planet, and profit. (Sia Partners, 2015). Organizations are concerned about CSR as it could increase the perception that organizations have a high level of ethics and integrity that enhance the social and economic environments (Lee, 2016).

Wu and Shen (2013) stated that the most significant relation of CSR with firm performance is through reputation. Consequently, firms use CSR to enhance customer loyalty and develop a good reputation since a higher participation level leading to social well-being can improve a firm's reputation.

Compared to other sectors such as manufacturing or agriculture industry, the banking industry has a lower impact on the environment (Branco & Rodrigues, 2006). However, Lentner, Szegedi, and Tatay (2015) revealed that the banking industry should not merely consider profit maximisation but also voluntarily support social concerns. Even though it is not in their economic interest, it is still the business' ethical responsibility. Campbell (2007) claimed that the financial industry would perform more socially responsible activities to increase their competitive advantages when competition is fiercer. Wu and Shen (2013) affirmed that corporate social responsibility is associated with bank reputation. Banks with good reputation show better profitability and credit quality of borrowers in the three years from the loan initiation. Bank reputation might indicate borrower quality. Therefore, banks that perform corporate social responsibility activities are able to choose and draw more credit-worthy borrowers that can provide better revenue and higher asset quality to financial organizations.

According to Chapple and Moon (2005), corporate social responsibility varied among Asian countries and the percentage of firms comprehensively reporting CSR was relatively low. Campbell (2007) mentioned that firms were more likely to behave more socially responsibly when there were well-enforced and strong regulations. Only some of the ASEAN country members have established policies and practices while other are still developing them. One of the primary strategies to strengthen the ASEAN Economic Community, all country members should prepare a competitive strategy including CSR Anggadwita, Amani, Saragih, & Alamanda, 2016). Even for those who implement CSR, their policy and regulations could be very dissimilar from each other. The differences are presented in Table 1.

Singapore will move from voluntary to mandatory sustainability reporting for all listed companies starting from the financial year ending December 2017 (Today Online, 2016). In Malaysia, since 2007, it has been mandatory for publically-listed companies to report their CSR practices with the contents of disclosure remaining voluntary. CSR policy in Indonesia affirms that the government of Indonesia supports the adoption of CSR for limited liability companies that are directly involved with natural resources (Gentile, 2014; Rahman, 2014). For the Philippines, it is not mandatory to disclose environmental or social practices (Global Reporting, 2016). Thailand's CSR policy is similar with the Philippines. Listed companies in Vietnam are required to report their impact on both environment and society.

Non-Performing Loans

Simpson and Kohers (2002) stated that lending deposits of clients to other clients who require loans is the main business of commercial banks. Loans are believed as a main asset for banks and its business operations, for the reason that it creates revenue or cash flow for banks through the principal and interest payments (Saunders & Cornett, 2011).

Table 1.

General Overview of CSR Disclosure in ASEAN

	Singapore	Malaysia	Indonesia	Philippines	Thailand	Vietnam	Laos	Myanmar	Brunei	Cambodia
Policy & Regulation	✓	✓	✓	✓	!	✓	!			
Expectation	✓	✓	✓	✓	✓	✓		✓		✓
Incentives		✓	✓							

Source: CSR ASIA 2016
✓ Exist
! Expected Change

NPLs are loans that are ninety days or more overdue in payments of interest or principal. They are not generating income as the principal or the interest of the loans has been unpaid. NPLs are described as problem loans that are harmful to banks' assets (Joseph, Edson, Faitira, Mutibvu, & Kamoyo, 2012). A healthy banking industry is very important for a country's economic growth and stability. However, a persistant increase in NPLs could be detrimental to the banking industry (Michael, 2006). In their study Karim, Chan, and Hassan (2010) corroborated that NPLs are an obstruction to economic growth and stability.

In 2014, Singapore banks were harmed due to weak oil prices. The sitation worsened when the demand for oil field service providers and equipment suppliers dissolved, because those businesses are Singapore banks' customers (Tani, 2017). Consequently, the NPLs rate rose from 0.75% in 2014 to 1.22% in 2016 (The World Bank Group, 2017). The increase of minimum capital adequacy of banks in Malaysia resulted in the rise of household debts that reached 87% of GDP in 2013 ~~(Hajja, 2017)~~. Nevertheless, the current banking industry NPL rate remains low at 1.6% in 2016 (The World Bank Group, 2017).

The economic slowdown and the fall in commodity prices resulted in Indonesia's NPL rate rising (Indonesia Investments, 2017). Banks NPLs continued to rise from 1.6% in 2013 to 2.8% in 2016 (Rahadiana & Ho, 2017). In the Philippines, due to its healthy economy, the NPLs rate decreased from 2.4% to 1.7% in 2013 and 2016 respectively (The Global Economy, 2017).

Thailand's continuous weak operating environment and the remaining impact of high credit growth prior to 2014 raised the risks of deteriorating banks' asset quality. The country's NPLs rate of 2.9% in 2016 was relatively high compared to other ASEAN countries (The World Bank Group, 2017). By selling its NPLs to Vietnam Asset Management Company in exchange for special bonds, Vietnam succeeded to decrease its NPLs. The country's outstanding and potential NPL volume were still at high level, placing risks on the health and efficiency of its banking industry (Harrison & Marsden, 2017; The World Bank Group, 2017).

The Relationship between NPLs and CSR

Wu & Shen (2013) mentioned that there is a link between CSR and NPLs. The study showed that CSR is related to bank reputation which is revealed to have incentives to be engaged in more severe pre-loan evaluations of the borrowers. Good reputation banks could indicate borrower quality. It is revealed that borrowers have positive abnormal stock returns when there are loan announcements from good reputation banks. Hence, banks that accomplish corporate social responsibility might choose and draw more creditworthy borrowers that can provide better revenue and higher asset quality to financial organizations. The study highlights that good reputation banks are linked to better profitability through return on assets (ROA), return on equity (ROE) and creditworthiness through NPL. The results disclosed that CSR has a positive influence towards financial performance, as it is more likely for banks with more CSR to be more profitable and have less non-performing loans.

Simpson and Kohers (2002) argued that there is a positive linkage between CSR and financial performance, measured by loan losses and ROA. The study established that banks who engaged more in social activities have approximately half of the loan losses experienced by banks with less social performance. Hence, CSR is positively associated with financial performance as banks engaging more in CSR have fewer non-performing loans. Moreover, Attig, Ghoul, Guedhami, and Suh (2013) stated that there is a link between CSR and credit ratings through loan performance which is related to NPLs. The study displayed that credit rating agencies are more likely to reward high ratings to socially responsible firms. This can be related to this study between CSR and NPLs because banks are more likely to choose firms with better creditworthiness in order to minimize the level of NPLs. As firms with good social performance are more likely to experience better credit ratings, it might be more favorable to banks as it might not deteriorate their NPLs.

CSR is considered to have an influence on NPLs. Banks actively engaging in CSR activities tend to have lower NPLs which may indicate a better financial performance. According to Simpson & Kohers, (2002); Wu & Shen, (2013) CSR is negatively correlated with NPLs. Hence, the first hypothesis is proposed as follows: *H1: CSR negatively impacts NPLs of ASEAN banks*

MATERIALS AND METHODS

This paper aims to establish whether corporate social responsibility influences non-performing loans. The authors' research questions is as follows: Does CSR impact upon NPLs? This study covers a total of 10 top publically-listed banks from Indonesia, Singapore, Malaysia, Thailand, Philippines, and Vietnam that are listed as the Financial Services Authority of each country. The timeframe of the research is six years from 2011 to 2016. Some of the top banks are excluded because of data unavailability in any of the years of study.

The dependent variable is non-performing loans (NPLs) and is measured as the NPL ratio which is the standard measure that is frequently applied to assess loan portfolios' quality (Beck, Jakubik, & Anamaria, 2015).

NPL = Non performing loans / Total gross loans [1]

CSR disclosure is the independent variable which is measured using content analysis by converting the words into coding based on GRI G4 criteria illustrated in Appendix A.

The control variables in this study are *ROE*, *ownership structure*, and *size*. ROE as a proxy to measure banks' profitability provides the amount of return that a bank can earn from its equity. It displays the ability of the management to efficiently utilize its equity to maximize the bank's performance (Louzis, Vouldis, & Metaxas, 2012). The data of ROE is accumulated from a bank's individual statement. ROE = Net operating income / Average total equity [2]

Hu, Li, & Chiu (2004) proposed that banking ownership significantly influences NPLs. Banks are divided into two categories: state-owned and private-owned. Their findings showed that state-owned banks displayed lower level of NPLs. For this variable a dummy variable is used, where state-owned banks will be given a score of 1 and private-owned banks will be given a score of 0.

Salas and Saurina (2002) established that banks of a larger size seem to have fewer problem loans compared with banks of a smaller size because size allows more diversification opportunities. Size will be measured by total assets reported in the annual report of the banks. Since the total assets are reported in the local currency, the number will be converted into USD based on the average exchange rate of each country within that year from the World Bank's database.

To examine the related hypotheses the following regression model will be used:

$$NPL = \beta_0 + \beta_1 CSR + \beta_2 ROE + \beta_3 Own + \beta_4 Size + \varepsilon \quad [3]$$

Where: NPL = Non Performing Loans; CSR = Corporate Social Responsibility; ROE = Profitability; Own = Banking Ownership; Size = Firm Size; ε = Error term

FINDINGS AND DISCUSSION

Table 2 shows that CSR has a mean of 54.3 indicating that only about 54 CSR disclosures were conducted by ASEAN banks during the period of study. The means of *ROE, ownership*, and *size* show that they were normally distributed.

Table 2.
Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
NPL	360	.0000	.0900	.018516	.0131988
CSR	360	3.0	387.0	54.283	66.8241
ROE	360	-.0480	.4249	.132130	.0629092
Own	360	0	1	.12	.321
Size	360	7.5183	14.3351	10.466879	1.0797178
Valid N (listwise)	360				

Firstly, from table 3 the negative t-value of CSR indicates that CSR had a negative influence on NPLs and that is similar with previous studies of Simpson and Kohers (2002) and Wu and Shen (20130). However, CSR impact on NPL is insignificant. CSR disclosure does not have any contribution to the change in NPLs for ASEAN banks.

The outcomes from Table 3 shows that there is no influence of CSR on NPL which opposes the finding of Wu & Shen (2013) who substantiated that there is a link between CSR and NPLs. On one hand, the insignificant relationship might disclose that loan performance is not closely related to bank reputation, that is good reputation banks could signal borrower quality. On the other hand, ASEAN banks suggest that their strict loan selection and evaluation of the borrowers might be based on different criteria, such as financial gain.

The result shows that ROE significantly affects NPLs; however with a negative sign. It implies that an increase of ROE will result in decrease of NPLs. This finding is consistent with Louzis, Vouldis, and Metaxas (2012), Klein (2013),–and Chaibi (2016) who ascertain that profitability has a negative relationship with NPLs, where an increase in profitability will produce a higher performance of assets such as loans that may lead to a decrease in NPLs.

The insignificant influence of banking ownership and NPLs is confirmed by Geletta (2012) and Gunawan, Lim, Marquis, and Amal (2014) who concluded that ownership was not associated with NPLs.

Table 3. *Coefficients**

Independent Variable	Coefficients	T-Stat.	P-Value
Constant	0.042	6.019	0
CSR	-7.55E-06	-0.725	0.469
ROE	-0.033	-2.936	0.004***
Ownership	-0.002	-1.000	0.318
Size	-0.002	-2.71	0.007***
F-Stat (P-value)	4.853(0.001)		
R^2	.295[a]		

Adjusted R^2	0.09

Notes: *** indicates significant at 99% level
Dependent: NPL – Non Performing Loan
CSR - Corporate Social Responsibility: ROE - Return on Asset:

Table 3 unveils a significant but negative impact of Size and NPLs which may imply that the bigger the banks the lower their NPLs. Salas and Saurina (2002) and Hu, Li and Chiu, (2004) found a similar result which confirmed that larger size banks have more resources in evaluating loans that help to improve the loan quality.

CONCLUSIONS

This study aimed to identify whether there is any significant link between CSR disclosure and NPLs in ASEAN banking industry based on ASEAN banks operating in Indonesia, Singapore, Malaysia, Thailand, Philippines, and Vietnam from 2011 to 2016. For that purpose, other factors that may affect NPLs such as profitability, banking ownership, and firm size are included.

Derived from the research outcome, the study concludes that CSR showed insignificant influence toward NPLs in the ASEAN banking industry. There might be plausible reasons to justify that finding. First, it could mean that the implementation of CSR in ASEAN is still just at an awareness level. Second, it is also possible that many companies consider CSR merely as a charity contribution. As Campbell (2007) mentions companies are more likely to perform and disclose socially responsible activities when there are well-enforced and strong government regulations about CSR. It might be possible that bank reputation which is assumed to be related to borower selection might not be the main criteria for loan recipients.

And lastly, the ASEAN banking industry might treat CSR as a mere responsibility rather than a mandatory obligation. In Indonesia, CSR is only mandatory for limited liability companies that are directly involved with natural resources. Among ASEAN countries, Bursa Malaysia, Philippines Stock Exchange, Thailand Stock Exchange, and Ho Chi Minh City Stock Exchange require listed companies to disclose their CSR practices but the contents of disclosure still remain voluntary. Since 2014, Securities and Exchange Commission of Thailand has stated that new publically-listed companies will be subject to mandatory CSR disclosure. However, this has not been implemented yet. ~~Nguyen et al. (2015)~~ revealed that in Vietnam CSR implementation has not been legalized.

This paper also established that profitability has a significant but negative effect on NPLs. Banks with higher profitability have lower non-performing loans. High profitability, resulting from good management illustrates the ability of the management to efficiently utilize the company's equity to maximize its performance. According to Louzis, Vouldis, and Metaxas (2012), and Chaibi (2016) high efficiency, indicating better skills in credit scoring and monitoring borrowers, will lead to lower level of NPLs.

The result of this study also discloses that firm size negatively and significantly impacts on NPL. That may establish that larger-sized banks have a lower level of NPLs compared to smaller-sized banks. The insignificant impact of ownership on NPLs may suggest that NPLs are mostly related to the business side of companies.

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APPENDIX A

GRI ASPECTS

Category	Aspects
Economic	Economic Performance, Market Presence, Indirect Economic Impacts, Procurement Practices
Environmental	Materials, Energy, Water, Biodiversity, Emissions, Effluents and Waste, Products and Services, Compliance, Transport, Overall, Supplier Environmental Assessment. Environmental Grievance Mechanisms
Social: 1. Labor Practices & Decent Work	Employment, Labor / Management Relations, Occupational Health and Safety, Training and Education, Diversity and Equal Opportunity, Equal Remuneration for Women and Men, Supplier Assessment for Labor Practices, Labor Practices Grievance Mechanisms
2. Human Rights	Investment, Non-discrimination, Freedom of Association and Collective Bargaining, Child Labor, Forced or Compulsory Labor, Security Practices, Indigenous Rights, Assessment, Supplier Human Rights Assessment, Human Rights Grievance Mechanisms
3. Society	Local Communities, Anti-Corruption, Public Policy, Anti-Competitive Behavior, Compliance, Supplier Assessment for Impacts on Society, Grievance Mechanisms for Impacts on Society
4. Product Responsibility	Customer Health and Safety, Product and Service Labeling, Marketing Communications, Customer Privacy, Compliance