ITALIAN MUTUAL BANKS: CORPORATE SOCIAL AND FINANCIAL PERFORMANCE

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Abstract
        The aim of this study is to evaluate the intensity of the relationship between social and financial performance by using a sample of Italian mutual banks. The existence of this potential relation is an issue already investigated in the literature, but with ambiguous results due to the difficulty of defining a univocal social performance measure. This study provides novel evidence on this relationship by employing the canonical correlation method which allows simultaneous account to be taken of several measures for both social and financial performance. Five main dimensions are considered to measure social performance covering the principal stakeholders. The findings suggest that a positive relation exists, but only between some dimensions of both social and financial performance

Keywords: Mutual banks, social reports, corporate social performance, financial performance, canonical correlation analysis, corporate social measures

Introduction
        Although banks play a central role in the economy, there is a lack of literature on the social and environmental aspects of that role (Campbell and Slack, 2011). Nevertheless, there is increasing pressure for banks to be more socially responsible (Tilt, 1994). In this case, their reputation may improve and the relationship with stakeholders may generate potential benefits (Baldarelli and Gigli, 2011).
        Corporate Social Performance (CSP) and its relation with corporate financial performance (CFP) has been the main focus of many empirical investigations (Griffin and Mahon, 1997; Pava and Krausz, 1996; Preston and O'Bannon, 1997; Roman et al., 1999; Ullman, 1985; Wood and Jones,1995; Igalens and Gond, 2005; Fauzi, 2008), but with the exception of Soana (2011), no empirical study has focused on this concept within Italian banks, and in particular Italian Mutual Banks (IMBs).

The aim of this study is to evaluate the intensity of this relationship by using a sample of 60 IMBs. The choice of treating IMBs is determined both by their lower integration and their greater autonomy compared with other cooperative banks operating abroad (Gutiérez, 2008) and by their business model, in which proximity to customers and the mutual control performed by member clients play a crucial role (Boscia and Di Salvo, 2009; EACB, 2010). The presence of these characteristics has been the basis of IMBs' capacity to promote the stability of the financial system even in adverse conditions, such as times of crisis (Groeneveld and De Vries, 2009; Ayadi et al. , 2010).

The existence of relations between CSP and CFP is a question already investigated, but with ambiguous results due to the difficulty of defining a CSP measure. As the full spectrum of CSP is broad, finding the proxy that can reflect its full scope may be challenging (Chen and Delmas, 2010). With the exception of Andersen and Olsen (2011), most studies have attempted to find a relation by applying correlation or regression analyses in which the variables are represented by a single composite measure.

This study provides novel evidence on this relationship by employing a canonical correlation analysis (CCA) which allows simultaneous account to be taken of several measures for both CSP and CFP. Using several measures enables the analysis of many facets of CSP. The findings suggests that a positive relation exists, but only between some dimensions of both social and financial performance.

The paper is structured as follows: Section 2 reviews the main contributions in the literature; section 3 explains methodological aspects and the sample; section 4 presents the empirical results, and section 5 sets out the main conclusions.

Review of the literature

One of the first definitions of Corporate Social Responsibility (CSR) takes into account the obligations of business persons ''to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society'' (Bowen, 1953, p. 6). Since this definition was formulated, the literature has provided contradictory definitions of the concept (Davis, 1973; Eells and Walton, 1974; Carrol, 1979; Wartick and Cochran, 1985; Carrol, 1999; Wood, 2010; Mohr et al., 2001; Sims, 2003; Turker, 2009; Garriga and Melè, 2004; Holder-Webb et al., 2008; Lyon and Maxwell, 2007; Mahon and Wortick, 2012).

At the same time, the CSR literature has begun to discuss the question of how to measure CSP (Turker, 2009)). In this regard, some authors have offered broad frameworks for indicators that could be used for

this purpose. Clarkson (1995), for example, offers a list of indicators evaluating CSP starting from the stakeholder framework, and Queiroz (2007) develops a list of 50 factors divided into seven categories relative to both the firm and society. Some estimates of CSP try to measure numerical variables corresponding to the expression of some kind of impact or social output. The Kinder, Lyndenberger, Domini & Co (KLD) ratings consider, for example, a corporation's social actions along the dimensions of local community, corporate governance, diversity, employee relations, environment, human rights and product (Andersen and Olsen, 2011). Because CSP is qualitative in nature, three dimensions seem to emerge: environmental performance, community relations and labour relations. Each of them may be assessed by different measures, such as the degree of compliance with GRI; renewable energy as a share of total energy consumption; gender diversity; days of vocational training per year provided to non-management workers; philanthropy as a share of profits (Muller and Kolk, 2010). Mahoney and Roberts (2007) used measures of social performance including the following variables: community and society, corporate governance, customer, employee, environment, human rights, controversies, business activities. On analysing empirical studies, five different approaches to measurement of CSP seem to emerge (Igalens and Gond, 2005). The first approach is based on analysis of the contents of annual reports (Ullman, 1985); the second relies on pollution indices such as the Toxic Release Inventory (Griffin and Mahon; 1997); the third focuses on perceptual measurements derived from questionnaire-based surveys (O'Neil et al., 1989; Ruf et al., 1998); the fourth relies on Corporate Reputation indicators like, for example, the Corporate Reputational Index (CRI) measured by Fortune Magazine (Tichy et al., 1997; Stanwick and Stanwick, 1998), or the degree of compliance with the Community Reinvestment Act (Simpson and Kohers, 2002); finally, the last approach involves data produced by measurement organisations, such as ethical rating agencies (Brammer and Pavelin, 2006; Van De Velde et al, 2005; Soana, 2011) or the Domini Social Index 400 issued by the American financial analysis company Kinder, Lyndenberger, Domini & Co., or sustainability Indexes like the Dow Jones Sustainability World Index (DJSWI) and The Financial Times Stock Exchange4Good.

   All the methods outlined have made important contributions to research, but each of them has limitations. Several authors, in fact, have described the challenges associated with measuring CSP due to its many facets (Carroll 1999, Graves and Waddock 1994). This multi-dimensionality is the primary difficulty in measuring CSP. Some authors attempt to overcome this problem by using an aggregated measure of CSP, but it has been proved that aggregation methodologies fail to provide an effective measure of CSP (Chen and Delmas, 2010).

The diversity of the measures of CSP has generated a great deal of ambiguity in empirical studies focused on the relations between social and financial performance (Griffin and Mahon, 1997; Simpson and Kohers, 2002; Cuesta-Gonzales et al., 2006; Callado-Munoz and Utrero-Gonzales, 2009; Soana, 2011). In some empirical analyses, a positive relationship between CSP and FP seems to emerge (Blacconiere and Northcut, 1997; Freedman and Stagliano, 1991; Waddock and Graves, 1997; Stanwick and Stanwick, 1998; Preston and O'Bannon, 1997; Mahoney and Roberts, 2004; Simpson and Kohers, 2002), and in others a negative relationship is shown (Meznar et al., 1994); in yet others, there is no relation (Freedman and Jaggi, 1986; Patten, 1991).

The positive link between CSP and CFP can be explained by considering that if a firm acts in a socially irresponsible manner, its explicit cost will increase, reducing its profit (Waddock and Grave, 1997). By contrast, a negative relationship between CSP and CFP (Preston & O'Bannon, 1997) is based on neoclassical economic theory, which states that positive social performance generates a cost increase and that this can lower profit and shareholders' wealth. It is worth noting that these mixed findings may have been caused not only by different CSP measures but also by contextual circumstances like industry growth (Russo and Fouts, 1997), or different economic sector (Andersen and Olsen, 2011).

Further complications arise concerning the direction of causation. And the question on the priority may arise: that is, which one, CSP or financial performance, comes first? (Andersen and Olsen, 2011). There are two theories to answer this question: slack resource theory and good management theory (Waddock and Graves, 1997). Under the slack resource theory, financial performance comes first because good performance can create financial resources to spend on meeting social needs. In this case, the independent variable should be the CSP. Under good management theory, social performance is the independent variable since it is only through a good reputation, built thanks to social position, that financial performance can improve.

Most empirical works analysing the link between CSP and CFP are based on correlation analysis or regression analysis in which a CSP and CFP are proxied by one single measure at a time, no matter if it is a combination of multiple aspects. Given the complex construct of CSP, this may be a major limitation. In this paper the use of CCA makes it possible to remedy this limitation because several measures for both CSP and CFP are simultaneously taken into account.

Methodology and data

In attempting to evaluate the relation between CSP and CFP, multiple measures have been used, as suggested by Griffin and Mahon (1997), to capture all the numerous facets of these constructs. Following Andersen and Olsen (2011), a canonical correlation analysis (CCA) was conducted using 5 and 6 variables respectively for CFP and for CSP.

Similarly to regression, the aim of CCA is to quantify the degree of the relationships between two sets of variables; but whereas the multiple regression applies when there is a set of independent variables but only one dependent variable, CCA simultaneously predicts multiple dependent variables from multiple independent variables (Lattin et al., 2003). CCA makes it possible to explain the observed variations in one set of variables using the information in another set of variables. The aim of canonical correlation is to find pairs of linear combinations, called canonical variates, of each set of variables which are highly correlated. Each canonical variate is orthogonal to the other canonical variates except for the one with which its correlations have been maximized (Sherry and Henson, 2005). The canonical correlation coefficient measures the strength of the relationship between the two canonical variates. Each canonical variate is interpreted with canonical loadings, the correlation of the individual variables and their respective variates (Hair et al., 2009)

Corporate Social and Financial performance indicators

As stated above, it is hard to find an all-encompassing and exhaustive CSP measure (Carroll, 1999). Moreover, in Italy ethics or reputation indices do not exist, particularly for small banks like mutual banks. Following Igalens and Gond (2005), five main dimensions are considered in measuring CSP. They cover the principal stakeholders: Community and Civil Society; Corporate Governance; Clients and Suppliers; Hygiene, Safety and the Environment; and Human Resources. Each of them is proxied by the indicators shown in Table 1, which are built by harnessing the information displayed in the social reports and balances of banks.

With respect to CSP, for which there is no single best way to measure it (Wolfe and Aupperle, 1991) CFP can be most easily measured by three possible alternative approaches: 1) market-based measure (Cochran and Wood, 1984; Shane and Spicer, 1983; Preston, 1978; Simerly, 2003); 2) accounting-based measure, (Turban and Greening, 1997; Russo and Fouts, 1997) and 3) perceptual measure (Orliztky et al, 2003). The accounting-based measure is the criterion used in this paper. In particular, following the literature (Waddock and Graves, 1997; Mahoney and Roberts, 2007), ROE and ROA are used. Because risk can affect the relationship between social and financial performance (McWilliams and Siegel, 2000; Waddock and

Graves, 1997), three ratios have been added: the ratio of total equity to total assets as a proxy for solvency; bad debts to net loans to customers as a proxy for credit risk; and operating costs to operating income as a proxy for operating risk or efficiency. Table 1 shows all the afore-mention indicators.

Moreover, by targeting one industry in one country, and given their homogeneous characteristics in terms of business model, mission and ethical values, the role of variations in context has been eliminated (Treviño, 1986). Consequently, specific contexts and country factors were excluded from the analysis.

Table 1: set of indicators used to proxy the social and financial performance

Areas	Dimensions	Dimension proxy	**Micro level Indicators**	Source of data *
	Risk	Solvency	Equity/totale assets	AR
	Risk	Credit risk	Bad debts/net loans to customers	AR
Financial performance	Profitability	Profitability	ROA= Operating income/total assets	AR
	Profitability	Profitability	ROE = Net income/equity	AR
	Risk	Efficiency	Cost/income = operating costs/operating income	AR
Social performance	Clients and suppliers	Economic convenience (more favorable lending interest rate)	$-(\text{average interest rate on loans}_{i\text{-th bank}}$ - average interest rate on loans of bank sample) (1)	AR
	Humain resources	Attention to the personnel training	Training hours per employees	SR
	Community and society	Local community advantage	Economic value distributed to the community/total economic value	SR
	Corporate governance	Apical members remunerations	Directors, Auditors and manager compensation/total economic value	SR
	Community and society	Attention to the members	Donations and sponsorship/number of bank members	SR
	Environment	Environmental attention	$-(\text{energy costs/number of branches}_{i\text{-th bank}}$ – average energy costs/number of branches in the bank sample) (1)	AR

* AR stands for annual report (management report, balance sheet, income statement and notes to the financial statements) and SR stands for social report.

In Table 1, the indicators labeled 1 have been built as the difference, changing the sign, between the value of the indicator in the i-th bank in the sample and the average value of the indicator in the whole sample. In this way, the banks with interest rates or energy costs higher than those of the sample are negatively considered for the purposes of the inquiry.

Data and descriptive statistics

The analysis focused on a sample of 60 IMBs referred to 2010-2011, representing 42.1% of the total assets of IMBs. In particular, only 60 IMBs were chosen because the other banks had not posted their social reports updated to 2010 on the website. The data for the performance measurement was taken by social reports and the financial statements of banks. Two consecutive years data are needed because between CSP and CFP a one-year lag is used. The use of this time lag is consistent with Waddock and Graves (1997) in their testing and discussion of the potential relationship between CSP and firms' future financial performance.

Finally, Tables 2 and 3 respectively report the descriptive statistics and the correlations of the indicators outlined in the methodology section.

Table 2: descriptive statistics of the financial and social indicators

Variables	Obs	Mean	Min	Max
Financial performance				
Equity/totale assets	60	0.09840	0.06370	0.15239
Bad debts/net loans to customers	60	0.02175	0.00000	0.06000
ROA= Operating income/total assets	60	0.02982	0.01000	0.04000
ROE = Net income/equity	60	0.02333	-0.05000	0.08000
Cost/income = operating costs/operating income	60	0.74386	0.46000	1.04000
Social performance				
-(average interest rate on loans$_{i-th\ bank}$ - average interest rate on loans of bank sample)	60	0.0000	-0.02000	0.01000
Training hours per employees	60	40.11123	0.00000	110.9000
Economic value distributed to the community/total economic value	60	0.02895	0.00000	0.11000
Directors, Auditors and manager compensation/total economic value	60	0.04772	0.02000	0.16000
Donations and sponsorship/number of bank members	60	0.12596	0.00000	0.79000
-(energy costs/number of branches$_{i-th\ bank}$ − average energy costs/number of branches in the bank sample)	60	0.00018	-27.280	7.38000

Table 3: correlation between variables

	Equity/totale assets	Bad debts/net loans to customers	ROA= Operating income/total assets	ROE = Net income/equity	Cost/income = operating costs/operating income	-(average interest rate on loans$_{i-th\ bank}$ - average interest rate on loans of bank sample)	Training hours per employees	Economic value distributed to the community/total economic value	Directors, Auditors and manager compensation/total economic value	Donations and sponsorship/number of bank members	-(energy costs/number of branches$_{i-th\ bank}$ − average energy costs/number of branches in the bank sample))
Equity/totale assets	1										
Bad debts/net loans to customers	0.24583	1									
ROA= Operating income/total assets	0.38194	0.90972	1								
ROE = Net income/equity	-0.2113	-0.5882	0.67361	1							
Cost/income = operating costs/operating income	-0.0176	1.7444	-0.2336	-0.5425	1						
-(average interest rate on loans$_{i-th\ bank}$ - average interest rate on loans of bank sample)	0.36527	-0.4001	-0.2817	1.07847	-0.0800	1					
Training hours per employees	00:5 6	1.16944	0.67361	-0.1480	0.52986	0.08889	1				
Economic value distributed to the community/total economic value	0.861806	-0.2092	0.09514	2.46944	-0.2543	0.54375	-0.0083	1			
Directors, Auditors and manager compensation/total economic value	0.278472	1.86042	0.08333	-0.50572	3.670139	-0.3593	-0.0436	-0.0695	1		
Donations and sponsorship/number of bank members	0.336806	-0.0984	-0.00010	1.43611	-0.1835	0.22431	0.775	5.94444	-0.0773	1	
-(energy costs/number of	-0.30	0.1708	0.17847	0.30625	-0.066	-0.11	-0.2	-0.091	-0.0499	-0.1730	1

branches$_{i\text{-th bank}}$ – average energy costs/number of branches in the bank sample)	85	3			9	23	393	6			

Empirical Results

The analysis generated five functions – that is, the smaller numbers of the two variable sets – whose squared canonical correlations were respectively: .534, .308, .146, .025, .004. Canonical correlation, when squared, can be considered as the proportion of variance shared between the variable sets across all functions (Sherry and Henson, 2005). Overall, the full model across all functions was statistically significant using Wilk's $\lambda = .268$ criterion, F(30, 186) = 2.4192, p<0.001.

The full model (Functions 1 to 5) was statistically significant. Functions 2 to 5 were not statistically significant, $F(20, 156.831) = 1.4296$, so that they did not explain a statistically significant amount of shared variance between the variable sets. Given the effects for each function, only the first functions were considered. Table 4 shows that the first functions reflect the amount of variance (63.91%) explained by the corresponding canonical correlations.

Table 4: canonical correlations and eigenvalues for each functions

Functions	Canonical correlations Rc	Sq. Canonical correlations	Eigenvalue	%	cum
1	0.7304	0.533484	1.14354994	63.91%	63.91%
2	0.5547	0.307692	0.44444399	24.84%	88.75%
3	0.3825	0.146306	0.17138025	9.58%	98.33%
4	0.1587	0.025186	0.0258364	1.44%	99.77%
5	0.0638	0.00407	0.00408708	0.23%	100.00%

(1)Eigenvalue is obtained by dividing the squared correlations of each function to (1-squared correlations of each function); (2) % is the ratio between the eigenvalue for each function and the sum of eigenvalues of all functions.

At this point one may conclude that there is a noteworthy relationship between the two variables sets, i.e. CFP and CSP, by evidence of statistical significance. Moreover, this relationship is largely captured by the first functions in the canonical model.

Table 5 presents the standardized canonical function coefficients (Coeff), the structure coefficients or canonical loadings (CL), and the canonical cross loadings (CCL) for Functions 1. To be emphasised is that the CCL involves correlating each of the variables directly with the other canonical variate and vice versa.

Table 5: canonical solution for the social and financial performance relation

	Coeff.	CL	Squared CL	CCL	Squared CCL
Financial performance					
Equity/total assets	-0.315**	-0.1466	0.021492	-0.1071	0.01147
Bad debts/net loans to customers	-0.1041	0.2904	0.084332	0.2121	0.044986
ROE = net income/equity	-0.8748***	-0.8913	0.794416	-0.651	0.423801
Operating income/total assets	0.1405	-0.0427	0.001823	-0.0312	0.000973
Efficiency = operating income / operating costs	-0.2978*	-0.7064	0.499001	-0.5159	0.266153
Social performance					
Economic value distributed to the community/total economic value	-1.0365***	-0.5479	0.300194	-0.4002	0.16016
-(average interest rate on loans$_{i\text{-th bank}}$ - average interest rate on loans of bank sample) (1)	0.1171	-0.2368	0.056074	-0.1729	0.029894
Donations and sponsorship/number of bank members	0.6493**	-0.3128	0.097844	-0.2285	0.052212
Directors, Auditors and manager compensation/total economic value	0.8024***	0.7653	0.585684	0.5589	0.312369
-(energy costs/number of branches$_{i\text{-th bank}}$ – average energy costs/number of branches in the bank sample) (1)	0.1758	0.0617	0.003807	0.0451	0.002034
Training hours per employees	0.1915	0.1985	0.039402	0.145	0.021025

Canonical loadings are the correlations between each variable in a set (sets are financial performance and social performance) and the set's canonical variate. Canonical loading can be interpreted like a factor loading in evaluating the relative contribution of each variable to the canonical function (Hair, 2009). Canonical variate is a linear combination of each set of variables. Canonical cross loadings involves correlating each of the variables directly with the other canonical variate and vice-versa.

In Table 5, both the squared canonical loadings and the squared canonical cross loadings are also shown: these represent respectively the percentage of shared variance between the observed variables and the canonical variate created from the observed variable's sets and the

percentage of variance that the observed variable shares with the other canonical variate. On looking at Table 6, it is possible to observe what variables contribute to the relationship between CFP and CSP, taking into account that a larger correlation implies the greater contribution of that variable to the linear combination from that set of variables. Typically, a correlation equal to 0.30 or above is considered to be important (Haslem, et. al, 1992).

In regard to the corporate financial variables (CFP), it will be seen that the coefficients involving: 1) equity to total assets, 2) ROE, and 3) efficiency level are statistically significant, and that this conclusion is supported by the squared canonical loadings. Those variables that refer to solvency, profitability and efficiency also tend to have the larger canonical loadings and cross loadings. Moreover, all of these variables' canonical loadings have the same sign, indicating that they are all positively related.

Regarding the social performance variables sets, one observes that the dimensions of community and civil society and corporate governance are the primary contributors to the canonical variate. The canonical loadings of these variables, except for corporate governance, have the same sign, confirming that they are positively related to each other and to mainly financial performance variables. This means that the greater the attention paid to the community and civil society dimension, the greater the solvency, profitability and efficiency of mutual banks.

Corporate governance is negatively related, but this is intuitive if one considers that a greater amount of remuneration paid to directors, auditors and managers reduces the funds available to help members, clients and suppliers, and that this signals something wrong in the governance. From a different point of view, the lower the remuneration, the greater the positive impact on financial performances.

These results are not only generally supportive of the positive relationships theoretically expected between CFP and CSP but they also show that not all social dimensions are significant for IMBs. In particular, human resources, clients and suppliers and the environment seem to be neglected. Moreover, on the financial performance side, ROE is very important, together with solvency and efficiency, whereas credit risk and ROA are not critical factors.

To be stressed is that these results must be interpreted with some caution. First, the CSP measures used in the analyses are subject to the limitations inherent to the proxies used as measurements of CSP. The use of such indicators was largely due to the lack of public information disclosed on balance and social reports. Obtaining good proxies for CSP is largely dependent on the existence of relevant data within a bank. Future research using different indicators for each of the CSP dimensions may prove fruitful.

Summary and conclusions

The aim of this study has been to evaluate the intensity of the relations between social and financial performance for Italian mutual banks. The research question in itself is not original in the literature. Nevertheless, the study provides novel evidence regarding this relationship in two respects. First, it has used a canonical correlation method which allows simultaneous account to be taken of several measures both for corporate social and financial performance . Second, it has considered Italian mutual banks, on which there is a lack of literature even if their social performance should be their distinctive and central feature.

The study generally supports the presence of a positive relation with social and financial performance. More specifically it provides evidence that community and corporate governance are significant dimensions that should be investigated when analysing this relation. Other dimensions, like human resources, clients and suppliers and environment, referring to different stakeholders, seem not to be critical.

On the financial performance side, the results reported suggest that ROE, solvency and efficiency are key measures.

It is important to recognize the limitations of this study: the results reported are dependent on how well the measures operationalize the constructs of social performance. Given the problems associated with the quantitative measurement of CSP, caution is necessary in generalizing the conclusions.

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