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Antecedents of corporate social  
responsibility in the banks of  
Central-Eastern Europe and in  
the countries of the former  
Soviet union

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# **ANTECEDENTS OF CORPORATE SOCIAL RESPONSIBILITY IN THE BANKS OF CENTRAL-EASTERN EUROPE AND IN THE COUNTRIES OF THE FORMER SOVIET UNION<sup>1</sup>**

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## **ABSTRACT**

This article explores the determinants of corporate social responsibilities (CSR) in the banking sector of the transition countries of Central and Eastern Europe (CEE), as well as those of the former Soviet Union (FSU). Our panel fixed-logit results for 237 banks, covering the period 2000–2012, show that while financial performance is not associated with CSR, larger banks are more likely to engage in CSR. Additionally, a government's effectiveness and its regulatory quality increase the likelihood that the banks will engage in social activities. A range of possible approaches that governments can take to encourage social activities in the banking sector of transition countries are provided. Overall, our results are consistent with the theory that the necessary conditions must be in place to support CSR, which seem to be absent in the countries under investigation.

**Keywords:** Banks, corporate social responsibility, performance, transition economies.

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**JEL Classification:** P20, M14, G21

## 1. INTRODUCTION

Following the development in international trade and the advent of globalization, enterprises have been conducting their businesses more responsibly over the last three decades. To meet rising demands from various stakeholders, firms are integrating social and environmental issues into their business strategies and operations to a greater extent (Jamali and Mirshak 2007; Yin and Zhang 2012). However, the significant scholarly attention to CSR focuses mainly on North American and Western European advanced and developing countries; there is limited knowledge of the social-environmental perceptions and activities in the former socialist countries of CEE and the FSU. As the practices of engaging in CSR depend on elements of institutions and legal norms, the CSR theories developed in the context of advanced and developing countries have limited their utility for the former socialist countries of CEE and the FSU. Moreover, combinations of state policies, macroeconomic situations, industrial norms, institutions, civil organizations and community groups result in different perceptions of CSR and different strategic choices (Campbell 2007; Yin and Zhang 2012).

Although the concept of CSR is popular, it has no single, universally adopted definition. However, all existing definitions share in common the belief that firms are responsible for public goods. In particular, CSR addresses the activities that corporate executives need to undertake in order to balance the interests of all stakeholders – namely, the shareholders, employees, customers and suppliers, as well as the community and the society in which they operate (Thompson et al. 2013). While achieving their corporate goals, businesses will use societal resources and, thus, have an impact on the environment.

The dominant research within the CSR perspective mainly focuses on developed countries, where resources are abundant and institutions are well-developed; it also explores the relationship between the availability of financial resources and CSR. The majority of

these studies suggest that the availability of financial resources improves a companies' involvement in CSR (Gamerschlag, Möller, and Verbeeten 2011; Waddock and Graves 1997). However, a recently emerging research stream has extended this by considering an institutional difference hypothesis (IDH), and suggests that more profitable companies are less likely to engage in CSR under conditions where capital resources are limited, and also where the level of corruption is high (Julian and Ofori-dankwa 2013).

The countries under investigation, particularly those of the FSU, are different from other countries and there is no study which extensively explores CSR and its driving forces in these countries. Thus, the aim of this article is to investigate the antecedents of CSR in the banks of CEE and in the countries of the FSU.

The structure of the article is as follows: we begin by reviewing the theory and the relevant existing studies. The subsequent section generates the hypotheses and is followed by a section describing the data and the methodology. The article closes with a discussion of the results and draws various conclusions.

## **2. THEORY**

Over the last three decades, scholars have explored various CSR theories (Cochran and Wood 1984; Frooman 1997; McGuire, Sundgren, and Schneeweis 1988; Roman, Hayibor, and Agle 1999; Simpson and Kohers 2002; Waddock and Graves 1997). One may observe that scholars have often linked CSR with theories such as agency, stakeholders, legitimacy, stewardship, the resources-based view, slack resources, an institutional approach (Branco and Rodrigues 2006; Campbell 2007; Hill and Jones 1992; McWilliams and Siegel 2000; Seifert, Morris, and Bartkus 2004; Yin and Zhang 2012), and political cost (Gamerschlag, Möller, and Verbeeten 2011). *Agency theory* states that CSR is a misuse of corporate resources that would be better utilized in financing valued-added internal projects or returned to shareholders; it is

thus seen as a procedure whereby the firm's earnings are taken away from their rightful owners (McWilliams, Siegel, and Wright 2006). Freeman's *stakeholder theory*, which runs contrary to agency theory, implies that managers of firms must satisfy various elements, such as workers, customers, suppliers and the local community (Freeman 2010). This suggests that focusing only on the stockholders and owners of firms is not sufficient, and that managers could benefit more from engaging in CSR activities which non-financial stakeholders perceive as important (T. Donaldson and Preston 1995; McWilliams, Siegel, and Wright 2006). Additionally, *legitimacy theory* explicitly recognizes that firms are bound by the social contract according to which they agree to engage in social activities and that this guarantees their sustainable existence (Brown and Deegan 1998; Deegan 2002; Reverte 2009). Moreover, the *stewardship theory* views managers as being responsible for engaging in social activities, without regarding the impact of such activities on the firm's financial performances (L. Donaldson and Davis 1991). Another perspective views companies' CSR activities via the lens of the resources-based view, and presumes companies to be bundles of heterogeneous resources and capabilities with imperfect mobility from one company to another (Barney 1991; Wernerfelt 1984). Thus, the resource-based view implies that valuable, rare, inimitable and non-substitutable resources and capabilities, including CSR activities, can lead firms to achieve a sustained competitive advantage (Barney 1991; Julian and Ofori-dankwa 2013; McWilliams, Siegel, and Wright 2006).

Additionally, the theory of *slack resources* focuses on the availability of slack resources and their impact on CSR – particularly, on philanthropic donations by firms. The results of the relevant studies imply that firms with comparatively more slack resources (cash flow/sales) donate relatively more (Seifert, Morris, and Bartkus 2004). *Institutional CSR theory* considers the impact of institutional-economic conditions, and their effect on a firm's CSR activities (Campbell 2007; Jones 1995). In particular, this theory specifies the conditions

under which firms are likely to engage in CSR. It argues that the relationship between basic economic conditions and a firm's behaviour is mediated by institutional conditions, such as public–private regulations, and the presence of NGOs and independent organizations monitoring institutionalized norms on a firm's behaviour (Campbell 2007). The theory of *political cost*, on the other hand, states that managers are concerned with political considerations, implying that they engage in CSR to prevent explicit and implicit taxes, and other regulatory actions (Gamerschlag, Möller, and Verbeeten 2011).

Throughout the theoretical perspectives discussed so far, the research themes considering CSR can be broadly divided in two groups. Particularly, the first investigates the various impacts of a firms' CSR such as on financial performance (Brammer and Millington 2008; Jayachandran, Kalaignanam, and Eilert 2013), access to finance (Cheng, Ioannou, and Serafeim 2014), on stakeholder value maximization (Deng, Kang, and Low 2013), on the costs of bank loans (Goss and Roberts 2011), and on national competitiveness (Boulouta and Pitelis 2014). However, the second explores antecedents and the driving forces of CSR disclosure and CSR expenditures (Chih, Chih, and Chen 2010; Farook, Kabir Hassan, and Lanis 2011; Gamerschlag, Möller, and Verbeeten 2011). Our focus will be on the second group addressing the antecedents of CSR, which has so far been relatively less explored (Chih, Chih, and Chen 2010; Julian and Ofori-dankwa 2013). Moreover, the results will help policy-makers of the target countries to build strategies to encourage social and environmental activities.

### **3. HYPOTHESES**

The conditions in transition countries are significantly different from those of developed and developing countries; this article contributes to the research area by providing new evidence on the link between CSR and its determinants. In particular, we discuss the institutional

conditions in the transition countries, which are distinctly different from those of developed and developing countries.

As the monitoring of environmental and social activities by NGOs is poorly developed, banks are not put under significant pressure by them to engage in social and environmental activities. Where the business environment is not well-developed, markets do not reward banks engaged in social and environmental activities. Thus, environmental and social activities do not provide competitive advantages for banks; neither do they improve their image. Since more profitable banks have comparatively more resources to spend through their retained earnings, we argue that the profitability of banks is not associated with their social and environmental activities in the banking sectors of the target countries.

***Hypothesis 1: Profitability is not associated with CSR disclosure.***

The governments of transition countries are comparatively interested in environmental and social activities. They are new market economies and the majority of the FSU countries are still in a transition process from a planned to a market economy. Therefore, these governments are facing constrained economic circumstances, using their resources mainly for the alleviation of poverty, economic reforms and job creation. Additionally, the governments are still privatizing state-owned enterprises and are very much in need of foreign direct investment. Since the majority of investments in these countries flow from the West and are quite sensitive to environmental and social issues, the governments of transition countries attempt to motivate businesses to engage in CSR by imposing political pressure and/or by providing incentives (e.g. government loans at lower than market rates, tax incentives and a licence to operate). Since larger businesses are more visible to governments, we argue that larger banks are more likely to engage in CSR to prevent political costs (political pressure), to explore the advantage of government loans and to secure the licence to operate. Moreover, larger banks have higher scale of operations, which places them in a better position to

implement CSR activities more successfully. On the other hand, larger banks are more powerful in their resistance to pressure from the outside (Udayasankar 2008). Therefore, it is worthwhile investigating the relationship between bank size and CSR disclosure, considering the unique environmental conditions of transition countries. Further extending the impact of size on CSR, some studies suggest the impact to be non-linear (Amato and Amato 2007; Udayasankar 2008). Particularly, they state that small and large firms are relatively more engaged in CSR (compared with medium-size firms) if the results of a cubic function follow a plus-minus-plus (linear, squared and cubed firm size) pattern (Amato and Amato 2007). They argue that a cubic specification allows social and environmental activities to rise with firm size up to an initial threshold, decrease with medium-size firms and increase at the upper end of the firm size distribution, suggesting the link between size and CSR to follow a plus-minus-plus pattern (Amato and Amato 2007). Small firms have relatively more resource constraints and the main strategic motive to engage in CSR activities is to improve their image in communities neighbouring those in which they operate and thus improve their access to resources. Scholars suggest that medium-size firms are the least motivated to engage in social and environmental activities, as they have relatively better access to resources compared with that of small firms. However, the relevant studies consider advanced economies, where markets and environment reward small firms' social and environmental activities. Thus, we argue that the link between size and CSR is best described by a cubic function following the existing studies.

***Hypothesis 2: The link between size and CSR is best described by a cubic function.***

The transition countries, mostly those of the FSU, have inherited the Soviet style of social and environmental activities; for example, *subbotnik* days. The tradition of '*subbotnik*' days (from Russian 'Saturday days') are days of volunteering work (following the October Revolution in 1917) is continued in some FSU and CEE countries. They are usually initiated

by governments and organized for cleaning the streets of garbage, fixing public amenities, collecting recyclable material, and other community services. These *subbotnik* days mostly take place before national holidays in these countries. We can, therefore, argue that government policy in transition countries has an impact on CSR.

***Hypothesis 3: Government policy impacts on CSR disclosure.***

Although the majority of transition countries do not have explicit CSR regulations and legislation in place, the EU parliament has adopted various requirements regarding disclosing CSR activities in 2005, 2006, 2013 and 2014. Therefore, we can argue that these regulations have had an impact on CSR activities and their disclosure in CEE and, subsequently, in the FSU transition countries. Moreover, under these conditions, where the institutional, political, business and legal infrastructure is comparatively less well-developed, the banks have attempted to build legitimacy with governments to avoid political costs (Marquis and Qian, 2013).

***Hypothesis 4: Regulatory quality impacts on CSR disclosure.***

## **4. DATA AND METHODS**

Our sample includes 237 banks from 14 transition countries of the FSU and CEE. Our banking data is taken from Bankscope and is unbalanced, as it has included only those commercial banks whose financial statements are available for at least three years over the period 2000–2012. All of the banks' relevant data are shown in a common currency (US dollars). The governance indicators and the competition variable (Boone indicator) are taken from the World Governance Indicators by (Kaufmann, Kraay, and Mastruzzi 2011) and the World Bank's Global Financial Development database. The statistics for inflation are from the World Banks' World Development Indicators (2013). The CSR data are collected from the banks' websites.

## 4.1 MEASURES

### ***Dependent variable (Corporate Social Responsibility)***

The data available on CSR for transition economies is limited. Additionally, the bank reports were published using various formats, which made it difficult to count the numbers of keywords used in reports (either manually, or by using content analyses software). Moreover, considering that the aim is to investigate what improves the probability of CSR disclosure, we chose use a binary variable, where CSR takes the value of ‘1’ if a bank publishes CSR reports (or uses CSR relevant keywords in annual reports) and ‘0’ when it does not. Following the study by Gamerschlag, Möller, and Verbeeten (2011), we searched for the keywords from the framework of the Global Reporting Initiative (GRI), referring to it as the global standard. In addition to the environmental and social keywords derived by Gamerschlag, Möller, and Verbeeten (2011) from the GRI (Table 1), we searched for two philanthropic keywords: ‘sponsorship’ and ‘charity’.

Table 1 Keywords of the GRI framework

Environmental	Social
Recycled; energy consumption; biodiversity; emissions; effluents; waste; spills; environmental impacts.	Employment; employee turnover; collective bargaining; collective agreements; occupational health; occupational safety; training; diversity; equal opportunities; human rights; discrimination; freedom of association; child labour; forced labour; compulsory labour; community; corruption; public policy; compliance; fines; sanctions; product responsibility; customer health; customer safety.

*Source:* Gamerschlag et al. (2011). *Note:* We used singular and plural forms of the keywords, as well as British and American English spellings.

***Independent variables:*** Following the existing studies, we elected to use *return on assets* (ROA) and *return on equity* (ROE) to proxy banking performances. We utilized the pre-tax profit to calculate the ROA in order to avoid the effects from differing cross-country tax policies. *Size* is the natural logarithm of a bank’s total assets. There are several approaches to proxy banking competition. We chose to use the *Boone indicator*, taken from the World

Bank's Global Financial Development database. The advantage of the Boone indicator, compared with the H-statistic suggested by (Panzar and Rosse 1987), is that it focuses on a single sub-market, while the H-statistic considers the entire market (Van Leuvensteijn et al. 2011). Thus, we concluded that the Boone indicator would be more suitable, as the banking sectors of transition countries still generate the majority of their income from traditional banking operations. To control for risk, we used *credit risk*, which is calculated as loans divided by total deposits.

Another group of CSR determinants are governance indicators. Although many governance indicators have recently been discussed by policy-makers and researchers, there is no single definition of them. Over the last two decades, the World Bank has been publishing various governance indicators, some of which very narrowly focus on whether existing policy regulations are enforced ('narrow' definition), while the remainder consider the fairness of the content of regulations ('broad' definition). We used governance indicators from the World Bank (Kaufmann, Kraay, and Mastruzzi 2011), which navigate between the broad and narrow definitions of governance. Using various data sources, they construct indicators capturing the specific aspects of governance; we used two governance indicators relevant to the study. The scores of each indicator range from -2.5 to +2.5, with higher values corresponding to better governance. The first indicator is Government Effectiveness, focusing on the perceptions of the quality of public services, civil services (including their independence from political pressures) and policy formulation and its implementation. The second indicator, Regulatory Quality, considers the perceptions of the ability of governments to formulate and implement sound policies and regulations to promote private sector development.

Table 2 Variables, definitions and sources

Variable name	Definition	Data source
CSR (dependent)	Binary taking 1 if a bank publishes CSR reports or uses GRI keywords in its annual reports, 0 when it does not.	Bank websites
Bank variables		
ROA	Pre-tax profit divided by Total Assets	Authors' calculations
ROE	Pre-tax profit divided by Total Equity	Authors' calculations
Size	Natural logarithm of total assets	Authors' calculations
Credit risk	Loans divided by total deposits	Authors' calculations
Competition and governance		
Boone Indicator	A variable to account for competition	World Bank's Global Financial Development database
Government Effectiveness	Focusing on the perceptions of the quality of public services, civil services (including their independence from political pressures), policy formulation and its implementation	(Kaufmann et al., 2011)
Regulatory Quality	Considers the perceptions of the ability of governments to formulate and implement sound policies and regulations to promote private sector development	
Control variables		
Inflation	Annual changes in Consumer Price Index (CPI)	World Development Indicators (World Bank, 2014).
GDP growth	Annual changes in GDP (%)	
Crisis	Dummy variable for 2007–2010	Authors' calculations

To control for macroeconomic effects, cross-country heterogeneity and the effects of the recent global crisis (2007–2010), we used *inflation* (annual changes in the CPI), *GDP growth* (annual growth of GDP) and *Crisis* dummy variables. Table 2 summarizes all the variables and their sources.

## 4.2 ECONOMETRIC MODEL

Often, panel models are divided into two groups, where one group treats the unobserved firm-specific effects (fixed effects), while the other does not (random effects). Considering the feature of our dependent variable (binary), cross-country heterogeneity and the theories discussed, we chose to use a dynamic panel fixed effects logit model of the following general form:

$$P(y_{it} = 1 | y_{i,t-1}, \dots, y_{i0}, z_i, c_i) = G(z_{it} \delta + \rho y_{i,t-1} + c_i) \quad (1)$$

where our observation starts at  $t = 0$ , so that  $y_{i0}$  is the first observation on  $y$ ,  $z_{it}$  is a vector of contemporaneous explanatory variables,  $z_i = (z_{i1}, \dots, z_{iT})$ , and  $G$  is the logit function. There are some points in this model we wish to highlight. Firstly,  $z_{it}$  are assumed to satisfy a strict

exogeneity assumption conditional on  $c_i$  (unobserved effects). Secondly, the probability of success at time  $t$  ( $\text{CSR}_t = 1$ ) is allowed to depend on the outcome in  $t-1$  as well as unobserved heterogeneity ( $c_i$ ). Our particular interest is to test the hypothesis  $H_0: \rho = 0$ , which is whether there is *state dependence* ( $\rho \neq 0$ ) after controlling for the unobserved heterogeneity ( $c_i$ ). Thus, the advantages of this approach are that it controls for unobserved heterogeneity and it investigates whether the outcome in  $t$  is dependent on the outcome in  $t-1$ , which may produce relevant policy implications.

## 5. RESULTS

Table 3 presents the mean, the standard deviation and the correlation matrix of the variables. The table shows that there is a strong correlation between Government Effectiveness and Regulatory Quality. Therefore, we chose to include only one governance indicator at a time.

To assess the robustness of our findings we:

- replaced ROA with ROE in models 5–8;
- substituted Government Effectiveness and Regulatory Quality with their principal component in models 4 and 8 (combining Government Effectiveness and Regulatory Quality, we generate a variable of Principal Component using the principal component technique);
- included Government Effectiveness<sup>2</sup>, Regulatory Quality<sup>2</sup> and Principal Component<sup>2</sup>, as scholars state that many relationships in strategic management follow a U-shaped pattern, implying that too much can be as bad as too little (Haans, Pieters, and He 2015).

Table 3 Descriptive statistics and correlations

Variable	Observations	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1. CSR	2142	0.433	0.496															
2. ROA	2070	0.011	0.058	-0.044**														
3. ROE	2065	0.045	2.297	-0.024	0.204***													
4. Size*	2078	1.20e-07	1.992	0.321***	-0.016	0.044**												
5. Size <sup>2</sup> *	2078	3.965	5.483	0.033	-0.027	-0.030	-0.052**											
6. Size <sup>3</sup> *	2078	25.106	38.577	0.187***	-0.009	-0.001	0.548***	0.430***										
7. Credit risk	2095	1.551	28.887	-0.017	-0.038*	-0.004	-0.022	-0.001	-0.006									
8. Boone indicator	1941	-0.065	0.161	0.127***	-0.052**	-0.022	-0.123***	0.052**	-0.104***	-0.001								
9. Inflation	2130	9.242	13.773	-0.023	0.038*	0.010	-0.127***	-0.059***	-0.121***	-0.012	0.529***							
10. GDP growth	2130	5.482	6.652	-0.108***	0.152***	0.042*	-0.216***	-0.027	-0.107***	-0.012	-0.125***	0.075***						
11. Government Effectiveness	2048	0.031	0.708	0.194***	-0.078***	0.007	0.436***	0.048**	0.255	0.020	-0.265***	-0.419***	-0.286***					
12. Regulatory Quality	2048	0.256	0.836	0.188***	-0.072***	0.010	0.407***	0.031	0.237***	0.021	-0.353***	-0.481***	-0.279***	0.964***				
13. Principal Component <sup>a</sup>	2048	0.000	1.401	0.193***	-0.075***	0.008	0.425***	0.040*	0.248***	0.021	-0.312***	-0.454***	-0.285***	0.991***	0.991***			
14. Government Effectiveness <sup>2</sup>	2048	0.502	0.326	0.071***	0.039*	0.029	0.006	0.14***	0.097	-0.002	0.442***	0.155***	-0.051**	-0.039*	-0.131***	-0.086***		
15. Regulatory Quality <sup>2</sup>	2048	0.764	0.643	0.101***	0.002	0.025	0.147***	0.129***	0.150***	0.008	0.426***	0.122***	-0.156***	0.336***	0.159***	0.249***	0.679***	
16. Principal Component <sup>2</sup>	2048	1.963	1.525	0.010	0.048**	0.023	-0.088***	0.124***	0.026	-0.005	0.588***	0.333***	0.007	-0.241***	-0.392***	-0.320***	0.884***	0.787***

Notes:

<sup>a</sup>Principal component of Government Effectiveness and Regulatory Quality.

\*The values are statistically significant at 10 per cent, \*\*the values are statistically significant at 5 per cent, \*\*\* the values are statistically significant at 1 per cent.

There is a strong correlation among *Size*, *Size*<sup>2</sup> and *Size*<sup>3</sup> and therefore, to minimize the correlation, we used *Size\** subtracting an arithmetic mean from *Size*.

Adding Government Effectiveness<sup>2</sup>, Regulatory Quality<sup>2</sup> and Principal Component<sup>2</sup> will help us to gain deeper insights into the conventional wisdom that too much of a good thing can be harmful to financial performance and help us identify whether these variables have U-shaped relationships with CSR. Table 3 shows that these variables do not have strong correlations with Government Effectiveness, Regulatory Quality and Principal Component. Moreover, the results in Table 4 are very similar, suggesting that our estimates are stable across the models.

The results in Table 4 indicate that  $CSR_{t-1}$  is significant across all the models, with a positive sign implying the presence of *state dependence*, so we reject the null hypothesis ( $H_0: \rho = 0$ ) stating that  $CSR_t$  is not dependent on  $CSR_{t-1}$ . Thus, the banks engaged in CSR in time  $t-1$  are more likely to engage in CSR in time  $t$ , too.

Our profitability variables ROA and ROE are not significant in all models, implying that profitability is not associated with CSR. Thus, we fail to reject Hypothesis 1, which states that the profitability is not associated with CSR disclosure in the banking sectors of transition countries. Although the majority of studies suggest the presence of a strong link between profitability and CSR (Gamerschlag, Möller, and Verbeeten 2011; Julian and Ofori-dankwa 2013), our results are consistent with a small number of empirical studies which show the absence of such a link (Reverte 2009).

Although  $Size$  is not significant,  $Size^2$  and  $Size^3$  are significant across all the models with negative and positive signs respectively, implying that larger banks are more likely to engage in CSR relative to medium-size banks in the banking sector of the transition countries. Thus, we support Hypothesis 2, which states that the size impact on CSR is best described with a cubic function. Although inconsistent with small banks, our results for medium-size and large banks are consistent with the results from the relevant studies (Amato and Amato 2007; Chan, Watson, and Woodliff 2014; Gamerschlag, Möller, and Verbeeten 2011; Reverte 2009; Udayasankar 2008). Additionally, Table 4 results show that Government

Table 4 Estimates from the logistic regression of bank CSR report probability, 2000–2012

Variable	Panel Fixed Effects Logit Models (ROA)				Panel Fixed Effects Logit Models (ROE)			
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8
CSR <sub>t-1</sub>	1.196 (0.418)***	1.098 (0.464)**	1.032 (0.399)**	1.089 (0.411)***	1.201 (0.331)***	1.099 (0.373)***	1.032 (0.329)***	1.089 (0.323)***
Credit risk	0.255 (0.412)	0.377 (0.709)	0.317 (0.403)	0.354 (0.464)	0.240 (0.355)	0.373 (0.738)	0.319 (0.401)	0.354 (0.396)
Boone indicator	1.943 (1.621)	2.288 (1.351)*	1.605 (1.554)	2.251 (2.142)	1.968 (1.403)	2.294 (1.499)	1.592 (1.358)	2.245 (1.918)
Inflation	-0.040 (0.023)*	-0.031 (0.022)	-0.039 (0.020)**	-0.033 (0.024)	-0.041 (0.023)*	-0.031 (0.023)	-0.040 (0.024)	-0.034 (0.025)
GDP growth	0.003 (0.021)	-0.001 (0.020)	-0.005 (0.015)	-0.003 (0.015)	0.002 (0.016)	-0.001 (0.013)	-0.005 (0.019)	-0.003 (0.016)
Crisis (2007–2010)	-0.484 (0.357)	-0.421 (0.319)	-0.914 (0.386)**	-0.676 (0.329)**	-0.487 (0.347)	-0.422 (0.388)	-0.921 (0.379)**	-0.679 (0.329)**
ROA <sub>t</sub>	-1.456 (2.868)	-1.062 (5.228)	-0.993 (4.429)	-1.025 (3.982)				
ROE <sub>t</sub>					-0.047 (0.271)	-0.068 (0.303)	-0.088 (0.559)	-0.086 (0.794)
Size*	1.306 (0.710)*	0.740 (0.647)	0.580 (0.674)	0.509 (0.791)	1.307 (0.657)**	0.739 (0.694)	0.578 (0.632)	0.506 (0.855)
Size <sup>2</sup> *	-1.371 (0.456)***	-1.655 (0.484)***	-1.534 (0.435)***	-1.636 (0.508)***	-1.374 (0.455)***	-1.658 (0.597)***	-1.536 (0.487)***	-1.638 (0.539)***
Size <sup>3</sup> *	0.270 (0.077)***	0.314 (0.082)***	0.316 (0.071)***	0.323 (0.092)***	0.270 (0.078)***	0.315 (0.103)***	0.316 (0.092)***	0.324 (0.087)***
Government Effectiveness		4.078 (2.188)*				4.085 (1.763)**		
Government Effectiveness <sup>2</sup>		-1.330 (1.588)				-1.338 (1.789)		
Regulatory Quality			5.037 (1.979)**				5.051 (1.978)**	
Regulatory Quality <sup>2</sup>			-0.537 (1.625)				-0.539 (1.655)	
Principal Component*				2.791 (1.584)*				2.793 (1.823)
Principal Component <sup>2</sup> *				-0.540 (0.801)				-0.542 (0.680)
Number of observations	614	549	549	549	614	549	549	549
Log likelihood	-127.01	-113.65	-113.05	-111.42	-127.10	-113.66	-113.06	-111.43
Wald $\chi^2$	62.34 (10)***	64.65 (12)***	168.47 (12)***	50.37 (12)***	109.22 (10)***	101.95 (12)***	83.52 (12)***	57.52 (12)***

Notes: Heteroskedasticity-robust (bootstrap) standard errors are in parentheses.

\*The values are statistically significant at 10 per cent, \*\*the values are statistically significant at 5 per cent, \*\*\* the values are statistically significant at 1 per cent.

There is a strong correlation among Size, Size<sup>2</sup> and Size<sup>3</sup> and therefore, to minimize the correlation, we used Size\* subtracting an arithmetic mean from Size.

Effectiveness and Regulatory Quality are statistically significant with positive signs in all models, implying that government policy as well as the regulatory quality increases the likelihood of banks engaging in CSR in transition countries. Thus, we fail to reject Hypotheses 3 and 4 which, respectively, state that government policy and regulatory quality impact on CSR.

Moreover, our results also indicate that our control variables *credit risk*, *Boone indicator*, *inflation*, *GDP growth* and *Crisis* are not statistically significant across all the models. Additionally, they show the absence of U-shaped links between CSR and governance indicators.

## 6. DISCUSSION

Empirical studies investigating the driving forces of CSR focus mainly on developed countries (Brammer and Millington 2008; Gamerschlag, Möller, and Verbeeten 2011; Reverte 2009); only a small number of studies address the driving forces of CSR in developing countries (Hu and Scholtens 2014; Julian and Ofori-dankwa 2013). To explain the relationship between CSR and the availability of financial resources, the majority of these studies only consider the theory of *slack resources*, and the research investigating this link by mixing the theories of *slack resources* and *institutions* is still limited (Chih, Chih, and Chen 2010; Ducassy, Montandrou, and others 2015; Julian and Ofori-dankwa 2013).

To fill this gap, we chose to investigate the factors affecting CSR by mixing the theory of *slack resources* and IDH for transition countries, which have unique business conditions that differ from those of developed and developing countries. We argue that the driving forces of CSR vary significantly under different business and institutional conditions. Transition countries are relatively new market economies, which started their transition from a planned to a market economy nearly 25 years ago (1989-1990 in CEE, 1992 in FSU).

Although the CEE transition countries that are now EU members completed their transition processes relatively swiftly, their business environment and conditions still suffer from considerable business obstacles. The businesses of almost all CEE and FSU transition countries experience significant constraints by having *limited access to finance*. Moreover, the presence of the *practices of the informal sectors* is quite significant, providing unfair competition among businesses. In a business environment with such major business constraints, markets do not reward banks engaging in CSR. Moreover, the legislation and regulations addressing CSR are absent in the FSU countries. Although the EU has regulations in place addressing CSR, they have limited focus on the banking sectors. Therefore, we argue that the profitability of banks is not associated with CSR, as the constrained business environment does not improve the image or reputation of banks; neither does it provide any competitive advantage for them. Considering the theory of *slack resources* and IDH, our results suggest that in transition countries there is no link between bank profitability and CSR which is in support of Hypothesis 1.

Following the existing studies, we argue that the link between size and CSR is best described with a cubic function. Our results indicate that the larger banks are more likely to engage in environmental and social activities. However, medium-size banks are less motivated to conduct social and environmental activities. Although our results for small banks are not statistically significant, we support Hypothesis 2 considering the results for medium-size and large banks. Moreover, the governments in transition countries play an important role, in that they impose directives for public and private organizations to engage actively in CSR. In particular, the governments have inherited a unique style of Soviet governance, which includes the *subbotnik*. Thus, we argue that government policy in transition countries has had an impact on CSR. Where governments are mostly concerned with the alleviation of poverty, economic development and job creation (because of limited

financial resources), as well as where institutions and NGOs are still weak, government policies such as the *subbotnik* is a relatively efficient way to improve CSR in transition countries. Additionally, governments in these countries attempt to attract more foreign direct investment using CSR as a signalling device (Goyal 2006), and thus encourage local firms to engage in social activities. Therefore, we argue that government policies and the quality of their regulation have had an impact on CSR in Hypotheses 3 and 4. Our results suggest that government policies and their level of regulation have improved the likelihood of banks engaging in environmental and social activities, which supports Hypotheses 3 and 4, respectively. Moreover, this supports the view that it is critical for the banks to build legitimacy with governments, and respond to their requirements, as well as responding to signals that accordingly consider the comparatively less developed institutional, political and legal infrastructure in transition countries (Marquis and Qian 2013).

In conclusion, the results of this study suggest that the driving forces of CSR vary under different institutional contexts. Our article makes several contributions to existing theory and research. Firstly, by capturing the main characteristics of institutions and the business environment of the transition countries, we have challenged the existing theories supporting the presence of a positive link between profitability and CSR (Frooman 1997; Gamerschlag, Möller, and Verbeeten 2011; Griffin and Mahon 1997; Hu and Scholtens 2014; Simpson and Kohers 2002; Waddock and Graves 1997) or a negative link between profitability and CSR (Alexander and Buchholz 1978; Aupperle, Carroll, and Hatfield 1985; Julian and Ofori-dankwa 2013; Moskowitz 1972). This is consistent with recent studies showing that the ‘implicit’ form of CSR is dominant in Eastern European countries and the FSU (Matten and Moon 2008). However, as the institutions and NGOs develop a more European style of state-oriented ‘implicit’ CSR, they will also move towards an American style of an ‘explicit’ form of CSR in European as well as transition countries (Matten and

Moon 2008). Secondly, we investigated the impact of government policies and their regulatory quality on CSR by considering that a unique governance style is present in transition countries. This is the first work considering the majority of the FSU transition countries, and using dynamic panel logit fixed effects controlling for unobserved bank-specific features, and producing heteroscedasticity-robust (bootstrap) standard errors.

There is a range of possible approaches that we propose that the governments of transition countries could use to encourage banks engaging in social activities:

- They could stimulate the demand for CSR information, and encourage the banks to report their social activities through improving the relevant legislation;
- They could improve competition in the financial sector by attracting foreign investors (Luo et al. 2015), particularly from the West where social activities are popular, as well as by developing securities markets;
- They could sustain political and economic stability as well as improve the legal environment, which would directly and indirectly enhance government effectiveness and its regulatory quality.

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