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## CSR AND FINANCIAL PERFORMANCE : EVIDENCE FROM PAKISTANI BANKS

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### **Abstract**

*This research intends to explore the relation between the practices of Corporate Social Responsibility (CSR) and the financial performance of Banks using the measures of ROA and ROE. This research would help to improve the knowledge of managerial practices. The current study used Pakistan's banking industry as the empirical setting. The methodology of the study was based on the creation of a 34-item scale CSR Disclosure Index, to measure CSR and then regression results were applied to the models. The study concluded that all Banks in Pakistan view CSR practices as a strategic activity and they are included in the annual reports of banks. Also, public banks in Pakistan executed more CSR activities than private banks. Though there was strong positive association between CSR and ROA, there was only moderate positive association between CSR and ROE. Overall, Banks that implemented CSR practices tended to increase their profitability.*

**Keywords:** *Corporate Social Responsibility, Financial Performance, ROA, ROE, Pakistan, Banking Industry*

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## 1. Introduction

In recent years, many students of management direct their attention towards the paradigm of Corporate Social Responsibility (CSR), through the studies of Ethics, Corporate Citizenship etc. The term CSR is used in all the concepts of social enterprise, corporate responsibility, social responsibility, sustainable development, corporate citizenship, ethics and governance or triple bottom line (**Bassen et al., 2006**). Majority of definitions are based on social, economic and environmental facets, called the triple bottom line. The triple bottom line encourages the notion that corporations do not rely only on the objective of increasing profit and instead they are also responsible to add social and environmental value to the society (**Mirfazli, 2008; Sebastian, B. et al., 2018**). According to **Harpareet (2009)**, CSR can use both social and environmental factors for the decision making practice. Hence CSR is included into the decision making practices of corporates and make the triple bottom line of Profit, People and Planet. Each company implements the activities of CSR differently if they were in to implement it. The difference in implementation depends on various factors, such as the size of company, the involvement of certain industry, the professional culture of corporates, demands of stakeholders and the historical progression of company regarding CSR engagement. Some organization integrates CSR to one area only, the area they considered the most important one or the one having high vulnerability of impact such as human rights or environment, while others intend to integrate CSR to all facets of operations. The principles of CSR should be part of values and strategic planning of corporates for their successful implementation. Moreover, the employees and management should be committed to CSR practices. Also, the particular objectives of corporations as well as core

competencies should align CSR strategy with them for proper operations. **Blowfield & Frynas (2005)** called for a necessary and critical research, on the agenda of CSR in developing countries. Moreover, the limited publications on CSR, in developing countries mostly shed the light on ethical, philanthropic and governance concerns (**Abor, 2007; Coleman & Biekpe 2007; Ofori, 2007a, Wu et.al 2003, Soana et. al 2011**) while others shed light on typology concerns of wholesale CSR (**Ofori, 2006, 2007b; Ofori & Hinson, 2007**). But important aspects are ignored. Financial aspects of the corporations are not explored in developing countries, regarding their link with CSR. The current study, therefore, will cover the research gap.

## 2. Review of Literature

In modern age, the increased development of CSR literature has presented new ideas and many global institutions and scholars have rejected the traditional impression of firms to exert their entire resources and efforts on the maximization of profit (**Carroll, 1991; Crane et al., 2008**). In fact, these scholars and global institutions argued that business and society are interdependent and it is the obligation of management to take action for the protection and improvement of the societal welfare as well as organizational interests (**Cannon, 1992; Davis & Blomstrom, 1975**). Consequently, such additional actions are present in numerous models of CSR, propounded by the researchers over a period of time, that seem to capture varied responsibilities of organizations. Several previous studies attempted to examine the relationship of CSR with financial performance indicators. However, the studies have focused on various subjective methods to measure CSR. **Bowman & Haire (1975)** selected 82 food processing firms, listed in the Industrial Manual of Moody's in 1973. Annual reports are an

important aspect of the present research. It has been stated by **Unerman (2000)** that annual reports are essential documents. Moreover, the studies examining the notion of Corporate Social and Environmental Responsibility (CSER), also supported the exclusive use of annual reports. It was argued that all commercial communications, regarding the social matters, are virtually impossible to be recognized over a long time period, and hence, it is impossible to be confident on the data provided by annual reports and also the consistency of results obtained by the content analysis (**Gray et al., 1995a**).

### **3. Statement of the Problem**

The current study identified the Pakistan's banking industry for the empirical setting because of their profit oriented nature. But banks also fulfill their responsibilities towards the increasing demands of complex and diverse groups of stakeholders, like economic groups or public groups. Therefore, the current study particularly chose the banking industry of Pakistan for CSR practices, the motives of banks behind the strategic practices of CSR and the link between CSR and financial performance of banks.

### **4. Need of the Study**

This study would be helpful to improve the knowledge of managerial practices of Pakistani banks. Banks could improve their financial performance and thereby enhance the contribution towards corporate social responsibility by the Pakistani banks.

### **5. Objectives of the Study**

The major objectives of the study are given below:

- i. To check the views on CSR by the employees, customer and general public.
- ii. To analyze the motives of their employees, customer and general public to be engaged in CSR practices.

- iii. To check the impact of CSR practices on the financial performance (ROA, ROE) of Banks.

## **6. Hypotheses of the Study**

Following hypotheses were tested in the study.

**NH-1:** Pakistani Banks do not view CSR activities as being a strategic activity.

**NH-2:** Operating Banks in Pakistan do not include corporate social disclosures in its annual reports.

**NH-3:** Pakistani banks do not undertake CSR activities for profit maximization

**NH-4:** There is no positive association between Pakistani banks' CSR activities and their financial performance (ROA and ROE).

## **7. Research Methodology**

### **7.1 Sample Selection**

The sampling frame for the study consisted of all the banks, licensed by the State Bank of Pakistan (SBP), to operate commercial banking services in the country. Hence the sample was 27 banks, operating in Pakistan. Convenient sampling technique was used in the study. Though almost all the banks were taken, but still some banks were excluded due to lack of availability of data.

### **7.2 Sources of Data**

Data collection technique was based on the index formation, in order to obtain the value of CSR for banks. Annual reports were deeply and carefully examined for the presence of social disclosure practices. The financial performance (ROA & ROE) was used as the dependent variable while Corporate Social Responsibility (CSR) was the independent variable of the study. These variables were named as debt ratio, growth, size and origin. The line count technique was also cross validated by the authors, by

applying the same technique to 14 high level CSR firms used by Moskowitz. The outcomes indicated to have greater space devoted to CSR as compared to 14 firms, that were randomly chosen. Moreover, the study analyzed the five years of ROE of each category and found that the highest ROE was reported by the category where medium lines were devoted to CSR and this displayed an inverted U-shape association between the two variables. The information used in the disclosure indices was categorized into two wide categories; voluntary disclosure and required disclosure. Voluntary disclosures arise where the benefits of corporate perceptions exceeded their costs.

### 7.3 Period of the Study

Data for the study were gathered first by analyzing the annual reports, for the time period of five years from 2013 to 2017, for determining CSR disclosures, provided in the annual reports of banks.

### 7.4 Tools Used in the Study

The study employed the panel data technique in order to explore the influence of CSR on the profitability or financial performance of Banks. The study uses the Descriptive Statistics, the Pearson Correlation and Multiple Regressions. Association between CSR activities and Financial performance was measured through these models:

$$ROA = \beta_0 + \beta_1 (CSR) + \beta_2 (DR) + \beta_3(\text{growth}) + \beta_4 (\text{size}) + \beta_5 (\text{origin}) + \varepsilon$$

$$ROE = \beta_0 + \beta_1 (CSR) + \beta_2 (DR) + \beta_3(\text{growth}) + \beta_4 (\text{size}) + \beta_5 (\text{origin}) + \varepsilon$$

Where, CSR = Corporate Social Responsibility; ROE = Return on Equity; ROA = Return on Assets; SIZE = Size of the bank ; GROW = Growth in sales for bank; ORIGIN = The total life of bank; DR = Debt Ratio;  $\varepsilon$  = the error term;  $\beta_0$  = The average performance of the bank in the absence of the control factors.

## 8. Analysis of Data

**Figure-1** shows the conceptual framework of the study. The results of Pearson Correlation are shown in **Table-1**. The figures of correlation also reveal the relationship between Corporate Social Responsibility (CSR) and Profitability of banks in Pakistan. The financial performance or profitability indicators (ROA and ROE) revealed the direct and positive relationship with CSR. This positive relationship between CSR and performance indicators supported the general assumption that banks would become more profitable if they were to carry out CSR activities in a proper manner. Similarly, if the banks were to initiate, develop and implement the CSR activities, they would be able to get more return on their assets due to a positive correlation between CSR and ROA in the study. Similarly, banks were able to give more return to their shareholders by implementing CSR activities. Hence the more the banks use CSR implementation practices as strategy, the more they are able to increase the value to their shareholders. Hence **NH-3: Pakistani banks do not undertake CSR activities for profit maximization**, was rejected. This confirmed the assumption that CSR was positively linked with the profitability of banks in Pakistan. Apart from CSR, the size of firm was positively related to ROE only, indicating that more the banks increase their equity of shareholders' return, the more they become profitable. The correlation between growth and size was consistent with the study of **Abor (2007)**, who revealed a significant positive relation between size and growth. These variables were also taken as control variables in his study during the analysis of working capital management with profitability. On the contrary, debt ratio reported mixed results. This ratio was positively related to ROA but negatively to ROE. It indicated that banks increase their assets at the expense of debt or

liability. Moreover, the origin of banks was also positively related to ROA and ROE, indicating the more the life of banks, longer they are able to increase their profitability.

The study also examined the unique contribution of CSR and other individual control variables to the ROA and ROE of banks. The models are depicted in **Table-2** and **Table-3** respectively. Moreover, the Variance Inflation Factor (VIF) of all variables is also shown in the models to explain the presence or absence of multi-collinearity. All the values of VIF were less than five, indicating non-existence of multi-collinearity in the data. Similarly, in order to check the presence or absence of heteroskedasticity in the data set, Breusch-Pagan or Cook-Weisberg Test was applied to the data set. The probability of  $\chi^2$  in Model 1 was 0.0725, indicating the value to be significant at level  $p < 0.1$ . Similarly, the probability of  $\chi^2$  in Model 2 was 0.0620, indicating the value to be significant at level  $p < 0.1$ . In other words, both models in the study indicated the presence of heteroskedasticity in the data. Model 1 in **Table-2** reveals that debt ratio (model 1:  $\beta = -0.067$ ,  $p < 0.01$ ), firm size (model 1:  $\beta = -0.0030$ ,  $p < 0.01$ ), origin (model 1:  $\beta = 0.000538$ ,  $p < 0.01$ ) and growth (model 1:  $\beta = 0.0481$ ,  $p < 0.01$ ) were the significant critical factors that contributed to the ROA of banks. All these factors tended to increase the return on assets for the banks. On the contrary, Model 2 in **Table-3** reveals that firm size (model 2:  $\beta = 0.0364$ ,  $p < 0.05$ ), and growth (model 2:  $\beta = 0.1760$ ,  $p < 0.1$ ) were the substantial factors that contributed to ROE of banks. Size and sales growth of banks tended to increase the ability of banks to pay more to their shareholders.

On the contrary, the result of Model 1 in **Table-2** depicts that  $\beta$  coefficient for the important independent variable of Corporate Social Responsibility, CSR ( $\beta = 0.001289$ ,

$p < 0.01$ ) posit a significant positive influence on the dependent variable, Return on Assets (ROA). Similarly, Model 2 in **Table-3** depicts that  $\beta$  coefficient for CSR ( $\beta = 0.004908$ ,  $p < 0.1$ ) also depicts a noteworthy positive impact on Return on Equity (ROE). This indicates that CSR was an important contributing variable towards the indicators of profitability in the operating of private as well as Government owned public banks of Pakistan. All these banks adopted CSR practices to increase their profitability and financial performance. Results of the study indicated that all banks in Pakistan considered CSR practices as strategic activity and CSR disclosures were also present in the annual reports of banks in Pakistan, Hence reject “**NH-1: Pakistani Banks do not view CSR activities as being a strategic activity**” and “**NH-2: Operating Banks in Pakistan do not include corporate social disclosures in its annual reports**”. However, the study accepted **NH-3** as the results concluded that Public Banks executed more CSR activities than Private Banks. In other words, there was a positive relationship between the CSR practices of banks in Pakistan and their financial performance (ROA, ROE). The results also revealed the existence of positive relationship between CSR and two performance indicators, ROA and ROE. Therefore, the performance or profitability of banks in Pakistan increased with the spending on CSR practices. Hence “**NH-4: There is no positive association between Pakistani banks’ CSR activities and their financial performance (ROA and ROE)**”, was rejected.

## 9. Findings of the Study

**Table-2** and **Table-3** depict the values of  $R^2$  and adjusted  $R^2$ . The value of  $R^2$  indicated the explanatory power of the selected independent variables in the study, to explain the dependent variable. The adjusted  $R^2$  indicated

the goodness of model due to the independent variables chosen. Less value of adjusted  $R^2$  indicated that the model should include more significant independent variables. Good independent variables increase the value of adjusted  $R^2$  but less effective variable decreases its value.

In Model 1 of **Table-2**, the value of  $R^2$  was 0.9951. It indicated that 99.51% of variation in ROA was caused by CSR and other four factors. This high value of  $R^2$  implied that variation in dependent variable was completely explained by the independent variables in the model. Similarly, the value of adjusted  $R^2$  0.9939 in Model 1 indicated that the chosen variables of the study could explain 99.39% of the model. Therefore, the model was a good model. On the other hand, the value of  $R^2$  in Model 2 of **Table-3** was 0.5585. It indicated that 55.85% of variation in ROE could be explained by CSR and other factors in the model. In other words, 45% of variation in ROE remained unexplained by the respective model. Similarly, the value of adjusted  $R^2$  at 0.4533 also revealed that model needed some factors in order to make it a good model. Therefore, this relationship was not so strong.

The Model 1 and 2 also displayed the value of Model-F. The fitness of model in the study was explained by F-ratio. A good model should indicate a larger value of F-ratio, at least more than one (**Andy, 2000**). The value of F-ratio in Model 1 (846.87) was significant at  $p < 0.01$ . The value was quite high, indicating that all the explanatory variables recorded a linear relationship with ROA. On the contrary, the value of F-ratio in Model 2 (5.31) was also significant at  $p < 0.01$  but also revealed that at least one of the explanatory variables recorded a linear relationship with ROE and the model was somehow valid.

## 10. Suggestions

Pakistani banks contributed, on a large scale, towards the social well-being of the society, improved health facilities, enhanced living standards and protection of environment from perilous changes. The banks or the corporates in Pakistan should implement CSR practices, as strategic activities, to reduce promotion cost and to improve profitability. Banks have to take care of their shareholders and employees for building confidence and trust. Moreover, the managers in the banks in Pakistan can communicate the important contribution of CSR and generate a good and positive image.

## 11. Conclusion

The study investigated the influence of implementing Corporate Social Responsibility (CSR) practices on the financial performance or profitability of Private and Public Banks operating in Pakistan. The values of CSR were obtained by developing a 31-item Corporate Social Responsibility Disclosure Index. The information was obtained, using annual reports of all the banks selected in the sample. The financial performance was indicated, using two measures, ROA and ROE. The study concluded that Corporate Social Responsibility (CSR) factor ultimately did influence the financial performance of Pakistan's private and public banks. CSR was used as a strategy for the development of a competitive advantage and increasing financial performance. Organizations and financial institutions, in the developed countries, are more serious in implementing the practices of CSR but developing nations like Pakistan are less aware about the importance of CSR practices.

## 12. Limitations of the Study

The current study was subjected to certain limitations. The study focused only on the

banking industry. Also, the study did not use questionnaire-based study for the collection of CSR data and instead it generated an index scale for the purpose.

### 13. Scope for Further Research

Further studies can cover wider geographical area or other sectors for the implementation of CSR practices. Researchers can take Islamic Banks as well, along with conventional ones. The sample can also be increased, depending on the reliability of generalized data. Future research can investigate the effect of CSR on other factors like knowledge and talent management, human capital development etc. Furthermore, other developing countries can be taken in the study for the investigation of CSR.

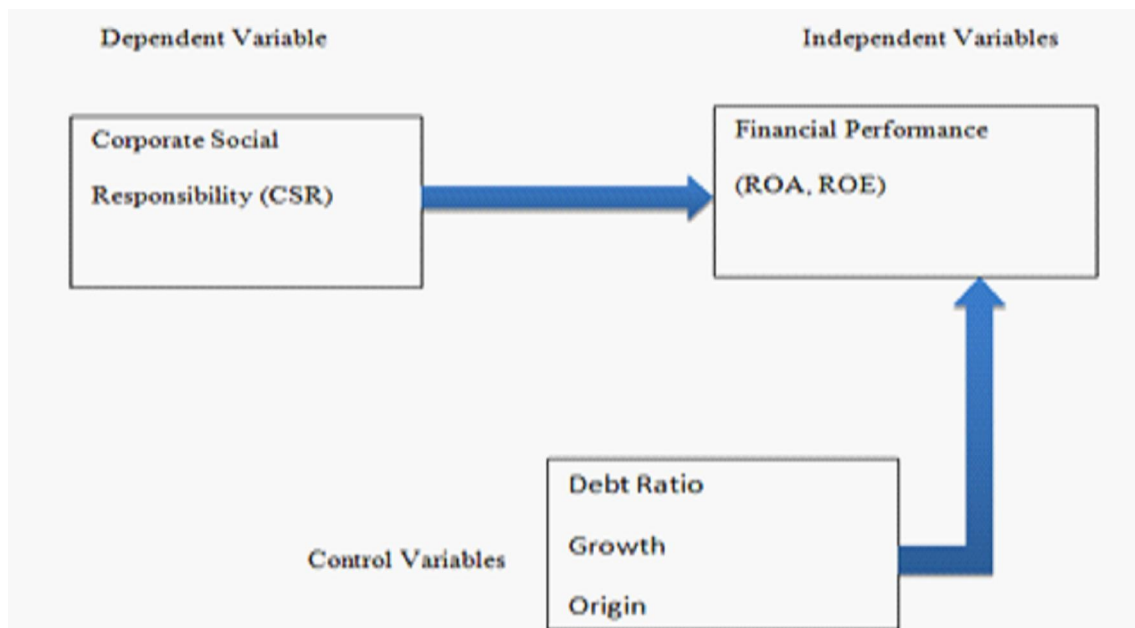
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**Figure-1: Framework**



**Source:** Author's proposed Model (2018)

**Table-1: Correlation Matrix for Sample Variables of CSR and Financial Performance**

|        | CSR  | ROA   | ROE  | DR    | Growth | Origin | Size |
|--------|------|-------|------|-------|--------|--------|------|
| CSR    | 1    |       |      |       |        |        |      |
| ROA    | 0.48 | 1     |      |       |        |        |      |
| ROE    | 0.46 | -0.18 | 1    |       |        |        |      |
| DR     | 0.53 | -0.99 | 0.24 | 1     |        |        |      |
| Growth | 0.02 | 0.16  | 0.39 | -0.11 | 1      |        |      |
| Origin | 0.15 | 0.01  | 0.42 | 0.07  | 0.08   | 1      |      |
| Size   | 0.44 | -2.27 | 0.68 | 0.32  | 0.29   | 0.55   | 1    |

Source: Data extracted from Annual Reports and Computed using SPSS 20.

**Table-2: Regression Results of (Model-1) for Sample Variables of CSR and Financial Performance**

| Variables  | Beta Coef. | t-statistics | VIF  |
|------------|------------|--------------|------|
| CSR        | 0.001289** | 2.61         | 1.56 |
| DR         | -0.06783** | -54.14       | 1.48 |
| Growth     | 0.048197** | 2.93         | 1.18 |
| Origin     | 0.000538** | 4.46         | 1.50 |
| Size       | -0.00308** | -1.22        | 2.07 |
| Cons.      | 0.030384** | 0.68         |      |
| R          | 0.9951     |              |      |
| Adjusted R | 0.9939     |              |      |
| Model      | 846.87**   |              |      |

Source: Data extracted from Annual Reports and Computed using SPSS 20.

Note: Significance level; \*p < 0.05, \*\*p < 0.01, \*\*\*p < 0.001

**Breusch-Pagan / Cook-Weisberg test for heteroskedasticity**

Ho: Constant variance; Variables: fitted values of ROA

chi<sup>2</sup> (1) = 0.32; Prob > chi<sup>2</sup> = 0.0725

**Table-3: Regression Results of (Model-2) for Sample Variables of CSR and Financial Performance**

| Variables  | Beta Coef.  | t-statistics | VIF  |
|------------|-------------|--------------|------|
| CSR        | 0.004908*** | 1.42         | 1.56 |
| DR         | -0.00071    | -0.08        | 1.48 |
| Growth     | 0.176087*** | 1.53         | 1.18 |
| Origin     | 0.000604    | 0.72         | 1.50 |
| Size       | 0.036469*   | 2.07         | 2.07 |
| Cons.      | -0.76674*   | -2.47        |      |
| R          | 0.5585      |              |      |
| Adjusted R | 0.4533      |              |      |
| Model      | 5.31**      |              |      |

Source: Data extracted from Annual Reports and Computed using SPSS 20.

Note: Significance level; \*p < 0.05, \*\*p < 0.01, \*\*\*p < 0.001

**Breusch-Pagan / Cook-Weisberg test for heteroskedasticity**

Ho: Constant variance; Variables: fitted values of ROE

chi<sup>2</sup> (1) = 0.24 ; Prob > chi<sup>2</sup> = 0.062