

CORPORATE SOCIAL RESPONSIBILITY AND FINANCIAL PERFORMANCE IN ITALIAN COOPERATIVE BANKS

Abstract

This paper investigates the relationship between Corporate Social Responsibility and financial performance for a sample of 88 Italian cooperative banks during the period 2007-2011. Following previous studies, the analysis first assesses CSR reports by measuring both the volume and quality of disclosure; two disclosure scores are constructed. The empirical analysis tests the relationship between CSR disclosure and the CBs' financial performance. The CBs' performance is measured in terms of bank's profitability and risk. Our main result is that CSR fails to produce effects on the banks' performance.

1. Introduction

This paper investigates the relationship between Corporate Social Responsibility (CSR) and financial performance (FP) for a sample of Italian cooperative banks (Banche di Credito Cooperativo) during the period 2007-2011. For a long time, Cooperative banks (hereafter CBs) characteristics and performance remained unexplored or underdeveloped (Kalmi, 2007). The renewed interest towards CBs derived from two facts. First, CBs have been relatively less involved in the recent profound transformation process of the banking sector, that moved away from a relationship banking model towards a more standardised and impersonal model (Ayadi et al., 2010). CBs have been showed sustainability and resilience to financial shocks compared to commercial and investment banks (EACB, 2010; Draghi, 2009). Second, today CBs continue to constitute an important segment of the European.

The focus of the analysis is the Italian banking sector where CBs traditionally play an important role that has profoundly transformed over time. Out of 684 banks in Italy, 422 were popular banks and cooperative credit banks; of those, 385 (over 90%) were CBs (Bank of Italy, 2014). The deep knowledge of the local economy and the ability to assess the entrepreneurial projects have contributed over time to make these intermediaries important interlocutors for small and medium enterprises and micro-enterprises. Adherence to the principle of mutuality has not prevented the business model of BCC to evolve gradually, expanding its range of products and services (Cannata et al., 2013). During the last decade Italian CBs experienced a period of profound transformation. Trends already in place in the previous decade have combined with changes that have occurred more recently. The financial crisis erupted in 2007 also determined for CBs an important moment of transition, marking the border between a phase of strong growth (which continued from the mid-nineties), and a period characterized by consolidation, rationalization and revision of the strategic choices.

CBs differ from commercial and investment banks because they are based on member ownership; thus, they reflect an approach that is not anchored solely to the maximisation of value for shareholders like shareholder value banks, i.e. commercial banks. Instead, CBs aim to maximise value for a larger and more diversified group of subjects representing varied interests, such as stakeholder value banks (Coco & Ferri, 2010). CBs thus pursue a two-fold objective: they provide the community with both economic and social benefits. From a managerial point of view, CBs constitute a dual challenge: as a financial institution, they have to consider their economic and financial performance in terms of profitability, solvency and efficiency (Relano & Paulet, 2012); as an association of persons, they have to pursue the wellbeing of their stakeholders and the development of the local economy in a socially responsible way. Therefore, they must encapsulate their activities within strong corporate social responsibility (CSR) practices (EACB, 2010).

Due to their stakeholder orientation and values-based approach, CBs are expected to fulfill their corporate social responsibility (CSR), including accountability. However, although cooperative principles and values (International Cooperatives Alliance; ICA, 1995) are based on concepts of responsibility and solidarity, it is not possible to define CBs as socially responsible a priori since they have to deliver value to their stakeholders (Harvey, 1995). To understand how CBs interpret these principles today, CBs require a clear strategy to communicate and account for their values and to translate these into relevant products and services (Davis & Worthington, 1993): “The challenge

for co-operative banks is to combine their cooperative specificities [...] with external guidelines for CSR (i.e. Global Reporting Initiative, UN Global Compact, OECD, etc.) in order to enshrine the co-operative banks' contribution to a more sustainable economic and social development" (EACB, 2010, p. 4).

Due to the economic and social role that banks and CBs play in the European context, the aim of this paper is to assess whether there exist a relationship between CSR and CBs performance, focusing on the CSR disclosure

This paper offers several contributions to the previous literature. First, the paper completely considers CSR disclosure by investigating both the quantity and quality of disclosure in the stand-alone social and environmental reports, thus going beyond limitations associated with CSR disclosure analysis (Mallin et al., 2014). Second, although there have been a few empirical studies investigating the link between CSR and FP in the banking sector, as far as we are aware, this is the first study that empirically investigates this relationship in a nonprofit context, specifically with reference to the cooperative banks system. Third, to the best of our knowledge, there are no previous studies focused on the relationship between CSR and FP in Italian CBs. Fourth, given the importance of CBs in the Italian economy and the changes that the crisis has determined for the banking system (as whole as well as for the CBs), considering the crisis period can contribute to add new insights to the literature on banks and CBs.

The remainder of the paper is organized as follows. In Section 2 we review the literature. In Section 3 we present the research sample and discuss the data sources and collection. In Section 4 we discuss the methodology employed to conduct the empirical analysis. In Section 5 we present the results. In Section 6 we conclude with some final remarks.

2. Literature review

The literature related to the topic of this paper can be grouped into three groups: studies on (banks and) CBs performance, studies on the relationship between CSR and firms performance, studies CSR (disclosure) in banks and CBs.

2.1 CBs performance

What do we mean as performance? In banking literature, we can look at the performance using different perspectives and taking into account different profiles of the profitability. More recently, given the importance of the risks' system in banks the performance is viewed as a more complex concept that has to take into account both profitability and risk. The measures generally used to capture this complex dimension are risk-adjusted performance measures such as RAROC and EVA.

If we focus on CBs, the literature on performance consider different topics that appears to be central in CBs studies: i) profitability and efficiency; ii) capitalization, role and resilience during the crisis; iii) the relationship between performance and corporate governance; iv) competition¹.

¹ The nexus performance-governance is relevant given the very special governance system of the CBs. Gorton and Schmidt (1999) argue that when membership increases, the incentives of each individual member to monitor management get diluted. Furthermore they argue that increases diversity in member preferences are likely to

The third and the fourth strand of literature are not relevant for the purpose of this paper. Given the specialness of the present period characterized by the crisis, regarding the issues related to the CBs capitalization, and to their role and resilience during the crisis is sufficient to highlight some points. From a regulators perspective, Fonteyne (2007) argues that two are the main challenges that modern CBs have to face. First, their governance problems. In this sense, the author highlights two main potential risks: i) managers may use the intergenerational endowment for purposes other than members' best interests; ii) there is a risk that inevitable attempts to appropriate (part of) the endowment may succeed². Second, from a financial stability point of view, the competitive dynamics between CBs and commercial banks. The author argues that CBs can use their low-cost/abundant capital and the absence of a profit maximization constraint to pursue expansion plans that put competitive pressure on the other financial institutions. If regulators insist that CBs achieve similar returns on equity as commercial banks, they may induce CBs to expand into riskier activities that they cannot adequately control. Furthermore, authorities concerns are related to the impact of their potentially limited ability to raise capital and their capacity to face the crisis. Cannata et al. (2013) test the impact of new Basel 3 rules (capital and liquidity) on Italian CBs (*banche di credito cooperativo*, BCC). They highlight that, also taking into account the new Basel rules, the challenges that CBs have to face are: the deterioration of credit quality, the difficulty in funding, the reduction of profitability, the need to improve the governance mechanism and the risk management (practices). They show that the main risks are related to the progressive reduction of capital (even though Italian CBs banks have more capital than other Italian banks). Hesse and Cihac (2007) study the role of CBs in financial stability. They find that these banks are more stable than commercial banks. They argue that this is due to the lower volatility of the CBs returns, which more than offsets

increase the costs of decision-making. Coco and Ferri (2010) argue that the agency problem between members and management is only one governance problem. On the other hand, CBs may have specific advantages in two other governance relations (between depositors and management, and between management and borrowers). See also Crespi et al. (2004).

The issues related to the CBs competition arise from the fact that generally CBs compete in local markets. For instance, Fiordelisi and Mare (2014) analyze whether competition affect the stability of CBs focusing on European banks between 1998 and 2009. They demonstrate that there is a positive relationship between competition (estimated using the Lerner Index of Monopoly, considered as a measure of CBs market power) and stability (measured using the Z-score) along the whole period considered. Furthermore, their results show that increased homogeneity in the CBs sector positively affects bank soundness. Jones and Kalmi (2010) consider relatively standard measures in the banking literature: cost efficiency (the ratio of operating costs over operating income), and increase in market share (proxied by the rate of growth of customer loans/customer deposits). They also include two additional independent variables: competition intensity (measured as the number of competing bank branches operating in the location of the bank over 10,000 inhabitants), and share of non-interest income relative to total income, as an inverse measure of retail orientation – the first variable is expected to be negatively related to performance, and the second positively.

² "... cooperative banks face fundamental challenges rooted in their institutional set-up. Most cooperatives were designed from the outset to perpetually accumulate capital. This was done by defining members' ownership rights as applying only to the notional value represented by paid-up membership shares (and any capitalized dividends) and by limiting the disbursement of profits. As a result, the economic value of a cooperative, net of debts and the nominal value of member shares, constitutes an intergenerational endowment without final owners. It is available to current members, under the implicit or explicit understanding that they will further grow the endowment and pass it on to the next generation of members. In this interpretation, cooperative bank managers can be seen as custodians of this endowment...The existence of such an owner-less endowment constitutes a major challenge to the governance systems of a cooperative. It reduces members' incentives to exert effective oversight over management, while at the same time increasing the need for such oversight. In many respects, governance systems may struggle to meet this challenge. These systems were originally designed for small institutions functioning within close communities, but are now being applied with little fundamental change to large, complex, financial conglomerates. Moreover, the functioning of corporate governance mechanisms could be hampered by collective action problems that appear more daunting than in investor-owned companies, the absence or reduced impact of market signals, and in many cases lower disclosure of information." (Fonteyne, 2007, p. 4).

their lower profitability and capitalization, most likely due to CBs' ability to use customer surplus as a cushion in weaker periods. In their model CBs performance is compared with other banks performance. As a performance measure (dependent variable) the z-score (Boyd and Runkle, 1993; Laeven and Levine, 2007) is used, considered a measure of bank individual risk. The independent variables include a vector of bank-specific variables, a vector of time-varying banking industry-specific variables in different countries analyzed – they also consider the interaction between the type of banks and some of the industry-specific variables as well as bank-specific variables –, some macroeconomic variables, plus country and yearly dummy variables (the independent variables used in the model are: assets, loans/assets, cost/income ratio, income diversity, Herfindhal index, GDP growth, inflation, exchange rate appreciation, real long term interest rate, share of cooperatives, governance).

Considered the purpose of this paper, the strand of literature more relevant is that focused on performance and efficiency. The main rationale for analyzing these issues is that CBs are considered not-profit-maximizing entities and generally are considered less efficient than commercial banks, due to the fact that they pursue mutual goals (Stefancic, 2010).

Altunbas et al. (2011) analyse German banks during the 1989-2006 period. The authors do not find any significant performance differences among different categories of banks. They focus on cost and profit efficiencies and show that saving banks seem to waste less inputs than commercial banks.

Iannotta et al (2007) study the relationship between the performances and risk of banks in 15 European countries from 1999 to 2004, distinguishing among mutual banks, public sector banks and private banks, and banks with different ownership concentration. First, they test the influence of ownership structures on banks' profit, measured as profit (the ratio of operating profit to total earning assets), income (the ratio of operating income to total earning assets), costs (the ratio of operating costs to total earning assets). The independent variables includes a vector of ownership variables, a vector of time-specific dummy variables, a vector of country-specific dummy variables; the national GDP annual growth rate, plus a vector of control variables: size (the log of total assets), loans (the ratio of loans to total earning assets), liquidity (the ratio of liquid assets to total assets), deposits (the ratio of retail deposits to total funding), capital (the ratio of book value of equity to total assets), loan loss (the ratio of loan loss provision to total loans). Successively, they test the influence of ownership structures on banks' risk. The authors use the same model used to test the influence on profitability; the independent variable is loan loss. They show that significant differences in performance and risk do exist, although their signs are not always consistent with expectations. Private banks seem to be more profitable than mutual and public sector banks, due to higher net returns on their earning assets rather than from a superior cost efficiency. Public and mutual banks' costs are relatively lower. On the risk side, public sector banks have poorer loan quality and higher insolvency risk than other types of banks, while mutual banks have better loan quality and lower asset risk than both private and public sector banks.

Girardone et al. (2009) investigate the efficiency in European banks and the relation with corporate governance issues deriving from differences in ownership, bank type and financial structure. They estimate the cost X-efficiency levels for a large sample of commercial, savings and co-operative banks in the EU-15 during the period 1998-2003. They find that mutual banks are more cost efficient than the commercial banks. Furthermore, in bank-based countries savings banks have

significant cost efficiency advantages over those operating in market-based ones and over commercial banks.

Ayadi et al. (2009) study profitability, efficiency, competition, earning stability and role on regional growth of savings banks in five European countries (Austria, Belgium, Germany, Italy and Spain), and in EU-15 as whole when possible, during 1996-2006. They measure banks performance, using accounting ratios (ROE, ROA, cost-to-income ratio total operating costs/total operating income), and efficiency, using indicators based on econometric models (the X-efficiency score, based on the estimation of the best-practice cost frontier). Second, efficiency and competition indicators are computed and used (separately for saving and commercial banks) to examine the determinants of competition (controlling for bank size, market capitalization, entry, contestability and institutional diversity). Successively, the determinants of regional growth in three countries are examined focusing on savings banks. Finally, z-scores (considered as measures a corporation's capacity to absorb deviations in income) are used to test the earnings stability of savings and commercial banks. Their results show that there are no relevant differences between savings banks and commercial banks in terms of profitability, cost-efficiency, market power and earnings stability in the five countries analyzed. The only country where a notable difference exists across the three performance is Italy. They highlight two distinguishing aspects of savings banks: i) savings banks fulfill an important role in assisting regional economic growth; ii) in some countries savings banks cope with income volatility better than other banks. In a similar study Ayadi et al. (2010) study the comparison of profitability, efficiency, market power and earnings stability for commercial, savings and cooperative banks in six European countries (Austria, Finland, France, Germany, Italy, the Netherlands and Spain) during the period between 2000 and 2008. Their results fundamentally confirm those of Ayadi et al. (2009).

Fiordelisi et al. (2010) study the relationship between CBs' efficiency and environmental conditions focusing on a sample of Italian CBs between 2000 and 2005. They estimate the cost and profit efficiency using Stochastic Frontier Analysis considering several environmental variables accounting for disparities among Italian regions. The study show that environmental conditions determine effects on efficiency.

Fiordelisi and Mare (2013) analyze a sample of Italian CBs between 1997 and 2009. They study the influence of efficiency to the estimation of the probability of default showing that higher efficiency levels have a positive link with the probability of survival of CBs.

Stefancic and Kathitziotis (2011) study the performance of Italian banks during the 2006-2009 period by comparing CBs and commercial banks. They measure the performance with ROE. In their model ROE is related to a number of independent variables able to capture the banks' quality (total capital ratio, net loans/total assets, net loans/total deposits net), the quality of investment (loan loss provision/net interest revenue), profitability (net interest margin, recurring earning power, that is measured of after tax profits adding back provisions for bad debts as a percentage of total Assets), liquidity (liquid assets/total assets). They show that by contrast to commercial banks, Italian CBs do not perceive profit-making as a principle itself. These banks have been able to accumulate capital and provide credit to customers despite the ongoing crisis. On average, they manage their loan portfolio better than commercial banks.

Di Colli et al. (2011) analyze the relationship between banks' loans growth during the expansion economic cycle and the increase of bad loans (*sofferenze*) during the subsequent recession. They compare the Italian CBs to the other banks.

Manetti and Bagnoli (2103) use the value-added indicator and to the cost-to-income ratio to study the Italian CBs efficiency compared to non-cooperative banks. The author show that CBs appear efficient and mission-oriented.

Barra et al. (2013) focus on the effects of the crisis on the technical efficiency of Italian CBs. They show that local shocks (proxied by SLL-level of GDP per capita) affect differentially CBs (with respect to other banks category).

2.2 CSR and firms' performance

The relationship between firms' social and financial performance has been a topic of research for some time (e.g., Preston & O'Bannon, 1997; Griffin & Mahon, 1997; Waddock & Graves, 1997). However, if we focus on banking sector, even if banks play a central role as financial resource providers to broad economic sectors, a limited number of studies focus on the banking sector and the relationship between social and financial performance (Simpson & Kohers, 2002; Wu & Shen, 2013; Carnevale & Mazzuca, 2014; Mallin et al., 2014); there is no previous study that empirically investigates this relationship in the cooperative banking context.

Researchers have employed different theories and methodologies to assess the relationship between CSR and firms' performance, obtaining various results. On the one hand, supporters of stakeholder theory argue that social and financial performance tends to be positively associated in the long run (Freeman, 1984): if the organization is able to meet the stakeholders' claims, it will have positive financial effects in the long term. On the other hand, critics to this theory – dating back to the neoclassical thinking of Milton Friedman (1970) – argue that a firm is an instrument for economic efficiency, disregarding any specific role for social activities or ethical consequences and values.

The controversy about the relationship between social and financial performance is not only limited to the existence (or not) of this relationship, but it also considers the *direction* and the *sign* of this relationship (Preston & O'Bannon, 1997; Waddock & Graves, 1997). Preston and O'Bannon (1997) propose a typology of possible social-financial performance relationships in which they summarize six different approaches and theories on the basis of this relationship. By running a longitudinal analysis on a database of 67 large U.S. firms covering an 11 year time period, the authors highlight that there is no support for a *negative* association between social and financial performance; on the contrary, the majority of the analysis reveals a positive link between CSR and FP, thus reducing their typology scheme to three main theories: social impact (social performance affects financial performance), available funding (financial performance affects social performance) and positive synergy (social and financial performance are synergetic). Similarly, Griffin and Mahon (1997), developed a review of empirical studies on the social-finance performance relationship from 1972 to 1997, shedding light on the need to better investigate this relationship because of the controversy of the results. The majority of studies shows a positive link between social performance and financial performance even if some empirical evidence has been inconclusive, revealing both a positive and negative link in the same sample of analysis.

Two theories seem to prevail in literature: the social impact theory and the available funding theory. The first theory (Preston and O'Bannon, 1997), also called good management theory (Waddock &

Graves, 1997) holds that there is a high correlation between the capacity of companies to meet various corporate stakeholders' needs and financial performance. Similarly, Waddock and Graves (1997) argue that companies that foster satisfaction by maintaining positive relationships with all stakeholders (employees, community members and customers) enjoy better financial performance; improvements in reputation deliver increasing revenues while reducing costs. Wu and Shen (2013) consider the beneficial adoption of CSR practices both at the micro and macro level. At the macro level, they note environmental improvements and reductions in social injustices and inequalities; at the micro level, they emphasize the company's reputation enhancement as a consequence of CSR behaviour. CSR initiatives and practices therefore lead to financial benefits that are greater than the resulting costs, thereby improving the company's long-term financial performance: "Accordingly, adopting CSR can be beneficial to both corporate shareholders and stakeholders, which creates a potential win-win situation" (Wu & Shen, 2013, p. 3529). The social impact theory therefore suggests that CSR practices enhance the reputation of the company, which later leads to a better FP. In the banking sector, Simpson and Kohers (2002), study 385 U.S. commercial banks, solidly supporting the hypothesis that the link between social and financial performance is positive. The results of this analysis are consistent both with social impact theory and good management theory and, showing that the financial resources required to put socially-responsible actions into practice are not so relevant as to make the bank unprofitable. Furthermore, the results clearly show that the creation of favourable stakeholder relationships could be a competitive driver in terms of financial performance (Waddock & Graves, 1997).

From another perspective, the available funding theory (Preston and O'Bannon, 1997) suggests that social and financial performance could be positively associated, but the causal relationship goes from financial to social performance. Motivations thus should be found in the level of available funds or slack resources (Waddock & Graves, 1997); when (and if) slack resources are available, the company could, at its own discretion, allocate these resources to social performance outcomes, such as improving employee and community relations or fostering environmental programs. In the banking industry, Mallin et al. (2014) analysed a sample of 90 Islamic banks from 2010-2011 and found that the surpluses generated by Islamic banks from high financial performance encouraged them to invest in socially responsible activities. Islamic banks with high financial performance have slack resources to devote to undertaking socially responsible activities, benefitting all stakeholders, including the community. Finally, Preston and O'Bannon (1997) recognize the possibility that social and financial performance are positively synergetic, interacting over time in a simultaneous relationship, a 'virtuous circle' (Waddock & Graves, 1997) that is difficult to detect through statistical analysis.

Finally, focusing on the banking sector, other (few) studies investigated the relationship between CSR and the lending activity by banks. Thomson and Cowton (2004) study the relationship between bank lending activity and the environment. Even if banks are not directly concerned about the environmental issue, they have incentives to understand the environmental implications of their lending decisions because of the rising public concern about the state of the natural environment poses risks for the state of a bank's lending portfolio. They empirically investigate the interface between bank lending and the demand for environmental information. Based on a survey on banks in the UK, they report on the extent to which UK banks incorporate environmental considerations into their corporate lending decisions, the sources of this information, and lending bankers' views on developments in environmental reporting. Their main result is that bankers attribute significant

to the annual report. Aintablian et al. (2007) focus on the importance of banks monitoring and on the signaling power of banks loans. By making a loan to environmental firms banks signal that the borrower passed a number of tests for excessive environmental risk exposure. They study loan announcement effects for 152 Canadian companies. Their results show that market reaction to the announcement of bank debt to “environmental” firms is more positive and significant than for “non-environmental” firms. Scholtens (2006) arguments that finance is able to promote socially and environmentally desirable activities. He investigates the transmission mechanisms between finance and sustainability. He states that in economic literature three linkages exist between finance and sustainable development or CSR: the environmental Kuznets curve (EKC) (Gylfason, 2001), socially responsible investment (Sparkes and Cowton, 2004), and active stakeholders (SIF, 2005). He concludes that, even though most of the literature concentrates on the role of public shareholders, the credit channel and private equity have a potential impact on a firm’s non-financial policies and performance.

2.3 CSR disclosure in banks and CBs

Discussing the issue of CSR disclosure in banks encompasses several studies focused on disclosure, on CSR and CSR disclosure, on banks’ (CSR) disclosure. Disclosure can be considered in its double dimension, as compulsory or voluntary disclosure. This last type of disclosure, and the motivations underlying this disclosure, is that in which we are interested in.

The literature focused on (CSR) disclosure (and its positive effects), especially in a capital market setting, relies on the agency and information problems that can impede the efficient allocation of resources in a capital market economy (Healy and Palepu, 2001). Disclosure can facilitate these problems that arise from the fact that, while both savers and entrepreneurs would like to do business with each other, matching savings to business investment opportunities is complicated for two main reasons: i) entrepreneurs typically have better information than savers about the value of business investment opportunities and incentives to overstate their value; therefore, savers have to face an “information problem” (Akerlof, 1970); ii) once savers have invested in their business ventures, entrepreneurs have an incentive to expropriate their savings, creating an “agency problem” (Jensen and Meckling, 1976)³.

From a more general perspective, it is recognized that a higher level of disclosure can help to reduce the information asymmetry between managers and investors, to reduce uncertainty regarding a firm’s future securities returns and to lower transaction costs for investors (Diamond and Verrecchia, 1991; Kim & Verrecchia 1994; Lang & Lundholm 2000). A higher level of disclosure can contribute to increase the credibility of the company and allows investors to make more efficient decisions (Beaver 1989; Feltham et al. 1991; Blacconiere and Patten 1994). This is particularly true in the case of banks since they have to explicitly consider their reputational risk. In this sense the second Pillar of Basel II states that banks have to consider the reputational risk in defining their internal capital (at risk).

With specific reference to CSR disclosure literature there exist a number of theories, and some authors speak about a multi-theoretical framework (Cormier et al. 2005). As highlighted by

³ For a review of the empirical disclosure literature see Healy and Palepu (2001) that analyze this topic in a capital market setting. With reference to the motives for voluntary disclosure, these authors focus on the incentives of managers in making disclosure decisions.

Carnevale and Mazzuca (2014) most of the theories relies on the social–political theories that start from the idea that a firm is an economic entity that cannot be separated from the social context in which it operates and lives (and by which it is shaped and influenced); accordingly, to survive the company must obtain the support and approval of all its stakeholders. CSR activity and CSR disclosure can be viewed as a part of the communication process necessary to create and maintain this support Clarkson (1995). Successively, stakeholder and legitimacy theories are derived from political theory and consequently several researchers have advanced various theoretical arguments on CSR activity and disclosure (e.g. Gray et al., 1995; Campbell, 2000, Maignan & Ralston 2002).

With specific reference to the CSR disclosure in banking sector, few studies analyze these topic. Carnevale and Mazzuca (2014) study the effects of sustainability report on European banks' stock prices also testing whether there are differences across countries. They find that the financial markets assign a positive value to the sustainability report. They argue that probably this is because it can reduce information asymmetries and enables them to make more efficient decisions. Cross-country analysis confirms that the importance of voluntary disclosure is conditional on the differences between (groups of) countries, consistently with the varieties of capitalism approach (different institutional contexts influence the value relevance of the sustainability report).

Carnevale et al. (2014b) apply the varieties of capitalism approach on a sample of European listed banks from 2005 to 2011, to assess whether the different institutional contexts affect the value relevance of sustainability reporting. The main findings are that systemic and institutional factors influence the impact of sustainability reporting on the firm's market value. They show that sustainability reporting is more relevant in coordinated market economies compared with liberal market economies and mixed market economies.

Finally, very few studies have analysed the CSR focusing on CBs and this represents an interesting research opportunity. Valor et al. (2007) examine the socially responsible offer of savings banks and credit unions in Spain. Their methodology employs a self-administered questionnaire mailed to the analysed banks to describe their current portfolio of SRI-related products, the marketing and financial strategy for these products, the weight these products have in their portfolios, and their perceived forecasts of growth for the future. Their main finding is that a socially responsible market in Spain is at an introductory stage among credit unions, and at a growth stage among savings banks.

Carnevale and Mazzuca (2014b), that analyze the value relevance of the sustainability report in European banks, focus on the differences between cooperative and non-cooperative banks. Their results show that the relationship between stock price and social report is not significant in the case of CBs and, therefore, it seems that investors do not assign value to the SR published by cooperative banks because they believe that the SR does not provide any additional information. However, the authors recommend to evaluate the results with caution because the number of cooperative banks in the sample was very limited.

3. Sample and data

The empirical evidence presented in this paper is based on a study of both the annual report and the stand-alone social and environmental report from 88 CBs in Northern Italy from 2007-2011 (five

years). The research builds a complete database of CBs by retrieving information from the official website of the Cooperative Movement and from the Bank of Italy, mapping out all CBs in Northern Italy. A list of 228 CBs in Northern Italy was compiled. Out of these 228 CBs, 98 published at least one stand-alone social report from 2007 to 2011. This sample was reduced to 88 based on the availability of the annual report, thus enabling an analysis of 440 bank-year observations (Table 1).

Table 1 Sample banks

Year	Number of banks without social report	Number of banks with social report	Number of banks with social report on their website	Total
2007	34	54	45	88
2008	16	72	49	88
2009	15	73	70	88
2010	20	68	54	88
2011	22	66	57	88
Total	107	333	275	440

A large number of studies on CSR consider the annual report as the document to analyse (Gray et al., 1995). As argued by Mallin et al. (2014), one of the main limitations of the CSR-FP literature is that these studies assume that CSR disclosure can be inferred from the annual report. In order to methodologically contribute to this literature and extend beyond these limitations, this research considers stand-alone social and environmental reports. Additionally, in Italy, there are no binding requirements to integrate social and environmental issues into annual reports. In order to promote the diffusion of CSR disclosure practices, in 2001 and later in 2006, the Italian Banking Association (ABI) has built up a specific standard for the banking sector's social and environmental reporting (Zappi, 2007), which has been taken as a reference for this study.

Data on the volume and the quality of CSR derive from the implementation of a content analysis⁴. In this study we have performed a quantitative manual content analysis in order to fully capture both the volume and the quality score of the disclosed information employed in stand-alone social and environmental reporting in northern Italian CBs.

The volume of CSR disclosure. Following previous studies (Unerman, 2000), the volume was measured by selecting sentences as the unit of analysis. By starting from the list of indicators/information suggested by the ABI standard, the analysis considers all the narrative information presented in the stand-alone social report. The researchers read the 88 reports more than once to count all of the sentences belonging to the following five areas: economics, customers, human resources, community and environment (Guthrie & Parker, 1990). In constructing our final volume measure for every CB, we calculated a ratio between the total number of sentences per area

⁴ Content analysis enables the researcher to collect large amounts of textual information and systematically identify its properties (Krippendorff, 2004). Beck et al. (2010) suggest that accounting research has used content analysis in two broad ways, either interpretative or mechanistic. Within the mechanistic approach, content analysis can usually be classified into two main groups.

The first group consists of counting every word, sentence, page or page proportion (for a review, see Unerman, 2000; Pesci & Costa, 2014). This research is based on the assumption that the volume of disclosure signifies the importance of the disclosure (Unerman, 2000). The second group uses a scoring system to assess the quality of the information. Different kinds of scoring systems have been employed (for a review, see Al-Tuwaijri et al., 2004), including binary code (presence/absence) and completeness ratings (information only mentioned, detailed information, information supported by numerical data).

and the total number of indicators presented within the same area. This procedure was carried out within each of the five areas of the disclosure.

The quality score of CSR disclosure. The second measure investigates the quality score of the disclosure. According to previous studies, the level of informational detail can vary from a vague and descriptive statement to quantified and numerical data. Non-quantified information is generally considered less significant when compared with numerical information because it is more susceptible to the “green-washing” technique. After considering existing scales, we employed a 4-points score (0-3) like Al-Tuwaijri et al. (2004). Following this scoring scale, the quantitative-numerical disclosure receives the greatest weight (+3). The next highest weight (+2) is assigned to non-quantitative narrative information, which provides a rich and comprehensive description of the topic. Finally, vague qualitative disclosures receive the lowest weight (+1). When certain information is not presented in the report, it is attributed a zero score.

Table 2 and 3 provides the results for CSR disclosure volume and quality score for 88 Italian cooperative banks in 2008. Table 2 presents the descriptive statistics for CSR volume with a focus on different areas of the disclosure.

Table 2 CSR disclosure volume (2008)

Area	Average	Min	Max	Median	DS
Economic	5.3	0	32.0	3.0	6.7
Customer	2.5	0	14.5	2.2	2.2
HR	2.3	0	6.3	2.3	1.5
Community	5.1	1	17.2	4.0	3.9
Environmental	2.0	0	13.3	1.0	2.8
Total	3.7	1.0	8.3	3.3	1.7

Table 3 CSR disclosure quality (2008)

Area	Average	Min	Max	Median	DS
Economic	2.58	0.0	3.0	3.0	1.04
Customer	2.19	0.0	3.0	2.5	1.0
HR	2.34	0.0	3.0	2.71	0.93
Community	2.4	1.0	3.0	2.5	0.60
Environmental	0.5	0.0	2.0	0.5	0.48
Total	2.4	1.3	3.0	2.4	0.4

As we will explain in next section, CSR disclosure volume and quality score are used to test the relationship with CBs FP.

4. Methodology

The empirical analysis is aimed at testing the relationship between CSR and financial performance in Italian CBs over the period of 2007-2011. The analysis has been developed in two steps. First, the paper presents a panel data analysis (with fixed effects) over the period of 2007-2011 to test the relationship between CSR disclosure and FP. Over this period, CSR has been evaluated with a binary approach considering the presence/absence of a social report.

Second, a cross-sectional analysis assesses the relationship, in 2009, between FP and CSR, as captured by the volume (V_CSR) and quality (Q_CSR) score variables. The year 2009 was selected because of the available data on 2008 CSR quality and volume. The data were coherent with previous empirical studies highlighting that in 2008, the stand-alone report was still considered predominant within Italian companies (KMPG, 2011).

Following previous literature, in both types of analyses, the CSR measures have been collected in 2008 and the FP measures in 2009, thus considering a lead-lag effect. This effect is explained by Preston and O'Bannon (1997) and Simpson and Kohers (2002) as implying that social performance, and therefore, social reputation develops first; then, financial performance follows.

To assess whether the presence/absence of the social report produces effects on banks' financial performance, the following panel regression model is estimated [1]:

$$perf_{it} = \beta_0 + \beta_1 CSR_{it-1} + \beta_2 TA_{it} + \beta_3 EQTA_{it} + \beta_4 DF_{it} + \beta_5 LOANTA_{it} + \beta_6 INTMARG_{it} + \beta_7 COST_{it} + \beta_8 TIER1_{it} + \beta_9 BLR_{it} + \mu_{it} \quad [1]$$

where:

$perf_{it}$ = financial performance measures ROA, ROE and z-score for bank i at year t ,

CSR_{it} = dummy variable for bank i at year $(t-1)$, equal to 1 if social report is present and 0 if not,

TA_{it} = total assets value of bank i at year t ,

$EQTA_{it}$ = book value of equity/total assets of bank i at year t ,

DF_{it} = retail deposits/total funding of bank i at year t ,

$LOANTA_{it}$ = loans/total assets of bank i at year t ,

$INTMARG_{it}$ = interest margins of bank i at year t ,

$COST_{it}$ = cost/income ratio of bank i at year t ,

$TIER1_{it}$ = Tier1 ratio of bank i at year t ,

BLR_{it} = bad loans ratio of bank i at year t ,

μ_{it} = error.

The analysis includes 308 bank-year observations because of the exclusion of bank-year observation where the data were not available.

Following previous literature, as performance measures we use two accounting ratios, ROA and ROE (Ayadi et al., 2009; Stefancic & Kathitziotis, 2011), and the z-score (Boyd and Runkle, 1993; Ayadi et al., 2009). We are aware of the limitations that accounting measures of profitability (ROE, ROA) undergo (ECB, 2010). First, they should be complemented by market-based indicators; however, in the case of CBs such measures would have been difficult to analyse because the CBs are generally unlisted. Second, a comprehensive assessment of the performance would have to consider other dimensions - different from profitability and risk – such as that of governance.

The z-score score is a measure of riskiness of the bank that owns several properties: a) combining profitability, leverage, and return volatility in a single measure, it increases with higher profitability

and capitalization levels, and decreases with unstable earnings (Berger et al., 2008); b) it has become a popular measure of bank soundness because it is directly related to the probability of a bank's insolvency (the probability that the value of its assets becomes lower than the value of the debt) (Hesse & Cihac, 2007); c) compared to other risk measures, the z-score seems to be able to better capture the overall riskiness of the bank (Berger et al., 2008); d) given the new rules of Basel III – that includes a leverage ratio – the z-score appears a relevant measure of risk, also from the perspective of the regulators; e) it is used in the studies focused on CBs (Hesse & Cihák, 2007; Garcia-Marco & Robles-Fernandez, 2008; Ayadi et al., 2009; Beck et al., 2010), also in the Italian setting (Cioli, 2014); f) it is employed to make comparisons among different types of banks and cross-country analyses (e.g., Hesse & Cihák, 2007; Demirgüç-Kunt and Huizinga, 2009; Barry et al., 2011; Kohler, 2012).

The regressors include the key independent variable; as mentioned CSR (disclosure) has been evaluated with a binary approach considering the presence/absence of a social report. The model includes a vector of bank-specific variables. The first control variable, total assets, captures the size of the bank. Since larger banks have better risk diversification opportunities, and thus, lower costs of funding than smaller ones, they should exhibit relatively higher levels of performance (McAllister & McManus, 1993); a positive sign of the coefficient is expected. Better capitalized banks should be associated with higher management quality, lower expected bankruptcy costs (Berger, 1995), and riskier assets portfolios (also due to Basel Accord pressure). As a result, the sign of the coefficient should be positive. The same considerations can be applied to the Tier1 variable. The direction of the relationship between the incidence of retail deposits and performance is an open empirical question. Retail deposits carry a lower interest cost with respect to other types of liabilities. On the other hand, retail deposits are costly in terms of the required branching network. As a result, the sign of the coefficient could be either positive or negative (Iannotta et al., 2007). Since loans might be more profitable than other assets, we expect a positive coefficient sign of the ratio loans/total assets. The relationship between net interest margin and profitability is expected to be positive, as interest forms the main positive component of banks' income statements. The bad loans ratio captures the banks' asset quality (Iannotta et al., 2007; Stefancic & Kathitziotis, 2011). Since the profitability of riskier loans is expected to be higher, the relationship with performance could be positive. On the other hand, since a poorer asset quality should increase the bank's cost of funding, this typically implies more resources on credit underwriting and loan monitoring, thus increasing costs (Mester, 1996); therefore, the relationship could be negative.

To assess whether the volume and quality score of CSR is linked to FP we perform a cross-section regression, by adding the one-year lagged volume and quality CSR measures. Due to exclusion of cases where data were unavailable, the cross-section regression analysis includes 59 bank-year observations.

5. Results

Table 4 shows the results obtained by estimating the panel regression model [1], in which the dependent variables are, in turn, represented by RoA (column 1), RoE (column 2) and z-score (column 3). Overall, the results are mixed. When RoA is considered, the results provide evidence that the presence/absence of the stand-alone social and environmental report produces negative

effects on the performance of the sample banks from 2008 to 2011. The CSR variable is slightly statistically significant at 10%. The CSR is not statistically significant when RoE and z-score are investigated; however, the sign of the coefficients seems to confirm the negative influence of CSR on bank performance.

Contrary to our expectation, focusing on RoA showed a negative influence. However, this evidence is not confirmed by other performance measures. The cost-to-income ratio (COST) is strongly significant, and the sign of the coefficient is coherent with our expectations. In the case of z-score, the variable on bank's capitalization (EQTA) is strongly significant with the expected positive sign.

Table 4 Regressions of CSR on Performance (2008-2011)

	(1) RoA	(2) RoE	(3) z-score
CSR	-0.102* (-2.16)	-15.30 (-0.56)	-0.288 (-1.05)
TA	-0.0000** (-2.51)	-0.000000872 (-1.20)	6.23e-10 (0.26)
EQTA	2.096 (0.58)	-265898.8 (-1.15)	300.0*** (9.77)
DF	-0.0959 (-0.14)	2927.5 (1.20)	4.211 (0.88)
LOANTA	-0.645 (-1.07)	1132.0 (0.98)	0.555 (0.16)
INTMARG	1.56e-08 (0.86)	0.0000190 (1.09)	-3.41e-08 (-0.54)
COST	-1.346** (-2.14)	-311.6 (-0.96)	0.630 (0.34)
TIER1	-5.532** (-2.07)	9855.0 (1.21)	7.161 (0.48)
BLR	5.772 (1.14)	-3872.5 (-0.90)	9.334 (0.59)
CONST	3.435** (2.59)	-156.3 (-0.25)	4.931 (0.87)
N	308	308	308
R-sq	0.3541	0.2408	0.8530
adj. R-sq	0.3345	0.2178	0.8485
F (9.79)	.	0.18	53.86

t statistics in parentheses * p<0.10, ** p<0.05, *** p<0.01

To examine whether the volume and the quality score of CSR affects banks' financial performance, we conduct a cross-sectional analysis. Results are presented in Table 5.

We first conducted two regressions in which the quality score and volume of CSR were considered separately. The results of these estimates do not prove the existence of a statistically significant relationship between the FP of Italian cooperative banks and CSR quality score or volume, respectively. We successively estimated a regression in which the CSR quality score and volume variables were both included as independent variables. Table 6 shows the results of these estimates. Ultimately, these findings do not provide evidence that CSR dimensions produce effects on the banks' financial performance. The negative sign of the CSR quality variable seems to confirm the results of previous estimates, while the positive coefficient of the CSR volume variable seems to indicate that the volume of CSR information disclosed positively influences the banks' performance. The significance of the other variables' coefficients substantially confirm the results of the previous panel regressions.

In conclusion, the results of the regression analysis fail to provide evidence that CSR affects banks' performance. However, especially in the case of the cross-sectional analysis, these findings have to

be interpreted with caution because the sample was limited and because the variability of the CSR quality score was not very high.

Table 5 Regressions of CSR Quality and Quantity on Performance (Year 2009)

	(1) RoA	(2) RoE	(3) z-score
Q_CSR	0.0767 (-0.97)	-0.579 (-1.01)	-21.20 (-1.67)
V_CSR	0.0345 (1.71)	0.229 (1.84)	0.757 (0.27)
TA	-0.00000 (-0.62)	-0.00000 (-0.46)	0.00000 (0.41)
EQTA	-1.271 (-0.40)	-21.19 (-1.00)	678.6 (1.06)
DF	0.696* (2.06)	5.973* (2.47)	-13.70 (-0.24)
LOANTA	0.00147 (0.30)	-0.00000310 (-0.00)	-0.136 (-0.19)
INTMARG	-6.55e-09 (-1.26)	-5.41e-08 (-1.74)	-0.00000156 (-0.99)
COST	-2.870*** (-4.51)	-19.40*** (-7.17)	-92.84 (-1.68)
TIER1	0.338 (0.15)	-7.670 (-0.43)	-316.6 (-0.83)
BLR	-5.238 (-1.52)	-58.74 (-1.88)	867.3 (0.95)
CONST	2.330*** (4.21)	20.24*** (7.02)	145.2 (1.64)
N	59	59	59
R-sq	0.7155	0.6753	0.1332
adj. R-sq	0.6563	0.6077	-0.0474
F (10, 48)	.	.	0.45

t statistics in parentheses * p<0.10, ** p<0.05, *** p<0.01

6. Conclusions

This paper investigates corporate social responsibility and its disclosure within the cooperative bank context. A sample of 88 northern Italian CBs from 2007 to 2011 have been used in the analysis in order to better understand if CBs discharge accountability on their social responsibility and to assess if corporate social performance may positively affect long-term financial performance.

In order to make a contribution to the theoretical debate regarding CSR disclosure, this paper considers both the annual report and the stand-alone social and environmental reports while holistically assessing the volume and quality of the disclosures in five different areas: economics, customers, employees, community and environment. The paper also empirically investigates the CSR-FP link in order to support the social impact theory (Preston & O'Bannon, 1997; Waddock & Graves, 1997).

The empirical analysis represented a first attempt to analyse the relationship between banks' financial performance and CSR. It provided evidence that CSR fails to produce effects on the banks' performance. These results opens new avenues of research to understand why a higher financial performance would remain unaffected by higher social performance in the cooperative bank context. Due to the mutualistic nature of the cooperative banks analysed, many possibilities could explain our results, and each of them requires further research and explanation. First, by

referring to Wu and Shen's (2013) arguments, future investigation should consider alternative CSR and FP measures in order to avoid miscalculating the economic dimension within the volume and quality score of CSR disclosure. Moreover, CB financial performance could be better interpreted in terms of economic added value. Future research could also extend the analysis by adopting a larger sample of CBs and using a longer time-span, in order to better test different lead-lag effects.

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