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*Full Length Research Paper*

# Factors affecting bank profitability in Europe: An empirical investigation

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The aim of this paper was to explore the relationship between bank-specific characteristics and profitability in European banking sector in order to determine the impact of internal factors on achieving high profitability. A regression analysis was done on an unbalanced panel dataset related to 28 European banks over the period of 2006-2015. The largest bank for any single country of the European Union was selected. Regression results show that capital ratio and size have positive impacts on bank profitability in Europe,; while higher asset quality results in lower profitability levels. Findings also suggest that banks with higher deposit ratio tend to be more profitable. The study provides interesting insights into the characteristics and practices of profitable banks in Europe. Few econometric studies have empirically explored the determinants of profitability in Europe banking sector so far, even though similar studies have been conducted in several developed countries.

**Key words:** Bank profitability, determinants of bank performance, internal factors of bank profitability, European banking sector.

## INTRODUCTION

It is generally agreed that the banking sector fulfills an important economic function in stoking up a sustainable economic development. In this regard, banks play an important role in economy and their stability is relevant and critical for the financial system. Consequently, if a financial system is efficient, then it should record profitability advances, growing the amount of funds rolling from savers to borrowers, and increasing better quality services for customers (De Bandt and Davis, 2000). In the literature, the performance of banking system has been widely debated and some prior studies contributed to explore the determinants of profitability for banking sector, inspecting - for example - the size of the bank and

how it is diversified, the bank's ownership characteristics, the attitude of the bank's owners and managers towards risk and the extent of competition a bank deals with (Goddard et al., 2001).

While there has been wide literature examining the profitability of financial institutions in developed countries, empirical studies on factors influencing the performance of banks in European economy are quite few. Especially with respect to the impact of internal factors on banks' profitability, a limited number of theoretical studies have been carried out for the European region, while several others have investigated the matter related to specific countries. Likewise, limited econometric studies have

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already inspected the determining factor of profitability for the European banking system. For example, prior studies on European banks were focused on other aspects of bank performance. For instance, Claeys and Vander Vennet (1998) examined the determinants of bank interest margins and they evaluated to what extent, the low bank margins can be accredited to limited efficiency and non-competitive market conditions of the macroeconomic environment in the Central and Eastern European Countries (CEEC).

The purpose of this study was to inspect bank profitability in the context of 28 European banks, by using cross-sectional time series data. An extensive literature that focused on specific determinants of bank profitability was followed. Thus, on the basis of the existing studies that highlighted the impact of internal factors on bank profitability, a cluster of internal variables in our regression model was included in order to capture their effects on European banks' performance.

This paper is organized as follows: The introduction is developed in Section 1. Section 2 provides a literature review on the determinants of bank profitability and describes the research hypotheses based on previous studies. Section 3 defines the research methodology and data sample. The econometric model applied and the variables used in the regression model are described in this Section. Empirical findings of the study are presented and investigated in Section 4. The final section underlines the results achieved by this research and offers some proposals for future empirical studies.

## LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

The importance of bank profitability at the micro and macro levels led researchers, academics, bank managers and bank regulatory authorities to grow wide interests on the determinants of banks' profitability (Athanasoglou et al., 2008). Some banks gain relatively high rates of return, while others earn lower ones. How much variation in these banks' profitability came from differences in external factors under the control of bank management? The earnings performance differs widely from one bank to another and a number of causes could be assumed to contribute to the variability of bank profits, such as differences in bank's size, structure and location, as well as variances in quality of bank management, asset portfolios and liabilities composition.

There have been several studies on the influence of firm characteristics on profitability and following early works by Short (1979) and Bourke (1989), more recent studies have attempted to recognize some of the main determinants of bank profitability in many countries. Some studies are country-specific (Garcia-Herrero et al., 2009; Saeed, 2014; Ghazouani and Moussa 2013; Gul et al., 2011; Ali et al., 2011; Tarus et al., 2012; Sufian

and Habibullah, 2009; Sufian and Chong, 2008; Dietrich and Wanzenried, 2009), while few of them consider panel of countries (Abreu and Mendes, 2002; Staikouras and Wood, 2004; Pasiouras and Kosmidou, 2007).

The empirical findings of the mentioned studies diverge significantly because of the differences in time periods, datasets and examined countries. Many factors affect bank profitability but it is possible to find some common elements that can be used to further categorize its determinants. Particularly, these factors are classified into two main categories: i.e, factors that are controlled by the management (managerial or internal factors) and those that are beyond the control of management (environmental or external factors). For this reason, the authors prefer to categorize the related literature according to internal and external determinants of bank profitability rather than according to investigation based on a specific country or on a set of countries. In the literature, bank profitability is usually expressed as a function of internal and external determinants, but especially the internal ones (also termed micro or bank-specific factors) have been shown to be the most important in influencing this profitability.

The internal determinants of profitability are empirically well investigated and most of the previous studies stated that size (Berger et al., 1987; Bikker and Hu, 2002), capital ratio (Molyneux and Thornton, 1992), liquidity ratio (Bourke, 1989; Molyneux and Thornton, 1992), asset quality and operational efficiency of the banks are important factors in achieving high profitability. The mixed results reached in prior literature implicated uncertain findings on the relationship between internal factors and bank profitability and then a growing interest towards this subject.

Additionally, Abreu and Mendes (2002) investigated the causes of bank's profitability in some European countries in the previous decade. They found that well capitalized banks face lower estimated bankruptcy costs and this circumstance results in greater profitability. Beccalli (2007) inspected whether investments in information technology (IT) affect the performance of banks. Using a sample of European banks over the period 1995-2000, Vander (2002) analyzed the cost and profit efficiency of European banks.

Altunbas and Marques (2008) studied the effect of European Union banks' strategic similarities on post-merger performance and they discovered that, on average, mergers lead to much performance in banking sector. Thus, a specific more recent analysis of the determinants of bank profitability in Europe is substantially missing since only few authors (Molyneux and Thornton, 1992; Abreu and Mendes, 2002; Pasiouras and Kosmidou, 2007) focused on this specific subject.

Hence, the purpose of this study was to investigate the relationship between internal factors and profitability in top 28 European banks and to contribute to the development of the pertinent literature. Based on the

contents and the aim of studies cited in the literature review, a number of explanatory variables have been considered as internal determinants of bank profitability. In particular, the management controllable (internal) factors considered in this study are: deposit ratio, asset quality (loan loss provisions) ratio, size, capital ratio and loan ratio. Based on the prior literature, this study aims to verify the following hypotheses.

### **Deposit ratio**

The more the deposits a bank collects, the more the loan opportunities it will be able to provide to customers and then it will be able to generate further profits. It could be expected that higher upward deposits would develop the business of the bank and consequently produce more profits. Lee and Hsieh (2013) underlined this matter by concluding that additional deposits can be advantageous to banks in generating more profits while low deposits may impact negatively on their profitability. It is generally supposed that customer deposits affect banking performance positively if there is a satisfactory demand for loans in the market. Increasing deposits (the ratio of total deposits to total assets) implies the growth of the funds available to different profitable uses (e.g. lending activities and investments), which should upsurge bank's return on assets when other factors are constant.

Therefore, customer deposits are positively related to bank profitability but more deposits may dampen earnings, since loan demand is little and not too profitable. Bank's incapacity in releasing money through loans may reduce its profitability level because of the interests paid to depositors. Hence, the impact on profitability that originates from a growth in deposits depends on several factors. First, this impact is influenced by bank's ability to transform deposit liabilities into income-earning assets, which reveals bank's operating efficiency as well. Hence, a positive impact of deposits on bank profitability relies on the credit quality of these assets. The effect of fund source on profitability is measured by deposits over total assets ratio and, according to prior literature, it can be hypothesized that:

H1: There is a positive relationship between deposit ratio (DEP) and bank profitability.

### **Asset quality ratio**

The ratio of loan loss provisions over total loans (asset quality ratio) is now analyzed to measure the effect of a bank's asset quality on profitability. If banks operate in more risky and uncertain environment and they find difficulties controlling their lending operations, the loan loss provision ratio probably will be higher, indicating a reduced credit quality and thus a lower profitability. A negative impact of loan loss reserves on bank profitability

would suggest a reduced quality of loans that upsurges the provisioning costs and declines interest revenue. Hence, the loan loss provisions to total loans ratio is expected to have a negative relationship with bank profitability because bad loans are expected to decrease profits.

In this way, Miller and Noulas (1997) found a negative association between credit risk and profitability. They argued that such correlation indicates a greater risk of loans because the more the exposure of the banks to high risk loans increases, the more the growth of unpaid loans would be enlarged and profitability would decline.

However, according to the risk-return hypothesis, a high asset quality ratio together with a sound quality of loans could suggest a positive correlation between risk and profits. In this regard, Kosmidou et al. (2008), Athanasoglou et al. (2008) and Vong and Chan (2009) stated a positive relationship between the ratio of loan loss provisions over total loans (asset quality ratio) and profitability. However, according to Fu and Heffernan (2010), the estimated relationship of this ratio with profitability can be positive or negative due to the assessment of a possible loan loss in the future or a timely recognition of bad banks' loans. According to what was pointed out above, the results of the majority of the existing studies lead to the following hypothesis:

H2: There is a negative relationship between asset quality ratio (ASSQ) and bank profitability.

### **Size**

One of the main enquiries in the literature is whether bank size maximizes banks' profits. The relationship between size and profitability has been inspected in some prior studies and many empirical results proved the role of size as a determinant of bank profitability. Following the review of the existing literature concerning the relation between bank size and profitability, different results have been observed.

In previous studies by Alp et al. (2010), Bikker and Hu (2002) and Dogan (2013), a significant positive correlation between size and profitability was identified. Also Camilleri (2005), Athanasoglou et al. (2008), Pasiouras and Kosmidou (2007), Gul et al. (2011) and Saeed (2014) found that size positively influences the profitability of the banks they have investigated. Mainly, prior studies on the effect of size on bank profitability joined with the idea that large banks can benefit from economies of scale enable cost reduction (Molyneux and Thornton, 1992; Bikker and Hu, 2002; Goddard et al., 2004a). Based on this efficiency hypothesis, larger banks are more profitable than smaller ones because economies of scale lead to the increase of operational efficiency. Large banks might also benefit from scope economies (reduced risks and product diversification), by accessing markets in which small banks cannot enter.



However, the impact of such economies is not unequivocal because the findings do not reveal that an increase in size always amplifies the profitability level. Some studies have tested economies of scale for large banks (Altunbas et al., 2001) while others have found diseconomies for them or economies of scale for small ones. In particular, Vander (2002) observed economies of scale only for the smallest banks in Europe and diseconomies of scale for the largest ones. Some researchers suggested that banks could reduce costs by increasing their size but on the other hand, banks might incur in scale of inefficiencies (Berger and Humphrey, 1997); for this reason, smaller banks could be more profitable than larger ones. According to these studies, large banks' size might imply a negative relationship between size and profitability, caused by costs related to the management of extremely large firms, overheads of bureaucratic processes and agency costs (Stiroh and Rumble, 2006; Pasiouras and Kosmidou, 2007; Athanasoglou et al., 2008). Also, other researchers confirmed a negative relation between profits and bank size, suggesting that larger banks attain a lower level of profitability as compared to smaller ones. These results are suggested by Sufian and Chong (2008) in Asia, Miller and Noulas (1997) in the USA, Jiang et al. (2003) in Hong Kong and Bashir (2003) for Middle Eastern Islamic banks.

Hence, the mentioned existing findings produce a vague understanding of the effect of size on profitability in banking sector. As a result, size is encompassed in the regression model to catch the cost advantages associated with size (economies of scale) and the higher ability of larger bank in the differentiation of their products and services. As in the literature, bank size is considered an independent variable. Based on main literature review, bank size is measured by total assets and is stated to be positively associated with profitability:

H3: There is a positive relationship between size (SIZE) and bank profitability.

### Capital ratio

Capital ratio is comprised in the regression model to inspect the relationship between profitability and bank capitalization. The equity to total assets ratio (capital ratio) is considered a basic measure of capital strength (Golin, 2001) and is widely used to analyze the status of a bank's financial power. The capital ratio is a valued tool for assessing capital adequacy as it represents the strength of capital structure to bear losses and to dismiss the risk of insolvency during crisis times.

Researchers extensively theorize that banks with higher capital are more protected from insolvency. For instance, some empirical evidences by Pasiouras and Kosmidou (2007), Garcia-Herrero et al. (2009), Kosmidou

(2008), Obamuyi (2013) and Dietrich and Wanzenrid (2009) demonstrated that the best performing banks are those who preserve a high level of equity relative to their assets. Such positive correlation has been confirmed also by Sufian and Chong (2008), Hassan and Bashir (2005) and Vong and Chan (2009). It is largely assumed that well capitalized banks challenge lower probable costs of financial distress and such circumstance will then be turned into high profitability (Abreu and Mendes, 2002). In particular, Abreu and Mendes (2002) found that in some European countries, well capitalized banks meet low predicted bankruptcy and low funding costs together with higher interest margins on profitable assets, thus demonstrating a positive relationship between capital and bank profitability. Then, higher volume of equity will reduce the cost of capital, causing a positive effect on profitability. Furthermore, it is estimated that banks with higher capital ratio are less dependent on external funding, with a positive impact on their profits. Therefore, well capitalized banks achieve greater profitability because lower risk raises bank's creditworthiness and reduces the cost of funding. On the contrary, lower capital ratio involves higher leverage risk, which implies higher borrowing costs. Some authors mentioned above considered banks with higher capital ratios less risky as compared to others with lower capital ratios. To this point, high capital ratio is considered a measure of low leverage and therefore of low risk.

Even though capitalization has been tested to play an overall and essential role in improving the performance of financial institutions, some empirical findings demonstrated that this direct relation is not always assured. In line with these findings, it should be expected that banks with lower capital ratio should have higher profits as compared to well capitalized ones (Saona, 2011; Ali et al., 2011; Staikouras and Wood, 2004). Therefore, this risk-return assumption would entail a negative relationship between capital ratio and bank profitability.

Anyway following to the previous considerations and regarding most of the prior studies cited, capital ratio is estimated to show a positive relationship with profitability because well capitalized banks are assessed to be more profitable. The findings of majority of the prior literature led to the following hypothesis:

H4: There is a positive relationship between capital ratio (CAP) and bank profitability.

### Loan ratio

A lot of academics assign a prominent role to asset and liability composition ratios in influencing bank performance. In this regard, the volume of loans and deposits detained are used to measure the efficiency of asset and liability portfolio management, respectively.

Consistent with prior literature, total loans to total assets ratio (loan ratio) is considered an indicator of liquidity and liquidity is very important in explaining bank profitability and loans are the main source of income and are estimated to have a positive impact on bank performance. Much literature found a positive relationship between liquidity and profitability (Abreu and Mendes, 2002; Bashir, 2003; Sufian and Abibullah, 2009) as a bank which holds a reasonably high quantity of liquid assets will probable obtain high profits.

Even though bank loans are the main source of returns and are anticipated to impact profits positively, evidences from many existing studies revealed a negative correlation between bank loans and profits. For these reasons, empirical results of studies concerning the relationship between liquidity and profitability in banks are diversified. When banks increase their loans portfolio, it could be assumed that they have to pay upper costs for their funding provisions.

In this case, a very elevated loan ratio could imply that banks have rapidly grown their loans portfolio paying a higher cost for their funding necessities and this circumstance could cause a negative effect on profitability.

From a theoretical perspective, the influence of loans on bank performance is quite challenging to predict. For example, a bank with a higher growth rate of its loan volume, apparently, would be more profitable in consequence of the added business created. However, a high growth of the loan volume might also result in a drop of credit quality and consequently in a reduced profitability. A big credit portfolio could lead to reduced bank profits if it largely includes high-risk loans which could cause lower returns and financial losses.

Furthermore, if the bank increases loan volume along with lower margins, it could be presumed a negative effect on profitability (Hassan and Bashir, 2005; Staikouras and Wood, 2004).

In this regard, Duca and McLaughlin (1990), among others, concluded that differences in bank profitability largely depend on changes in credit risk and also Miller and Noulas (1997) stated a negative relationship between credit risk and profitability as variations in credit risk produce changes in the credit quality of a loan portfolio (Cooper et al., 2003).

Since the impact of loan ratio on profitability could be positive or negative, the effect on bank profitability cannot be predicted theoretically. In fact, the profits of a bank depend on either the amount and the composition of its credit portfolio.

Hence, it is possible to conclude that the size of a bank's credit portfolio affects its profitability either positively or negatively, depending on its credit quality. However, in line with the majority of the mentioned studies, the following hypothesis is suggested:

H4: There is a positive relationship between loan ratio (LOAN) and bank profitability.

## Data source and research design

In this paper, the cross-sectional and time series data downloaded from Bank scope have been examined applying a panel data multiple regression. The sample is an unbalanced panel dataset of 28 large European commercial banks, based on 280 observations over a 10-year period from 2006 to 2015. To account for profit persistence and potential endogeneity problems, the system GMM estimator was applied for our panel of European banks. The authors applied the GMM up-to-date econometric technique to address the issue of endogeneity of regressors which can lead to inconsistent estimates in this type of study.

Regarding the time period, the panel data are collected from 2006 to 2015 in order to study the period before and after the beginning of the financial crisis. The investigation of banks' profitability is particularly interesting in this period as the financial system and banks have been exposed to several financial shocks and challenges in many countries.

As this study is related to commercial banks in Europe, non-banking credit institutions, securities houses, investment banks and the European Central Bank (ECB) were excluded. Within the sample selection, the 28 European banks (Appendix 1) have been selected for data collection as each of them is scheduled the "largest bank" in each country of the European Union by Bankscope according to the amount of total assets. Overall, the banks in this sample are focused on commercial banking activities, with a median of approximately 80% of their income produced in the traditional field of interest income.

Banks had to meet a series of conditions in order to be included in the sample. First, they had to be European owned commercial banks among the financial institutions operating within the European Union banking sector, in line with the nationality analysis of the European Central Bank (ECB) updated at 31st December 2015. Second, data of the annual balance sheets and income statements had to be available for all the years between 2006 and 2015 (collected from the Bankscope database).

In this section, both the dependent and independent variables that we selected for our analysis are also defined. Even if the definition of profitability differs in banking literature, this study postulates return on equity (ROE) as the measure of profitability (dependent variable), in line with previous literature. ROE indicates the returns to shareholders on the book value of their investments (equity) and then it measures a firm's efficiency to generate profits from every unit of shareholders' equity. In other words, ROE shows how successfully a company invests funds to grow earnings. In line with prior studies on bank profitability, ROE is defined as the ratio of net profits to total equity.

Five bank-specific independent variables are investigated in the study as internal determinants of European banks' profitability. Precisely, the internal factors used in the regression model are: total deposits to total assets (DEP), asset quality expressed as the ratio of loan loss provisions over total loans (ASSQ), total assets of a bank representing bank's size (SIZE), ratio of equity to total assets indicating capital strength (CAP) and loans to total assets (LOAN).

The ratio of deposits to total assets (DEP) is estimated to have a positive effect on banks' profits even though the effect on profitability originating from a growth in deposits is influenced by several factors. For example, it depends on a bank's operating efficiency (the bank's ability to transform deposit liabilities into income-earning assets) and on the credit quality of interest-earning assets.

The ratio of loan loss provisions over total gross loans is used as a measure of a bank's asset quality (ASSQ) and it is combined as an independent variable in the regression analysis. The ratio of loan loss provisions to total loans is also an indicator of credit risk. A higher ratio shows lower credit quality and, thus, a lower

**Table 1.** Explanation of variables used in the regression model.

| Variable                     | Description         | Measure                                | Expected effect on profitability |
|------------------------------|---------------------|--|----------------------------------|
| <b>Dependent variables</b>   |                     |  |                                  |
| ROE                          | Return on equity    | Net income/average total equity (%)    | NA                               |
| <b>Independent variables</b> |                     |  |                                  |
| DEP                          | Deposit ratio       | Total deposits/total assets            | +                                |
| ASSQ                         | Asset quality ratio | Loan loss provisions/total gross loans | -                                |
| SIZE                         | Bank size           | Total assets (mil EUR)                 | +                                |
| CAP                          | Capital ratio       | Equity/total assets                    | +                                |
| LOAN                         | Loan ratio          | Net loans/total assets                 | +                                |

profitability. Hence ASSQ is estimated to have a negative relationship with profitability.

In this study, the size of the bank (SIZE) is included in the regression model and it is measured by total assets. Usually, the effect of increasing size on profitability has been verified to be positive to a certain extent but the impact of size could be negative especially due to bureaucratic reasons for those banks that are excessively large.

Capital ratio is measured by equity over total assets (CAP). It represents bank capitalization and identifies the ability of a bank to manage losses and risk exposures. A higher capital level raises profitability since a bank can certainly be compliant with regulatory capital standards by having more capital and consequently by using the excess capital as loans. Capital ratio is predictable to have a positive relationship with profitability because well capitalized banks are less risky and more profitable.

The ratio of net loans to total assets (LOAN) is estimated to have a positive association with bank profitability. Other conditions being constant, the more the deposits are converted into loans, the higher the level of profitability is. Nevertheless, it could be possible that banks that are fast growing their loans have to meet higher costs for their funding supplies and this circumstance could impact negatively on profitability.

The explanations of dependent and independent variables investigated in our study are presented in Table 1. Which lists all the variables used in the regression model, including their description, measure and expected effects on profitability.

To test the hypotheses of the study, a linear regression model was constructed using the cross-sectional time series data of European banks in the period 2006-2015. As a result, a multivariate analysis was carried out applying a OLS-regression model and panel regression techniques. As the data set proves that European banks reply to cyclical movements similarly, the authors applied pooled least squares (OLS) method. OLS-regression model is the most consistent regression method because of its general attitude in minimizing biases and variance (Koutsoyiannis, 2003; Greene, 2004). Panel data (or cross-sectional time series data) were selected because they can measure respectively individual variability and dynamic change of the cross-sectional units over time. To examine the determinants of European banks' profitability, a linear regression model is estimated as follows:

$$Y_{it} = \delta_0 + \alpha_1 DEP_{it} + \alpha_2 ASSQ_{it} + \alpha_3 SIZE_{it} + \alpha_4 CAP_{it} + \alpha_5 LOAN_{it} + \varepsilon_{it}$$

where  $Y_{it}$  is the profitability of bank  $i$  at time  $t$ ;  $i$  refers to an individual bank;  $t$  refers to year;  $\delta_0$  constitutes the fixed effect, DEP, ASSQ, SIZE, CAP and LOAN represent the internal factors (determinants) of a bank's profitability;  $\varepsilon_{it}$  is a normally distributed random variable

disturbance term (error term).

The model is estimated using a fixed effects regression analysis, using the least square method to a fixed effects model. The firm-level heterogeneity was eliminated through the use of mean deviation data. White's (1980) transformation was applied to verify cross-sectional heteroscedasticity of the variables and the standard errors tested for all coefficients were based on White's adjustment.

The option of a fixed effects model rather than a random effects one has been verified with Hausman test (Baltagi, 2001). The Breusch-Pagan test was also used to check for residual heteroscedasticity. Given the dynamic nature of this model, least squares estimation methods generate biased and inconsistent evaluations. Therefore, techniques for dynamic panel estimation that are able to deal with the biases of our estimates were used. Another challenge concerning the estimation of bank profitability refers to the endogeneity problem which is addressed in this study by employing the generalized method of moments, also known as system GMM estimator.

## REGRESSION RESULTS AND DISCUSSION

Based on panel data, all the variables are observed for each cross-section and time period. Descriptive statistics, correlation matrix and multivariate regression results are presented in Tables 2, 3 and 4, respectively. Table 2 shows summary statistics of the dependent and independent variables used in the regression model. The table reports the results of descriptive statistics for all the variables included in the sample data set. A wide variety of profitability information is found. Particularly, the value of ROE has significant dispersion in the scores, as revealed by the minimum, maximum and standard deviation values. On average, European banks show a ROE of 0.405073 over the entire period of 2006 to 2015. The amount of ROE ranges from -94.5790 to 20.8770 and the highest standard deviation is 16.5710. The difference between mean and standard deviation reveals the existence of great differences among the profitability of banks.

A large variation is also marked with regard to some of the independent variables as signified by their minimum and maximum values. Especially, there is a large

**Table 2.** Summary statistics.

| Variables                    | Mean     | Median   | Minimum    | Maximum      | Std. deviation | 5%       | 95%          |
|------------------------------|----------|----------|------------|--------------|----------------|----------|--------------|
| <b>Dependent variables</b>   |          |          |            |              |                |          |              |
| ROE                          | 0.405073 | 4.25300  | -94.5790   | 20.8770      | 16.5710        | -9.3508  | 15.2754      |
| <b>Independent variables</b> |          |          |            |              |                |          |              |
| DEP                          | 2.56763  | 2.48703  | 0.220000   | 8.65300      | 1.64302        | 0.536700 | 5.63161      |
| ASSQ                         | 0.543716 | 0.560350 | 0.00000    | 0.856000     | 0.131395       | 0.433800 | 0.907620     |
| SIZE                         | 709513.  | 581808.  | 16689.0    | 2.41562e+005 | 545162.        | 45207.4  | 1.75401e+005 |
| CAP                          | 4.97803  | 4.38020  | -0.0690000 | 16.7950      | 2.75968        | 1.50320  | 11.4948      |
| LOAN                         | 45.7238  | 47.2790  | 8.89600    | 76.7042      | 15.7267        | 18.9161  | 72.5516      |

**Table 3.** Correlation matrix.

| Variables | ROE    | DEP    | ASSQ    | SIZE    | CAP     | LOAN    |
|-----------|--------|--------|---------|---------|---------|---------|
| ROE       | 1.0000 | 0.1294 | -0.2730 | 0.0199  | 0.3427  | 0.0976  |
| DEP       |        | 1.0000 | -0.0784 | -0.0123 | 0.0478  | 0.0327  |
| ASSQ      |        |        | 1.0000  | -0.0310 | 0.0642  | 0.0365  |
| SIZE      |        |        |         | 1.0000  | -0.1691 | -0.1284 |
| CAP       |        |        |         |         | 1.0000  | 0.2574  |
| LOAN      |        |        |         |         |         | 1.0000  |

**Table 4.** Regression analysis.

|  | Coefficient | Std. Error        | t-ratio   | p-value    |
|--|-------------|-------------------|-----------|------------|
| <b>Model 1 - Dependent variable: ROE</b> |             |                   |           |            |
| Const                                    | -23.7040    | 6.81397           | -3.3989   | 0.00084*** |
| DEP                                      | 2.03139     | 0.92625           | -2.4782   | 0.01486**  |
| ASSQ                                     | -24.9967    | 10.4186           | 2.4110    | 0.01802**  |
| SIZE                                     | 5.96725e-04 | 2.37309e-04       | 2.5089    | 0.01406**  |
| CAP                                      | 1.94366     | 0.473487          | 4.3267    | 0.00005*** |
| LOAN                                     | 0.0426859   | 0.0934593         | 0.3675    | 0.72537    |
| R-squared                                | 0.243516    | Log-likelihood    | -707.7532 |            |
| F-statistic                              | 5.176401    | Schwarz criterion | 1582.255  |            |
| S.E. of regression                       | 15.20784    | Akaike criterion  | 1523.696  |            |
| Adjusted R-squared                       | 0.776023    | Hannan-Quinn      | 1565.481  |            |
| P-value(F)                               | 2.69e-04    | Durbin-Watson     | 1.897152  |            |

\*\*\*, \*\* and \* indicate significance at the level of 0.01, 0.05 and 0.10, respectively.

variation within the data set of SIZE. Some of the banks have large size and higher capital because they are well established for a long period, while the others have small size and thus less capital. The standard deviation for SIZE amounts is 545162, while all the other independent variables display lower standard deviation values which indicate much more consistency of the data set. For example, the value of capital ratio (CAP) varies among banks (as well as the other internal determinants) but the

standard deviation is quite low (2.75968), showing a small variation in the values. In this sample, the best capitalized bank show a capital ratio of 16.7950, whereas it amounts to -0.0690000 for the least capitalized bank.

To carry out the regression analysis, the existence of an econometric problem of data set is checked by using the correlation matrix. The authors tested the independence of variables to verify the absence of multicollinearity problems that may compromise the

results. The relationships among the research variables used in the model can be found in Table 3.

Table 3 presents correlation coefficients for the variables involved in the regression model. The matrix shows that the correlation between the bank specific variables is not strong, suggesting that multicollinearity problems are not severe and confirming that the model employed is soundness and reliable (Kennedy, 2008). In this regard, the correlation between each of the variables is not high and the maximum degree of correlation found is very satisfactory. As a result, the coefficients show that a multivariate analysis can be implemented by inspecting individual correlations between independent and dependent variables. The regression results are shown in Table 4. The full regression results, which include both time and bank-specific fixed effects are not reported in this paper.

The empirical analysis shows some relevant differences with respect to both the significance and the size of the estimation findings. In particular, the R-square indicates how internal factors are related to bank profitability and the adjusted R-squared refers to the reliability of additional predictor variables with statistical shrinkage. The difference between R-square and adjusted R-squared (shrinkage level) is low, showing an acceptable level of correlation between dependent and independent variables. The value of F-statistic is significant confirming the validity and the stability of the model employed in our study. The explanatory power of the models is reasonably high since the value of the R-squared adjusted (0.776023) evidences that about 77% of the variation of the dependent variable ROE is explained by the independent variables included in the analysis.

The deposit ratio - amount of deposits to total assets (DEP) - has a positive and significant influence (at the level of 5%) on ROE. This result supports similar studies concerning banks' profitability such as Al-Jarrah et al. (2010), Gul et al. (2011) and Saeed (2014). The results concerning the variable DEP sustain the view that banks depending on deposits for funds can realize high return on assets. More deposits improve the lending capacity and determine higher profits. After the crisis period, top banks in Europe were able to collect additional saving deposits and to transform the growing amount of deposit liabilities into greater income earnings. As the demand for lending increased, even profitability enlarged because banks had been able to find attractive investment opportunities lending their additional deposits.

Literature shows that wide exposure to credit risk is generally related to low firm profitability and, hence, the authors assumed a negative relationship between the ratio of loan loss provisions to total gross loans ratio (ASSQ) and profitability. In this analysis, ASSQ is established to have a significant negative impact on banks' profitability. As expected, the regression coefficient is negative and significant for ROE (at the level of 0.05), suggesting that European banks with

higher credit risk have a lower profitability. The sign of this ratio is in line with the results of other studies performed in the most developed countries as mentioned in the literature review.

The findings advise that European banks would expand profitability by screening and monitoring more efficiently credit risk and thus by improving the estimation of future risks. In this regard, European banks should dedicate more on credit risk management which would support financial institutions in assessing well credit risk. Nevertheless, the relationship between asset quality ratio and ROE depends on the reliability of the financial system over the cycle as higher risk assets could imply higher returns during an economic upturn.

Turning to another explanatory variable, SIZE has a significant positive impact on profitability, showing that larger banks better succeed than smaller ones in achieving a higher ROE. This result is consistent with prior evidence (Pasiouras and Kosmidou, 2007; Staikouras, et al., 2008; Goddard et al., 2004a; Gul et al., 2011). Since a bank expands its operations, there are more opportunities of a growth in profitability. The first explanation for the positive relationship between size and profitability is linked to economies of scale (Hauner, 2005; Pasiouras and Kosmidou, 2007; Staikouras et al., 2008). In this regard, a potential cause is related market power because banks having huge amounts of assets generally control a larger portion of the market, improving profits through the allocation of fixed costs over a larger volume of services (Hauner, 2005). This position should enable such banks to pay less for their inputs and to acquire less expensive capital. It also reveals that larger banks are able to take advantage of higher production and loan diversification opportunities (Bikker and Hu, 2002). For these reasons, since the unit costs of large scale banks are likely to be lower than those of smaller banks, their profitability ratios will be higher.

For hypotheses testing, results document that capital ratio (CAP) is positively related with profitability because well capitalized banks experience higher returns by reducing their cost of funding and by facing lower risks of going bankrupt. On the contrary, lower capital ratios imply greater leverage and risk, and then higher borrowing costs. If an increase in the amount of equity may allow banks to reduce their level of debt, lower funding costs are expected. Therefore, it is logical that the profitability level should be higher for the better capitalized banks. In fact, the regression coefficients of the capital ratio are positive and statistically significant (at the level of 0.01), reflecting the positive impact of capital strength on profitability in European banking sector (the value of the coefficient is 1.94366). These empirical results are consistent with previous studies of Kosmidou et al. (2006), Berger (1995a, b), Dermiguc-Kunt and Huizinga (1999), Staikouras and Wood (2004), Goddard et al. (2004a), Pasiouras and Kosmidou (2007), Sufian and Chong (2008) and Saeed (2014). It can be concluded that banks with low leverage ratios (banks financed by

high amounts of equity) are able to be more profitable. A robust capital structure is crucial for financial institutions in pursuing successfully business opportunities and in withstanding unexpected losses, thus achieving more profitability.

Regarding loan ratio (LOAN), this study hypothesis is not supported by the findings as the analysis suggests that LOAN has a positive but insignificant influence on the level of ROE. The results show that more loans increase the chances of achieving higher profitability but the effect is not certain. Regression findings invalidate a correlation between this independent variable and the mentioned measure of profitability used as dependent variables, in contrast with the hypothesis 5 which states that loan ratio is positively related to profitability. Moreover, the results do not confirm those obtained from other similar studies (Kosmidou, 2008) which have found that the ratio of net loans to total assets of European banks has a negative influence on profitability.

## Conclusion

This study examines the impact of bank-specific characteristics (internal factors) on European banks' profitability. In this scope, factors affecting bank profitability have been analyzed in a multiple regression model by using a sample of banks operating in Europe in the period 2006-2015. Panel data estimation has been applied to 28 large European banks, analyzing the cross-sectional and time series data for the mentioned period. Regression results suggest that there are differences in profitability among the banks included in the sample and a significant extent of this variation can be explained by the analyzed independent variables. SIZE- represented by total assets, is the main determinant of European banks' profits, demonstrating that large banks take advantage of the economies of scale and the differentiation of their products and services. Empirical results also demonstrate that asset quality ratio (ASSQ) is another internal determinant of bank profitability in Europe but its impact is negative. On the contrary, the effect of deposit ratio (DEP) on ROE is positive and significant. The findings also show that capital strength, measured by equity to total assets (CAP), is a significant determinant of bank profitability. Well capitalized banks reduce costs of external financing and such an advantage can be turned into higher profitability. On the other hand, regression analysis shows that the ratio of net loans to total assets (LOAN) does not explain the variability of profitability measured by ROE.

The findings provide interesting insights into the characteristics and practices of commercial European banks. In this regard, some suggestions may be beneficial for banks' management, policy maker, shareholders and bank regulatory authorities (i.e. the central banks, banker associations, governments) in order to intensify and sustain soundness and stability of

the banking sector. This study has considerable policy implications since the ability to maximize risk-adjusted returns on investment and to sustain stable and competitive advantages is a crucial factor in order to safeguard the competitiveness of the European banking sector. It would be useful to identify the profitability determinants of successful banks in order to define policies for intensifying and maintaining the strength and the stability of the banking sector in Europe.

The results of this study have other important implications. First, the results offer comprehensive new insights into the factors determining the profitability of commercial banks in Europe. Single bank's characteristics explain a portion of the within-country variation in European bank profitability, suggesting that much more attention should be dedicated on bank's specifics to increase the profitability. Secondly, the study could be a support for investors in their decision making process and particularly could be useful for the global institutional investors looking for profitable investment opportunities in European banking sector.

Finally, the study extends prior literature in several ways. To date, very few econometric studies have empirically explored the determinants of profitability of the European banking sector (Goddard et al., 2004b; Athanasoglou et al., 2006), even though similar studies have been conducted in some developed countries. Therefore, the present paper tries to bridge the gap in the existing literature improving the insights of bank profitability in Europe. Based on this study, many others could be carried on by investigating any internal and/or external variables that could affect the bank profitability. Furthermore, future research may be conducted by including further European banks in the sample or by increasing the number of variables to improve the consistency of the study. For example, future research could consider further variables such as taxation, exchange rates and indicators of the quality of the offered services or other information on employees, management and board members (e.g. number, education, skill level and experience). Another potential improvement could be the inspection of differences in the determinants of profitability between small and large banks as well as between high and low profitable banks.

## Conflict of interest

The authors have not declared any conflict of interest

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**Appendix 1.** European banks included in the sample.

| <b>Bank name</b>                                    | <b>City</b>       |
|---|-------------------|
| Latvijas Banka-Bank of Latvia                       | Riga              |
| AB SEB Bankas                                       | Vilnius           |
| Bank of Valletta Plc                                | Valletta          |
| Swedbank As   | Tallinn           |
| NLB dd-Nova Ljubljanska Banka d.d.                  | Ljubljana         |
| Bulgarian National Bank                             | Sofia             |
| Zagrebacka Banka dd                                 | Zagreb            |
| Narodna Banka Slovenska-National Bank of Slovakia   | Bratislava        |
| ABH Financial Limited                               | Nicosia           |
| National Bank of Hungary-Magyar Nemzeti Bank        | Budapest          |
| Ceskoslovenska Obchodni Banka A.S.- CSOB            | Prague            |
| National Bank of Romania-Banca Nationala a Romaniei | Bucharest         |
| Narodowy Bank Polski-National Bank of Poland        | Warsaw            |
| Bank of Greece                                      | Athens            |
| Caixa Geral de Depositos                            | Lisbon Codex      |
| Erste Group Bank AG                                 | Vienna            |
| Nordea Bank Finland Plc                             | Nordea - Helsinki |
| Dexia   | Brussels          |
| Merrill Lynch International Bank Limited            | Dublin            |
| Danske Bank A/S                                     | Copenhagen        |
| Nordea Bank AB (publ)                               | Stockholm         |
| European Stability Mechanism-ESM                    | Luxembourg        |
| UniCredit SpA                                       | Milan             |
| ING Groep NV  | Amsterdam         |
| Banco Santander SA                                  | Madrid            |
| Crédit Agricole-Crédit Agricole Group               | Paris             |
| HSBC Holdings Plc                                   | London            |
| Deutscher Sparkassen-und Giroverband eV             | Berlin            |



*Full Length Research Paper*

# CSR, sustainability and the fate of oil communities in the Niger Delta, Nigeria

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The purpose of this paper is to critically examine oil multinational corporations (MNCs) and their corporate social responsibility (CSR) initiatives in Nigeria. Its special focus is to examine the fate of oil producing communities in the Niger Delta region and the long-term negative effect of oil extraction as well as the benefits of the oil companies' CSR/community development initiatives. This paper employs a qualitative methodology, drawing on semi-structured interviews conducted in three oil producing communities in this region and the oil MNC operating there. The study found that despite the high expectations of the MNCs by the host communities for development initiatives, the communities also want projects that provide hope of a stable and prosperous future. However, findings suggest that the MNCs have embraced development initiatives primarily to demonstrate that they are socially responsible and have not given adequate consideration to issues of sustainability. The implication of this study is that the agitations from the host communities indicate that they do not feel the CSR projects will lead to a social, economic and environmentally sustainable development. This research therefore adds to the literature on MNCs' CSR initiatives in developing countries and the rationale for sustainable practice of CSR for critical environment.

**Key words:** Corporate social responsibility, sustainability, Niger Delta region, Nigeria, multinational corporations.

## INTRODUCTION

Incorporating sustainability in business developmental objectives is gradually becoming the trend in modern business practices (Tullberg, 2012). CSR can hardly be discussed without mention of sustainability. However, incorporating such practices is still found wanting in most developing countries. An insight into the continuous out cry of the oil producing communities in Nigeria, with regards to constant degradation of their environment reveals that the communities are under intense suffering

and poverty, as most of the communities have lost their traditional sources of livelihood (Ejumudo et al. 2012). This requires both the government and multinational corporate (MNCs) to give serious attention to injecting good initiatives for economic growth and environmental sustainability in these communities. The vital role of CSR is founded on the principles and practice that covers all stakeholders in business. As opined by Kakabadse and Kakabadse, (2007), cited in Smith and Sharicz (2011)

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and Adeyanji (2012), corporate organisations should no longer concentrate on the satisfaction of shareholders but also its stakeholders. In other words, corporations should be involved in deliberate activities to pay back to society and communities in order to harness maximum benefits from their environment (Adeyanju, 2012). In defining the function of CSR, Frederick et al. (1992) cited in Rolland and Bazzoni (2009) submitted that CSR means that corporations should be held responsible for any of its actions and behaviours that affect people, communities and environment. Due to this fact, social responsibilities of business has to double its characteristics so that it could be seen in the modern organisation as performing an essential function for society as well as having great influence on the lives of the people. On the other hand, sustainability considers the ability of an action/ initiative to meet the present need as well as the future needs of its beneficiaries. This therefore presupposes that effective CSR is only that which is sustainable. Based on this background, the aim of this paper is to examine how CSR activities in the Niger Delta region can be effectively carried out and how such activities could inculcate the issue of sustainability for the benefit of the future generation of the oil producing communities. With reference to available research on this area and empirical evidence, this paper is also aimed at making useful recommendations to aid the government and the MNCs achieve their desired goal of the continuous operation.

### **Multinational Corporations (MNCs) and CSR**

Multinational corporations (MNCs) are companies that have subsidiaries in many countries. They are organisations that conduct business not only in the country it is registered to do business but also in several other countries (Soni, 2012). They can also be called International corporations, global giants and transnational corporations. Based on their status of temporarily operating in any foreign country, MNCs are known to be involved in the extraction of natural resources in their host communities and engaging the people in casual jobs. The presence of multinational companies in some developing countries have in time past triggered poverty, violence, wars, conflict and corporate-stakeholder stalemate as their corporate ideology and institutional viewpoints are usually inconsistent with stakeholders' requirements and objectives (Frynas, 2005). However, the MNCs have contributed greatly to the development of the areas where they operate as most of the facilities in such areas had either been lacking or not functional (Idemudia, 2009). Hence, most modern organisations seek to develop CSR initiatives that would provide a competitive advantage, improve the firm's reputation and enhance their performance (Cantrell et al., 2015, Simionescu, 2015). The MNCs are therefore seen to carry out several CSR initiatives to improve their reputation.

Such obligations are closely related to the concept of sustainability.

According to the World Business Council of sustainable development, CSR is defined as the obligation of a business to contribute to sustainable economic development, working with employees, their families, the local community and society at large to improve their quality of life (WBCSD, 2004). This definition is all encompassing as it includes the family, employees and the society which includes the community. The emphasis here is on sustainable economic development. This therefore points to the fact that any economic development activity that does not consider future generation is not an effective CSR. Corporate social responsibility is also described as the commitment of businessmen to pursue those policies and make those decisions and line of action which are desirable with regards to purposes and values of the society (Inyang et al., 2011). Hence, CSR is enclosed in three broad sentences; firstly, CSR creates a connection between corporations and societies with whom they interact, secondly, it involves responsibilities that exist on the two sides of these relationships and by society. Thirdly, all the stakeholders who make up the groups sustain continuous interest in the corporations (Werther and Chandler, 2006). It is implied in these three broad descriptions of CSR that business does not operate in isolation hence, there is a connection between business and the society which is made possible through CSR. It also suggests that there is a reciprocal responsibility for both business and society which relates to their expectations from each other. Similarly, this description presupposes that the stakeholder interest has to be accommodated in the delivery of a firm's CSR.

In the Nigerian context, the concept of CSR is not new to the MNCs. The oil multinationals have operated in Nigeria for several decades. Table 1, indicates that companies like ExxonMobil have been operating in this region for more than six decades. In as much as the MNCs have in one way or the other been engaged in CSR initiatives, a lot of devastation has occurred in the Niger Delta both on people and environment (Ejumudo et al., 2012). There are several negative environmental impacts associated with the exploitation of crude oil. The people/communities have been suffering from pollution (Aghalino, 2009). Pollution affects the natural environment, health and economic rights of the communities whose needs and sources of living depend on the natural environment (Emeseh and Songi 2004). Over the years, the communities have protested against the effect of the MNC's unhealthy activities on their environment like gas flaring and oil spillages (Afinotan and Ojakorotu, 2009).

These have usually been marched with violence from the state security agents, accusing them of illegal activities. Severally, the communities (victims) could not seek legal redress, due to unsupportive national regulation and enforcement framework. These inadequacies

**Table 1.** Multinational oil companies operating in Akwa ibom state.

| Multinational Oil company | Commenced operation in Nigeria | Origin of MOC | Exploration site | Local government area            |
|---------------------------|--------------------------------|---------------|------------------|----------------------------------|
| Exxon Mobil               | 1955                           | American      | Off-shore        | Eket, Esit Eket , Ibeno and Onna |
| Total PLC                 | 1992                           | French        | Off- shore       | IkotAbasi,Eastern Obolo          |
| Addax                     | 1998                           | Chinese       | Off- shore       | Mbo,Oron, Udungu Uko             |

Source: Researcher's field work.

arise from factors like; capacity deficits, governance, and lack of political will that could strictly control the industries. What this means is that these communities lack the required legal backing to fight the government which in many cases have failed in their capacity to address these issues hence, their last resort is the MNCs. George et al. (2012) argue that the MNC operating in this region do not seem to take the issue of CSR and sustainability as seriously as they should because of lack of government regulations. The MNC are perceived to have support and complicity of the federal government (Orogun, 2010) which has made them neglect their duties, the conviction of these communities is therefore dashed. This is why Emeseh (2009), maintains that a wide responsibility of companies is to overcome the negative impact of their operational activities through being socially responsible which can only be evaluated through the core values of sustainability.

### Issues of sustainability

Sustainability means meeting the needs of the present without compromising the ability to meet the needs of future generations (Brundtland, 1987 in Li et al., 2014). In other words, issues of sustainability focus on the future and its demands. Li et al. (2014) assert that people have various understanding towards sustainability; some school of thought describe it to mean ideas to keep steady the output so as to align it with the continuous increase in demand. Some others lay hold on the importance of putting a steady appreciable way of living in the future, and others emphasise on how the ecological aspect could lead to equity. However, Biddle, (2011) cited in Li et al. (2014), opined that a wider outlook of sustainability, embraces all ideas and put forward that sustainability relates to the environment in a method that ensures accommodation of future generations. Sustainability is sometimes linked to the triple bottom line (TBL) (Elkington 1998). Elkington (1998) opines that an approach to business that considers economic, environmental and social issues in a holistic and long-term ways that benefit current and future generations of concerned stakeholders could be seen as a sustainable one.

The (TBL) which takes the form of economic, ecological

and social effects therefore has an impact on sustainability (Pisaraki 2010; Schneider et al., 2014, Smith and Sharicz, 2011). TBL ideology that embraces the performance from these three dimensions, aid to operationalize sustainability into practical terms (Seuring and Muller, 2008). Hence, sustainability refers to overtaking the present needs of the people (communities) in relation to that of their future generation with the continuous increase in demand while interacting with the environment in the specification of the triple bottom line (that is, economic, social and ecological aspects). Bonini (2010) cited in Millar (2012) maintain that sustainability has been described as one of the major forces that have redesigned the world now and in the future. It then means that in business, sustainability has an impact on the economic success of firms and a key driver for risks and opportunities (Tegger 2011). The findings from the data obtained from the host communities indicate that the issues of sustainability are not taken seriously by the MNCs operating in the Niger delta region. The MNC are accused by the host communities of considering the economic aspect of their activities which pertains to profit maximisation without consideration of the other two bottom lines (social and environmental aspects). Their activities are perceived as not having the ability to meet the future needs of their host communities due to the environment and social havoc oil exploitation has caused the people of this region.

Considering the number of years multination oil companies have operated in this region, it is believed that their activities are more of a curse to the host communities than a blessing because of the negative impacts (Orogun, 2010). Participants of the research argue that matters of sustainability in this region are more of theory than in practice as the MNC claim to include sustainability in their CSR agenda when in actual practice such tenets are not upheld. Schneider et al. (2014) conducted a study on implementing sustainability on corporate activities. The study revealed that the implementation of corporate sustainability requires more internal coordination than implementing sustainability on the functional level (Schneider et al. 2014). Sustainability can therefore not be effectively implemented in any organisation without involving the different units and levels of the corporation's operations. In other words, every employee of the organisation should be involved; it



Figure 1. Map of Nigeria showing the Niger Delta state; Source: Idemudia and Ite (2006).

starts from top to bottom. The critical nature of this region requires a sustainable practice in order to attract investors and carry out operations in a manner that is beneficial to all parties concerned.

## MATERIALS AD METHODS

### The study area

This research is focused on the Niger Delta region of Nigeria which is mainly inhabited by minority ethnic groups such as Ijaws, Istekiris, Urhobos, Ibibios and Edos. This region extends over an area of about 70,000 square kilometres, which amounts to about 7.5% of Nigeria's total land mass (Idemudia, 2007). The population of this region is approximately 27 million people, of which 75% live in rural areas (NDDC, 2004). Dwelling in the rural area explains why the people are often having conflicts with the MNCs for a better life rather than affecting their livelihoods negatively. There are nine states that make up the Niger Delta region which includes; Abia, Akwa-Ibom, Bayelsa, Cross River, Delta, Edo, Imo, Ondo and Rivers states (Figure 1). Due to the vast nature of this region, Akwa Ibom state was selected for the study. The selection criterion was based on the fact that the state is one of the highest oil producers in the country. In Akwa Ibom state, the communities selected include Edo in Esit Eket Local government area, Mkpapanak in Ibene local government area and Atabong in Eket Local government area. The communities were selected based on their proximity to oil multinationals operating within the state.

### Research design

This study adopts an exploratory approach using the qualitative technique. In an exploratory study, the researcher tries to find out and clarify the nature of a phenomenon (Saunders et al., 2009).

Saunders et al. (2009) also opine that the exploratory method has been criticised for being too flexible. However, Adams and Schvaneveldt (1991) argue that the flexibility characterised in exploratory design does not mean the absence of a direction to the enquiry, but that the focus of the research starts from an extensive sense to a narrow one. This therefore makes it rigorous and credible. Using a qualitative method of research enables the researcher to develop detail information about individual/s or place/s and to be highly involved in the participants' actual experiences (Creswell, 2003). Gray (2009) also asserts that qualitative research is one that comprises a deep, complete and intense study of the context. Qualitative research focuses on quality rather than quantity (Bazeley, 2013) and can be used from different methodologies depending on the researcher's philosophical point of view (Robson, 2011). The choice of an exploratory qualitative design was considered most appropriate for this kind of research.

### Sampling strategy

Those recruited to participate in the study were identified through the use of purposive and snowballing sampling strategy. Purposive sampling is the choice of a sample of participants based on the requirements of the research questions or theoretical considerations (Robson, 2011). This choice therefore suits the purpose of this paper. The main source of data for the study was the primary source which was obtained through in-depth semi-structured interviews. Interviews are purposeful discussions between interviewers and interviewees aimed at collecting views and relevant information on a particular research topic (Frey and Oishi, 2003). Interviews are useful tools for people who enjoy talking about the phenomenon surrounding them rather than writing (Gray, 2009). They are beneficial when participants cannot be observed directly (Creswell, 2008). The interview process enables the researcher to generate new knowledge and ideas through the enquiries from the interviewee (Bryman, 2006). Kvale (2007) supports the use of interviews as a means of knowing more about

other people, their feelings, experiences and practices. Kvale also asserts that the research interview is the process where knowledge is constructed in the interaction between the researcher and the researched. A total of twenty-eight interviews were conducted in three host communities in Akwa Ibom state of Nigeria. Participants for the study were chiefs, women, local politicians and youth leaders that have privileged information due to either their position in the community or they have been directly or indirectly involved in negotiations with oil MNCs on behalf of the communities. The interview guide was structured to include open-ended questions geared towards obtaining information from participants on their perception of the activities of the MNC in their region and how they have benefits or been impacted by oil extraction processes for more than five decades. Questions were also put forth to understand their feelings on the contributions of the MNCs to a sustainable economy for the people. Through prompting, the researcher was able to gain insight and a better understanding of the situation in the study area.

## RESULTS AND DISCUSSION

Data obtained from in-depth interviews with members of the host communities in this region suggest that participants acknowledged the contributions of the MNC to the development of the area. However, they attribute such gestures to efforts to boost their social image rather than an attempt to meet the dying need of the communities as some of the CSR initiatives and areas of interest of the MNCs differ from the expectations of the host communities. For example PE from Eket states that:

*“Oil money should be properly managed for the interest of the communities. Social responsibilities should be taken seriously. It’s not something that is optional, it is an obligation. [...] The company should ensure that it should do what it supposed to do. The company should find out from the people what their problem is not just bringing somebody from America put him in the best hotel and then he comes with an apparatus and puts it under your armpit and chest and says your heart beat is so high and you feel you have done something. [...] (laughs) who now benefits from the social responsibilities?”* (PE, Eket, 18th Sept, 2014).

This suggests that some investment in CSR by the MNCs do not adequately address the needs of the communities. However, the activities of the MNC have also impacted on the traditional livelihoods of the host communities. One of the participants from Mkpanak community asserts as follows:

*“Before the discovery of oil Ibeno, being riverine people, their main occupation is fishing. And before the advent of the Europeans who brought in salt the, they were salt makers but definitely now they are fishermen, they are farmers. Though now they cannot do the fishing because of the oil operation. The incessant oil spills, killing the aquatic lives and so on”.* (KA, Mkpanak 27<sup>th</sup> Oct 2014). *The findings from this study indicate that the activities of the MNCs have negatively impacted on the livelihoods*

*and social activities of the host communities as opined by Ejumudo et al. (2012). Participants from the host communities attest to the fact that the MNCs have carried out several CSR initiatives but such initiatives do not mean so much to them as the cost outweighs the benefit they derive from the MNCs (Tuodolo, 2009). It is also noted that the provision of infrastructural facilities like water, road, electricity and other social amenities are not sustainable because of lack of maintenance of such facilities. Similarly, other participants express concerns over the activities of the MNC and the fate of the people of the Niger Delta region in a couple of decades as nothing is done to ensure that the negative impacts are completely eliminated. This is as noted by PA:*

*“We are as good as dead. If you go to my village, I am from Mkpanak village, where you have (company), I am almost one of the oldest persons in the village when my age is not and shouldn’t place me there, all the old men have died because of difficulties.[...] The people realise that the fishermen, farmers and others who depend on the forest and sea products as means of livelihood are seriously damaged both the land and the sea has been polluted and the forest destroyed. So when we saw all that we know that it was a curse.[...] They could not fish again because if there is oil spill (company) will try to bring chemical to spray on top and the chemical will make the oil in the form of a ball and they will sink into the bed of the sea. When fishes in the water do not see food to eat, they will eat the oil and they will die, that is why we don’t have fish. If you are fortunate enough to get fish, you cannot get the taste again because of the oil. There is no future for our people if nothing is done as fast as possible about this problem”.* (PA, Mkpanak, 27th Oct 2014).

The findings also suggest that the future of this region cannot be guaranteed if the environmental challenges of gas flaring and oil spillages are not arrested on time as opined by Afinotan and Ojajorotu (2009). The activities of the MNCs have caused environmental degradation and the loss of different species of plants, animals and fishes. This area is regarded as a critical area due to issues of pollution of soil, water and air through gas flaring and oil spillage (Ejumudo et al., 2012) which have a multiplier effect. This is so because it does not only affect the fishes in the water and the different species of plants and animals but invariably affect the livelihoods of the generations unborn as the negative impacts usually take a long time to be corrected. Considering the fate of the locals who bear the brunt of oil extractive processes in this region, there is a need for a proactive measure to ensure that future generations do not suffer from the mistakes of the present. Therefore there is an urgent need for the MNCs to initiate effective CSR initiative that inculcates sustainable practices in this region to guarantee continuous economic and environmental survival of the people. Similarly, the research by Sharma

and Khanna (2014) establish that there is a significant relationship (correlation) between CSR and sustainability. They therefore recommend that CSR and sustainability should be entrenched within the corporate governance principles and practices of the firms.

### **Initiatives for sustainability practice of CSR in oil communities of the Niger Delta**

The core problem of the Niger Delta is caused by environmental degradation of communities where the multinational corporation carry-out their business operation (George et al., 2012). Most of these MNCs operations are being carried out offshore. However, some of them are onshore and these activities have affected the rural community – dwellers. In the rural communities, their source of livelihood comes from subsistence fishing and farming (Emeseh, 2009). There is no tangible development in these communities (Idemudia and Ite, 2006). To make matters worse, the environment is highly polluted by the waste products of these corporations. Regrettably, oil spills and gas flaring have been attributed to causing deaths and health implications of the lives and properties of the communities. The dependence of the Nigeria economy on crude oil, therefore, means that this area cannot be ignored as it is critical to the economic growth and development of the entire nation (Orogun, 2010). With all these in mind, it is expected that something should be done to sustain these communities if the MNCs would continue to operate and gain the support of the host communities. Due to the situation above, the following initiatives should be put in place for the government and the MNCs to improve environmental sustainability of this region; Firstly, Government has the responsibility to cater for the welfare of the citizen. According to Emeseh (2009) government owns the responsibility of enacting law and order, security, provision of general infrastructures that helps the society to function efficiently and effectively. It is also the responsibility of the government to provide essential services like water electricity, schools, hospitals etc. In other words, both the government and the MNCs have their various roles to play. If such facilities and services are provided by the government as they ought to, then there will be no need to be over expectant from the MNCs. Secondly, the government should provide adequate regulatory and enforcement agencies to monitor and ensures that firms operating in this local communities comply with what is stated in the laws of the government. For example, there should be laws regarding incessant oil spillage. With the regulations in place and constant monitoring and evaluation, there will be less degradation of the environment. MNCs who default should be penalised or banned from operating. Thirdly, efforts should be made to develop human capital in terms of acquisition of skilled manpower. Intellectual capital development is a critical factor to sustainability

(Pisarski, 2010). The training and development of workforce (especially youths), with knowledge, skills and abilities would lead to gainful employment in the multinational companies as well making a positive impact in their communities. Alternatively, the government should provide grants to the youths and women who are interest in establishing a business and should ensure that such grants are used for the purpose for which it was given.

On the other hand, the firms (MNCs) should be socially responsible to the host communities where they are located for business (George et al., 2012). Firstly, the MNCs should establish training centres to train women in certain trade and skills. This would help alleviate poverty and help them make a livelihood. Secondly, companies should make it a mandate to offer employment to youths of their host communities, who are qualified to work in the companies. Casual labour employment should go to the youths who are unskilled. Thirdly, the MNCs should see the host communities as a partnership in business. They should extend friendliness to the communities by inviting those who are capable of investing in the corporations business. A friendly disposition will enhance a cordial relationship which will invariably reduce the intense conflicts arising between the youths of the communities and the MNCs (Idemudia and Ite 2006). The MNCs are also advised to create strategies for understanding the need for sustainability in the company. The business structure of the MNCs, which include leaders such as executives, consultant and management leaders need to build new strategies/structures to embrace sustainability in the business operations so that the communities could benefit from them. Hence, sustainability should not only be in theory but in practice. It is believed that if the government and the multinational corporations are able to embrace and implement these recommendations, CSR will create sustainable impact in the Niger Delta region of Nigeria.

### **Limitations of the research**

This study is limited to data obtained from three host communities. It was difficult to obtain information from the MNC, some felt releasing information may affect their jobs though anonymity and confidentiality were guaranteed. This amounted to the recruitment of participants from only the host communities. Therefore, the analysis was loaded with excerpts from the host communities. The use of only qualitative research methods, although, considered appropriate, could limit the findings of the study despite the efforts to reduce the limitations. Another limitation is that this study employs a fairly small number of cases which are usually criticised for generating findings which are context-specific, and therefore lack generalisation to other situations and contexts. It can be argued that for this study, the findings

generated are not for purposes of generalisation but is aimed at developing an understanding of the issue of CSR in this region which could better be gained from a qualitative –interpretive and exploratory study, looking at the depth rather than the breadth. Accepting these findings may lack generalisability but they do certainly offer transferability.

### Areas for future research

This study could be replicated using multiple case studies. If possible, such a study should involve more local communities. The study was carried out in Akwa Ibom, being one of the major oil-producing states in the Niger Delta region. Similar investigation could be carried out in other parts of this region. Similarly, research could also be undertaken to accommodate more multinational companies of varying sizes operating within the country. Such studies could likewise be carried out with indigenous oil companies to compare the outcomes. Most of the research in CSR in developing countries are focused on the oil industry, it is suggested that further studies should be carried out in other sectors of the Nigerian economy.

### Conclusion

This paper has considered the manner in which multinational corporations (MNCs) engage in corporate social responsibility (CSR) initiatives in the Nigerian oil industry. The MNCs have operated in this region exploiting oil for several decades and have carried out CSR initiatives in their own way. Most of the CSR initiatives carried out by MNCs are primary to demonstrate that they are socially responsible and have not imbibed the culture of sustainability. However, it is perceived that such CSR initiatives are not appreciated by the host communities because of their constant agitations with the MNCs. This has dampened the hope for a better future for the oil producing communities in the Niger Delta region due to the long-term negative effect of oil extractive processes. The benefits of the oil companies' CSR/community development initiatives are perceived to be at a huge cost to the host communities. Their activities are therefore viewed as a curse rather than a blessing. The adoption of a qualitative approach using semi-structured interviews conducted in oil producing communities afforded one an opportunity to talk to the rural dwellers and appreciate things from their own perspective. This bridges the gap in the literature as most research in this region are theoretically based. The study found that despite the high expectations of the MNCs by the host communities for development initiatives, the communities also want projects that are sustainable hence, providing hope of a stable and prosperous future. The implication of this study is that the agitations from the host communities indicate that they do not feel that the

CSR projects will lead to a social, economic and environmentally sustainable development. This is the trend in modern business practice which every good corporation cannot afford to ignore irrespective of its country of operation. As a nation that depends so much on oil, the issues of sustainability cannot be overlooked as this would determine the fate of the host communities and the success of oil exploitation. The recommendations and suggestions made are to enable both the government and the MNCs address issues of sustainability and responsibility in its agenda. The research, therefore, adds to the literature on MNCs' CSR initiatives in developing countries and the rationale for sustainable practice of CSR for a critical environment like the Niger Delta region of Nigeria.

### Conflict of interest

The authors have not declared any conflict of interest

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