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# A Study on the effect of Environmental Social and Governance adoption and bank characteristics on the financial performance of commercial banks in Uganda.

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**A STUDY ON THE EFFECT OF ENVIRONMENTAL SOCIAL AND  
GOVERNANCE ADOPTION AND BANK CHARACTERISTICS ON THE  
FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN UGANDA**



**A RESEARCH THESIS SUBMITTED TO STRATHMORE UNIVERSITY  
BUSINESS SCHOOL IN PARTIAL FULFILLMENT FOR THE DEGREE  
OF MASTER BUSINESS ADMINISTRATION AT STRATHMORE  
UNIVERSITY**

**MAY 2023**

## DECLARATION

This thesis is an original work and has not been presented for a degree at any other University.

Signature:



Date: **4 May 2023**

**Lydia Awour (No.13774)**

This thesis has been submitted for examination with our approval as the Supervisor.

Signature:



Date: **4 May 2023**

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## **LIST OF ACRONYMS**

**BOU** – Bank of Uganda

**CFO** – Chief Finance Officer

**ESG** – Environmental Social and Governance

**FIA** – Financial Institutions Act

**GDP** – Gross Domestic Product

**GRI** – Global Reporting Initiative

**ICPAU** – Institute of Certified Public Accountants of Uganda

**IFAC** – International Federation of Accountants

**IIRC** – International Integrated Reporting Council

**IR** – Integrated Reporting

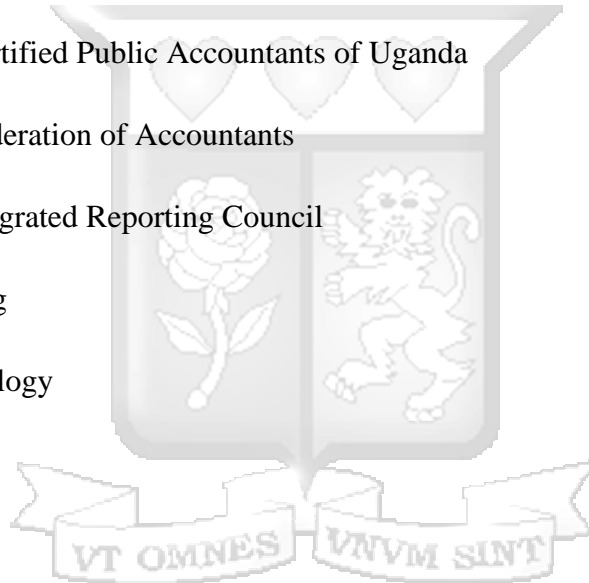
**IT** – Information Technology

**PR** – Public Relations

**ROE** – Return on Equity

**SASB** -Sustainability Accounting Standards Board

**USA** – United States of America



## DEFINITION OF KEY TERMS

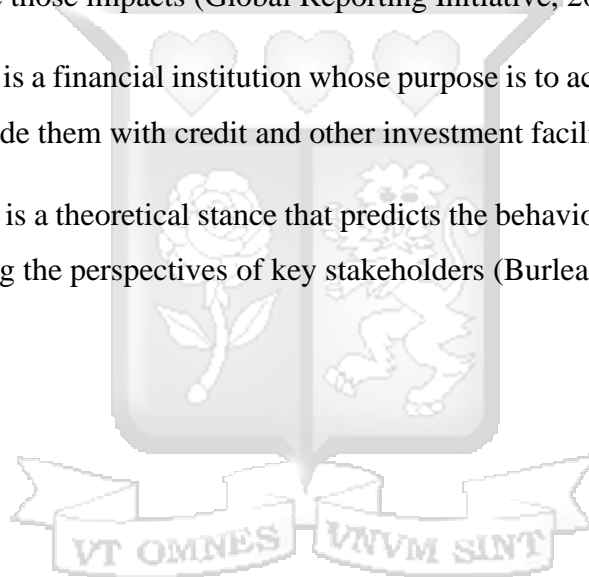
**Environmental Social and Governance:** This term refers to an organization's corporate financial interests focusing largely on sustainable and ethical impacts (Gartner, 2023).

**Integrated Reporting:** This process is founded on integrated thinking for communicating the organization's strategy, governance, performance, and prospects, leading to value creation in the short, medium, and long term (IFRS, 2023).

**Global Reporting Initiative:** This independent, international organization helps businesses and other organizations take responsibility for their impacts by providing them with a common language to communicate those impacts (Global Reporting Initiative, 2023) .

**Commercial Bank:** This is a financial institution whose purpose is to accept deposits from people and institutions and provide them with credit and other investment facilities. (Investopedia, 2023)

**Legitimacy theory:** This is a theoretical stance that predicts the behaviours of companies towards managing and maintaining the perspectives of key stakeholders (Burlea & Popa, 2023).



## ABSTRACT

Recent changes to corporate external reporting have sparked discussions around the need to evolve the practice. Reports by influential organizations suggest a need to incorporate forward-looking, nonfinancial, and soft information in financial reports for the benefit of all stakeholders, hence the emergence of Environmental, Social, and Governance (ESG) disclosure requirements. In Uganda, the law does not require institutions to disclose ESG matters; this has, however, not deterred its voluntary adoption by players in the commercial banking sector. Most banks are, however, likely to face hurdles in compliance, and the lack of guidance on ESG disclosures makes it difficult for stakeholders to compare results across early-adopting organizations. The objective of this study is to investigate the effect of ESG adoption and bank characteristics on financial performance in Uganda. Data from published financials and structured questionnaires was used to collect data from all the licensed commercial banks between 2012-2021. By employing a multivariate regression analysis, the study established that ESG has a slightly positive effect on ROE and a slightly negative effect on ROA. However, both relationships are not statistically significant. Therefore, this study has not approved or disapproved of any of the theoretical expectations of the two hypotheses that ESG positively or negatively affects financial performance. The relationship with bank characteristics has also shown that profitability positively and significantly affects ROE and ROA. Finally, the findings indicate that having ESG adoption enforced by regulatory bodies (both financial sector regulators and accounting bodies) would be the most effective way to ensure that banks in Uganda observe sustainable practices. Future studies could extend the investigations to longer periods to establish whether the current findings hold over time. Future research could also examine specific ESG factors in isolation, say environmental, social, and governance, to investigate their individual effects on the financial performance of Ugandan commercial banks.

**Keywords:** Environmental, social, environmental, ESG reporting, sustainability disclosure, sustainability reporting, bank-specific characteristics, and financial performance.

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# CHAPTER ONE: INTRODUCTION

## 1.1 Background

Corporate financial reporting provides disclosures relevant to stakeholders to aid decision-making and promote efficiencies within capital markets (Palepu, 2000), and this makes it an important activity for all businesses. It allows companies to share their story with stakeholders and is generally viewed as an indication of competitiveness and superior corporate governance (Aruwa, 2010). Corporate Financial reporting has evolved in reaction to the global financial scandals, and professional accountancy bodies, regulators, and organizations of interest have had to re-examine, in whole or part, aspects of corporate financial reporting (Beattie, 2000).

Traditional matrices for assessing value and economic progress no longer provide a comprehensive picture of the sustainability of organizations (Sura, 2017). Though the inclusion of corporate social responsibility (CSR) practices was encouraged by different stakeholders, this alone was not sufficient to guarantee an organization's sustainability and ability to cope with exposed risks (Ruhaya et al., 2016). According to a joint report published by the United Nations Environment Programme Finance Initiative (UNEPFI) and World Business Council for Sustainable development (WBCSD), it is more relevant to incorporate environmental, social, and governance (ESG) elements in financial reports as a risk mitigant for investors, in addition to aiding sustainability in corporate decision-making processes (UNEPFI & WBCSD, 2010).

ESG is a framework designed to be embedded in the business strategy of organizations that takes into consideration sustainable practices in its generation of value for stakeholders (Hoang, 2018). It represents a stakeholder-centric approach to doing business. Because companies are embedded within stakeholder environments, they cannot act in isolation (Orefice & Nyarko, 2022). Their purpose is determined by stakeholders who pursue varying economic, ecological, and social goals and in return demand disclosures related to their goals. Stakeholder management is no longer sufficient on its own as the stakeholders require to be provided with information on processes and structures put in place within the organization to ensure businesses promote environmental and social sustainability (Schaltegger & Bennett, 2006). ESG adoption, therefore, ensures that the needs of the present are met without compromising on the ability of future generations to meet their own needs.

### 1.1.1 ESG Adoption

In the past, shareholders only paid attention to the profit maximization objective of institutions (Battilana et al., 2022). The primary obligation of businesses was to maximise short-term returns for shareholders without regard for factors such as social and environmental impact. ESG adoption is, however, on the rise globally and this has largely been fuelled by client demand and desire to make an impact (Singhania & Saini, 2021). A 2022 global survey of 1,130 investors across 19 regions by the Capital Group showed an 89% ESG adoption rate among institutional and wholesale investors up from 84% in 2021 (Capital Growth, 2022). The rate of ESG adoption remains highest in Europe due to a mature market and regulatory frameworks in place (Dicuonzo et al., 2022). North America has the lowest percentage of documented ESG adopters (Capital Growth, 2022).

While the African market is ripe and booming with opportunities, ESG adoption has not been prioritised and the rate of adoption remains low (Omololu, 2021). South Africa has proven itself a leader in ESG adoption. The Institute of Directors South Africa (IDSA) launched its Code for Responsible Investing in South Africa (CRISA) in 2012 and in doing so made South Africa the second country, after the UK to encourage investors to integrate ESG principles in their investment decisions. Except for South Africa, the level of adoption in the rest of Africa remains low (Singhania & Saini, 2021). One of the reasons sighted for the low rate of adoption in Africa, in general, is the lack of legal and professional support, despite regulatory and stakeholder concurrence that the adoption of ESG will enhance transparency in current reporting practices (Ullah & Rahman, 2015). Scholars argue that without regulation, voluntary reporting is unlikely to result in a high quality and sufficient level of reporting (Ullah & Rahman, 2015).

Kenya's Capital Markets Authority has raced ahead of its East African counterparts in promoting ESG implementation (Songi & Dias, 2019). Since joining the Sustainable Stock Exchange initiative in 2015, the Nairobi Securities Exchange has made significant strides in improving the quality of ESG disclosures by listed entities (Nairobi Securities Exchange [NSE], 2021). An analysis of 50 firms listed on the NSE in 2016 showed that 14% of the firms had voluntarily adopted Integrated Reporting and in doing so improved the quality and content of their ESG disclosures (Injeni et al., 2020). In 2021, the NSE (2021) issued ESG disclosure guidance against which listed entities were required to comply. By providing a framework for compliance, the NSE

(2021) aimed at improving and standardizing ESG information disclosures reported by listed entities and in the process allowed for investors, capital owners, and the public at large to have a well-rounded view of a company's activities and performance beyond the financial numbers.

In Uganda, ESG disclosure practices are voluntary, and the general level of adoption remains low (Bananula et al., 2022). According to GRI (2019) statistics on sustainability reporting, only 10 companies in Uganda had prepared and uploaded on the website sustainability reports with ESG disclosures and, of these, only two companies had prepared their reports per the GRI standards. By the end of 2022, no Ugandan company had been listed as a member of the GRI community and a promoter of the sustainability reporting standards. However, a study on determinants of ESG reporting in emerging economies like Uganda indicated that over 80% of members of the Ugandan Manufacturing Association did include ESG disclosures in their annual reports and financial statements (Taurigana, 2021). Also, a review of the company websites of commercial banks in Uganda showed that institutions such as Centenary Bank, Stanbic Bank, and DFCU bank did prepare financial reports and included ESG disclosures, though these were not uploaded on the GRI website. This implies that the practice of inclusion of ESG disclosures as part of the annual reporting process is on the rise in Uganda. However, the extent of adoption remains unknown (Bananuka et al., 2022). Our study will seek to fill in this gap by providing insights as to the extent of adoption within the commercial banking industry.

### **1.1.2 ESG in the Financial Services Sector**

Financial institutions play an important role in leading sustainable development (Mezher & Jamali, 2002). Though financial institutions are by nature exposed to risks emanating from organizations they fund, for most banks, sustainability was only often used in reference to environmental matters such as energy use in buildings, employee relations, and impact on surrounding communities whose direct environmental and social footprints were negligible (Nwobu, 2017).

Following the financial crisis of 2007, financial institutions came under a lot of scrutiny for being profit focused and not adding any social benefits to the communities in which they conduct business (Trumbull, 2012). Sustainability practices were only applied when they resulted in more profits (Haanaes et al., 2013). Despite the hindrances in ESG adoption, voluntary adoption by

financial institutions has been the highest with over 10% of companies that have voluntarily adopted sustainability reporting operating in the financial services sector. All the institutions are, however, based in the developed world (Adams, 2022).

In Uganda, the financial services sector has registered progress in the adoption of ESG as evidenced in the annual FiRe awards organized by the Institute of Certified Public Accountants of Uganda (ICPAU) (Bananuka et al., 2021). According to ICPAU, except for 2013, 2015 and 2020, financial services firms won the award for best sustainability report between 2012 and 2020. However, the level of participation remains low with only three of the twenty-five licensed commercial banks participating in the awards in 2020. As part of its strategic plan for the years 2022- 2027, commercial banks regulator, Bank of Uganda, came out to confirm that environmental and sustainability matters will form the focus point of their supervisory agenda starting in 2023. This will see banks required to observe minimum environmental, social and governance standards and in doing so, make relevant disclosures of such activities (Bank of Uganda, 2023). Though some banks have voluntarily adopted ESG standards, the content and quality of disclosures are largely driven by the mission of the bank rather than compliance with any framework.

### **1.1.3 Institutional Context of Commercial Banks in Uganda**

According to Bategeka and Okumu (2010), Uganda's first commercial bank, the National Bank of India (currently known as Stanbic Bank) was established in 1906. Bank of Uganda, the country's central bank was established in 1966 under the Bank of Uganda Act. This was followed by the establishment of a legal framework for regulation, the Banking Act in 1969. Since its inception, the sector has undergone several policies, legal, and regulatory reforms with varying degrees of results. The evolution of the sector was characterised by closures, mergers, and acquisitions. By 1970, the number of commercial bank branches was 290 but this reduced to 84 in the period 1970 to 1980 due to political instability and political unrest. Following several economic reforms, the sector experienced liberalization resulting in new laws and monetary policy formulation that resulted in a shift from strict administration by the government to privatization and open market operations. This led to an increased level of participation by the private sector, the introduction of supervision structures within the central bank, liberalization of interest and exchange rates, and finally, improvement in the quality of loan assets by banks (Bategeka & Okumu, 2010).

Most indicators of financial development in Uganda are still low by international standards (Sande, 2021). Like most low-income countries, its financial market depth in general and banking system size in particular, are smaller relative to its GDP than its counterparts in developed countries, and largely informal (Abuka et al., 2019). From a review of relevant statistics from the Bank of Uganda, the Financial Stability Department reports, the banking system's contribution to GDP increased from 10.4% in 2012 to 11.9% in 2020. The economy is characterised by a large dependence on the sector with an average of 95% of private sector credit coming from banks. Though largely informal, the formal banking sector is well established and adequately capitalized, though with a relatively small number of banks.

The sector is quite dynamic with several product and service innovations (Iwumbwe, 2015). Most of the banks are, however, foreign-owned, such as Stanbic, Citibank, Barclays, and Standard Chartered. Several locally owned banks have been established over the years including DFCU Bank, Crane Bank, and Centenary Rural Development Bank (PricewaterhouseCoopers, 2022). According to the Bank of Uganda Quarterly report of 2022, 57% of the banking sector assets are held by only five of the twenty-five licensed players.

The Bank of Uganda has the mandate to supervise and regulate the operations of financial institutions in Uganda. This is done using several Acts and regulations such as the BOU Act of 2000, the Financial Institutions Amendment Act of 2016, and over 15 supervision regulations (BOU, 2022). Through its supervisory activities, BOU ensures a safe and sound financial system that guarantees the protection of depositor funds and enables a conducive environment for economic stability. While BOU (2022) regulates the industry, there is no standardised and mandatory framework to guide ESG adoption in Uganda. Adoption of ESG is purely voluntary as there is no legal requirement for firms to disclose sustainability matters in their reports to stakeholders.

#### **1.1.4 Financial Performance of Commercial Banks in Uganda**

The financial performance of a financial institution enables one to analyse the outcome of its policies, performance, efficiency, and effectiveness in monetary terms (Pinto et al., 2017). Commercial Banks in Uganda prepare financial statements per International Financial Reporting Standards (IFRS), the Companies Act of Uganda, and the Financial Institutions Act (FIA), 2004

(as amended in 2016). In the FIA as issued by the Bank of Uganda, the only additional disclosures outside mandatory IFRS relate to those recommended under the Basel Core Principles for effective regulation which is already under criticism for overlooking systemic environmental risk, despite its overriding objective of guaranteeing banking stability (Alexander, 2014). The Basel core principles are backward-looking in nature, making it difficult for local and foreign investors to assess the short, medium, and long-term sustainability of the operations of financial institutions.

BOU adopted a supervisory rating system known as CAMELS to assess the performance of commercial banks in Uganda (Bank of Uganda, 2022). CAMELS is an acronym for Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk. Capital Adequacy is a measure of whether an institution has sufficient capital to conduct business and absorb losses that would lead to the collapse of the institution. This is measured as a ratio of core capital or total qualifying capital to risk-weighted assets and is a required disclosure in the institution's financial statements. Asset quality is assessed using net loans and investment portfolio as disclosed in the statement of financial position. The larger the asset size, the more stable a bank is deemed. Asset size is a widely used measure in the market to rank financial institutions (Ding, 2006).

The earnings of a financial institution ensure that they are profitable enough to avoid erosion of capital and depositors' funds. In evaluating earnings, this study focused on net profits after tax as opposed to total comprehensive income. This was because differences in accounting policies adopted across the banks would result in disclosures under other comprehensive income segments of the financials that would make it difficult to perform a like-for-like comparison of earnings. Liquidity is a measure of available funds to meet the day-to-day needs of customers. For purposes of assessing the liquidity of banks, one of the ratios used is the Liquidity Coverage Ratio (LCR). This was determined by dividing the financial institution's assets by liabilities.

In assessing the management of the institution, BOU focuses on the credibility and capability of those charged with governance. Sensitivity to market risks is assessed to ensure that financial institutions diligently assess market risks in making informed investment decisions. This study did not, however, focus on management and sensitivity to market risks in assessing the effect of the

relationship between ESG adoption and bank characteristics and their effect on financial performance.

## **1.2 Problem Statement**

There is currently no law mandating Ugandan banks to disclose ESG matters as part of their annual reporting process. Despite this, some players have voluntarily adopted ESG and disclosed their performance in annual reports and publications. However, due to the lack of regulatory involvement in providing guidelines for ESG disclosures, the nature and content of the disclosures vary from bank to bank, making it difficult for stakeholders to compare performance across the sector.

According to Al-Shammari et al. (2021), the inquiry into ESG as a non-market strategy to signal legitimacy by bank management lacks a consensus on the general nexus of the dual relationship between society and these institutions and the effect on corporate financial performance. The exact motive of ESG adoption by these banks remains unclear because of the heightened noise in the environment these institutions operate in (Komarnicka & Komarnicki, 2022). Banks that have not yet adopted the ESG framework would benefit from knowing the contribution it has on financial performance.

From a global lens, there exists an academic debate on the relationship between ESG, and bank financial performance, with some studies advancing that there exists a positive relationship between the two (Akdogan et al., 2020; Buallay et al., 2021) while others find a negative relationship (Menicucci & Paolucci, 2022; Miralles-Quirós et al., 2019). Other studies conclude that there is a neutral relationship between ESG and financial performance (El Khoury et al., 2023; Friede et al., 2015). There is also a scarcity of studies addressing developing countries and Africa at large compared to advanced economies and other regions (Bananuka, 2018) while the effect of bank characteristics on firm performance and ESG adoption has also yielded mixed results depending on economies in which the studies have been done. This study sought to fill the research gap by addressing the ESG and financial performance of banks while controlling for bank-specific characteristics in Uganda.

## **1.3 Research Objectives and Questions**

### **1.3.1 General Objective**

The objective of the study was to establish the effect of ESG adoption and bank characteristics on financial performance of commercial banks in Uganda.

### **1.3.2 Specific Objectives**

- I. To determine the joint effects of ESG adoption and bank characteristics on the financial performance of Ugandan banks over the period 2012-2021.
- II. To determine the effect of bank characteristics on ESG adoption of Ugandan banks over the period 2012-2021.
- III. To determine the key stakeholders' views and perceptions on ESG reporting by commercial banks and what opportunities exist to promote adoption.

### **1.3.3 Research Questions**

- I. What is the joint effect of ESG adoption and bank characteristics on the financial performance of Ugandan banks over the period 2012-2021?
- II. What is the effect of bank characteristics on the ESG adoption of Ugandan banks over the period 2012-2021?
- III. What are key stakeholders' views and perceptions on ESG reporting by commercial banks and what opportunities exist to promote adoption?

## **1.4 Significance of the Study**

### **1.4.1 Policy Makers**

The research is important to the legal and institutional frameworks in Uganda including the Bank of Uganda, ICPAU, and the Uganda Bankers Association (UBA) in setting guidelines to improve the adoption of ESG reporting in the country.

### **1.4.2 Banking Institutions**

The research will be of value to commercial banks in Uganda looking to incorporate sustainability reporting in their financial reports by guiding them on what to consider in determining the nature and content of disclosures and how to navigate hurdles to effective sustainability reporting. It will also be of value to banks already incorporating sustainability disclosures by guiding them on what improvements to make to their reports.

### **1.4.3 Academicians**

Given the limited empirical studies on the adoption of ESG disclosures in Uganda, future researchers and academic institutions of higher learning can use the findings of this research to further advocate for the adoption of ESG.

## **1.5 Scope of the Study**

Uganda is one of the countries in Africa where the extent of adoption remains unknown (Bananuka et al., 2022). Our study will seek to fill in this gap by providing insights as to the extent of adoption within the commercial banking industry.

The study involved an analysis of annual reports and financial statements of licensed commercial banks in Uganda, over the 10 years, from 2012 to 2021. Commercial banks were selected because of their important contribution to the Ugandan economy as the primary providers of external funds for capital needed for economic development. Also, banks are mandated by law to publish their summary financial statements to the public in a bid to promote transparency and market discipline within the sector.

The study only focused on the period between 2012 to 2021. The 10-year period was sufficient to analyse the extent to which the banks have adopted ESG reporting. The period allowed the researcher to check recent trends in improvement in disclosures as well as provide a firm basis for making recommendations for the involvement of regulators in streamlining the quality and content of disclosures to ensure consistency and comparability amongst players.

The study involved a survey of senior staff involved in the financial reporting process of the Banks comprising of CFOs, financial controllers, and finance managers. This was because, by virtue of their positions, they are required by law to hold relevant accounting professional qualifications and by extension have knowledge of best practices in accounting and financial reporting. Given that the study involved all licensed commercial banks in Uganda, the findings were generalized to the Uganda commercial banking fraternity. The study was conducted between February 2023 and May 2023.



## **CHAPTER TWO: LITERATURE REVIEW**

### **2.0 Introduction**

In this Chapter, literature relevant to the research is reviewed and the theory that would form the foundation of the study analysed in detail. Secondary information comprising bulletins, articles, financial reports, and newsletters were of interest in addition to technical guidance issued by relevant regulatory bodies. From the information reviewed, the researcher developed a conceptual framework that summarises the key findings, magnifies the relevant theories, and thereafter, identifies key variables of interest.

### **2.1 Theoretical**

A theoretical literature review involves studying relevant theories to an area of research to establish their relationships to the research subject and in the process, identify and address an existing research gap (Nidhal, 2021). While there are several theories linked to ESG adoption such as agency theory, legitimacy theory, and stakeholder theory (Adegboyegun et al., 2020), this research is anchored on the legitimacy theory. Whilst the stakeholder theory advocates for companies to ensure the needs of all stakeholders are identified and addressed (Ofoegbu et al., 2018), limitations around the practicability of the application of this theory by companies have been identified. Given the evolving nature of needs and categories of stakeholders (Narbel & Muff, 2017), it is deemed impracticable for the requirement to be catered to by ESG. Agency theory, on the other hand, points out the relationship between managers and owners of an entity and how the agency problem that arises due to information asymmetry can be solved by the adoption of disclosure frameworks (Mio et al., 2020). However, the early thinking that ESG is an agency problem that creates wealth deterioration no longer holds (Peng & Isa, 2020).

#### **2.1.1 The Legitimacy Theory**

According to Şeker and Şengür (2021), firms must safeguard their socially acceptable status, and this can be explained through the legitimacy theory. Organization legitimacy theory can be defined as a condition or status that exists when the value system of an entity is aligned with the values of the social system of which the entity is part of (Dowling & Pfeffer, 1975). Dowling and Pfeffer (1975) observed a contrast between actual and perceived value systems that cause threats to an

entity's legitimacy. Thus, legitimacy theory can be applied to explain why companies adopt sustainable reporting practices like ESG in response to the global demand for sustainable reporting practices. This implies that companies may adopt sustainability practices to address perceived discrepancies between their value systems and that of key stakeholders (James, 2017).

According to the legitimacy theory, an entity has to continuously demonstrate that its actions are legitimate, and that society perceives it as operating within acceptable norms and bounds (Şeker & Şengür, 2021). The homogenization of the relations between the external social responsibility of the firm and its internal social responsibility makes the legitimacy theory stand for the business ethics fundamentals (Şeker & Şengür, 2021). Legitimacy theory explains the behaviour of a company in developing and implementing voluntary environmental, social, and governance information disclosure (Baldini et al., 2018). The goal is to fulfil the social contract that exists between the organisation and the society that allows the recognition of the former's objectives and for survival in the unpredictable and turbulent operating environment (Burlea & Popa, 2013). In this regard, the legitimacy theory has been adopted by multiple scholars as a theoretical construct to explain the disclosure of ESG information by organisations and make viable predictions in empirical inquiries (Burlea & Popa, 2013). The pressure from internal and external actors and the firm's need to protect its reputation motivates the adoption of ESG practices and their disclosure in annual reports or through the media. Legitimacy provides a firm with the right to conduct its operations in line with the stakeholder's interests.

While the theory previously faced criticism for only being seen as a convincing exploitation of managerial motivations while failing to indicate how adoption and disclosure by management may or may not promote accountability and transparency (Mahmud, 2020; Owen, 2008), its rich disciplinary background qualifies it as an ideal theory to anchor this study (Meutia et al., 2022). The disciplinary background culminates from institutional, management, and stakeholder theories (Owen, 2008). Besides, legitimacy theory's sustainability in informing research emerges from the management heritage that connects conventional values and norms with modern ethics (Meutia et al., 2022). This explains why legitimacy has emerged among the conditions that should exist for a company's actions to be accepted by stakeholders (Alam, 2021; Mahmud, 2020; Martin-de Castro, 2021). The final reason for anchoring this study on the legitimacy theory is the presence of overwhelming evidence that suggests that executives adopt and disclose ESG performance

survival reasons instead of objectively declaring their proper social, environmental, and governance responsibility (Martin-de Castro, 2021). Such an argument provides a strong basis to be sceptical on the reason banks in Uganda adopt ESG practices and test if the adoption is related to meeting management objectives rather than for the pursuit of sustainability practices.

## **2.2 Empirical Literature**

The empirical review will involve an examination of the available relevant empirical literature on ESG.

### **2.2.1 Corporate Financial Performance**

One of the major goals of a firm is to satisfy its shareholders. Shareholders' satisfaction means a firm maximises the former's utility by increasing its worth. The heterogeneous nature of shareholders' satisfaction makes the selection of a unitary basis for measuring their utility in corporate financial performance a challenge (Belghitar et al., 2019). Empirical evidence suggests there are many ways of measuring a firm's performance, and the most utilised indicators include return on equity (ROE), return on assets (ROA), and Tobin's Q (Aras et al., 2018; López-Toro et al., 2021; Yoo & Managi, 2022; Naimy et al. 2021; Zubeltzu-Jaka et al., 2018).

ROA is an accounting-based measure that has been consistently used by researchers to evaluate the corporate financial performance of a firm (El Khoury et al, 2023; Puni & Anlesinya, 2020; Saputra, 2022). According to Husna and Satria (2019), ROA is a yardstick that shows a firm's efficiency in using available assets to maximise profits. It is calculated by dividing a firm's profits after tax by its total assets. This makes ROA an ideal measure to characterise the financial performance of a company, and it is used in combination with ROE and Tobin's Q to achieve this end (El Khoury et al., 2023). On the other hand, ROE is an accounting-based yardstick that evaluates a company's profits after tax against the ordinary equity holding (El Khoury et al., 2023). Put differently, it is an indicator that researchers and investment experts use to measure the stability and health of a company from the view of the shareholders, that is, comparing the average profitability to the shareholding (Naimy et al., 2021).

Tobin's Q has emerged as one of the most used financial performance market indicators to characterise a firm's management (El Khoury et al., 2023). According to Ishaq, Islam, and Ghouse

(2021), Tobin's Q is the economic theory of investment behaviour that measures the ratio of the firm's market value to its replacement cost. It is calculated by summing the market value of preference shares, long-term debt, short-term debt, and market capitalisation and dividing it by the firms' total assets at book value (Minutolo et al., 2019). Tobin's Q is a rather complex performance measure to calculate. However, when it is used, a firm that is managed well will have assets with a higher value than their replacement cost and adds value to the company (Ishaq et al., 2021). This study will use ROE and ROA as indicators for bank financial performance. Tobin's Q has been excluded because it is a market indicator and there is limited access to data on the market value of the private banks in Uganda.

### **2.2.2 ESG and Corporate Financial Performance**

Extensive literature has developed over the years on the relationship between ESG and financial performance. From this literature, two contrasting hypotheses have emerged. The first is the social impact hypothesis that argues there exists a positive relationship between ESG and financial performance (Nirino et al., 2021; Whelan et al., 2022; Zhou et al., 2022). Studies that support the social impact hypothesis argue that ESG is a firm's source of competitive advantage.

The second is the trade-off hypothesis, which argues that there exists a negative relationship between ESG and financial performance (El Khoury et al., 2023). Studies that support the trade-off hypothesis debate that spending the firm's resources to achieve social and environmental targets increases the costs of operations, impairs the entity's competitiveness and harms profitability (Azmi et al., 2021; Landi & Sciarelli, 2018; Velte, 2017). The social and environmental targets may include donations, community support initiatives, improved employee compensation, and investment in green efforts (El Khoury et al., 2023).

A seminal study that holds the trade-off view was conducted by Naimy et al. (2021) using 108 East Asian public companies between 2012 and 2017. The results of the study concluded that there existed no significant relationship between the accounting indicators of corporate financial performance and ESG. This disposition supports the argument that the firm exists to satisfy the needs of shareholders by maximising profits and creating value for the firm and that satisfying other stakeholder has the potential to negatively impact the performance of the firm. Other studies

conclude that there is a neutral relationship between ESG and financial performance (Friede et al., 2015), that is, a socially and environmentally responsible organisation does not affect performance.

Interestingly, ESG and financial performance studies in the banking industry have achieved contradictory results. Where some have found there exists a positive and significant relationship between ESG pillars and financial performance (Akdogan et al., 2020; Buallay et al., 2021), others have shown there is no significant relationship between bank performance and ESG (Menicucci & Paolucci, 2022; Miralles-Quirós et al., 2019). One seminal study in the banking sector showing a neutral relationship was conducted by El Khoury et al. (2023). The study employed panel regression using data between 2007- 2019 from 46 public companies in the Middle East, North Africa and Turkey (MENAT) region to test this relationship between ESG and financial performance. The indicators for financial performance were total revenue, ROE, ROA, and Tobin's Q. The study used ESG squared values to account for nonlinearity, and the findings established there was a positive relationship between ESG and financial performance in the short term to a certain level above which it becomes harmful (El Khoury et al., 2023). The results imply that in the short run, the investment in ESG by banks positively affects profitability but, in the long run, it turns negative.

The difference in the discourses expanded on above is yet to be settled by empirical studies. Africa's case is further complicated by the limited empirical inquiry into the phenomenon (Bananuka, 2018). A lack of accepted standardised ESG framework such as GRI that has been successfully deployed in Europe and the U.S. (Giannarakis et al., 2023) and the premise that ESG adoption and disclosure is voluntary in most African nations (Singhania & Saini, 2021) has greatly contributed to the insufficiency of empirical inquiries. However, policymakers in Africa are establishing measures that will see firms adopt ESG and further make it mandatory to disclose (ALN Kenya, 2022). An example is the recent declaration by the NSE (2022) that listed firms in Kenya should report on their ESG performance. Challenges exist in these markets, but all indications point to a unitary adoption and disclosure of ESG, more so for legitimacy purposes besides regulatory compliance. The current research will exhaustively test the relationship between ESG and the financial performance of banks in Uganda. Based on the empirical evidence reviews and the justifications therein, the following hypothesis has been derived:

*H1: The effect of ESG on corporate financial performance is linear, and this infers that the relationship is positive.*

### **2.2.3 Effects of Bank Characteristics on Firm Performance**

This research seeks to investigate the effect of ESG adoption and bank characteristics on corporate financial performance. According to Irawati et al. (2019), capital adequacy is used to measure the health of a bank by establishing the presence of adequate capital to cover unexpected liquidity needs. The higher the capital adequacy ratio, the higher the bank's capacity to deal with financial risks. There exists a considerable body of literature that indicates that capital adequacy has a significant positive relationship with the financial performance of deposit-taking banks (Alfadli & Rjoub, 2020; Dao, 2020; Goh et al., 2022; Madugu et al., 2020; Rafique et al., 2020; Ukinamemen & Ozekhome, 2019).

*H2: Capital adequacy has a positive relationship with the financial performance of commercial banks.*

Asset quality, which focuses on the quality of loans that earn revenues for banks, has been shown to affect the performance of financial institutions (Abata, 2014; Sile et al., 2019; Velliscig et al., 2022). The argument behind these findings is that nonperforming loan ratios act as the ideal proxies for asset quality, and the lower the level of these nonperforming assets, the higher the profitability of banks, and vice versa (Roselyne et al., 2022).

*H3: Asset quality has a positive relationship with the financial performance of commercial banks in Uganda.*

Some studies argue that there is a positive significant relationship between liquidity and the financial performance of firms (Chen et al., 2018; Tabash et al., 2020). Specifically, Tabash et al., (2020) studied 1598 firms in India between 2010 to 2016 and found that a company's liquidity has a positive relationship with financial performance, while others conclude that the relationship is adverse (Li et al., 2020).

*H4: Liquidity has a statistically meaningful effect on the financial performance of commercial banks in Uganda, either positive or negative.*

Further, Susiowati et al. (2020) argue that there is a positive and significant relationship between profitability as measured using net profit and the financial performance of firms. As such, the higher the net profit ratio, the higher the firm's financial performance.

*H5: Profitability has a positive effect on the financial performance of commercial banks in Uganda.*

A series of recent studies have indicated that the number of employees, total assets, and customer deposits, all proxies of bank size, have a cumulative positive effect on the financial performance of banks (Abisola, 2022; Jaouad & Lahsen, 2018; Kachumbo, 2020; Nyabaga & Wepukhulu, 2020).

*H6: Bank size has a positive effect on the financial performance of commercial banks in Uganda.*

While macroeconomic variables affect the financial performance of banks, this study will use bank-specific characteristics reviewed above as control variables to show the relationship between ESG and bank characteristics and financial performance in Ugandan banks.

#### **2.2.4 ESG, Bank Characteristics, and Financial Performance**

In their research, Trisnawati et al. (2022) investigated the effect of ownership, profitability, board size and frequency of commissioner meetings on sustainability reporting disclosures. Using a multivariate linear regression method, data from forty-five companies listed on the Indonesian Stock Exchange was analysed and a conclusion was that, though the number of directors on the board had a significant effect on the ESG disclosures, ownership and profitability did not impact the disclosures made.

Tanjung (2021) analysed the impact of good corporate governance, profitability, and company size on sustainability report disclosures by reviewing data from companies participating in the Indonesia Sustainability Report Award (ISRA) between 2015 and 2019. The findings of the study were that though the profitability and size of the companies reviewed did not affect sustainability report disclosure, good corporate governance was a significant contributor to the sustainability disclosures made.

Dey (2020) investigated the determinants of integrated reporting and its association with firm value and liquidity in the context of voluntary adoption by the Bangladesh Banking sector. The study involved a review of information across 5 years of all banking companies in Bangladesh using the IR Index. The results inferred those banks with bigger board sizes, higher proportions of female and independent directors and larger growth opportunities are likely to adopt IR. The study is however silent on other financial factors that impact the nature of disclosures such as foreign ownership, profitability, and asset size under investigation in our research. The study also focused on IR in general and not specific to ESG which is our area of focus.

Dienes et al. (2016) in their research investigated the drivers of sustainability reporting using a systematic literature review. The results of their findings were that firm size; media visibility and ownership structure are the most important determinants of sustainability reporting in firms. In contrast, profitability, capital structure, firm age or board composition did not influence disclosure levels for entities that adopted sustainability reporting.

In their study of the influence of board characteristics and ownership structure on ESG disclosures in an emerging market using Chilean firms, Jaime and Alejandro (2021) found that a board's independence and gender diversity positively influenced the level of ESG adoption. The study also found that for listed firms in Chile that were reviewed, ownership structure did not influence the nature and level of ESG adoption and therefore not a determinant for ESG adoption. We will seek to establish whether the findings can be prorated to the banking sector in Uganda.

*H7: Ownership structure does not affect the level of ESG disclosures by commercial banks in Uganda.*

### **2.2.5 Stakeholders' Views on ESG Reporting and Opportunities for Adoption**

A study by Bananuka et al. (2021) explored the impact of intellectual capital on sustainability reporting practices in Uganda. The study sought to understand how human, structural, and relational capital impacted sustainability practices. Using data collected over a year from 62 financial services firms through interviews with CFOs and accountants, the study found that not only did financial and board governance attributes contribute to the adoption of sustainability reporting but also staff competencies and intellectual capacity were critical in the driving of adoption of ESG.

Steyn (2014) investigated the challenges in the adoption of mandatory IR from the perspective of senior executives in South African listed companies, two years into the mandatory disclosure regime. The study focused on the organizational benefits of IR, key implementation challenges experienced and reasons for producing an integrated report in an IR regulatory scheme. Following a self-administered web survey of all CEOs and CFOs, the study revealed that protection of corporate reputation seemed to be the key motive for adoption as opposed to compliance with significant emphasis on satisfying stakeholder needs than investor needs. This could explain the low rate of adoption in Uganda and Africa at large where the number of firms listed on stock exchanges is few hence low stakeholder engagements. Also, the adoption of IR did not lead to cost reduction or better resource allocation, contrary to views advocating for IR adoption. The study highlights two key challenges faced by institutions in the adoption of IR. These are costly adjustments to management reporting systems to comply with data requirements and ambiguity in determining material disclosures. Despite the research focusing on companies in different industries, insights provided are relevant to the Uganda financial services sector and similar questions will be posed to respondents to assess whether challenges are consistent in the Ugandan context. Also, though the study focuses on IR, we would seek to establish whether local commercial banks face similar hurdles in ESG adoption.

Bananuka et al. (2018) in their study sought to establish why firms in developing countries were slow to adopt IR. They also identified matters for consideration to drive adoption using evidence reviewed from Uganda. By carrying out interviews of senior executives in the Capital Markets Authority, professional accountancy bodies, the Uganda Securities Exchange and firms listed on the Uganda Securities Exchange between the period 2010 to 2016, they suggest that firms are slow to adopt IR for the following reasons: a scarcity of resources, leadership and organizational culture, stakeholder demand, lack of awareness of IR and nature and size of businesses. They recommend that IR be made mandatory for all institutions of public interest such as financial institutions and those listed on the stock exchange. Unlike the study, our research will focus purely on commercial banks which the majority were excluded in the study as only three of the licensed twenty-five commercial banks would have been covered in our scope. Also, the period of this research is outside the timelines of their study and with improvements in levels of adoption of IR as cited by

(Bananuka et al., 2021), we will seek to understand whether the hindrances to the adoption of ESG by Uganda financial institutions are similar.

Injeni et al. (2019) used agency and stakeholder theories to review various regulatory frameworks supporting the IR of listed companies in Kenya. Using semi-structured questionnaires, they obtained and evaluated the views of regulators on current reporting and IR requirements. The study finds that whilst regulators concur that the adoption of IR will enhance transparency in reporting practices, they are still hesitant to harmonise and address the challenges of duplicate reporting under multiple regulations which increase reporting burdens on companies. Similar conclusions can be prorated to other emerging markets like Uganda where further empirical studies would need to be conducted to propose improvements to existing regulatory reporting requirements in a bid to improve corporate reporting in general.

Dumay et al. (2017) in their study focused on the possible barriers to the adoption of IR and emphasised specific issues which in their view if rectified will advance the rate of IR adoption. Using insights from academic literature as well as directives, policies, and framework pronouncements, they advocate for the accounting professional bodies, in general, to be involved in the drive for the adoption of IR as it would help ensure consensus among practitioners and consistency in the application of the guidelines.

While several studies have been done confirming that preparers of financial information prefer voluntary approaches to adoption, less is known about the preferences of users of non-financial information. Stubbs and Higgins (2018) performed an exploratory study on the preferences of users of non-financial reporting for regulatory or voluntary approaches to IR. The study found that there was more support for voluntary approaches as most participants thought it was too early for regulatory reforms. Despite the low appetite for regulatory reform, more than half of shareholders supported mandatory IR because, in their experience, voluntary adoption had not improved the quality of disclosures in general. Whilst this study concluded that regulatory reforms were not required, our study delved into the effect of regulatory involvement as one of the contributory factors to the increased adoption of ESG.

### 2.3 Research Gaps

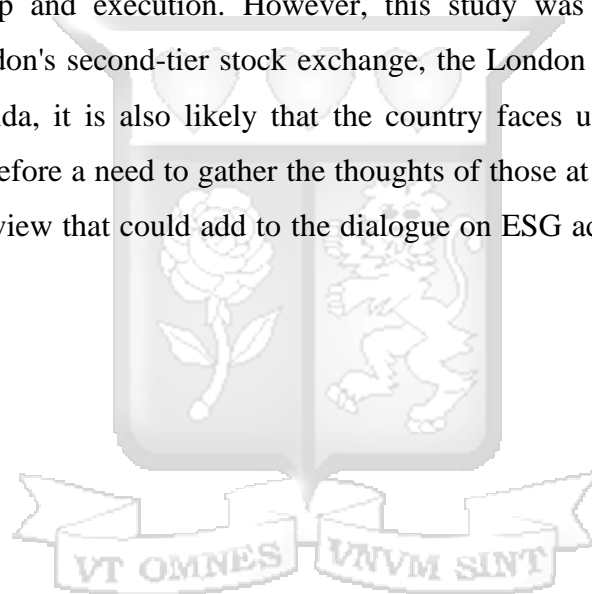
A synthesis of the literature has found the effect of ESG on firm financial performance, and banks in particular, to be mixed, and emerging are two diverging theories that explain the contradicting results. On one hand, there is the social impact hypothesis which argues that ESG can give firms a competitive edge and should thus have a positive effect on the bottom line, while on the other hand is the trade-off hypothesis which posits that ESG adoption makes firms incur additional costs that adversely affect the bottom line. Part of the reason that the literature has revealed contradicting views is that the studies conducted focused on countries, regions, or industries which could bias the results to one extreme based on widespread exogenous factors prevalent in the study population. El Khoury's (2023) study mitigated this somewhat and the results revealed a threshold over which ESG adoption adversely affected firms' financial performance, but under which it had a positive effect on the bottom line. All these reveal that the effect of ESG adoption on financial performance is a complex phenomenon which needs domain-specific studies to unveil. Therefore, by studying the effect of ESG adoption and bank characteristics on the financial performance of Ugandan banks, this research shed light on the direction, magnitude, and significance of this relationship in the context of Uganda, which will go a long way in informing policymakers, among others, to guide their decision making.

One of the implications of the trade-off hypothesis is that highly capitalised banks are more likely to adopt ESG since they can afford the additional costs. At the same time, the social impact hypothesis implies that firms with low profitability should more readily adopt ESG to gain a competitive edge. Indeed, the literature review revealed that both these effects have been observed in different parts of the world. For example, El Khoury (2021) found that larger sizes banks with lower profitability had higher ESG disclosure. This shows that the effect of bank characteristics on ESG adoption is varied. Given that ESG adoption is not mandatory in Uganda, studying the effect of bank characteristics on ESG adoption has shed light on which of the two competing hypotheses holds in the country, which could help various stakeholders understand what to leverage to accelerate ESG adoption in the Ugandan banking sector.

While numerous studies have established the effects of ESG adoption and disclosure of ESG performance on the financial performance of firms, there is still a scarcity of studies conducted in Africa, especially in less developed African nations like Uganda. Further, such studies often focus

on the effects of ESG adoption, disclosure or performance, or bank characteristics in isolation. This study, on the other hand, seeks to combine the two to give a more integrated perspective of the dynamics involved between both ESG adoption and bank characteristics against bank financial performance.

ESG adoption in Uganda is still in its infancy and there is space to formulate policies that promote ESG adoption for the benefit of many stakeholders. In addition to studying the effect of bank characteristics on ESG adoption, this study also surveys key figures in the banking sector to understand the challenges, hindrances, or successes surrounding ESG adoption. Morais et al. (2022) found that gaps in ESG adoption were due to four primary reasons: knowledge, accountability, leadership and execution. However, this study was conducted using mature companies listed in London's second-tier stock exchange, the London AIM. While similar gaps may be present in Uganda, it is also likely that the country faces unique challenges to ESG adoption. There was therefore a need to gather the thoughts of those at the fore of ESG adoption to gain a more nuanced view that could add to the dialogue on ESG adoption in Uganda among stakeholders.



## 2.4 Conceptual Framework

The conceptual framework provides a link between the theoretical and empirical literature reviewed in the previous sections. Figure 2.1 illustrates the link between the study's research objectives, theoretical framework, and associated dependent and independent variables. The independent variable for the study is ESG adoption while the dependent variable is the corporate financial performance of banks in Uganda. The indicators for the dependent variables are, return on assets and return on equity. Bank characteristics are the mediating variables. Among the indicators for the bank characteristics include capital adequacy, liquidity, asset quality, ownership, bank size, and profitability.

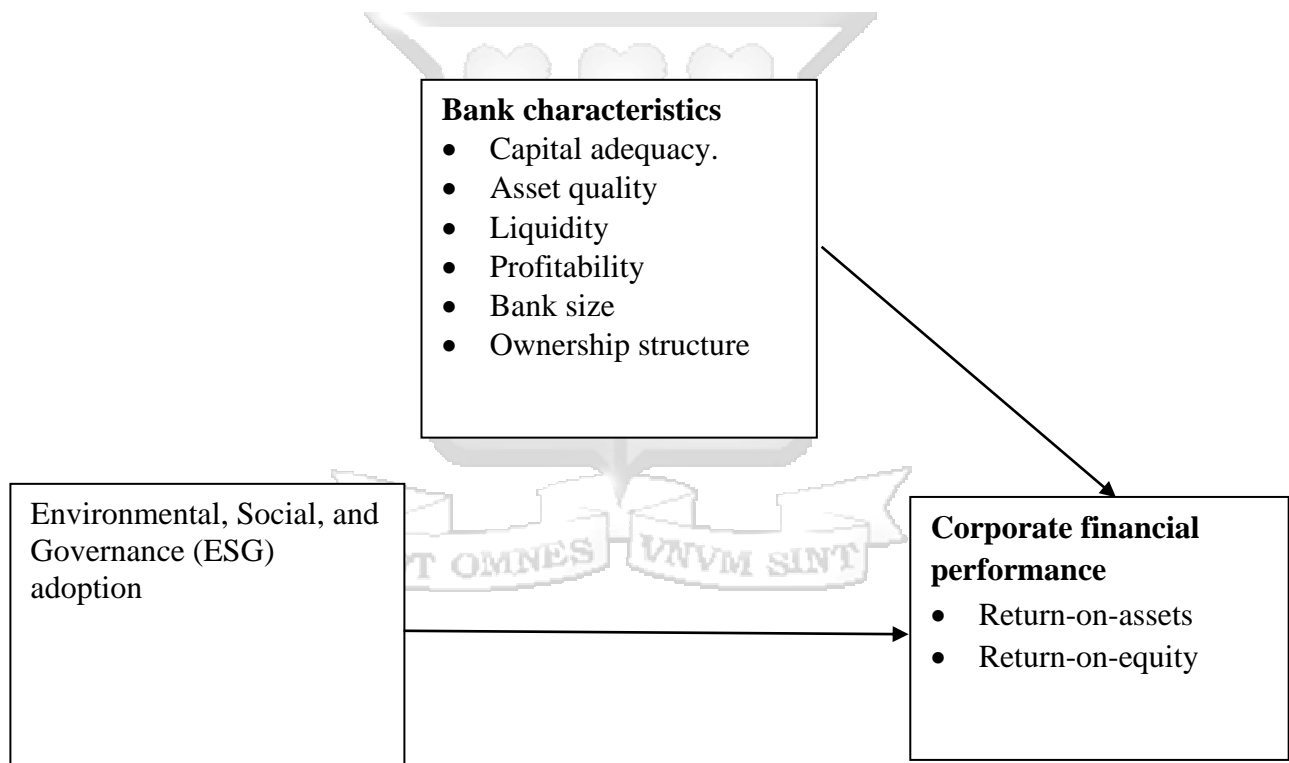


Figure 2.1 Conceptual framework (Author, 2023).

Table 2. 1 Operationalisation of study variables.

Variable	Variable Type	Indicator	Foundation Literature
<b>Independent: ESG Adoption</b>			
Environmental, Social, and Governance ESG adoption	Continuous numeric	ESG score	Arun et al (2022)
<b>Control: Bank-specific variables</b>			
Capital Adequacy	Continuous numeric	Core capital/Risk weighted assets	(Alfadli & Rjoub, 2020; Dao, 2020; Goh et al., 2022; Madugu et al., 2020; Rafique et al., 2020; Ukinamemen & Ozekhome, 2019).
	Continuous numeric	Total qualifying capital/Risk weighted assets	(Alfadli & Rjoub, 2020; Dao, 2020; Goh et al., 2022; Madugu et al., 2020; Rafique et al., 2020; Ukinamemen & Ozekhome, 2019).
Asset Quality	Continuous Numeric	Gross loans less impairment provision/Total loans	(Abata, 2014; Sile et al., 2019; Velliscig, Floreani, & Polato, 2022; Roselyne et al., 2022).
Liquidity	Continuous Numeric	Liquidity coverage ratio = Total assets/Total liabilities	(Chen et al., 2018; Tabash et al., 2020; Li et al. 2020)
Profitability	Continuous Numeric	Net profits after tax	Susiowati et al. (2020)
Bank Size	Continuous Numeric	Log of total assets	(Abisola, 2022; Jaouad & Lahsen, 2018; Kachumbo, 2020; Nyabaga & Wepukhulu, 2020).
Ownership	Continuous Numeric	% of foreign ownership	Jaime & Alejandro (2021)
<b>Dependent variable: Corporate financial performance</b>			
Return-on-assets	Continuous Numeric	Profit after tax / Total assets	El Khoury et al (2021)
Return-on-equity	Continuous Numeric	Profit after tax/shareholder's equity	El Khoury et al (2021)

(Author, 2023).

## 2.5 Summary of the Chapter

This chapter has identified the theoretical and empirical literature that would form the foundation of the current inquiry. Based on the study's research objectives, the literature review has identified independent (ESG adoption) and control variables that were hypothesised to influence the financial performance of commercial banks in Uganda. The hypotheses from the literature review are:

H1: The effect of ESG on corporate financial performance is linear, and this infers that the relationship is positive.

H2: Capital adequacy has a positive relationship with the financial performance of commercial banks.

H3: Asset quality has a positive relationship with the financial performance of commercial banks in Uganda.

H4: Liquidity has a statistically meaningful effect on the financial performance of commercial banks in Uganda, either positive or negative.

H5: Profitability has a positive effect on the financial performance of commercial banks in Uganda.

H6: Bank size has a positive effect on the financial performance of commercial banks in Uganda.

H7: Ownership structure does not affect the level of ESG disclosures by commercial banks in Uganda.

Whilst many studies have been done on the concept of ESG adoption and its benefits to management and stakeholders, little has been done to explain why the levels of adoption in Africa, except for South Africa, remain low. In the case of Uganda, studies on the extent of adoption by the banking sector are unknown despite its influence on the country's economy. This study has also helped to identify hindrances to ESG adoption by commercial banks and areas of focus to drive the level of adoption.

## **CHAPTER THREE: METHODOLOGY**

### **3.1 Introduction**

This chapter outlines the methods used to collect and analyse data for this research. It discusses the research design, data collection methods and tools, the population of the study, methods of data analysis, and considerations on data reliability, validity, and ethics.

### **3.2 Research Philosophy**

A research philosophy is a belief that drives the way information is gathered, analysed, and used (Saunders, 2009). This study adopted both a positivist and post-positivist approach. The positivist approach emphasises that researchers should be independent of their study and use statistical approaches in making inferences from the study. This approach was applied during the review of secondary data to determine the relationship between ESG adoption and bank characteristics on the financial performance of commercial banks in Uganda.

Post-positivism focuses on research issues in the context of involving the experiences of the majority and announcing results of what the majority deems acceptable (Panhwar et al., 2017). The post-positivism philosophy was applied in the research in identifying and analysing key stakeholders' views and perceptions of ESG reporting and opportunities that exist to promote adoption.

### **3.3 Research Design**

A research design is a framework that guides the methods and procedures to collect, analyse, and interpret data. This study employed an explanatory research design. According to Molina-Azorin et al. (2021) this research design is based on philosophical assumptions that guide the collection and analysis of data using quantitative data collection and analysis techniques. A mono-method quantitative method research (Injeni et al., 2020) within a single phase of data collection and analysis was applied. This allowed for quantitative analysis and interpretation to provide a rich and more detailed response to the study hypotheses.

Scores derived from the ESG adoption and other company attributes like profitability, asset size, total income etc were quantitative. Also, the data collected using questionnaires was quantitative.

A semi-structured questionnaire was used to collect data from personnel involved in the financial reporting process within the banks. A quantitative analysis was applied in a bid to establish a relationship between identified variables.

### **3.4 Data Collection Methods and Tools**

Online questionnaires were used to collect primary data from respondents comprising staff involved in the financial reporting process in the respective commercial banks. The format of the questionnaire used is shown in Appendix B. Secondary data was collected from the annual reports of all licensed commercial banks between the period 2012 and 2021. Since the data used in this study was obtained from published annual reports, it was categorized as secondary data. Depending on which of the study's objectives was being analysed, the dependent variables were either financial performance and ESG adoption, while the independent variables were bank characteristics and ESG adoption. ESG adoption was measured using a dummy variable indicating whether or not (1 or 0) a bank had voluntarily adopted ESG reporting. Financial performance was measured using return-on-equity (ROE) and return-on-assets (ROA). The bank characteristics considered in this study were capital adequacy, asset quality, liquidity, profitability, bank size, and ownership structure. The specific measures of these variables are shown in Figure 2.1. All the data was obtained from published annual reports from 2012 to 2021.

#### **3.4.1 ESG Adoption**

Reporting disclosures in the annual reports was assessed for compliance with the Nairobi Stock Exchange ESG Disclosures guidance manual issued in November 2021. The guidelines provide a granular and tactical approach to ESG reporting that meets international standards on ESG reporting as set out in the GRI 2021. This study only assessed compliance with the four mandatory ESG disclosures categories: General, Economic, Social and Environmental with an emphasis on the sector-specific topics for the Banking sector as outlined under Annex 6 in the report.

The study determined whether a bank has adopted ESG or not. The scores were awarded using a nominal scale where 0 represented the absence of the disclosure and 1 represented the existence of the disclosure. The scores were then be summarised using statistical measures of mean, mode, maximum and minimum values (Saunders et al., 2019).

### **3.4.2 Financial Reporting Disclosures**

Panel data applied to this study since it observed several variables over a period at a regular frequency. Given that data was not available for some periods as some banks were not in existence, unbalanced panel data was applied.

## **3.5 Population and Sampling**

### **3.5.1 Population**

A population is the full set of data from which a sample is taken. This study's population comprised the total number of licensed commercial banks in Uganda between 2012 and 2021. As of 31 December 2022, the total number of licensed commercial banks were twenty-five (Bank of Uganda, 2023)

### **3.5.2 Sampling**

Given that the sample size is less than fifty (Saunders et al., 2019), data was collected from the entire population of licensed commercial banks. Though collecting data on the entire population reduces the risk of missing potential insights about the population, it was time-consuming and required a lot of effort to collect the required information across all the banks. In addition, respondents to questionnaires did not provide feedback on time thus delaying the research process. To mitigate these risks, research assistants were employed to aid with the data collection process. Also, a follow-up tool was designed to enable regular follow-ups on pending questionnaires. The questionnaires were administered online to allow for ease in the distribution and collection of data from the respondents.

## **3.6 Data Analysis**

The type of data analysis performed was dependent on the research objectives and data collection tools and methods employed. Below is the summary of the nature of the data collected and the type of analysis that was deployed using EViews 12 SV Lite. The units of analysis for this study were all the licensed commercial banks in Uganda that were in operation between 2012 and 2021. Since the data was sampled for each of the experimental units across time, the data contained both a cross-sectional and a time series dimension, which conforms to the definition of panel data

provided by Sarafidis and Wansbeek (2012) that panel data is data where the time series and cross-sectional dimensions are of equal magnitude. Therefore, the consideration of candidate models to analyse the data was bound to panel models only. Objectives 1 and 2 require quantitative analysis using panel models, however, depending on the type of dependent variable, and the results of the Hausmann tests, panel fixed or random effects models, and panel logit models were used. These models are expounded on below.

### 3.6.1 Panel Regression Models

According to Torres-Reyna (2007), the fixed-effects (FE) model and the random-effects (RE) model are examples of panel data models used in research. The author advances the fixed-effects model as:

$$y_{it} = \beta_i' X_{it} + \alpha_i + u_{it}$$

In this model, the  $\alpha_i \forall i = 1, \dots, n$  is the unknown intercept for each of the cross-sectional units, in this case, banks, of which there are  $n$  of them.  $y_{it}$  is the dependent variable where  $i$  is the cross-sectional unit, and  $t$  is time.  $X_{it}$  are the independent variables, while  $\beta'$  is the vector of parameters and  $u_{it}$  is the error term. According to the author, the FE model controls for all the time-invariance differences between the cross-sectional units and therefore, cannot be biased due to omitted time-invariant characteristics.

The RE model, according to the author, is written as:

$$y_{it} = \beta_{it} + \alpha + u_{it} + \epsilon_{it}$$

In this model,  $\alpha$  absorbs both the time-invariant and the cross-sectional invariant factors,  $u_{it}$  is the between-entity error and  $\epsilon_{it}$  is the within-entity error. The author remarks that the advantage of the RE model is that it can explicitly capture the cross-sectional invariant factors. According to Torres-Reyna (2007), Hausman (1978) established a formal test to help determine which model was optimal for a given panel dataset. This test, known as the Hausman test, is based on the fixed-effects estimator,  $Q_{FE}$ , and the random-effects estimator,  $Q_{RE}$ . The null hypothesis is that there is no correlation between the individual entity terms and the regressors. The test statistic is calculated as:

$$m = (Q_{FE} - Q_{RE})' [cov(Q_{FE})] (Q_{FE} - Q_{RE})$$

The Hausmann test statistic follows a chi-square distribution. If the null hypothesis is rejected the fixed-effects model is chosen, otherwise the random effect is chosen.

### 3.6.2 Preliminary Statistical Tests

#### 3.6.2.1 Test for Panel Cross-Sectional Dependence

The interdependence among the cross-sectional units has significant implications for parameter estimate and subsequent inference, according to Sarafidis and Wansbeek (2012). Cross-sectional dependence is the name given to this phenomenon (CSD). The author claims that when ignored, CSD has an impact on the objectivity and consistency of conventional panel estimators. Additionally, the author claims that panel data analysis is useless in the extreme situation of CSD and that it is preferable to apply straightforward classical regression. The Pesaran (2004) test, according to De Hoyos and Sarafidis (2006, 486), is used to assess panel CSD. The null hypothesis is the absence of CSD. The test statistic is:

$$CD = \sqrt{\frac{2T}{N(N-1)} \left( \sum_{i=1}^{N-1} \sum_{j=i+1}^N \widehat{\rho}_{ij} \right)}$$

Where:

$$\widehat{\rho}_{ij} = \widehat{\rho}_{ji} \frac{\sum_{t=1}^T u_{it} u_{jt}}{(\sum_{t=1}^T u_{it}^2)^{1/2} (\sum_{t=1}^T u_{jt}^2)^{1/2}}$$

is the sample correlation. The Breusch-Pagan LM test, Pesaran-scaled LM test, and Bias-corrected scaled LM test are other tests to be conducted. These tests have a null hypothesis of no panel CSD and an alternative hypothesis of panel CSD.

### 3.6.2.2 Test for Panel Unit Root Stationarity

Asteriou and Hall (2021) provide the following definition of unit-root stationarity. Think about the AR (1) model:

$$y_t = \phi y_{t-1} + e_t$$

where  $e_t$  is white noise. If  $|\phi| < 1$ , then the series is stationary, if  $|\phi| > 1$  the series is explosive, and if  $|\phi| = 1$ , the series contains a unit root and is non-stationary. The unit-root stationarity of each series in the panel is tested using the panel unit root. The most widely used panel unit-root tests are Levin, Lin, and James Chu (2002), Choi (2001), Im et al. (2003).

### 3.6.3 Experimental Setup

- I. To determine the joint effects of ESG adoption and bank characteristics on the financial performance of Ugandan banks over the period 2012-2021.

Using ROA to measure the financial performance of the banks, the following fixed-effects model:

$$ROA_{it} = \alpha_i + \beta_1 CA_{it} + \beta_2 AQ_{it} + \beta_3 LIQ_{it} + \beta_4 PROF_{it} + \beta_5 BS_{it} + \beta_5 OS_{it} + \beta_6 ESG_{it} + u_{it}$$

And the following random effects model;

$$ROA_{it} = \alpha + \beta_1 CA_{it} + \beta_2 AQ_{it} + \beta_3 LIQ_{it} + \beta_4 PROF_{it} + \beta_5 BS_{it} + \beta_5 OS_{it} + ESG_{it} + u_{it} \epsilon_{it}$$

were estimated.

Further, using ROE to measure the financial performance of the banks, the following fixed-effects model:

$$ROE_{it} = \alpha_i + \beta_1 CA_{it} + \beta_2 AQ_{it} + \beta_3 LIQ_{it} + \beta_4 PROF_{it} + \beta_5 BS_{it} + \beta_5 OS_{it} + \beta_6 ESG_{it} + u_{it}$$

And the following random-effects model;

$$ROE_{it} = \alpha + \beta_1 CA_{it} + \beta_2 AQ_{it} + \beta_3 LIQ_{it} + \beta_4 PROF_{it} + \beta_5 BS_{it} + \beta_5 OS_{it} + ESG_{it} + u_{it} \epsilon_{it}$$

were estimated. In both cases, the Hausmann test was used to choose the best model whose parameter estimates was discussed further. In the above models, CA=capital adequacy, AQ=asset quality, LIQ=liquidity, PROF=profitability, BS=bank size, OS=Ownership structure, and ESG = ESG adoption.

- II. To determine the effect of bank characteristics on ESG adoption of Ugandan banks over the period 2012-2021 the following fixed-effects model:

$$ESG_{it}^* = \alpha_i + \beta_1 CA_{it} + \beta_2 AQ_{it} + \beta_3 LIQ_{it} + \beta_4 PROF_{it} + \beta_5 BS_{it} + \beta_5 OS_{it} + u_{it}$$

And random effects model;

$$ESG_{it}^* = \alpha + \beta_1 CA_{it} + \beta_2 AQ_{it} + \beta_3 LIQ_{it} + \beta_4 PROF_{it} + \beta_5 BS_{it} + \beta_5 OS_{it} + u_{it} + \epsilon_{it}$$

were estimated.

### 3.6.4 Stakeholder Views on ESG Adoption

To gain an understanding of the challenges faced in ESG adoption and identification of opportunities for improvements, a questionnaire was used as shown in Appendix B. To improve ease of dissemination, the questionnaire was designed in Google forms which allowed for the exportation of data into Excel and finally the IBM SPSS Statistics 29 statistical tool was utilised for further analysis. SPSS enabled an analysis of responses along the descriptive statistics. For the open-ended questions, an approach recommended by (Cresswell, 2003) was used that involved the identification of themes across the responses and summarising them into broad categories for interpretation.

## 3.7 Reliability and Validity of Data Analysis and Collection

### 3.7.1 Reliability

Reliability is concerned with the robustness of the questionnaire and whether it produces consistent findings at different times under different conditions (Saunders et al., 2019). Internal consistency, which involved correlating responses to questionnaire questions was assessed. Cronbach's alpha was used to measure internal consistency. It consists of an alpha coefficient with a value between

0 and 1. A score of 0.7 and above implied that questions combined in the scale were internally consistent with their measurement. To perform this assessment, a pilot study of 5 sample respondents from the targeted population was selected. The respondents were conveniently selected as statistical conditions do not (Saunders et al., 2019). A Cronbach alpha of 0.77 on the five items that formed the study variables of stakeholder perceptions of ESG , availability of information for disclosure, was included in these variables. The measuring device was reliable because of the Cronbach alpha being higher than 0.7.

### **3.7.2 Validity**

Validity assessed the ability of our data collection tool, in this case, the questionnaire, to measure what we intend to measure. Our validity assessment focused on content and criterion validity as defined by (Saunders et al., 2019). Content validity focuses on the extent to which the study questionnaire provides adequate coverage of the research questions. To assess content validity, the questionnaire was reviewed by peers, supervisors, and subject matter specialists within Strathmore University to ensure the comprehensiveness of the tool. Changes were made to the structure and content of the questionnaire where required.

Criterion validity, also known as predictive validity, is the extent to which a measure can predict an outcome (Messick, 1989). It is largely applied in quantitative analysis such as regression analysis. To do this, the study assessed whether the above regression models have been applied to prior studies and the outcomes of the findings suggest the models were valid (Adegboyegun et al., 2020).

### **3.8 Ethical Issues and Management**

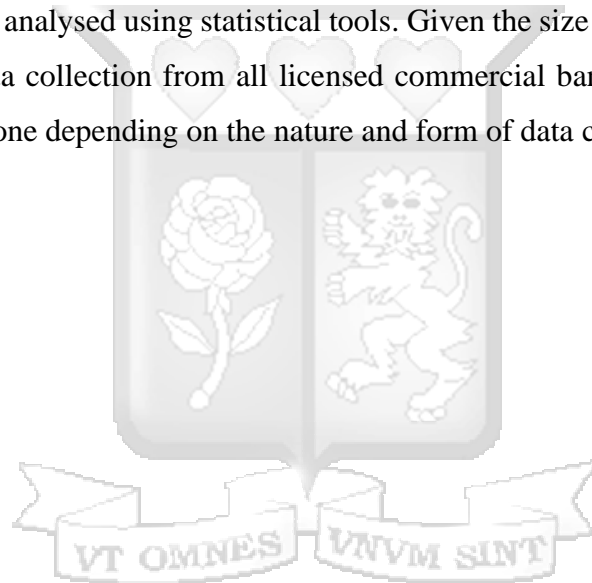
In conducting this research, several issues were addressed to ensure that the objectives were achieved ethically. The proposal was submitted to the Strathmore Institutional Ethics and Scientific Review Committee (SESRC), and then approval to conduct the research sought from the local regulator, Uganda National Council for Science & Technology (UNCST).

The participants were required to confirm if they wished to take part in the research. No participant was coerced or deceived to take part in the study. Further, the participants were assured of confidentiality by omitting their names in the questionnaires and maintaining anonymity. More

importantly, the research participants were not subjected to any form of harm, that is, physical harm, psychological distress, discomfort, and intrusion on privacy. Finally, the information was obtained, analyzed, and discussed objectively to avoid misleading reporting. The works of other authors where relevant were appropriately referenced. The use of any assistants in data collection and analysis was objective and quality assured.

### **3.9 Summary of the Chapter**

This chapter has summarised the methodology the study will use to collect and analyse data. The quantitative research design was applied in this study. Primary data was collected using questionnaires while secondary data from annual reports of the respective commercial banks was summarised in Excel and analysed using statistical tools. Given the size of the target population, a full census involving data collection from all licensed commercial banks was carried out. Data analysis was thereafter done depending on the nature and form of data collected.



## CHAPTER FOUR: FINDINGS

### 4.0 Introduction

This study's main aim was to establish the effect of ESG adoption and bank characteristics on financial performance in Uganda. The dependent variables used to estimate the relationship included ROE and ROA. The independent variable was ESG adoption measured by ESG score. More importantly, this study's control variables included capital adequacy ratio, tier 1 capital ratio, asset quality, bank liquidity, bank profitability ratio, bank size, and percentage of foreign ownership. This chapter presents the findings of the analysis based on the results of each specific objective. The chapter begins with the descriptive statistics for the panel data, followed by the presentation of the result based on each study objective.

### 4.1 Descriptive Statistics

The descriptive statistics for the dependent and control variables are presented in Table 4.1. The results indicate that the average ESG score was 20.31, with a standard deviation of 16.99. The average was above the midpoint (13), an indication that Ugandan banks have an above-average ESG adoption. Table 4.1 further indicates that the ESG score ranges from a minimum of 0 to a maximum of 70. ESG's Jarque-Beta test results indicate that the data was not normally distributed.

**Table 4. 1** Descriptive statistics for the independent and control variables.

	ESG adoption	Capital adequacy ratio	Tier 1 leverage ratio	Asset quality	Liquidity	Profitability	Bank size	% Foreign owned
Mean	20.31	0.24	0.25	0.042	0.66	37,105,548	20.46	0.8
Standard Deviation	16.99	0.13	0.12	0.05	0.26	55,115,847	1.15	0.3
Min	0	0.08	0.09	-0.21	0	-22,837,857	17.87	0
Max	70	1.05	1.06	0.25	1.58	275,438,162	22.89	1
Median	13	0.2	0.22	0.03	0.64	17,028,639	20.46	0.99
Skewness	1.12	3.12	3.12	0.56	0.86	2.01	-0.3	-1.67
Kurtosis	3.49	15.77	16.54	7.86	4.57	7.33	2.5	4.61
Jarque-Beta	34.51	1525.22	1603.07	187.77	41.01	264.04	4.54	154.41
p-value	0.01	0.01	0.01	0.01	0.01	0.01	0.1	0.01

Controlling for firm characteristics, results in Table 4.1 indicate that the average capital adequacy ratio for Ugandan banks was 0.24 while the tier 1 leverage ratio was 0.25 (both ratios used to

control for capital adequacy). The capital adequacy ratio spanned from 0.08 to 1.05 while the tier 1 leverage ratio had a low of 0.09 and a high of 1.06. Both were not normally distributed (Jarque-Beta statistic was statistically significant). The average asset quality was 0.042 (SD of 0.05) and ranged from -0.21 to 0.25. The average was within the midpoint (0.03), denoting that Ugandan Banks' asset quality is above average. As measured by the loan-to-deposit ratio, the liquidity ratio had a mean of 0.66 (SD of 0.26) and varied from 0 to 1.58. An ideal loan-to-deposit ratio falls between 80% to 90% (Asfar and Inayati, 2022). While Ugandan banks had an average loan-to-deposit ratio below the ideal, the mean for the banking industry was 0.6, showing that the banks were within the industry liquidity ratio.

Profitability, evaluated using net profits after tax, had an average of Ush. 37,105,548 (SD = Ush. 55,115,847) and ranged from a loss of Ush. 22,837,857 to profits of Ush. 275,438,162. The bank size, measured by getting a log of total assets, had an average of 20.46 (SD of 1.15) and ranged from 17.87 (low) to 22.89 (high). The median was equal to the average. Finally, the percentage of foreign ownership of Ugandan banks had an average of 0.8 (SD of 0.3), a low of zero foreign ownership and a high of 100% ownership. All the control variables had a statistically significant Jarque-Bera, indicating that the data was not normally distributed.

Results in Table 4.2 indicate the descriptive statistics for the dependent variables: ROA and ROE. ROA had an average of 0.017 (SD of 0.034). As such, ROA ranged from -0.08 to 0.32. A median of 0.02 indicates that most Ugandan banks had a ROA close to or lower than the average. ROA was not normally distributed. On the other hand, the ROE had a mean of 0.088 (SD of 0.148), with values ranging between -0.78 and 0.36. The average was below the midpoint (0.12), indicating that most Ugandan Banks have a below-average ROE.

**Table 4. 2** Descriptive statistics for the dependent variables

	<b>ROA</b>	<b>ROE</b>
Mean	0.017	0.088
Standard Deviation	0.034	0.148
Min	-0.08	-0.78
Max	0.32	0.36
Median	0.02	0.12
Skewness	3.33	-1.99
Kurtosis	37.38	9.97
ADF		
P-value		
Jarque-Bera	9196.76	483.45
p-value	0.01	0.01

Table 4.3 indicates the correlation matrix for all the research variables. Since the panel data was not normally distributed, a non-parametric correlation measure was used. Specifically, the Spearman's rank correlation coefficient was used. The results show that profitability had a high correlation of 75% with bank size. In other words, bigger banks had a higher profitability ratio. This could be due to their asset size and the ease of such financial institutions raising capital and effectively using it in generating revenues and net income, in addition to economies of scale. There was also a high correlation, 56.15% between the ESG score and profitability ratio. This could indicate that highly profitable banks engaged in ESG or that ESG disclosure resulted in high profitability. ROE and ROA had a high correlation of 68.08%. this could be because both measures of financial performance used profit after tax for calculation. Finally, there was a high collection between bank size and ROE (54.98%). Bigger banks had higher ROE (positively moved in the same direction).

**Table 4. 3** Correlation matrix of the study variables

	ROA	ROE	ESG adopt	Asset qua	Bank size	Capital ad	Liquidity	% fgn on	Profit r	Tier_1_lev
ROA	1	0.680767	0.221083	-0.18281	0.310593	-0.007863	0.039173	-0.10691	0.39667	-0.01257
ROE	0.680767	1	0.339699	-0.22707	0.549771	-0.052531	0.109475	-0.14386	0.558436	-0.05579
ESG	0.221083	0.339699	1	-0.0584	0.424973	-0.115094	0.118939	-0.23667	0.561474	-0.12024
Asset	-0.18281	-0.22707	-0.0584	1	-0.01393	-0.114594	-0.10757	0.145892	-0.06532	-0.07885
Bank size	0.310593	0.549771	0.424973	-0.01393	1	-0.413919	-0.26021	-0.10898	0.752676	-0.40911
Capita ad	-0.00786	-0.05253	-0.11509	-0.11459	-0.41392	1	0.047805	0.088626	-0.10438	0.990046
Liquidity	0.039173	0.109475	0.118939	-0.10757	-0.26021	0.047805	1	-0.43893	-0.06227	0.064328
%fgn on	-0.10691	-0.14386	-0.23667	0.145892	-0.10898	0.088626	-0.43893	1	-0.03396	0.090528
Profit r	0.39667	0.558436	0.561474	-0.06532	0.752676	-0.10438	-0.06227	-0.03396	1	-0.10146
Tier 1	-0.01257	-0.05579	-0.12024	-0.07885	-0.40911	0.990046	0.064328	0.090528	-0.10146	1

## 4.2 Pre-Estimation Tests

### 4.2.1 Panel Cross-Sectional Dependence Tests

Indicated in Table 4.4 are the results of the cross-sectional dependency (CSD) test. This is to ascertain that there was no correlation among the variables in the panel data. Considering that the sample was obtained from the registered Banks in Uganda, some common unobservable attributes could influence the research variables, leading to cross-sectional dependence.

**Table 4. 4** Pesaran's CSD test results

ROA and all independent variables		
Test	Statistic	Prob
<i>Pesaran's CD</i>	319.74	0
<i>Breusch-Pagan LM</i>	11.14	0
<i>Bias-scaled Breusch-Pagan LM</i>	0.43	0.67
ROE and all independent variables		
Test	Statistic	Prob
<i>Pesaran's CD</i>	336.25	0
<i>Breusch-Pagan LM</i>	12.14	0
<i>Bias-scaled Breusch-Pagan LM</i>	3.52	0

The cross-sectional dependency test used the null hypothesis that no cross-sectional dependence exists in the data. However, the results of the CSD test indicated that all the test statistics were significant at 5%, rejecting the null hypothesis that there was no cross-sectional dependency.

#### 4.2.2 Panel Unit Root Tests

This study's data's panel unit root test was carried out using the Levin-Lin unit panel root test. Table 4.5 indicates the results of the panel unit root test for each of the study variables. The test's null hypothesis was that the panel data was non-stationary. Of the 10 variables, liquidity, profitability, and ROE returned non-stationary results. Since the analysis could not proceed with the estimation of these variables in their non-stationary state, each of these variables was transformed by differentiating them to bring them to stationarity. Upon achieving a statistical significance p-value for each variable, the analysis rejected the null hypothesis by concluding that each of the study variables was stationary.

**Table 4. 5** Levin-Lin panel unit root test results.

	<b>rho</b>	<b>p-value of rho</b>
ESG adoption	-30.5	0
Capital adequacy ratio	-2.22	0
Tier 1 leverage ratio	-10.55	0
Asset quality	-2.87	0
Liquidity	-8.69	0
Profitability	-11.09	0
Bank size	-4.08	0
% Foreign owned	-29.77	0
ROA	-26.84	0
ROE	-5.08	0

#### 4.3 Panel Regression Results for Objective 1: To Determine the Joint Effects of ESG Adoption and Bank Characteristics on the Financial Performance of Ugandan Banks Over the Period 2012-2021.

The Hausman test was applied to inform the selection of the ideal model for estimation between the random effects or the fixed effects model. Olanrewaju et al. (2019) assert that if the p-value of the Hausman test is significant, a researcher should select the fixed effects model. Upon application of the Hausman test, the researcher arrived at the results in Table 4.6. The analysis

chose the random effects model as the appropriate model for estimating the ROE because the Hausman test was not statistically significant, hence accepting the null hypothesis that the random effect model was ideal. On the other hand, ROA used the fixed effect because the Hausman test was statistically significant, rejecting the null hypothesis that the random effect model was appropriate. Therefore, the joint effects of ESG adoption and bank characteristics on the financial performance using ROE of Ugandan banks over the period 2012-2021 was analysed using the random-effects model while using ROA was analysed using the fixed-effects model.

**Table 4. 6** Hausman test results

	<b>ROE</b>	<b>ROA</b>
<i>Test Statistic</i>	<b>10.59</b>	22.53**
<i>Selected Model</i>	Random-Effects	Fixed-Effects

#### **4.3.1 Model Estimates: ROE**

Table 4.7 indicates the model estimates for the ROE model. The hypothesis (H1) tested was that the effect of ESG on corporate financial performance is linear, and this infers that the relationship is positive. From the results, ESG adoption had a slightly positive but insignificant effect on ROE. This means that a unit increase in ESG adoption in Ugandan banks increased ROE by 0.000195, though this effect was statistically insignificant. Therefore, the alternative hypothesis was rejected. The association of the independent and control variables (association between ESG adoption and bank characteristics) explained 30% of changes in ROE, though this was not statistically significant. This is an indication that other underlying reasons explain the performance of Ugandan banks using ROE other than ESG adoption and the bank characteristics.

For the control variables, the hypothesis (H2) capital adequacy has a positive relationship with the financial performance of commercial banks was tested. The results indicate that capital adequacy ratio positively affected ROE at 0.8 and was significant at 10%. In contrast, the tier 1 leverage ratio had a negative but insignificant effect on ROE (-0.71). This result rejects the alternative hypothesis and indicates that factors other than the capital adequacy might explain banks' ROE. The results further indicate that asset quality had a slightly negative but insignificant effect on ROE, rejecting hypothesis H3 that asset quality has a positive relationship with the financial performance of commercial banks in Uganda. Similarly, both percentages of foreign ownership

and bank size had a slightly negative but insignificant effect on ROE, while liquidity has a slightly positive but insignificant effect on ROE. These results reject the hypothesis H4 that liquidity has a statistically meaningful effect on the financial performance of commercial banks in Uganda, either positive or negative and H6 that bank size has a positive effect on the financial performance of commercial banks in Uganda. Finally, the results indicate that profitability had a strong positive (coefficient of 4.78) effect and a significant effect on ROE (1% significance). This accepts the hypothesis H5 that profitability has a positive effect on the financial performance of commercial banks in Uganda.

#### **4.3.2 Model Estimates: ROA**

From the results in Table 4.7, ESG adoption had a slight negative but insignificant effect on ROA. This means that a unit increase in ESG adoption in Ugandan banks decreased ROE by 0.0004, though this effect was statistically insignificant. The independent and control variables explained 79.92% of changes in ROA, though this was not statistically significant. This is an indication that other underlying reasons explain the performance of Ugandan banks using ROA other than ESG adoption and the bank characteristics.

From the control variables indicated in Table 4.7, the capital adequacy ratio had a positive (0.022) but not statistically significant effect on ROA. In contrast, both tier 1 leverage ratio and asset quality had a slightly negative but statistically insignificant effect on ROA (-0.033 and -0.034, respectively) rejecting hypotheses H2 and H3. Liquidity has a slightly positive but insignificant effect (0.008) on ROA, rejecting hypothesis H4. The effect identified between bank size (0.001) and ROA were negative and statistically insignificant, rejecting hypothesis H6. There was a slightly negative and significant effect (-0.046) of percent of foreign ownership and ROA at a significance level of 1%. Finally, profitability had a strong positive (317) and significant (5%) association effect on ROA, accepting hypothesis H5 that profitability has a positive effect on the financial performance of commercial banks in Uganda.

**Table 4. 7** Model estimates of the panel regression models for objective 1.

	Dependent variable:	
	ROE	ROA
ESG adoption ( <b>independent variable</b> )	0.000195 -0.000546	-0.0004 -0.0002
<b>Control variables</b>		
Capital adequacy ratio	0.8* -0.47	0.022 -0.084
Tier 1 leverage ratio	-0.71 -0.48	-0.033 -0.09
Asset quality	-0.13 -0.14	-0.034 -0.024
Liquidity	0.05 -0.06	0.008 -0.0087
Profitability	4.78*** -9.16	3.17** -1.3
Bank size	-0.007 -0.008	0.001 -0.004
% Foreign owned	-0.003 -0.02	-0.046*** -0.0097
Constant	0.14 -0.16	0.046 -0.086
Observations	250	250
R2	0.3	0.7992
Adjusted R2	0.24	0.7385
F Statistic	4.89	13.16
Note:	*p<0.1; **p<0.05; ***p<0.01	

#### 4.4 Panel Regression Results for Objective 2: To Determine the Effect of Bank Characteristics on ESG Adoption of Ugandan Banks Over the Period 2010-2022

Table 4.8 used the results from the Hausman test to ascertain the ideal model to achieve the second objective. The analysis selected the random effects model as the appropriate model for estimating the effect of bank characteristics on ESG adoption in Ugandan banks. The random-effect model

was selected because the Hausman test was not statistically significant, accepting the null hypothesis that the random-effect model was appropriate.

**Table 4. 8** Hausman test results

	<b>ESG</b>
<i>Test Statistic</i>	4.98
<i>Selected Model</i>	Random-Effects

The results presented in Table 4.9 indicate that bank size had the strongest positive and significant effect on ESG adoption in Ugandan banks (coefficient of 6.58 at 1% significance). The capital adequacy ratio had a strong positive (26.62) but insignificant effect on ESG adoption. Similarly, asset quality (coefficient of 4.92), liquidity (coefficient of 5.28), and profitability (coefficient of 1.57) all had positive but insignificant associations with ESG adoption in Ugandan Banks. The results further indicate that the tier 1 leverage ratio had a strong negative but insignificant effect on ESG adoption (-18.86). The percentage of foreign ownership had a negative (-1.49) but insignificant effect on ESG adoption in Ugandan banks.

**Table 4. 9** Model estimates of the panel regression models for objective 2.

	<b>Dependent variable:</b>
	<b>ESG</b>
Capital adequacy ratio	26.62
	-35.86
Tier 1 leverage ratio	-18.86
	-38.38
Asset quality	4.92
	-10.03
Liquidity	5.28
	-3.72
Profitability	1.57
	-5.62
Bank size	6.58***
	-1.46
% Foreign owned	-1.49
	-3.91
Constant	-115.98***

	-31.35
Observations	250
R2	0.2237
Adjusted R2	0.1646
F Statistic	3.79
Note:	*p<0.1; **p<0.05; ***p<0.01

#### 4.5 Objective 3 Results: To Determine the Key Stakeholders' Views and Perceptions on ESG Reporting by Commercial Banks and What Opportunities Exist to Promote Adoption

The results show that 20 respondents took part in the survey carried out to determine the key stakeholders' views and perceptions on ESG reporting by commercial banks and what opportunities exist to promote adoption. Table 4.10 indicates that each bank in the sample was represented by 1 respondent. This brought the total of those that responded to the questionnaire to 20.

**Table 4. 10**The organisations represented by the study respondents.

	Counts	% of Total	Cumulative %
Bank of Baroda Uganda Limited	1	5.0 %	5.0 %
Bank of Baroda	1	5.0 %	10.0 %
United Bank for Africa	1	5.0 %	15.0 %
Stanbic Bank	1	5.0 %	20.0 %
DFCU Bank	1	5.0 %	25.0 %
Bank of Africa	1	5.0 %	30.0 %
ABSA	1	5.0 %	35.0 %
Centenary bank	1	5.0 %	40.0 %
Citi Bank	1	5.0 %	45.0 %
Diamond Trust Bank	1	5.0 %	50.0 %
Eco Bank	1	5.0 %	55.0 %
Equity Bank	1	5.0 %	60.0 %
Finance Trust	1	5.0 %	65.0 %
Housing Finance Bank	1	5.0 %	70.0 %
KCB	1	5.0 %	75.0 %
NCBA	1	5.0 %	80.0 %

I&M Bank (Orient)	1	5.0 %	85.0 %
Opportunity Bank Uganda Limited	1	5.0 %	90.0 %
ABC Bank	1	5.0 %	95.0 %
Guaranty Trust Bank	1	5.0 %	100.0 %

**Table 4. 11** Positions held by the respondents in the banks they work for.

	Counts	% of Total	Cumulative %
Banking Assistant Finance	1	6.3 %	6.3 %
CFO	1	6.3 %	12.5 %
Finance	13	81.3 %	93.8 %
Finance Head	1	6.3 %	100.0 %

To achieve objective 3, this study surveyed senior staff involved in the financial reporting process of the banks comprising of CFOs, financial controllers, and finance managers in Ugandan banks. As Table 4.10 indicates, 81.3% of the respondents worked in the finance department, while the rest (6.6% each) included a banking assistant finance, a CFO, and a finance head. Of the 20 respondents that took part in the study, 80% were qualified certified public accountants with CPA and ACCA qualifications while 15% only had CPA qualifications. Only one respondent has only ACCA certification, as Table 4.12 indicates.

**Table 4. 12** Qualifications of respondents

	Counts	% of Total	Cumulative %
CPA	3	15.0 %	15.0 %
ACCA	1	5.0 %	20.0 %
ACCA, CPA	16	80.0 %	100.0 %

The results further indicate that only 20% of the banks in Uganda were locally owned, as indicated in Table 4.13. This indicates most of the banks in Uganda were controlled by foreign entities or individuals. Asked whether the commercial banks in Uganda were well staffed, 80% of the

respondents acknowledged the presence of enough employees to oversee banking operations while 20% were undecided. Table 4.14 indicates that none of the respondents reported that banks were not well staffed. From this result, one can assert that Ugandan banks are sufficiently staffed.

**Table 4. 13** Bank ownership.

	Counts	% of Total	Cumulative %
Foreign-owned	16	80.0 %	80.0 %
Locally-owned	4	20.0 %	100.0 %

**Table 4. 14** Staffing level of commercial banks in Uganda.

	Counts	% of Total	Cumulative %
Neutral	4	20.0 %	20.0 %
Agree	8	40.0 %	60.0 %
Strongly agree	8	40.0 %	100.0 %

More importantly, the survey sought to establish whether banks in Uganda incorporated ESG reporting in their annual disclosures. Table 4.15 shows that 90% of the respondents ascertained that their organisations disclosed their ESG performance. As such, 10% of the banks in the sample did not disclose their ESG performance. The leading motivations for disclosure included stakeholder requirements, the need to advance corporate reputation, and a form of best practice.

**Table 4.15** Banks incorporate ESG in reporting

	Counts	% of Total	Cumulative %
Yes	18	90.0 %	90.0 %
No	2	10.0 %	100.0 %

#### 4.5.1 Benefits of Incorporating ESG in Financial Reports

Emerging from the results is that most respondents believed that incorporating ESG performance in finance reports was integral in providing more accurate non-financial data to users of these

reports. This is indicated in Table 4.16 under an average of 4.5 (SD = 0.883). More importantly, the results show that most respondents believed that including ESG in financial reports would lead to reporting information better aligned with stakeholder needs. Similarly, the results indicate that most respondents believed incorporating ESG in financial reports would lead to higher stakeholder trust in Ugandan Banks. Besides lowering reputation risks, respondents indicated that incorporating ESG in financial reports would lead to greater engagement with investors and other stakeholders.

**Table 4. 16** Summary statistics on the benefits of incorporating ESG In financial reports

	N	Mean	Median	SD	Minimum	Maximum
More accurate non-financial data is available for users.	20	4.6	5	0.88	2	5
Reporting information better aligned to stakeholder needs.	20	4.5	5	0.89	2	5
Higher levels of stakeholder trust	20	4.8	5	0.41	4	5
Lower reputational risk	20	4.25	4.5	0.91	2	5
Greater engagement with investors and other stakeholders	20	4.8	5	0.41	4	5

#### **4.5.2 Challenges in the Adoption and Implementation of ESG Disclosures in the Financial Reporting Process**

This study sought to understand the challenges that the respondents associated with ESG adoption and implementation in the reporting process. The averages in Table 4.17 indicate that the perceptions on the level of difficulty associated with the adoption or attempts to adopt ESG disclosures in the bank reporting process were moderate, with the means to all the questions asked falling between 2.1 to 2.35. The results demonstrate that determining materiality for inclusion of items in the report, a lack of guidelines and frameworks for reporting, inadequate information systems and processes to provide required information reliably, defining the content and scope of the report, and indicators for measurement of non-financial performance were challenges that had a moderate effect to the ability of Ugandan banks to adapt and implement ESG reporting. Additionally, the results in Table 4.18 indicate that most of the respondents (80%) believed that information on ESG matters was not available in a system but could easily be obtained in the banks.

**Table 4. 17** Summary statistics of the challenges in adopting and implementing ESG reporting

	N	Mean	Median	SD	Minimum	Maximum
Determining materiality for inclusion of items in the report.	20	2.1	1	1.6	1	5
Lack of guidelines and frameworks for reporting.	20	2.25	2	1.5	1	5
Inadequate information systems and processes to provide required information reliably.	20	2.25	2	1.3	1	5
Defining the content and scope of the report	20	2.2	2	1	1	4
Indicators for measurement of non-financial performance	20	2.35	2	1	1	4

**Table 4. 18** Availability of ESG information

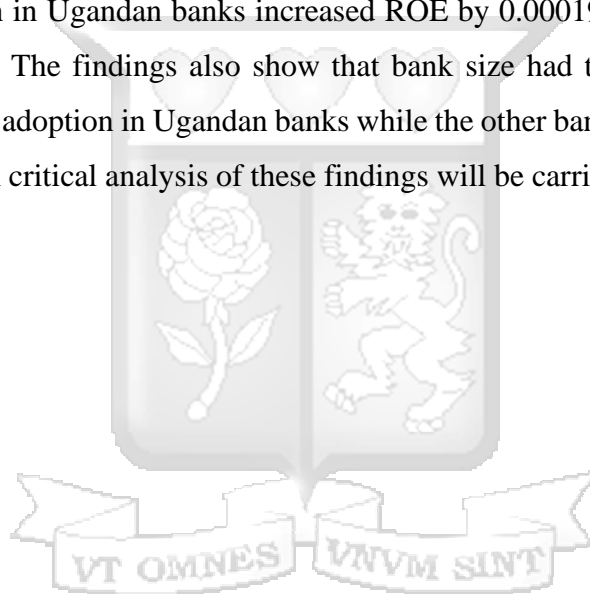
	Counts	% of Total	Cumulative %
A manual process requiring the involvement of other departments.	4	20.0 %	20.0 %
Information is not available in a system but can easily be obtained.	16	80.0 %	100.0 %

#### 4.5.3 Respondents' Recommendations Regarding the Adoption of ESG Reporting

Finally, the study was able to identify the most effective measures for driving the level of ESG reporting by commercial banks in Uganda as per the respondents' views. As such, most of the respondents (75%) believed that enforcement of ESG adoption by regulatory bodies was the most effective measure for driving the level of ESG reporting by commercial banks in Uganda. In second place was the enforcement by accounting bodies (55%). More importantly, 45% of the respondents placed training and sensitization on ESG benefits to banks as the third most effective way of increasing ESG adoption in Ugandan banks. As such, 85% of respondents place voluntary adoption as the least's effective measure of driving ESG reporting by Ugandan banks.

## 4.6 Chapter Summary

Overall, the findings have indicated that, though the joint effect of ESG and bank characteristics explained 30% of changes in ROE, this was not statistically significant. This is an indication that other underlying reasons explain the performance of Ugandan banks using ROE other than ESG adoption and the bank characteristics. Further, the association between ESG and bank characteristics explained 79.92% of changes in ROA, though this was not statistically significant. This is also an indication that other underlying factors explain the performance of Ugandan banks using ROA other than ESG adoption and the bank characteristics. The findings have also shown that ESG adoption had a slightly positive but insignificant effect on ROE. This means that a unit increase in ESG adoption in Ugandan banks increased ROE by 0.000195, though this effect was statistically insignificant. The findings also show that bank size had the strongest positive and significant effect on ESG adoption in Ugandan banks while the other bank characteristics were not statistically significant. A critical analysis of these findings will be carried out in the next chapter.



## **CHAPTER FIVE: SUMMARY, DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS**

### **5.0 Introduction**

This study's main aim was to investigate the effect of ESG adoption and bank characteristics on financial performance in Uganda. Guided by this aim, this chapter discusses the findings, conclusion and recommendation for further research based on the specific research objectives. More importantly, the chapter triangulates the results with the literature review.

### **5.1 To Determine the Joint Effects of ESG Adoption and Bank Characteristics on the Financial Performance of Ugandan Banks Over the Period 2012-2021**

This study sought to find out the effect of ESG adoption and bank characteristics (capital adequacy, asset quality, liquidity, profitability, bank size, and ownership) on the financial performance (ROE and ROA) of banks in Uganda. The period of analysis was 10 years (2012-2021). The study met this objective with results indicating that ESG adoption had a slightly positive but insignificant effect on ROE. These results are similar to the results by Liu et al (2021) who found that ESG had a positive but insignificant effect on ROE. Similarly, the results support those by Menicucci and Paolucci (2022) and Miralles-Quirós et al. (2019) that there is no significant relationship between bank performance and ESG.

These findings contrast those by El Khoury et al. (2023) that ESG has a positive and significant association with ROE. However, this relationship takes a concave shape such that, with time the relationship becomes negative. Similarly, this research contrasts the findings by Akdogan et al. (2020) and Buallay et al. (2021) that ESG is a positive and significant predictor of financial performance. The manner in which ESG adoption affects the performance of Ugandan banks suggests that it is neither a shareholder value creator nor a value destroyer. The interaction between ESG and capital adequacy ratio, tier 1 leverage ratio, asset quality, liquidity, bank size, and ownership did not have a significant effect on the financial performance of Ugandan banks. These findings imply that these variables did not significantly affect banks' profitability in Uganda. Nevertheless, Ugandan commercial banks should ensure that they maintain good asset quality, adequate capital, adequate liquidity, balanced ownership, and appropriate sizes to enhance their

value creation. Only the interaction between ESG and bank profitability ratio had a positive and significant association with bank performance. This result implies that profitability is the most critical determinant of commercial banks' accounting-based financial performance in Uganda. Therefore, banks should focus on improving their profitability to enhance their financial performance.

Using the ROA as the outcome variable, this analysis performed eight regressions, one on ESG and seven on bank characteristics. ESG did not have a significant effect on ROA. The findings were similar to those by Ahlklo and Lind (2018) and Naimy et al. (2021) who concluded that ESG had an insignificant effect on ROA. However, unlike this study, the Ahlklo and Lind (2018) coefficient was positive for ROA while Naimy et al.'s (2021) study concluded that there was no relationship between the two variables. This study's findings contradict those arrived at by El Khoury et al. (2023) that supported the presence of a positive and significant ESG-ROA relationship as compared to this study's coefficient which was statistically insignificant. The difference in these results can be tied to the samples selected since El Khoury et al.'s (2023) study used a sample of 46 listed banks in the Middle East, North Africa, and Turkey (MENAT) region between 2007–2019. The differences indicate both time series and the cross-sectional difference between the two studies' samples.

Of the control variables, only the profitability ratio had a significant and positive effect on ROA from the regressions conducted. On the other hand, the percentage of foreign ownership was the only control variable with a negative and statistically significant relationship with ROA. These findings support those arrived at by Rossi et al. (2021) whose study found that bank ownership is not associated with financial performance. This study highlights that Ugandan banks' profitability reflects their ability to generate earnings based on their total assets and create value for the shareholders in the process.

When controlled for bank-specific characteristics, on average, the effect of ESG on the financial performance of commercial banks in Uganda is not statistically significant. Thus, the current study rejects H1: the effect of ESG on corporate financial performance is linear, and this infers that the relationship is positive. The study also does not back the social impact hypothesis that argues there exists a positive relationship between ESG and financial performance (Nirino et al., 2021; Whelan

et al., 2022; Zhou et al., 2022) nor does it support the trade-off hypothesis, which suggests that there exists a negative relationship between ESG and financial performance (El Khoury et al., 2023).

More importantly, while literature suggests that ESG practices can have a positive impact on the financial performance and the legitimacy of banks and that commercial banks that prioritise ESG are considered socially responsible thus giving them more legitimacy, this study's findings do not support nor reject this position. The lack of a significant relationship between Ugandan banks' performance and ESG interaction with bank characteristics suggests there may be a need for more investigations of this nature to ascertain whether the integration of ESG practices in commercial banks' operations improves legitimacy and whether this comes with improved financial performance (accounting measures, that is, ROE and ROA).

## **5.2 To Determine the Effect of Bank Characteristics on ESG Adoption of Ugandan Banks Over the Period 2012-2021**

This study also investigated the effect of bank characteristics of ESG practices in Ugandan banks between 2012 and 2021. Specifically, the research aimed to determine how capital adequacy, asset quality, liquidity, profitability, bank size, and ownership affect Ugandan banks' ESG practices. The result suggests that, on average, only bank size has a positive and significant effect on the level of ESG adoption in commercial banks in Uganda. While the rest bank-specific characteristics have both positive and negative effects, these associations are not statistically significant. As such, the findings support the findings by Abdul Rahman and Alsayegh (2021), Nawaiseh (2015), and Baldini et al. (2018) which suggest that firm size is a significant and positive predictor of ESG adoption and disclosure. Overall, the current study suggests that, on average, larger commercial banks in Uganda are more likely to adopt ESG practices. This may be due to larger commercial banks having more resources to devote to ESG practices or because of a greater need to maintain legitimacy due to their size and overall visibility.

The findings that tier 1 leverage ratio and capital adequacy ratio, both ratios for measuring bank capital adequacy, have no significant effect on ESG adoption are not surprising since previous research by Embuningtiyas et al. (2020) suggests that capital adequacy ratios and ESG have no relationship. In other words, a bank's soundness as measured by the capital adequacy ratio and tier

1 leverage ratio, has no substantial impact on bank management's willingness to observe ESG practices. As such, regulators strictly control commercial banks' capital in Uganda. However, this study has established that the concentration of management in commercial banks in maintaining adequate capital does not associate with the motivation for ESG practices.

The insignificant effect of liquidity on ESG practices is surprising considering previous research by Chams et al. (2021) suggest that companies with strong liquidity positions tend to invest more in ESG practices. The conclusion that foreign ownership has an insignificant effect on bank ESG practices supports previous findings by Yu and Van Luu (2021) who assert that foreign ownership does not augment the ESG practices of companies. The results that profitability and asset quality have no significance on ESG practices is surprising as findings by Abdul et al. (2021) suggest that firm-level characteristics such as profitability and asset quality influenced organisations to disclose additional ESG information. Generally, while more profitable banks have the highest probability of disclosing their ESG information as a way of legitimising their practices (demonstrative their commitment to responsible business practices), the contrary results from this study suggest there may be other underlying determinants of ESG practices in Ugandan banks other than the bank characteristics covered in this study.

### **5.3 To Determine the Key Stakeholders' Views and Perceptions on ESG Reporting by Commercial Banks and What Opportunities Exist to Promote Adoption**

This research also sought to identify the opinions and perspectives of the primary stakeholders in the commercial banking industry in Uganda regarding ESG reporting and explore potential avenues to encourage its implementation. From the survey, the results indicate that the adoption of ESG practices in Ugandan banks is high. These findings support those by Tumwebaze et al. (2022) that Ugandan financial services firms are high adopters of sustainability reporting practices, with their study indicating that 64% of these firms used the GRI sustainability reporting standards. Considering the survey shows that 80% of the respondent's banks were foreign-owned, the perception of finance practitioners in banks was that the attitude towards sustainability reporting in Ugandan banks is positive.

The study's findings that ESG reporting provides critical and more accurate non-financial data to stakeholders is consistent with the finding by Bananuka et al. (2021) that ESG issues contain

material implications on a firm's long-term financial performance, and stakeholders, among them investors are increasingly interested in the non-financial information disclosed through ESG reports. More importantly, this study found that stakeholders perceive the incorporation of ESG in financial reporting can contribute to providing information about a bank that is aligned with different stakeholders' needs. This is critical considering each stakeholder group has diverse concerns and interests, and including ESG disclosure in the reporting practices can help Ugandan banks communicate their holistic value and performance to a range of stakeholders.

Furthermore, the findings indicate that the bank officials perceive that including ESG in financial reports can increase stakeholder trust in Ugandan banks. The finding is similar to that of Steyn (2014) who suggests that the enhancement of corporate reputation was a key motivation for banks to adopt ESG. This is significant since trust is an essential component of any business relationship, and adding ESG information can assist in building trust by demonstrating a commercial bank's commitment to a sustainable business. Finally, the findings indicate that including ESG in financial reports can lead to increased engagement with investors and other stakeholders. This is significant because involvement can assist businesses in better understanding stakeholder expectations and concerns, leading to more productive communication and collaboration. Generally, the perceptions and views of the respondents suggest that including ESG performance in finance reports is critical to presenting customers with more accurate non-financial data. The findings also imply that including ESG information in financial reporting has several potential benefits, including better alignment with stakeholder demands, higher levels of stakeholder confidence, and improved engagement with stakeholders.

Besides the perceptions on the benefits tied to ESG adoption, the study was able to collect opinions and respondents' perceptions on the challenges that banks face in adopting and implementing ESG practices in the financial reporting process. The results indicate that Ugandan commercial banks face a challenge in terms of selecting the indicators for measuring non-financial performance used in ESG reporting. These findings concur with Injeni et al.'s (2019) assertion that regulators are still hesitant to harmonise and address the challenges of duplicate reporting under multiple regulations which increases reporting burdens on companies. Particularly, this is compounded by a lack of a regulatory framework guiding a standardised reporting framework that could give indicators for measurement. The current finding is similar to that by Steyn (2014) who recognised

that the ambiguity in determining material disclosures was a major challenge faced by banks in their ESG efforts. This position accrues from the fact that ESG reporting is yet to be made mandatory by financial regulatory bodies in Uganda, specifically the Bank of Uganda. In relation to this challenge is the lack of information systems and processes that could be used to reliably produce ESG information to ascertain its validity. These findings contrast those by Bananuka et al. (2018), who suggested that the most significant challenges for banks in Uganda when adopting and disclosing ESG performance were a scarcity of resources, leadership and organizational culture, stakeholder demand, lack of awareness of IR and nature and size of businesses.

Overall, the respondents opined that having ESG adoption enforced by regulatory bodies would be the most effective way to ensure that banks in Uganda observed sustainable practices. The respondents further believed that accounting bodies would also act as great enforcers of ESG practices by Ugandan commercial banks. These perceptions support the findings by Dumay et al. (2017), who advocated for the involvement of accounting professional bodies in enforcing sustainability disclosure as it would help ensure consensus among practitioners and consistency in the application of the guidelines.

#### **5.4 Conclusions**

The empirical literature on ESG and financial performance relationship suggest two hypotheses: the social impact hypothesis which argues there exists a positive relationship between ESG and financial performance and the trade-off hypothesis, which argues that there exists a negative relationship between ESG and financial performance. The current study has concluded that while ESG has a slightly positive effect on ROE and a slightly negative effort on ROA, both relationships are not statistically significant. Therefore, this study has not approved or disapproved of any of the theoretical expectations of the two hypotheses. The interaction with bank characteristics has also shown that profitability has a positive and significant effect on ROE and ROA.

More importantly, this research has unearthed some key policy implications for commercial banks in Uganda in the process of integrating ESG practices in their operations. This implication indicates that Ugandan banks' cost of investment in ESG does not exceed the benefits since the study has not shown any significant positive or negative relationship. However, it is the conclusion

of this research that banks in Uganda should continue investing in ESG and aligning their operations for sustainable practices.

Policy implications have also been unearthed by this study. Based on these findings, the research suggests that both financial system regulatory authorities and accounting regulatory bodies in Uganda are better placed to enhance the adoption and disclosure of ESG practices by Ugandan commercial banks. Policymakers and banks should continue to explore avenues of promoting and implementing ESG practices in Uganda with a focus on the long-term stakeholder engagement and sustainability of their businesses. Opportunities still exist for academicians to further interrogate the ESG practices in Ugandan commercial banks to add more literature to an under-addressed research area. Such investigations will be critical to informing evidence-based policy making, evidence-based ESG practices implementation, and further scholarly in general.

## **5.5 Recommendations**

Informed by the findings, this study presents three recommendations for policymakers and banking institutions. To begin with, policymakers (both accounting and regulatory bodies) should consider providing guidance and direction by formulating mandatory regulations that promote ESG adoption and reporting among commercial banks in Uganda using a unitary framework or reporting standards.

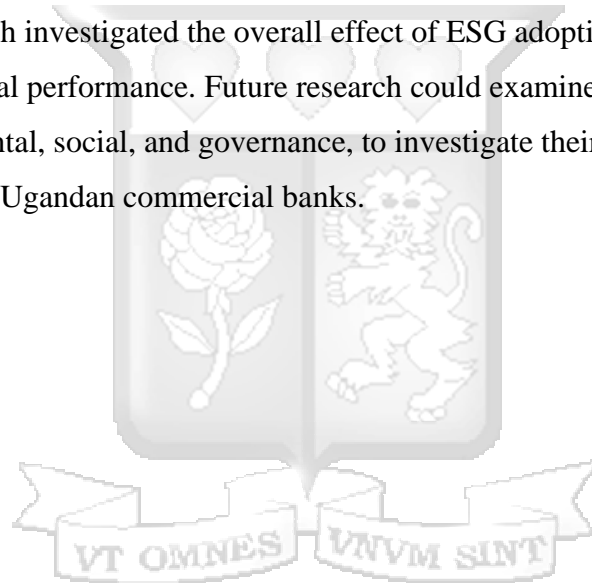
More importantly, this study's findings suggest that, while ESG adoption has no significant direct effect on the corporate financial performance of commercial banks in Uganda, it has the potential to contribute to long-term financial performance. Besides, this study has shown that ESG is adopted mainly for legitimacy reasons by most Ugandan banks. To this end, banks should incorporate ESG attributes into their decision-making processes. They should improve their ESG disclosure processes to cover material and relevant ESG aspects affecting the banks' operations or the interests of stakeholders. Such means that Ugandan banks have the potential to improve their ESG data quality and the credibility of their ESG disclosure.

Finally, the accounting bodies and financial system regulatory bodies in Uganda should cooperate with commercial banks to offer capacity building and training on environmental, social, and governance adoption and disclosure practices. The goal of this recommendation is to improve the

capacity of commercial banks in Uganda to provide reliable and accurate ESG data and support ESG disclosure best practices.

## **5.6 Suggested areas for further research**

This research suggests that opportunities exist by replicating the current study but include other factors as control or moderating variables such as business environment factors since the current study has shown that ESG and bank characteristics do not explain the financial performance of Ugandan commercial banks. Further, this study investigated the effects ESG adoption and bank characteristic on financial performance over 10 years between 2012-2021. Future studies could extend the investigations to longer periods to establish whether the current findings hold over time. Finally, this research investigated the overall effect of ESG adoption and bank characteristics on financial performance. Future research could examine specific ESG factors in isolation, say environmental, social, and governance, to investigate their individual effects on the financial performance of Ugandan commercial banks.



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## APPENDICES

### Appendix A List of Commercial banks in Uganda

1. ABC Bank Uganda Limited
2. Absa Bank Uganda Limited
3. Afriland First Bank Uganda Limited
4. Bank of Africa Uganda Limited
5. Bank of Baroda Uganda Limited
6. Bank of India Uganda Limited
7. Cairo Bank Uganda
8. Centenary Bank
9. Citibank Uganda
10. DFCU Bank
11. Diamond Trust Bank
12. Ecobank Uganda
13. Equity Bank Uganda Limited
14. Exim Bank (Uganda)
15. Finance Trust Bank
16. Guaranty Trust Bank
17. Housing Finance Bank
18. KCB Bank Uganda Limited
19. NCBA Bank Uganda



20. Opportunity Bank Uganda Limited

21. Orient Bank

22. Stanbic Bank Uganda Limited

23. Standard Chartered Uganda

24. Tropical Bank

25. United Bank for Africa



## Appendix B: Questionnaire

Dear Participant,

This questionnaire seeks to obtain your views on ESG adoption by commercial banks in Uganda including hindrances and challenges to adoption. You have been selected as a participant in this survey as you are involved in the financial statement preparation process for your organization. There are five sections in this questionnaire and the exercise should take you between 7 to 10 minutes to complete. Kindly answer the questions truthfully and to the best of your ability. All information provided will be held in strict confidence. Choose by ticking (√) the box next to the answer of choice.

### Part A: General Information

1. Your current position in the company.

.....

2. Do you possess any of the following qualifications?

- ACCA
- CFA
- CPA
- Others (provide details below)

.....

.....

3. The Bank is:

- Locally owned (Majority Shareholding by Local Persons)
- Foreign owned (Majority Shareholding by Foreign Persons)

### Part B Nature of Environmental, Social and Governance (ESG) disclosures

4. The Finance department is sufficiently staffed to enable it to meet the reporting needs of the organization and stakeholders.

- Strongly agree
- Agree
- Neither agree nor disagree
- Disagree
- Strongly disagree

5. In addition to the financial statements, Chairman's/CEO reports and corporate governance reports, does the bank disclose any other information of non-financial nature?

- Yes
- No

6. What is the nature of information disclosed?

- Environmental impact activities
- Social impact activities (CSR)
- Governance
- No additional disclosures are made
- Other (provide details below)

.....  
.....  
.....

7. What is the motivation for disclosing such information?

- Stakeholder requirement
- Investor/shareholder requirement
- Compliance requirement
- Materiality of events
- Advancing corporate reputation
- Best practice
- Other (provide details below)

.....  
.....  
.....

**Part C Benefits of implementation of Environmental, Social and Governance (ESG) matters in the financial reporting process**

8. Do you perceive any benefits in including ESG disclosures in your financial reports?

- Yes
- No

On a scale of 1-5 where 1= Very beneficial, 2= Moderately beneficial, 3= Beneficial, 4= Least beneficial and 5= Not beneficial, indicate your degree of agreement with the following benefits of incorporation of ESG matters in your financial reports.

	<b>Benefits</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
i.	More accurate non-financial data available for data vendors.					
ii.	Reporting information better aligned to investor needs.					
iii.	Higher levels of trust with stakeholders.					
iv.	Greater engagement with investors and other stakeholders.					
v.	Development of common language and greater collaboration across different functions in the organization.					
vi.	Enhanced risk management.					
vii.	Better identification of opportunities.					
viii.	Better resource allocation.					
ix.	Cost reductions including lower costs of capital.					
x.	Lower reputational risk.					

**Part D Challenges in adoption and implementation of Environmental, Social, Governance disclosures in the financial reporting process**

9. Which statement below best describes extent to which information on Environmental, Social, Governance matters is available in your organization?

- Information is readily available on a system
- Information is not available on a system but can easily be obtained
- Manual process requiring involvement of other departments
- No formal record of such information is maintained.
- Other (provide details below)

.....  
 .....  
 .....

On a scale of 1-5 where 1= Not significant, 2= Least Significant, 3= Moderately significant 4= Significant and 5= Most Significant, indicate the level of difficulty associated with your adoption or attempts to adopt ESG disclosures in your reporting process as proposed below.

	<b>Challenge area</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
i.	Determining materiality for inclusion of items in the report.					
ii.	Lack of guidelines and frameworks for reporting.					
iii.	Inadequate information systems and processes to provide required information reliably.					
iv.	Defining the content and scope of the report.					
v.	Indicators for measurement of non-financial performance.					

**Part E Recommendation for adoption of ESG reporting**

14. In your view, kindly rank the effectiveness of following proposals as measures for driving the level of ESG reporting by commercial banks in Uganda ranging from most important (1<sup>st</sup>) to least important (5<sup>th</sup>).

- Training and sensitization on benefits of ESG (Rank....)
- Enforcement by Regulatory Bodies (Rank....)
- Enforcement by local and global accounting bodies (Rank....)
- Voluntary adoption (Rank....)
- Mandatory listing of commercial banks (Rank....)



## Appendix C GRI 2021 Disclosures Scoring Table

GRI STANDARD	DISCLOSURE	Score	Total Maximum Score
<b>GRI 2: General Disclosures 2021</b>	2-1 Organizational details	1	<b>30</b>
	2-2 Entities included in the organization’s sustainability reporting	1	
	2-3 Reporting period, frequency and contact point	1	
	2-4 Restatements of information	1	
	2-5 External assurance	1	
	2-6 Activities, value chain and other business relationships	1	
	2-7 Employees	1	
	2-8 Workers who are not employees	1	
	2-9 Governance structure and composition	1	
	2-10 Nomination and selection of the highest governance body	1	
	2-11 Chair of the highest governance body	1	

<b>GRI STANDARD</b>	<b>DISCLOSURE</b>	<b>Score</b>	<b>Total Maximum Score</b>
	2-12 Role of the highest governance body in overseeing the management of impacts	1	
	2-13 Delegation of responsibility for managing impacts	1	
	2-14 Role of the highest governance body in sustainability reporting	1	
	2-15 Conflicts of interest	1	
	2-16 Communication of critical concerns	1	
	2-17 Collective knowledge of the highest governance body	1	
	2-18 Evaluation of the performance of the highest governance body	1	
	2-19 Remuneration policies	1	
	2-20 Process to determine remuneration	1	
	2-21 Annual total compensation ratio	1	
	2-22 Statement on sustainable development strategy	1	

<b>GRI STANDARD</b>	<b>DISCLOSURE</b>	<b>Score</b>	<b>Total Maximum Score</b>
	2-23 Policy commitments	1	
	2-24 Embedding policy commitments	1	
	2-25 Processes to remediate negative impacts	1	
	2-26 Mechanisms for seeking advice and raising concerns	1	
	2-27 Compliance with laws and regulations	1	
	2-28 Membership associations	1	
	2-29 Approach to stakeholder engagement	1	
	2-30 Collective bargaining agreements	1	
GRI 3: Material Topics 2021	3-1 Process to determine material topics	1	<b>3</b>
	3-2 List of material topics	1	
	3-3 Management of material topics	1	
	201-1 Direct economic value generated and distributed	1	<b>4</b>

<b>GRI STANDARD</b>	<b>DISCLOSURE</b>	<b>Score</b>	<b>Total Maximum Score</b>
GRI 201: Economic Performance 2016	201-2 Financial implications and other risks and opportunities due to climate change	1	
	201-3 Defined benefit plan obligations and other retirement plans	1	
	201-4 Financial assistance received from government	1	
GRI 202: Market Presence 2016	202-1 Ratios of standard entry level wage by gender compared to local minimum wage	1	<b>2</b>
	202-2 Proportion of senior management hired from the local community	1	
GRI 203: Indirect Economic Impacts 2016	203-1 Infrastructure investments and services supported	1	<b>2</b>
	203-2 Significant indirect economic impacts	1	
GRI 204: Procurement Practices 2016	204-1 Proportion of spending on local suppliers	1	<b>1</b>
GRI 205: Anti-corruption 2016	205-1 Operations assessed for risks related to corruption	1	<b>3</b>
	205-2 Communication and training about anti-corruption policies and procedures	1	

<b>GRI STANDARD</b>	<b>DISCLOSURE</b>	<b>Score</b>	<b>Total Maximum Score</b>
	205-3 Confirmed incidents of corruption and actions taken	1	
GRI 206: Anti-competitive Behavior 2016	206-1 Legal actions for anti-competitive behavior, anti-trust, and monopoly practices	1	<b>1</b>
GRI 207: Tax 2019	207-1 Approach to tax	1	<b>4</b>
	207-2 Tax governance, control, and risk management	1	
	207-3 Stakeholder engagement and management of concerns related to tax	1	
	207-4 Country-by-country reporting	1	
GRI 301: Materials 2016	301-1 Materials used by weight or volume	1	<b>3</b>
	301-2 Recycled input materials used	1	
	301-3 Reclaimed products and their packaging materials	1	
GRI 302: Energy 2016	302-1 Energy consumption within the organization	1	<b>5</b>
	302-2 Energy consumption outside of the organization	1	

<b>GRI STANDARD</b>	<b>DISCLOSURE</b>	<b>Score</b>	<b>Total Maximum Score</b>
	302-3 Energy intensity	1	
	302-4 Reduction of energy consumption	1	
	302-5 Reductions in energy requirements of products and services	1	
GRI 303: Water and Effluents 2018	303-1 Interactions with water as a shared resource	1	<b>5</b>
	303-2 Management of water discharge-related impacts	1	
	303-3 Water withdrawal	1	
	303-4 Water discharge	1	
	303-5 Water consumption	1	
GRI 304: Biodiversity 2016	304-1 Operational sites owned, leased, managed in, or adjacent to, protected areas and areas of high biodiversity value outside protected areas	1	<b>4</b>
	304-2 Significant impacts of activities, products and services on biodiversity	1	
	304-3 Habitats protected or restored	1	

<b>GRI STANDARD</b>	<b>DISCLOSURE</b>	<b>Score</b>	<b>Total Maximum Score</b>
	304-4 IUCN Red List species and national conservation list species with habitats in areas affected by operations	1	
GRI 305: Emissions 2016	305-1 Direct (Scope 1) GHG emissions	1	<b>7</b>
	305-2 Energy indirect (Scope 2) GHG emissions	1	
	305-3 Other indirect (Scope 3) GHG emissions	1	
	305-4 GHG emissions intensity	1	
	305-5 Reduction of GHG emissions	1	
	305-6 Emissions of ozone-depleting substances (ODS)	1	
	305-7 Nitrogen oxides (NOx), sulfur oxides (SOx), and other significant air emissions	1	
GRI 306: Waste 2020	306-1 Waste generation and significant waste-related impacts	1	<b>5</b>
	306-2 Management of significant waste-related impacts	1	
	306-3 Waste generated	1	

<b>GRI STANDARD</b>	<b>DISCLOSURE</b>	<b>Score</b>	<b>Total Maximum Score</b>
	306-4 Waste diverted from disposal	1	
	306-5 Waste directed to disposal	1	
GRI 308: Supplier Environmental Assessment 2016	308-1 New suppliers that were screened using environmental criteria	1	<b>2</b>
	308-2 Negative environmental impacts in the supply chain and actions taken	1	
GRI 401: Employment 2016	401-1 New employee hires and employee turnover	1	<b>3</b>
	401-2 Benefits provided to full-time employees that are not provided to temporary or part-time employees	1	
	401-3 Parental leave	1	
GRI 402: Labor/Management Relations 2016	402-1 Minimum notice periods regarding operational changes	1	<b>1</b>
GRI 403: Occupational Health and Safety 2018	403-1 Occupational health and safety management system	1	<b>10</b>
	403-2 Hazard identification, risk assessment, and incident investigation	1	

<b>GRI STANDARD</b>	<b>DISCLOSURE</b>	<b>Score</b>	<b>Total Maximum Score</b>	
	403-3 Occupational health services	1		
	403-4 Worker participation, consultation, and communication on occupational health and safety	1		
	403-5 Worker training on occupational health and safety	1		
	403-6 Promotion of worker health	1		
	403-7 Prevention and mitigation of occupational health and safety impacts directly linked by business relationships	1		
	403-8 Workers covered by an occupational health and safety management system	1		
	403-9 Work-related injuries	1		
	403-10 Work-related ill health	1		
<b>GRI 404: Training and Education 2016</b>	404-1 Average hours of training per year per employee	1		<b>3</b>
	404-2 Programs for upgrading employee skills and transition assistance programs	1		

<b>GRI STANDARD</b>	<b>DISCLOSURE</b>	<b>Score</b>	<b>Total Maximum Score</b>
	404-3 Percentage of employees receiving regular performance and career development reviews	1	
GRI 405: Diversity and Equal Opportunity 2016	405-1 Diversity of governance bodies and employees	1	<b>2</b>
	405-2 Ratio of basic salary and remuneration of women to men	1	
GRI 406: Non-discrimination 2016	406-1 Incidents of discrimination and corrective actions taken	1	<b>1</b>
GRI 407: Freedom of Association and Collective Bargaining 2016	407-1 Operations and suppliers in which the right to freedom of association and collective bargaining may be at risk	1	<b>1</b>
GRI 408: Child Labor 2016	408-1 Operations and suppliers at significant risk for incidents of child labor	1	<b>1</b>
GRI 409: Forced or Compulsory Labor 2016	409-1 Operations and suppliers at significant risk for incidents of forced or compulsory labor	1	<b>1</b>
GRI 410: Security Practices 2016	410-1 Security personnel trained in human rights policies or procedures	1	<b>1</b>

<b>GRI STANDARD</b>	<b>DISCLOSURE</b>	<b>Score</b>	<b>Total Maximum Score</b>
GRI 411: Rights of Indigenous Peoples 2016	411-1 Incidents of violations involving rights of indigenous peoples	1	<b>1</b>
GRI 413: Local Communities 2016	413-1 Operations with local community engagement, impact assessments, and development programs	1	<b>2</b>
	413-2 Operations with significant actual and potential negative impacts on local communities	1	
GRI 414: Supplier Social Assessment 2016	414-1 New suppliers that were screened using social criteria	1	<b>2</b>
	414-2 Negative social impacts in the supply chain and actions taken	1	
GRI 415: Public Policy 2016	415-1 Political contributions	1	<b>1</b>
GRI 416: Customer Health and Safety 2016	416-1 Assessment of the health and safety impacts of product and service categories	1	<b>2</b>
	416-2 Incidents of non-compliance concerning the health and safety impacts of products and services	1	
	417-1 Requirements for product and service information and labeling	1	<b>3</b>

<b>GRI STANDARD</b>	<b>DISCLOSURE</b>	<b>Score</b>	<b>Total Maximum Score</b>
GRI 417: Marketing and Labeling 2016	417-2 Incidents of non-compliance concerning product and service information and labeling	1	
	417-3 Incidents of non-compliance concerning marketing communications	1	
GRI 418: Customer Privacy 2016	418-1 Substantiated complaints concerning breaches of customer privacy and losses of customer data	1	<b>1</b>
<b>Total</b>		<b>117</b>	<b>117</b>

