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Equity Financing and Social Responsibility: Further International Evidence☆

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Abstract

This paper investigates how corporate social responsibility (CSR) influences the cost of equity capital from a global perspective. With a full sample of 10,803 firm-year observations from 25 countries, the study finds that, in general, firms with better CSR scores are significantly associated with a reduced cost of equity capital in North America and Europe. In contrast, the results do not continue to hold in Asian countries.

Our study provides implications for global regulators and policymakers when setting social reporting standards, suggesting that institutional and/or cultural factors affect top management's social reporting behavior and regional investors' impressions of CSR value. In particular, the Asian regulators should effectively promote public understanding and awareness of CSR information. Additionally, our findings may be informative to international managers and investors when considering CSR as an indicator in their internal governance designation and decision-making. Firms should carefully evaluate the risk of CSR investing and its effect on equity financing in different regions.
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Keywords: Corporate social responsibility; Cost of equity capital; Global perspective

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1. Introduction

Porter and Kramer (2006) state that, under the scrutiny of government bodies, activist shareholders, and the media, corporate social responsibility (CSR) is "*an inescapable priority for business leaders in every country.*" The notion of CSR is increasingly important in today's global business climate, as companies pursue economic growth through internationalization[1]. In 2001, the Commission of the European Community provided a clear definition of CSR as "*a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.*"

More recently, negative publicity about working conditions in Apple's Chinese supply chain has raised renewed concern about CSR[2]. Because international capital market regulations, government laws, environmental policies, labor protection and financial reporting standards may all increase the legal liabilities of multinational companies, investing in CSR is seen to be one way to reduce the cost of financing and maintain a competitive advantage. It has also been suggested that effective use of CSR strategies can obtain public support, achieve subconscious advertising, and help compete in globally competitive markets (Fry et al., 1982). In practice, major institutional investors, such as CalPERS, also prefer to invest in companies with better CSR performance (Galema et al. 2008).

Because it is important for public companies and market investors to know whether better CSR performance can actually reduce the cost of equity capital, prior studies have conducted empirical research on this issue in numerous Western countries. For example, Dhaliwal et al. (2011) indicate that US firms with a high level of CSR tend to voluntarily disclose more environmental and general social responsibility information, which results in a lower cost of equity capital, because these companies want to convey positive messages to investors and stakeholders. Likewise, El Ghoul et al. (2011) also find that those US firms that make clear efforts to improve employee welfare and environment protection benefit from a lower cost of equity capital. In addition, Bassen et al. (2006) survey 44 companies in developed countries, 37 of which are in the North America or Europe, and find that good CSR performance reduces the overall risk of a firm being negatively perceived by analysts and investors, and in turn leads to less expensive equity financing.

However, these findings may only apply to firms in North America or Europe, where CSR has been developed for many decades, and it is likely that the value of CSR is viewed differently worldwide. Whitely (1999) suggests that differences in political and financial climates, labor education, and culture can explain different attitudes regarding CSR in various countries. Muirhead et al. (2002) investigate the practices, expectations, and trends of global management with regard to corporate citizenship, and report how senior managers value the effects of CSR with regard to the future success of their firms. Their report shows that more than 50% of US and European managers rate CSR as "extremely effective" or "somewhat effective" with regard to improving firm performance; in contrast, more than 60% of Asian managers see it as "not very effective" or "not effective at all" (Appendix A).

Opponents of CSR argue that firms only carry out such efforts to enhance their reputations with stakeholders for commercial benefits, to attract more employees, to reduce

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