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Discussion of “Equity Financing and Social Responsibility: Further International Evidence”

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Abstract

Even though corporate social responsibility (CSR) has grown substantially in recent years, there has been limited empirical research on the relation between CSR and the perceptions of capital market participants. One stream of the literature focuses on the relation between CSR and firm cost of capital. The Wang et al. (forthcoming) study advances our understanding of the CSR–financial performance relationship by investigating whether CSR performance significantly reduces the cost of equity capital internationally. Future research on CSR should a) provide more in-depth economic intuition and address methodological issues related to differences in cross-country analyses, and b) investigate further and in greater detail the circumstances in which investments in CSR are not beneficial to the firms.
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JEL classification: G10; G30
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1. Introduction

Corporate social responsibility (CSR) has grown in importance in recent years. The World Bank Council for Sustainable Development defines CSR as “the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as the local community and society at large.” As McWilliams and Siegel (2001) state, CSR in general

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refers to "actions that appear to further some social good, beyond the interests of the firm and that which is required by law."

A growing number of firms internationally have undertaken substantial efforts to incorporate CSR activities into their businesses. Moreover, firms dedicate a significant part of their annual reports and websites to illustrate the emphasis they place on such practices. In this way, firms demonstrate to investors heightened awareness of social, environmental, ethical, and corporate governance issues. Firms may voluntarily implement CSR strategies because they (a) soften competition and therefore increase firm value, (b) signal better quality and improve reputation, and (c) increase employee motivation (Renneboog, Horst, & Zhang, 2008).

CSR reporting naturally raises such questions as: What benefits do companies gain from spending resources on CSR? Do such activities create shareholder value? What is the impact of CSR on financial performance? Recent research on the relationship between CSR and financial performance has been fuelled by a considerable and rapid increase in CSR implementation.

Nevertheless, CSR research has produced mixed findings because it focuses on accounting-based or market-based measures of financial performance. The review study by Renneboog et al. (2008) highlights three findings. First, event studies cannot show that the significant market reaction to CSR news releases comes about due to investors caring more about CSR or because of higher expected future cash flows. Second, the superiority of abnormal returns from investing in firms with increased CSR may imply that public information about CSR is underpriced, and therefore the market efficiency hypothesis is not applicable. Finally, even though CSR is associated with higher shareholder value, the direction of causality remains ambiguous.

To date, there is limited empirical evidence on the relation between CSR and the perceptions of capital market participants. One stream of the literature focuses on the relation between CSR and firm cost of capital. Wang, Feng, and Huang (forthcoming) advance our understanding of the CSR–financial performance relationship by investigating whether CSR performance significantly reduces the cost of equity capital internationally. These authors provide comparative multi-country evidence from a global sample of 10,803 firm–year observations over the period 2002–2010. They posit that prior research findings may apply only to firms in North America and Europe, whereas CSR may be viewed differently in Asia.

Specifically, we can draw a number of conclusions from this study. First, consistent with the literature (e.g., El Ghoul, Guedhami, Kwok, & Mishra, 2011), the coefficient of the CSR score is significantly negatively associated with the cost of capital for North American and European firms. On the other hand, CSR practices are less attractive to Asian managers. Second, results indicate that among all the dimensions of CSR, economic performance is most significant for reduction of cost of capital in North America, while in Europe, environmental protection and social concerns also contribute to a great extent. Interestingly, when the same test is applied in Asia, the results show that firms with improvements in employee rights, environmental protection, and corporate governance may suffer from increased cost of capital. Third, additional analysis of this study generates evidence on acceptance of the market equilibrium hypothesis, under which larger capital markets with common law systems provide firms with more opportunities to diversify risk and to lower cost of capital.

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