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Reply

Reply to Discussion of "Equity Financing and Social Responsibility: Further International Evidence"☆

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Comment #1:

(1) *Replication and extension of* El Ghoul et al. (2011) — *need to justify why above methodology is the proper for all countries, plus why not use analyst forecast variables as in El Ghoul et al. (2011)*;

(2) *Dhaliwal et al.* (*2011*) *conclude*: "*firms with high Re* (*t* − *1*), *tend to initiate CSR at t, and superior CSR leads to reduction in Re* (*t*)." *How did you take this into consideration in your study*?

Our responses:

(1): The model we use to link the CSR variables and cost of equity is extensively employed in prior studies (Ge and McVay, 2005; Dhaliwal et al., 2011; Ashbaugh-Skaife et al., 2007; Doyle et al., 2007; Ogneva et al., 2007; El Ghoul et al., 2011), as we mentioned in the paper. To ensure our results are not driven by specific countries, we have controlled the following cross-country variables (see Hail and Leuz, 2006): government efficiency (GOV_EFF), GDP per capital (GDP_POP), and voice of accountability (ACC). We have also controlled potential influence of IFRS adoption in our model.

Based on the reviewer's suggestion, we have added an analyst forecast variable, DISPERSION, as a control variable in our regression models. Our results are still consistent.

☆ We sincerely appreciate the constructive comments from Prof. Andreas Charitou, which was helpful to improve the quality of our paper.

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We also present the results for individual countries in Table A for your reference. Please see our response to comment #6.

(2): We have already considered the finding of Dhaliwal et al. (2011), and have discussed it in our additional analyses. The negative association between cost of equity and CSR score still exists for North American and Europe firms in both High/Low stock return samples, and the positive association between cost of equity and CSR score is more prominent for Asian firms in the Low stock return sample. These results are mostly consistent with our main results.

Comment #2:

(1) *Why should someone expect CSR to affect Japanese* (*keiretsu/banking related*) *or Chinese* (*state owned* [*p.9]*, *family owned*) *or French or German* (*code law*) *firms compared to US or rest firms that rely more on capital markets* (*common law*)? *How does the investor base or institutional ownership relate to your hypotheses*? *Need to test for that.*

Our response:

We thank the reviewer for this very helpful comment. As the reviewer suggested, we classify our sample countries by four legal origins: (1) English; (2) French; (3) German; and (4) Scandinavian (La Porta et al., 1997; Djankov et al., 2008), and present the results of the CSR score on the cost of equity of subsamples in Table 6. As expected, the negative association between cost of equity and CSR score is more prominent for firms operating in countries with English-based legal regimes, whose common law systems provide better protection for shareholders, and such countries tend to have bigger equity markets (La Porta et al., 1997). Under market equilibrium theory, a larger capital market will have more investors and more opportunities for diversifying risk, thus lowering the cost of equity capital.See Table A

This is likely because, in contrast to common law countries, civil law nations provide inferior investor protection, thus resulting in smaller equity markets. (Please see our detailed discussions in CSR Score and Legal Origin Diversity and Table 6.)

In summary, firms with better CSR ratings usually have a larger population of investors (Galema et al., 2008), and thus their cost of equity capital is likely to be lower. In particular, firms in countries with English-based legal systems and a larger investor base have a lower cost of equity capital than those in countries with different legal regimes.

Comment #3:

Major question could have been "*Under what circumstances could CSR be value relevant or reduce cost of equity worldwide or in Asia or in Europe*?"

Our response:

Lattemann et al. (2009) analyze data from 68 multinational companies in China and India, and find that the latter communicate more about their CSR practices to stakeholders than the former. This supports our untabulated results for individual countries, which show that Indian firms with high levels of CSR engagement have lower costs of equity capital, while the reverse is true for Chinese firms. Lattemann et al. (2009) argue that the main

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