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Corporate social responsibility and firm financing decisions: A literature review

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ABSTRACT

During the last few decades, multinational enterprises have become more involved in socially responsible activities to meet their stakeholders' expectations. The literature on the financial implications of high CSR firms has evolved and covered a wide variety of topics. This paper presents a literature review on studies that focus on the link between CSR and firms' financing decisions worldwide. First, we show from prior literature that high CSR involvement firms disclose more information, which results in a negative relationship between CSR and information asymmetry. Second, studies on the cost of capital provide evidence that the cost of equity is lower for firms with high CSR scores, and that the premium associated with CSR for private loans is not significant or is significant but marginal. Third, our literature review argues that high CSR firms prefer equity over debt because of the low cost of equity they enjoy. The conclusion discusses future research on the field from a multinational perspective.

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1. Introduction

Corporate social responsibility (CSR), corporate social performance (CSP), corporate environmental responsibility and firm sustainability are only some examples of terms commonly used to assign a name to a very popular concept with blurred, but high stakes. According to the European commission (2001), CSR is “a concept whereby companies integrate social and environmental concerns in their business operations and in their interactions with their stakeholders on a voluntary basis”.¹ As The European Commission also emphasizes, “CSR concerns actions by companies over and above their legal obligations towards the society and the environment. Certain regulatory measures create an environment more conducive to enterprises, voluntarily meeting their social responsibility”. The World Bank (2003) defines CSR as “the commitment of business to contribute to sustainable economic development, working with employees, their families, the local community and society at large to improve quality of life, in ways that are both good for business and good for development”.² While the definition of CSR may present differences across organizations, it generally refers to “actions that appear to further some social good, beyond the interests of the firm and that which is required by law” (McWilliams and Siegel, 2001, p. 117).

Since the new classic view of CSR expressed first by Friedman (1970),³ the concept of CSR continues to be at the heart of financial, economic and political debates. For example, The European Parliament has adopted on April 15th, 2014 the

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¹ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0681:FIN:EN:PDF>.

² http://info.worldbank.org/etools/docs/library/57434/publicpolicy_econference.pdf.

³ “the social responsibility of business is to increase profit”.

directive on the disclosure of environmental and social information: “The plenary of the European Parliament adopted on 15th of April 2014 the directive on disclosure of non-financial and diversity information by certain large companies and groups. . . Companies concerned will need to disclose information on policies, risks and outcomes as regards environmental matters, social and employee-related aspects, respect for human rights, anti-corruption and bribery issues, and diversity in their board of directors. The new rules will only apply to some large companies with more than 500 employees. . . The scope includes the 6000 largest companies and groups across the EU”⁴

From a multinational perspective, business leaders have recently highlighted the role that CSR plays in supporting firm’s business. For McKinsey CEO [Ian Davis \(2005\)](#), CSR represents a strategic opportunity as well as a set of obligations. Multinational enterprises should apprehend CSR strategy with the same tools and skills they apply to market strategy. CSR activities require a real involvement from multinational enterprises to consider both global and local issues as discussed in [Logsdon and Wood \(2005\)](#). It is a trade off between the strong pressures of local and international institutions and the rational decision-making process that aims to increase firm’s financial performance while improving the community well-being.

In this general context, where CSR does not cease to evolve, academic research in relation with the subject has also evolved and covered a wide variety of topics including financial decisions, consumer behavior and business ethics. One of the most debated questions in this field is the relationship between corporate social performance (CSP) and corporate financial performance (CFP). For almost forty years, academics have been trying to establish the empirical link between CSP and CFP. There may not be an easy yes-or-no answer to the question of whether CSP leads to high financial performance. [Margolis and Walsh \(2003\)](#) and [Margolis, et al. \(2009\)](#) emphasize that, with increased opportunities to learn from past CSP investments, more recent social and environmental activities may produce better financial fruit than similar activities in the past. This argument might explain, in part, the mixed results shown in the literature regarding the association between CSP and CFP. In their meta-analysis, gathering more than 200 published studies on the question, [Margolis, et al. \(2009\)](#) observe that 59% of these studies reveal a non-significant relationship, 28% a positive relationship and 2% a negative relationship between CSP and CFP with a positive and small overall effect of CSP on CFP. This lack of consensus can be assigned to several factors such as differences in periods and the market studied, inappropriate measures of social and financial performances and problems related to the choice of model specifications or control variables. Since the relationship between CSP and CFP is inconclusive, it is thereby no accident that academic research continues to investigate more subtle questions about the topic. It is rather the consequence of a complete need to deepen our comprehension of the implications of CSR involvement. Individuals, managers and institutions, anxious by the CSR aspects of their investments, would like to know whether CSR can increase returns, but also, whether it can affect other firms’ financing decisions. Indeed, the focus on the CSR-CFP link in the literature has not prevented the emergence and development of other avenues of research in relation to CSR. Nowadays, CSR is playing an important role in the overall corporate strategy and has recorded a dramatic growth in the industry. It is also considered as a part of firms’ daily management. Managers would like to learn more about the ways they can efficiently include the principles of good sustainability in their practices in order to gain and sustain better strategic relationships with all stakeholders. Managers would also like to have better information about the financial implications of adopting a socially responsible approach. These arguments motivate an important body of the literature on CSR that includes the impact of CSR on earnings management ([Chih et al., 2008](#); [Yip et al., 2011](#); [Kim et al., 2012](#)), dividend policy ([Benlemlih, 2015b](#)), information asymmetry ([Dhaliwal et al., 2011](#); [Lopatta et al., 2016](#); [Cho et al., 2013](#)), audit quality and audit fees ([Chen et al., 2012](#); [Laventis et al., 2013](#); [Berglund Kang, 2013](#)), cost of capital ([Sharfman and Fernando, 2008](#); [El Ghouli et al., 2011](#); [Girerd-Potin et al., 2014](#)), cost of debt, ([Goss and Roberts, 2011](#); [Ye and Zhang, 2011](#)) and capital structure ([Girerd-Potin et al., 2011](#); [Pijourlet, 2013](#); [Benlemlih, 2015a](#)).

In this paper, we present a literature review on the studies that have been performed with respect to firms’ financing decisions on relation with CSR. We discuss, from theoretical and empirical perspectives, some recent works that show the impact of CSR on information asymmetry, the cost of debt and equity capital, and the capital structure. To the best of our knowledge, no literature review has systematically and comprehensively assessed the different financial decisions associated with firm’s CSR involvement. We therefore make several contributions to the existing literature. First, we provide a systematic assessment of theoretical considerations and help to identify how CSR firms adjust their financing decisions. Second, we offer a narrative-based assessment of empirical results in relationship with such decisions. Finally, we provide an overview of the current state of research and provide academics with directions that may guide future research.

The rest of the paper is organized as follow, the next section presents the relationship between CSR and information asymmetry. Section 3 discusses the financing cost of high CSR firms, while Section 4 presents the choice between debt and equity financing. Section 5 discusses the idea of CSR as a source of conflict between all their stakeholders. Finally, the conclusion presents some orientation for future research.

2. CSR and information asymmetry

Before discussing the effect of CSR on the cost of capital and capital structure, this section reviews the relationship between CSR and information asymmetry. It is considered one of the main channels that may explain the relationship between CSR and capital structure.

⁴ http://ec.europa.eu/internal_market/accounting/non-financial_reporting/index_en.htm.

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