ARTICLE IN PRESS

China Journal of Accounting Research xxx (2018) xxx–xxx

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Contents lists available at ScienceDirect

China Journal of Accounting Research

journal homepage: www.elsevier.com/locate/cjar

Religious atmosphere and the cost of equity capital: Evidence from China

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ARTICLE INFO

Article history:
Received 27 September 2016
Accepted 10 January 2018
Available online xxxx

Keywords:
Religious atmosphere
Cost of equity capital
Complementary relationship
Mediation effect

ABSTRACT

The cost of equity capital (ICC) is a crucial component of investment decisions and corporate performance evaluations. This study explores the effect of a region's religious atmosphere on ICC and finds that ICC tends to be lower when stronger religious atmosphere is created. We further use the mediation effect method to clarify the specific channel through which religious atmosphere reduces ICC, and find that earnings quality, corporate investment efficiency and corporate social responsibility partially mediate the effect of religious atmosphere on ICC. Moreover, the relationship between religious atmosphere and ICC is more pronounced in firms with stronger external law environments and higher audit quality, indicating that formal institutions and religious tradition complement each other.

1. Introduction

The impact of formal legal and governmental institutions on the accounting and auditing behavior of listed firms has been a central concern of capital market accounting research. Recently, more and more researchers have begun to emphasize the importance of informal institutional arrangements and their effect on economic growth (North, 1990; Williamson, 2000; Allen et al., 2005). Informal institutional arrangements are the norms or unconsciously accepted standards that are rooted in a culture; they include, but are not restricted to, ethics, values, religions and customs (Helmke and Levitsky, 2004). Relevant literatures have made various elaborations in this fields. Lacker (2013) and Chen (2015) find that social networks can relieve financial constraints

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https://doi.org/10.1016/j.cjar.2018.01.001
1755-3091/

Please cite this article in press as: Hu, N., et al. Religious atmosphere and the cost of equity capital: Evidence from China. China Journal of Accounting Research (2018), https://doi.org/10.1016/j.cjar.2018.01.001

and increase investment and management efficiency. Bunkanwanicha et al. (2013) and Xu et al. (2015) note that marriages and divorces have a great impact on the stock prices and returns of family firms. Gul et al. (2011) and Li and Liu (2012) find that gender diversified boards of directors can drive up investment efficiency and the informativeness of stock prices and reduce the risk of stock price crashes. As an important part of human culture, religion has also attracted researchers' attention. With the development of religious economic theory and research paradigms, the study of religious culture has become an emerging field in corporate governance at home and abroad (Hilary and Hui, 2009; Dyreng et al., 2012; McGuire et al., 2012; Chen et al., 2013; Du, 2013; Du et al., 2014a, 2014b).

The geographical proximity of religious structures is usually used to measure the strength of religious influence (Malloy, 2005; Betler, 2008; Chen, 2013; Du, 2013). Chen et al. (2013) and Du (2013) use the number of Buddhist and Taoist temples within a given radius of a Chinese listed firm as a proxy for the intensity of the religious atmosphere. Using this proxy and quasi-firm-level religious data of Chinese firms from the 2007–2014 period, we focus on the impact of religious atmosphere on a firm's cost of equity capital. We find that listed firms located in areas with stronger religious atmosphere enjoy a lower cost of equity capital. In order to further clarify the channel how religious atmosphere reduces the cost of equity capital, based on mediation effect method (Wen, 2004), we prove that religious atmosphere reduces the cost of listed firms' equity capital by improving the quality of accounting information and investment efficiency and by increasing the performance of corporate social responsibility. Moreover, the negative impact of religious atmosphere on listed firms' cost of equity capital is more pronounced in firms with more stringent external legal environments and higher auditing quality, which suggests that there is a complementary relationship between the internal and external formal institutional arrangements of a firm (referred to as formal institutions) and religious tradition (referred to informal institutions).

Our study makes several contributions to the literature. First, we emphasize and expand the understanding of the economic consequences of religious atmosphere. Prior studies have focused on how religion affects a wide range of corporate governance mechanisms, investment decisions, principal-agent problems and stock price collapse risk (Callen et al., 2011, Dyreng et al., 2012; McGuire et al., 2012; Chen et al., 2013; Du et al., 2014a, 2014b; Callen and Fang, 2015), but little attention has been paid to the economic consequences, especially the effect on the cost of equity capital. Our study enriches the literature on the economic consequences of religious atmosphere. Second, we expand the literature on religious economics in emerging markets. Previous studies of the consequences of religious atmosphere have been conducted in developed countries such as the USA, and the religion has been Christian; this study is conducted in a developing country, China, where Buddhism is the largest religion, closely followed by Taoism. Buddhism and Christianity, as Chinese and Western religions, have different ideas about God, the nature of good and evil, repentance, the ultimate goal of life, precepts and artistic traditions (Yao, 2004; Zhu, 2010; Shi and Chen, 2014; Chen and Fei, 2015). The Chinese capital market is undergoing a key stage in its economic transformation; it currently lacks fully established formal institutions and efficient law enforcement, which makes it very important to investigate how the informal institutions such as religious culture affects firms' behaviors and what are the economic consequences of this process. Our study provides a more comprehensive understanding of the role of religion in China. Third, we supplement the literature on the relationship between informal institutional arrangements (religious atmosphere) and formal institutional arrangements. Our research shows that there is a complementary effect rather than a substitution effect between these informal and formal institutional arrangements, which further supports the arguments of Chen et al. (2013) on the economic consequences of religion. Fourth, we enrich and expand the application of geographical proximity as a proxy for religious influence in the context of China. Most previous studies of religious economics have been conducted in developed markets and they usually measure religious atmosphere at the state (county) levels. In this study, we measure religious atmosphere at the corporate level, which means that we not only more accurately catch the religious atmosphere of a listed firm, we also alleviate the possible cross-sectional self-correlation problem (Malloy, 2005; Butler, 2008; Du, 2013).

The remainder of this paper is organized as follows. Section 2 reviews the literature and describes the theoretical analysis and research hypothesis. Section 3 details the research design. Section 4 summarizes the statistics and the empirical results. Section 5 concludes the paper.