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Corporate Social Responsibility, Cost of Equity and Cost of Bank Loans

Yuan Chang[a*], Chia-Hui Hsieh[a], Tsung-Cheng Wang[b], Tsung-Yu Hsieh[b]

a. Department of Finance, National Changhua University of Education
b. Department of Finance, Tamkang University

ABSTRACT

The linkage between corporate social responsibility (CSR) and a firm's financial performance (FP) had been well documented, yet the corporate control mechanism associated with a firm's CSR-FP nexus has rarely been examined. Theoretically, positive views advocating the merits of CSR postulate that a firm with CSR tends to have a greater base of investors, less uncertain earnings streams and lowers investors' perceived risks. These risk-reducing benefits from CSR provide firms with an advantageous position on financing, namely, enjoying a lowered risk premium and smaller financing cost. However, an alternative view claims that putting a firm's resources into non-profit-maximizing activities aggravates managerial monitoring burdens and incurs overinvestment concerns, thus increases agency problems and costs. In this paper, we examine whether firms devoted to CSR are associated with an easier financing burden, namely, a lowered cost of equity and cost for bank loan. Based on yearly data of listed companies on the Taiwan Stock Exchange (TWSE) covering the period 2005~2011, regression results generally show that firms with CSR tend to have a lower cost of equity, regardless of whether we measure the equity cost using the CAPM or the discounted dividend model with constant growth of dividends. Empirical findings also show that firms with CSR enjoy lowered bank loan rates. Our evidence supports the positive view of firms devoted to CSR, such as superior performance on CSR being associated with a lower financing cost. Our findings establish the linkage that a lower cost of financing is a channel through which financial markets encourage firms to be socially responsible.

Keywords: Corporate Social Responsibility, Cost of Equity, Cost of Bank Loan

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