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Cost of equity capital is reduced by corporate social responsibility activities

Review of El Ghoul, S., O. Guedhami, C. C. Y. Kwok and D. Mishra. (2010) "Does corporate social responsibility affect cost of capital?" (Working Paper, Moore School of Business, University of South Carolina),

Review by Robert Kropp.

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According to Sadok El Ghoul, Omrane Guedhami, Chuck C. Y. Kwok, and Dev Mishra, equity capital represents "Investors' required rate of return on corporate investments and thus is a key input in firms' long-term investment decisions."

By examining the effect of corporate social responsibility (CSR) on the cost of equity capital from a sample of 12,915 US firm-year observations from 1992 to 2007, the authors "find that firms with a better CSR ranking exhibit lower cost of equity capital." Furthermore, the authors find, "CSR investment in improving responsible employee relations, environmental policies, and product strategies substantially contributes to reducing firms' cost of equity." While both CSR strengths and concerns affect the cost of equity capital, the authors found that investors are especially sensitive to the latter. Finally, the authors find the cost of equity financing is higher in the case of stocks traditionally excluded by responsible investors, such as tobacco and nuclear power. In conclusion, the authors state, "our findings contribute to the debate on whether CSR investments are value-enhancing, value-destroying, or value-neutral by showing that improved corporate social responsibility can enhance firm value by reducing the firm's cost of equity capital."