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Do creditors value corporate social responsibility disclosure? Evidence from Ghana

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Abstract

Purpose – Drawing on risk mitigation theory, this study aims to examine the link between corporate social responsibility (CSR) disclosure and the cost of debt financing (CDF). In particular, this paper seeks to determine whether firms with higher CSR disclosure scores have a lower CDF.

Design/methodology/approach – This paper uses a panel data analysis of non-financial Ghanaian firms listed on the Ghana Stock Exchange from 2006 to 2019. The CSR index constructed from firms' annual reports and sustainability reports is used as a proxy for the extent of CSR information disclosures by Ghanaian companies.

Findings – The empirical results demonstrate that CDF is positively related to CSR disclosure scores. Besides, the results show that the levels of long-term debt increase with CSR disclosure in a highly risky industry. However, the finding does not meet the lenders' expectations in terms of CSR attracting favourable debt financing sources.

Research limitations/implications – The research is based only on the quantity of the CSR information disclosed by Ghanaian companies and does not account for the quality of the CSR disclosures. The empirical model omits some control variables such as the age of the firm and external business conditions. The results should not be generalized, as the sample was based on three listed industries in Ghana for 2006–2019.

Originality/value – This study extends the scope of previous studies by examining the importance of CSR disclosures in financing decisions. More precisely, it focuses on the relatively little explored relationship between the extent of CSR disclosures and access to debt financing. Moreover, this study focuses on the rather interesting empirical setting of Ghana, which is characterized by its low level of CSR awareness. Achieving a better understanding of the effects of CSR information is useful for corporate managers desiring to meet lenders' expectations and attract debt financing sources.

Keywords Corporate social responsibility, Ghana, Disclosure, Debt financing

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1. Introduction

In recent decades, business executives of many of the largest companies have allocated considerable amounts of time and resources to corporate social responsibility (CSR) strategies and an increasing number of academics studying CSR (European Commission, 2001). According to the UN Global Compact – Accenture CEO study, 93% of the 766 participant CEOs from worldwide declared CSR an "important" or "very important" factor for their organizations' future success (Hayward and Neuberger, 2010). Despite all this attention, the answer to the fundamental question of whether CSR leads to value creation for the business firm remains inconclusive. The extant research has failed to give a definitive

answer to this question (Margolis *et al.*, 2007). The literature on the link between CSR and financial performance provides mixed results (Margolis and Walsh, 2003; Orlitzky *et al.*, 2003; Zhang and Rezaee, 2009).

This article enters the debate by examining the empirical evidence for one specific instrument through which CSR might generate long-run value by investigating the link between CSR and the cost of debt. The idea that a link exists between social responsibility, financial performance and value appear to be a popular reason behind the increased attention paid by companies worldwide to CSR issues. The key drivers of value include effective risk management, which is seen as a critical factor contributing to superior economic performance. Ye and Zhang (2011) posit, based on risk mitigation theory, that improved social performance can reduce business operating risks by generating positive moral capital among stakeholders and making firms less vulnerable to negative events. Reputational risk has also been important to many companies, some of whom have sought to leverage their CSR image to help mitigate this risk.

Ye and Zhang (2011) opine that as operating risk is a primary driver of debt capital cost, reducing business risk will lead to a lower cost of debt. Besides, improved social performance reduces business risk (Ye and Zhang, 2011; Tan *et al.*, 2020). Superior CSR performance is linked to better stakeholder engagement, limiting the likelihood of short-term opportunistic behaviour (Benabou and Tirole, 2010; Eccles *et al.*, 2012), which results in reducing overall contracting costs (Vincent-Jones, 2005). Again, firms with better CSR performance are more likely to disclose their CSR activities to the market (Dhaliwal *et al.*, 2011) to signal their long-term focus and differentiate themselves (Spence, 1973; Benabou and Tirole, 2010). The increased availability and quality of data about the firm in itself leads to lower capital constraints (Hubbard, 1998). Because of lower agency costs through stakeholder engagement and increased transparency through CSR reporting, this article posits that a firm with superior CSR performance will face lower capital constraints. If effective CSR investments and social performance result in a reduction of the firm's risks and consequently lower capital constraints, then lenders should apply better terms to loan contracts with the firm. On the contrary, if lenders do not ascribe value to risk reduction resulting from CSR investments and social performance, then firms will be seen as incurring unnecessary additional costs by investing in CSR, which will not lower their debt cost.

Financial institutions are considered to be experts at reducing information asymmetry by gaining greater access to firm information than other lenders and can monitor the loans they grant to manage their risk (Mishkin and Eakins, 2009). They are also considered to be neutral agents without bias either for or against CSR (Goss and Roberts, 2009). In this regard, lenders will formulate their decisions and evaluations taking the risk-reducing effect of CSR into account if it is significant, but not otherwise. In this paper, we investigate whether CSR disclosure affects the cost of debt financing (CDF) and the understanding of whether and how CSR activities impact the overall cost of debt. Specifically, this article focuses on non-financial listed firms by analyzing three industries' oil and gas, manufacturing and food and beverages. The contribution of this article is to fill the gap in the empirical literature on the relationship between CSR and the cost of debt. Moreover, examining this link should help managers understand CSR investments' effect on a firm's financing costs, and hence has important implications for strategic planning.

This study contributes to the extant literature in several aspects. Firstly, this article fills the empirical literature gap on the relationship between CSR and the cost of debt, extending the traditional research on CSR beyond the focus on the cost of equity or performance. Secondly, we conduct the relationship between CSR and CDF within the context of Ghana, which to our knowledge, is the first article that explores the relationship between CDF and

an aggregate measure of CSR. Moreover, we expect managers to understand the effect of CSR activities on a firm's financing costs, with relevant implications for strategic planning. The focus of our research is in Ghana, a representative active member of the group of developing countries, where such a study has yet to be carried out and where the increasing internationalization of the country's companies should clearly illustrate the importance of adopting far-reaching corporate social policies.

The rest of the paper is structured as follows: in the literature review, we analyse the theoretical framework to define the main assumptions of the work in Section 2. In Section 3, the sample is explained, all the variables are presented and then the regression model is depicted. Finally, Section 4 on empirical results shows the main results of the model. The article concludes with the consideration of the results, the presentation of managerial implications, the limitations of the work and suggestions for further research to be carried out in Section 5.

2. Literature review

2.1 Corporate social responsibility and risk reduction

In a well-known article by Milton Friedman in the New York Times Magazine of September 13, 1970, he put forward the so-called Shareholder Theory regarding CSR. He concluded the article by quoting from his book, *Capitalism and Freedom*, "there is only one responsibility of business-to use its resources and engage in activities designed to increase its profits as long as it stays within the rules of the game, which is to say, engages in free competition without deception or fraud." In this view, firm management has no business spending its time and resources on CSR, as its mandate is to increase shareholder wealth. This is the predominant view held by economic and legal scholars, according to Margolis *et al.* (2007).

An alternative position, held by some management theorists and other scholars is the Stakeholder view (Freeman, 1984; Donaldson and Preston, 1995), which holds that firms ought to be run in the collective (and often competing) interest of all stakeholders and not narrowly to increase shareholders wealth only. In this view, other stakeholders include customers, employees, suppliers, the community and society at large. While many who hold the stakeholders' view try to reconcile it with the shareholder view, proponents of the instrumental stakeholder version (Donaldson and Preston, 1995; Freeman *et al.*, 2004) go further to say that a firm needs to take the interest of other stakeholders seriously to perform well. The stakeholder view fits in well with the concerns of supporters of CSR. This is clear from descriptions of CSR such as that by McWilliams and Siegel (2000), who describe CSR as actions that appear to further some social good, beyond the interest of the firm and that which is required by law. Tsoutsoura (2004) views CSR as an integrated set of policies and practices and programmes by a business that takes into account other issues concerning business ethics, the environment, community investment, governance and human rights.

According to finance theory, financial performance and risk are closely related and are key considerations of any investor. There is a trade-off between expected return and risk, which would suggest that lower firm risk should have a beneficial effect on its cost of raising finance. The key benefits of CSR are its risk-reducing and information asymmetry reducing effects which theoretically have a negative effect on the cost of debt (Magnanelli and Izzo, 2017). The literature on CSR shows that firms' CSR activities reduce their risk factors (Ye and Zhang, 2011; Magnanelli and Izzo, 2017). Regular reporting of CSR engagements creates a perception of responsibility and risk reduction for the firm resulting in a lower cost of debt.

In a competitive and dynamic business environment, managing the firm's risk profile effectively can be critical for its survival and sustainability. According to Menz (2010), credit

risk, liquidity risk and systematic risk are some of the main components of a firm's risk premium on debt but do not explain it fully. Other factors such as corporate governance, ethical behaviour, environmental issues and CSR could also have an impact on the risk premium. In this scenario, the relationship of a firm with key stakeholders assumes a fundamental role and stakeholders become a part of the environment to be managed (Berman *et al.*, 1999). The attention paid to stakeholders has the potential to significantly lower the costs of the firm (Barney and Hansen, 1994; Hill, 1995; Jones, 1995; Wicks *et al.*, 1999) and it aims to avoid decisions that will push stakeholders to oppose the organization's objectives or policies (Bowie and Dunfee, 2002) and it creates insurance for negative events (Godfrey *et al.*, 2009; Desender *et al.*, 2020). Ye and Zhang (2011) posit, based on risk mitigation theory, that improved social performance can reduce business operating risks by generating positive moral capital among stakeholders and making firms less vulnerable to negative events. This way, socially responsible firms can sustain less volatile and less risky performance.

According to Soppe (2004) and Francis *et al.* (2018) socially responsible firms are generally considered to be less risky and Spicer (1978) demonstrates that institutional investors consider low-CSR firms to be riskier investments. This risk arises from the possibility of costly sanctions resulting from adverse regulatory actions and judicial decisions that can affect consumers' perceptions of the distribution of future costs and revenues. While the key purpose of debt covenants is to protect lenders' interests against corporate risks, firms perceived as high-risk are more likely to face more and stricter debt covenants (Shi and Sun, 2015; Liu and Lu,2019). Spicer (1978) noted that, in terms of the theory of finance, an investment in a company that is socially irresponsible could be inefficient. By choosing a similar but socially responsible company, an investor might achieve the same return with less risk. Investors are assumed to consider both risk and the return and high social responsibility may reduce risk, thus providing an incentive for company managers to invest in positive CSR measures. According to efficient markets theory (Fama, 1970), institutional investors consider both of the above issues when determining the appropriate risk-adjusted discount rate to use in discounting future cash flows. Managers must not focus on financial performance alone but should consider the risk reduction signals of firms. They should rather focus on the stability of their firm performance and risk reduction in the long run (Magnanelli and Izzo, 2017).

The minimization of internal and external firm risks, in today's competitive business environment which may influence firm value, is essential to an organization's continuity and viability. Accordingly, firms with better CSR performance will have a good reputation and face lower capital constraints. In particular, Ye and Zhang (2011) opine that as operating risk is a primary driver of debt capital cost, reducing business risk will lead to a lower cost of debt. Besides, improved social performance helps to reduce business risk (Ye and Zhang, 2011); superior CSR performance is linked to better stakeholder engagement, limiting the likelihood of short-term opportunistic behaviour (Benabou and Tirole, 2010; Eccles *et al.*, 2012), which results in reducing overall contracting costs (Vincent-Jones, 2005). Again, firms with better CSR performance are more likely to disclose their CSR activities to the market (Dhaliwal *et al.*, 2011) to signal their long-term focus and differentiate themselves (Spence, 1973; Benabou and Tirole, 2010). The increased availability and quality of data on CSR about the firm in itself leads to lower capital constraints (Hubbard, 1998).

2.2 The ethical role of corporate social responsibility in a debt management

An ethical organization in its activities has to respect stakeholders' rights, create a better framework for developing debtors, offer new perspectives to the local community and

provide environmental protection. Ethical CSR is based on the strong relationship between rights and ethical responsibilities to attain legitimacy. An efficient market should recognize an "ethical financial premium" to socially responsible firms, corresponding to a lesser CDF. Ethical banking relates to financial services that seek to advance sustainable development and equality and supposedly hold the notion that profitability measurement should be in monetary and social terms. Further, it allows direct financing by offering loans and venture capital to meet the needs of business owners, businesses and institutions.

No bank would claim that accepting bribes in return for loans, lending to connected parties or cheating customers would be claimed as ethical. Bribery and corruption are generally seen as challenges confronting the banking sector. As a result, honesty and transparency are essential in the banking sector. Ethics in the banking sector is normally breached when lenders tend to take too much risk by looking for shortfalls in the banking regulations to attract more loans. Proper adherence to principles and financial instruments in the financial sector enables bankers to approve loans to all deserving parties without bias. It stems from the above, that each bank should respect the general and the specific principles in formulating its credit policy. Effective debt management has become an essential issue in many developing economies. The ability to access financial capital is crucial for all firms to retain going concerned. When firms expand into global markets, they must take their codes of ethics and policies on CSR with them. Responsible multinationals implement ethical guidelines such as honesty, lawfulness and respect for others within the organization in the host country. By fulfilling these responsibilities, the company fosters respect for both local and international laws. Multinational corporations must often balance stakeholders' conflicting interests when making decisions regarding social responsibilities, especially in human rights. The unsustainable debt burdens of many firms in developing countries highlight the practically urgent problem of excessive indebtedness. High debt levels can limit a firm's capacity to provide social services necessary for citizens' well-being and divert resources and energy from the pursuit of long-term development strategies. Consequently, the ethical role of CSR in debt management has recently become critical.

Researchers have investigated a range of ethical decision-making factors such as moral issue intensity, individual characteristics and organizational aspects. Ethical issue intensity pertains to the awareness among employees that specific issues have an ethical component to them. It considers how vital these issues are to an organization and how it wants employees to behave when those issues arise. Awareness is created through ethics training, codes of ethics and communication and actions from the top down. The individual factors in this model pertain to character, psychological influences and moral development. A consistently honest person respects the rights of others and is generally virtuous. The final piece in the Ferrell, Fraedrich and Ferrell model is the organizational context, which can influence even the most honest individuals to behave in ways contrary to their moral value system. Organizational factors include culture, immediate workgroup and opportunity. The need for multinationals and their executives to act according to stakeholders' expectations, both locally and globally, creates significant CSR challenges. Understanding the role CSR poses in society, thus constitutes a primordial component for companies to consider. CSR can be deployed as a value creator, protector and innovation stimulus; it can even be regarded as a legitimate business activity with organization resource allocated to that function. Companies have been using CSR activities to address consumers' social concerns such as trustworthiness and integrity, create a positive corporate image and develop a positive relationship with consumers and other stakeholders, by stressing their environmental and social initiatives (Yoon *et al.*, 2006). Ethically lenders are expected to consider these activities and reward borrowers accordingly.

Previous researchers found that even though firms perceived as “doing good” within their target markets may enhance corporate associations and overall brand equity by promoting and marketing social initiatives. They cannot use these social initiatives in place of high-quality products and strong brand management (Becker-Olsen *et al.*, 2006). At the reputational level, although consumers are aware that companies engage in CSR for image-promotional goals, Yoon *et al.* (2006) defend that CSR activities can help companies improve their image and make a real difference by contributing to worthy social causes such as transparency and equality. CSR is seen as yet another component of competition among companies, independent of their sector. Besides, as an increasing number of consumers have the cognitive capacity and moral concern to make ethically informed choices about what they buy, CSR represents an alternative and better, way of managing the firm that forms part of a new and synergistic relationship between business and society (Mason and Simmons, 2011). Past research has demonstrated that CSR is a multi-faceted concept, as CSR influences corporate reputation, consumer trust and consumer loyalty, providing evidence that a company that devotes substantial efforts to CSR activities can expect several beneficial outcomes (Stanaland *et al.*, 2011; Tan *et al.*, 2020).

An emphasis can be placed on how organizations do their daily work in treating their employees, producing goods or supplying services, marketing them, etc. CSR is not so concerned with what businesses do with their profit, but much more with how they make that profit (Vilkė *et al.*, 2014). However, the CSR initiatives do not directly benefit the business but serve to enhance its image and social standing in the community (Rangan *et al.*, 2012; Aqueveque *et al.*, 2018). To juxtapose perspectives of CSR as an essential factor for debt management and societal sustainability against CSR as unaffordable or irrelevant in the current economic climate, Mason and Simmons (2011) analysed CSR from different points of view: as a means of achieving legitimacy, minimizing risk and obtaining the support of powerful stakeholders, as a philanthropic activity to assist the disadvantaged with part of profits allocation or even as a transformational tool towards a moral and altruistic perspective of the business by changing management ideology. The authors present “CSR at a tipping point”, questioning if CSR can survive and proliferate as the tool by which business tackles problems of pollution, irresponsible corporate governance, short-term and shareholder-focused investment, harmful products to health and customer and employee alienation while creating a sustainable business future in debt management, economic and environmental terms.

2.3 Corporate social responsibility and bank debt financing

If effective CSR investments and social performance result in a reduction of the risks of the firm and consequently lower capital constraints, then lenders should apply better terms to loan contracts with the firm. On the contrary, if lenders do not ascribe value to risk reduction resulting from CSR investments and social performance, then firms will be seen as incurring unnecessary additional costs by investing in CSR, which will not lower their cost of debt.

Majority of the studies on the relationship between CSR and cost of debt use data from the public bond markets such as credit ratings to measure the cost of debt (Menz, 2010; Chang and Shen, 2014) while only a few uses the cost of bank debt. Goss and Roberts (2009), in studying CSR and private debt find that firms with below-average environmental, social and governance records pay between 5 and 23 basis points more for debt, but for the majority of firms, the impact of CSR on their cost of debt is not economically important. Magnanelli and Izzo (2017) on the other hand document a positive relation between CSR performance and cost of debt, indicating that CSR is not considered as a value driver by bank lenders but rather as a sort of a waste of resources.

Banks can gain greater access to firm information than other lenders and are seen to be experts at reducing information asymmetry and adverse selection in pursuing their lending operations. This is complemented by their ability to monitor the loans they grant to manage further their risk (Mishkin and Eakins, 2009). They are also assumed to be neutral agents with no social agenda to promote and not favour the stakeholder view of the corporation (Goss and Roberts, 2009). Thus, they are without bias either for or against CSR but are only interested in their borrowers' ability to repay loans. If, therefore, CSR investments lead to lower firm risk then it should be expected that banks will provide more attractive terms to socially responsible firms (Goss and Roberts, 2009; Tan *et al.*, 2020), including better pricing of firm loans.

Ye and Zhang (2011) study the effects of CSR on the cost of debt from the risk mitigation viewpoint with a focus on the corporate philanthropy aspect of CSR. Corporate philanthropy according to Godfrey (2005) may create positive ethical capital among the stakeholders in the society and reduce the stakeholders' speculative assessment of firms' irresponsible behaviours, and thus minimizes firms' risk. Using the risk mitigation theory, Ye and Zhang hypothesize that enhanced CSR performance reduces firm risk by creating positive ethical capital among shareholders and by reducing the firm's vulnerability to unfavourable circumstances. Because firm risk is a dominant determinant of debt capital cost, a decline in corporate risk leads to a reduced cost of debt (Ye and Zhang, 2011; Desender *et al.*, 2020).

Goss and Roberts (2011) studied the impact of CSR on the cost of bank loans. Using a sample of 3,996 loans to US firms, their result indicates that firms with less social responsibility concerns pay between 7 and 18 basis points more than more responsible firms. Lenders are more sensitive to CSR concerns in the absence of security. Goss and Roberts (2011) document a mixed reaction to discretionary CSR investments. Low-quality borrowers that engage in discretionary CSR spending consequently face higher loan spreads and shorter maturities, but lenders are indifferent to CSR investments by high-quality borrowers.

Magnanelli and Izzo (2017) investigate the link between corporate social performance and CDF in Italy. Using a sample from 332 firms over five years antecedent to the global financial crisis, the results show a positive relation between CSP and cost of debt, demonstrating that CSR is not a value driver with an impact on the firm's risk profile. Similarly, Hamrouni *et al.* (2019) examine whether CSR reporting has better access to debt financing. Using panel data of non-financial French firms listed on the Euronext Paris Stock Exchange and members of the SBF 120 index from 2010 to 2015, the results demonstrate those leverage ratios are positively related to CSR disclosure scores. Besides, the results show that the levels of long-term and short-term debt increase with the disclosure of ESG information, thus suggesting that CSR disclosures play a significant role in reducing information asymmetry and improving transparency around companies' ESG activities. Thus, this finding meets lenders' expectations in terms of extra-financial information.

Tan *et al.* (2020) concluded that borrowing firms with higher levels of CSR disclosure tend to rely more on public debt than private debt. The researcher further revealed that the relation between CSR disclosure and firms' reliance on public debt is stronger for borrowing firms with higher financial reporting quality and with standalone or externally assured CSR reports. Also, they found that borrowing firms with higher levels of CSR disclosure tend to issue bonds at more favourable terms.

Desender *et al.* (2020) examine whether international corporate governance systems shape the relationship between a firm's engagement in CSR and its cost of financing. Using a large international sample, their findings reveal that although the link between CSR performance and the cost of equity is negative in a shareholder-oriented system, this

relationship is positive in a stakeholder-oriented system. Furthermore, the link between CSR performance and the cost of debt is negative for firms that are close to default in both systems.

The extant literature advances several arguments to explain why CSR disclosure could positively affect a firm's access to debt financing. However, some studies document a negative effect of CSR on access to debt financing, indicating a higher debt cost (Chava, 2014; Goss and Roberts, 2011; Magnanelli and Izzo, 2017). According to Magnanelli and Izzo (2017), banks consider CSR activities as a costly diversion of firm resources. Goss and Roberts (2011) document mixed reactions of lenders to CSR investments. In the light of previous literature, we argue that lenders should remain sensitive to CSR activities as the disclosures include relevant non-financial information missing from the corporate financial statements but may be useful for the assessment of a firm's value and risks. However, the theoretical debate is still unresolved.

3. Methodology

3.1 Sample selection and data sources

This research aims at determining whether CSR is related to a firm's cost of financial debt. The authors expect the cost of debt applied by banks to be affected, among the other factors, by the firm's CSR. In our opinion, the financial market should recognize a premium to those firms that are socially responsible and thereby reducing their risk exposure. In this regard, we expect that if CSR activities lower risk, then banks will favour firms with more attractive loan conditions. The initial sample consists of all listed food and beverage, manufacturing and oil and gas firms on the Ghana stock exchange from 2006 to 2019. As in prior studies, financial firms are excluded because of their specific disclosure practices, accounting rules and financing policies. All firms with missing data are also discarded.

The difficulties in measuring CSR, as frequently reported in the international literature, are yet more severe in developing economies in which the question is still incipient. Ghanaian firms are not obliged to disclose information about their social action. So, firms that decide to do voluntarily act with no standard format. Such absence of uniformity on the format and the specific data to be disclosed adds difficulty to research. The authors used a multi-method approach in the current study. Data concerning firms' cost of debt and corporate social disclosure were gathered from 2006 to 2019 of 18 listed companies on the Ghana Stock Exchange. Firms typically report social responsibility activities through an annual report or with sustainability reporting in a separate stand-alone document. According to Deegan *et al.* (2002), the annual report is likely the preferred source of corporate information for a number of different stakeholder groups. Also, annual reports give some consistency over time and for comparability purposes, annual reports have been used in a number of social and environmental reporting studies (Deegan *et al.*, 2002; Tang and Li, 2009; Thompson and Zakaria, 2004). As CSR disclosure is relatively new in Ghana, annual reports were solely used.

3.2 Variables and models

This article used a dichotomous approach for calculating the CSR index. This process included three steps: dichotomous, the decision to weigh an item or not and adjusting for non-disclosed items (Hossain *et al.*, 1994). Previous disclosure studies have used this method (Hossain *et al.*, 1994) and the three steps are described below.

The approach to scoring items is essentially dichotomous, with a score of *1* assigned to an item if it is disclosed and a score of *0* when it is not. The total score T for a company is:

$$T = \sum_{t=1}^{n} di$$

where di is 1 if the item i is disclosed and 0 otherwise; n is the maximum number of items. All disclosure scores used in this study are unweighted. The reason was to eliminate any bias inherent in a weighted score (Chow and Wong-Boren, 1987), which may reflect the significance of objects to a particular group of information users (Chau and Gray, 2002). Further, the implied assumption is that each item disclosed is equally important for all user groups. It has been shown that the resulting favouritism is less than it would be if it resulted from assigning prejudiced weights to the items, although this assumption cannot be practical (Chau and Gray, 2002). Nevertheless, some of the disclosure literature supports unweighted indices (Robbins and Austin, 1986). The applicability of any item to each company was taken into account. It was then decided that the company should not be penalized for an undisclosed item. For example, when CSR information from the sustainability reports was observed and found that a particular item was not declared, it was assumed that the item was not significant. Thus, the highest score M for each company was computed as follows:

$$M = \sum_{t=1}^{n} di$$

where di is the disclosure item and n is the number of items applicable to that company and adjusted index is calculated as T/M. This modification procedure for non-applicable items was used in most of the empirical studies reviewed (Cooke, 1993; Raffournier, 1995).

3.3 Measurement of cost of debt

Following Francis *et al.* (2005) the dependent variable for this research is the cost of debt, measured by the ratio of interest expenses to the interest-bearing debt outstanding during year t, which is a proxy of the total cost of debts faced by the firm. Interest expenses on debt include all the service charges for the use of capital before the reduction for capitalized interest. Total debt includes all interests bearing debts, including loans, bonds, convertible bonds and short-term financial debt.

3.4 Model

This article used panel regression analysis to study the causal relationship between CSR and CDF (McWilliams and Siegel, 2000; Magnanelli and Izzo, 2017) as the main statistical method when CSR is an independent variable and CDF is a dependent variable, as shown in equation (1):

3.5 The model

One accounting variable was used to represent the cost of debt: the dependent variable CDF. The panel data equation for this study as follows:

$$\gamma \mathrm{it} = \alpha \mathrm{i} + \beta 1\mathrm{X1it} - 1 + \beta 2\mathrm{X2it} + \mu \mathrm{it} \quad (1)$$

where γit = company i cost of debt in year t, αi = the intercept on the cost of debt axis, X1it−1 = CSR for the company i in year $t-1$, X2it = Control variable for the company i in

year t, $\beta 1$ and $\beta 2$ are the coefficients of CSR and the control variables and μit is the error term.

Model 2 depicts that cost of debt is a function of leverage, sales growth, industry type, short term profitability and size:

$$CDF_{it} = \beta_0 + \beta_1 CSR_{it-1} + \beta_2 LEV_{it} + \beta_3 SALESGTH_{it} + \beta_4 IND_{it} + \beta_5 STPROF_{it} + \beta_6 SIZE_{it} + E_{it} \quad (2)$$

where

CDF = the ratio of interest expenses to financial debt of the firms;

CSR = a measure of CSR disclosure across selected firms;

LEV = ratio of total liabilities to total assets and liabilities;

SALESGTH = Annual sales growth is measured by the percentage of sales growth from year $n-1$ to year n;

IND = industry type represents a dummy variable of 1 if the industry is manufacturing otherwise 0;

STPROF = short term profitability;

SIZE = firm size as a log of total assets of the selected banks over the time period of the study; and

E_{it} = a white noise process.

3.6 Control variables

Previous studies of the link between CDF and CSR have used company size, risk, research and development intensity as control variables to render the research results more complete. In this study, firms' size, leverage, sales growth, industry type and operating profits are used as control variables (Cheng *et al.*, 2014; Yang *et al.*, 2018; Ghoul *et al.*, 2011).

SIZE: Different studies used different variables as a proxy for size. The study of Belkaoui and Karpik (1989) used a net log of sales, while Chen and Metcalf (1980) used total assets. Larger firms are better able to withstand negative shocks to cash flow and are, therefore, less likely to default. Larger firms have a better capability of resources required regarding society and reputation and are regarded as less risky by banks, and thus should enjoy lower yields on the debt. Larger companies are more mature and attract the attention of the public more easily, and thus, should respond more to the needs of public interest stakeholders. This study uses a log of total assets to control for firm size.

LEV: To control for risk, Benlemlih (2017) used the long-term debt to total assets ratio of the firm while Trebucq and d'Arcimoles (2002) used the debt to total capital ratio. McWilliams and Siegel (2000) stated that risk can affect the relationship between social and firm performance. In this study, the net debt to total assets ratio has been used as a proxy to control for the riskiness of the firm. It controls for financial pressure and is expected to be positively correlated with the cost of debt. Firms with higher leverage are expected to pay higher spreads.

STPROF: We include earnings before interest and taxes scaled by total assets to control for the possibility that any relationship between the CDF and CSR is actually being determined by free cash flow in the firm. Return on investment is measured as operating income scaled by the book value of assets. Generally, a higher short-term profit implies the firm's ability to cover debt obligations. So, we expect STPROF to be negatively related to CDF.

IND: Following Magnanelli and Izzo (2017), we control for differences across industries. Magnanelli and Izzo demonstrate the importance of controlling for industry effects in CSR studies. Moreover, we took into account the industry as a control variable, considering that lenders could apply a higher cost to firms operating in high-risk industries such as oil and gas and manufacturing.

SALESGTH: Annual sales growth is measured by the percentage of sales growth from the previous year to the current year. Companies are able to improve upon cash flows, efficiency and more growth as sales increase to service the cost of debt.

4. Empirical results

4.1 Descriptive statistics

Table 1 reports the descriptive statistics of our empirical measure and the correlation matrix. The average CSR is 0.65 and the standard deviation is 0.142. The mean of CDF is 7.31% which is comparable to 6.74% in Ye and Zhang (2011). The control variables also offer a wide range of values. Sales growth, firm size, short-term profit and sales have mean values of 554.24, 7.48, 11.46 and 141.12, respectively, with standard deviations of 8,730.24, 1.47, 52.04 and 2,215.41, respectively.

The Pearson correlation matrix for CDF and CSR disclosure indicates that *SALESGW*, *SIZE*, *STPROFIT* and *LEV* have a negative association with CDF. In the same vein, CSR and IND show a positive link with CDF. The results also show that the highest value of correlation exhibited between two variables is 0.70 which was found in the case of *IND* and *SALESGW* which indicates the absence of multicollinearity issues among variables. For more reliable analysis, multicollinearity diagnostics was conducted using both VIF and Tolerance tests. VIF has a maximum value of 1.52 and the lowest value of tolerance is 1.02 which indicates that there are no multicollinearity problems among independent variables and conclude that the variables are normally distributed around the mean (p-value $> z$ for the Swilk test).

4.2 Regression

To determine the appropriate econometric estimation method, some statistical tests are conducted. Firstly, the Hausman specification test is conducted, which is the classical test of whether fixed or random-effects models should be used for the panel data. The results show that the random-effects model is more relevant than the fixed effects model ($p = 0.2607$). Secondly, tests of the heteroskedasticity of errors are conducted to verify the absence of bias, which may affect the significance of the coefficients. Therefore, the Breusch–Pagan Lagrange multiplier test is applied to detect any possible heteroskedasticity. The results indicate that the structure of the errors among the panels is heteroskedastic ($p < 5\%$). The problem of heteroskedastic is removed by applying a robust test to the random effect model. Table 2 presents the results from the regression of the CSR on the CDF scores over the period 2006–2019.

The multivariate regression analysis has been performed on a cross-sectional basis, on 248 firm-year observations. For each year there were some missing data on interest expense because some companies did not use external funding, and thus did not report any figure for total debt. As already explained, the panel is composed of firms with at least a CDF and CSR score of over 14 years' time horizon.

Table 2 presents the empirical results of the relationship between the overall CSR and CDF. Surprisingly, the result shows a positive and statistically significant relationship between the CSR disclosure score and CDF, suggesting that lenders do not interpret a high CSR as a risk reduction factor. This result suggests that lenders register CSR activities as a

Table 1. Descriptive statistics

Variable	Obs	Mean	Std. dev.	Z	VIF	1	2	3	4	5	6	7
(1) CDF	249	0.0732	0.2222	11.038***		1.000						
(2) CSR	252	0.6523	0.1420	4.746***	1.27	0.038	1.000					
(3) SALESGW	249	554.237	8,730.239	12.001***	1.02	−0.027	0.099	1.000				
(4) SIZE	250	7.4849	1.4701	2.019***	1.52	−0.092	0.366	0.107	1.000			
(5) IND	252	0.5556	0.4979	–	1.23	0.179	−0.243	−0.706	−0.243	1.000		
(6) STPROFIT	250	11.4555	52.0458	11.485***	1.35	−0.072	0.107	−0.014	−0.334	−0.244	1.000	
(7) LEV	250	141.1234	2,215.408	12.011***	1.02	−0.021	−0.131	−0.004	−0.099	−0.043	−0.012	1.000

Notes: Table 2 reports the summary statistics and correlations for the major variables used in the empirical analysis during the sample period of 2006–2019. *CDF* = cost of debt; *CSR* = corporate social responsibility; *SALESGW* = sales growth; *SIZE* = firm size; *STPROFIT* = short term profit; *LEV* = financial leverage; *IND* = dummy variable for industry; *Z* = Swilk nornality. *Low 0.1 0.05 $< x <$ 0.1; **medium 0.05 0.001 $< x <$ 0.05; ***high 0.001 $x <=$ 0.001

Variables CDF	Model 1 Coef	$p > \|z\|$	Model 2 Coef	$p > \|z\|$	Model 3 Coef	$p > \|z\|$
CSR	0.2102353	0.076	−0.0144925	0.478	0.3820476	0.061
SALESGW	−4.14E−07	0.024	−1.30E−07	0.000	0.001597	0.304
SIZE	−0.0201055	0.009	−0.0088027	0.101	−0.0341308	0.044
STPROFIT	−0.0003986	0.001	−0.0000913	0.020	−0.0124993	0.366
LEV	−1.94E−06	0.005	−0.0266011	0.000	−3.88E−07	0.777
con	0.0533077	0.558	0.128753	0.021	0.114437	0.495
IND		YES				
No of groups	18		8		10	
No of obs.	248		111		137	
Wald $\chi 2(6)$	3,347.55		386.49			
Prob > $\chi 2$	0.000		0.000		0.000	

Notes: This table shows the coefficients from the robust regression. The dependent variable is the cost of debt financing. Industry variable is included in the regression, but coefficient is not reported; *low 0.1 0.05 < x< 0.1; **medium 0.05 0.001 < x < 0.05; ***high 0.001 x <= 0.001; *CDF* = cost of debt; *CSR* = corporate social responsibility; *SALESGW* = sales growth; *SIZE* = firm size; *STPROFIT* = short term profit; *LEV* = financial leverage; *IND* = dummy variable for industry. Model 1 = all companies; Model 2 = manufacturing; Model 3 = oil and gas

Table 2. Multiple regression results

costly diversion of firm resources leading to an increase in risk. The result agrees with previous studies on CSR overinvestment, which illustrate how managers overinvest in CSR activities to gain private benefits at the expense of shareholders. Overinvestment in CSR occurs when managers gain by implementing CSR initiatives at the expense of shareholders (Barnea and Rubin, 2010). The positive relation between CSR performance and CDF can be justified by the lack of lenders' belief that firms' CSR disclosure information is not reliable, and thus, cannot be taken into account for their decisions. Also, a lender may misunderstand firms' CSR activities and the market does not correctly value what firms declare in their reports concerning CSR activities. CSR is now gaining awareness in developing countries such as Ghana and is purely reported voluntarily basis.

This finding, however, is not necessarily the proof of the financial market loathing to CSR activities, but the confirmation of the market's need for more reliable information. This result is consistent with the study of Yang *et al.* (2018) and Tan *et al.* (2020), which documented a positive relation between CSR disclosure and access to debt. Other reasons could explain this finding. Firstly, firms disclosing information about their social activities send a signal that conveys their long-term perspectives (Menz, 2010' Liu and Lu, 2019) and their ethical convictions. This leads to lenders' positive perceptions of CSR as indicative of the long-term sustainability of firms' performance rather than their short-term performance (Yang *et al.*, 2018). Secondly, consistent with the legitimacy theory, the extent of the social information disclosed by Ghanaian firms is likely to improve their legitimacy and reputation, which subsequently improves their access to debt financing. Also, in line with the stakeholder theory, Ghanaian firms that disclose CSR information are more likely to meet the expectations of their creditors in terms of extra-financial information and their ability to service debt. Such firms may obtain better support and trust from creditors leading to preferential treatment from banks through better access to debt financing sources.

The largest part of the control variables in the model seems significantly correlated with the cost of debt, in line with our expectations and previous studies' results. Table 2 shows an

inverse relationship between the cost of debt and the leverage of a firm (p = 0.005), for all the three models expressed by the control variable LEV, highlighting how a high level of debt makes a declining cost of debt. Similarly, a negative and significant relation (p = 0.009) is found between the dependent variable and the size of the firm, which indicates that larger firms enjoy a lower cost of debt applied by banks, in accordance with previous studies results (Tan *et al.*, 2020; Liu and Lu, 2019; Desender *et al.*, 2020).

SALESGW and *STPROFIT* have an inverse significant relationship with CDF. In line with the theory of reputation (Datta *et al.*, 1999), these results might be because companies with higher CSR disclosure disclose their CSR strategy, leading to a stronger corporate image and creates anticipation of continuing financial performance and lower risk exposure. In times of economic growth and stability, banks tend to perceive CSR as a strategic project and those adopting this strategic approach are able to obtain loans at lower costs. Aligned with the literature, Table 2 shows an inverse relationship between the cost of debt and both the sales growth and operating profitability of the firm, expressed by *SALESGW* (p = 0.02) and *STPROFIT* (p = 0.001), indicating that the more the company is profitable and has a high sales growth, the lower the cost of debt it has to pay to finance itself. This finding agrees with Francis (2018) and Desender *et al.* (2020). It, however, contradicts the results of Huang *et al.* (2017). Finally, the variable controlling for the industry (*IND*), expressed by dummies, shows a significant and positive impact on the cost of debt for two industries, namely, manufacturing and other non-financial firms. These results have to be interpreted considering the fact that the oil and gas sector has a high level of risk. Thus, industry type has a positive relationship with the cost of debt as the high cost of production has contributed to the high operating and financial risks.

Table 3 shows the financing options, cost of debt and average CSR disclosure for the three industries.

Although the manufacturing sector has the highest total debt, the oil and gas industry recorded the highest interest expense, indicating that lenders perceive the oil and gas industry as a highly risky venture. From the risk-mitigating theory, oil and gas should have recorded the lowest cost of debt as it has the highest CSR disclosure. Firm characteristics can influence the relationship between CSR and both firm cost of debt and debt maturity. Table 3 also suggests that high CSR firms substitute shareholders' equity for long-term debt. Ghanaian banks in particular and lenders, in general, might rely more on firm characteristics and risk when pricing loan facilities.

5. Conclusion

This paper examines the relation between CSR disclosure and the CDF. More precisely, it assesses whether firms with higher CSR disclosure scores have a better CDF. The disclosure scores are collected from the annual reports and sustainability reports from the company's website. This research argued that CSR disclosure reduces information asymmetry (Dhaliwal *et al.*, 2011; Bose *et al.*, 2017; Agbola *et al.*, 2019) and improves companies'

Variable	Oil and gas (GHS)	Manufacturing (GHS)	Food and beverages (GHS)
Short term debt	1,067,141,705.67	3,436,795,438.83	10,709,861.05
Long term debt	1,717,492,625.14	457,973,348.48	21,498,422.21
Interest expense	59,273,225.16	9,544,292.03	793,227.79
Total debt	2,784,634,330.81	3,894,768,787.31	32,208,283.26
CSR disclosure	0.715821	0.624037714	0.64085

Table 3. Financing options, cost of debt and CSR disclosure

reputation and image (Krasodomska and Cho, 2017). Besides, firms that disclose extensive CSR information have lower risks (Benlemlih *et al.*, 2018) and better performance (Platonova *et al.*, 2016; Cahan *et al.*, 2016; Tan *et al.*, 2020). Using a robust year trend random effect model, the results reveal interesting insights into the relationship between CSR disclosure and CDF in Ghana.

The findings of this paper are related to a recent line of inquiry on the implication of CSR disclosure on a firm's cost of financing. This study extends the examination of the consequences of CSR by filling the gap of an evident link between CSR and the cost of debt. In this regard, we investigate whether managers should focus on CSR to get a positive effect on the CDF. According to the outcomes of the research, CSR does not play an essential role in the cost of debt's definition, in contrast with our expectation that high CSR scores are inversely related to the cost of debt. Thus, we document a positive correlation between the cost of debt and CSR. These results suggest that lenders do not attribute to CSR practices an important role in reducing the operating risk facing by the firms. To our knowledge, this paper is one of the few that examine the impact of social responsibility activities on the cost of debt. Although previous studies did not deeply explore this relation, it represents a relevant issue to be explored, as financial debt is one of the predominant forms of external financing for firms and the growing investments in CSR could be justified if this relation is proved.

Our results appear to be partially coherent with Goss and Roberts (2011), who found that low-quality borrowers who engage in discretionary CSR activities face higher loan spreads and shorter maturities. This suggests, as in our case, that banks do not regard CSR as a significantly value-enhancing or risk-reducing factor. This study contributes to the CSR theory, in the field of the relationship between CSR and debt financing cost, by enriching the scarce debate on the link between CSR and cost of debt; and broadening the CSR-CDF discussions. CSR in Ghana is probably a second-tier determinant for debt cost. There seems to be evidence that CSR affects the interest-bearing cost of debt, but the nature of the effect is still equivocal and needs to be further researched.

5.1 Implications

The success key of any CSR policy is related not only to its contents and its intrinsic correctness but also to how it is communicated and is understood by a firm's stakeholders (Wood and Jones, 1995), banks and financial institutions. Managers should consider that the lack or the misleading communication on CSR actions could lead to a failure of CSR potential benefits to the firm itself, affecting, among all the other mentioned aspects, the CDF. The introduction of regulations and laws regarding CSR by policymakers needs to be developed to enhance uniformity in reporting. Laws requiring transparency in the environmental, social and corporate governance policies in Ghanaian firms should be enacted to improve upon social reporting. An increasing number of Ghanaian managers regard CSR activities as costs containing their progress instead of opportunities. Credit providers should pay more appropriate attention to the CSR activities of companies and reward them appropriately. Business managers and leaders should be more aware of the impact of CSR and the CDF. Managers of high-risk industries such as oil and gas can use CSR as a strategic tool to appear more reliable in the long run and pay less interest on debt as CSR continues to gain awareness in Ghana.

In the short run, CSR no longer plays the beneficial roles it generally plays in areas where CSR is well developed and understood and lenders tend to disregard CSR by focusing exclusively on financial performance. The main implication this study is believed to have is to contribute with a factor to a more comprehensive CSR-CDF model. The results can be

used to further investigate the likelihood of developing a model with different CSR factors according to their actual effects. This could be an effective tool both for investors and managers when analyzing the net value of investments into CSR. There is still much research work to be done in this field of research, as investors and managers are using sustainable models in their business strategies.

The findings of this study should be interpreted with caution, given that there are at least three limitations. Firstly, the results should not be generalized, as the sample was based on a large 18 listed Ghanaian firms' companies for 2006–2019. Moreover, the research sample was limited to three industries. The second limitation concerns the negligence of some control variables such as the age and nature of the industry that are likely to influence the findings of this study. The third limitation concerns the absence of the quality dimension of CSR information. This study is based only on the quantity of CSR information disclosed in their annual reports without addressing the quality of the CSR disclosure. For future studies, it would be valuable to use CSR disclosure proxies that take into account the quality dimension in addition to the extent of CSR disclosure. Disclosure of CSR was voluntary so there was no generally accepted standard rule, which can be used as a reference to measure the CSR index. Future studies in the area can involve other industries and include age and the nature of industries in more than one country.

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