Does the cost of borrowing increase to the firms that are socially and environmentally irresponsible?

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Synopsis

The research problem

This study aims to determine the financial repercussions for firms that engage in irresponsible Environmental, Social, and Governance (IESG) / Corporate Social Irresponsibility (CSI) practices. Specifically, it examines whether these practices influence the cost of debt through increased borrowing costs imposed by lending institutions.

Motivation

Amid growing scrutiny over corporate behaviour and its broader impacts, understanding how irresponsible practices affect corporate finance is crucial for stakeholders, including investors, policymakers, and regulators. This research is driven by the need to explore beyond the often-studied beneficial impacts of positive ESG/CSR practices, focusing on the consequences of their negative counterparts.

Hypotheses

H1: Ceteris paribus, there is a positive association between firms' IESG/CSI practices and their cost of debt.

H2: Ceteris paribus, the anticipated positive impact of IESG/CSI practices on the cost of debt is less pronounced in countries with high levels of corruption.

H3: Ceteris paribus, the anticipated positive impact of IESG/CSI practices on the cost of debt is more pronounced among firms in sinful industries.

Sample

The analysis covers a broad international sample of 50,281 firm-year observations from non-financial listed firms across 44 countries, covering the years 2002 to 2022. This comprehensive dataset allows for generalised insights across various geographic and industrial contexts.

Adopted methodology

Multivariate analysis using pooled regression with standard errors clustered at the firm level to account for intra-firm correlations and potential heteroskedasticity. A two-stage instrumental variable approach is also employed to address potential endogeneity issues, providing a robust framework for examining the causal impact of IESG/CSI practices on the cost of debt.

Analyses

The analyses focus on evaluating the direct impact of IESG/CSI practices on borrowing costs, alongside assessing the moderating effects of the corruption perception index (CPI) and

differentiating between industry types (sinful vs. non-sinful). Sensitivity tests are conducted to ensure the robustness of the findings against various model specifications and potential biases.

Findings and Implications

The findings indicate a universally significant positive relationship between IESG/CSI practices and the cost of debt, confirming that firms engaged in irresponsible practices incur higher borrowing costs. This effect is notably stronger in countries with higher corruption perception scores, emphasising the role of national governance in influencing corporate behaviour. Interestingly, no significant differences were found between sinful and non-sinful industries, suggesting that the financial penalties for irresponsible practices are uniformly applied across different sectors. These results are robust across a range of sensitivity analyses, affirming the reliability of the conclusions. The study offers crucial insights for lending institutions, firms, and credit rating agencies about the financial implications of irresponsible corporate practices. It highlights the importance for policymakers and regulators to enforce comprehensive ESG/CSR guidelines that encourage substantive disclosures and responsible behaviours.

JEL Classification: D22; D25; F23; G32; L21

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