Good corporate social performance may lead to higher credit ratings

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Does corporate social responsibility (CSR) or Corporate Social Performance (CSP) really pay off or is it just a waste of corporate resources? In our research, we empirically examine whether superior performance in CSR results in lower credit risk, measured by credit ratings and zero-volatility spreads (z-spreads).

Until now, only a limited number of studies have investigated the CSR-CFP relationship with credit risk as the dependent variable. Findings from these studies are very divergent and point only slightly toward a weak negative relationship between the two. This would be in line with the perspective of the risk-mitigating view that companies can reduce their risk profile by engaging in CSR spending that helps to develop and maintain close relationships with key stakeholders and subsequently creates valuable internal resources and intangibles. In contrast, the overinvestment view implies that companies will have lower ratings and higher spreads if their investments in CSR are regarded as a waste of scarce resources, often to the personal benefit of senior management at the expense of the company.

To reconcile these opposing views, we argue that companies can create valuable resources and intangibles only to the extent that their efforts are rewarded by stakeholders in the environment in which the company is embedded.

We use a sample of 872 bonds from companies located in twelve countries of the European Economic and Monetary Union (EMU) in the period from 2006 to 2012 and measure how CSP — the Thomson Reuters ASSET4 ESG ratings universe — impacts Standard & Poor's (S&P) credit ratings and corporate bond z-spreads, our two measures for credit risk. We find only weak evidence that superior CSP results in systematically reduced credit risk.

These results change when we add the sustainability of the corresponding country measured by Bloomberg ESG Country Ratings as a moderator. We do find strong support for our hypothesis that a country's ESG (Environmental, Social and Governance) performance moderates the CSP – credit risk relationship.

Superior CSP is regarded as risk-reducing and rewarded with better ratings and lower z-spreads only if it is recognized by the environment in which the company inserts itself. In addition, we find that companies benefit from better ratings and lower spreads if their relative ESG performance (above vs. below average) matches those of the corresponding country (above vs. below average). Being a high-ESG performing company in a country that rewards investments in CSR (or, conversely, a low ESG-performing firm in a country with low ESG performance) can reduce z-spreads by approx. 7.7 percent (which translates to 9.64 basis points) compared to companies whose CSR performance does not mirror those of the corresponding country.

Future research may also investigate which economic and institutional conditions drive our results. It would be interesting to see which country-specific factors – like state regulations demanding that firms act in socially responsible ways or the existence of NGOs – are linked to our results.

Notes:

- *This article is based on the authors' paper Corporate social responsibility and Eurozone corporate bonds: The moderating role of country sustainability, Journal of Banking & Finance, Vol. 59, p. 538-549.*
- *This post gives the views of the authors, and not the position of LSE Business Review or the London School of Economics.*

- *Featured image credit: Ron Mader CC-BY-2.0*

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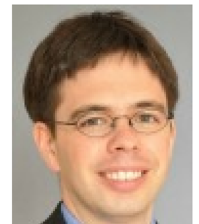

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