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Research Paper

More Corporate Social Responsibility, Less Leverage Adjustment Speed: A Fact?[1]

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INTRODUCTION

Existing theories about capital structure show that information asymmetry is an important factor in setting optimal leverage. These theories have grown significantly since Miller and Modigliani (1958) proposed the theory of "unrelated capital structure" to examine the factors affecting the corporate debt ratio. According to theories of signaling, information asymmetry, and dynamic equilibrium theory, companies with higher transaction costs (financing) move less toward their target leverage or so-called leverage adjustment speeds. Myers (1984) and Myers and Majloff (1984) show that firms with high information asymmetries face higher external financing costs. The signaling theory of capital structure shows that the stock market reacts positively (negatively) to the declaration of debt (stocks) (Ross, 1977; New, 1988). Dynamic balance theory allows companies to consider the balance between unoptimized financial structure and leverage adjustment costs (Flannery and Ranjan, 2006; Stroblaf, 2007). In this theory, it is assumed that companies balance the benefits of excess debt (such as the tax shield and prevent the problem of free circulation) with its costs (such as the cost of bankruptcy) to achieve the optimal capital structure. (Chen, 2001; Flannery and Ranjan, 2006; Antonio, 2008; Titman and Tsiplico, 2007; Hang and Ritter, 2009).

Thus, according to these theories, companies with higher transaction costs tend to adjust their leverage ratios less quickly than their targets. According to these theories, for companies that score higher in terms of CSR indicators, the possibility of financing through more leverage and using financial leverage costs less (Cheng, 2019).

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In this paper, the effect of CSR on lever adjustment speed is investigated. Since we expect the variables of firm size, leverage level, and information asymmetry to be effective in this relationship, the moderating effect of these three variables on the CSR relationship and leverage adjustment speed has also been investigated.

MATERIAL AND METHOD

In this study, a sample of 84 companies listed on the Iranian Stock Exchange over a period of 8 years from 2011 to 2018 has been studied. A multivariate regression model based on composite data was used to analyze the data and test the hypotheses. First, the target lever was estimated using a two-stage GMM. Then, the effect of CSR on lever adjustment speed was investigated.

In order to investigate the effect of CSR on lever adjustment speed (first hypothesis), the following model has been used:

Relationship (1) $$\Delta Lev_{it}=\alpha_0+\alpha_1 \text{ LevDev}_{it} + \alpha_2 \text{CSR}_{it} + \alpha_3 \text{CSR}_{it}(\text{LevDev}_{it}) + \varepsilon_{it}$$

In order to investigate the effect of lever level on CSR relationship and lever adjustment speed (second hypothesis), the following model has been used:

Relationship (2) $$\Delta Lev_{it}=\alpha_0+\alpha_1(\text{CSR}_{it})(L_{it}^{blow})(\text{LevDev}_{it})+\alpha_2(\text{CSR}_{it})(L_{it}^{abovs})(\text{LevDev}_{it}) + \varepsilon_{it}$$

In order to investigate the effect of firm size on the relationship between CSR and leverage adjustment speed (third hypothesis), the following model has been used:
Relationship (3)

$$\Delta Lev_{it}=\alpha_0+\alpha_1(\text{CSR}_{it})(S_{it}^{blow})(\text{LevDev}_{it}) + \alpha_2(\text{CSR}_{it})(S_{it}^{abovs})(\text{LevDev}_{it}) + \varepsilon_{it}$$

In order to investigate the effect of information asymmetry on the relationship between CSR and lever adjustment speed (Hypothesis 4), the following model has been used:

Relationship (4)

$$\Delta Lev_{it}=\alpha_0+\alpha_1(\text{CSR}_{it})(A_{it}^{blow})(\text{LevDev}_{it}) + \alpha_2(\text{CSR}_{it})(A_{it}^{abovs})(\text{LevDev}_{it}) + \varepsilon_{it}$$

To measure the speed of capital structure adjustment, the model of partial capital structure adjustment based on dynamic equilibrium theory has been used. Six dimensions of customers, employees, environment, community, shareholders, and corporate governance are used to measure corporate social responsibility based on studies such as Lannis and Richardson (2015). To measure information asymmetry, two relative gap variables, effective gap, have been used.

The leverage of the company is also considered as the sum of debts and the size of the company is calculated based on the logarithm of sales (in Rials), and according to the middle, it has entered the third hypothesis model as a fictitious variable.

RESULTS AND DISCUSSION

The findings of the present study confirm the positive effect of CSR score on lever adjustment speed. In other words, CSR has an impact on financing methods, transaction costs, and leverage changes, and the results of the present study support this effect.

Hypothesis testing also showed that firm size, leverage level, and information asymmetry can affect the CSR relationship and leverage adjustment speed.

Multiple regression analysis based on composite data using the ordinary least squares method has been used to estimate the research models. The results of testing the hypotheses are presented in the table below.

Table 1. Summary of hypothesis test results

Hypothesis		Results
1	The positive effect of corporate social responsibility on leverage adjustment speed.	Confirmation
2	The positive effect of leverage on the relationship between corporate social responsibility and leverage adjustment speed.	Confirmation
3	The negative effect of size on the relationship between corporate social responsibility and leverage adjustment speed.	Confirmation
4	The positive effect of information asymmetry on the relationship between corporate social responsibility and leverage adjustment speed.	Confirmation

CONCLUSION

Theoretical and empirical evidence discussed in the Theoretical Foundations section suggests the role of CSR disclosure in reducing market friction and information asymmetry. CSR is therefore expected to influence the gap between domestic and foreign financing costs by reducing information asymmetry and agency costs, and capital structure in general. The argument of the first hypothesis is based on this evidence and the positive effect of CSR on the lever adjustment speed at the 5% error level and the conditions of the sample under study were confirmed. Based on empirical and theoretical evidence, the speed of leverage adjustment is influenced by the size of the lever. The second hypothesis, in companies with more leverage, the impact of corporate social responsibility (CSR) on the speed of leverage adjustment is higher. This result shows that the speed of leverage adjustment is higher in companies with high leverage because the cost of not adjusting the leverage increases with increasing debt rate and the attractiveness of debt as a source of credit is due to its tax advantage. Therefore, the motivation of companies to adjust the capital structure is the balance between the costs and benefits of debt. According to theoretical and empirical records and testing of the third hypothesis, in smaller companies, the impact of corporate social responsibility (CSR) on the speed of leverage adjustment is greater. This result suggests that larger firms may be less constrained in terms of transaction costs due to the use of economic scales. According to the test of the fourth hypothesis, in companies with a larger price gap, the impact of corporate social responsibility (CSR) on the speed of leverage adjustment is greater. This result shows that better CSR performance increases the share of public debt in total debt, and this effect is stronger for companies with high agency costs and information asymmetry. According to this argument, CSR drives the debt structure by reducing these frictions.

According to the hypothesis test results, practical suggestions based on the findings and suggestions for future research are as follows:

1. Analysts are advised to pay attention to the company's CSR score as one of the factors affecting financing. In this regard, leverage companies, either small or with a higher price gap, deserve more attention
2. Company managers are advised to pay more attention to CSR development and reporting, and to take seriously the impact of social responsibility practices on funding methods, constraints, and flexibility.
3. It is recommended that other indicators be used in future research on CSR measurement, and that other possible factors that may affect the CSR relationship and lever adjustment rate be considered.

Keywords: Corporate Social Responsibility, Leverage Adjustment Speed, Information Asymmetry.

JEL Classification: G32, E31, C23.