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EXTRA-FINANCIAL DISCLOSURE AND THE COST OF DEBT OF BIG FRENCH COMPANIES

Ahlem NAJAH
University of Gabes, Gabes, Tunisia
ahlem.najah@gmail.com

Anis JARBOUI
University of Sfax, Sfax, Tunisia
anisjarboui@yahoo.fr

Abstract
The literature shows that there is a lack of studies concerning the relationship between corporate social responsibility and cost of debt in the French context. To participate in filling this gap, we present this work seeking to investigate the relationship between non-financial disclosure and the cost of debt of 202 big French companies from 2000 to 2010. Results of the empirical study show that there is no explicit relation between the social reporting and the cost of debt but when adding size and age as control variables, this relation tends to be negative.
Keywords: Corporate social responsibility, Extra-financial divulgation, Cost of debt.

1. INTRODUCTION

Disclosure policy of timely reliable information reduces the apprehension of bankruptcy risk of the company by lenders and thus restricts its cost of debt. Greater disclosure draws attention to the existence of a business and expands its investor base, which enhances the sharing of risks and reduces the cost of capital (Merton, 1987). Reducing the cost of acquiring information for investors and their expectations becoming more homogeneous can also reduce the cost of capital.

A number of studies agree that corporate social responsibility (CSR) is negatively related to the cost of capital; while others show that CSR affects positively the cost of capital. A third result shows neutrality or non-existence of a real relationship between CSR and cost required by lenders to socially responsible companies. We can explain this result by the disinterest of the donors to this strategic component they consider negligible in the rating system and thus to extend credit and to determine the debt ratio.

In this paper, we try to contribute to the literature by investigating the relation between CSR, social reporting and cost of debt. We first present a theoretical frame of this relation. Second, we study the impact of social reporting on the cost of debt of big French companies.

2. CSR AND COST OF DEBT: THEORETICAL FRAME

The literature on the determinants of the cost of debt generally announces a negative effect on the association between measures of business risk and the cost of debt. The literature on corporate social responsibility, however, shows this risk reduction as one of the potential benefits of these investments. Based on these evidences, Izzo and Magnanelli (2012) assume that an efficient market must recognize a "premium financial ethics" for socially responsible companies, corresponding to a lower cost of debt. According to these authors, CSR is relevant to reduce the risk. So if the socially responsible behavior and social responsibility investments involve risk reduction (current and/or perceived by the market) and, consequently, an improvement in the financial performance of the company (such as stakeholder theory argues), banks apply the best conditions of the loan agreement for these companies. On the contrary, if the financial market does not recognize a value (in terms of risk reduction) to CSR policies , socially responsible companies will suffer a competitive disadvantage because of the additional costs they incur in terms of non- reducing investment risk resources. To justify an "ethical premium" on the cost of the debt paid by companies, Izzo and Magnanelli (2012) believe that financial institutions are regarded as neutral agents between all stakeholders and they formulate their decisions and assessments taking into consideration exclusively the leverage, moral hazard of the business and its ability to meet its financial obligations. Indeed, the results of their empirical study of 332 firms on 5 years show a positive correlation between the social performance and the cost of debt. They realize that CSR is not considered as an element of value having an impact on the risk profile of the firm, but kind of waste of resources that may affect the performance of the company, regardless of the country field action.

In the same line, Girerd-Potin et al., (2008) note that the least ethical companies are using more massive debt, and in particular the bank loan to escape the punishment of the financial market. The authors add that the banks do not apply penalty on unethical borrowers explaining that the debt market is less able to provide companies with the ethical expectations of investors. Girerd-Potin et al., (2008) believe that the bank does not adjust its interest rate according to the ethical note of its customer and since prepared the same way; the cost to the unethical debtor is the same as the most ethical debtor.

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The authors also demonstrate “the role of financial arbitrage bond market which blurs any embryo ethical premium”.

Using a sample of 3996 loans of U.S. companies, Goss and Roberts (2011) found that those with low social responsibility issues pay between 7 and 18 basis points higher compared to those who are more responsible. Lenders are more sensitive to the concerns of CSR in the absence of security. Girerd-Potin et al. (2008) argument such results by the fact that banks do not allocate real interest to ethical rating of socially responsible companies, but what matters to these donors is respect the debt service by these companies . The authors argue that this is why a rate of pay of the lower debt can be offered to ethical business (p.10).

In a study by Hong and Kacperczyk (2007) concerning the shares of “sin companies” like alcohol, tobacco and gambling, the results showed a higher debt ratio for this type of companies (with 13.9 % more than the average for the " sin companies "). The authors justify these results by the lack of transparency in the debt market in comparison with the actions. According to Belkaoui and Karpik (1989), the company wishing to implement social responsibility will undertake specific expenditures which, in addition to improving the image of the company that they represent to the public, will have an impact on the net income of the period and some key variables in the debt contracts. It is also possible that firms engaged in CSR are more likely to attract capital from investors (eg, start-up) and take advantage of more favorable terms with creditors. According to Sprinkle and Maines (2010), many people want to align their investments with their moral goals. It is legitimate to question whether CSR efforts would increase companies' access to capital and / or lead to more favorable loan terms in the form of interest rates and other.

Izzo and Magnanelli (2012) highlight the lack of academic studies examining the relationship of the couple CSR - Cost of debt. To demonstrate this "scarcity of studies on CSR/performance relationship in terms of the debt", Goss and Roberts (2009) found that of the 52 studies reviewed by Orlitzky et al., (2003) and the 103 documents reviewed by Margolis and Walsh (2001), none of them focuses on the relationship between CSR and corporate debt .

We have also noticed a lack of studies looking at the relationship between the cost of debt and CSR and especially the relationship between non-financial disclosure and the same cost in the French context. To enrich the literature on the subject, we will focus in the rest of the paper on the study of the impact of social reporting in relation to the cost of debt of French companies.

3. HYPOTHESES

3.1. The relation between social reporting and cost of debt

Several authors have detected the existence of a relationship between the disclosure and the cost of debt (Sengupta, 1998, Wooldridge, 2002, Nikolaev and Van Lent, 2005). According to Sengupta (1998), a policy of timely and detailed disclosure reduces the perceived risk of default of the company among lenders and insurers, which reduces its cost of debt. Belkaoui and Karpik (1989) express the hypothesis of a negative relationship between levels of social information divulgation and the cost of monitoring and control they materialize by the level of debt of the company (Oxibar , 2003) .

Both authors base their argument on the theory of debt, political and contractual accounting theory assuming that firms prefer the debt accounting methods amplifying the result. Oxibar (2003, p.38) reported what is indicated by Belkaoui Karpik (1989) in their article: "*Given that the decision to disseminate social information is following by a decrease in net income due to the costs of implementation of social programs [...] companies with lowest contract and monitoring costs will be brought to disseminate more social information*".

Ullmann (1985) and Roberts (1992) believe that managers are expected to meet the expectations of creditors in relation to CSR when the company relies more on debt financing. Cormier (2002) states that the leaders must be sensitive to adverse economic and financial consequences resulting from the use of information provided by the company. According to him, exclusive costs may be incurred if there is a third party whose interests diverge from those of the company or its shareholders or interested in this information. This research shows, through these costs, the negative relationship between leverage and disclosure of environmental information.

The results of these studies lead us to propose the following hypothesis, which we will test later:

H1: Social reporting affects negatively the cost of debt of the company.

3.2. The impact of size as control variable on the relation between social reporting and cost of debt

This assumption will be broken down into two assumptions through which we will test if the control variables that we have chosen in this study affect the relationship between social reporting and the cost of debt. Taggesson et al., (2009) argued that most studies have shown a positive relationship between firm size and the social information disclosure, especially with regard to energy consumption and

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environmental issues. In fact, large companies have many stakeholders demanding more information than small ones and also have more pronounced effect on society.

Sengupta (1998) states that the largest companies are exposed to low-cost debt, as these companies have low market risk. Similarly, Reeb, Mansi and Allee (2001) suggest that the cost of debt is negatively related to firm size. Other studies show that large firms are characterized by high stability and they opt for scale economies .These studies postulate that the larger the company, the greater the cost of its debt will be low (Klock, Mansi and Maxwell, 2005). All this allows us to predict a negative relationship between the size of the company and the cost of debt, so it may also influence the relationship between social reporting and the cost of debt by making it more negative. To confirm this assumption, we will test the following hypothesis:

H 2: The size of the company increases the negative impact of social reporting on the cost of debt.

3.3. The impact of age on the relation between social reporting and cost of debt

The age of the company should pay a reflection that is required in assessing the cost of debt in connection with the company's reputation, its communication and its relationship with its stakeholders. Previous researches suggest that the problems of regular events information disappear with age, as companies build up notoriety about in financial markets (Fortin and Pittman, 2007). They provide theory and evidence that the magnitude of the response of stock prices to earnings announcements decreases with the company age; they justify this by the fact that the company specific information is revealed gradually over time. Pittman (2002) reports descriptive statistics on certain characteristics of the capital structure of firms stating that information asymmetry declines after the early years of information disclosure. Similarly, Diamond (1989) supports the idea that young firms suffer from a more severe asset substitution and moral hazard problems. Fortin and Pittman (2007) found similar evidence showing that firms are able to reduce their interest rates (borrowing rate) by expanding their reputation on the debt market over time.

So while there is little information available on young companies, lenders rely heavily on the disclosures of companies to evaluate their performance and future prospects (Sengupta, 1998). This leads us to assume that the age and the cost of debt will be negatively related and that the age will be also a catalyst for the negative relation between social reporting and the cost of debt. We measure the age of the company by the number of years between the dates of its incorporation to the year of observation.

H3: The age of the firm emphasizes the negative impact of social reporting on the cost of debt.

4. IMPACT OF SOCIAL REPORTING ON THE COST OF DEBT OF FRENCH COMPANIES

4.1. Models

To investigate the relationship between the disclosure of non-financial information (social and environmental) and the cost of debt we will test the following model.

Model1 (**M1**):

$$COD_{i,t} = \beta_0 + \beta_1 REP_{i,t-1} + \beta_2 LEV_{i,t-1} + \varepsilon_i$$

To examine the impact of the company size on the relationship between social reporting and the cost of debt we test the model 2 (M2):

$$COD_{i,t} = \beta_0 + \beta_1 REP_{i,t-1} + \beta_2 LEV_{i,t-1} + \beta_3 LogTA_{i,t-1} + \varepsilon_i$$

To check the impact of the firm age on the relationship between social reporting and the cost of debt we test the model 3 (M3) :

$$COD_{i,t} = \beta_0 + \beta_1 REP_{i,t-1} + \beta_2 LEV_{i,t-1} + \beta_3 LogTA_{i,t-1} + \beta_4 Age_{i,t-1} + \varepsilon_i$$

In these models, we are regressing the social reporting (REP) and the control variables: size (LogTA), risk (LEV) and age (AGE) in year t-1 (one year lag time) on the cost of debt (COD) of the year t.

The index ***(i)*** represents the company while the index ***(t)*** indicates the year belonging to the considered study period (from 2000 to 2010). The ***βi*** are the coefficients for the variables providing information on the quality of disclosure and the control variables and ***εi*** represents the margin of error of the model.

4.2. Variables

- **Explained variable: Measurement of the cost of debt (*CODi,t)***

The cost of debt is measured by the amount of interest expense divided by the total debts of the company. Financial expenses include all service charges for the use of capital before the reduction of capitalized interest. Total debt includes all interest on debts, counting loans, bonds, convertible bonds and short-term borrowings (Izzo and Magnanelli, 2012). This measure of the cost of debt was conducted by Pittman and Fortin (2004) to estimate the relationship between the quality of selection of auditors and the cost of debt. It has been used by several researchers such as Sengupta (1998) and Gray et al. (2009).

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$$COD_{i,t} = \frac{Finacial\_Charges_{i,t}}{Totol\_of\_Debts_{i,t}}$$

Reeb, Mansi and Allee (2001) used the yield to maturity and credit as other measures of cost of debt. Most other studies have used the actuarial rate of return as a measure of the cost of debt (see for example: Klock, Mansi and Maxwell, 2004; Bhojraj and Sengupta, 2003; Anderson, Mansi and Reeb, 2004).

- **Explanatory variable: Social Reporting**

We use the Social Reporting variable as a binary variable through which we want to test the impact of extra-financial information dissemination on the cost of debt of French companies. We chose this variable mainly for its direct connection with the transparency that emphasize all regulations regarding corporate governance and especially the NRE has encouraged French companies to disclose non-financial information since 2001. In fact, companies can communicate their CSR information using advertising, annual reports, public relations and their websites (Gray, et al., 1995). As in the study conducted by McWilliams and Siegel (2000), our measure of corporate social responsibility is a dummy variable. This variable has a value of one if the firm publishes a social report and 0 if it does not. Also Schnietz and Epstein (2005) measured the CSR reputation by a dummy variable taking the value 1 if the firm is included in the index mutual fund Domini Social and 0 otherwise. Cardebat and Sirven (2010) used the same technique for the European context. Their approach was to observe the behavior of the company in respect to the social disclosure. According to the authors, it is possible to create a CSR dummy variable. The company which has an available report on www.corporateregister.com[1] in year t will take 1 point, 0 otherwise. Cardebat and Sirven (2010) explain their methodological option by the assumption of rationality, which states that the opportunity cost of not being in the world's largest website will be very high for a company that wants to improve its image concerning CSR (p.3).

In our study, we will consider that the company discloses non-financial information if a social or sustainability report is available on its official website or on another website interested in this type of information, such as corporateregister.com or developpementdurable.fr, or if the company devotes a part of its annual report to the description of its social and environmental activities. We chose to consider any quote on sustainable development, social activities and good governance over 10 pages in the annual report as a CSR disclosure and thus denoted by 1. This choice was inspired by an empirical

[1] This website includes a huge number of reports (47 132 non-financial reports for 9880 companies in 2013). These reports provide information on the internal and external business activities in various fields such as the environment, social work, sustainable development, etc.

study in the French context developed by Chauvey and Giordano-Spring (2007), where they showed that 72 among 98 companies integrate their social reporting in the annual report and the number of pages of reports citing essentially the words "Social Corporate Responsibility" and "Sustainable Development" show more the performance of corporate communication. Their analysis shows as well that there is indeed a link between the publication volume and the degree of justification of the reporting quality (on average companies that publish the most have higher scores).

- **Control Variables**

A large number of studies (Sengupta, 1998; Anderson, Mansi and Reeb, 2004) state that the relationship between the quality of disclosure and the cost of debt is influenced by other control variables. In fact, there are specific variables such as company size, debt ratio and age.

LogTA$_{i,t-1}$: The size of the firm is measured by the natural logarithm of total assets. In fact, large companies tend to be more diverse, older and more famous, everything returns to reduce the risk of default and the corresponding costs. In addition, these companies usually have more efficient and transparent accounting systems, an asset for informational frictions vis-à -vis creditors.

LEV$_{i,t-1}$: The debt ratio is measured by the ratio of total net debt and total equity. This ratio, also called “leverage ratio", measures the debt capacity of a company. The higher the ratio tends to 1, the greater the risk of saturation and the greater the company is in a difficult situation. This ratio is important because it provides a good view of the indebtedness of the company. In some cases, the study of these ratios leads to restructure the debt in order to improve the performance of the company. We expect a positive relationship between the debt ratio and the cost of debt.

AGE$_{i,t-1}$: Fortin and Pittman (2007) report that existing research shows that information asymmetry between borrowers and lenders is decreasing in an aged company because young companies have emerging reputations in the financial markets. In fact, the empiricists frequently specify age as a measure of the magnitude of the ex ante uncertainty about the value of companies, for example Beatty (1989), Carter and Manaster (1990) and Ritter (1991).

4.3. Results and Discussion

- **Descriptive Analysis**

Table 1 shows the results of the Hausman test, the means and standard deviations of different variables in the models tested in this part. Indeed, the values of the Hausman test and probabilities for the last

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two models are null (0.0000), thus lead to the regression models through testing fixed effects. But for the first model (p = 0.3458> 10%), the regression will be done through the random effect test.

TABLE 1 - HAUSMAN TEST AND DESCRIPTIVE STATISTICS

		Modèle 3	Modèle 3.1	Modèle 3.2	
Chi2 for Hausman test-fixed x random effects		2.12	57.01	38.42	
(Prob > chi2)		0.3458	0.0000	0.0000	
	COD	**REP**	**LEV**	**Logta**	**Age**
Mean	.0232836	.2562189	3.385189	5.938697	53.01244
(Std. Dev.)	.0211436	.4366528	17.10901	.9294645	50.6531

- **Correlation results**

In table II, we present the correlation results between the variables of our three models. We can notice that there is no significant correlation between the cost of debt and social reporting as well as control variables. Negative but not significant correlation between the reporting and the debt ratio (risk) confirms the idea that when the firm becomes more accountable, transparent and discloses information on its environmental and social activities it incurs less risk.

Table 2 also shows that social reporting is strongly correlated with the size of the company. Cowen et al. (1987) showed that «larger firms tend to attract attention from the public and therefore to be subject to greater public pressure to disseminate information about their social responsibility". Another conclusion assumes that the least socially responsible companies should be the most indebted (Girerd - Potin et al., 2011).

TABLE 2 - RESULTS OF CORRELATION

Variable	COD	REP	LEV	LogTA	Age
Coût de Dettes	1.0000				
RSE (REP)	0.0269	1.0000			
LEV	-0.0056	-0.0301	1.0000		
Taille (Log TA)	0.0370	0.4185**	0.0521	1.0000	
Age	0.0294	0.1700**	-0.0435	0.2229**	1.0000

N=2010, ** Higher than 0.15 at the 1% level correlations

- **Regression Results**

The following table (Table III) presents the regression results of our three models. We applied in this step OLS regression (Ordinary Least Squares regression) on a model in which a dummy for each individual variable is introduced. It shows the regression of social reporting, the debt ratio, size and age

on the cost of debt. It shows that R2 has a low value (around 0.35 for all 3 models), so the social reporting and other control variables do not sufficiently explain the variation in the cost of debt.

The cost of debt is significantly and positively related to the debt ratio in the three models and this result is identical to that found by Girerd - Potin et al. (2011), which is not surprising. For Model 3, the social reporting is positively but not significantly related to the cost of debt, which allow us to reverse our first hypothesis implying that there is a negative impact of social reporting on the cost of debt. This result allows us to assume that there is no actual relationship between this couple, which is comparable to results found by Izzo and Magnanelli (2012).

We can interpret this result by the lack of confidence of donors in this type of relationship because, according to Dejean and Martinez (2009), some companies publish environmental information without actually being engaged in an environmental approach. This conclusion is an evidenced of the communication practices analysis of polluting and non-polluting sectors (Dejean and Martinez, 2009, p. 16).

The results of the second and third models can be explained by the fact of trust built between the donor and the company after many years of collaboration, especially when the latter has a reputation in the financial markets and the information asymmetry is minimized (Fortin and Pittman, 2007). At that time, social responsibility will be a bonus for the company to attract his creditor.

TABLE 3 - RESULTS OF REGRESSION -

		Model 1	Model 2	Model 3
Number of observations		2010	2010	2010
Number of societies		201	201	201
R-square		0.3500	0.3510	0.3629
F from regression		0.71	1.64	7.06
(Prob> F)		(0.1811)	0.1783	(0.0000)
REP	Std. Coef.	.0007472	.0000296	-.0041916
	T-statistic	0.83	0.03	- 3.16**
	p-values	0.404	0.977	0.002
Logta	Std. Coef.	xxxxxxxxx	.0041544	-.0046992
	T-statistic	xxxxxxxxx	1.49	-1.66**
	p-values	xxxxxxxxx	0.137	0.097
LEV	Std. Coef.	.0000239	.0000239	0.00025
	T-statistic	1.72**	1.72**	1.66**
	p-values	0.087	0.085	0.098
Age	Std . Coef.	xxxxxxxxx	xxxxxxxxx	0.011505
	T-statistic	xxxxxxxxx	xxxxxxxxx	5.26**
	p-values	xxxxxxxxx	xxxxxxxxx	0.0000

(***, ** and * represent the signification levels of 1%, 5% and 10%, respectively.)

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For Model 2, the addition of variable 'size' decreases slightly t -statistic (from 0.83 to 0.03), which may confirm our second hypothesis assumes that size affects the negative relationship between social reporting and the cost of debt. The size of the business generally explains the reduction of costs; the debt is no exception (Reeb, Mansi and Allee (2001), Klock, Mansi, and Maxwell, 2004). In addition, the size of the firm is positively related to the extent of social information, especially with regard to energy consumption and environmental issues (Taggesson et al., 2009).

For model 3, the regression results change totally when we add the variable 'age' and the third hypothesis of our work is confirmed. The t -statistic equal to (-3.16) indicates that the addition of this variable emphasizes the negative impact of social reporting on the cost of debt and that more the company is older and socially responsible; more the bank may grant lower debt interest rates.

5. CONCLUSION

Among a long list of benefits, the effect of risk reduction is often cited as a result of successful implementation of effective CSR policy (Izzo and Magnanelli, 2012). Because of this effect, we studied the relationship between the cost of debt for its negative related risk profile and corporate social reporting as a translation of an adaptation of CSR policy of 201 big French companies on a period from 2000 to 2010. To do so, we firstly explored the interesting literature on this subject. After we determined the assumptions that there is a negative relationship between social reporting and the cost of debt and that adding the size and the age as control variables enhances this negative association.

This study showed the absence of a clear link between social reporting and the cost of debt. Contrary to our hypothesis, indicating that the market financial and main donors grant to socially responsible companies an ethical financial premium, the results of our study seems to deny the existence of a particular character role of Socially Responsible in the process of determining the cost of debt. But what is surprising is that when we add the 'age' variable in our model, the result changes completely and the relationship between social reporting and the cost of debt turn out to be significantly negative. Our empirical results have led us to conclude that the age and the size of the company increase the probability of the existence of a negative relationship between social reporting and the cost of debt through their catalytic effect on the reputation of the company.

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