Business Sustainability Performance and Cost of Equity Capital

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Business sustainability has emerged as the theme of the 21st century. We examine whether and how different components of economic sustainability disclosure (ECON) as well as environmental, social, and governance (ESG) dimensions of sustainability performance affect cost of equity, individually and in combination. In addition, we investigate whether and how ESG sustainability moderates the relation between ECON and cost of equity capital. Cost of equity is calculated using a composite value estimated based on earnings forecasts generated by cross-sectional models. Using a sample of more than 3,000 firms during 1990-2009, we find that ECON overall, as well as its different components, are negatively associated with cost of equity. Non-financial ESG sustainability performance is negatively but only marginally related to cost of equity, and only environmental and governance sustainability performance contributes to this relationship. Social sustainability performance is positively associated with cost of equity. We also find that ESG sustainability performance affects the relationship between ECON and cost of equity. This relationship is strengthened (weakened) when governance (social) sustainability performance is strong.

Keywords: sustainability performance, cost of equity, financial sustainability, corporate governance, corporate social responsibility, environmental initiatives.

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