CORPORATE SOCIAL RESPONSIBILTY AND COST OF EQUITY: THE MEDIATING ROLE OF FINANCIAL PERFORMANCE

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CORPORATE SOCIAL RESPONSIBILTY AND COST OF EQUITY: The MEDIATING ROLE OF FINANCIAL PERFORMANCE

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A thesis submitted in partial fulfillment of the requirements for the Degree of Master of Philosophy/Science in Management with specialization in Finance at
the Faculty of Management Sciences
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Islamabad

Supervisor
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بسم الله الرحمن الرحيم

In the name of Allah, the most merciful and beneficent

DEDICATION

I dedicate this thesis to my parents and my supervisor whose support has

enabled me

to complete this research study successfully.

(Acceptance by the Viva Voice Committee)

Title of Thesis: "Corporate Social Responsibility and Cost of Equity: The Mediating Role of Financial Performance."

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ABSTRACT

This research study aims to investigate the relationship between corporate social responsibility and cost of equity with financial performance as mediator. The sample of the study comprises of 100 firms listed on Pakistan Stock Exchange. The period of the study ranges from 2005 to 2014. For obtaining precise results a number of statistical tools like descriptive statistics, correlation analysis and panel econometric procedures have been utilized. Stata 12 have been used as data analysis software. The mediating role of financial performance as measured by Tobin's Q between CSR and cost of equity is examined. It is found from the analysis that the indirect effect is not significant and hence it is concluded that financial performance does not mediate the relationship between CSR and cost of equity. The results of control variables are consistent with the previous studies. Overall the results of the study suggests that the corporate social responsibility is still in its infancy stage in Pakistan and there is a need for civil society, business and government to create mass awareness about corporate social responsibility.

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APPRECIATION AND GRATITUDE

No words of gratitude will ever be sufficient for the Allah Almighty who made me capable of learning, blessed me with the knowledge & intellect and facilitated me with the finest of the mentors all through my academic years.

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Muhammad Ishaq

FORWARDING SHEET

The thesis entitled "Corporate Social Responsibility and Cost of Equity: the Mediating Role of Financial Performance." submitted by Mr. Muhammad Ishaq as partial fulfillment of MS degree in Management Sciences with specialization in Finance, has completed under my guidance and supervision. The changes advised by the external and the internal examiners hava also been incorporated. I am satisfied with the quality of student's research work and allow her to submit this thesis for further process as per IIU rules & regulations.

Date:______________________ Signature:__________________

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Chapter 1

1. Introduction:

1.1. Background of the study:

In the present era Corporate Social Responsibility (hereafter referred as CSR) has become one of the dominant theme in the business and academic world. Many companies nowadays have started issuing CSR reports because of the pressure of the stakeholders. All the stakeholders including customers, investors, creditors, suppliers, government and local community forces the firms to become more socially responsible for the betterment of the society.

CSR has been defined by a number of researchers in a different way. According to McWilliams and Siegel (2001) CSR is basically undertaking of all those activities which are done for the betterment of society and which is not required by the law of the land.

Carroll (1979) introduced a definition of CSR with four Characteristics which are:

- Economic Responsibility, suggests that a firm has earn profit for its shareholders
- Legal Responsibility, suggests that a firm should comply to the law of the land
- Ethical Responsibility, the firm is expected to behave ethically beyond the law
- Discretionary Responsibility, includes firms contribution to society in the form of donations, it was revised by Carroll (2004) as Philanthropy.

Another definition has been given by Lea (2002) and according to him CSR means that a business or organization go beyond their legal obligations for managing the impact that they have on the environment and society. Particularly this include how an organization interact with their employees, customers, suppliers and the extent to which it strives for the protection of the environment. In order to get competitive advantage organizations have now made CSR an important element of their strategic planning. Now Corporations can gain enormous benefits from CSR and this is the reason why different companies have been involved in practicing CSR (Kotler & Lee, 2005).

CSR has witnessed increased popularity in the last decade in the academic literature (e.g. McWilliams & Siegel, 2001; Cajias, Furest, & Bienert, 2014; Lee & Faff, 2009; Orlitzky, James, Schmidt & Rynes, 2003; Dhaliwal, Li, Tsang & Yang, 2011, 2014; M. Kim & Y. Kim, 2014; Waddock & Graves, 1997) as well as in the business community. Corporate managers are facing the challenge to go beyond legal requirements and spend in activities related to CSR. These challenges vary from for example, an environmentally friendly process of production, contribution to society in the form donations, health and safety programs for employees, development of programs for non-animal testing or improvement in the overall safety and quality of the products. Consequently the attention of the firm's changed from only shareholder-orientation (Friedman, 1970) to a stakeholder-orientation (Freeman, 1984). Due to its high importance CSR has changed the perception of the relationship between corporations, the environment it is operating in and its stakeholders like shareholders, customers, suppliers, employees, creditors, NGOs, and the government. The role of investors cannot be ignored in this new emerging trend of the CSR. Investors nowadays incorporates social criteria while making investment decisions. This behavior of the investors had led to rapid growth in Socially Responsible Investing during the last years. Investors engaged in socially responsible investing obtains utility from the socially responsible element of their investment (Bollen, 2007).

In U.S the Socially Responsible Investing's assets had grown 22% from 2010 to 2012 with approximately 20% of the capital market is now represented by Socially Responsible Investing (US SIF, 2012). According to European Social Investment Forum (Euro SIF, 2012) there is an increase of 35% per year in the market share from 2009 to 2012. The largest growth is reported in U.K with Germany and the Netherlands to follow. This growth of socially responsible investing raises certain questions like whether socially responsible investing investors contributes to a highly responsible world: do these investors forces the firms to act in socially responsible manner or it is just a feel good sentiments for them.? It was first questioned by Renneboog, Horst and Zhang (2008) that whether investors demands a lower a rate of return for investment in high CSR firms and high premium for low CSR firms so as to encourage social behavior of the firms. Heinkel, Kraus and Zechner (2001) proposed a model which suggests that high CSR firms are perceived as less risky as compared to low CSR firm, consequently more investors invest in high CSR firms resulting in larger investor's base, low risk and ultimately lower cost of capital. Resultantly a new line of research has started in the existing CSR literature to examine the relation between CSR and cost of capital in U.S (Cajias et al., 2014; Ghoul, Guedhami, Kwok & Mishra, 2011; Scharfman & Fernando, 2008; Goss & Roberts, 2011; Chava, 2010).

The relation between CSR and cost of equity has been studied only by a few researcher in the developing economies (Hajiha & Sarfaraz, 2013; Gana & Dakhlaoui, 2011; Hamid, Asghar, Akash & Sajjad, 2011). In Iran the relation between CSR and Cost of capital has been studied by Hajiha and Sarfaraz (2013), and they concluded a positive relation between the two. In the same vein a study conducted by Gana and Dakhlaoui (2011) examined the relationship between cost of equity and CSR in Tunisia. The study found that there is no significant relation between CSR and cost of equity. Corporate social responsibility is not a value producer rather it is wastage of firm resources that could have been otherwise allocated to other financial or operational activities of the firm. This study has examined the relation between CSR and Cost of Equity with financial performance as mediating variable.

1.2. CSR in Pakistan:

In the developed markets CSR is considered as a benchmark for trusting corporation and a predictor of business survival. In our country, Pakistan it is still a new phenomenon for most of the people and organizations. Corporations are now trying to adopt the internationally accepted standards of the CSR. However they are either misunderstanding the true meaning of CSR or ignoring it. Multinationals are observing CSR to some extent due the fact that they are following the standards of their head offices located in developed countries. However overall situation of the CSR in Pakistan is not up to the mark. Being developing economy, our country is surrounded by a number of social problems like corruption, poverty, pollution, mismanagement and law and order situation. In industrial sector of Pakistan there is violation of labor laws, no proper mechanism for the pollutant produced by the firms which leads to environmental pollution, health, safety issues and excessive working timings. In the situation discussed above CSR may help in reducing such problems and can contribute in the betterment of the society. The accidents of fire breaking on regular basis in factories depicts the lack of concern of the regulatory authorities like Securities and Exchange Commission of Pakistan (SECP). Walt Disney has banned imports from Pakistan due to violation of labor laws and bad governance (Dawn, 3rd April, 2014).

Now Pakistani corporate sector is making their business strategies in line with CSR. The working of several NGO's for CSR awareness have prompted the government and business sector to develop strategies in compliance with international standards of CSR. However there is still a need for civil society and academia to get involved in and make a commanding CSR strategy for the country to be implemented with a strong regulatory authority to enforce the regulations.

Multinationals and some large national corporations have made policies for social and environmental compliances. They are also investing for the betterment of local community in the form of donations, education by making schools and health sector through establishment of hospitals. They are also focusing on cultural events like sports events and charity shows which may also improve reputation of these firms. All these activities are stakeholders oriented and very good social investments. These are the steps that makes difference, but firms can even make greater impacts on sustainability if they choose strategically sound CSR investments.

In Pakistan CSR is often used mistakenly as synonymously for corporate philanthropy. Even some individuals consider it a compliance with law. This situation creates misunderstanding as top management are still not aware of the real meaning of CSR. This shows a dire need of mass awareness which should specifically be targeted on businessmen, management and customers so that they could actually know what CSR is all about.

1.3. CSR in the context of Islam:

In Islam one of the best source of income is fair and ethical business. Islam promotes shared benefit in the business transactions. Islam emphasizes on transparent written contracts and acceptable working condition for employees. It demands fair exchange for human efforts as well as resources. Islam put special emphasis on Huquq-al-Ibad (Individual Rights) and the care for society. It encourages wealth sharing with poor and under privileged. Islam judges the action and decisions of the individual on the basis of individual's intention. Allah is omniscient, and knows all our intentions perfectly. Good actions with good intentions are treated as part of worship. Good intents does not make bad deeds as legitimate. Islam does not allow individuals the liberty of believing and acting whatever they desires at the cost of responsibility and justice.

The notion of responsibility and fairness discussed in the Quran and hadeth provides enough evidence of a concept alike to the current concepts of CSR's that has been a part of Islamic societies for fourteen hundred years. Based on *Shar'iah* principles, the aim of religious values and beliefs of Islam is good life and well-being of society, both of which are the essential part of modern concept of CSR's socio-economic justice and brotherhood.

Islam recognizes moral values as highly important in human life. There are several ethical norms and moral codes that are obvious from the verses of the Holy *Qur'an* and teachings of the Prophet (PBUH). Islam highly emphasis the observance of moral code of conduct in human life. Islam stresses to observe and respect fundamental rights of humanity. The effective moral system of Islam helps to achieving these rights. Thus whatever is done for the good of individual or society is regarded as moral while anything detrimental to society is immoral.

The responsibilities of individuals, corporation and the state are clearly defined in Islam. Several evidences of social responsibility and justice can be found from the verses of *Qur'an* and in *Hadith.* For instance the last sermon of Holy Prophet (PBUH) is about the social responsibility and justice. The Holy Prophet Muhammad (PBUH) says in last sermon:

> *"Verily, you will meet your Lord and He will ask you about your actions. You will neither commit injustice nor will you be wronged. No Muslim is allowed from his brother's property except what he gives away with good heart; so do not wrong each other. The most honourable of you with Allah is that believer who has morality"* (Haykal, 1976).

Islam believes in a relation of brotherhood between employer and employee. According to the Islamic teachings it is the religious as well as moral responsibility of employer to take care of the employees. Islam also stresses the employer to provide employee with fair wages and suitable working conditions. The Prophet Muhammad (PBUH) said regarding employees that their wages should be paid before the sweat dries on their body. As discussed above the Islamic concept of responsibility towards society and justice seems to resemble the prevailing notions of CSR.

1.4. Gap identification:

The past literature on the relationship between CSR and cost of equity suggests that majority of the research work is done in developed countries in general and U.S in particular (Chava, 2010; Ghoul et al., 2011; Dhaliwal et al., 2011, 2014; Cajias et al., 2014; Sharfman & Fernando, 2008; Tanke, 2013). In developing markets this relationship is examined by very few studies (e.g. Wu, Lin & Wu, 2014; Hajiha & Sarfaraz. 2013). In developing economies the concept of CSR is in its infancy stage and most of the firms are not quite aware of the benefits of CSR and thus less attention is paid to it.

As the impact of CSR on firm's cost of equity has not undergone through any research in Pakistan according to our knowledge so this study will bridge this gap by investigating the relation between Corporate Social Responsibility and cost of equity as well as the role of financial performance as mediator in the relationship between corporate social responsibility and cost of equity in detail in the context of Pakistan.

1.5. Theoretical Framework:

According to signaling theory (Ross, 1977) similar information is not available to everyone in the market rather there is information asymmetry. Different information is available to both the managers and investors at the same time. CSR may reduce a firm's cost of equity by reducing information asymmetry. This asymmetry of information may increase the investment risk which in turn may lead to high cost of equity. Empirical study conducted by Dhaliwal et al. (2011) shows that firms with high CSR discloses more information so that a positive image of responsible corporate citizens may be built in the minds of investors and stakeholders. According to Clarkson, Overell and Chapple (2011) companies with high environmental performance as well as companies which have higher tendency for pollution discloses more information related to environment and will thus reduce information asymmetry through this way. Increased corporate transparency will increase liquidity, especially stock depth, will increase (Tannous, Wang & Wilson, 2013) and risk will decrease, thereby reducing the cost of equity (Cheng, Ioannou & Serafeim, 2011). So this clearly indicates that corporate social responsibility enhances financial performance by reducing information asymmetry. This better financial performance results in lower cost of equity because good financial performance catches the attention of the investors resulting in larger investor's base which in turn reduces idiosyncratic risk. This lower risk will translates into lower cost of equity. (Siddiqui, 2008; Hamid et al., 2011).

Empirical literature presents various arguments regarding the fact that CSR reduces cost of equity of a firm. Among the various reasons that CSR reduces cost of equity, first one is that CSR activities reduces a firm's risk. A number of studies have been conducted regarding the relationship between CSR and risk. According to Lee and Faff (2009) firms engaged in high CSR activities tends to have lower firm's specific risks. On the contrary firms which are socially irresponsible may have to bear uncertain explicit claims in the future. For instance if a company sells product that are unsafe and may be hazardous for the environment, this situation can increase litigation risk and thus may increase a company's future cost of capital (Waddock & Graves 1997). According to Boutin and Savaria (2004) Canadian firms that are investing in CSR activities exhibits lower risk as compared to those firms which are socially irresponsible. Since cost of equity is the required rate of return an investor demands on a given investment so given the market perception regarding riskiness of a firm, a high rate of return will be demanded by investors for investing in a higher risk firm. It may be inferred from the above discussion that firms' investing in CSR activities will have low risk and enhanced financial performance.

Second, investors who are socially conscious will not invest in firms with low CSR. The interests of investors including shareholders may be affected by CSR. Firms that invests in CSR activities sends a positive signal to the investors making them believe that they can achieve their desired rate of return by investing in these firms (Cox & Wicks, 2011). According to Heinkel et al. (2001) investors who are environmentally conscious will invest in green firms only, resulting in a situation in which only neutral investors will hold socks of the polluting firms. It will results in lower investors base and high risk for those firms. As a result those firms will have to offer high rate of return to neutral investors so as to compensate them for high risk. Institutional investors also prefer to include firms that invests in CSR activites in their portfolio rather than those operating in alcohol, tobacco and gambling industries (Hong & Kacperczyk, 2009; Peterson & Vredenburg, 2009). Thus firms investing in CSR activities may obtain a wider range of investors. From the above discussion it is clear that deduce that CSR enhances financial performance and reduces cost of equity.

In short the above discussion shows that corporate social responsibility enhances financial performance which in turn leads to lower cost of equity. Thus it can be inferred that financial performance mediates the relationship between corporate social responsibility and cost of equity.

In addition some control variables will be utilized in this study. According to prior research, leverage and size is used as control variables (Cijias et al., 2014; Woodak & Graves 1997; Dhaliwal et al., 2011, 2014; Ghoul et al., 2011).

1.6. Problem Statement:

From the above discussion it is clear that corporate social responsibility is one of the important factor in reducing the firm's cost of equity (Chava, 2011; Ghoul et al, 2011; Dhaliwal, 2011; Cajias et al 2014). According to kashif et al (2011) financial performance mediates the relation between corporate social responsibility and cost of capital. But at the same time Richardson et al (2001) have predicted a positive association between corporate social responsibility and cost of equity of a firm. Thus the problem of this study is *whether the corporate social responsibility reduces the cost of equity or not. Furthermore whether there is a role of financial performance as mediator between corporate social responsibility and cost of equity or not.*

1.7. Research Questions:

- Does CSR affects a firm's cost of equity?
- Does financial performance mediates the relationship between CSR and cost of equity?

1.8. Research Objectives:

- To study the impact of CSR on cost of equity.
- To study that whether financial performance has a mediating effect in the CSR and cost of equity relationship.

1.9. Significance of the study:

This specific study is of high importance as it is the first study according to our knowledge that examines the relationship between CSR and cost of equity with financial performance as mediator in the context of Pakistan. It is important for both the academicians as well as business researchers. This study plays a pivotal role for business managers to analyze the present status of CSR in the country and take accurate decision in the context of Pakistan. Furthermore this study is also important for the researchers to make additional contributions in the literature of CSR in Pakistani context which is not quite developed in developing economies like Pakistan. This study helps firms to understand the relationship between CSR and cost of equity with intervening effect of financial performance in the context of Pakistan. Furthermore this study focuses on the importance of CSR in reducing firm's cost of equity with mediating effect of financial performance.

1.9.1. Practical Contribution of the Study:

The practical contribution of this study is that it would boost the confidence of socially responsible managers in pursuing CSR activities. The activities of CSR not only benefits society but also beneficial in lowering firm's financing costs. In the context of Pakistan firms are not considering CSR as strategic planning tool, it can be used for lowering the cost of promotion. This study would increase general awareness regarding the concept of CSR in Pakistan and would help to improve CSR practices in Pakistan.

The findings of this study would help in highlighting the current position of CSR and the potential challenges to it in Pakistan. The findings would also help businesses, civil society and regulatory authority to make a future CSR agenda in Pakistan.

1.9.2. Theoretical Contribution:

The theoretical contribution of this study will be that it would empirically test the stakeholder theory (Freeman, 1984), signaling theory (Ross 1977) in the context of Pakistan. It will also enrich the existing literature of corporate social responsibility by investigating the effect of CSR on firms cost of equity with mediating effect of financial of performance in Pakistan which is not studied before.

1.10. Structure of thesis:

The study is comprised of 5 chapters. Chapter first contains, background of the study, theoretical framework, and statement of problem, research objectives and questions, and significance of the study. Second chapter of this theses is about related literature that would help in developing the base of the study. The third Chapter of the study covers the methodology of this research theses. Fourth chapter covers the analysis of data and interpretation of results, and the finally fifth chapter contains conclusion of the study.

Chapter 2

2. Literature of the study:

2.1. CSR and Cost of Equity:

All the stakeholders of a company can safeguard their interest against the shortsighted behavior for profit of the firms through CSR. There are several ways in which CSR may reduce the cost of equity of a firm. First CSR activities may reduce a firm's risk. A number of studies have been conducted regarding the relationship between CSR and risk. According to Lee and Faff (2009) firms engaged in high CSR activities tends to have lower firm's specific risks. On the contrary firms which are socially irresponsible may have to bear uncertain explicit claims in the future. For instance if a company sells product that are unsafe and may be hazardous for the environment, this situation can increase litigation risk and thus may increase a company's future cost of capital (Waddock and Graves 1997). According to Boutin and Savaria (2004) Canadian firms that are investing CSR activities exhibits lower risk as compared to those firms which are socially irresponsible. Since cost of equity is the required rate of return an investor demands on a given investment so given the market perception regarding riskiness of a firm, a high rate of return will be demanded by investors for investing in a higher risk firm. It may be inferred from the above discussion that firms' investing in CSR activities will have low risk and enhanced financial performance.

Second, CSR may reduce a firm's cost of equity by reducing information asymmetry. According to efficient market hypothesis the markets are perfect, that is information is complete and timely. But in real world these assumptions does not hold rather information is asymmetric.

This asymmetry of information may increase the investment risk which in turn may lead to high cost of equity. Empirical study conducted by Dhaliwal et al. (2011) shows that firms with high CSR discloses more information so that a positive image of responsible corporate citizens may be built in the minds of investors and stakeholders. According to Clarkson et al. (2011) companies with high environmental performance as well as companies which have higher tendency for pollution discloses more information related to environment and will thus reduce information asymmetry through this way. Increased corporate transparency will increase liquidity, especially stock depth, will increase (Tannous et al., 2013) and risk will decrease, thereby reducing the cost of equity (Cheng et al., 2011).

Thirdly, investors who are socially conscious will not invest in firms with low CSR. The interests of investors including shareholders may be affected by CSR. Firms that invests in CSR activities sends a positive signal to the investors making them believe that they their desired rate of return can be achieved by investing in these firms (Cox & Wicks, 2011). Investors who are environmentally conscious will invest in green firms only resulting in a situation in which only neutral investors will hold socks of the polluting firms. It will results in lower investors base and high risk for those firms. As a result those firms will have to offer high rate of return to neutral investors so as to compensate them for high risk (Heinkel et al 2001). Institutional investors also prefer to include firms that invests in CSR activities in their portfolio rather than those firms that are part of alcohol, tobacco and gambling industries (Hong & Kacperczyk, 2009; Peterson & Vredenburg, 2009). Thus firms investing in CSR activities may attain a broader investors range. So it means that cost of may be reduced by investing in CSR activities.

Protection of environment from toxic waste materials also comes in the domain of CSR. In this regard a study conducted by Sharfman and Fernando (2008) on US firms reveals that firms that invest in activities for the betterment of environment experiences lower cost of equity than those who do not care for the environment. This low cost of equity is result of high number socially conscious investors who invests in the green firms which results in larger investor's base and lower risk through diversification.

Besides that firms with high CSR are perceived to have good reputation, they are also valued by equity market since their stocks are less volatile and much more stable (Di Giulio et al., as cited in Tannous et al., 2013). Socially responsible companies may suffer significantly less negative financial consequences as compared to those who are not socially responsible. Also lower risk and volatility makes it possible to plan better, and future benefits, cost and cash flows can be forecasted with certainty.

The other thing is that socially responsible firms experiences lower operational and financial risks which in turn results in lower risk premium for shareholder, because a socially responsible firm may be able to enhance the trust among different stakeholders of the firm, build social capital and thus can reduce uncertainty regarding it financial performance (Orlitzky & Benjamin, 2001).

The number of empirical studies investigating the relation between CSR and cost of equity are relatively small. General sources of finance for a company could be divided into debit and equity financing. According to Ghoul et al. (2011) firm's cost of equity is the rate of return an investor demands on his ownership in the company as compensation for taking risks that are undiversifiable. A company without socially responsible practices may be subject of higher financial and operational risks that may have an impact on the image of a company and hence investors would become concerned about these risks. Investors expects the companies to manage these risks professionally. Firms with no CSR practices lose investors base and will have to pay higher required rate of return. They also found that firms engaged in nuclear, tobacco and gambling industries needs to pay higher return on investment. They concluded that firms engaged in socially responsible activities enjoys lower risk and high corporate value.

Derwall and Verwijmeren (2007) conducted a study on CSR ratings developed by kinder, Lydenberg, Domini research and analytics (KLD) and documented a negative significant relationship among the three of the four indexes of CSR and cost of equity. Firms that have proven records of governance, product quality and environmental performance enjoys lower cost of equity. Contrary to this a positive relation is predicted between social index (which includes relation with employee, community involvement etc) and cost of equity, that is cost of equity increases with increase in social index.

The relationship between CSR and cost of equity proceeds along two opposing perspective which are risk mitigation and overinvestment perspective (Goss & Roberts, 2011). Risk mitigation perspective assumes that firms with CSR practices are perceived as less risky by the investors and thus lowers the cost of equity. Empirical literature on risk mitigation perspective provides several reasons for the fact that CSR lowers the cost of equity. The first reason is based on the company's investors' base which is larger for the firms with high CSR as compared to those firms which are socially irresponsible. The lager investors base results in lowers risk and ultimately lower cost of equity. The other argument in favor of risk mitigation perspective is that CSR disclosures reduces information asymmetry which in turn reduces firm specific risk and thus resulting in lower cost of equity (Boston, 1997; Hail & Leuiz, 2006). Dhaliwal et al. (2011) empirically studied US firms that have high cost of equity before the initiation of voluntary disclosures on CSR activities and after the initiation of such disclosures those firms have reduced cost of equity in the subsequent years. It means that increased information availability through CSR disclosures reduces information asymmetry which in turn could lessens the firm's riskiness and hence resulting in lower cost of equity. In short risk mitigation assumes that socially responsible firms have lower cost of equity as compared to socially irresponsible firms due to lower risk, larger investors' base and improved information asymmetry.

The overinvestment approach assumes that CSR is not an investment and rather it is wastage of firm's precious resources. It is assumed that CSR give birth to agency problem as mangers overinvest in CSR for their private benefits at the cost of shareholders (Jenson & Meckling 1976). According to stakeholders theory of Freeman (1982) managers should give due consideration to all the stakeholders and not just on shareholders wealth maximization. However this theory does not provide any explanation regarding the tradeoff among different stakeholders which makes it difficult to quantify CSR expenditures (MicWillams, & Siegel 2001). As a consequence the objectives for managers are vague which makes it difficult to monitor their performances. Thus CSR activities increases monitoring costs to monitor mangers so that they could act in the favor of the shareholders which may increase the riskiness of the firm (Renneboog et al., 2008). Thus overinvestment approach assumes that CSR activities increases a firms cost of equity due to high risk caused by the conflict of interest between shareholders and managers.

The literature on the relationship between CSR and financial performance is extensive but there is limited literature available on the relationship between CSR and firms cost of equity. Empirical study conducted by Tanke (2013) with a sample from 31 countries concluded that CSR is positively related to the cost of equity thus supporting the overinvestment perspective which assumes that CSR is the wastage of firm's resources. The author also found that the relation between CSR and cost of equity is weaker in more stakeholder oriented countries. It was also found that there is no significant relationship between the CSR and cost of equity. Similarly Izzo and Magnanelli (2011) studied the relationship between CSR and debt and they concluded that there is positive relationship between the two demonstrating that CSR is value destroyer for the company and it does not reduces the risk profile of the company. Hence CSR negatively affect firm performance.

Gana and Dakhlaoui (2011) examined the relationship between cost of equity and CSR in Tunisia. The study concluded insignificant relation between CSR and cost of equity. CSR is not a value producer rather it is wastage of firm resources that could have been otherwise allocated to other financial or operational activities of the firm. Richardson and Welker (2001) investigated the relation between the cost of equity and social disclosures. A number of Canadian firms were included in the sample of the study. The study found that there is significantly positive relation between social disclosures and cost of equity. It suggests that cost of equity increases with increase in social disclosures. However it can be reduced for the firms which have better financial performance. They also argued that even though cost of equity is not reduced by the social disclosures however the firms may benefit from social disclosures through its effect on other stakeholder of the firms.

According to Li and Foo (2015) there is inverse relationship between social responsibility and cost of equity. It is also revealed that this relationship is more prominent in privately owned firms than government owned firms. In the same vein a study conducted by Hajiha and Sarfaraz (2013) reveals that the relation between CSR and cost of equity is inverse, suggesting that investment in CSR activities would decrease the cost of equity of the firm. However their results regarding the relation between CSR and cost of debt is insignificant which shows that there exist no relation between the two.

2.2. CSR, Financial Performance and Cost of Equity:

To date empirical research had produced inconclusive results regarding the relationship between CSR and firm's financial performance. Literature documents three types of relations between CSR and financial performance which are positive, negative and no relation at all.

According to Freeman's (1984) Stakeholder theory that a firm should give due consideration to various stakeholder associated with firm directly or indirectly. This may lead to improve image and reputation of the corporation which in turn could enhance firm's overall productivity and financial performance (Hillman and Keim, 2001, Donaldson and Preston, 1995). On the contrary Friedman (1970) argue that the only responsibility of a business is to maximize the profit of the shareholders and CSR is not value creator rather it is waste of firm's resources. Other authors hold the same view and argues that investments, or expenditures in CSR activities are not aligned with the main objectives of the corporation and thus these investments are diversion of firm's resources from the main objective of its existence (Ullman, as cited in Goss & Roberts, 2011). Similarly under the framework of agency theory CSR may negatively affect the value creation as to fulfill the demands of vast group of stakeholder may cause additional agency cost.

A study conducted by Margolis and Walsh (2001) regarding the relationship between CSR and financial performance have produced controversial results. The authors have studied a number of research works regarding the relation between the CSR and value creation as to find out which one precedes the other. Among the studies 53% accounted for the impact of CSR on firm's performance while 68% shows that financial performance precedes CSR. It means that better financial performance results in investments in CSR.

2.2. CSR, Financial Performance and Cost of Equity:

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Margolis and Walsh (2003) studied 131 papers and reported inconclusive results. Even though a positive relationship is documented by 53% of the work but the remaining work shows either negative, mixed or no relation at all. The reasons for inconclusive results may be the measurement of the CSR such as Fortune and KLD database. In a meta-analysis carried out by Orlitzky et al. (2003) shows that the measurements of CSR and financial performance changes the relationship between the two. In literature CSR measurement problem is constant one (Waddock and Graves 1997).

By examining empirical literature, it is evident from it that CSR and performance of the firm are related in three directions. Baron et al. (2009) investigated the relationship between CSR and corporate performance using "social pressure" as moderating variable. The inclusion of the moderator in the study makes the relation as neutral. However the authors suggests that when moderating factor is not used in the study the relations becomes significant. This relation is negative for industrial corporations whereas positive for the commerce and service sectors. Majority of the empirical research is carried on samples from US and Europe indicating research carried out in developed markets. In emerging markets studies undertaken regarding CSR and corporate performance are scarce. Recent works includes, Hong Kong (M.Kim & Y.Kim, 2014), Pakistan (Malik and Nadeem, 2014) and Egypt (Whaba & Elsayed, 2014). In Pakistan Malik and Nadeem (2014) concluded that there exist no relationship between CSR and corporate performance. While the rest of two studies concluded with a positive relation between the two.

The literature on the relation between CSR and firm's performance presents threefold results, positive, negative and neutral relations. The analysis of research investigating this relation shows that research on this topic is more concentrated in developed markets than emerging markets such as Pakistan. In a given market there exist two groups, one that include shareholders, managers and creditors who are interested in the financial performance of the firm while the other group is that of the other stakeholders who are more concerned about the social action of the corporation. In developed markets stakeholder's activism is more mature as compared to the non-developed markets. Even investors in those markets take into account CSR activities before investing as is evident from the fact that socially conscious investors invest in green firm only (Heinkel et al., 2001).

According to M. Kim and Y. Kim (2014) CSR in restaurant industry have positive impact on the value of the firm. They have studied the individual effects of CSR strengths and concerns on financial performance and equity risk. The results of their study shows that CSR strengths enhances firm's value and reduces firm's risk. While CSR concerns reduces value and increases risk. Similarly research examining the relation between CSR and value produced mixed results for firms operating in different industries. Firms in hotel and restaurant industry have positive impact of CSR on value whereas firm in casino and airline industry have no significant impact of CSR on value of the firm (Kang, Lee & Hu, 2010).

Mollet and Ziegler (2014) empirically examined the relation between CSR and financial performance of the firm with a sample from US and European market. The results of their study shows that CSR significantly and positively affect the value of the firm in both the regions. It means the investment in CSR activities may enhance value of the firm. Similarly recent investigation by Sing (2014) suggests that CSR negatively affect value of the firm in short run which indicates that investments in CSR is the wastage of firm resources. The author also concluded that CSR has no significant relation with corporate value in the long run. Further it is suggested that CSR affect each industry differently.

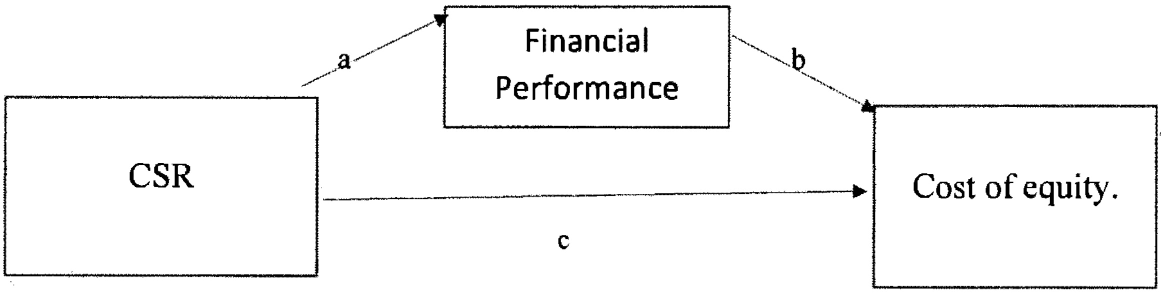
Malik and Nadeem (2014) examined the relation between CSR and firm value of Pakistan's banking sector for period of 2008-2012. Their study reported a neutral relation between CSR and firm value. Since CSR is in its infancy stage in Pakistan and no strict regulatory policy regarding CSR practices exist so companies do take it serious even though the results of CSR practices enhances value of the firm in more stakeholder oriented countries. Kanwal et al., (2013) empirically investigated the relation between CSR and financial performance of 15 KSE listed firms and reported that CSR have positive impact on financial performance. The study used correlation analysis for the examination of the relation.

Shu, Lin and Uya (2015) examined the relation between CSR and firm's performance with social capital as mediating variable in Taiwan. They showed that social capital fully mediates the relation between CSR and firm's performance. CSR enhances the financial performance which in turn increases the investor's base and larger investors' base reduces risk thereby reducing cost of equity. Financial performance mediates the relationship between CSR and cost of equity (Musabih & Alfatani, 2014). Based on the above literature it clear that CSR improves financial performance and better financial performance leads to larger investor's base which in turn reduces risk. This lower risk results in lower cost of equity. So the second hypothesis of the study may be proposed as follows.

H1: Financial performance mediates the relationship between corporate social responsibility and Cost of equity capital.

2.3. Conceptual Framework:

A conceptual framework of the study explains the main concepts or variables of the study either graphically or in narrative form. It basically guides the researcher in the whole process towards the solution of the problem. Below is the conceptual framework of this study.



Chapter 3

3. Research Methodology:

3.1. Research Approach:

As this study is investigating the relation between CSR and cost of equity with mediating effect of financial performance in Pakistan on the basis of existing theories, so this research has utilized deductive approach for carrying out the present study. A deductive approach is used to develop hypothesis on the basis of existing theories, and then designing a research strategy for testing the developed hypothesis (Wilson, 2010).

3.2. Population and Sample:

The population of this study is all the companies listed on a Karachi stock exchange. The variable of interest is the CSR. All those firms are selected randomly for which CSR's data is available. That's why random sampling technique is being used. The sample of the present study comprises of 100 companies which are selected randomly from firms listed on Karachi stock exchange over a period of 2005-2014.

3.3. Type of Data:

The type of data that is used in this research study is secondary data because most of the previous studies used secondary data. The secondary data is collected from different sources such as annual reports of the firms', from website of the state bank, from business recorder website and official websites of the companies. For data analysis Stata 12 have been used.

3.4. Calculation and Measurement of variables:

3.4.1. Dependent variable:

The dependent variable of this study is the cost of equity. In line with previous studies of Rehman and Zaman (2011) and Hajiha and Sarfaraz (2013) the capital asset pricing model is used to determine cost of equity of a firm. The cost of equity can be defined as the fair rate of return an investor demands on his ownership in the company for taking risk (Brealey & Myers, 2008). Fair means the right trade-off between risk profile of the firm (i-e risk investors are exposed to) and the return on investment. So the cost of equity represents the compensation that investors demands for ownership in the company and taking risk that is undiversifiable.

3.4.2. Explanatory variable:

The explanatory variable of the study is CSR. The measurement of the CSR is a constant problem in the literature of CSR (Waddock & Graves, 1997; Cajias et al., 2014). It has been perhaps one of the reason for great variety of measures and lack of uniformity on the measures of CSR (Margolis & Walsh, 2001). Such difficulty in measuring CSR may be due to lack of relevant data as is the case in Pakistan. In developed markets CSR is measured through KLD database which present score of the CSR for each company. In this study a CSR index is developed using three social actions relationship with employee, environment and donations to the society. In this study CSR index refers to the mean of all the social expenses over company's net sales (Crisóstomo, Freire & Vasconcellos, 2013). These three dimensions of the CSR of a company is utilized as proxies in number of pervious works as discussed by Orlitzky et al. (2003) and Margolis and Walsh (2003).

3.4.3. Mediating Variable:

The mediating variable in this study is financial performance. In line with previous studies of M. Kim and Y. Kim (2014), Surroca, Tribo and Waddock (2010), Kang et al. (2010) and Crisostomo et al. (2013) Tobin's Q is used to capture firm performance. Tobin's Q is mainly used because of its ability to capture long term value. It is the ratio of a firm's market value of assets to the replacement costs of assets. For estimation of q, accurate measures of firm's market value and replacement cost are necessary. It is easy to obtain market value of a firm but it is difficult to get the replacement cost until and unless there exist a market for used equipment. Therefore in line with previous studies of M. Kim and Y. Kim (2014) and many others, this study used value of total assets instead of replacement cost. Thus tobin q is estimated as

Tobin's Q = (MVE + D)/ TA

Where MVE is the product of firm's share price and number of shares outstanding; D is the total book value of debts and TA represents book value of total assets.

3.4.4. Control Variables:

Control variables are included in the model so as to moderate the results for a vaster number of factors. The study uses firm size and leverage as control variables which is also used by previous studies (Cajias et al. 2014; Dhaliwal et al. 2011 and Ghoul et al., 2011).

Table: 1 Measurement of variables

Variables (Abbreviations)	Measurement	References
	Dependent Variable	
Cost of Equity (Ke)	Cost of equity is calculated using Capital Assets Pricing Model (CAPM)	Rehman & Zaman 2010
	Independent Variable	
Corporate Social Responsibility (CSR)	CSR index will be measured through relative amounts spent on three social actions relationship with employees, external social action and environmental action. Here CSR index refers to the mean of all social expenses over the company's net sales	Crisostomo et al. 2013;
	Mediating Variable	
Financial Performance (FP)	Tobin'Q= Total Market value + Debt/total assets value	Kang et al (2010), Crisostomo et al. (2013)
	Control variables	
Size of the firm (size)	Size of the firm is calculated by taking the natural log of firm's total assets	Cajias et al, 2014; Dhaliwal et al, 2011;
Financial Leverage (LEV)	Debt Ratio = Total Debt/Total Assets	Cajias et al, 2014; Dhaliwal et al,

3.5. Empirical Models of the study:

To determine that whether financial performance mediates the relation between CSR and cost of equity the study uses a method proposed by Zaho, Lynch and Chen (2010) and Preacher and Hayes (2008) instead of Baron and Kenny (1986) approach.

According to Zaho et al. (2010) it is not necessary to have significant relationship between independent and dependent variable and significant relation between dependent and explanatory can be misleading sometimes. This is just because it represents the combined effect of the sum of the direct and indirect effects which includes mediator as well and mediation can only be established if there is an evidence of indirect effect only. In short for mediation all that matters is that indirect effect is significant (Zaho et al., 2010). Thus the following two models are developed for testing the effect of financial performance as mediator.

$$(FP)\ it = \alpha + \beta_1 CSRit + \beta_2 LEVit + \beta_3 Size + \mu\ it \text{ ------------------ } (2)$$

$$(CoEC)\ it = \alpha + \beta_1 CSR + \beta_2 FPit + \beta_3 LEVit + \beta_4 Size + \mu\ it \text{-------- } (3)$$

Where

- CoEC it = Cost of equity of ith firm in time t
- α = Constant of the equation
- CSR it = Corporate Social Responsibility of the ith firm in time t
- FP it= Financial Performance
- Lev it = capital structure proxy of ith firm in time t
- MtBv *it* = Market to book value of ith firm in time t
- MV it = Market value of ith firm in time t
- Size it = firm size of ith firm in time t
- μ it = Error term of the equation

Chapter 4

4. Results and Discussions of the study:

Since it is discussed in the previous section that the data is combination of time series (ten years) and cross section data (one hundred firms) so it is panel data. The study used different statistical tools like descriptive stat, correlation analysis and panel regression analysis in order to examine the relationship between CSR and cost of equity with financial performance as mediating variable. The results of different statistical tools are discussed in various tables given below.

Table 2: Descriptive Statistics.

Variables	Dimension	Mean	Standard Deviation
Cost of Equity	CAPM	0.2572334	0.2038302
CSR	CSR Index	0.7941521	6.984352
Financial Performance	Tobin's Q	1.412653	1.314519
Size	Natural log of total assets	15.61687	1.602833
Leverage	Total debit /total assets	.5176863	.239888

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The table 1 given above shows the mean and standard deviation values of both the dependent and independent variables. The dependent variable cost of equity has mean and standard deviation value of 0.2572334 and 0.2038302 respectively. The mean and standard deviation values of the main explanatory variable csr are 0.7941521 and 6.984352. The values for financial performance as measured by Tobin's Q are 1.412653 and 1,314519 respectively. The average value of financial performance is greater than 1 which indicates that sample firms chosen from KSE listed firms worth more than their book value. The mean and standard deviation values for leverage are 0.5176863 and 0.239888 respectively which indicates that most of the Pakistani firms are highly levered. The size has mean and standard deviation values of 15.61687 and 1.602833 respectively.

Table 3: Correlation Analysis

	KE	CSR	Tobin's Q	Size	Leverage
KE	1				
CSR	0.0278 0.837	1			
Tobin's Q	-0.0507 0.612	-0.0216 0.0672	1		
Size	-0.0001 0.003	0.0628 0.0471	-0.0286 0.3675	1	
Leverage	0.0814 0.066	0.0134 0.4960	-0.1179 0.0002	0.7565 0.0000	1

N=1000. **,. Correlation is significant at the 0.01 (1%) levels. *. Correlation, is significant at the 0.05 (5%) level.

The above table depicts correlation analysis of the dependent and explanatory variables of the study. CSR is positively correlated with cost of equity which indicates that with increase in CSR activities the value of cost equity may increase and thus supporting the view that CSR is wastage firm's resources (Goss & Roberts, 2011). The financial performance measured through Tobin's Q is negatively correlated with the dependent variable cost of equity. However this correlation is insignificant. The negative correlation suggests that cost of equity may be reduced through enhanced financial performance. Similarly the market to book value and size are significantly negatively correlated with cost of equity whereas market value is positively correlated with the dependent variable of the study. Also the size of the firm is positively correlated with CSR which depicts that larger firms invest more in CSR activities than smaller because larger firms have more stakeholder and more environmental concerns so they invest more in CSR activities in order to legitimize their behavior as well as to avoid future litigation and political costs (Ghoul et al, 2011; Reverte 2012).

4.1. Panel regression analysis:

Before multiple regression analysis the assumptions of Ordinary Least Squares Models (OLS) are tested which are discussed as follows.

4.1.1. Homoscedasticity:

To test heteroscedasticity in the data, Breusch- Pagan test is used. The p value of the said test is 0.403 which suggests that null hypothesis will be rejected that is data is homoscedastic.

4.1.2. Panel Unit Root Test:

To check the stationarity of the data, this study uses Levin, Lin and Chu (2002) test of panel unit root tests. The null hypothesis for the said test is that panel contain unit root. The result of the test shows a p value of less than 0.05 for the all the variables used in the study. Since p value is significant for all the variables so the null hypothesis is rejected and it is concluded that the data is stationary.

Table 4 Panel Unit Root Test

	Statistic	p-value
Cost of Equity (Ke)		
Unadjusted t	-48.0373	
Adjusted t*	-30.0771	0.0000
Corporate Social Responsibility (CSR)		
Unadjusted t	-5.4e+03	
Adjusted t*	-5.3e+03	0.000
Firm size (size)		
Unadjusted t	-54.6717	
Adjusted t*	-47.9342	0.000
Leverage (LR)		
Unadjusted t	-23.9981	
Adjusted t*	-14.2776	0.0000
Tobin's Q (Tq)		
Unadjusted t	-20.5583	
Adjusted t*	-8.1522	0.0000

4.1.3. Multicollinearity:

To test multicollinearity in the data Variance of Inflation Factor (VIF) is used. The value of VIF is 2.01 which is less than critical value of 10. Thus it is inferred that there is no multicollinearity in the data.

Table 5 Multicollinearity

Variable	VIF	1/VIF
CSR	1.01	0.9922
Leverage	1.24	0.8090
Size	3.27	0.3058
Tobin's Q	1.63	0.6134
Mean VIF	2.01	

To study the impact of explanatory variables on the dependent variable panel data regression has been used. Since the data of this research have both the features of cross sectional as well as time series data so panel regression is used to analyze the impact of independent variables on dependent variable. To decide between pooled regression and alternatives of panel data (i-e fixed effect and random effect) the Durbin Watson test is used. Gugrati (2004) in his book suggests that Durbin Watson test figure should be used for the decision of best model, in order to analyze the data. High value of Durbin Watson is the indication of better model. The Durbin-Watson test value calculated for fixed effect is 2.41 as compared to the value of common effect which is 1.42. Thus it is appropriate to use fixed effect model because Durbin-Watson value of fixed effect model is larger than common effect model. Hausman (1978) specification test has been used to select the appropriate model between fixed and random effect. If the value of p is significant then fixed effect model is best for the analysis otherwise random effect model should be used. The p value for Hausman test is 0.4728 which indicates that it is insignificant. Thus random effect model is used to analyze the impact of independent variable on dependent variable.

The table 6 given below shows the results of panel regression however only the results produced by random effect model given in table 7 will be discussed because it is the fit model for the given data.

Table 6 Panel Regression

Independent Variables	**Coefficients**		
	Common Effect Model	**Fixed Effect Model**	**Random Effect Model**
CSR	0.004741 0.832	0.000833 0.517	0.000225 0.537
Tobin's q	0.00356 0.189	-0.008774 0.113	-0.008074 0.082
Leverage	0.067056 0.069	0.027545 0.083	0.066309 0.0501
Size	-0.111641 0.000	-0.063757 0.003	-0.025662 0.000
Adjusted R Square	0.0496	0.0721	0.1613
Durbin-Watson test	1.42	2.39	2.41
F Statistics	8.34	34.22	48.76
P value (F)	0.00000	0.00000	0.00000
Hausman Test	0.4728		

Table 7: Random Effect model estimation

Explanatory Variables	Coefficients	
	Model 1 (Mediator =Tobin's Q)	**Model 2** (Dependent Variable = Ke)
CSR	-0.009532 0.081	0.000225 0.837
Tobin's Q		-0.008074 0.186
Leverage	0.542380 0.072	0.066309 0.066
Size	-0.419811 0.002	-0.025662 0.003
Adjusted R Square	0.222	0.1691
F Value	45.14	84.36
Prob (F-Statistics)	0.000	0.000

According to the results reported in table 7, there is a negative and weak significant relationship between CSR and the proposed mediator financial performance in model 1. When Tobin's q, CSR and control variables are included in model 2. It is found that there is no significant relation between CSR and cost of equity which represents that the direct effect is insignificant. Similarly tobin's q have negative insignificant relation with dependent variable of the study. Thus the indirect effect which is (a x b) in figure 1 is 0.000077. According to Zaho et al. (2010) and Preacher and Hayes (2008), Baron and Kenny method for testing mediation should be replaced with bootstrap test of indirect effect. Thus the bootstrap test (with 5,000 bootstrap samples) is employed to test the mediation effect of financial performance between CSR and cost of equity. The results show that the indirect effect is insignificant with a bias corrected 95 % confidence intervals including zero (-0.016, 0.085) thus there exist no mediation and hypothesis of the study is rejected. The results are consistent with the previous studies (Cajias et al., 2014; Tanke, 2013; Gana & Dakhloui, 2011; Sing, 2014). One of the main reason of the insignificant results is that of the measurement of the CSR as no unified method exists in developing countries for measuring CSR. Another possible reason is that CSR is not that much mature in country like Pakistan as compared to U.S and Europe where CSR is a much more mature concept. Perhaps that's why corporations in Pakistan especially local corporations do not pay much attention to the phenomenon of CSR. Also the positive the relation even though insignificant, supports the overinvestment view which argues that CSR is wastage of firm's resources and that it gives birth to agency problem because managers may overinvest in CSR for their private benefits at the expense of shareholders (Goss & Roberts, 2011; Renneboog et al., 2008). Among the control variables size is significantly negatively related with dependent variable cost of equity. Whereas leverage is weakly significantly related with the dependent variable. The results of the control variables are in line with the previous studies (Cajias et al., 2014; Whaba & Elsayed, 2015; Dhaliwal et al., 2011).

Table. 8 Direct, Indirect and Total effect.

	Coefficients	**P value**
	Direct effect	
CoEC <-		
Tq	-.0096713	0.069
CSR	.0009287	0.386
MV	.0011582	0.731
MBV	-.0008712	0.451
Size	0	
Lev	.0770796	0.004
	Indirect effect	
	Coefficients	**P value**
CoEC <-		
Tq	-.0876567	0.387
CSR	.0000777	0.323
MV	.0054712	0.070
MBV	.0003014	0.086
Size	-.0056286	0.070
Lev	.0053998	0.104
	Total effect	
	Coefficients	**P value**
CoEC <-		
Tq	-.0096713	0.069
CSR	.0008517	0.354
MV	.0066294	0.078
MBV	.0003014	0.616
Size	-.0056286	0.070
Lev	.0824794	0.003

Table 8 illustrates the direct, indirect and total effect In this analysis variables of interest are CSR and financial performance which is measured by Tobin's q. it is clear from the above table that total effect for CSR is 0.0008517 which is the effect we would have if there was no mediator in our model. The p value is insignificant in this case. As far as the direct effect is concerned it is 0.0009287 for CSR and is insignificant. The indirect effect (a x b) of CSR that passes through financial performance is 0.0000777 which is also statistically insignificant indicating that there exist no mediation at all.

Chapter 5

5. Conclusion:

This research study investigated the relation between CSR and cost of equity with financial performance as mediating variable in the context of Pakistan. For obtaining precise results a number of statistical tools like descriptive statistics, correlation analysis and panel econometric procedures have been utilized. The sample of this study consist of 100 KSE firm's for a period of 2005 to 2014. The study examined mediating role of financial performance as measured by Tobin's Q between CSR and cost of equity. It is found from the analysis that the indirect effect is not significant and hence it is concluded that financial performance does not mediate the relationship between CSR and cost of equity. Our findings complement the study of Hamid et al. (2011) who predicted a similar relation. The results obtained are in line with previous works of Cajias et al. (2014), Tanke (2013), Gana and Dakhloui, (2011) and Sing (2014). One among the possible reasons of the insignificant results is that of the measurement of the CSR as no unified method exists in developing countries for measuring CSR. Another possible reason is that CSR is not that much mature in country like Pakistan as compared to U.S and Europe where CSR is a much more mature concept. Perhaps that's why corporations in Pakistan especially local corporations do not pay much attention to the phenomenon of CSR. Also the positive the relation even though insignificant, supports the overinvestment view which argues that CSR is wastage of firm's resources and that it gives birth to agency problem because managers may overinvest in CSR for their private benefits at the expense of shareholders (Goss & Roberts,2011; Renneboog et al., 2008). The results of control variables are consistent with the previous studies (Cajias et al., 2014; Whaba & Elsayed, 2015; Dhaliwal et al., 2011).

5.1. Limitations of the Study:

The results of this study are subject to certain limitations.

i. The sample of this research study is only limited to 100 non-financial firm listed on KSE.

ii. The study only considers the time period from 2005 to 2014.

iii. Only those companies are considered for this study whose financial reports are available and accessible because availability of the data is one of the main issues in the context of Pakistan.

iv. The results of the study is limited to Pakistan.

5.2. Future Research:

The possibilities of future research is as follows

i. Different index can be made for CSR measurement to study the above relationship.

ii. Future research can take a larger sample size to study the relation between CSR and cost of equity.

iii. Future studies may include other relevant mediating variables to study the studied relation.

iv. Future research may include moderating variables to study the above relationship.

v. Future studies may conduct comparative analysis of South Asian Economies.

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