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STAKEHOLDER RESPONSE AND POLITICAL ACCESS

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CORPORATE PHILANTHROPY AND CORPORATE FINANCIAL PERFORMANCE: THE ROLES OF STAKEHOLDER RESPONSE AND POLITICAL ACCESS

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Corporate philanthropy is expected to positively affect firm financial performance because it helps firms gain sociopolitical legitimacy, which enables them to elicit positive stakeholder responses and to gain political access. The positive philanthropy-performance relationship is stronger for firms with greater public visibility and for those with better past performance, as philanthropy by these firms gains more positive stakeholder responses. Firms that are not government-owned or politically well connected were shown to benefit more from philanthropy, as gaining political resources is more critical for such firms. Empirical analyses using data on Chinese firms listed on stock exchanges from 2001 to 2006 support these arguments.

Research on the relationship between corporate philanthropy and firm profitability has largely been inconclusive. Some scholars have argued that corporate philanthropy positively affects corporate financial performance because decisions regarding charitable contributions can be made strategically to raise a company's image and reputation, as well as to increase the value of its "moral capital" (Brammer & Millington, 2005; Godfrey, 2005; Porter & Kramer, 2002; Saiia, Carroll, & Buchholtz, 2003). Philanthropy may promote products and enhance brand image, thus serving the role of cause-related marketing (File & Prince, 1998). In addition, it can mitigate the risks of reputational losses and secure critical resources from stakeholders, hence providing insurance-like protection (Fombrun, Gardberg, & Barnett, 2000; Godfrey, 2005; Williams & Barrett, 2000). On the other hand, other scholars have argued that corporate philanthropy has a negative net impact on corporate financial performance because it may represent a pure corporate expenditure that diverts valuable resources to areas unrelated to operations (Friedman, 1970). Moreover, many firms lack the expertise for efficient

investment in social causes, and top managers may use philanthropy to boost their personal reputations and to advance their careers (Galaskiewicz, 1997; Haley, 1991). Thus, rather than diverting corporate resources to philanthropic activities, firms should make better use of those resources to improve their operational efficiency (Friedman, 1970).

Empirical research examining the relationship between corporate philanthropy and corporate financial performance has also generated mixed results. Some scholars have examined corporate philanthropy as a component of the larger domain of corporate social responsibility. For instance, in an analysis of seven large chemical companies, Griffin and Mahon (1997) discovered that several dimensions of corporate social performance are significantly related to financial performance, but they did not find a significant relationship for corporate philanthropy. Similarly, Berman, Wicks, Kotha, and Jones (1999) found that corporate involvement in community relations, which includes philanthropic activities, has little influence on corporate financial performance. In contrast, a meta-analysis by Orlitzky, Schmidt, and Rynes (2003) suggested that corporate philanthropy is positively correlated with corporate financial performance; moreover, this relationship is stronger than that between other measures of corporate social performance and financial results. A similar pattern of mixed results has also been found in studies purely on corporate philanthropy. For example, Wokutch and Spencer (1987) found hints of a positive correlation between

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corporate philanthropy and financial performance, although they warned that the relationship might be moderated by firms' involvement in illegal activities. On the other hand, applying structural equation modeling with a sample of *Fortune* 1,000 firms, Seifert, Morris, and Bartkus (2004) did not find a significant relationship between corporate philanthropy and financial performance.

More recent empirical studies have explored the possibility of nonlinear relationships between corporate philanthropy and financial performance (Brammer & Millington, 2008; Wang, Choi, & Li, 2008), but the results have again been mixed. For instance, using a sample of 537 firms listed on the London Stock Exchange from 1990 to 1999, Brammer and Millington (2008) found that firms with both unusually high and low charitable contributions had better financial performance than those making an intermediate level of contributions. Firms making unusually low contributions did best in the short term, but those making unusually large contributions did best in the long term. On the other hand, using a panel data set of 817 U.S. firms stock-exchange-listed from 1987 to 1999, Wang, Choi, and Li (2008) found an inverse U-shaped relationship between corporate philanthropy and financial performance.

The continuing conceptual controversy and empirical inconclusiveness have resulted in a fragmented literature in this area, hindering research and further progress. One way to reconcile this inconclusiveness is to recognize that firms do not benefit equally from making charitable contributions and that the relationship between corporate philanthropy and corporate financial performance is contingent on some critical social and political factors. Instead of simply listing some contingency factors ad hoc, we set out to identify those factors systematically by uncovering the underlying mechanisms through which corporate philanthropy may have a positive impact on corporate financial performance. In particular, we argue that corporate philanthropy helps firms gain sociopolitical legitimacy, which further enables them to elicit positive stakeholder responses and to gain political access. Accordingly, two mechanisms are critical in determining the potential benefit that a firm can obtain from charitable contributions: stakeholder responses and political access. Firms may reap either one or both of these benefits from their philanthropic activities. Philanthropy can help firms gain social legitimacy or approval from the public, including their key stakeholders, which helps them obtain cooperation and support from stakeholders including employees, suppliers, customers, and residents of a colocated community. Firms might

also gain political legitimacy or approval from government officials through corporate philanthropy, which enables them to get access to political resources often critical to their development.

Although it is difficult to directly model and measure social and political legitimacies, it is possible to identify some contingent factors that are thought to affect the extent to which firms may benefit from gaining these legitimacies. Building on previous research on firm visibility and stakeholder expectations (Dooley & Lerner, 1994; Pollock & Gulati, 2007; Pollock, Rindova, & Maggitti, 2008; Rindova, Williamson, Petkova, & Sever, 2005; Suchman, 1995), we argue that stakeholders should respond more positively to corporate philanthropy carried out by firms with higher visibility (those with higher levels of advertising intensity and operating in more developed markets), and by firms with higher stakeholder expectations (those with good past financial performance), since gaining social legitimacy is more important for such firms. In addition, in the economies of many nations, including developed ones, their national governments play a critical role in influencing the extent to which firms gain resources and enjoy policy benefits. Moreover, government ownership of firms is not rare, even in many developed economies (Faccio & Lang, 2002; La Porta, Lopez-de-Silanes, & Shleifer, 1999). Applying resource dependence theory (Pfeffer & Salancik, 1978), we argue that some firms are more dependent on their nation's government for critical resources than others (e.g., Hillman, 2005; Meznar & Nigh, 1995; Peng & Luo, 2000). Along these lines, firms with higher government dependence should be in greater need of gaining political legitimacy and thus are more likely to benefit from corporate philanthropy.

These ideas were tested in the context of a transition economy—China. Previous work in the field has mostly examined Western contexts such as the United States and the United Kingdom. Although the conceptual arguments explored in this study are quite general, a transition economy provides a useful sociopolitical context in which to extend these arguments and test them in a profound and fine-grained manner. The diversity in China's markets and institutional environments lets us observe large variations in some of the specific factors potentially relevant to the relationship between corporate philanthropy and financial performance. Moreover, Chinese firms remain highly dependent on their national government despite the country's ongoing transition from a centrally controlled to a market-based economy.

CORPORATE PHILANTHROPY AND CORPORATE FINANCIAL PERFORMANCE

Eliciting Positive Stakeholder Responses and Gaining Political Resources through Corporate Philanthropy

Corporate philanthropy involves gifts or monetary contributions given by corporations to social and charitable causes, such as those associated with education, culture, the arts, minorities, health care, and disaster relief (Godfrey, 2005; Seifert et al., 2004; Wang, Choi, & Li, 2008). According to the traditional view of firms, they exist solely to serve the interests of their shareholders, which they do by maximizing economic efficiency (Bremmer, 1987; Friedman, 1970). However, the growing influence of firms in many aspects of social and political life in recent years has led to an increasing interest in not only the economic but also the social consequences of their actions (Paine, 2002; Rosen, Simon, Vincent, MacLeod, Fox, & Thea, 2003). Consequently, a growing number of stakeholders, including those who have direct relationships with firms, such as employees, customers, suppliers, and even some shareholders, have come to perceive corporate philanthropy as an appropriate and legitimate corporate activity (Margolis & Walsh, 2003; Sharfman, 1994). In some societies, governments are in favor of corporate charitable work because it helps reduce governmental burdens. When governments either have limited resources of their own or are constrained from directly distributing resources to certain community areas, the contributions of enterprises are considered legitimate and are immediately appreciated (Dickson, 2003).

Thus, corporate philanthropy helps a firm achieve sociopolitical legitimacy, which is obtained when the general public, including key stakeholders or government officials, accept a firm as appropriate and right in terms of existing norms and laws (Aldrich & Fiol, 1994: 648). We have to note that gaining acceptance from stakeholders and government officials should not, by itself, have a direct bearing on the financial consequences of charitable activities. But the allocation and use of certain resources necessary for the continued survival and financial success of a firm are often not fully controlled by the firm alone, but rather by some key stakeholders as well as some government bodies (Pfeffer & Salancik, 1978). To the extent that corporate philanthropy helps address the concerns of a firm's key stakeholders and those of government (Frooman, 1999), we propose that philanthropy can have an important influence on the firm's financial performance.

This view largely agrees with some recent developments in the stakeholder theory and corporate social responsibility literatures suggesting that a firm may take an instrumental or strategic approach to its stakeholders to manage their impacts on its overall objectives (Berman et al., 1999; Godfrey, 2005; Jones, 1995; Porter & Kramer, 2002). Viewed from this perspective, corporate philanthropy can be regarded as a means by which firms can build better relations with their primary stakeholders (Saiia et al., 2003) and thus elicit positive responses, such as increased participation and support (Berman et al., 1999; Haley, 1991). For instance, when a firm's employees perceive it as virtuous or having moral worth, they should be more willing to identify strongly with the firm (Dutton, Dukerich, & Harquail, 1994). Stronger identification can promote cooperation and prosocial behavior (Kramer, 1991; O'Reilly & Chatman, 1986; Organ, 1988). Corporate philanthropy can promote such perceptions. Moreover, companies that make substantial contributions are likely to promote a socially responsible public image, which could extend to other aspects of business practice, such as high standards of product quality and customer care (Adams & Hardwick, 1998: 642). This should, in turn, help a firm gain customer support.

In addition, charitable activities may help firms gain political legitimacy, which allows them to obtain valuable political resources that can be critical to their long-term survival and financial success (Hillman, 2005). Contributions to social causes send signals to government bodies that corporate managers are sincere in dealing with their stakeholders. This may mitigate the need for government to impose costly regulations, such as labor and consumer protection (Adams & Hardwick, 1998: 642), thus helping firms gain favorable policies and other support from their government. For instance, in its campaign to fight malaria in African countries, Exxon Mobil has not only benefited from an enhanced reputation, but has also built a strong relationship with local governments. This relationship building has helped the firm acquire resources from those governments, thereby advancing its strategic goals (Porter & Kramer, 2002: 11). Then, political leverage generated through corporate philanthropy may lead to a future government policy decisions favorable to a firm (Neiheisel, 1994; Sánchez, 2000). Corporate philanthropy is especially appreciated when governments do not have enough resources to engage in community and social welfare projects, and business contributions help alleviate their burdens (Dickson, 2003). Studies have demonstrated that corporate philanthropy can help ease access to credit, which governments often in-

fluence or even tightly control (Neiheisel, 1994). In summary,

Hypothesis 1. Corporate philanthropy is positively related to a firm's financial performance.

Corporate Philanthropy in China

Traditionally, the Chinese are deeply influenced by the Buddhist, Daoist, and Confucian philosophies. Buddhists believe that compassion is a principal virtue in life. People should be kind-hearted and benevolent. Similarly, Daoism emphasizes that a person should be aware of the needs of others. What may be the most important force shaping China's social values is the widely held set of Confucian beliefs, which define family relations, social order, and trust. In Confucianism, a person who spreads bounty or who rescues people is considered a sage.¹ One of the most famous Confucian sayings is, "A nation or a family does not worry that it has little but that that little is unevenly apportioned, does not worry that it is poor but that it is unstable" (Watson, 2007: 115).

Despite their significant departure from traditional Chinese values, the more recent communist ideologies share a similar view that there should be no disparity in the distribution of wealth in society. Communism is based on common property and the equal distribution of wealth; it aspires to an egalitarian and classless society based on common ownership and control. One of its goals is to extinguish private ownership. In China, the Communist Party once viewed wealth as the outcome of the exploitation of the poor, and thus undesirable, and such negative attitudes toward the rich still persist among many Chinese. Although the rapid development of the Chinese economy has resulted in positive changes in the public's perceptions of the wealthy, Chinese people are still deeply influenced by traditional values and communist ideologies (Hofstede, 2001; Leung, 2008). Therefore, they praise compassionate behaviors, and the Chinese stakeholders of firms are more likely to embrace those that contribute generously. The reactions of Chinese stakeholders to corporate contributions after the earthquake in Sichuan on May 12, 2008, exemplify this. Vanke, one of the largest and most profitable Chinese real estate firms, donated only CNY2 million for earthquake relief. The public strongly criticized this relatively small donation. The chairman of Vanke subsequently defended the company's behavior by stating, "Two million is

sufficient." This statement further induced a reputational crisis for the company, resulting in a 12 percent decrease in its stock price in just five days (May 15–20). In contrast, the JDB group, a much smaller company in terms of both total revenue and profitability, made a donation of CNY100 million, the largest donation by any Chinese company. Sales of the firm's main product—*Wanglaoji*, an herbal tea—dramatically increased within days. The public even circulated an article posted on the web praising *Wanglaoji*.

In addition to eliciting positive stakeholder responses, corporate philanthropy on the part of Chinese firms lacking strong political connections may have a role in creating goodwill with the national government, thus conferring legitimacy and access to political resources. In the absence of efficient market structures and contractual law hardened by routine compliance and enforcement, Chinese firms may need political allies in the negotiation and enforcement of contracts (Nee, 1992). Moreover, the political uncertainty in China is also a critical consideration; the Communist Party holds power, and reforms have undergone several ups and downs (Peng & Heath, 1996: 503). Political access enables Chinese firms to obtain government support and favorable policies that may help deal with such political uncertainty. For example, the China Youth Development Foundation initiated China's version of Project Hope in 1989, aiming to build Hope schools and help bring poor dropout children back to the classroom. Chinese companies (as well as individuals) have since donated over CNY35 billion to build 13,000 Hope primary schools, helping 2,900,000 poor students and training 35,000 village school teachers. These contributions are appreciated, especially by local governments that do not have the financial means to build new schools, better roads, or other similar projects (Dickson, 2003). Government can reward firms that make such contributions with tax benefits, access to bank loans, easier project approval, and higher recognition and status for the owners (Bai, Lu, & Tao, 2006; Ma & Parish, 2006).

In summary, Chinese stakeholders expect corporate philanthropy because of the influence of traditional values and recent sociopolitical factors. As a result, they are likely to respond to corporate philanthropy by showing greater cooperation and support. Moreover, the Chinese government and local authorities are more willing to cooperate with and recognize firms and managers who are active in charitable activities by providing them with critical resources when their rights are inadequately defined or enforced and when there is political uncertainty (Dickson, 2003; Nee, 1992). Sociopolitical

¹ Generated from the discussion between Confucius and one of his students, Zigong (Watson, 2007: 46).

legitimacy is critical for the success of Chinese firms, so Hypothesis 1 should hold for Chinese firms *a fortiori*.

THE RELATIONSHIP BETWEEN CORPORATE PHILANTHROPY AND CORPORATE FINANCIAL PERFORMANCE: SOME CONTINGENCIES

Although corporate philanthropy helps firms gain stakeholder and government support and is thus positively related to firm financial performance, the relationship between corporate philanthropy and financial performance is expected to vary significantly with the different characteristics of firms and their operational environments. We consider several potential factors that may help determine this variance, namely, firm visibility and stakeholder expectation, which are considered to affect stakeholder response to corporate philanthropy, and government ownership and political connections, which determine the firms' need for political resources.

Positive Stakeholder Responses and the Benefits of Corporate Philanthropy

Influences on stakeholder response to corporate philanthropy include firm visibility and stakeholder expectations. We capture firm visibility through two firm and environmental features: advertising intensity and degree of market development. Stakeholder expectations, on the other hand, are thought to be influenced by a firm's past financial performance.

Firm visibility: Advertising intensity and market development. Firm visibility serves as a prerequisite for stakeholder response to firm actions. Some recent research has shown that a firm's visibility (or prominence) is generally associated with positive responses from its stakeholders, including favorable evaluations from investors and the media (Pollock et al., 2008), customers' willingness to pay a price premium (Rindova et al., 2005), and an increased attractiveness to potential alliance partners (Pollock & Gulati, 2007). On the other hand, since visible firms draw greater attention from their stakeholders, visibility may exacerbate the tendency for firms to take excess risks to meet heightened stakeholder expectations. For instance, Mishina, Dykes, Block, and Pollock (2010) found evidence that firm prominence positively moderated the effect of performance above expectations on a firm's likelihood of engaging in illegal activities.

In the case of corporate philanthropy, stakeholders have to know about a firm and have information

about its charitable activities to make a meaningful response (McWilliams & Siegel, 2001). Thus, visibility should increase the benefit that a firm may obtain from corporate philanthropy. However, external stakeholders such as suppliers and customers may be only dimly or not at all aware of the extent of a firm's charitable activities, since they would not normally be direct beneficiaries (Wang, Choi, & Li, 2008). In the case of low visibility and stakeholder awareness, a firm will not benefit as much from engaging in philanthropy.

The intensity of a firm's advertising can be an important indicator of its visibility. Clearly, intensive advertising and marketing attract more attention from external stakeholders, especially from existing and prospective customers and potential employees (Brammer & Millington, 2005). Therefore, a firm advertising heavily is more likely to be known to various stakeholders, and as a result its charitable contributions are more likely to be recognized (Adams & Hardwick, 1998). It then follows that firms that do more advertising are likely to benefit more from their corporate philanthropy. These arguments should equally apply to Chinese firms, which have increasingly considered advertising as an investment with strategic implications (Luo, 2009).

Hypothesis 2a. The positive relationship between corporate philanthropy and a firm's financial performance increases with its advertising intensity.

Aside from advertising, a firm's visibility or stakeholder awareness also depends on the level of development of the market in which it operates. In general, firms located in relatively developed markets are more transparent and thus have higher visibility among the public and stakeholders. The public obtains information about a firm either directly from it or through other channels, such as the media or the stock market (Fombrun & Shanley, 1990). More developed markets not only provide firms with greater transactional efficiency, but also provide more advanced technology, media exposure, and capital markets, facilitating the flow of information from the firms to their stakeholders. Thus it is more likely that stakeholders of firms located in more developed markets will know about the firms' charitable contributions more promptly and accurately. Subsequently, these stakeholders will be in a better position to react to the charitable behavior by providing greater cooperation and support, tending to improve firm performance. In contrast, the philanthropic efforts of firms competing in less developed markets will be

less noticed because information about them is not efficiently communicated.

Although variations in the level of market development are often found among countries, in some economies such variations can be observed among regions. China is one such economy. Although China has made great progress in recent decades, the levels of market development in its different regions are far from equal (Fan & Wang, 2006). The coastal and eastern regions are relatively well developed, but the central and western regions remain largely underdeveloped. As a result, there are big differences among China's regions in prevailing wages, information flow, technology, and infrastructure (Qian, 2001). This logic leads to the following:

Hypothesis 2b. The positive relationship between corporate philanthropy and a firm's financial performance increases with the level of development of the market in which the firm operates.

Stakeholder expectations: Past financial performance. Stakeholders are generally interested in corporate philanthropy and willing to respond positively to a firm they know to be active in charitable activities, yet their expectations for and thus responses to corporate philanthropy may be influenced by the extent to which a firm is financially constrained from engaging in such activities.

Firms face both internal and external constraints that may limit managerial discretion over investment decisions (Hambrick & Finkelstein, 1987). The constraints should be greater if the firms are to engage in activities that go beyond those directly related to their business operations. Thus, corporate philanthropy, which is considered a social activity often remote from a firm's core business, is likely to face various constraints. Among the numerous factors, a firm's profitability (past financial performance) is considered to be one of the most important constraints on corporate philanthropy. A better-performing firm has more financial and physical resources that would allow it to engage in philanthropic activities. Consistently with this reasoning, Dooley and Lerner (1994) found that firm performance influences the extent to which CEOs are concerned with the expectations of stakeholders. In the context of the current study, a profitable firm would have more financial and physical resources to devote to activities that go beyond those directly related to its business operations.

Likewise, members of the public expect better-performing firms to contribute more to society. Moreover, they have greater motivation to reward those that do so. On the other hand, when a firm is

performing poorly, stakeholders may understand that its limited resources should be used to improve its business operations instead of being diverted to charity. Following this logic, good performers should benefit more from corporate philanthropy than poor performers, since the former are more likely to receive a positive stakeholder response from their charitable giving.

This logic may be better understood using an idea related to the association between pragmatic legitimacy and moral legitimacy (Suchman, 1995). "Pragmatic legitimacy" refers to the self-interested calculations of an organization's most immediate audiences, and "moral legitimacy," a construct very much in line with the social dimension of sociopolitical legitimacy (Aldrich & Fiol, 1994; Dart, 2004), refers to the public's normative evaluation of an organization and its activities (Suchman, 1995: 578–579). As argued earlier, corporate philanthropy helps a firm gain sociopolitical legitimacy. However, pragmatic legitimacy, which is largely based on stakeholders' utility calculations (Donaldson & Preston, 1995; Jones, 1995; Suchman, 1995), may influence the value of gaining sociopolitical legitimacy. Firms with high profitability are more likely to gain pragmatic legitimacy, typically by directing tangible rewards to stakeholders, such as granting employees better compensation, providing shareholders higher dividends, and delivering better-quality products to customers (Suchman, 1995). If a firm lacks pragmatic legitimacy (i.e., does not satisfy stakeholders' basic financial needs), stakeholders may attach less value to firm behaviors aimed at gaining sociopolitical or moral legitimacy. In other words, the concerns of stakeholders about a firm's contribution to society, and thus their motivations to respond positively, should be stronger when the firm has fulfilled its responsibility of meeting their basic financial needs.

Such differences in stakeholder responses to corporate philanthropy based on past firm performance should exist in both developed and developing economies alike, including China.

Hypothesis 2c. The positive relationship between corporate philanthropy and a firm's financial performance increases with the level of the firm's past financial performance.

Firm-Government Relationship and the Benefits of Corporate Philanthropy

Governments everywhere exert a major influence on firms (Hillman & Hitt, 1999; Keim & Zeithaml, 1986). Through its policies and regulations, a gov-

ernment can determine “the rules of commerce; the structure of markets (through barriers to entry and changes in cost structures due to regulations, subsidies, and taxation); the offerings of goods and services that are permissible; and the sizes of markets based on government subsidies and purchases” (Schuler, Rehbein, & Cramer, 2002: 659). Thus, government policy and its enforcement constitute a major external source of uncertainty and a critical influence on a firm’s operations (Hillman, Zardkoohi, & Bierman, 1999).

According to resource dependence theory, firms can take political action to decrease risk and uncertainty associated with government influence (Hillman, Withers, & Collins, 2009; Pfeffer & Salancik, 1978). This is a compelling rationale for why firms strive to establish good relationships with governments (e.g., Hillman, 2005; Hillman & Hitt, 1999). Firms that have good relations with their government can reduce the uncertainty associated with changes in government policy and regulations and thereby improve their long-run financial performance (Hillman, 2005). Previous research has examined various measures firms may adopt to establish good firm-government relations. These include lobbying, advocacy advertising, organizing political action committees, making financial contributions, forming coalitions, and offering jobs to former government officials (Getz, 1997; Hillman et al., 1999; Hillman & Hitt, 1999; Hillman, Keim, & Schuler, 2004; Lester, Hillman, Zardkoohi, & Cannella, 2008; Shaffer, 1995).

Unlike the above political tactics, which often explicitly target government, corporate philanthropy targets society at large. Thus its connection with government and political resources is indirect and sometimes even unintentional. However, to the extent that corporate philanthropy meets government needs for providing social services, it may substitute for other means of establishing links with a government. Thus, viewed from a resource dependence perspective, corporate philanthropy helps a firm reduce the risks associated with government influence. Consequently, firms more dependent on government for political resources should be more likely to benefit from corporate philanthropy.

We examine two specific factors that may determine a firm’s degree of dependence on the government: government ownership and political connections.

Government ownership. Firms with varying degrees of government ownership or government sponsorship are present around the globe, even in most market-oriented, developed economies (La Porta et al., 1999). For instance, although govern-

ment ownership differs in magnitude and historical legacy across Europe, many European economies, including the United Kingdom, Germany, Ireland, Austria, Italy, have nontrivial government ownership (Faccio & Lang, 2002). Typical sectors with state ownership include telecommunications, power, petroleum, railways, airports, airlines, public transport, health care, postal services, and banks. Many large industrial firms, such as British Steel, Statoil, and Irish Sugar, are also wholly or partially government-owned.

The leaders of firms with government ownership or sponsorship generally do not have to worry about political access as much as the leaders of privately controlled firms do, because the firms already enjoy preferential treatment in terms of inputs and access to product and capital markets (Wang, Wong, & Xia, 2008). For example, Hellman, Jones, and Kaufmann (2003) found that state-owned firms have more secure property, greater contractual rights, and closer ties with government. As a result, they enjoy significant advantages and exhibit faster growth. On the other hand, firms without government ownership have less secure property and contractual rights and thus are in greater need of assuring political access by establishing good government relations through other means, such as corporate philanthropy. Therefore, non-government-owned firms have a greater need to gain political access through charitable activities and are thus likely to benefit more from corporate philanthropy.

In China, non-government-owned, or privately controlled, firms have proliferated since the 1980s. But uncertainty about their legal status remains. Private ownership was declared legal in 1988, but owners remain worried about possible policy reversals that could devalue their ownership. Moreover, access to critical factors and capital resources such as debt financing is least favorable for privately controlled firms (Nee, 1992). To overcome these disadvantages, privately controlled firms may have incentives to engage in charitable activities as a means of creating goodwill with potential regulators and government officials (Neiheisel, 1994). A relevant survey showed that over 99 percent of all public officials and 80 percent of all private Chinese entrepreneurs believe that the social and political status of entrepreneurs and their firms clearly improves when they contribute to local causes (Dickson, 2003).

The above argument suggests that at the same level of corporate philanthropy, the political returns will be higher for non-government-owned firms than for government-owned ones.

Hypothesis 3a. The positive relationship between corporate philanthropy and financial performance is stronger for privately controlled firms than for government-controlled firms.

Political connections. It has been widely observed that firms with political connections may enjoy “preferential treatment by government-owned enterprises (such as banks or raw material producers), lighter taxation, preferential treatment in competition for government contracts, relaxed regulatory oversight of the company, or stiffer regulatory oversight of its rivals, and many other forms” (Faccio, 2006: 369). Firms cultivate political connections to manage the dependencies that constrain their actions, decreasing risk and uncertainty, and to gain access, information, legitimacy, and/or resources (Hillman, 2005). For instance, access to bank financing is known to be an important channel through which political connections operate (Claessens, Feijen, & Laeven, 2008; Khwaja & Mian, 2005). Analyzing a sample of 450 politically connected firms from 35 countries (including the United States, the United Kingdom, and other developed countries) during 1997–2002, Faccio, Masulis, and McConnell (2006) found that politically connected firms were significantly more likely to be bailed out from economic distress than similar, poorly connected firms.

In China, political connections between firms and the government are quite common. For example, the government may appoint a CEO or directors with political backgrounds for a government-owned company, with the objective of achieving better control of the firm and appropriating rents in the long run (Fan, Wong, & Zhang, 2007). However, such political connections are not limited to government-owned firms; some private firms may also have CEOs and/or directors with strong political backgrounds. For Chinese firms, a good relationship with the government is often instrumental for gaining institutional support (Peng & Luo, 2000; Xin & Pearce, 1996) and critical resources such as bank loans (Bai et al., 2006). Thus, companies without political connections have a strong incentive to cultivate them, in order to gain access to factor and capital resources critical to firm growth (Nee, 1992).

Thus, many of our points regarding the effect of ownership on the relationship between philanthropy and financial performance can also be applied to political connections. Firms that lack political connections may find they need to use philanthropy as a substitute in creating good will with the government (Ma & Parish, 2006; Neiheisel, 1994). Firms that already have access to political resources, in contrast, have little need to do so.

Therefore, the political benefits that firms obtain from corporate philanthropy should depend on their need for political resources (Li & Zhang, 2007; Peng & Luo, 2000).

Hypothesis 3b. The positive relationship between corporate philanthropy and financial performance is stronger for firms without political connections than for those with political connections.

METHODS

Data and Sample

Our sample comprised all Chinese firms listed on either the Shenzhen or Shanghai stock exchange between 2001 and 2006. The combined capitalization of the two exchanges was approximately 46 percent of China's gross domestic product (GDP) in 2006.² We chose 2001 as the initial study year because the quality of reported company information substantially improved in that year and afterward (Fan et al., 2007). Several data sources were used: the China Stock Market and Accounting Research (CSMAR) database, the National Economic Research Institute (NERI), and company annual reports. As one of the largest databases on Chinese listed firms, CSMAR serves as the primary source of information on Chinese stock markets and the financial statements of China's exchange-listed firms. It was designed and developed by GTA Information Technology, one of the major providers of data related to Chinese companies. The NERI provides information on provincial market development.

Company annual reports, our primary source of information about firms' political connections and corporate charitable contributions, were collected from the official web sites of the Shenzhen and Shanghai exchanges and the China Securities Regulatory Commission (CSRC). Some of the reports contained brief biographical sketches of the firms' CEOs, containing their experiences in industry and government (Fan et al., 2007). For those firms without CEO biographical information, we manually searched for their profiles and company codes on the web and coded the information accordingly. The annual reports also listed annual spending on charitable and sponsorship activities. Because of the need to log-transform the amounts, we confined our sample to those reporting nonzero contributions in their annual reports. According to the dis-

² China Securities Regulatory Commission: <http://www.csrc.gov.cn>.

closure regulations for corporate philanthropy in China's Accounting Standard for Business Enterprises, Chinese firms are required to report such contributions. Moreover, apart from the public relations benefits, firms that engaged in philanthropy have strong tax reasons to report their expenses. Hence, the sample was limited to firms that actually engaged in charitable activities.

Simply conducting regression analysis with this sample of firms, however, would not have been appropriate. This is because firms that engaged in philanthropic activities may differ systematically from those that did not. Specifically, it is possible that the factors affecting whether a firm engages in corporate giving may be correlated with our dependent variable—firm financial performance. We therefore used a two-stage Heckman selection model (Heckman, 1979) to correct for any such sample selection bias. In such analyses, parameter estimates from a first-stage probit model based on information that represents all the firms in a population are incorporated into the second stage. This two-stage approach also ensured comparability with some of the previous research in this area (e.g., Brammer & Millington, 2008; Wang, Choi, & Li, 2008). After we had merged the three databases and removed observations with missing key explanatory variables, the final unbalanced sample contained 1,453 firms and 2,765 firm-year observations.³

Measures

Financial performance. Two measures of financial performance were employed: *return on assets (ROA)* and *market-to-book ratio*. ROA, calculated as net income over total assets, is a common accounting-based measure of financial performance. Market-to-book ratio⁴ is calculated as the book value of a firm's equity divided by the year-end market value of its equity (Ashbaugh-Skaife, Collins, Kinney, & LaFond, 2008). Both measures have been commonly used in management research (e.g., Hillman, 2005; Tuschke & Sanders, 2003). There is often a lag between corporate contributions and their impact on financial performance, so the relationship between corporate contributions and fi-

nancial performance was evaluated in terms of ROA and market-to-book ratio following the year in which the charitable contributions were made (a one-year lag).

Corporate philanthropy. *Corporate giving* was assessed as the amount of a firm's charitable contributions during a specific year. The variable was highly skewed, so, following the lead of previous studies (Adams & Hardwick, 1998; Galaskiewicz, 1997), we computed its natural logarithm.

Moderating variables. *Firm advertising intensity* was calculated as the ratio of selling, general, and administrative expenses to sales. It captures a firm's willingness to spend on marketing and selling-related activities in an effort to differentiate itself from competitors (Berman et al., 1999; Hambrick, 1983; McWilliams & Siegel, 2001; Seifert et al., 2004). *Market development* was assessed from indexes developed by the NERI (Fan & Wang, 2006) and computed using data from Chinese statistical yearbooks, reports from the administrations of industry and commerce, and surveys. The NERI indexes capture the progress of institutional development in all 31 Chinese provinces, municipalities, and autonomous regions. Following the lead of previous research (Fan et al., 2007), we used one index—a province's GDP divided by its government's budget—to measure *market development*. This variable was used to reflect the extent to which provincial resources are allocated by markets rather than through the redistribution system of the Chinese government. The development score of the province where a firm operates was used as the level of market development for the firm. For firms operating in multiple provinces, we used the score of its primary location.⁵ *Past financial performance* was measured as ROA and market-to-book ratio lagged by one year.

Government ownership was a dummy variable coded 1 if the ultimate owner of a firm was the Chinese government and its agencies and 0 otherwise (Wang, Wong, & Xia, 2008). Following the methods of previous research on the political connections of China's listed firms (Fan et al., 2007; Li, Meng, Wang, & Zhou, 2008; Li, Meng, & Zhang, 2006), we used a firm's CEO's affiliation with government as an indicator of the firm's *political connections*, which was a dummy variable equal to 1 if the CEO was an official of the central or a local government, or of the military, and 0 otherwise.

³ Note that the final observations used in the regression cover 2001–05 instead of the sample period of 2001–06 because of our use of a lagged regression structure.

⁴ This measure is theoretically and empirically equivalent to Tobin's *Q*. Chung and Pruitt (1994) found that market-to-book ratio explains at least 96 percent of the variance in the more sophisticated Tobin's *Q*.

⁵ This is reasonable because most Chinese firms compete on a local and regional basis owing to the fact that nationwide markets are not yet fully developed (Peng, 2004).

Control variables. Firm size, age, and debt-to-asset ratio were controlled for. *Firm size*, measured as the natural log of total assets, has been shown to be an important variable in studies of the relationship between social and financial performance (Orlitzky, 2001). Larger firms have more resources and may enjoy economies of scale or scope (Roberts & Dowling, 2002). *Firm age* was measured as the number of years since a firm's initial public offering. Firms with different ages may have different cost structures; older firms may have organizational inertia, which is expected to affect firm performance (Barnett & Salomon, 2006). *Debt ratio*, measured as the ratio of long-term debt to total assets, has also been included in previous studies on social-financial performance relationships (see Barnett & Salomon, 2006; Seifert et al., 2004; Waddock & Graves, 1997). Furthermore, to control for possible differences in philanthropic activity among industries (Seifert et al., 2004), we included 12 industry dummies representing 13 different industry categories⁶ identified by the CSRC.

All these control variables were included in the first-stage probit model to predict the likelihood that a firm would make charitable contributions, but all were lagged by one additional year. Firm size, age, and debt ratio may have some effects on the likelihood of a firm's engagement in corporate philanthropy. Larger and older firms have greater visibility, and they attract more scrutiny from the public (Adams & Hardwick, 1998; Saiia et al., 2003; Seifert et al., 2004). A firm's debt ratio reflects the financial constraints its managers face, which in turn affect their discretion in making charitable contributions (Adams & Hardwick, 1998; Brammer & Millington, 2008). Firms with greater need to advertise may be more likely to engage in corporate philanthropy because philanthropy is often considered a form of advertising that improves image and reputation (Seifert et al., 2004). As has been argued earlier, firms with better financial performance may be more likely to make contributions, since they can better afford to do so. Thus, we also included prior financial performance in the first-stage model. Government ownership and CEO political connections were also included in the first-stage model because they may affect the likelihood

of a firm's making charitable contributions (e.g., Ma & Parish, 2006).

In addition, the first-stage equation of the Heckman model included slack resources and industry-average charitable contributions. Previous studies have shown that a firm's slack resources are an important antecedent of its charitable activities (see Buchholtz, Amason, & Rutherford, 1999; Seifert et al., 2004). Following Seifert and colleagues (2004), we measured *slack resources* as the total cash flow from a firm's operations, financing, and investing activities, scaled by its total assets. The behavior of its industry peers has been shown to affect a firm's philanthropic behavior (Galaskiewicz & Burt, 1991). Thus, we included *industry-level giving* in the first-stage model as well. Because industry-level giving is thought to affect charitable behavior but is less likely to have any direct impact on a firm's financial performance, it also served as a valid instrumental variable. Note that although past financial performance is a moderating variable, it was also included in all models as a control in the second stage. Including a lagged dependent variable in the equation is a common approach used in dealing with pooled time series and cross-sectional panel data (e.g., Beck & Katz, 1995; Dittmar & Mahrt-Smith, 2007; Harford, Mansi, & Maxwell, 2008; Wang, Choi, & Li, 2008). In the context of this study, we included it to mitigate concern about reverse causality (i.e., good financial performance leads to greater philanthropy instead of the other way around).⁷

Estimation Method

The first stage of the Heckman process involved estimating the degree to which a firm's level of charitable contributions differed from that predicted by various firm and industry factors. The likelihood of a firm's charitable contributions was estimated by applying a probit model to the entire sample of firms, including firms in both the main sample and the control group. We calculated an adjustment term, the inverse Mills ratio, from the first-stage probit regression. The ratio was then included as a control variable in the main second-

⁶ The categories are agriculture, forestry, livestock rearing and fishing; mining; manufacturing; electric power, gas, and water production and supply; construction; transport and storage; information technology; wholesale and retail trade; finance and insurance; real estate; social service; communication and cultural industries; and a comprehensive residual category.

⁷ To ensure that including a lagged dependent variable did not result in biased estimations owing to the potential existence of serial correlated errors, we ran a Prais-Winsten (1954) regression estimation, which uses the generalized least squares method to estimate the parameters in a linear regression model in which the errors are assumed to follow a first-order autoregressive process. The Prais analysis results were consistent with what we report here, so autocorrelation was not a serious concern.

TABLE 1
Descriptive Statistics and Correlations

Panel A: Heckman First-Stage Variables^a

Variables	Mean	s.d.	1	2	3	4	5	6	7	8	9	10
1. Giving choice dummy	0.47	0.50										
2. Firm age	4.97	3.04	.01									
3. Firm size	21.05	0.91	.14	.05								
4. Slack resources	0.02	0.12	.01	-.20	-.04							
5. Debt ratio	0.06	0.12	.01	.00	.13	-.02						
6. Advertising intensity	0.23	0.40	-.08	.11	-.24	-.10	.07					
7. ROA	0.01	0.11	.06	-.14	.16	.15	-.05	-.32				
8. Market-to-book ratio	3.45	5.29	-.05	.02	-.22	.02	-.06	.07	-.03			
9. Government ownership	0.76	0.42	.04	-.04	.18	-.03	.04	-.12	.12	-.03		
10. CEO political connections	0.22	0.41	.05	-.03	.06	.00	.03	-.02	.05	-.02	.00	
11. Industry level of giving	12.26	0.51	.04	-.14	.14	.02	.03	-.04	.11	-.04	.12	.08

^a The dependent variable is measured for year t ; the independent variable, for $t - 1$. Correlations $\geq |0.03|$ are significant at $p \leq .05$; $n = 5,932$.

Panel B: Heckman Second-Stage Variables^b

Variables	Mean	s.d.	1	2	3	4	5	6	7	8	9	10	11	12
1. ROA	0.01	0.09												
2. Market-to-book ratio	2.86	4.48	.02											
3. Past financial performance (ROA)	0.02	0.08	.44	-.04										
4. Past financial performance (market-to-book ratio)	3.17	4.69	-.07	.57	-.03									
5. Firm age	5.98	3.13	-.07	.03	-.12	.00								
6. Firm size	21.28	0.90	.15	-.15	.22	-.21	.09							
7. Debt ratio	0.06	0.08	.04	-.04	.00	-.06	-.04	.24						
8. Inverse Mills ratio	0.82	0.16	-.07	.08	-.09	.19	-.08	-.63	-.11					
9. Advertising intensity	0.21	0.32	-.30	.03	-.60	.08	.02	-.20	-.04	.17				
10. Market development	7.83	2.55	.07	-.06	.08	-.09	.05	.15	-.07	-.04	-.08			
11. Government ownership	0.76	0.42	.13	-.04	.06	-.06	.02	.15	.06	-.18	-.08	-.02		
12. CEO political connections	0.25	0.43	.02	.05	.02	.03	-.01	.04	.06	-.21	-.02	-.02	.02	
13. Corporate giving	11.36	2.00	.16	-.06	.16	-.10	-.02	.38	.08	-.25	-.06	.04	.03	.03

^b The dependent variable is measured for year $t + 1$; the independent variable, for t . Correlations $\geq |0.04|$ are significant at $p \leq .05$; $n = 2,765$.

stage equation (see Heckman, 1979), which examined the relationship between corporate philanthropy and financial performance using the sample of firms that had made charitable contributions.

Specifically, the following equation was used to test the hypotheses in the second stage:

$$\pi_{t+1} = \beta_0 + \beta_1\pi_t + \beta_2\text{giving}_t + \beta_3\text{moderators}_t + \beta_4\text{giving}_t \times \text{moderators}_t + \beta_5\text{IMR}_t + \beta_6X_t + \varepsilon_t$$

where π_{t+1} and π_t are corporate financial performance and its lagged value, respectively. X is a set of control variables expected to influence corporate financial performance. *Giving* is a continuous variable that reflects the level of corporate charitable giving for each firm-year observation. *Moderators* represent the several contingent factors mentioned in the hypotheses, including advertising intensity, market development, past financial performance,

government ownership, and political connections. "IMR" is the inverse Mills ratio based on the first-stage model. The ε is an error term.

RESULTS

Descriptive statistics and the correlation matrix are presented in Table 1. Panel A of Table 1 includes the variables used in the first-stage probit model of the two-stage Heckman analysis. The mean (0.47) and standard deviation (0.50) of the dummy variable *giving choice* are comparable to those of in previous study with a U.S. sample (Wang, Choi, & Li, 2008). As expected, firm size, government ownership, and CEO's political connections were significantly correlated to the likelihood of charitable giving. The descriptive statistics and correlation matrix for the key variables used in

TABLE 2
Probit Estimates for Heckman First-Stage Model:
Giving Choice Regressed on Firm and Industry Predictors^a

Variables	Model 1	Model 2	Model 3
Intercept	-3.73*** (0.42)	-3.62*** (0.42)	-4.92*** (0.63)
Firm age	0.01 (0.01)	0.01 (0.01)	0.01 (0.01)
Firm size	0.17*** (0.02)	0.17*** (0.02)	0.18*** (0.02)
Slack resources	0.04 (0.14)	0.05 (0.14)	0.04 (0.15)
Debt ratio	-0.10 (0.18)	-0.11 (0.18)	-0.04 (0.18)
Advertising intensity	-0.10*** (0.03)	-0.10*** (0.03)	-0.09** (0.03)
ROA	0.39* (0.17)	0.36* (0.17)	0.45** (0.17)
Market-to-book ratio	-0.01 (0.00)	-0.01 (0.00)	0.00 (0.00)
Government ownership		0.02 (0.02)	0.01 (0.02)
CEO political connections		0.05** (0.02)	0.04** (0.02)
Industry level of giving			0.09** (0.04)
Industry dummies	Included	Included	Included
Log-likelihood	-4,026.6	-4,022.2	-3,970.6
$\Delta\chi^2$		8.7*	102***

^a Standard errors are in parentheses. "Giving choice" was measured for year t ; firm and industry predictors, for year $t - 1$; $n = 5,932$.

* $p \leq .05$

** $p \leq .01$

*** $p \leq .001$

the second stage of the Heckman analysis are presented in panel B of Table 1. The correlations between the level of charitable giving and subsequent financial performance were positive for ROA (0.16) but not for market-to-book ratio (-0.06). Significant correlations were found among some variables, such as ROA, advertising intensity, and firm size; hence, we further investigated whether there was a potential multicollinearity problem by computing variance inflation factors (VIFs). The maximum VIF obtained in any of the models was 7.81 (firm size), and the mean VIF was around 2.40, substantially below the rule-of-thumb cutoff of 10.00 for regression models (Ryan, 1997). Therefore, multicollinearity was not an important issue in our results.

First-Stage Giving Choice Estimates

Table 2 presents the results of the first-stage Heckman selection model, which was a probit regression of the choice of charitable giving against the factors thought to predict whether a firm will engage in charitable giving. The dependent variable was the dummy variable *giving choice*, indicating whether a firm engaged in corporate giving. Model 1, the baseline model, included an intercept term and the measures of firm-level variables. Model 2 added industry-level giving and industry dummy variables as additional factors expected to affect corporate giving behavior. As anticipated, larger firms were found to be more likely to engage in charitable giving. The coefficients on firm age and slack resources had positive but insignificant signs.

Prior financial performance measured as ROA showed a positive impact on corporate philanthropy, but the market-based performance measure did not yield a significant effect. As expected, CEO political connections and industry-level giving were positively associated with the choice of corporate giving. Contrary to expectations (Seifert et al., 2004), however, advertising intensity had a negative and significant impact on the probability of giving. Possibly direct advertising and corporate philanthropy are considered substitutive means of attracting positive public responses. Moreover, Chinese listed firms are still in the early stages of development and facing stringent financial constraints. Thus, as advertising expenses increase, Chinese firms may defer corporate giving.

Second-Stage Financial Performance Estimates

Table 3 presents the results of Heckman's second-stage estimation using the inverse Mills ratio from the first-stage probit model in Table 2, accounting for selection bias. Panels A and B correspond to the models using the two different measures of financial performance: ROA and market-to-book ratio. Hierarchical multiple regression analysis was used to test for the hypothesized positive relationship between corporate contributions and financial performance and to test for the interaction effects.

Models A1 and B1 report the effects of the basic firm-level control variables: past (lagged) financial performance, firm age, firm size, and debt ratio.

TABLE 3
Estimates for Heckman Second-Stage Models

Panel A: Regression of ROA on Firm and Industry Predictors ^a										
Variables	A1	A2	A3	A4	A5	A6	A7	A8	A9	A10
Intercept	0.20 [†]	(0.12)	0.08	(0.13)	0.14	(0.13)	0.14	(0.13)	0.16	(0.13)
Past financial performance (ROA)	0.04***	(0.00)	0.04***	(0.00)	0.04***	(0.00)	0.04***	(0.00)	0.04***	(0.00)
Firm age	-0.01**	(0.00)	-0.01**	(0.00)	-0.01*	(0.00)	-0.01*	(0.00)	-0.01*	(0.00)
Firm size	-0.01	(0.00)	0.00	(0.01)	-0.01	(0.01)	-0.01	(0.01)	-0.01	(0.01)
Debt ratio	0.03	(0.02)	0.03	(0.02)	0.02	(0.02)	0.02	(0.02)	0.02	(0.02)
Inverse Mills ratio	-0.08*	(0.03)	-0.03	(0.04)	-0.03	(0.04)	-0.03	(0.04)	-0.03	(0.04)
Advertising intensity			-0.01*	(0.01)	-0.01*	(0.01)	-0.01*	(0.01)	-0.01*	(0.01)
Market development			0.01*	(0.00)	0.01*	(0.00)	0.01*	(0.00)	0.01*	(0.00)
Government ownership			0.01***	(0.00)	0.01***	(0.00)	0.01***	(0.00)	0.01***	(0.00)
CEO political connections			0.00	(0.00)	0.00	(0.00)	0.00	(0.00)	0.00	(0.00)
Corporate giving			0.01***	(0.00)	0.01***	(0.00)	0.01***	(0.00)	0.01***	(0.00)
Giving × advertising intensity										
Giving × market development										
Giving × past financial performance (ROA)										
Giving × government ownership										
Giving × CEO political connections										
F	36.44***	32.55***	32.36***	31.57***	30.05***	30.12***	29.29***	28.33***		
R ²	0.22	0.23	0.24	0.24	0.24	0.24	0.24	0.24		
ΔR ²		0.01***	0.01***	0.00**	0.00	0.01***	0.00*	0.00		

^a Standard errors are in parentheses. ROA was measured for year $t + 1$; firm and industry predictors, for year t ; $n = 2,765$. All models included industry and year dummies, which are not reported.

[†] $p \leq .10$

* $p \leq .05$

** $p \leq .01$

*** $p \leq .001$

TABLE 3
Continued
Panel B: Market-to-Book Ratio Regressed on Firm and Industry Predictors^b

Variables	A1	A2	A3	A4	A5	A6	A7	A8
Intercept	19.53*** (5.26)	15.64* (6.64)	15.91* (6.31)	16.26** (6.30)	16.34** (6.29)	17.05** (6.28)	16.36*** (6.27)	16.40*** (6.28)
Past financial performance (market-to-book ratio)	3.28*** (0.10)	3.25*** (0.10)	3.25*** (0.10)	3.27*** (0.10)	3.27*** (0.10)	3.50*** (0.11)	3.49*** (0.11)	3.49*** (0.11)
Firm age	0.00 (0.03)	0.01 (0.03)	0.01 (0.03)	0.01 (0.03)	0.01 (0.03)	0.01 (0.03)	0.01 (0.03)	0.01 (0.03)
Firm size	-0.62*** (0.19)	-0.49* (0.22)	-0.50* (0.23)	-0.51* (0.23)	-0.52* (0.23)	-0.54* (0.22)	-0.51* (0.22)	-0.51* (0.22)
Debt ratio	1.04 (0.91)	0.93 (0.93)	0.93 (0.93)	0.83 (0.92)	0.86 (0.92)	0.99 (0.92)	1.02 (0.92)	1.02 (0.92)
Inverse Mills ratio	-3.72** (1.45)	-2.48 (1.83)	-2.43 (1.83)	-2.51 (1.83)	-2.45 (1.83)	-2.82 (1.82)	-2.66 (1.82)	-2.68 (1.82)
Advertising intensity		-0.13 (0.15)	-0.14 (0.15)	0.02 (0.16)	0.01 (0.16)	0.07 (0.16)	0.08 (0.16)	0.08 (0.16)
Market development		-0.01 (0.07)	-0.01 (0.07)	-0.02 (0.07)	0.00 (0.07)	0.02 (0.07)	0.02 (0.07)	0.02 (0.07)
Government ownership		0.01 (0.08)	0.01 (0.08)	0.01 (0.08)	0.01 (0.08)	0.01 (0.08)	-0.01 (0.08)	0.00 (0.08)
CEO political connections		0.07 (0.08)	0.07 (0.08)	0.06 (0.08)	0.07 (0.08)	0.05 (0.08)	0.05 (0.08)	0.05 (0.08)
Corporate giving			0.04 (0.08)	0.05 (0.08)	0.07 (0.08)	0.11 (0.08)	0.10 (0.08)	0.10 (0.08)
Giving × advertising intensity				0.36*** (0.10)	0.40*** (0.10)	0.34*** (0.10)	0.32*** (0.10)	0.32*** (0.11)
Giving × market development					0.20** (0.07)	0.20*** (0.07)	0.19** (0.07)	0.19** (0.07)
Giving × past financial performance (market-to-book ratio)						0.38*** (0.10)	0.37*** (0.10)	0.37*** (0.10)
Giving × government ownership							-0.21** (0.07)	-0.21** (0.07)
Giving × CEO political connections								-0.03 (0.07)

^b Standard errors are in parentheses. Market-to-book ratio was measured for year $t + 1$; the predictors, for year t . All models included industry and year dummies, which are not reported.

* $p \leq .10$
 * $p \leq .05$
 ** $p \leq .01$
 *** $p \leq .001$

Models A2 and B2 have the proposed moderators added, namely, advertising intensity, market development, government ownership, and CEO political connections. Past financial performance showed a significant, positive relationship with financial performance. Firm age was negatively associated with ROA but not with market-to-book ratio. Although firm size was negatively associated with market-to-book ratio, market development and government ownership were positively associated with ROA.

In models A3 and B3, the level of corporate giving was added to the regression equation. In the subsequent models A4–A8 and B4–B8, we sequentially added the interaction terms between corporate giving and the key moderating variables (advertising intensity, market development, past financial performance, government ownership, and CEO political connections). Models A8 and B8 are the full models including all the interactions. We reported the results based on these two full models.

In keeping with our prediction, corporate giving had a positive and significant relationship with financial performance measured as ROA ($p < .001$). It was not, however, significantly related to market-to-book ratio. These results partially support Hypothesis 1.

Hypotheses 2a and 2b predict that advertising intensity and the level of market development positively moderate the relationship between corporate giving and financial performance. As shown in models A8 and B8, the interaction term between corporate giving and advertising intensity was positive and significant for both ROA and market-to-book ratio, strongly supporting Hypothesis 2a. However, the interaction term between corporate giving and market development was significant for market-to-book ratio but not for ROA, so was also partially supported.

Hypothesis 2c predicts that past financial performance positively moderates the relationship between corporate giving and financial performance. The coefficient on the interaction term in models A8 and B8 was significant for both measures of firm financial performance (both at $p < .001$). Therefore, Hypothesis 2c was supported.

Hypotheses 3a and 3b predict that the positive relationship between corporate giving and financial performance is stronger for privately controlled firms and for firms without political connections. The negative and significant coefficients of the interaction term between corporate giving and government ownership for both measures of financial performance were consistent with our prediction (ROA, at $p < .05$; market-to-book ratio, at $p < .01$). Thus, Hypothesis 3a was supported. The coeffi-

cients for the interaction term between CEO political connections and corporate giving, however, were not significant for either measure of financial performance. Hence, we did not find any support for Hypothesis 3b.

To interpret these results better, we used Aiken and West's (1991) approach to plot the significant interaction effects (Figures 1A–4B). The figures show that at high levels of advertising intensity, market development, and past financial performance, the relationship between corporate giving and firm performance is more positive. In contrast, at low levels of these variables the relationship tends to become negative or less positive. Also, the relationship is more positive for firms that are privately controlled.

These effects are both statistically and practically significant. For example, for firms with high visibility as indicated by advertising intensity, as corporate giving increases by one standard deviation, ROA increases by 1.2 percent, and market-to-book ratio increases by 15 percent (see models A8 and B8 and the corresponding Figure 1A and 1B). In contrast, for firms with low levels of advertising intensity, the same increase in giving is associated with slight decreases in ROA (by 0.03%) and sharp decreases in market-to-book ratio (by 18.5%). In Figure 2, for firms operating in more developed regions, as giving increases by one standard deviation, market-to-book ratio increases by 18 percent; in contrast, the figure shows a decrease in the ratio of 21 percent for firms in less developed regions. Similarly, significant patterns of change can also be found for models with other moderators, including past financial performance and government ownership, as shown in Figures 3A, 3B, 4A, and 4B.

DISCUSSION

We have argued that corporate philanthropy enhances a firm's financial performance by eliciting positive responses from its key stakeholders, such as employees, customers, and investors, and by gaining political resources from government. Moreover, we have suggested that this positive relationship between corporate philanthropy and financial performance should be contingent on the extent to which stakeholders positively respond to philanthropic giving and on whether the firm is in need of political access. Our analyses generally supported these predictions using either accounting or market-based financial performance measures. We found a positive relationship between corporate philanthropy and financial performance as measured by ROA (though not for performance mea-

FIGURE 1A
Interaction Effect between Corporate Giving and Advertising Intensity on ROA

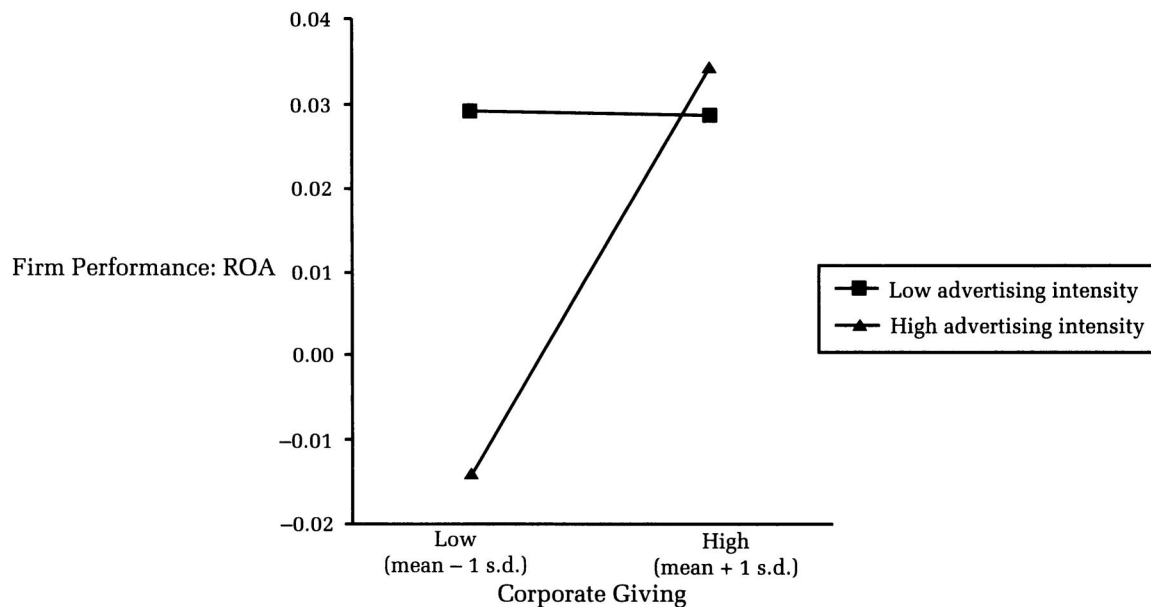
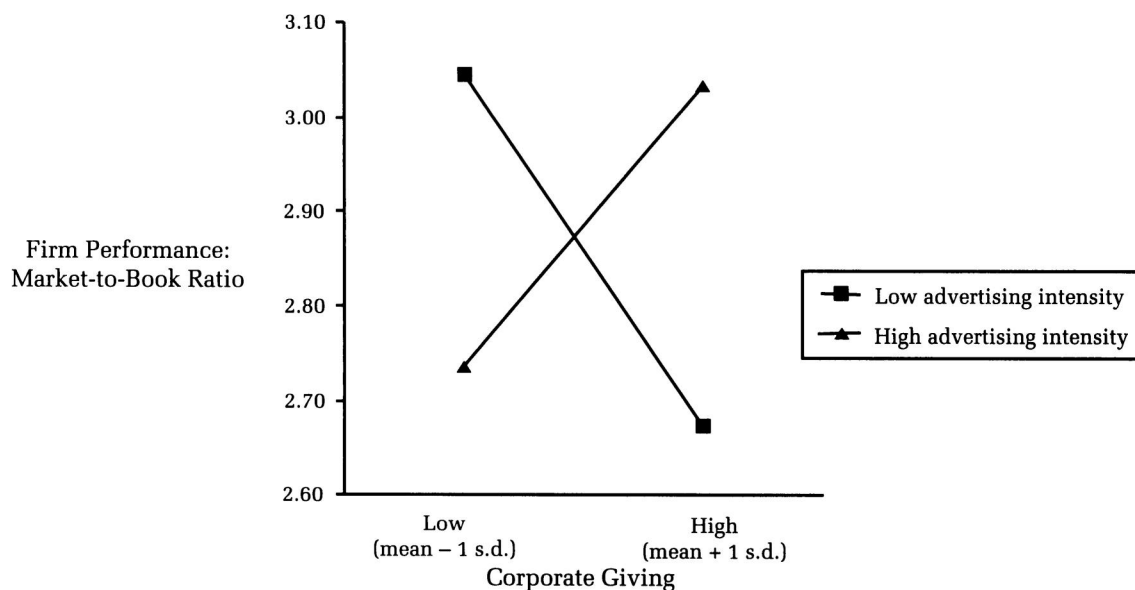


FIGURE 1B
Interaction Effect between Corporate Giving and Advertising Intensity on Market-to-Book Ratio



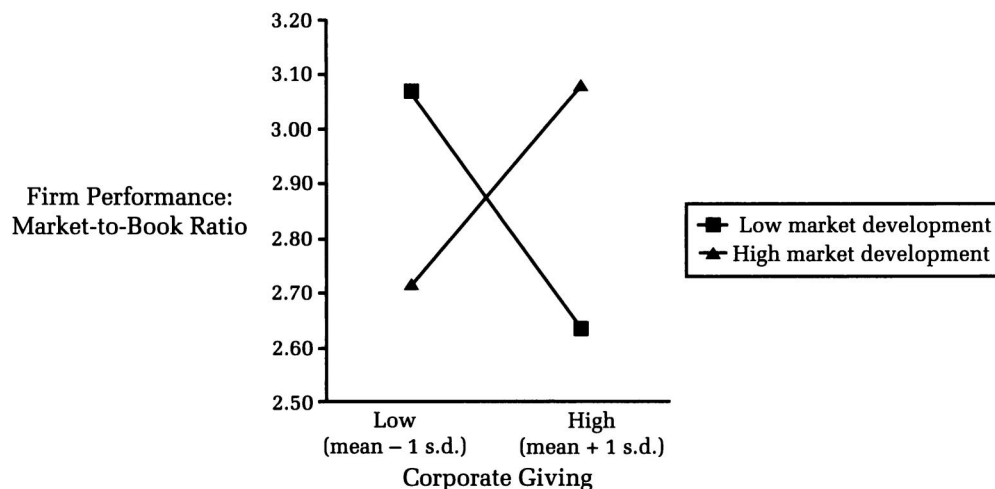
sured as market-to-book ratio). Further, the relationship was generally stronger for highly visible and profitable firms and for firms in need of political resources.

This study makes a number of contributions to the literature on corporate philanthropy. First, building on the general idea that corporate philanthropy helps firms gain sociopolitical legitimacy, we have identified two mechanisms—eliciting positive stakeholder responses and gaining political access—that underlie the relationship between phi-

lanthropy and performance. These findings help build a stronger theoretical foundation for a link between corporate philanthropy and financial performance.

We have also further elucidated the contingent factors influencing the relationship between corporate philanthropy and financial performance. Our findings that firm visibility, stakeholder expectations, and firm dependence on political resources have significant moderating effects on the relationship suggest that a firm's own characteristics and

FIGURE 2
Interaction Effect between Corporate Giving and Market Development on Market-to-Book Ratio



its social-political environment play an important role in determining the extent to which it can benefit from corporate philanthropy. Previous research has only occasionally hinted at but never explicitly examined the testable hypotheses that we have proposed. There have been calls for an examination of the conditions delimiting the social responsibility–financial performance relationship (Barnett, 2007; Hull & Rothenberg, 2008), and this study is a response providing a better understanding of the underlying mechanisms through which corporate philanthropy is related to a firm's financial performance.

According to the meta-analysis of 167 studies of corporate social and financial performance by Margolis, Elfenbein, and Walsh (2007), no previous study has investigated the relationship between corporate philanthropy and financial performance in a transition economy. Transition economies such as China are different from developed markets in which institutional conditions are well established, so they offer a promising new context for examining the generalizability of findings developed in Western contexts (Wright, Filatotchev, Hoskisson, & Peng, 2005). The results developed here demonstrate that without understanding a society's broad values and political system, one may fail to understand philanthropy and its implications for corporate financial performance in a complex social system.

These results have practical implications as well. There have been debates about whether firms should engage in philanthropic activities (e.g., Griffin & Mahon, 1997; Orlitzky et al., 2003; Saiia et al., 2003). We contend that charitable giving is not only consistent with Chinese traditional values (thus

eliciting positive responses from various stakeholders), but can also help Chinese firms gain legitimacy and political support from their government. This view suggests that it is generally helpful for Chinese managers to commit firm resources to corporate philanthropy. However, we have further demonstrated that Chinese firms do not all equally benefit from philanthropy. Stakeholders will respond more positively when they are aware of such activities, so firms with more visibility, such as those advertising heavily and/or operating in more developed regions, have the most to gain. Managers whose firms are already active in corporate philanthropy should find ways to attract the attention of stakeholders and to make them aware of the firms' contributions. In addition, seeing that the relationship between corporate philanthropy and financial performance strengthens with past performance, managers of successful firms should be more active in philanthropic activities. In contrast, firms performing poorly have less to gain from engaging in charitable giving. They might instead place greater emphasis on improving operational efficiency. Managers of privately owned firms should be particularly active in corporate philanthropic activities because they are in greater need of political support and resources from the government.

The interpretation of the current findings should be considered in light of the limitations associated with this study. First, we focused on only one dimension of corporate social activity: corporate philanthropy and its links with financial performance. Future research might profitably examine other dimensions of social responsibility, such as those associated with the environment, products, and community activities. In addition, a systematic ex-

FIGURE 3A
Interaction Effect between Corporate Giving and Firm Past Financial Performance on ROA

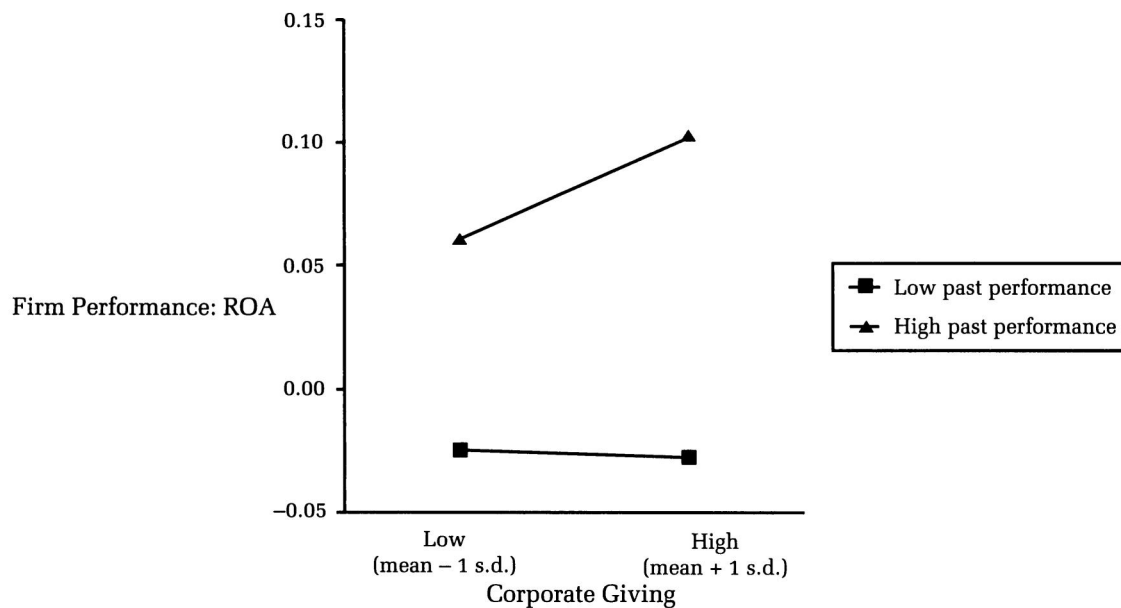
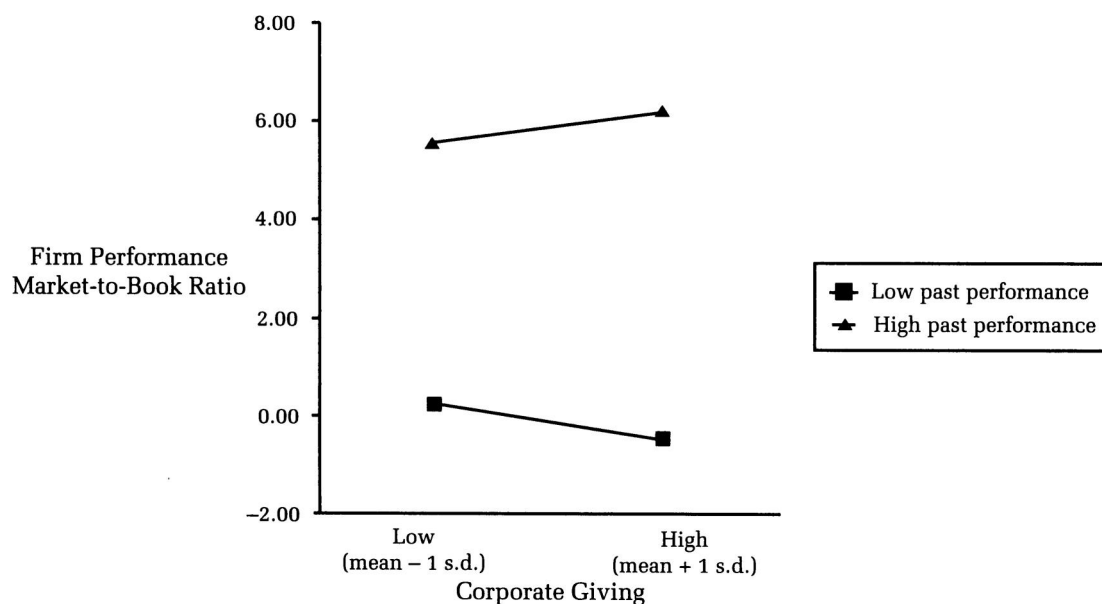


FIGURE 3B
Interaction Effect between Corporate Giving and Firm Past Financial Performance on Market-to-Book Ratio



amination of corporate social responsibility in transition economies in general could be promising. Of course, unlike in the United States, where there are secondhand databases that evaluate corporate social performance, the collection of data on corporate social behaviors is generally more challenging in China and in other transition economies. But as data on other dimensions of corporate social performance in transitional contexts become gradually

available, it would be very interesting to understand whether those activities have the same impact on corporate financial performance as corporate philanthropy does.

Second, although we have argued that corporate philanthropy influences financial performance by eliciting positive stakeholder responses and/or by affording political access, data limitations prevented our directly measuring some of the factors

FIGURE 4A
Interaction Effect between Corporate Giving and Ownership Type on ROA

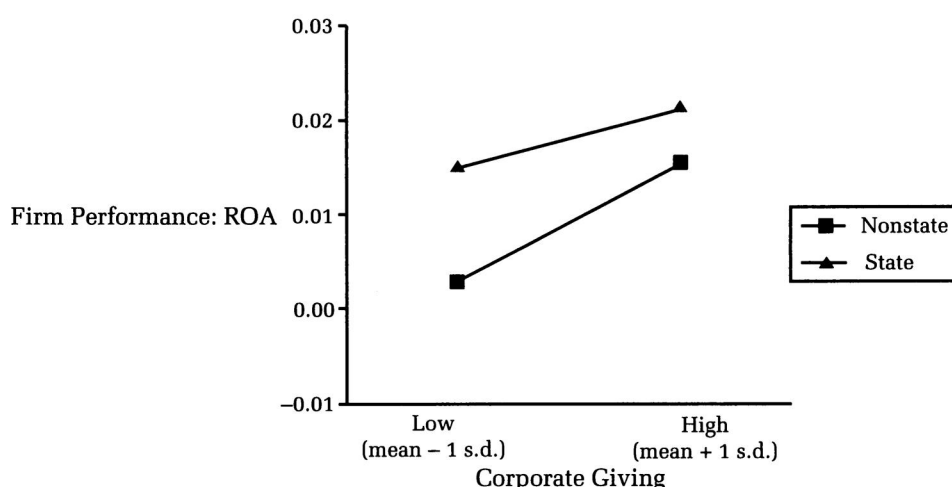
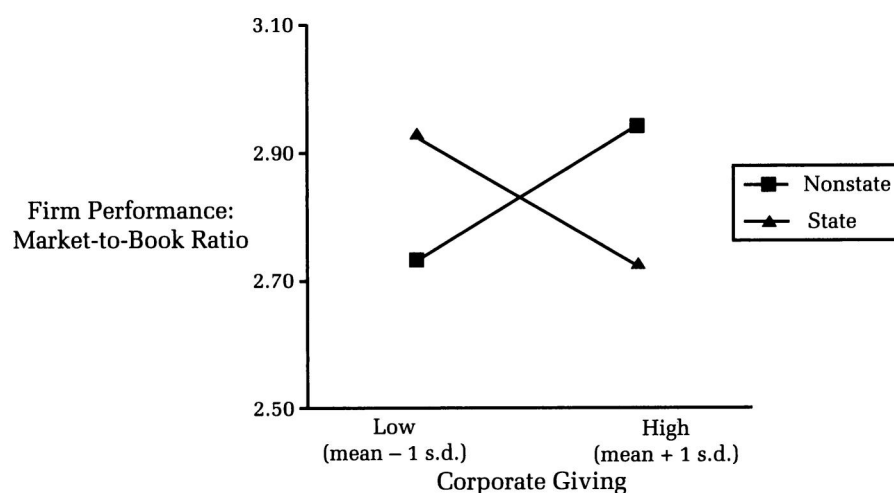


FIGURE 4B
Interaction Effect between Corporate Giving and Ownership Type on Market-to-Book Ratio



(e.g., stakeholder response) underlying these mechanisms. We have, though, identified several key conditions for which these two mechanisms are likely to be critical. The arguments and empirical tests would be greatly strengthened if future studies could directly explore these underlying mechanisms or, alternatively, find even better conditional factors. For example, future studies might go beyond the factors that we have identified as influencing stakeholder responses (firm visibility and stakeholder expectation) and study the performance benefits of eliciting positive responses.

Moreover, our measurements of some of the moderating variables have limitations. For example, the moderating effect of political connections was found to be relatively weak, but this might be because our measure focused only on the connections of a firm's CEO. Future research might set out to

construct more robust measures, including, for example, other political connections through board members and a firm's other top managers. Also, in addition to the two variables that we have used to capture the need for political resources (ownership type and political connections), future research could examine other contingent factors that could reflect a firm's political access, such as whether its managers are involved in political networking (Li & Zhang, 2007).

Fourth, we used advertising expenditures as our proxy for visibility, but our finding that it positively influences the relationship between philanthropy and financial performance contrasts with those of Hull and Rothenberg (2008). They suggested that corporate social activities function as a differentiating mechanism that can substitute for advertising and innovation. Drawing on this logic,

Hull and Rothenberg (2008) concluded that advertising, as a form of industry differentiation, negatively affects the social–financial performance relationship. Future studies might fruitfully attempt to resolve these somewhat contradictory arguments. In particular, it would be worthwhile to examine whether the opposite findings reflect differences in the empirical contexts (China vs. the United States) or differences between philanthropy and corporate social responsibility in general.

Lastly, although we tried our best to check and improve the validity of our main constructs, data from a developing country such as China may raise validity concerns in general. Future researchers may consider testing these arguments using alternative data, such as those from developed economies. Also, our sample was limited to publicly listed companies. Despite their large total market capitalization, publicly listed companies only represent a subset of Chinese enterprises, and good performance was presumably a prerequisite for stock market listing (Xu & Wang, 1999). Our results should therefore be generalized only with caution, as their applicability may be limited to the unique cultural and social environment surrounding listed Chinese companies. Future research could attempt to confirm these results in other economies, including both developing and developed ones.

Conclusions

By analyzing data on the philanthropic activities of publicly listed Chinese firms from 2001 to 2006, we have demonstrated that corporate philanthropy enhances corporate financial performance by enabling firms to elicit better stakeholder responses and to gain political resources. We hope that this study will serve as an important step toward a better understanding of the relationship between corporate social behavior and financial performance. Future studies can bring new insights by examining the influence of other potential factors, especially those related to various sociopolitical contexts, on the relationship between corporate philanthropy and firm financial performance.

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