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SECONDARY STAKEHOLDERS

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PRODUCT DIVERSIFICATION AND FINANCIAL PERFORMANCE: THE MODERATING ROLE OF SECONDARY STAKEHOLDERS

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The challenges firms face increase with their product diversification levels because different product markets possess different sociopolitical issues. We argue that secondary stakeholders, as represented by various nonprofit or non-governmental organizations, serve as agents mitigating the external constraints embedded within sociopolitical environments. Firms should therefore maintain relationships with different secondary-stakeholder scopes commensurate with their product diversification levels in order to enhance financial performance. Analyzing a sample of U.S. Fortune 500 firms during the period from 1996 to 2003, we found that secondary stakeholders play a positive moderating role in the relationship between product diversification and financial performance. Furthermore, this moderating effect was stronger in the case of unrelated diversification than in related diversification.

Product diversification is an important issue in strategic management (Montgomery, 1994; Palepu, 1985; Penrose, 1959; Rumelt, 1982). While there is debate concerning the main relationship between product diversification and financial performance, research suggests that the benefit of product diversification will emerge under a fit between internal and external organizational conditions (see Hoskisson & Hitt, 1990; Palich, Cardinal, & Miller, 2000; Wan, Hoskisson, Short, & Yiu, 2011 for reviews). Several contingencies, such as the top management team (Calori, Johnson, & Sarnin, 1994; Michel & Hambrick, 1992; Wiersema & Bantel, 1992), board of directors (Kor & Leblebici, 2005), shareholders (David, O'Brien, Yoshikawa, & Delios, 2010), employees (Farjoun, 1994; Neffke & Henning, 2013), suppliers (Cesaroni, 2004; Narasimhan & Kim, 2002), and customers (Zuckerman, 2000), have been found to play important roles in aligning the fit between internal organizational conditions and external environments. These important moderators are, collectively, a firm's primary stakeholders who can directly influence business operations via internal changes (Clarkson, 1995; Freeman, 1984). Results from

studies concerning them imply that effective interaction and coordination between firms and their stakeholders is crucial to successful product diversification.

Prior studies also implicitly assume that firms will face similar sociopolitical environments when they diversify into multiple product markets. However, this assumption is at odds with the reality, in which firms must address distinct institutional environments and societal expectations that vary from one industry to another (Chakrabarti, Singh, & Mahmood, 2007; Kang, 2013; Maurer, Bansal, & Crossan, 2011). Since the main contingencies of sociopolitical environments are secondary stakeholders such as nonprofit organizations, religious organizations, and other non-governmental organizations (NGOs) (Baron, 1995; Clarkson, 1995; Eesley & Lenox, 2006; Freeman, 1984; Post, Preston, & Sachs, 2002), the financial consequences of product diversification are therefore not only associated with primary stakeholders, but also contingent on secondary stakeholders. Unlike primary stakeholders, secondary stakeholders are organizations or groups of people that are indirectly involved in a firm's operations and actions (Baron, 1995; Clarkson, 1995; Mitchell, Agle, & Wood, 1997; Suchman, 1995). Represented by diverse nonprofit organizations or NGOs, secondary stakeholders usually act as agencies that challenge or support

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a firm's legitimacy in accessing various resources controlled by primary stakeholders and external environments (Freeman, 1984; Frooman, 1999; Hill & Jones, 1992; King, 2007; Wang & Qian, 2011). As the number of product markets increases with a firm's level of product diversification, so do the environmental constraints that firms will face (Kang, 2013). Unfortunately, secondary stakeholders' roles as important agents in moderating a firm's sociopolitical environments have been underexplored in the product diversification literature. Therefore, the purpose of this study is to answer the question: *What moderating role do secondary stakeholders play in the relationship between product diversification and firm financial performance?*

We propose that maintaining good relationships with secondary stakeholders plays a positive moderating role in the relationship between product diversification and firm financial performance. We argue that product diversification increases the cost of a firm's external controls within its sociopolitical environments. Secondary stakeholders that act as agents to mitigate sociopolitical challenges may help reduce the external costs associated with product diversification and accordingly contribute to financial performance. Furthermore, the positive moderating effect of secondary stakeholders is stronger in the case of unrelated than in related diversification because unrelated diversifiers face more unpredictable and diverse sociopolitical environments than do related diversifiers. We find empirical support for the above arguments based on a sample of Fortune 500 firms in the United States between 1996 and 2003.

This study's main contribution is to enhance our understanding of the relationship between product diversification and firm financial performance by highlighting the role of secondary stakeholders. Although prior research has documented how firms can diversify into different product markets, few studies give sufficient attention to the diverse environments firms will face when they implement product diversification. Maintaining relationships with secondary stakeholders helps firms gain social legitimacy and learn how to better manage their external constraints given the increasing institutional pressures from their sociopolitical environments. To the best of our knowledge, this study is the first to provide evidence that secondary stakeholders play a critical role in influencing firm financial performance when firms pursue product diversification. Thus, it responds

to recent calls seeking additional moderators from institutional environments in order to refine scholars' understanding of product diversification (Chakrabarti et al., 2007; Wan et al., 2011). Furthermore, this study also responds to the call for examining how corporate social behaviors and corporate strategies interactively influence financial performance (Baron, 1995; Bruch & Walter, 2005; Maurer et al., 2011; McWilliams, Siegel, & Wright, 2006).

THEORY AND HYPOTHESES

Product Diversification

"Product diversification" means that firms have operations in more than one industry or product market. According to Palepu (1985: 244), a firm's product diversification consists of "related diversification" (i.e., products *within* the same industry group) and "unrelated diversification" (i.e., products *across* different industry groups). The decision for product diversification can be analyzed from the resource-based view or from the perspective of transaction cost economics.

The resource-based view proposes that firms can enter into different product markets by leveraging their resources or capabilities (Wan et al., 2011). Early research suggested that physical or knowledge-based resources are associated with related diversification, and internal financial resources are associated with unrelated diversification (Chatterjee & Wernerfelt, 1991). However, recent studies have begun to show different patterns (Neffke & Henning, 2013; Ng, 2007). For example, Diestre and Rajagopalan (2011) found, based on a sample of U.S. firms from 1995 to 2003, that, if firms have a capability for handling highly toxic but regulated chemicals, then they can diversify themselves into unrelated product markets that also require the capability to handle the same chemicals.

Transaction cost economics argues that, compared to unrelated diversification, related diversification is more likely to enjoy economies of scope where inputs are shared and utilized jointly by different business units (Jones & Hill, 1988). Moreover, related diversification may also gain from economies of integration, a benefit typically associated with vertical integration. Although related diversification generates greater economic benefits than unrelated diversification, it also incurs higher costs from coordinating production across

business units (Jones & Hill, 1988). When business units share resources and become jointly specialized in order to realize economies of integration and scope, then monitoring the performance of individual units becomes more difficult, resulting in a higher potential for shirking and other opportunistic behaviors. Moreover, when firms diversify, they must reorganize their business units to achieve economies of scope by altering existing routines and contracts, but reorganization is costly because of organizational rigidity (Rawley, 2010).

In spite of the benefits of diversification highlighted by the resource-based view and transaction cost economics, substantial internal coordination costs arise from diversification. Prior studies have significantly enhanced our understanding of how to better control such costs via organizational structure (Markides & Williamson, 1996), corporate governance (Michel & Hambrick, 1992; Kor & Leblebici, 2005), and knowledge management (Miller, 2006; Robins & Wiersema, 1995). These important cost control mechanisms usually work through primary stakeholders who can directly influence firm operations, such as managers (Càlari et al., 1994; Michel & Hambrick, 1992; Wiersema & Bantel, 1992), boards of directors (Kor & Leblebici, 2005), shareholders (David et al., 2010), employees (Farjoun, 1994; Neffke & Henning, 2013), suppliers (Cesaroni, 2004; Narasimhan & Kim, 2002), and customers (Zuckerman, 2000). By focusing on internal coordination costs, the prior literature seems to have assumed that a firm deals with virtually identical external environments regardless of the number of product markets it enters. However, the more product lines a firm has, the more complex the environments and the sociopolitical demands it will face (Kang, 2013). When firms diversify into multiple product markets, they must not only control internal coordination costs via primary stakeholders, but also solicit additional support from secondary stakeholders that may either facilitate or hamper firm operations indirectly.

Secondary Stakeholders

“Secondary stakeholders” refers to those that either indirectly influence or are influenced by the firm without legal obligations (Clarkson, 1995; Eesley & Lenox, 2006). Secondary stakeholders in the present study include institutions such as religious organizations, nonprofit organizations, and NGOs, but exclude governmental organizations

(because they have direct legal authority over firms).¹ On the one hand, these organizations can help a firm maintain amiable relationships with potential customers, employees, and investors. On the other hand, they can also create a hostile environment that complicates business operations by hurting a firm’s public image. It is essential for firms to maintain good relationships with these secondary stakeholders since they may either facilitate or constrain a firm’s business.

One of the major strategic outcomes of corporate philanthropy is external stakeholder management, targeting “interest groups that have already exerted pressure on the firm or that are thought likely to do so in the future” (Logsdon, Reiner, & Burke, 1990: 100). Firms may manage their relationships with these interest groups via donations. Generally speaking, directly donating to nonprofit organizations is an effective means for firms to develop and maintain relationships with these organizations, for two main reasons. First, corporate philanthropy is a reciprocal and dynamic activity (Argenti, 2004; Bosse, Phillips, & Harrison, 2009; Godfrey, 2005); a donation is not the end of give but a start of take. Corporate philanthropy enables firms to leverage not only their own resources but also those of nonprofit organizations (Porter & Kramer, 2002). Nonprofits possess the professional and specific knowledge required for addressing sociopolitical issues. Firms can benefit from such knowledge by donating to various nonprofits and establishing relationships with them. For example, in 2007, a reporter from Britain’s *Observer* newspaper discovered child labor in an Indian factory that produced T-shirts for the GapKids brand. Gap investigated the case and found that one of its approved suppliers had subcontracted part of the job to the factory. To prepare its response, Gap followed the guidelines learned from multiple stakeholders,

¹ In the literature, there is no conclusion as to whether governments belong to the category of primary stakeholders (e.g., Clarkson, 1995) or secondary stakeholders (e.g., Freeman, Harrison, & Wicks, 2007). However, it is common to treat governments independently in empirical studies of stakeholder management (e.g., Berman, Wicks, Kotha, & Jones, 1999; Eesley & Lenox, 2006). We use “nonprofit organizations” and “non-governmental organizations” interchangeably in this study since there is no clear distinction between two terms (Husted, 2003). It should be noted that the label “nonprofit” refers to not only charitable organizations but also any nonprofit organizations dedicated to humanities, health, education, environment, religion, science, social service, and civic and public affairs.

including NGOs and trade unions, about how to deal with a child labor incident. In particular, Gap started funding Bachpan Bachao Andolan, a local child labor NGO, to serve as an educator against child labor (Smith, Ansett, & Erez, 2011).

Second, compared to internalization, donating to nonprofits is a more effective governance mechanism for firms to address sociopolitical issues if these issues are peripheral to a firm's core function and difficult to predict (Bruch & Walter, 2005; Husted, 2003). Donations allow firms to transfer their financial and other resources to nonprofit organizations that undertake charitable, social, educational, community, or scientific work, thereby filling such firms' voids in these sociopolitical domains while fulfilling the nonprofits' financial needs (Argenti, 2004; Husted, 2003) in a symbiotic relationship (Saiia, Carroll, & Buchholtz, 2003). Moreover, sociopolitical issues often require a communal collaboration between one firm and multiple nonprofits. For example, in 2002, Starbucks began a collaborative project with Oxfam, the Oaxacan State Coffee Producers Network, and the Ford Foundation with the goals "to create a sustainable community across a range of issues, each intertwined within the community, reduce their negative social footprint, and to improve the sustainability of Starbucks and the coffee-growing regions in Mexico" (Peloza & Falkenberg, 2009: 105). Another example is the Nestlé Healthy Kids Global Program that works in partnership with NGOs aiming at raising nutrition, health, and wellness awareness of school-age children around the world. As part of the program, NGOs can apply for and receive grants of up to US\$540,000 for engaging in innovative projects (FundsforNGOs, 2012). It would be prohibitively costly for Starbucks or Nestlé to work on these goals on its own.

Moderating the Relationship between Product Diversification and Performance

Although firms may enter new markets based on their core competencies, the value-creating process may be socially complex because firms are embedded within a multiplicity and diversity of stakeholder relationships (Barney, 1991; Freeman, 1984; Post et al., 2002). Firms become more constrained when they have more products spreading across different markets as every product market has its unique industrial norms and societal expectations (Kang, 2013). A firm's secondary stakeholders can play an important role in moderating the relationship

between product diversification and firm financial performance when sociopolitical environments change. We argue that firms with a high level of product diversification are likely to have better financial performance when they maintain relationships with a broader diversity of secondary stakeholders, for three main reasons.

First, secondary stakeholders can lower a firm's external costs by providing legitimacy in both social and environmental contexts (Argenti, 2004; Post et al., 2002). Secondary stakeholders such as interest groups and local communities can easily increase business costs via protests, boycotts, and non-cooperation (Argenti, 2004; Frooman, 1999). These costs not only affect firms in the short term, but also stain firm reputation in the longer term (Fombrun 1996; Zadek, 2004). When firms diversify their products into multiple markets, they will interact with diverse regulatory agencies and interest groups that they may not have experienced before. Engaging and maintaining good relationships with a diversity of secondary stakeholders can provide firms with the legitimacy required to receive reciprocal support (Barnett, 2007; Bosse et al., 2009; Godfrey, 2005). This moral capital derived from reciprocal stakeholder support can weave a safety net protecting firms from financial fluctuations (Fombrun, Gardberg, & Barnett, 2000; Godfrey, Merrill, & Hansen, 2009). The classic example of Nike's sweatshops in Asia has educated businesses into allying with nonprofits dedicated to social issues such as environmental protection and human rights (Zadek, 2004). However, secondary stakeholders are usually quite diverse and difficult to identify *ex ante*. It is therefore important for diversified firms to develop good relationships with a diversity of secondary stakeholders as a precautionary measure.

Second, maintaining relationships with a broad diversity of secondary stakeholders provides firms with professional knowledge in sociopolitical domains. This specific knowledge helps firms learn how to respond to social and environmental issues (Smith et al., 2011). For instance, garment companies are often criticized because of their contractors' environmental pollution or inhumane working conditions. Having relationships with secondary stakeholders can offer targeted companies a means of tackling these kinds of social problems. For example, executives from Gap said that having relationships with multiple nonprofits provided the company with a safe forum in which to discuss its challenges and gain insights into the best ways to handle particular sociopolitical issues. Gap can

even resolve issues with contractors “below the radar screen” rather than in public (see Smith et al., 2011, for details). Firms with more diversified product portfolios may therefore have better financial performance if they receive support from a diversity of secondary stakeholders.

Third, interacting with secondary stakeholders may elicit positive responses from primary stakeholders (Wang & Qian, 2011). Diversified firms usually require talented and skillful employees in order to manage and coordinate different product lines (Farjoun, 1994; Neffke & Henning, 2013). Greening and Turban’s (2000) experimental study using business student subjects indicated that job applicants are attracted to and intend to pursue their careers with firms that have positive social performance reputations. The existing literature also suggests that firms engaging in socially oriented activities, such as charitable donations and community engagements, can create shared values between firms and employees that enhance employees’ job satisfaction, organizational commitments, and psychological well-being, thereby increasing productivity (Brady, 2012; Grant & Sonnentag, 2010; de Luque, Washburn, Waldman, & House, 2008; Edmans, 2012). Likewise, it is important for diversified firms to have more diversified management teams and board compositions so that they can benefit from a greater variety of professional knowledge and external connections (Kor & Leblebici, 2005). Prior studies have shown that firms with high social performance usually have more diversified top management teams and board compositions (Bear, Rahman, & Post, 2010; Wong, Ormiston, & Tetlock, 2011). Having good relationships with secondary stakeholders would therefore help diversified firms bring in more diversified managers and outside directors, which could in turn improve performance. The positive reputation derived from good relationships with various secondary stakeholders can also give rise to additional business opportunities from suppliers and customers (Fombrun et al., 2000; Godfrey, 2005; Porter & Kramer, 2002). Firms gain the reputation of being socially or environmentally responsible by associating with nonprofits devoted to addressing human rights or environmental concerns, which consequently can help elicit additional business.

In contrast, shunning secondary stakeholders may send a negative signal to primary stakeholders and harm firm reputation. Consumers often pay special attention to whether or not firms are socially responsible (Bhattacharya & Sen, 2004; Lev,

Petrovits, & Radhakrishnan, 2010; Walker & Kent, 2009); they are less disposed to buy products manufactured by firms that are perceived as illegitimate (Wagner, Lutz, & Weitz, 2009; Zadek, 2004). Since diversified firms have products sold in multiple markets, donating to various nonprofits would send a positive signal to their customers that they place a high priority on corporate philanthropy (Godfrey, 2005). Lev and colleagues’ (2010) study of charitable donations made by U.S. public firms from 1989 to 2000 showed that customer satisfaction with corporate philanthropic activities benefits firms financially—in terms of sale growth, for example. Likewise, potential investors may also be concerned with whether or not firms have amiable secondary stakeholder relationships (Hillman & Keim, 2001; Johnson & Greening, 1999; Mackey, Mackey, & Barney, 2007). Firms with multiple product lines should exercise special caution because they face greater reputational risks from latent attacks (Eesley & Lenox, 2006; Fombrun et al., 2000; Godfrey et al., 2009). Diversified firms, in particular, must maintain good relationships with a broad range of secondary stakeholders in order to weave a wide safety net protecting them from financial fluctuations.

To summarize, firms with a high level of product diversification will face greater sociopolitical challenges (Kang, 2013), and it is essential for them to maintain relationships with a broad range of secondary stakeholders. Doing so will require the investment of management time and effort; however, the investment is not expected to be as great as that of maintaining relationships with customers or suppliers. As donors, firms are in a favorable position to shape their relationships with the nonprofits that receive their donations and determine how the relationships will evolve. The investment is therefore cost effective in view of the benefits discussed above. Maintaining relationships with a wide range of secondary stakeholders is therefore crucial regardless of the main relationship between product diversification and firm financial performance. If product diversification increases financial performance, then reciprocal support from a diversity of secondary stakeholders will enhance this positive relationship. On the other hand, if product diversification is detrimental to financial performance, then maintaining good relationships with a broad range of secondary stakeholders will mitigate external costs, weakening the negative effect. That is, the moderating effect of secondary stakeholders is positive regardless of whether the relationship between

product diversification and financial performance is positive or negative.

Hypothesis 1. Secondary stakeholders will have a positive moderating effect on the relationship between product diversification and firm financial performance such that diversified firms maintaining relationships with a broad range of secondary stakeholders have better financial performance than those with a narrow scope of secondary stakeholders.

Related Diversification versus Unrelated Diversification

We argue that the positive moderating effect of secondary stakeholders on the relationship between product diversification and financial performance will be stronger in the case of unrelated as opposed to related diversification. Prior literature has suggested that unrelated diversifiers may have greater difficulty in stimulating financial performance because they may not be able to efficiently leverage their resources from one product line to another (Palepu, 1985; Palich et al., 2000). However, recent literature has refuted this line of argument by showing that firms can effectively enter unrelated industries by leveraging their core competences (Diestre & Rajagopalan, 2011; Neffke & Henning, 2013; Ng, 2007). Although firms may enter unrelated markets by utilizing their superior capabilities, these capabilities, with a focus on internal knowledge transfer from one product line to another, may not be suitable for managing stakeholder relationships or responding to the sociopolitical issues firms may face in different markets (Barnett, 2007; Maurer et al., 2011; Neffke & Henning, 2013). As with absorptive capacity (Cohen & Levinthal, 1990), the capability to address sociopolitical concerns requires the investment of time, effort, and resources (Barnett, 2007). The necessary knowledge for effectively addressing sociopolitical issues is also professional and specific to various types of secondary stakeholders (Argenti, 2004; Barnett, 2007; Husted, 2003). Thus, the capability of extending product markets is different from that of addressing sociopolitical issues (Barnett, 2007; Maurer et al., 2011).

Unrelated diversifiers face more diversified primary stakeholders, such as customers and suppliers, compared to related diversifiers. It becomes particularly important for unrelated diversifiers to gain legitimacy and enhance firm reputation by maintaining good relationships with a diversity of secondary stakeholders in order to elicit positive responses

from these primary stakeholders. Unrelated diversifiers must also associate with more diversified secondary stakeholders because unrelated diversifiers are subject to different regulations across industries. Firms may resort to NGOs for political endorsement in order to deal with these institutional constraints. For instance, it has become popular for corporations to sponsor breakfasts with political figures, the mainstream media, and business-related associations (Suddath, 2013); these events help firms increase their awareness, exchange information, and facilitate business operations. Maintaining good relationships with a broad range of secondary stakeholders can help firms that pursue unrelated diversification better control their sociopolitical environments and improve their financial performance.

On the other hand, it is more likely that related diversifiers are able to accurately identify their latent secondary stakeholders, compared with their unrelated counterparts. When firms face similar sociopolitical environments over time, they may have learned how to manage their environments by identifying relevant stakeholders, understanding their potential impacts, harmonizing conflicting interests, and developing cooperation for mutual benefit (Post et al., 2002: 23). Hence, it is less necessary for related diversifiers to maintain relationships with a broad range of secondary stakeholders. Maintaining relationships with a narrow scope of secondary stakeholders instead is strategic enough to control their external constraints, since most latent secondary stakeholders that pose threats to the company have been identified and studied. It may therefore be a waste of resources in terms of time and effort for related diversifiers to associate with a great variety of secondary stakeholders. We expect that maintaining relationships with a broad range of secondary stakeholders will benefit unrelated diversification more than related diversification.

Hypothesis 2. The positive moderating effect of secondary stakeholders on the relationship between product diversification and firm performance is stronger in the case of unrelated diversification than in related diversification.

METHODS

Sample and Data Sources

The sample for this study consists of U.S. public firms on the Fortune 500 list between 1996 and 2003. Large firms were chosen because they are more likely

to pursue product diversification and address sociopolitical issues (Kang, 2013; Markides & Williamson, 1996). In addition, large firms are more likely to be the target of interest groups and to have interactions with various types of secondary stakeholders due to their high visibility (Frooman, 1999). We collected our data from several sources. First, we collected corporate financial data and product-market segment information from Compustat. Second, we collected corporate governance variables from RiskMetrics (formerly IRRG). Finally, we collected secondary stakeholder information from the *Taft Corporate Giving Directory* (Taft Group, 1998-2006). This data source discloses corporate charity information, including the amounts given and the types and categories of nonprofit organizations to which firms donate. The *Directory* divides nonprofit organizations into nine main categories—Arts and Humanities, Civic and Public Affairs, Education, Environment, Health, International, Religion, Science, and Social Services—and each category is further divided into a number of types. For example, nonprofits that handle legal aid (a type) belong to the category of Civic and Public Affairs. This information allowed us to identify the kinds and diversity of secondary stakeholders with which a firm is associated.

Firms are not legally required to disclose their donation information. Some companies disclosed for all the sample years, some disclosed for only part of the sample period, and other firms did not disclose at all. This non-disclosure by the last group of firms could prompt a concern of sample selection bias. We accordingly conducted a two-stage Heckman selection model (Heckman, 1979). The first-stage model estimated the likelihood of a firm's disclosure choice by applying a probit model to the entire sample of firms. Then an adjustment term, the inverse Mills ratio, was calculated as a control variable and put in the second stage, in which the models examine the relationship between product diversification and firm performance using the sample of firms with donation information. After merging different databases, we obtained a final sample that contained 391 firms and 2,364 firm-year observations for the first-stage model and 197 firms and 990 firm-year observations for the second-stage models.

Dependent Variable

Financial performance. We argue that secondary stakeholders help firms pursuing product diversification better control their sociopolitical environments and secure the resources provided by

stakeholders. Secondary stakeholders therefore facilitate the efficiency of resource usage. In this vein, we chose return on assets (ROA) as the measurement of firm financial performance, because this accounting-based performance indicator captures the efficiency of resource allocation via firm operation (Waddock & Graves, 1997). Since this study involves philanthropic donations, there may be a concern that the tax deduction for donations could bias a firm's net income. We controlled for the tax effect by following Kacperczyk (2009), and calculated ROA as the ratio of earnings before interest, taxes, depreciation, and amortization (EBITDA) to total assets.

Independent Variables

Product diversification (related/unrelated diversification). Palepu (1985) suggested that a firm's total product diversification (DT) consists of both related diversification (DR) and unrelated diversification (DU). We adopted the entropy measure proposed by Jacquemin and Berry (1979) since we hypothesize that secondary stakeholders have a general moderating effect on the relationship between product diversification and firm financial performance, as well as that the intensity of the moderating effect is different in related versus unrelated diversification. Specifically, DT is calculated as $\sum_i P_i \ln(1/P_i)$ where P_i is the proportion of a firm's sales in industry i at the four-digit Standard Industrial Classification (SIC) level, while DU is calculated as $\sum_i P_i \ln(1/P_i)$ where P_i is the proportion of a firm's sales in industry i at the two-digit SIC level. Finally, DR is equal to DT minus DU.

Secondary stakeholders. The variable of secondary stakeholders with which a firm maintains relationships is measured as the diversity of nonprofit organizations to which it donates (Harrison & Klein, 2007). Since secondary stakeholders are usually quite diverse and have their own distinct purposes, people who share and care for similar interests may eventually form or participate in different nonprofits in order to pursue their goals (Rowley & Moldoveanu, 2003). Since each nonprofit organization to which a firm donates is discretely different but equally important, we draw on the concept of heterogeneity in order to capture the diversity of secondary stakeholders with which a firm maintains relationships (Blau, 1977; Harrison & Klein, 2007). The concept of heterogeneity implies that each nonprofit organization has its categorical attributes, and that there is no specific or

hierarchical order among these organizations. In our study, the heterogeneity of secondary stakeholders is calculated using Blau's (1977) index of heterogeneity: $1 - \sum_j K_j^2$, where K represents the proportion of types of nonprofits within a category of secondary stakeholders and j is the number of different secondary stakeholder categories with which firms associate. Suppose a firm donates to 18 different types of nonprofits, and 10 of them belong to the Arts and Humanities category while the rest are evenly distributed among the remaining 8 categories. The firm then has a value of 0.67 in terms of its secondary stakeholder diversity. If these 18 types of organizations are evenly distributed among the 9 categories, then the firm scores 0.89 for its secondary stakeholder diversity. A value close to 0 implies that firms mainly associate with only a few categories. A high value implies that firms have an association with a broad range of nonprofits evenly (i.e., a high diversity of secondary stakeholders). Blau's (1977) index of heterogeneity has been extensively applied in the management literature to capture the heterogeneity of the top management team and board diversity in terms of demography, education, and function (e.g., Harrison & Klein, 2007; Harrison, Price, Gavin, & Florey, 2002; Richard, 2000; Wiersema & Bantel, 1992).

Control Variables

We also included several control variables in the models. Prior studies have documented that firm size has an influence on a firm's financial performance (Fama & French, 1992). We used the total number of employees as a proxy for firm size, but, because this variable is positively skewed, we logged and transformed it in order to lower skewness. Previous studies have also suggested that a firm's research and development (R&D) activity is highly associated with absorptive capacity that can contribute to its learning and innovation (Cohen & Levinthal, 1990). We therefore included R&D intensity as measured by a firm's R&D expenditure scaled by total firm sales in order to control for financial influence from the intangible knowledge effect (Morck & Yeung, 1991). We also controlled for advertising intensity as measured by a firm's advertising expenditures scaled by total firm sales. Advertising expenditures may not only influence a firm's visibility but also enhance a firm's differentiation, thereby affecting its profitability (McWilliams & Siegel, 2000).

We also included a firm's financial slack, measured as current assets scaled by current liability, in

order to control for the influence of slack resources on subsequent financial performance (Bromiley, 1991). Recent literature has suggested that corporate philanthropy has an effect on firm financial performance (Brammer & Millington, 2008; Wang, Choi, & Li, 2008; Wang & Qian, 2011). We therefore controlled for corporate charitable giving as scaled by total sales in order to reduce the halo effect. Prior literature has also documented that international diversification, defined as the extent to which a firm exploits foreign market opportunities, has an impact on firm financial performance (Hitt, Hoskisson, & Kim, 1997). Following Kang (2013) and Tallman and Li (1996), we used the ratio of sales from foreign operations to total firm sales as a proxy for international diversification. We also included past financial performance in our regression models as a control variable in order to account for the contribution of past financial performance to the current financial performance (McNamara, Vaaler, & Devers, 2003).

We included three corporate governance variables in our models. First, prior literature has shown that, if a CEO simultaneously serves as the chairperson (i.e., CEO duality), then he or she has greater power and discretion to make critical decisions (Rechner & Dalton, 1991). Opponents consider that CEO duality may increase agency costs because it weakens directors' monitoring effects, while advocates argue that it may increase managerial efficiency due to the unity of command (Finkelstein & D'Aveni, 1994). We used a dummy variable to control for the effect of CEO duality on firm financial performance where "1" represents CEO duality and "0" otherwise. Second, outside directors are those directors who do not hold a management position in the boardroom. Prior studies have documented that outside directors can not only provide novel advice but also serve as a bridge connecting with resources from outside the firm (Kor & Sundaramurthy, 2009; Westphal & Khanna, 2003). We controlled for the effect of outside directors on firm financial performance by calculating the ratio of outside directors as the number of outside directors over the total number of directors. Yet, some still criticize that currently outside directors are not independent since they are usually associated with either the firm or top managers (such as through family relationships). We therefore excluded the affiliated directors identified in the RiskMetrics database in order to enhance board independence in our measurement (Hermalin & Weisbach, 2003). Third, Yermack (1996) documented that board size

is associated with the effectiveness of corporate governance systems and accordingly directly influences firm financial performance. We therefore included board size, as measured by the number of directors, in our models. Lastly, we included year dummies in order to control for intertemporal trends.

Statistical Models

As we noted above, some firms chose not to disclose their donation information. These firms may systematically differ from those that voluntarily disclose this information, resulting in a selection bias (Heckman, 1979). We addressed the concern of selection bias by executing Heckman's selection model. In the first stage, we applied a probit model to estimate the likelihood of firms disclosing their donation information. We regressed the disclosure choice with some of the control variables mentioned above and one instrumental variable (i.e., industrial level of charitable giving). A high level of industrial charitable giving may indicate that firms in such an industry face pressure to engage in philanthropy (Campbell, 2007; Marquis, Glynn, & Davis, 2007), and are therefore more likely to donate and subsequently disclose their philanthropic information (Wang & Qian, 2011). After the first-stage regression, we calculated the inverse Mills ratio and included it in the second stage.

Since the data in our study were organized in a panel structure (i.e., pooled cross-sectional time-series), they would generate biased estimates if we only ran an ordinary least squares regression (Greene, 2008). We used firm fixed effects models to analyze the panel data in order to control for

unobserved firm heterogeneity. However, there could still be a concern that the estimates would be biased due to the endogeneity of secondary stakeholders. That is, firms may choose a diversity of donations based on the anticipated effect on performance. We therefore used two-stage least squares regression analysis to address this problem (Kennedy, 2003). In the first stage, the dependent variable was secondary stakeholders. We chose the industrial average of diversity of secondary stakeholders (based on 4-digit SIC code) as an instrument because it is well correlated with the first-stage dependent variable (i.e., diversity of secondary stakeholders), but uncorrelated with the second-stage outcome variable (i.e., firm performance). Then, we generated an estimated variable of secondary stakeholders and included it in the second-stage models in which the outcome variable was firm performance. The second-stage models therefore included the estimated diversity of secondary stakeholders, its interactions with product diversification, the inverse Mills ratio, and other control variables.

RESULTS

Table 1 presents the descriptive statistics and correlations: Panel A shows the variables used in the first-stage selection model while Panel B shows the variables used for the second stage. The correlations for all variables were below 0.6 except for two cases. The first was between current financial performance and prior financial performance. We later conducted the Arellano–Bond dynamic panel model (Arellano & Bond, 1991) in order to address this concern. The second is between total diversification and unrelated

TABLE 1
Descriptive Statistics and Correlations
Panel A: First-Stage Variables

Variables	Mean	SD	1.	2.	3.	4.	5.	6.	7.	8.
1. Disclosure choice _{t + 1}	0.54	0.50								
2. ROA	0.14	0.08	0.04*							
3. Firm size	3.36	1.05	0.23*	0.14*						
4. Advertising intensity	0.01	0.03	0.05*	−0.08*	−0.01					
5. R&D intensity	0.02	0.04	0.11*	−0.12*	−0.03*	0.13				
6. CEO duality	0.77	0.42	0.06*	0.00	0.14*	0.00	0.00			
7. Outside director ratio	0.65	0.18	0.28*	−0.04*	0.07*	0.00	−0.01	0.05*		
8. Board size	11.57	3.14	0.25*	−0.07*	0.40*	−0.01	−0.02*	0.06*	0.08*	
9. Industrial level of giving	0.32	0.67	0.15*	−0.12*	−0.02*	0.00	0.01	0.05*	−0.06*	0.17*

n = 2,364.

* *p* < 0.05

Panel B: Second-Stage Variables

Variables	Mean	SD	1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.	12.	13.	14.	15.
1. $ROA_t + 1$	0.148	0.07															
2. ROA	0.153	0.07	0.88*														
3. Secondary stakeholders	0.789	0.09	-0.01	-0.02													
4. Total diversification	0.569	0.57	-0.14*	-0.12*	0.11*												
5. Related diversification	0.160	0.31	-0.08*	-0.07*	0.05	0.56*											
6. Unrelated diversification	0.409	0.47	-0.12*	-0.10*	0.09*	0.83*	0.02										
7. Firm size	3.560	1.03	0.10*	0.09*	0.04	0.16*	0.09*	0.13*									
8. Advertising intensity	0.014	0.03	0.40*	0.40*	0.01	0.01	-0.01	0.02	0.15*								
9. R&D intensity	0.026	0.04	0.25*	0.28*	0.12*	0.12*	0.16*	0.04	0.14*	0.13*							
10. Charitable giving	0.083	0.13	0.26*	0.26*	0.07*	-0.04	0.01	-0.06*	0.01	0.23*	0.45*						
11. Slack	1.358	1.05	0.07*	0.08*	-0.22*	-0.10*	0.00	-0.13*	-0.06	0.02	0.17*	0.06					
12. International diversification	0.019	0.05	-0.02	-0.03	0.06*	0.09*	-0.01	0.11*	0.12*	-0.14*	0.07*	0.01	0.03				
13. CEO duality	0.817	0.38	-0.09*	-0.10*	0.11*	0.02	-0.06	0.07*	-0.01	0.03	-0.06*	-0.05	-0.05	-0.01			
14. Outside director ratio	0.703	0.14	-0.07*	-0.06*	0.09*	0.08*	0.03	0.08*	-0.04	-0.10*	0.06*	-0.03	-0.12*	-0.07*	0.14*		
15. Board size	11.730	2.54	0.04	0.03	0.06	0.13*	0.09*	0.10*	0.26*	0.10*	-0.03	0.03	-0.11*	0.05	-0.07*	-0.09*	
16. Inverse Mills ratio	0.626	0.30	-0.26*	-0.27*	-0.16*	-0.18*	-0.10*	-0.15*	-0.54*	-0.19*	-0.33*	-0.17*	0.09*	-0.04	-0.05	-0.56*	-0.47*

n = 990.

* $p < 0.05$

diversification. However, since these two variables were not simultaneously included in regressions, their high correlation should not be a concern.

Table 2 shows the results of the sample selection model. Since the dependent variable is dichotomous, the regression results indicate the propensity of firms to disclose their donation information. Firms operating within industries with high levels of charitable giving are more likely to disclose their donation information. This finding is in line with prior literature (Wang & Qian, 2011) and provides evidence that using this variable as an instrument for the sample selection model is valid.

Table 3 shows the results of second-stage firm fixed effects regressions where we included the inverse Mills ratio to adjust for selection bias. Model 1 shows the effect of our control variables. The coefficient of secondary stakeholders is non-significant in Model 2, but significant in Models 5 and 6. These significant coefficients indicate that the effect of secondary stakeholders on financial performance is conditional upon the level of product diversification (Aiken & West, 1991: 37–39). Model 2 also shows a significantly negative association between product diversification and financial performance. This finding is in line with the results of prior studies indicating a diversification discount (e.g., Campa & Kedia, 2002; Rajan, Servaes, & Zingales, 2000).

From Models 3 to 6, we added the interaction terms between secondary stakeholders and various

types of product diversification in order to test our hypotheses. Hypothesis 1 predicted that the scope of secondary stakeholders has a positive moderating effect on the relationship between product diversification and financial performance. The positive coefficient of the interaction term in Model 3 is significant at the 0.05 level ($\beta = 0.219$). We graphically present the finding in order to further examine the moderating role that secondary stakeholders play (Aiken & West, 1991). Figure 1 shows that a broader range of secondary stakeholders would weaken the negative relationship between product diversification and financial performance, and may even change it to positive. In the high level of product diversification scenario, firms that maintain relationships with a wide scope of secondary stakeholders have better financial performance than do firms that maintain relationships with a narrow scope of secondary stakeholders. In contrast, in the low level of product diversification scenario, the situation is just the opposite. Hypothesis 1 is therefore supported.

Hypothesis 2 predicted that the positive moderating effect of secondary stakeholders would be stronger in the case of unrelated diversification than in related diversification. Models 4, 5, and 6 provide supportive results for this hypothesis. Specifically, we did not find a statistically significant coefficient in Model 4 (related diversification, $\beta = -0.171$, $p > 0.1$), while we did find one in Model 5 (unrelated diversification, $\beta = 0.370$, $p < 0.01$). Model 6 is the full model in which both related and unrelated diversification were included. The results are similar to those of the separate models. The coefficient for the interaction between secondary stakeholders and related diversification is not significant, while the coefficient for the interaction between secondary stakeholders and unrelated diversification is positively significant ($\beta = 0.386$, $p < 0.01$). Hypothesis 2 is therefore supported.

Robustness Checks

We conducted several additional analyses in order to ensure that the study's results are robust. First, we changed the measure of financial performance to a more proximal outcome than ROA. We considered return on sales (ROS) as an alternative because it is usually an indicator of a firm's ability to control costs and operate efficiently. Maintaining relationships with various secondary stakeholders can help firms gain legitimacy, enhance firm image,

TABLE 2
Probit Regression of Donation Disclosure Choice
Estimates

Variables	Philanthropy disclosure choice	
ROA	0.82*	(0.38)
Firm size	0.23***	(0.03)
Advertising intensity	1.21	(1.04)
R&D intensity	2.37**	(0.72)
CEO duality	0.01	(0.07)
Outside director ratio	2.26***	(0.17)
Board size	0.08***	(0.01)
Industrial level of giving	0.15**	(0.05)
Constant	-3.14	(0.20)
χ^2	490.59***	

$n = 2,364$. Two-tailed tests. Disclosure choice is measured for year $t + 1$; all other variables, for year t . Robust standard errors are in parentheses. Year fixed effects are controlled.

* $p < 0.05$

** $p < 0.01$

*** $p < 0.001$

TABLE 3
Results of Firm Fixed Effects Regression Analyses for Financial Performance ($ROA_t + 1$)

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
ROA	0.329*** (0.082)	0.326*** (0.082)	0.329*** (0.081)	0.326*** (0.082)	0.329*** (0.081)	0.327*** (0.081)
Firm size	-0.008 (0.011)	-0.007 (0.011)	-0.007 (0.011)	-0.008 (0.011)	-0.006 (0.010)	-0.006 (0.010)
Advertising intensity	0.356 (0.273)	0.382 (0.278)	0.392 (0.278)	0.361 (0.274)	0.393 (0.279)	0.391 (0.278)
R&D intensity	-0.165 (0.116)	-0.156 (0.116)	-0.162 (0.115)	-0.155 (0.118)	-0.155 (0.116)	-0.144 (0.117)
Charitable giving	0.039 [†] (0.023)	0.037 (0.024)	0.037 (0.024)	0.039 [†] (0.023)	0.038 (0.024)	0.038 (0.024)
Slack	-0.001 (0.001)	-0.001 (0.002)	-0.000 (0.002)	-0.001 (0.001)	-0.000 (0.001)	-0.000 (0.001)
International diversification	0.030 (0.029)	0.029 (0.029)	0.033 (0.029)	0.030 (0.029)	0.029 (0.030)	0.029 (0.030)
CEO duality	0.004 (0.004)	0.003 (0.004)	0.003 (0.004)	0.004 (0.004)	0.003 (0.004)	0.003 (0.004)
Outside director ratio	0.121* (0.052)	0.117* (0.052)	0.115* (0.051)	0.121* (0.052)	0.117* (0.051)	0.117* (0.051)
Board size	0.003 [†] (0.002)	0.003 [†] (0.002)	0.003 [†] (0.002)	0.003 [†] (0.002)	0.003 [†] (0.002)	0.003 [†] (0.002)
Inverse Mills ratio	0.079* (0.038)	0.076* (0.038)	0.074* (0.037)	0.079* (0.037)	0.074* (0.037)	0.074* (0.037)
Secondary stakeholders		-0.032 (0.074)	-0.155 (0.100)	-0.004 (0.086)	-0.202* (0.095)	-0.184 [†] (0.100)
Total diversification		-0.007** (0.003)	-0.181* (0.086)			
Total diversification × Secondary stakeholders			0.219*			
Related diversification				0.133 (0.156)		0.141 (0.147)
Related diversification × Secondary stakeholders				-0.171 (0.196)		-0.180 (0.184)
Unrelated diversification					-0.304** (0.094)	-0.316*** (0.093)
Unrelated diversification × Secondary stakeholders					0.370** (0.118)	0.386*** (0.118)
Firm fixed effects	Included	Included	Included	Included	Included	Included
Year fixed effects	Included	Included	Included	Included	Included	Included
Constant	-0.031 (0.096)	0.000 (0.116)	0.095 (0.126)	-0.026 (0.120)	0.132 (0.125)	0.118 (0.127)
Adjusted R^2	0.836	0.837	0.838	0.836	0.839	0.838
ΔR^2 (compared to Model 1)		0.001*	0.002*	0.000	0.003***	0.002***

$n = 990$. Two-tailed tests. Robust standard errors are in parentheses.

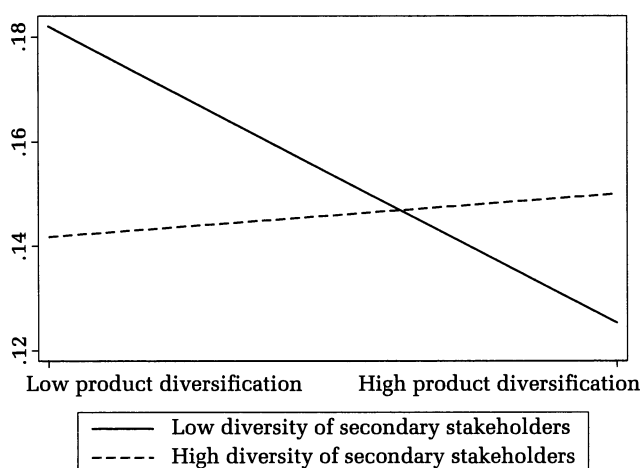
[†] $p < 0.10$

* $p < 0.05$

** $p < 0.01$

*** $p < 0.001$

FIGURE 1
Moderating Effect of Secondary Stakeholder
Diversity on the Relationship between Product
Diversification and Financial Performance (ROA_{t+1})



and help firms learn how to withstand adverse conditions. The benefits from secondary stakeholders may not be reflected via a firm's capital investment such as assets, but can be directly reflected through a firm's sales performance such as falling costs, rising sales revenues, or improved profit margins. We therefore expected that our hypotheses would also be empirically supported in terms of ROS. In fact, the results were largely similar to those obtained using ROA as the measure of financial performance,² and thus all our hypotheses remain supported.

Second, the positive moderating effect of maintaining a wide scope of secondary stakeholders for diversified firms could be the result of reverse causality. We therefore examined whether highly diversified firms that were more profitable were more likely to spread their donations to various secondary stakeholders than were diversified firms that were less profitable. We treated secondary stakeholders as the dependent variable and examined whether financial performance positively moderated the relationship between product diversification and diversity of secondary stakeholders. The coefficient of the interaction term between ROA and product diversification was not statistically significant. We also did not find a significant main effect for financial performance on the diversity of secondary stakeholders.

² We do not include these and other robustness checks' results here due to space limitations, but will provide them on request.

The concern of reverse causality is therefore not supported.

Third, there could be a concern that firms might engage in "greenwashing" (Delmas & Burbano, 2011; Lyon & Maxwell, 2011). Adopting a broader definition of the term, Marquis and Toffel (2012) considered greenwashing to mean a firm's symbolic compliance to socially oriented requirements. Based on this definition, firms would be regarded as engaging in greenwashing if they engaged only symbolically with the nonprofits to which they donated. Unfortunately, we did not have any data that would have allowed us to directly investigate this issue. We therefore explored the possibility of greenwashing by adopting a conservative assumption that the more types of nonprofits to which a firm donates, the more likely it is that it engages in greenwashing. It is difficult for firms to substantively engage with various types of nonprofits, given limited managerial resources. If that is the case, then some of the nonprofits might not offer positive responses to the greenwashing firm. The positive moderating role of secondary stakeholders between product diversification and financial performance may therefore be less salient. We tested this possibility by changing the measure of secondary stakeholders from the index of heterogeneity to the number of types of nonprofits to which firms donate.³ We still observed a significantly positive moderating relationship, alleviating the concern of greenwashing.

Finally, including a lagged dependent variable in a regression model could increase the concern of autocorrelation, as a firm's prior financial performance is usually correlated with subsequent financial performance (McNamara et al., 2003). We therefore conducted the Arellano–Bond dynamic panel regression model in order to accommodate the influence of prior financial performance on subsequent financial performance (Arellano & Bond, 1991). We treated all our control variables and secondary stakeholders as endogenous variables since these firm-level variables are mostly related to corporate policies. These endogenous variables were instrumented with the generalized method of

³ Although the number of types of nonprofits may also contribute to the variety of secondary stakeholders with which firms associate, the index of heterogeneity is a more precise measure of variety (Harrison & Klein, 2007). The correlation between these two measures was 0.52 ($p < 0.05$).

moments technique. We considered year effects as strictly exogenous, and also included the industrial level of giving as an additional exogenous variable. The results from the Arellano–Bond dynamic panel regression were all in line with our predictions (Table 4).

DISCUSSION

Drawing on the literature of product diversification and stakeholder management, we proposed that maintaining relationships with secondary stakeholders can help firms pursuing diversification mitigate the costs of external controls in their sociopolitical environments. We argued that the relationship between product diversification and firm financial performance is contingent on the scope of secondary stakeholders with which firms associate. We found that maintaining relationships with a broad diversity of secondary stakeholders helps firms with a high level of product diversification obtain better financial performance. In contrast, firms with a low level of product diversification achieve better financial performance through engaging a narrow scope of secondary stakeholders rather than a broad one. We also found that secondary stakeholders have a stronger positive moderating effect on the relationship between product diversification and financial performance in the case of unrelated diversification than in related diversification. Our findings therefore generate several theoretical contributions and managerial implications.

Contributions

Our study contributes to the product diversification literature in two ways. First, the results suggest that some of the costs impairing financial performance from product diversification may be caused by stakeholders, particularly secondary stakeholders. David and colleagues (2010) showed that product diversification might not necessarily yield higher financial returns for shareholders because stakeholders may have different demands. Based on a sample of Japanese firms from 1992 to 2001, they found that transactional owners (i.e., shareholders) emphasize the potential profitability to be gained from product diversification. In contrast, relational owners (i.e., bankers) emphasize firm growth and accordingly allow managers to appropriate the rents generated from product

diversification. Their study demonstrated that pursuing product diversification might incur conflicts of interest among primary stakeholders such as shareholders, bankers, and managers. Our study further demonstrated that the secondary stakeholders that constitute a firm's sociopolitical environments are one factor that firms cannot overlook when implementing product diversification. Second, our study also sheds light on the ambiguous relationship between product diversification and financial performance by highlighting the external costs. Unlike most prior studies adopting an inward-looking perspective such as the resource-based view, our study provides another angle in reviewing the mixed findings concerning the relationship between product diversification and financial performance. We point to the firm's secondary stakeholders located within its environment as one important factor explaining this contentious relationship neglected by the literature.

Our contributions to stakeholder theory are two-fold. First, we theoretically provide and empirically test a new lens discussing stakeholder management. The prior work in this line of research has primarily focused on a monolithic measure of corporate social performance such as monetary giving (e.g., Brammer & Millington, 2008). However, stakeholders are heterogeneous, and our measure of the diversity of a firm's donations to different nonprofit organizations helps capture an aspect of this heterogeneity (Barnett, 2007; Harrison & Klein, 2007). This measure is more fine-grained than the traditional measure of monetary giving and accordingly provides a better picture of the multidirectional relations between the focal firm and its secondary stakeholders (Godfrey et al., 2009; Hillman & Keim, 2001). Second, our findings contribute to the literature on stakeholder management, particularly the instrumental perspective (e.g., Jones, 1995). This study describes a method that may help managers to better control the external constraints in their sociopolitical environments by maintaining relationships with secondary stakeholders as represented by various types of nonprofits. Firms can strategically decide how diversified their engagement in charitable, social, and political domains should be based on direct contributions to relevant organizations. Since primary stakeholders such as customers and suppliers may be affected by secondary stakeholders such as regulatory agencies and interest groups, maintaining relationships with a broad range of secondary stakeholders indirectly reflects how extensive a safety net firms may build

TABLE 4
Results of Arellano-Bond Dynamic Panel Modeling on Financial Performance (ROA_{*t* + 1})

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
ROA	0.341*** (0.101)	0.342*** (0.100)	0.345*** (0.099)	0.340*** (0.101)	0.345*** (0.099)	0.346*** (0.098)
Firm size	-0.070*** (0.024)	-0.068*** (0.024)	-0.067*** (0.024)	-0.070*** (0.025)	-0.068*** (0.023)	-0.067*** (0.023)
Advertising intensity	0.327 (0.427)	0.346 (0.428)	0.353 (0.426)	0.335 (0.427)	0.343 (0.426)	0.347 (0.426)
R&D intensity	-0.209 (0.147)	-0.166 (0.154)	-0.181 (0.154)	-0.205 (0.153)	-0.194 (0.149)	-0.189 (0.154)
Charitable giving	0.066* (0.030)	0.063* (0.029)	0.063* (0.030)	0.065* (0.030)	0.066* (0.029)	0.065* (0.029)
Slack	-0.001 (0.002)	-0.001 (0.002)	0.000 (0.002)	-0.001 (0.002)	-0.000 (0.002)	0.000 (0.002)
International diversification	0.060† (0.033)	0.066* (0.033)	0.072* (0.034)	0.060† (0.033)	0.074* (0.037)	0.075* (0.037)
CEO duality	0.001 (0.007)	0.000 (0.007)	0.000 (0.007)	0.001 (0.007)	0.002 (0.007)	0.001 (0.006)
Outside director ratio	-0.006 (0.022)	-0.002 (0.023)	-0.000 (0.023)	-0.004 (0.022)	-0.000 (0.023)	0.000 (0.023)
Board size	0.003* (0.002)	0.003† (0.002)	0.003* (0.002)	0.003* (0.002)	0.003* (0.002)	0.003* (0.002)
Secondary stakeholders		-0.028 (0.048)	-0.066 (0.054)	-0.031 (0.048)	-0.076 (0.052)	-0.077 (0.052)
Total diversification		-0.008† (0.004)	-0.063* (0.026)			
Total diversification × Secondary stakeholders			0.070* (0.032)			
Related diversification				-0.018 (0.036)		-0.019 (0.029)
Related diversification × Secondary stakeholder				0.021 (0.045)		0.006 (0.009)
Unrelated diversification					-0.096** (0.037)	-0.096** (0.036)
Unrelated diversification × Secondary stakeholders					0.106* (0.045)	0.040* (0.017)
Wald χ^2	94.49***	100.39***	106.85***	103.63***	97.7***	103.19***
Serial correlation: AR(1) test	0.000	0.000	0.000	0.000	0.000	0.000
Serial correlation: AR(2) test	0.961	0.808	0.980	0.926	0.932	0.936

$n = 773$. Two-tailed test. Standard errors are in parenthesis. AR(1) and AR(2) are the Arellano-Bond tests (Arellano & Bond, 1991) for autocorrelation. The residuals in first differences are expected to be correlated (by construction), and therefore the p value for AR(1) should be significant. But serial correlations in second differences are not expected to be present, and therefore the p value for AR(2) should be insignificant.

† $p < 0.10$

* $p < 0.05$

** $p < 0.01$

*** $p < 0.001$

in order to secure the resources controlled by stakeholders (Fombrun et al., 2000; Godfrey, 2005).

Finally, our study responds to the call to mingle corporate social behavior research with corporate strategy research (Berman et al., 1999; McWilliams et al., 2006). Researchers interested in corporate social behaviors usually examine how these behaviors affect firm financial performance, independent of corporate strategies (e.g., Wang et al., 2008). However, the bottom line is whether social behaviors are in line with corporate strategies, no matter how important these activities are (Maurer et al., 2011). Our study contributes to the current but limited literature concerning how corporate social behaviors and firm strategies interactively influence firm financial performance. Our findings show that the relationship between product diversification and financial performance is contingent on the scope of the nonprofits with which firms engage. Furthermore, echoing Barney (1991) and Maurer et al. (2011), our results provide evidence that the value-creating process is characterized by social complexity: creating competitive advantages involves complicated and specific relations between firms and their social communities. Corporate strategy requires complementary support from secondary stakeholders in order to enhance firm financial performance.

Managerial Implications

This study provides two main implications for practice. First, one of the biggest current challenges for managers is how to enhance firm financial performance using product diversification. Managers are eager to diversify to different product markets in order to create a diversification premium. The resource-based view suggests that managers identify the firm's core competence and then diversify into the market where they can best utilize their resources and capabilities (Wan et al., 2011). However, the deficiency of this argument is that managers may overlook the sociopolitical issues that firms will face when they implement product diversification. Our study alerts managers to the latent sociopolitical challenges in different product markets.

Second, our study provides an important implication for managing secondary stakeholders. Since society has become more conscious of firm behaviors, managers must pay greater attention to addressing the latent issues in sociopolitical environments. Secondary stakeholders such as nonprofits, local communities, and interest groups are

peripheral to business operations. Yet, firms can directly donate to various organizations associated with specific sociopolitical problems in order to engage with these secondary stakeholders. Our results suggest that firms may strategically control the scope of the secondary stakeholders in which they are interested. Although some research suggests that engaging in social activities is a waste of firm resources (Jensen, 2002; Karnani, 2011), our findings show that firms adjusting their social engagements in accordance with their product scopes have better financial performance. For example, Figure 1 shows that, in the case of high product diversification, firms that maintain relationships with a high diversity of secondary stakeholders outperform firms with a low diversity of secondary stakeholders by about 2%, in terms of ROA. That is an additional EBITDA of \$20 million if the firm has \$1 billion in assets. Likewise, in the case of low product diversification, firms that have a narrow scope of secondary stakeholders outperform those with a broad range of secondary stakeholders by around 4% in terms of ROA.

Limitations and Future Research Directions

This study has some limitations, in spite of the various contributions discussed above. First, we were unable to directly assess the extent of latent threats in sociopolitical environments that have been mitigated via corporate donations. We were also unable to identify the motives behind corporate donations. Although managers may donate to nonprofit organizations with opaque motives, both parties have legitimate claims to each other once financial resources have been transferred from firms to such organizations (Hill & Jones, 1992; Mitchell et al., 1997). Donations allow firms to gain the social legitimacy they desire, while the organizations obtain the resources they need to pursue their social goals (Godfrey, 2005; Husted, 2003). Nevertheless, future studies could implement several different methods, such as surveys and interviews, in order to further understand how firms can control their external environments via secondary stakeholders, or how engaging with secondary stakeholders may become greenwashing (e.g., Crilly & Sloan, 2012; Delmas & Burbano, 2011; Husted, Allen, & Rivera, 2010).

Second, we did not have access to the exact amount of corporate donations made to each nonprofit organization, due to the categorical nature of our data on corporate donations. Similarly, we could not match the nonprofits to which a firm

donated with the industries within which it operated. For instance, if the firm's manufacturing process involves pollution, it makes sense for the firm to donate to nonprofits that promote environmental protection. Although corporate donations reflect the breadth of the corporate social performance construct to a greater degree than other proxies such as pollution control (Brammer & Millington, 2008), they fail to capture other kinds of engagement with secondary stakeholders. Future research should use more fine-grained donation data as well as data concerning other aspects of social performance, if available.

Third, our study focuses only on the diversity of corporate donations to nonprofit organizations. Our results suggest that product diversification may also require firms to have a diversity mentality in engaging with other stakeholders. For instance, they may need to install a diverse set of organizational practices, such as human resource policies, customer relations, and procurement logistics. How diversity in these areas would affect the relationship between product diversification and firm performance is a fruitful future research direction.

Another avenue for further research stems from the implication of diversity in secondary stakeholders. Harrison and Klein (2007) suggested that diversity could refer to separation, variety, and disparity. We adopt diversity as variety that emphasizes differences in knowledge or experiences among secondary stakeholders. Future research might further discuss diversity as separation that focuses on differences in attitude or value among secondary stakeholders. Scholars could also examine diversity as disparity, emphasizing the inequality derived from either status or position among secondary stakeholders. For example, firms have the opportunity to collaborate with multiple nonprofits (Peloza & Falkenberg, 2009). It may be useful to investigate whether or not firms can effectively achieve their corporate social responsibility objectives if the nonprofits have conflict of interests among themselves (i.e., diversity as separation), or if there is a significant power imbalance among the nonprofits (i.e., diversity as disparity). Research on these underexplored dimensions may shed further light on the stakeholder management literature.

CONCLUSION

We advance the understanding of how firm strategies and social behaviors interactively influence

firm financial performance. Given increasing challenges in a firm's sociopolitical environments, our results show that the financial performance of firms with different levels of product diversification is influenced by the scope of secondary stakeholders with which firms maintain relationships. Our study suggests that both researchers and managers should pay greater attention to the sociopolitical issues firms face when they implement corporate strategies.

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