RESEARCH NOTES AND COMMENTARIES

STAKEHOLDER RELATIONS AND THE PERSISTENCE OF CORPORATE FINANCIAL PERFORMANCE

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We examine the effect of a firm's relations with its nonfinancial stakeholders, including its employees, suppliers, customers, and communities, on the persistence of both superior and inferior financial performance. In particular, integrating and extending the resource-based view of the firm and stakeholder management literatures, we develop the arguments that good stakeholder relations not only enable a firm with superior financial performance to sustain its competitive advantage for a longer period of time, but more importantly, also help poorly performing firms to recover from disadvantageous positions more quickly. The arguments are supported by the analysis of a series of first-order autoregressive models. Our findings further suggest that the positive effect of good stakeholder relations on the persistence of superior performance is not as strong as that of some other firm resources, such as technological knowledge, but it is the only factor examined that promises to help a firm recover from inferior performance. Therefore, the role of positive stakeholder relations in helping poorly performing firms recover is found to be more critical than its role in helping superior firms sustain their performance advantage. Copyright © 2009 John Wiley & Sons, Ltd.

INTRODUCTION

The literature on corporate social performance in general, and on stakeholder relations in particular, has argued that a firm's good relationships with its various stakeholders increase its financial performance (Orlitzky, Schmidt, and Rynes, 2003; Roman, Hayibor, and Agle, 1999). Building upon the resource-based view (RBV) of the firm, some recent work regards a firm's good relations with its stakeholders as valuable, rare, inimitable, and non-substitutable resources that contribute to the firm's gaining and sustaining a performance advantage (Hillman and Keim, 2001; Ruf *et al.*, 2001; Russo and Fouts, 1997). This suggests that good stakeholder relations not only help firms to gain performance advantages but also enable the performance advantages to persist.

Many existing empirical studies in this area have focused on examining the cross-sectional

relationship between stakeholder relations and firm financial performance and generally found that there is a positive association between the two (for reviews, see Orlitzky *et al.*, 2003; Roman *et al.*, 1999). But a finding that stakeholder relations are positively associated with firm financial performance does not necessarily suggest that they contribute to the persistence of that performance (Waring, 1996). To fill the gap of the previous research, in this study we explicitly examine the effect of stakeholder relations on the *persistence* of a firm's superior financial performance.

Moreover, the role of stakeholder relations in influencing the persistence of a firm's *inferior* financial performance is largely left unexplored. Some arguments in the RBV and dynamic capabilities literatures suggest that core resources that bring a firm competitive advantage may also be a source of 'core rigidities' when business conditions change (Eisenhardt and Martin, 2000; Teece, Pisano, and Shuen, 1997). However, in this study we argue that while this logic generally applies to firms' resources such as technological knowledge, it does not directly apply to relationship-based resources. More specifically, we posit that unlike other typical firm resources, good stakeholder relations can enhance a poorly performing firm's flexibility in implementing strategic changes, and thereby help the firm move out of its disadvantageous position more quickly.

HYPOTHESES

This study focused on a firm's relationships with several stakeholder groups 'whose primary benefit derived from the company is not from... shareholder returns' (Coombs and Gilley, 2005: 827). In particular, the stakeholders in this study include employees, customers, suppliers, and the community at large.

Stakeholder relations and the persistence of superior financial performance

A firm's good relations with its various stakeholders can be a valuable resource that may lead to performance advantages for the firm (Hillman and Keim, 2001; Ruf *et al.*, 2001; Russo and Fouts, 1997): employees will work harder to enhance the firm's effectiveness (Dutton, Dukerich, and Harquail, 1994); customers will increase their demand

or pay premium prices for the firm's products (Brown and Dacin, 1997); suppliers will be more willing to engage in knowledge sharing with the firm (Dyer and Singh, 1998); and local communities may provide favorable terms for the use of local infrastructure (Fombrun, 1996).

Moreover, good stakeholder relations are likely to exist only in a relatively small number of firms; and, because each firm is idiosyncratic and has a unique history, there exist diverse stakeholder management practices, as well as differences in what each firm aims to achieve from stakeholder management. Not only are sound stakeholder relations rare, but they are generally difficult to imitate because different firms are likely to develop firm-specific stakeholder management practices that are tailored to their stakeholders and organizational objectives (Ruf *et al.*, 2001). In addition, because the trust characterizing any sound stakeholder relationship takes a long time to build (Barney and Hansen, 1994), it is unlikely that any rival firm can quickly construct stakeholder relationships as strong as those of the focal firm (Fombrun, 1996; Hillman and Keim, 2001). Thus the time dimension, an important path-dependent attribute, makes good stakeholder relations difficult for competing firms to imitate or substitute for, at least in the short run (Hillman and Keim, 2001).

The complexity inherent in managing diverse stakeholders, which involves close interaction with a number of interrelated social actors, including employees, customers, suppliers, and communities, further impedes competitors from imitating or substituting for a firm's good stakeholder relations (Hillman and Keim, 2001). Indeed, some managers may simply not know how to build good relations with myriad stakeholders effectively. In addition, the complexity in firm-specific stakeholder relationships makes it difficult for managers to obtain useful advice from outside the firm on how to build strong stakeholder relations (Preece, Fleisher, and Toccacelli, 1995). Moreover, due to differences among firms in their cultural values, organizational structures, and other internal and external features, some firms may incur higher costs in building relationship assets with their stakeholders than others. For example, Graves and Waddock (2000) have argued that building stakeholder relations is likely to derive directly from the values embedded in a company's culture, implying that companies with core values that provide stakeholders with a sense of meaning and belonging are more likely to be

able to build good stakeholder relations more efficiently than firms without such values. So, competing firms without such core values may not be able to develop substitutes for a focal firm's strong stakeholder relationships at a similar cost.

In addition to a direct effect on a firm's sustainable performance advantage, good stakeholder relations may also function as a complementary resource that protects against the dissipation of profits generated from other core resources. For example, skilled employees are likely to be a source of superior performance; but, such a performance advantage may not be sustainable if the employees can be lured away to competing firms. However, since good relations with employees can create stronger loyalty and commitment, it reduces employees' incentive to leave (McWilliams and Siegel, 2001).

In sum, good stakeholder relations are valuable, rare, and costly for rival firms to imitate and/or substitute for; moreover, they function as a complementary resource that helps sustain the performance advantage generated from other firm resources. We therefore propose:

> *Hypothesis 1: Stakeholder relations are positively associated with the persistence of superior financial performance.*

Stakeholder relations and the persistence of inferior financial performance

The dynamic capabilities approach in strategy research (Eisenhardt and Martin, 2000; Teece *et al.*, 1997) suggests that core resources or capabilities that bring a firm competitive advantage are often specialized to the firm's particular operating context (Brush and Artz, 1999; Priem and Butler, 2001). This feature of firm resources contributes to the sustainability of firm performance advantage, but it may also be a source of 'core rigidities' or a 'competence trap' in the face of changing business conditions (Leonard-Barton, 1992; Teece *et al.*, 1997). These resources or capabilities may thus prevent a firm from recovering from a disadvantageous position. For example, although organizational routine is difficult to imitate and thus often contributes to sustained performance advantage, it can also create inertia that prevents the necessary change that a firm needs for successful

recovery from inferior performance (Hannan and Freeman, 1984; Stuart and Podolny, 1996).

If this logic applied equally to all kinds of resources, it might be reasonable to expect that the good stakeholder relations that help sustain superior performance might also be a source of persistent inferior profitability when the firm experiences financial difficulties. However, we argue that unlike other typical firm resources or capabilities that only create value in a firm's specific, existing operational setting, good stakeholder relations built on trust and loyalty are generally not so specialized. As a result, a firm's need to make strategic adjustments in order to recover from poor performance is unlikely to reduce the benefits of maintaining good relations with its stakeholders. Rather, already established good stakeholder relations will remain valuable because they encourage stakeholders to maintain their commitment and support (Godfrey, 2005), which may in turn enable the firm to implement strategic changes. As such, good stakeholder relations that have already been built before a firm experiences poor performance may help the firm recover more quickly from its performance disadvantage.

More specifically, inferior financial performance is often a strong signal of the failure of existing strategy. To recover, a poorly performing firm needs to adjust its business-level strategies by, for example, improving its operational processes, redesigning its products, or innovating in its existing lines of business (Arogyaswamy, Baker, and Yasai-Ardekani, 1995). For this purpose, already established good relations with internal stakeholders may facilitate combining knowledge and capabilities that are scattered within the firm; good relations with external stakeholders may allow the firm to access diverse external knowledge and information. Thus, stakeholders' cooperation, facilitated by good firm-stakeholder relations, can contribute to the integration of internal and external resources needed for such strategic adjustments in order to recover from poor performance (Blomqvist and Seppänen, 2003; Hillman and Keim, 2001).

Good stakeholder relations may also be crucial when the firm needs to move out of poor performance by adjusting its corporate-level strategy, such as exploring new lines of business (Cohen and Prusak, 2001). For example, timely market information from suppliers, customers, and the community can offer valuable inputs about where and how a poorly performing firm should invest its limited

resources (Dyer and Singh, 1998). Furthermore, the community and the government can provide a well-connected firm with local infrastructure or licenses on favorable terms, which are often essential for exploring new business opportunities (McBeth, 1994).

The Chrysler Corporation's recovery during the recession of 1990 and 1991 owed much to the close relationships it had established with its diverse stakeholders, especially with its suppliers (Rigby, 2001). Chrysler's suppliers suggested various ways to cut costs, which enabled Chrysler to substantially improve efficiency. As a result, Chrysler was able to use its 'improved cash flows to invest in new product development, introducing cross-functional platform teams to improve quality and speed' (Rigby, 2001: 102). As another example, Malden Mills, a textile manufacturer in Massachusetts, experienced a serious financial crisis in 1995 as a result of an industrial accident (Ulmer, 2001). However, the company was able to recover from the crisis within less than one year. The main reason, according to CEO Aaron Feuerstein, was that its employees, suppliers, customers, and community stood behind the company and supported it in various ways. Ulmer (2001) has documented that the firm's employees and many of its customers showed loyalty and strong support for the firm's recovery efforts, the community raised donations for the firm, and the media publicized the company as an example of corporate responsibility.

In summary, already established good stakeholder relations that are built on trust and loyalty can help a firm to more quickly move out of a disadvantageous position by facilitating its strategic adjustments.

Hypothesis 2: Stakeholder relations are negatively associated with the persistence of inferior financial performance.

METHODS

Data and measures

Data from KLD Research and Analytics Inc. was used to construct measures of stakeholder relations. Information on stakeholder relations relating to firms belonging to the S&P 500, the DSI 400, or both, was analyzed for the 11-year period of 1991 to 2001. It was then merged with COMPUSTAT data to obtain information on firm financial performance and other control variables. After removing firms with only one year stakeholder relations data during the sample period, we obtained a final sample of 518 firms and 4,113 firm-year observations.

An aggregate measure of *stakeholder relations* was computed incorporating the community relations, diversity, employee relations, environment, and product dimensions of the KLD data (Hillman and Keim, 2001). Each of the five dimensions is tabulated in terms of several 'strengths' and 'concerns' in the KLD index. To arrive at a net score for each dimension, the total number of concerns was subtracted from the total number of strengths (Graves, Waddock, and Kelly, 2005). In addition, each dimension was standardized to make the scores across dimensions directly comparable (Mattingly and Berman, 2006). The average of standardized scores on the five dimensions with an equal weight was then used to obtain an aggregate stakeholder relations score (Hillman and Keim, 2001).

Corporate financial performance was measured in two ways: return on assets (ROA) and Tobin's q. Following the lead of previous studies on the persistence of financial performance (Waring, 1996; McGahan and Porter, 1999), each measure of financial performance was adjusted by its industry average calculated at the four-digit Standard Industrial Classification code level.

Several variables that may affect the persistence of profits were included as controls. First, *technological knowledge,* estimated in terms of research and development (R&D) intensity, is often cited as one of the key sources of persistent performance advantage (Kogut and Zander, 1992). Second, *firm risk,* or the ratio of long-term debt to total assets, was also included, since risk has been found to be associated with both stakeholder relations and financial performance (Waddock and Graves, 1997). *Firm size*, measured by the natural logarithm of total sales, was also added, because large size often brings economies of scale or scope, which may be difficult to imitate (Roberts and Dowling, 2002). Furthermore, since inertia is generally more significant in older firms (Hannan and Freeman, 1984), *firm age* may show some effect on the persistence of performance differences, and

was thus included in the equation. Industry dummies were also included to control for any variation across industries.

Modeling the persistence of firm profitability

Following previous studies (Geroski and Jacquemin, 1988; McGahan and Porter, 1999; Waring, 1996), we examine the persistence of firm profitability using a series of first-order autoregressive models.[1] The following equation, which is a variation of a typical first-order autoregressive model, is estimated in this study.

$$
\begin{aligned}
\pi_{it} = {} & \alpha_0 + \alpha_1 \times SR_{i(t-1)} + \alpha_2 \times X_{i(t-1)} \\
& + \beta_0 \times \pi_{i(t-1)} \\
& + \beta_1 \times SR_{i(t-1)} \times \pi_{i(t-1)} + \beta_2 \times X_{i(t-1)} \\
& \times \pi_{i(t-1)} + Ind_{i(t-1)} + \varepsilon_{it}
\end{aligned} \tag{1}
$$

where β_0 is the persistence rate when there is no influence from other factors (i.e., when β_1 and β_2 are 0). $SR_{i(t-1)}$ is the lagged value of stakeholder relations for firm i. $X_{i(t-1)}$ represents other lagged factors that are expected to affect the persistence of firm profits, including R&D intensity, firm risk, firm size, and firm age. $Ind_{i(t-1)}$ includes all industry dummy variables.

Hypothesis 1 predicts positive estimates for β_1 if the sample is composed of firms with superior profitability, because a positive β_1 indicates that the above-normal profits earned by firms with good stakeholder relations have a greater persistence rate. In contrast, Hypothesis 2 predicts a negative β_1 for a sample of firms with inferior profitability, as a negative β_1 indicates a lower profit persistence rate, that is, firms with good stakeholder relations move out of inferior financial performance more quickly. α_1 indicates the independent contribution of stakeholder relations on profitability.

A firm fixed-effects approach was taken to allow for any correlation of stakeholder relations with the firm-specific component of the error term. However, some econometricians (e.g., Nerlove, 1967; Nickell, 1981) have established that the standard

methods of firm fixed-effects model estimation are liable to generate seriously biased coefficients when estimating a first-order autoregressive model like ours, due to the correlation of the lagged dependent variable with the error term. Nerlove (1967) and Nickell (1981) have also demonstrated that the biases are most serious when the panel has a large number of firms and a rather small number of time periods, which is again the case for our sample (518 firms across 11 years). A formula developed by Nickell (1981), which has also been applied by McGahan and Porter (1999) and Waring (1996) in their studies, was therefore applied to correct for any bias.[2]

Furthermore, stakeholder relations may be an endogenous variable influenced by a number of factors, which, if not taken into consideration, may lead to biased estimates (Greene, 1997). To address such concerns, we conducted a two-stage instrumental variable analysis (Greene, 1997). In this procedure, technological knowledge, slack resources, firm size, age, and risk were included in the first-stage equation to predict stakeholder relations, but all were lagged by one additional year. Studies in stakeholder management and social issues (e.g., Hillman and Keim, 2001; McWilliams and Siegel, 2000; Seifert, Morris, and Bartkus, 2004; Waddock and Graves, 1997) provide rationales for including each of these factors. In addition, an industry level of stakeholder relations was included as an instrumental variable.

RESULTS

The key analyses were conducted using two different samples: an above average sample (i.e., superior financial performance: N = 1, 618), and a below average sample (i.e., inferior financial performance: N = 1, 510). The two subsamples were constructed based on whether the firm's financial performance (in terms of both ROA and Tobin's q) was above or below the industry average.[3] Some

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[1] In order to verify whether or not a simple first-order autoregressive (AR(1)) model properly represents profit diffusion for this data, higher order models were tested up to order four. The first-order autoregressive model consistently produced the lowest Akaike Information Criterion and Schwarz's Bayesian Criterion values, confirming it as preferable to higher-order models.

[2] This involved estimating a fixed-effects model that differs from Equation (1) by subtracting each variable from the firm's mean over the time period. After the persistence parameters of the fixed-effects model were estimated, the amount of bias was then added back using Nickell's (1981) formula to obtain unbiased estimates of the persistence parameters.

[3] Since the ROA and Tobin's q used in this study were industry-adjusted values, the above average group was composed of firms with both lagged ROA and lagged Tobin's q greater than zero;

analyses were also conducted using a full sample (N = 4, 113), which serve primarily as a baseline for comparison. Table 1 presents descriptive statistics and correlations for the key variables in this study, using the full sample.

Stakeholder relations and the persistence of financial performance

Table 2 presents the relationship found between stakeholder relations and the persistence of financial performance. Hypothesis 1 states that good stakeholder relations can sustain a firm's profit advantage over a long period. Consistent with the prediction, the coefficients on the interaction terms (*stakeholder relations*lagged ROA* and *stakeholder relations*lagged Tobin's q*, Models 4a and 4b, Table 2) were significantly positive, indicating that good stakeholder relations contribute to the persistence of superior financial performance. Thus, Hypothesis 1 was supported. However, stakeholder relations did not show a significant effect on the intercept term (i.e., the coefficient on the stakeholder relations term was insignificant), suggesting that although the superior profits of firms with high stakeholder relations ratings dissipate more slowly, they eventually converge back to a profit rate that is not significantly different from the industry average (top chart, Figure 1).[4]

Hypothesis 2 predicts a negative sign on the interaction term (*stakeholder relations*lagged financial performance*) for firms with below-average performance. Models 6a and 6b of Table 2 show that the coefficients on the *stakeholder relations*lagged financial performance* interaction terms were significantly negative. This suggests that a high stakeholder relations rating predicts that a firm will be able to move out of a disadvantageous position more quickly. Thus,

and the below average group comprised firms with both values less than or equal to zero.

[4] The chart compares the path of profit convergence of two hypothetical firms with superior profitability, one with a high stakeholder relations score (one standard deviation above the mean), and the other with a low score in stakeholder relations (one standard deviation below the mean). Using the parameter estimates from Model 4a, the figure shows that a relative ROA of 0.13 in year zero erodes more slowly if the firm in question has a better stakeholder relations rating. Because stakeholder relations showed similar relationships with the persistence of both ROA and Tobin's q, only the ROA relationship is charted. The chart depicting the effect on Tobin's q is available from the authors upon request.

Hypothesis 2 was supported. Similar to the results with Models 4a and 4b, the stakeholder relations scores did not show a significant effect on the intercept term, suggesting that below-normal profits of firms with high stakeholder relations scores, in the long run, converge toward the industry average (bottom chart, Figure 1).

The economic significance of stakeholder relations may be demonstrated by examining the influence of a one unit increase in the stakeholder relations measure on the persistence of financial performance. According to Table 2, a one unit increase in the stakeholder relations measure makes 90 percent of a firm's superior ROA persist 27 percent longer (or from 3.35 years to 4.38 years: Model 4a), and in the case of Tobin's q, 32 percent longer (or from 4.27 years to 5.62 years: Model 4b). Similarly, 90 percent of a firm's inferior ROA will dissipate 55 percent faster (or in 0.75 years rather than 1.69 years: Model 6a) and in the case of Tobin's q, 23 percent faster (or in 2.41 years instead of 3.15 years: Model 6b).

Control variables and the persistence of financial performance

The positive and significant coefficients on both technological knowledge and its interactions with lagged ROA and Tobin's q among well-performing firms indicate that investment in R&D predicts both better long-run profits and the persistence of superior profits. Among poorly performing firms, the coefficients on the interaction terms between technological knowledge and lagged financial performance remained significantly positive, supporting the argument that a high level of technological knowledge locks a firm into disadvantageous positions. Technological knowledge, however, contributes positively to the intercept term, suggesting a positive effect on long-run converged profit levels.

Also, firms with high debt ratios are less likely to sustain superior ROA. This result is consistent with expectations. Interestingly, large firms were found to be less likely to sustain a superior ROA, but more likely to sustain a superior Tobin's q. This result seems to suggest that although large firms delivering superior performance are more likely to have fluctuating accounting returns, they tend to receive stable evaluations from stock market investors. Firm risk had a positive effect on the persistence of inferior financial performance

Table 1.   Descriptive statistics and correlation matrix

Variables	Mean	s. d.	1	2	3	4	5	6	7	8	9	10	11	12	13
1. ROA[a]	0.005	0.057													
2. Lagged ROA	0.004	0.055	0.602*												
3. Tobin's Q	0.126	1.368	0.360*	0.355*											
4. Lagged Tobin's Q	0.148	1.497	0.588*	0.384*	0.574*										
5. Technological knowledge (R&D)	0.068	0.117	0.094*	0.102*	0.434*	0.210*									
6. Firm risk (debt ratio)	0.184	0.138	−0.145*	−0.151*	−0.298*	−0.201*	−0.283*								
7. Firm size	16.55	1.633	−0.013	−0.019	−0.102*	−0.069*	−0.076*	0.105*							
8. Firm age	40.30	11.56	−0.104*	−0.096*	−0.228*	−0.210*	−0.141*	0.113*	0.248*						
9. Stakeholder relations (aggregate)[b]	0	0.545	0.048*	0.067*	0.148*	0.151*	0.106*	−0.087*	−0.059*	−0.129*					
10. Community	0	1	0.050*	0.062*	0.042*	0.018	0.016	−0.066*	0.185*	0.017	0.461*				
11. Employee	0	1	0.068*	0.084*	0.120*	0.068*	0.147*	−0.080*	−0.005	−0.055*	0.589*	0.072*			
12. Diversity	0	1	0.022	0.059*	0.076*	0.020	0.055*	0.003	0.122	0.040*	0.470*	0.369*	0.132*		
13. Product	0	1	0.072*	0.058*	0.061*	0.088*	0.037*	−0.025	−0.107*	−0.161*	0.615*	−0.038*	0.171*	−0.068*	
14. Environment	0	1	0.061*	0.069*	0.060*	0.021	0.014	−0.080*	−0.272*	−0.146*	0.526*	0.142*	0.111*	0.011	0.253*

N = 4, 113. * Significant at the $p < 0.05$ level.
[a] Industry-adjusted values are shown for the performance measures (variables 1–4).
[b] Stakeholder relations (aggregate) is calculated as the average of the five individual dimensions of stakeholder relations.

Table 2.   Stakeholder relations (aggregate measure) and the persistence of profitability (autoregressive models with firm-fixed effect)[ab]

Variables	DV: ROA						DV: Tobin's Q					
	Total sample		Superior perf.		Inferior perf.		Total sample		Superior perf.		Inferior perf.	
Models	1a	2a	3a	4a	5a	6a	1b	2b	3b	4b	5b	6b
Lagged DV	0.551*** (0.009)	0.465*** (0.042)	0.611*** (0.017)	0.503*** (0.037)	0.552*** (0.020)	0.255*** (0.071)	0.725*** (0.007)	0.609*** (0.073)	0.721*** (0.010)	0.583*** (0.062)	0.529*** (0.011)	0.481*** (0.060)
Stakeholder relations		0.001 (0.001)		-0.001 (0.001)		-0.005 (0.005)		0.061+ (0.035)		0.088 (0.064)		0.066 (0.051)
Technological knowledge (R&D)		0.062*** (0.012)		0.067*** (0.012)		0.072*** (0.012)		3.329*** (0.158)		4.133*** (0.342)		2.482*** (0.343)
Risk (debt ratio)		-0.011** (0.004)		-0.010 (0.007)		-0.012+ (0.007)		-0.200* (0.090)		-0.179 (0.149)		-0.284** (0.111)
Firm size		-0.001* (0.000)		0.001 (0.001)		0.003* (0.001)		-0.032* (0.014)		-0.055* (0.028)		-0.013 (0.025)
Firm age (×10⁻³)		-0.011 (0.049)		0.012 (0.091)		0.134 (0.094)		0.045 (0.052)		0.035 (0.107)		0.154* (0.077)
Stakeholder relations * Lagged DV		0.019 (0.020)		0.088* (0.037)		-0.209*** (0.042)		0.037 (0.030)		0.081** (0.030)		-0.096+ (0.053)
Technological knowledge * Lagged DV		0.189*** (0.050)		0.745*** (0.084)		0.995*** (0.138)		0.077 (0.091)		0.833*** (0.141)		0.523* (0.260)
Size * Lagged DV		0.059*** (0.005)		-0.053*** (0.012)		0.075*** (0.010)		0.071*** (0.012)		0.075*** (0.016)		0.097*** (0.020)
Risk * Lagged DV		-0.224** (0.074)		-0.280+ (0.145)		0.221 (0.136)		-0.493*** (0.129)		-0.156 (0.311)		0.325+ (0.225)
Age * Lagged DV (×10⁻²)		0.278*** (0.075)		0.055 (0.138)		0.234* (0.115)		0.602*** (0.067)		-0.083 (0.151)		1.141*** (0.107)
No. of observations	4,113	4,113	1,618	1,618	1,510	1,510	4,113	4,113	1,618	1,618	1,510	1,510
Adjusted R²	0.521	0.591	0.464	0.514	0.335	0.442	0.626	0.689	0.610	0.666	0.572	0.661
ΔR²		0.070***		0.050***		0.107***		0.063***		0.056***		0.089***

[a] : Standard errors are shown in parentheses. Significant at the $^+ p < 0.10$, $^* p < 0.05$, $^{**} p < 0.01$, or $^{***} p < 0.001$ level.
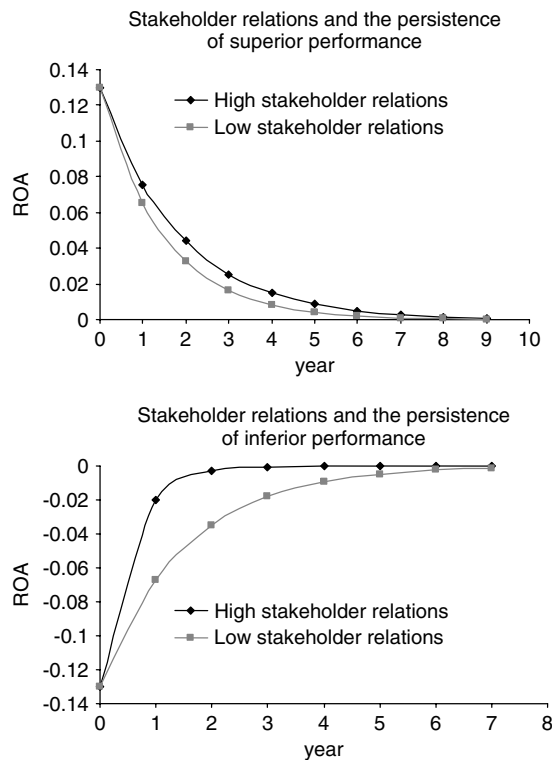[b] : Industry controls were included but are not reported.

Figure 1.   Stakeholder relations and the persistence of financial performance

important role of a firm's relations with key stake-holders in creating and sustaining economic rents for the firm.

Stakeholder relations and technological knowl-edge assets demonstrated both similarities and dif-ferences in terms of their influence on the persis-tence of superior or inferior profits. Although both a high stakeholder relations rating and a greater level of technological knowledge predict the per-sistence of superior profits, the predictive power of technological knowledge is apparently greater (top chart in Figure 2). On the other hand, these two factors show opposite effects on the persis-tence of inferior profits, as seen in the bottom chart in Figure 2. While technological knowledge tends to lock a poorly performing firm into disadvanta-geous positions, good stakeholder relations make inferior profits more transient. This notable dis-crepancy implies that the common argument that resources that are sources of sustained superior profits are also likely to be the sources of ongo-ing losses (Leonard-Barton, 1992) may not apply to stakeholder relations.

These findings also suggest that the role of good stakeholder relations in helping poorly perform-ing firms recover is more critical than its role in helping superior firms sustain their performance. In particular, while good stakeholder relations help successful firms sustain their superior profits, the degree of influence is not as high as that of some other firm resources, such as technological knowl-edge. On the other hand, having good stakeholder relations is the only factor (among those exam-ined in this study) that promises to help a firm recover from inferior performance. This highlights the importance of good stakeholder relations to poorly performing firms: a firm is unlikely to recover quickly from inferior performance without good stakeholder relations. Please note that this result does not suggest that a firm should build its stakeholder relations after it incurs poor per-formance. In fact, that would probably be too late due to the difficulty in building good relations in a short period of time, as well as the resource con-straints typical of poorly performing firms. Rather, our arguments and empirical results suggest that a poorly performing firm only benefits from good stakeholder relations already built before the per-formance downturn.

Some promising directions for future research may include a further exploration of the role of each stakeholder group on a conceptual level.

(Tobin's q), but to a lesser extent than technolog-ical knowledge and firm size. Firm age also had a positive effect on the persistence of inferior perfor-mance for both performance measures, consistent with the argument that inertia is stronger in older firms.

DISCUSSION AND CONCLUSIONS

This study found support for the arguments that a high stakeholder relations rating both helps a well-performing firm to sustain superior profits, and helps a poorly performing firm to move out of its disadvantageous position more quickly. In particular, this study has placed a special empha-sis on poorly performing firms and demonstrated that, unlike many other rare and hard-to-imitate resources, good stakeholder relations do not lock a firm into poor positions when it incurs a down-turn in financial performance; instead, they help the firm recover more quickly from poor perfor-mance. As such, our study has emphasized the
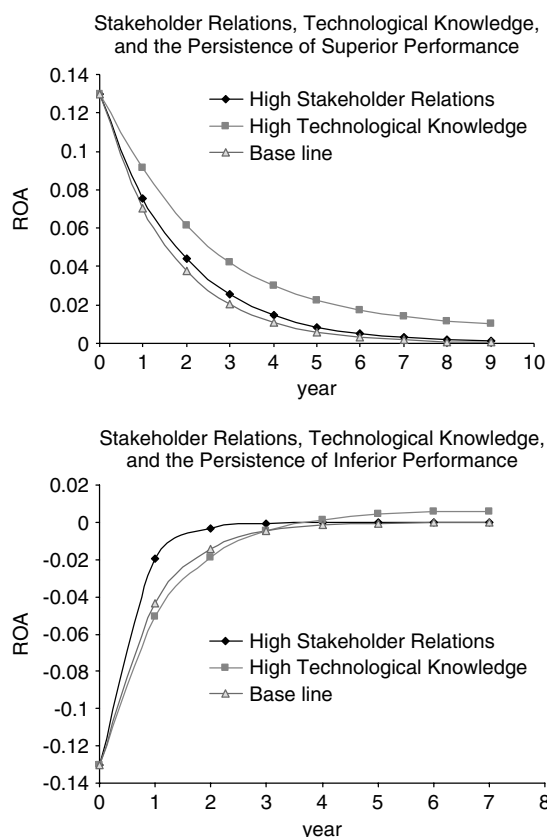
Figure 2.   Comparing the effects of stakeholder relations and technological knowledge (R&D)

This study has investigated the influence of each stakeholder group on the persistence of financial performance empirically (see the Appendix), but more theoretical development that focuses on the contribution of each group is necessary. Variations may exist even within a same stakeholder group. For example, a firm's relationship with different types of employees, such as that with key knowledge employees versus that with low-level laborers, are expected to have different degrees of impact on the persistence of corporate financial performance. Further research efforts along these lines can enrich stakeholder theory and provide meaningful, practical guidelines for managing stakeholder groups. In addition, in this study stakeholder relations were assessed with a measure in which strengths and weaknesses (concerns) in the KLD ratings were combined. However, some recent work (e.g., Mattingly and Berman, 2006) has suggested that the effects of strengths and weaknesses in stakeholder relations be separately investigated. Thus future research might explore

this further by examining the separate effects of strengths and weaknesses, both conceptually and empirically.

In addition to its direct contribution to the stakeholder management and corporate social responsibility literature, this study also contributes to the RBV. While recent studies increasingly acknowledge the usefulness of applying the RBV to enhance the theoretical development in the area of corporate social performance and stakeholder theory (McWilliams, Siegel, and Wright, 2006), empirical studies in this area have primarily focused on the role of stakeholder relations in gaining superior financial performance. This study thus complements the existing research by explicitly demonstrating the influence of stakeholder relations on the *persistence* of corporate financial performance. Moreover, the study's special attention on inferior-performing firms fills a gap in the RBV literature, which has largely focused on the sustainability of superior performance or competitive advantage. An additional contribution to the RBV is that we have explicitly distinguished between resources specialized to a firm's operational context and relational resources that are noncontext-specific in terms of their influence on a firm's recovery from inferior performance.

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APPENDIX: INDIVIDUAL DIMENSIONS OF STAKEHOLDER RELATIONS AND THE PERSISTENCE OF FINANCIAL PERFORMANCE

Each of the five dimensions of stakeholder relations was examined separately to obtain a more in-depth understanding of its contribution to the persistence of corporate financial performance. Table A1 presents the results of these additional analyses.

For the superior-performing firms, both the employee relations and product dimensions have positive effects on the persistence of superior ROA and Tobin's q. In addition, good management of diversity enables firms to sustain superior ROA, and positive relations with the community contributed to the persistence of superior Tobin's q. For the inferior financial performance sample (Models 6–10 in Table A1), both the employee relations and diversity dimensions help firms to recover from disadvantaged positions more quickly. It was also found that high ratings in the product dimension enable a firm to recover from low Tobin's q more quickly. Lastly, high scores in the community relations and environment dimensions make inferior ROA less persistent.

Taken together, employee relations and product quality were found to be the most critical in making superior performance more persistent; respect for diversity and product quality are particularly helpful in overcoming inferior financial performance more quickly. This suggests that it might be necessary for firms to strategically prioritize their attention to different stakeholder groups in order to benefit the most from their stakeholder management practices. The results suggest that management of human resources (employee relations and diversity) and marketing (product) should be at the top of a manager's agenda, ahead of community and environmental issues. Such prioritization should be especially important for firms that are especially constrained in the amount of resources they can dedicate to nonfinancial stakeholders.

Table A1.   Stakeholder relations (individual dimensions) and the persistence of profitability (autoregressive models with firm-fixed effect)[ab]

Variables	DV: ROA									
	Superior performance					Inferior performance				
Models	1a	2a	3a	4a	5a	6a	7a	8a	9a	10a
Lagged DV	0.539***	0.535***	0.538***	0.533***	0.532***	0.236***	0.244***	0.245***	0.231***	0.233***
	(0.035)	(0.035)	(0.035)	(0.036)	(0.035)	(0.069)	(0.069)	(0.067)	(0.071)	(0.069)
Community	0.001					0.001				
	(0.001)					(0.001)				
Com.* Lagged DV	0.008					−0.067*				
	(0.020)					(0.029)				
Employee		0.001					−0.001			
		(0.002)					(0.001)			
Emp.* Lagged DV		0.105***					−0.043*			
		(0.019)					(0.021)			
Diversity			−0.002					0.001		
			(0.002)					(0.002)		
Div.* Lagged DV			0.040*					−0.088***		
			(0.019)					(0.019)		
Product				0.002+					−0.001	
				(0.001)					(0.002)	
Prod.* Lagged DV				0.032+					−0.018	
				(0.018)					(0.026)	
Environment					0.002					−0.005+
					(0.002)					(0.003)
Env.* Lagged DV					−0.035					−0.066*
					(0.028)					(0.032)
# Obs.	1,618	1,618	1,618	1,618	1,618	1,510	1,510	1,510	1,510	1,510
Adjusted R²	0.514	0.518	0.512	0.513	0.513	0.436	0.436	0.440	0.432	0.437
ΔR² vs. Model 3a/5a (Table 2)	0.050***	0.054***	0.048***	0.049***	0.049***	0.101***	0.101***	0.105***	0.097***	0.102***

Variables	DV: Tobin's Q									
	Superior performance					Inferior performance				
Models	1b	2b	3b	4b	5b	6b	7b	8b	9b	10b
Lagged DV	0.731***	0.709***	0.691***	0.682***	0.679***	0.541**	0.552**	0.678***	0.655***	0.554**
	(0.062)	(0.062)	(0.064)	(0.065)	(0.062)	(0.209)	(0.194)	(0.204)	(0.193)	(0.193)
Community	0.077*					0.007				
	(0.032)					(0.031)				
Com.* Lagged DV	0.049+					0.033				
	(0.027)					(0.042)				
Employee		0.006					0.075**			
		(0.035)					(0.028)			
Emp.* Lagged DV		0.055*					−0.059*			
		(0.026)					(0.029)			
Diversity			0.032					0.092**		
			(0.035)					(0.030)		
Div.* Lagged DV			0.019					−0.061*		
			(0.022)					(0.030)		
Product				0.031					0.065*	
				(0.031)					(0.029)	
Prod.* Lagged DV				0.056*					−0.071**	
				(0.026)					(0.028)	
Environment					0.009					−0.033
					(0.038)					(0.030)
Env.* Lagged DV					0.033					0.019
					(0.049)					(0.052)
# Obs.	1,618	1,618	1,618	1,618	1,618	1,510	1,510	1,510	1,510	1,510
Adjusted R²	0.672	0.666	0.661	0.665	0.661	0.652	0.663	0.662	0.662	0.655
ΔR² vs. Model 3b/5b (Table 2)	0.062***	0.056***	0.051***	0.055***	0.051***	0.080***	0.091***	0.090***	0.090***	0.083***

[a] : Standard errors are shown in parentheses. Significant at the $^{+}\ p < 0.10$, $^{*}\ p < 0.05$, $^{**}\ p < 0.01$, $^{***}\ p < 0.001$ level.
[b] : Variables associated with technological knowledge, firm risk, firm size, firm age, and industry controls are included (as in Table 2) but not shown.