

RESEARCH BRIEFS

THE PAYOFF FROM CORPORATE SOCIAL RESPONSIBILITY IN CHINA: DOES THE POLITICAL CONTEXT MATTER?

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RESEARCH QUESTIONS

Many questions surround the potential relationship between a firm's corporate social responsibility (CSR) and its corporate political activity (CPA). For instance, when CSR and CPA are aligned, does it lead to an improvement in a firm's social legitimacy and financial performance? Do the benefits of alignment depend on the institutional and political context—for example, are the benefits likely to be more substantive in a transitional economy than in a developed economy? How can a firm's CSR efforts enhance its political effectiveness and, alternatively, how can a firm's CPA affect and enhance its CSR? Moreover, does a firm's politically motivated CSR lead to an increase in a firm's financial performance?

Despite increasing scholarly interest about how firms' nonmarket strategy, CSR, and CPA interrelate, answers to these questions remain elusive. It would be important to know, for instance, whether aligning CSR and CPA positively impacts a firm's legitimacy and financial performance (Anastasiadis, 2014; den Hond et al., 2014; Fremeth & Richter, 2011; Rehbein & Schuler, 2013; Richter, 2011; Wang & Qian, 2011; Werner, 2015). Most recently, Werner (2015) found that a firm's sociopolitical reputation can impact its ability to gain political access. A firm's treatment of its stakeholders helps to differentiate the firm in the political market and sends a signal to politicians that the firm may be an important political ally (Werner, 2015). Alternatively, scholars have looked at how CPA may benefit a firm's social strategy, helping the firm to develop its social priorities and create credible commitments (den Hond et al., 2014). What little empirical work exists in this research area has focused on developed countries with democratic political institutions. An important and understudied question is whether and how a firm's political context impacts the value of aligning a firm's CSR and CPA.

That said, a recent study by Karen Jingrong Lin (University of Massachusetts, Lowell), Jinsong

Tan (Sun Yat-Sen University), Liming Zhao (State Grid Corporation of China), and Khondkar Karim (University of Massachusetts, Lowell) sheds some light on this issue. Lin and her colleagues investigate if a firm's CSR efforts can help it develop a political network in transitional economies and whether positive payoffs in the form of government subsidies and an increase in financial performance will occur. Specifically, they examine the market for politically motivated CSR in China at the local level and the market for political connections.

China is a transitional economy with a top down, single party system. Central government officials appoint local officials based on their ability to promote the social and economic development of their local regions. They also appoint the local officials based upon personal relationships with government officials. Often, the local government lacks the funds to address social goals such as education and promotion of economic development, so it seeks corporate funds to fill budget gaps. Corporations are willing to provide these social donations because it solidifies their political ties with local government officials. While numerous studies (Faccio, 2006; Siegel, 2007) have looked at firm-specific benefits resulting from political ties with officials (e.g., preferential regulatory decisions; see Sun, Mellahi, and Wright, 2012, p. 70), Lin and her colleagues focused on the government subsidies that firms are more likely to receive if they provide charitable contributions (engaged in CSR) and their resulting financial effects.

With respect to political connections, Lin and her colleagues argue that the demand for political connections will depend on the type of firm. They contend that state-owned enterprises will have less interest in expending funds to develop political relations since they already have a more extensive political network with government officials. However, smaller and non-state-owned enterprises (NSOEs)

are more likely to be interested in using CSR to develop political ties. Indeed, in more corrupt regions, firms may use CSR to navigate among corrupt government officials. Another interesting question surrounds the timing of social expenditures and how this affects a firm's ability to strengthen its political network as well as maximize firm-specific benefits. In examining city-level mayoral turnovers, Lin and her colleagues argue that firms will spend money on social issues around the time new mayors are appointed. The appointment of a new mayor signals a new market for political connections, so all firms have an opportunity to build new political relationships. However, smaller firms and NSOEs will have more of an incentive than state-owned enterprises to use social expenditures to build these relationships since they have fewer political connections.

STUDY DESIGN AND METHODOLOGY

The study sample consisted of 1,553 firms with A-shares listed on either the Shenzhen or Shanghai stock exchange between 2005 and 2009. To assess socially responsible behavior, the authors collected charitable contribution data from annual reports. The appointment of new mayors was a key variable for assessing changes in political connections, and those data were drawn from public announcements. In addition, the authors collected information from annual reports about government subsidies. To measure a firm's political connections, they created a dummy variable to indicate whether the CEO or chairperson of the board had worked in any government position and/or for a state-owned bank. To establish political context, the authors gathered information concerning the entertainment fee charged by government officials in each region. Regions classified as high government quality charged a lower entertainment fee. Some control variables were also included in the study such as size, cash holdings, and geographic region. Lastly, the authors collected information about the financial performance of the firm to discern the political payoffs associated with a firm's politically motivated CSR.

KEY FINDINGS

The results clearly demonstrate that Chinese firms generally increase their amount of CSR contributions after the appointment of a new mayor in the regions where firms are operating. Firms also increase their

propensity to provide CSR contributions after a political turnover. This was especially noticeable among firms facing more challenges in establishing political connections, relatively smaller firms, firms not owned by the state, and firms operating in more corrupt regions. Regardless, Chinese firms that increase their CSR expenditures after a new mayor is appointed tend to enjoy positive payoffs (i.e., an increase in annual and windfall subsidies). Firms making these social investments also improve their financial performance, as measured by their return on assets and return on equity.

Another interesting finding was that there was no relationship between a firm's political connections and its politically motivated CSR. There has often been speculation about whether CSR and political efforts are substitutes or complements for one another (Richter, 2011). This finding may reflect the pervasiveness of political connections that Chinese firms possess, making it more difficult to detect the payoffs associated with having a CEO or chairperson with political experience.

CONCLUSION AND IMPLICATIONS

This study clearly illustrates the importance of considering the political context in evaluating the payoffs associated with politically motivated CSR. In addition, it provides some interesting insights into how CSR and CPA are interconnected in the context of transitional economies. To begin with, the political context changes with the appointment of a new mayor, which leads to an increase in CSR expenditures. These social expenditures help establish a good political relationship with the new mayor, resulting in an increase in government subsidies and, in turn, better financial performance for the firm. Previous studies have discussed how a firm's CSR can contribute positively to its political relationships by helping to establish a firm's legitimacy and credibility (den Hond et al., 2014; Rehbein & Schuler, 2013; Werner, 2015). Likewise, scholars have discussed the benefits of firms establishing political ties, especially in emerging countries (Faccio, 2006; Siegel, 2007). Studies have shown that firms with political ties are more likely to receive bailouts and preferential political treatment (Faccio, 2006) while also acknowledging the downside of political ties and their potential adverse effects (Dieleman & Boddewyn, 2012). Lastly, numerous studies (e.g., Brammer & Millington, 2008; Dean, 2003) have examined the relationship between CSR and a firm's financial performance in developed and developing countries.

Although this study sheds light on the interaction between CSR and CPA, it does so in a specific political context. This raises questions about generalizability beyond China. Unlike other countries, in China there is no specific way to predict the appointment of new mayors, creating an element of surprise that may not exist elsewhere. Moreover, political appointees in China are judged on their social achievements, and corporations are expected to help provide funds when there are fiscal gaps. Finally, the level of corruption in some of the regions may affect the necessity to provide CSR funds to develop some political connections. This raises the question of whether engaging in CSR is a good way to develop more productive relationships with government officials in a corrupt political system.

Another question that results from the work of Lin and her colleagues is whether the findings say anything about how the relationship between CSR and CPA might impact foreign competitors. Chinese firms that are less well connected politically seem more motivated to provide CSR funds to the newly appointed mayors in their regions. One might assume that foreign firms would be at a disadvantage relative to Chinese firms in terms of establishing political connections since they are even less politically connected to begin with. Consequently, the abrupt end of political ties for Chinese firms in a region may also provide a competitive opportunity for foreign firms—if they can develop political relationships through their social efforts.

SOURCE

Lin, K., Tan, T., Zhao, L., & Karim, K. (2015). In the name of charity: Political connections and strategic corporate social responsibility in a transition economy. *Journal of Corporate Finance*, 32, 327–346.

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