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The impact of corporate charitable giving on hospitality firm performance: Doing well by doing good?

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ABSTRACT

While corporate charitable giving (*CCG*) may have a positive or negative effect on corporate performance (based on value enhancement theory and agency cost theory, respectively), *CCG* could also have no impact at all. This article tests the extent to which *CCG* can influence corporate performance of Taiwan's publicly traded hospitality companies. The variable of *CCG* is defined as the ratio of the total value of corporate giving to total sales revenue. The measures of corporate performance are profitability (return on assets and return on equity), stock performance and Tobin's Q. Panel regression test results reveal that *CCG* can affect all measures of corporate performance except for stock return. In particular, the impact of *CCG* on return on assets, return on equity and Tobin's Q is an inverted U-shape, implying that an increased *CCG* can enhance corporate performance, but as the level of *CCG* reaches its optimal point, an increase in *CCG* could have a negative influence on corporate performance. Empirical test results can offer valuable managerial insights for the hospitality industry.

1. Introduction

As a specific component of corporate social responsibility, corporate charitable giving (*CCG*) is the act of corporations donating a portion of their profits or resources to social and charitable causes, including support for education, culture, the arts, minorities, health care, the environment and other public benefits (Godfrey, 2005; Wang et al., 2008). Why do corporations do this? According to value enhancement theory, *CCG* creates value for shareholders (Brown et al., 2006; Fry et al., 1982; Navarro, 1988). Brown et al. (2006) argued that *CCG* could be viewed as a form of investment to maximize shareholder value by enhancing employee morale, customer loyalty, and preferential treatment by regulators or policymakers. Researchers in finance, management and social science have attempted to identify the effects of *CCG* on corporate performance (Brammer and Millington, 2008; Lev et al., 2010; Wang et al., 2008). However, there is no consensus on the effects of *CCG* on corporate performance (Brammer and Millington, 2008; Wang et al., 2008).

Empirical studies have found mixed evidence on whether *CCG* can enhance or deteriorate corporate performance. Wang et al. (2008) concluded that *CCG* facilitates stakeholder cooperation and helps secure access to critical resources controlled by those stakeholders, suggesting that *CCG* should be positively associated with corporate financial performance. In addition, according to the value enhancement theory, *CCG* can persuade target stakeholders that a firm is socially responsible. Brown et al. (2006) and Navarro (1988) indicated that a positive company image could create the competitive advantages of brand differentiation, stakeholder loyalty and insurance-like protection. These competitive advantages thereby improve operational efficiency, reduce cost and generate profit for shareholders. Consequently, *CCG* should have a positive impact on corporate performance.

In contrast, *CCG* could have a negative influence on corporate performance. Based on agency cost theory, *CCG* may be considered as an additional agency cost generated by the conflict between shareholders and managerial insiders (managers and board directors) over charitable donation (Brown et al., 2006). When managerial insiders pursue their own interest through discretionary giving, they tend to give more to charity but at the expense of shareholders' interest (Barnett, 2007; Haley, 1991; Wang et al., 2008). Thus when the managerial insiders have an incentive to use *CCG* to enhance their own interests, *CCG* would not benefit the corporation and its shareholders. Instead, it may divert valuable corporate resources and undermine corporate performance.

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Nonetheless, some research studies revealed that *CCG* has a negligible effect on corporate performance. Griffin and Mahon (1997) investigated the relationship between *CCG* and corporate performance. They found no support for the relationship between *CCG* and corporate profitability measures (return on asset and return on equity). Berman et al. (1999) also showed that *CCG* could not significantly affect corporate financial performance measured by return on asset. Similarly, Seifert et al. (2004) showed that *CCG* could not have a strong effect on corporate stock return.

Wang et al. (2008) showed a curvilinear relation between *CCG* and corporate financial performance. Specifically, they detected an inverted U-shaped relationship between *CCG* and return on asset, and between *CCG* and Tobin's Q. In other words, an increased *CCG* can enhance return on asset and Tobin's Q. However, as the level of *CCG* reached a certain point, an increase in *CCG* could have a negative influence on return on asset and on Tobin's Q.

This study examines whether *CCG* affects the corporate performance of publicly traded hospitality companies in Taiwan. Several examinations of the effects of *CCG* on firm performance, on the one hand, have been conducted for developed countries, such as the UK (for example, Brammer and Millington, 2008) and USA (Seifert et al., 2004; Wang et al., 2008; Lev et al., 2010). No research studies have investigated whether corporate giving affects the corporate performance in an emerging country. Since economic, ethic, social, legal, political and culture factors differ between developed and emerging countries, corporate structure (such as firm characteristics, agency conflicts and business environment) in emerging countries would be different from those in developed countries (Wright et al., 2005; Young et al., 2008). As Brown et al. (2006), Navarro (1988) and Wang et al. (2008) noted, agency cost, value-enhancing and other firm-related factors are critical determinants of corporate giving. Given the potential differences in corporate structure across countries that may lead to the diverse giving determinants from country to country, corporate giving and its relative importance would vary across countries (Seifert et al., 2003). Accordingly, it would be interesting and worthwhile to see if corporate giving also affects corporate financial performance in an emerging country.

On the other hand, the impact of *CCG* on corporate performance is also likely to differ among industries given that corporate structure and financial performance can vary widely across industry sectors (Bodie et al., 2012). While it may be true, no research has analyzed the issue using data from the industry sectors. This study is the first empirical research paper to extend the investigation of the effects of *CCG* on corporate performance to the hospitality industry.

As Chen et al. (2012) noted, the prosperity of the hospitality industry in Taiwan due to the strong growth of both domestic and international tourism markets (Chen, 2010, 2011) has attracted academic researchers' attention and has generated several financial studies of the Taiwanese hospitality industry. For example, Chen et al. (2005) tested the impact of a set of macroeconomic variables on hotel stock returns in Taiwan. Chen et al. (2007) examined the effect of the 2003 outbreak of Severe Acute Respiratory Syndrome (SARS) on Taiwanese hotel stock prices. Chen (2007) studied whether monetary policy changes could affect Taiwanese hotel stock returns. Chen et al. (2012) investigated the impact of insider managerial ownership on financial performance of publicly traded tourist hotels in Taiwan. Although previous hospitality studies have analyzed various financial issues and made different contributions to the research on the hospitality industry in Taiwan, this study can further enrich the hospitality financial literature by examining the impact of *CCG* on the Taiwanese hospitality firms' performance.

Moreover, corporate giving in the Taiwanese hospitality industry has expanded rapidly since the 1990s. Specifically, the total value of annual corporate giving of the Taiwanese hospitality industry was approximately NT$ (New Taiwan dollar) 2.70 million in 1996. The total value increased to 6.62 million in 2009, 11.42 million in 2010 and 11.62 million in 2011, an approximately 330.4% growth rate over that 16-year period. According to the Market Observation Post System (http://newmopsov.twse.com.tw/), the total value of *CCG* made by Taiwanese publicly traded companies was about NT$ 2.80 billion in 2011. This figure represents about 0.28% of all annual pre-taxable profits of all publicly traded companies in Taiwan. The total value of *CCG* from hospitality companies amounted to approximately NT$ 11.62 million in 2011. The hospitality industry, among 27 industry sectors listed on the Taiwan Stock Exchange from 1996 to 2011, was ranked second in terms of the ratio of the total value of *CCG* to sales revenue, only behind the biotechnology industry (see Fig. 1).

Why were Taiwan's publicly traded companies in the hospitality industry willing to give to charity? Do publicly traded hospitality companies in Taiwan expect *CCG* to have a beneficial effect on their corporate performance by conveying a positive company image as the value enhancement theory suggests? Do hospitality companies realize that *CCG* could have an adverse impact on corporate performance according to agency cost theory, or that *CCG* may not even affect corporate performance at all? Accordingly, the major contribution of this study is to analyze whether *CCG* affects the corporate performance of publicly traded hospitality companies, and if so, whether the relation between *CCG* and corporate performance is curvilinear and whether the impact is positive, negative or negligible.

Given that the mixed measures of corporate performance used in previous studies (Brammer and Millington, 2008; Lev et al., 2010; Wang et al., 2008), the study uses a broader set of performance measures to provide a comprehensive insight on the effects of *CCG* on the corporate performance measures of publicly traded hospitality companies in Taiwan. The indicators of corporate performance under consideration are profitability measures (return on assets and return on equity), stock performance and Tobin's Q. Return on assets (*ROA*) and return on equity (*ROE*) are two of the most popular profitability measures used in the business and finance literature. Stock price, reflecting the earnings prospects of a company, can be used to compute shareholders' return and evaluate financial performance of publicly traded hospitality companies. Tobin's Q is commonly used to measure the intangible asset values of companies.

The remainder of this study is organized as follows. Section 2 reviews the literature. Section 3 describes data and variables. Section 4 presents the methodology of panel regression tests. Section 5 reports panel regression test results. Section 6 concludes the study with a discussion of the major findings.

2. Literature review

Value enhancement theory and agency cost theory have been most frequently used to explain the behavior of *CCG* (Brown et al., 2006; Fry et al., 1982; Navarro, 1988). Value enhancement theory suggests that *CCG* acts as a specific business expense that can benefit firm performance (Navarro, 1988). Alternatively, agency cost theory advocates that *CCG* may be considered as an additional agency cost generated by the conflict between shareholders and the managerial insiders concerning charitable donation (Brown et al., 2006). The interaction of benefit and cost generated by *CCG* consequently determines the effects of *CCG* on corporate performance (Barnett, 2007; Brammer and Millington, 2008; Godfrey, 2005; Lev et al., 2010; Seifert et al., 2004; Wang et al., 2008). The financial consequence of *CCG* could be positive, negative or even neutral.

In the hope of enhancing corporate performance, companies can use *CCG* to convey a socially responsible image to key stakeholders, including employees, consumers, investors, stockholders, publics and societal institutions (Brammer and Millington,