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Do Chinese state subsidies affect voluntary corporate social responsibility disclosure?

Edward Lee, Martin Walker *, Cheng (Colin) Zeng

Alliance Manchester Business School, University of Manchester, Booth Street East, Manchester M13 9SS, UK

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ABSTRACT

This paper examines whether state subsidy is a determinant of the voluntary corporate social responsibility (CSR) disclosures of Chinese listed firms. Using archival data from a sample of manufacturing firms listed on the Shanghai and Shenzhen Stock Exchanges from 2008 to 2012, we find that state subsidies have a material influence on CSR disclosure choice beyond the variables that commonly figure in Western models. This effect is concentrated among the non-state-owned enterprises (NSOEs) rather than the state-owned enterprises (SOEs), and especially when subsidies are granted through non-tax based rather than tax-based channels. Further analysis also suggests that these findings are more pronounced among firms domiciled in regions with a higher level of corruption. Our findings shed light on how political cost considerations influence firms' decisions to disclose CSR information in China where government intervention in the economic and business environment is pervasive.

1. Introduction

This study examines if state subsidies influence the voluntary corporate social responsibility (CSR) disclosures of Chinese listed firms. The determinants of CSR disclosure have been regularly discussed in the Western literature. However, there are relatively few papers that address this issue by focusing on institutional factors specific to transitional economies such as China, which is evolving from a centrally planned to a market oriented system. We believe that China is especially interesting to study with regard to CSR disclosures for two reasons. First, although China is now the manufacturing center of the world it is also facing significant environmental and social issues. Second, the political economy of China is materially different from the traditional Western economies for which most of the existing research on CSR has been carried out. Unlike existing studies, we pay special attention to the role of subsidies granted by the government, and we highlight the differential impact of subsidies offered through tax and non-tax channels, which are interesting features of the Chinese state capitalism that distinguishes firms in China from their Western peers.

State subsidies are pervasive among Chinese listed firms (e.g., Allen et al., 2005; Lee et al., 2014). For example, a report by the government official Xinhua news agency reveals that up to 88% of Chinese listed firms were granted state subsidies in 2014, with a total amount of nearly 32.26 billion yuan (over 5 billion US dollars).[1] Existing studies provided evidence that state subsidies generate a material impact on the market value (e.g., Chen and Wang, 2004; Lee et al., 2014) and the financial

* Corresponding author.
E-mail addresses: edward.lee@mbs.ac.uk (E. Lee), martin.walker@mbs.ac.uk (M. Walker), cheng.zeng@mbs.ac.uk (C. (Colin) Zeng).

[1] http://www.ceweekly.cn/2014/0909/92091.shtml.

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reporting (Chen et al., 2008; He, 2016) of Chinese firms. Despite of this, the issue of state subsidies has not been examined by prior studies as a determinant of CSR disclosures in China (Li and Zhang, 2010; Marquis and Qian, 2013). Thus, our study fills this research gap and investigates whether Chinese state subsidies influence CSR disclosures, after controlling for the other determinants that have been identified by existing literature. In particular, we investigate if the influence of state subsidies on CSR disclosures in China varies across state-owned enterprises (SOEs) and non-state-owned enterprises (NSOEs). More importantly, we also examine if the effect of state subsidies depends on whether they are granted through tax or non-tax channels. While state subsidies are applied around the world by government to overcome market imperfections, exploit economies of scale, and promote social policies (e.g., Stiglitz, 1993; Schneider and Goulder, 1997; Schwartz and Clements, 1999; Jaffe et al., 2005), the decisions to offer subsidies in China, especially through the non-tax channels, are also driven significantly by political influences (Haley and Haley, 2013). Therefore, to explain our findings based on the context of Chinese political economy, we draw upon the political cost hypothesis (Watts and Zimmerman, 1978, 1986), which is often applied in the corporate disclosure literature (Daley and Vigeland, 1983; Wong, 1988; Cahan, 1992; Key, 1997; Grace and Leverty, 2010), including CSR reporting (e.g., Buhr and Freedman, 2001; Patten and Trompeter, 2003; Li and Zhang, 2010; Giuli and Kostovetsky, 2014; Patten, 2015; Christensen, 2015).

The political cost hypothesis implies that corporations engage in socially desirable activities to reduce the risk of adverse actions (Stigler, 1971; Watts and Zimmerman, 1978, 1986) from politicians, who are assumed to have the power to influence corporate wealth through means such as regulations and taxation (Milne, 2002). Since the influence of the government in the economic and business environment is widespread in China (Allen et al., 2005; Lee et al., 2014), it especially provides an interesting and appropriate research setting to examine whether political cost considerations (Ball et al., 2000; Fields et al., 2001; Healy and Palepu, 2001) associated with state subsidies affect CSR disclosure. Our focus on the political cost hypothesis instead of alternative perspectives such as stakeholder theory (Freeman, 1984) or legitimacy theory (Perrow, 1970) stems from two reasons: First, the dominating economic influence of government and the weaknesses in legal enforcement in China (Allen et al., 2005) may cause firms to prioritize political cost considerations above the need to cater for other stakeholders (e.g., customers, suppliers, or employees) or to fulfill social values and norms for legitimacy.[2] Second, existing literature confirms that voluntary disclosure (Chen et al., 2015) and CSR reporting (Marquis and Qian, 2013; Wang and Li, 2016) of Chinese listed firms are heavily influenced by political cost considerations, and shows that this factor has greater explanatory power over the legitimacy theory (Wang et al., 2013).[3]

CSR issues are an increasingly important item on the Chinese government's agenda for at least two reasons. First, over the past decade the Chinese government is proactively directing the country away from an overemphasis on economic growth toward a more balanced approach that also addresses social and environmental issues (See, 2009). Since 2005 the concept of "Harmonious Society" was officially introduced as the policy-making principle across all levels of government, and incorporated into the central government's 11th Five-Year Plan as well as the constitution of the Chinese Communist Party (CCP). For instance, the CCP has issued an official statement that encourages firms to contribute to the development of societal harmony by enhancing "social responsibility among citizens, enterprises, and all kinds of organizations" (Marquis and Qian, 2013). Second, in recent years the Chinese public is increasingly demanding their government to pay attention to CSR issues as a result of high profile business ethics scandals as well as environmental pollution problems. For instance, the public outrage at the tainted milk scandal of 2008 (Wang et al., 2011) as well as the on-going and well-publicized air pollution across major Chinese cities (Li et al., 2017) have generated persisting awareness and demand for CSR in China. Due to these policy initiatives and public pressures, the Chinese government has stepped up its demand for businesses to behave socially and environmentally responsible.

Since CSR reporting enables Chinese firms to demonstrate their compliance with the government demand, such disclosure is also expected to help them address political cost considerations, which is likely to be greater for those that receive more state subsidies. In the case of China, the political cost that firms incur from state subsidies is likely to vary in two ways. First, the NSOEs are expected to be more concerned about possible backlash for not complying with government policy than the SOEs, who enjoy innate government support. Since political connectedness are important in emerging economies where the business environment is heavily influenced by the government (La Porta et al., 1999; Faccio and Lang, 2002), NSOEs are also especially keen to preserve the connections that underlie state subsidy grants by demonstrating policy compliance (Hung et al., 2015). Second, while subsidies through non-tax channels (such as direct tax injections, loan guarantees, and debt forgiveness) are based on competitive applications in developed economies like the U.S. (Alesina and Ardagna, 2010), such grants in China are largely determined by the discretion of officials and the political connectedness of firms (Chen et al., 2008; Du and Mickiewicz, 2016). Therefore, to the extent state subsidies expose firms to greater pressure and scrutiny to comply with government policies (Wong, 1988; Schwartz and Clements, 1999), this effect is expected to

[2] Existing literature suggests that ethical, philanthropic, and discretionary factors may also influence CSR activities in China (e.g., Yin and Zhang, 2012). However, state subsidies are less likely to serve as a direct proxy of these alternative factors, and more likely to capture the effect of political cost considerations given the associated institutional context in China (Allen et al., 2005; Lee et al., 2014).

[3] Wang et al. (2013) document more disclosure of CSR information by Chinese firms in environmentally sensitive industries than their counterparts in high-profile consumer proximity industries. They interpret this as evidence that CSR disclosure in China is driven by political cost rather than legitimacy theory based on the argument that the former set of industries is more likely to be affected by environmental regulations and policies, while the latter set of industries is associated with greater social visibility.