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A theoretical link between corporate giving and hospitality firm performance

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ABSTRACT

This study makes a unique contribution to the hospitality literature by offering a theoretical model of the link between corporate giving (CG) and hospitality firm performance based on a duopolistic competition model with rational profit-maximizing hospitality firms. The equilibrium outcomes of the proposed model explicitly explain the mixed findings of the relationship between CG and hospitality firm performance found in the previous empirical studies. Specifically, the optimal level of a hospitality firm's CG is positively related to the total market demand and the competitive advantage of CG, and negatively related to the induced cost of giving practices. Moreover, a positive or neutral relationship between CG and hospitality firm performance depends on whether CG could induce a competitive advantage of brand differentiation and customer loyalty to increase profit.

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1. Introduction

Business research studies have empirically examined the effects of corporate social responsibility (CSR) on firm performance. [Mishra and Suar \(2010\)](#) and [Rettab et al. \(2009\)](#) showed the positive effect of CSR on firm performance. However, [Griffin and Mahon \(1997\)](#) indicated that CSR may not affect firm performance. Similarly, there is no consistent relationship between CSR and firm performance in the hospitality research literature.

[Garay and Font \(2012\)](#) found a positive impact of CSR on Spain's hospitality industry. [Kim and Kim \(2014\)](#) revealed that CSR strengthening actions enhance shareholder value of publicly listed restaurant firms, whereas CSR weakening actions reduced shareholder value. [Lee and Park \(2009\)](#) found no relationship between CSR and casino firm performance. [Inoue and Lee \(2011\)](#) studied the financial consequence of CSR behaviors of airline, casino, hotel and restaurant companies and obtained inclusive results.

As [Godfrey \(2005\)](#) noted, the main reasons for these mixed results may be the lack of a theoretical model that links CSR directly with firm performance, and the conceptual ambiguity and measurement difficulty of CSR. [Carroll \(1979\)](#) suggested that CSR

comprises moral, ethical, and philanthropic responsibilities as well as the responsibilities to earn a fair return for shareholders and comply with the law. Consequently, different aspects of CSR may be differently motivated and may therefore have diverse effects on firm performance ([Brammer and Millington, 2008](#)).

Alternatively, this study uses corporate giving (CG) to explain how CSR can affect firm performance. CG, a specific component of CSR, is the act of corporations donating a portion of their profits to nonprofit organizations. The CG practice is generally handled by the corporation or by a foundation that is created, and thus has a considerable degree of external visibility ([Brown et al., 2006](#)). Therefore, CG offers a transparent insight into corporate operations and management and can serve as a good quantitative measurement for CSR.

Empirical studies also found a mixed relationship between CG and firm performance based on value enhancement theory and agency cost theory. Value enhancement theory hypothesizes that CG could be considered as a form of moral capital investment, which could enhance a firm's image ([Godfrey, 2005](#)) and hence increases firm value by promoting customer loyalty ([Lev et al., 2010](#)). Agency cost theory posits that managerial insiders are likely to engage in CG to promote their personal reputation while shareholders suffer an opportunity loss ([Brown et al., 2006](#)).

[Lev et al. \(2010\)](#) showed a positive relationship between CG and customer satisfaction and suggested that CG is positively associated with future sales revenue. [Brammer and Millington \(2008\)](#)

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mentioned that firms with high CG differentiated themselves from those with lower CG to the target consumer and reaped the benefits of consumer loyalty. Seifert et al. (2004) showed no influence of CG on corporate stock return. In the hospitality research literature, Chen and Lin (2015a) concluded that CG can enhance hospitality firm performance in Taiwan.

Moreover,ENZ (2009) indicated that the hospitality industries, such as theme parks, casinos, cruise and airline are often characterized by a few very large firms and might be classified as an oligopoly. As Dwyer et al. (2010) noted, tourism markets often exhibit elements of both monopolistic competition and oligopoly and it may be that many tourism markets are oligopolistic in the main but monopolistically competitive at the edges. Given that the hospitality industry can be classified as an oligopoly, game theory provides a perfect framework for understanding how hospitality firms interact in an oligopoly (Varian, 1992).

Accordingly, this study contributes to the literature by providing a theoretical model of the link between CG and hospitality firm performance based on a duopolistic competition framework with rational profit-maximizing hospitality firms. There are two major results derived from the model. First, the model identifies the optimal level of a hospitality firm's CG and the relationship between the optimal level of CG and its determinants. Second, the model explains whether CG can affect hospitality firm performance and offers theoretical support to previous empirical findings.

2. The basic model

In this section, a duopolistic framework is used to analyze the giving behavior of a rational profit-maximizing hospitality firm and understand the effect of CG on hospitality firm performance. The model uses two possible cases: no hospitality firm gives to charity (the NN case) and only one hospitality firm gives to charity (the NG case) to demonstrate how CG can affect hospitality firm performance.

2.1. The NN case

Assume that there are two competing hospitality firms producing and selling a similar hospitality product and service, q_i^{nn} (the quantity of the competing goods produced by hospitality firm i ($i = 1, 2$) in the NN case) is greater than zero ($q_i^{nn} > 0$) because both hospitality firms under duopolistic competition enjoy abnormal profits in the long run. The market demand of hospitality firm i is modeled as:

$$q_i^{nn} = a - p_i^{nn} + p_j^{nn}, \quad (1a)$$

where $a - p_i^{nn} + p_j^{nn} > 0$, a represents a positive parameter of total market demand ($a > 0$), p^{nn} is the market price and $i = 1$ if $j = 2$ ($i = 2$ if $j = 1$).

Assume that both competing hospitality firms use similar management and technology in supply and thus have the same cost function. The cost function of hospitality firm i 's supply is defined as:

$$c_i^{nn} = m q_i^{nn} + fc, \quad (1b)$$

where m is a unit marginal cost ($m > 0$) and fc represents fixed costs ($fc > 0$). Thus, the profit function for each hospitality firm is equal to:

$$\pi_i^{nn} = p_i^{nn} q_i^{nn} - m q_i^{nn} - fc = (a - p_i^{nn} + p_j^{nn} - m) q_i^{nn} - fc, \quad (1c)$$

where $\pi_i^{nn} > 0$, i.e. $(a - p_i^{nn} + p_j^{nn} - m) q_i^{nn} - fc > 0$, because both competing hospitality firms make abnormal profits in the long run.

2.2. The NG case

In line with value enhancement theory, the model assumes that CG produces a socially responsible image (Godfrey, 2005). This positive image can enhance the competitive advantages of brand differentiation and customer loyalty (Brammer and Millington, 2008; Lev et al., 2010). As Bhattacharya and Sen (2003) pointed out, corporate responsible activities may induce customers to increase their demand for the firm's products and services.

Therefore, when a duopolistic competing hospitality firm gives to charity, its market demand is assumed to increase by bg , where the parameter b reflects the degree of increased demand for hospitality firm's products and services because of the competitive advantage of brand differentiation and customer loyalty induced by CG (the competitive advantage of CG hereafter) and $b \geq 0$. The larger the competitive advantage of CG (higher b), the higher the market demand for hospitality firm's goods and service increased. This also implies that the increase in market demand is proportional to the size of hospitality firm's direct giving spending g ($g \geq 0$). As only one duopolistic hospitality firm engages in CG, the market demand functions for hospitality firm with CG (q_n^{ng}) and its rival without CG (q_g^{ng}) are:

$$q_n^{ng} = a + p_g^{ng} - p_n^{ng}, \quad (2a)$$

and

$$q_g^{ng} = a + bg - p_g^{ng} + p_n^{ng}, \quad (2b)$$

where $a > bg$.

When a hospitality firm gives to charity, it incurs cost. The total cost of engaging in CG includes direct giving expenses, human resource and administrative cost, and agency cost of managerial misconduct (Wang et al., 2008). The cost of human resource and administration may not increase linearly because economies of scale and learning have an effect on managing giving practices (McWilliams and Siegel, 2001). The agency cost of managerial misconduct results from the giving conflicts between the directors and managers participating in CG and shareholders. The cost of agency conflicts is supposed to be minimal at low levels of CG, but they are likely to become more significant as CG increases (Wang et al., 2008).

Thus, the model assumes that the cost of CG takes a quadratic form $rg^2/2$, where g is the direct cost of CG, and r ($r > 0$) represents the induced cost of giving practices, including human resource and administrative cost and agency cost of managerial misconduct. Note that the assumption of $rg^2/2$ can also simplify the calculation process of the results of proposed model. The cost functions for hospitality firm with CG (c_n^{ng}) and its rival without CG (c_g^{ng}) are:

$$c_n^{ng} = m q_n^{ng} + fc, \quad (3a)$$

and

$$c_g^{ng} = m q_g^{ng} + \frac{rg^2}{2} + fc. \quad (3b)$$

In the NG case, depending on whether the duopolistic hospitality firm gives to charity, we have two possible profit functions:

$$\pi_n^{ng} = p_n^{ng} q_n^{ng} - m q_n^{ng} - fc = (p_n^{ng} - m)(a + p_g^{ng} - p_n^{ng}) - fc, \quad (4a)$$

and

$$\pi_g^{ng} = p_g^{ng} q_g^{ng} - m q_g^{ng} - \frac{rg^2}{2} - fc = (p_g^{ng} - m)(a + bg - p_g^{ng} + p_n^{ng}) - \frac{rg^2}{2} - fc. \quad (4b)$$

where π_n^{ng} , p_n^{ng} and q_n^{ng} are the profits, market price and demand of the hospitality firm without CG, respectively, π_g^{ng} , p_g^{ng} and q_g^{ng}

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