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Analyst coverage and corporate social performance: Evidence from China

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ABSTRACT

This paper uses a set of unique data from Chinese listed companies to examine the influence of analyst coverage on corporate philanthropy. Results show that companies followed by more analysts engage in more philanthropy, which provides support for the reputational capital view of corporate philanthropy. The effect of analyst coverage on philanthropy is more pronounced for nonstate-owned enterprises (non-SOEs) than for state-owned enterprises (SOEs). Using the number of analysts following the firm and media coverage as alternative measures, distinguishing star analysts and ordinary analysts and applying the change model and 2SLS model with merge of brokerage houses as the instrumental variable, we confirm the robustness of the conclusions. Our research enriches the literature on corporate social responsibility and analyst coverage.

1. Introduction

In recent decades, corporate social responsibility (hereafter CSR) strategies have been adopted by an increasing number of firms (Campbell et al., 2002; Peloza and Shang, 2011). Firms are enthusiastic about CSR because it can enhance consumer perceptions of product quality (Milgrom and Roberts, 1986; Grewal et al., 1998a,b), promote employee recruitment, increase employee loyalty and retention (Turban and Cable, 2003), lower capital costs (Beatty and Ritter, 1986), and increase firm value (Fombrun and Shanley, 1990; Su and He, 2010).

To understand how CSR contributes to achieving these benefits, researchers highlight the importance of reputational capital (Gardberg and Fombrun, 2006; Servaes and Tamayo, 2013). Reputational capital is the collective impression of a firm held by its stakeholders, including investors, customers, suppliers, employees

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and so on (Kitchen and Laurence, 2003). Whether CSR leads to positive economic consequences greatly depends on how stakeholders value corporate philanthropic behaviors (MacMillan et al., 2002). For example, if CSR is positively evaluated by investors, it may improve firm value and lower the cost of equity (Lim, 2010). Likewise, positive valuations from creditors help firms obtain loans more conveniently and lower their cost of debt (Ye and Zhang, 2011), and positive valuations from customers promote sales and improve firm competitiveness (Mohr and Webb, 2005). Similar to financial capital and human resource capital, reputational capital is also vital for firms to maintain a competitive edge in an intense market.

Prior studies have found that CSR has a positive effect on reputation (McGuire et al., 1988; Fryxell and Wang, 1994). However, most of these studies neglect the fact that CSR may not necessarily transform into corporate reputational capital. To obtain reputational capital through CSR, certain media are needed to deliver information about firms to stakeholders. If the CSR information is not conveyed to stakeholders completely, there will be a discount on the valuation firms receive from stakeholders (Brown, 2000; Jegadeesh et al., 2004), and firms' reputational capital will likewise be discounted (Brammer and Millington, 2005). The existing literature on how CSR relates to the reputational capital of firms is scarce, and we aim to bridge the gap.

This paper seeks to contribute to this body of work by investigating the role of analyst coverage on the establishment of firms' reputational capital. According to Brammer and Millington (2005), organizational visibility is a key factor that affects the perceptions of firms held by their stakeholders. Only when firms are sufficiently visible can information about the firms' salient advantages be delivered to stakeholders and therefore contribute to an improved reputation. Serving as an information medium, analyst coverage is an important mechanism to improve organizational visibility (Healy and Palepu, 2001; Jiraporn et al., 2012). Analysts help to reduce the information asymmetry between firms and external stakeholders by engaging in private information production (Francis et al., 1998; Ayers and Freeman, 2003; Piotroski and Roulstone, 2004). Firms with higher levels of analyst coverage usually receive more attention from the public and are more likely to be positively evaluated by stakeholders when they achieve good corporate social performance (hereafter CSP), which will help the firms accumulate more reputational capital and in turn encourage the firms to continue to engage in CSR. Therefore, we expect that analyst coverage will be conducive to CSR and CSP.

We study this issue in the context of China for the following reasons. First, the mainstream literature on CSR has been carried out in the context of developed countries, and we still know little about CSR practices in emerging markets (Gao, 2009). As the world's second largest economic entity, China has been witnessing a growing number of firms engaging in CSR (Ye and Zhang, 2011; Zhang et al., 2014), which makes it interesting to investigate CSR practices there. The findings on CSR in China will also provide valuable implications for other emerging markets (Zhang et al., 2014). Second, most empirical results on CSR are based on U.S. data, focusing on CSR scores from the database of KLD Research & Analytics (Gelb and Strawser, 2001; Kang, 2012; Deng et al., 2013), and research focused on the special aspect of CSR–corporate philanthropic giving is very limited for lack of donation data. In China, firms are required to annually disclose special expenses such as philanthropic donation expenses, disposal losses on non-current liabilities and fines under “non-operating expenses” in the notes to firms' financial statements, which enables us to obtain a large sample of quality donation data with less concern of selection bias. Third, a remarkable feature of the Chinese stock market is its poor information environment (Piotroski et al., 2011), and it is more difficult for Chinese firms than for firms from developed countries to convey information to outside stakeholders. In this environment, the information-conveying role of analyst coverage becomes extremely important (Xu et al., 2013). Consequently, it is interesting to study whether analyst coverage can help firms build reputational capital when the firms engage in CSR in a weak information environment and in turn push the firms to engage in CSR even more.

Using data from Chinese listed companies, we investigate the relationship between analyst coverage and corporate philanthropy, one of the most important aspects of CSR, from the following perspectives. First, we directly test whether analyst coverage promotes firms to engage in more philanthropy. We use three variables to measure the level of corporate philanthropy: the ratio of philanthropic donation expenses to total assets, the natural logarithm of philanthropic donation expenses and donation dummy. The empirical results show that analyst coverage is positively related to corporate donations, suggesting that analyst coverage does have a positive influence on corporate philanthropy.

Second, we explore the different influences of analyst coverage on corporate philanthropy for non-state-owned enterprises (hereafter non-SOEs) and state-owned enterprises (hereafter SOEs). As explained above, the potential benefits related to reputational capital could be the main driver for