

The Impact of Litigation Risk on Corporate Philanthropic Giving: Evidence from China

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Abstract—Using a sample of Chinese listed companies, this paper investigates the impact of litigation risk in capital market on corporate philanthropic giving. The empirical evidence shows that the litigation risk faced by Chinese listed companies can significantly increase the level of corporate philanthropy, and the greater the litigation risk, the higher the level of corporate giving. Further findings show that this effect is only significant when the company is a defendant in a lawsuit and the lawsuit is economic-related. The results confirm the 'reputation insurance' motivation of corporate philanthropy in Chinese institutional context and provide a reference for government supervision on Chinese charitable market.

Keywords-litigation risk; corporate philanthropy; instrumental motivation; reputational capital.

1. Introduction

In recent years, with the improvement of Chinese legal environment, the risk of litigation risk faced by listed companies has also been increasing, and the number of enterprises involved in litigation and the amount of compensation have both increased greatly. Statistics indicated that 1,118 listed companies were involved in litigation in Chinese A-shares capital market in 2018. The total number of cases reached 6,285 and the total disclosed money involved is as much as RMB 307.3 billion. In January 2019, 31% of listed companies were involved in litigation cases. Companies involved in litigation may not only face high damages for losing the case, but also suffer huge reputational losses. Therefore, in addition to actively responding to litigation, improving relationships with stakeholders, and rebuilding external image is important for companies in lawsuit. Corporate donations can divert public attention and offset negative influences (Campbell, 2002), and therefore may be a way for companies to mitigate the adverse effects of litigation risk^[1]. So, do companies in Chinese capital market use charitable donations to mitigate the reputational loss caused by lawsuit? Based on data from Chinese A-share capital market from 2014 to 2018, this study will investigate whether donations can act as 'reputation insurance' and are used as a means of crisis communication to help companies relieve the adverse effects of litigation risk.

2. Literature Review

2.1 The Antecedents of Corporate Philanthropy

The antecedents and mechanism of corporate philanthropy is a hot topic in management research field. Previous literature provides many conclusions and evidence. Campbell (2002) summarized four drivers of corporate philanthropy: strategic, altruistic, political and managerial utility. The strategic perspective assumes that companies are profit-driven and can make rational strategic decisions that are in their best interests^[1]. Porter (2002) defined it as "strategic philanthropy", arguing that strategic contributions to "mutually beneficial" philanthropic areas can bring both social and economic benefits. Maintaining the Integrity of the Specifications^[2].

Empirical research based on Chinese context shows that the motivations for corporate philanthropy are complex. The study found that corporate philanthropic giving is influenced by top managers' experience^{[8][9]}, and it may also be a kind of corporate strategy decision to build up corporate external political connections^[4].

A few recent articles have addressed that traditional culture, as informal institution, play an important role in corporate philanthropic behavior. Lu Lunwei and Zhou Donghua (2020) argued that Confucian culture can promote corporate level of charitable giving^[5], and Yu Wei et al. (2020) found that companies that located in 'red culture' regions are more likely to engage in charitable giving and will give more than other companies^[6]. Zhu Jinfeng et al. (2022) found Integration of traditional culture in corporate culture can promote level of corporate philanthropic giving^[7].

Furthermore, some studies demonstrated that corporate philanthropic giving is "instrumental", and it is used to distract and divert public attention to corporate misconduct^[3].

2.2 The Economic Consequences of Litigation Risk

The impact of litigation risk on firms is mainly reflected in the following aspects: financing costs, information disclosure, surplus management, audit fees, and innovation investment. Liu Yingfei (2019) found that when the risk of corporate litigation is high, auditors will choose to disclose more critical audit matters, which in turn leads to an increase in audit fees^[10]. Ji Yafang (2022) showed a positive relationship between corporate litigation and business risk^[11]. Si Haiping and Chen Shuhuan et al. (2021) argued that litigation will lead to financing constraints; financing constraints will be more severe when companies are involved in capital-type litigation; companies involved in litigation as defendants and private companies will face stronger financing constraints after litigation than companies involved in litigation as plaintiffs and state-owned enterprises^[12].

2.3 The Impact of Litigation Risk on Corporate Philanthropy

Fu Chao (2017) argued that the litigation risk faced by listed companies can significantly increase the level of philanthropic giving, especially the effect of the experience of losing a lawsuit in the previous period and the risk of off-site litigation on increasing the company's philanthropy level in the current period is more significant^[13]. While Dai Yiyi and Peng Zhen (2016) et al. found that there is an inverse relationship between litigation risk and philanthropy, this relationship varies significantly depending on the business status of the firm, with higher

litigation risk in the ST sample being associated with higher donation likelihood and donation levels; in the non-ST sample, the opposite is true^[14].

In general, being involved in legal disputes can damage corporate reputation and social image, and have negative impacts on corporate normal operation, while charitable donations can help reduce reputational damage in the event of a negative event, thus acting as a kind of "reputation insurance". This paper will examine the impact of litigation risk on corporate philanthropy, enriching the literature in this area and providing implications for government policy making.

3. Research Hypothesis

Godfrey (2005) suggested that philanthropy is a unique type of harm insurance investment^[15]. Firstly, charitable acts generate positive moral capital when they orient public opinion towards the organization and the managers involved receive positive evaluations from the beneficiary community and other subjects; secondly, moral capital contributes to the formation of a relationship-based intangible asset that fulfils the core function of an insurance contract, thus It provides a form of insurance-like protection for shareholders. In addition to insuring relationship-based assets, the positive moral capital created by philanthropy can also mitigate the intensity of stakeholder sanctions, thereby providing companies with the benefit of reduced penalties or even non-conviction and non-action of sanctions.

Based on the above, we believe that when a company is in litigation risk, its operational and financial risks increase and managers are motivated to compensate for the loss of reputation, by making charitable donations as an 'insurance' investment to enhance stakeholders' confidence in the company and reduce stakeholders' negative perceptions and sanctions. Further, different litigation status and types of litigation may pose different litigation risks for companies, which in turn may have different impacts on their philanthropy behavior. Based on this, this paper proposes the following hypothesis.

H1: Litigation risk significantly enhances corporate philanthropy level, Companies involved in higher litigation risk make more philanthropic giving than those in lower litigation risk.

H2: Litigation risk has a greater impact on corporate philanthropy for companies in a defendant position than those in a plaintiff position.

H3: Litigation risk has a greater impact on corporate philanthropy for companies in economic-related litigation than those in non-economic related litigation.

4. Research Design

4.1 Data and sample

We conducted our research in the period from 2014 to 2018, using data of Chinese listed firms. The sample selecting process is: (1) excluding samples with missing or odd values; and (2) we exclude firms in the finance and insurance industry because of their different financial information. Considering the substantial increase in the level of corporate giving since the outbreak of the COVID-19, the period 2014-2018 was selected, because we aim to explore the relation-

ship between litigation risk and corporate philanthropy in the non-disaster situation. In total, we identified 16,617 sample data. We winsorized the top and bottom 1% of each continuous variable. Data of philanthropy in this study are obtained from annual reports or CSR reports. Data on litigation risk are mainly obtained from the WIND. Control variables and other information are from CSMAR (China Stock Market& Accounting Research Database).

4.2 Hypotheses and Variables Definition

Based on the literature review and relevant theoretical analysis, the following research model was developed to test the above hypotheses.

$$DONATION = a_0 + a_1 L_dummy + a_2 SIZE + a_3 GYSHR + a_4 ROA + a_5 GROWTH + a_6 \Sigma IND + a_7 \Sigma YEAR \quad (1)$$

$$DONATION = a_0 + a_1 L_Count + a_2 SIZE + a_3 GYSHR + a_4 ROA + a_5 GROWTH + a_6 \Sigma IND + a_7 \Sigma YEAR \quad (2)$$

$$DONATION = a_0 + a_1 L_Amount + a_2 SIZE + a_3 GYSHR + a_4 RO + a_5 GROWTH + a_6 \Sigma IND + a_7 \Sigma YEAR \quad (3)$$

The specific variables are defined in Table 1 below.

Table 1 Definition of Variables

Variables	Definition
DONATION	Ln (Donation amount+1)
L_dummy	Involved in litigation=1, Not litigation involved=0
L_Count	Ln (Number of lawsuits+1)
L_Amount	Ln (Amount of litigation+1)
SIZE	Ln (total assets)
GYSHR	Percentage of state-owned shareholding
ROA	Return on total assets
GROWTH	Sales revenue growth rate
IND	Dummy variables for the industries
YEAR	Dummy variables for the year
L_STATE	Grouping of data by defendant and plaintiff
L_TYPE	Grouping of data by economic and non-economic litigation

5. Empirical Results

5.1 Descriptive statistics

Table 2 provides the descriptive statistics of variables in the sample. The Max of DONATION is 20.6464, indicating some enterprises make large donations. The Mean of L_dummy is 0.15, suggesting average 15% of the total enterprises are involved in litigation. In addition, the Max of L_Count and L_Amount is 5.5334 and 25.6869 separately, meaning that some listed companies are faced with serious legal disputes and are in high litigation risk environment.

Table 2 Descriptive Statistics

Variables	N	Min	Max	Mean	SD
DONATION	16617	0	20.6464	8.4692	6.0602
L_dummy	16617	0	1	0.1500	0.3570
L_Count	16617	0	5.5334	0.1866	0.5186
L_Amount	16617	0	25.6869	2.2020	5.7140
SIZE	16617	14.9416	28.5200	21.9516	1.4114
GYSHR	16617	0	0.9219	0.0323	0.1135
ROA	16617	-1.8591	7.2493	0.0556	0.0972
GROWTH	16617	-1.0000	87.4837	0.2226	1.6114

Table 3 provides the descriptive statistics of number of companies involved in litigation from 2014 to 2018. The results show that the number has been increasing during the five years with an average 15% of enterprises involved in litigation, and the proportion of enterprises even rose to 23.32% in 2018. The results indicate that with the enhancement of public legal awareness in recent years, the lawsuits risk faced by companies has been increasing.

Table 3 Statistics on Number of Companies Involved in Litigation Risk

Year	L_dummy=1		L_dummy=0		Total
	N	Percentage	N	Percentage	
2014	244	7.35%	3077	92.65%	3321
2015	381	11.46%	2943	88.54%	3324
2016	486	14.62%	2838	85.38%	3324
2017	608	18.29%	2716	81.71%	3324
2018	775	23.32%	2549	76.68%	3324
Total	2494	15.00%	14123	85.00%	16617

Table 4 provides the times of lawsuits and number of companies. There is a growing trend obviously. Most enterprises are involved in lawsuits for 1, 2 or 3 times, especially 1 time is the majority. In 2018, 270 enterprises (35% of the total) are involved in lawsuits once. However, in recent years, more companies have been involved in litigation more than 3 times. In 2018, 44.77% companies (347/775) are involved in litigation more than 3 times, and even 14.45% (112/775) of companies are involved in litigation more than 7 times. This also indicate the litigation risk faced by companies has been increasing with the enhancement of public legal awareness.

Table 4 Statistics on Litigation Times of Listed Companies

Litigation times	1	2	3	4	5	6	7	>7	Total
2014	149	41	20	10	4	4	4	12	244
2015	187	74	42	23	11	9	4	31	381

2016	229	82	62	20	25	12	7	49	486
2017	241	127	65	47	28	16	19	65	608
2018	270	158	95	56	26	32	26	112	775
Total	1076	482	284	156	94	73	60	269	2494

Table 5 provides the statistics of corporate donation amount. The number of enterprises making philanthropic giving has increased year by year, especially in 2017 and 2018, the growth rate is more than 4%. The proportion of enterprises participating in donations was 67.98% on average and 75% in 2018, indicating that with the increasing of CSR in recent years, more enterprises are enhancing their social image and strengthening their communication with stakeholders by charitable donations.

Table 5 Statistics on Number of Corporate Donation

Year	DONATION=1		DONATION=0		Total
	N	Percentage	N	Percentage	
2014	2128	64.08%	1193	35.92%	3321
2015	2144	64.50%	1180	35.50%	3324
2016	2181	65.61%	1143	34.39%	3324
2017	2354	70.82%	970	29.18%	3324
2018	2490	74.91%	834	25.09%	3324
total	11297	67.98%	5320	32.02%	16617

5.2 Regression results

1) Litigation risk and corporate philanthropy

The full sample regression results are shown in tables 6.

Table 6 Regression Results of Litigation Risk and Corporate Philanthropic Giving

	(1)		(2)		(3)	
L_dumy	0.049** (1.968)	0.020** (2.320)				
L_Count			0.084* (1.730)	0.039** (2.064)		
L_Amount					0.042** (2.035)	0.021** (2.302)
SIZE		0.001*** (18.479)		0.001*** (18.477)		0.001*** (18.471)
GYSHR		0.045** (-2.009)		0.044** (-2.013)		0.043** (-2.021)
ROA		0.001*** (3.962)		0.001*** (3.921)		0.001*** (3.946)
GROWTH		0.067* (-1.831)		0.069* (-1.818)		0.069* (-1.816)
IND	Control	Control	Control	Control	Control	Control
YEAR	Control	Control	Control	Control	Control	Control
N	16617	16617	16617	16617	16617	16617
F	3.875	70.455	2.992	70.226	4.142	70.438
R2_a	0.015	0.021	0.013	0.021	0.016	0.021

Note: *, **, and*** represent the 10%, 5%, and 1% levels of significance

From the results, the three separate independent variables of litigate risk (L_dummy, L_Count, and L_Amount) basically have a positive impact on the dependent variable of philanthropic giving (DONATION) at the 5% level, indicating that higher litigation risk make more philanthropic giving than those in lower litigation risk. The hypothesis H1 was proved. The results show that company may donate with an "instrumental" and 'self-interested' motivation. The risk of litigation has a negative impact on enterprises, which motivates enterprises to make charitable donations because philanthropy has a "reputation capital" function. By undertaking social responsibility and sending a "good message" to the outsiders, companies can reduce the impact of negative events and maintain a good social image.

2) Grouped regression results in different litigation status

Further, to examine the impact differences under different litigation positions, this paper divides the data into two groups according to litigation position. Table 7 show only when the company is the defendant in lawsuit, there is a positive relationship between litigation risk and corporate giving at 1% level while the relationship is negative, but not significant when the company is the plaintiff. The H2 hypothesis of this paper is proved. The results also imply that when listed companies are defendants in litigation cases, it is more important to strengthen external communication and crisis management. In this condition, actively assuming social responsibility may reduce the damage to corporate reputation from external litigation risks.

Table 7 Grouped Regression Results of Litigation Status and Corporate Giving

L_Amount	defendant		plaintiff	
	0.001*** (5.018)	0.002*** (3.182)	0.128 (-1.524)	0.228 (-1.208)
∑Cont	Y	Y	Y	Y
Ind_Dummy	Y	Y	Y	Y
Year_Dummy	Y	Y	Y	Y
N	633	633	443	443
F	25.179	25.017	2.323	1.504
R2_a	0.037	0.166	0.005	0.017

Note: ∑Cont represent all control variables, the T values are in parentheses, and *, **, and*** represent the 10%, 5%, and 1% levels of significance

3) Grouped regression results for different types of litigation

Further, we divided the sample into two groups according to the type of litigation. From the Table 8, the relationship between litigation risk and corporate philanthropy amount is positive at 1% level of significance, only when the firm is in economic-related litigation, while the positive relationship is not significant when it is in the non-economic litigation. H3 hypothesis is proved.

Table 8 Grouped Regression Results of Litigation Types and Corporate Giving

L_Amount	Economic-related litigation		Non-economic litigation	
	0.001*** (3.741)	0.003*** (2.988)	0.278 (1.087)	0.218 (1.235)
∑Cont	Y	Y	Y	Y
Ind_Dummy	Y	Y	Y	Y

Year_Dummy	Y	Y	Y	Y
N	775	775	301	301
F	13.998	14.126	1.18 1	3.764
R2_a	0.017	0.084	0.063	0.036

Note: Σ Cont represent all control variables, the T values are in parentheses, and *, **, and*** represent the 10%, 5%, and 1% levels of significance

6. Robustness tests

To further verify the relationship between litigation risk and corporate philanthropy, this paper conducts robustness tests. There may be a lag effect of litigation risk. Therefore, based on the existing research, we replaced the current litigation risk values with the previous values. Using a total of 13,293 data, the regression test was conducted again, and the conclusions remain unchanged. The results are not listed because of space limit, please request it from the authors if necessary.

7. Conclusions

This study investigates the relationship between the risk of litigation and corporate philanthropy. Using data of Chinese listed companies, we find that litigation risk faced by companies can significantly increase the level of corporate philanthropy, and the higher the risk of litigation, the higher the level of corporate philanthropic giving. Further research shows that this effect is significant only when the company is a defendant in a lawsuit and the lawsuit is economic-related. The findings suggest that there exists an 'instrumental' motivation of corporate philanthropy. Companies take philanthropy as a kind of 'insurance' to build up corporate reputational capital, compensating for the negative impacts of litigation risk to divert public attentions on corporate social responsibility misconduct or failure.

The conclusions of this study can provide references for understanding the motivation of corporate philanthropic giving in China. The motivation of corporate philanthropy is complex and diverse and may not be purely altruistic. The findings show that philanthropic giving can reduce the adverse impact of outside litigation risk, and it's an effective corporate crisis communication strategy. Firstly, listed companies in China should fully attach great importance to philanthropy strategy and develop suitable and strategic philanthropy behavior to enhance the competitive advantage of enterprises. Secondly, from the perspective of government regulations, it is important for government to strengthen supervision on Chinese charity market and improve the quality of philanthropy information disclosure, preventing listed companies from taking philanthropy as a "tool" to cover up corporate misconducts. We believe that the evidence revealed from this study of China is useful to other emerging economies around the world with cultural, legal, economic, and ethical backgrounds different from those of the developed countries.

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