CORPORATE SOCIAL RESPONSIBILITY IN CHINA: LAW & THE BUSINESS CASE FOR STRATEGIC CSR

Virginia Harper Ho
University of Kansas School of Law
CORPORATE SOCIAL RESPONSIBILITY IN CHINA: LAW & THE BUSINESS CASE FOR STRATEGIC CSR

Cover Page Footnote
CORPORATE SOCIAL RESPONSIBILITY IN CHINA: LAW & THE BUSINESS CASE FOR STRATEGIC CSR

Virginia Harper Ho*

ABSTRACT

Research on the drivers of corporate social responsibility (CSR) has long focused on the business case; that is, how market pressure can shift the dominant norms of business culture toward acceptance of CSR practices as part of the way business should operate. Drawing on institutional theory, prior work has also observed that variations in firm CSR practice are a function of their local and global institutional contexts that result from interactions among market institutions, formal legal institutions, and informal norms. This article examines the empirical evidence in support of the business case for CSR among Chinese firms to determine whether market forces are likely to drive the norms of Chinese business culture toward an embedded, or strategic, CSR. It then explicitly examines how legal institutions undergird (or undermine) the business case for CSR in China. This effort contributes new insights to the comparative literature on the business case for CSR by moving beyond studies of the business case in Western markets that have often assumed the existence of strong legal institutions as a backdrop to the business case. This article concludes that recent efforts by emerging market governments to advance CSR by harnessing market forces will only succeed if they are accompanied by continued efforts to strengthen legal institutions. In the People’s Republic of China (PRC) context, equally important is commitment by local officials and state agencies as primary stakeholders of Chinese firms.

* Associate Professor & Docking Faculty Scholar, University of Kansas School of Law. This article benefitted greatly from the insights of the 2015 South Carolina Journal of International Law and Business Symposium participants and presenters, as well as the excellent work of the Journal’s editorial board.
I. INTRODUCTION

Over the past several decades, corporate social responsibility (CSR) has become a global phenomenon, capturing the attention of governments around the world as well as firms themselves. The term CSR or simply “corporate responsibility” is generally used to refer to a firm’s voluntary commitment to meet and exceed legal mandates and to take account of the impacts of corporate operations on the firm’s stakeholders. Firms that embrace a commitment to CSR often do so in recognition of the firm’s dependence on diverse resources, including financial, labor, and reputational capital, as well as natural resources, aligning concepts of economic and environmental sustainability. In the West, market forces have played an important role in the evolution of CSR practice from a focus on corporate philanthropy, to an emphasis on stakeholder impacts as part of legal compliance and risk management, to, most recently, identifying CSR as a source of “shared value” for companies, shareholders, and other stakeholders. Firms that have adopted this third, deeper vision of CSR see it as integrated with corporate strategy and work to embed CSR concepts across their operations.

Empirical evidence of how attention to stakeholder welfare can drive firm financial performance—the business case for CSR—has been a critical catalyst of this transition, but whether market pressure can drive a similar transformation in China and other emerging markets with very different institutional starting points is

---

1 See William C. Frederick, Corporate Social Responsibility: Deep Roots, Flourishing Growth, Promising Future, in The Oxford Handbook of Corporate Social Responsibility 522, 528 (Andrew Crane, Dirk Matten, Abagail McWilliams, Jeremy Moon, & Donald S. Siegel eds., 2008).


3 See generally Frederick, supra note 1, at 522–23 (discussing liability when CSR is violated).

4 See id. at 527–28.


6 See Frederick, supra note 1, at 526–27.

7 See id. at 528.
an open question. As in other emerging markets, CSR concepts have taken root in China over the past decade among local firms and have been embraced by state agencies and local governments.\(^8\) However, the norms of business culture in which Chinese firms operate do not presently reflect broad acceptance or support of strategic CSR.\(^9\)

This article begins by surveying current empirical evidence on the business case for strategic CSR in China as a potential stimulus for institutional change. Examining how markets reshape the informal norms that affect firm behavior is an important starting point; especially because the empirical literature using data from Chinese firms is relatively new and a number of recent Chinese policies seek to harness market forces as an alternative to formal regulation and as a way to promote CSR practices. This article focuses on strategic CSR instead of isolated CSR practices, such as corporate philanthropy or sustainability reporting, because isolated CSR practices, whether adopted by particular firms or widely across the economy, may be motivated by market demand but may not necessarily signal a fundamental institutional change in the broader business culture.\(^10\) Strategic CSR, in contrast, represents a transformation of the way companies do business.\(^11\) It is therefore a better indicator of institutional change in the informal norms that shape firm behavior and may more powerfully reorient corporate power in ways that simultaneously enhance firm value and societal welfare.

This article also squarely examines the question of how legal institutions affect the business case for strategic CSR and the extent to which law facilitates or impedes institutional change in the norms of business culture for firms based in, or operating in the People’s Republic of China (PRC).\(^12\) Because much of the vast


\(^9\) See generally id. at 438–39 (discussing the limitations of state CSR programs).


\(^11\) See Frederick, supra note 1, at 528.

\(^12\) Under Chinese law, foreign-invested companies are considered domestic legal entities; therefore, much of the discussion here will apply equally to them. This article does not distinguish locally invested firms from
literature on the business case for CSR has been done from a Western perspective, it has generally assumed the presence of robust legal institutions without examining how different legal environments or changes might support or undermine the business case for CSR. However, institutional theory suggests that the potential for Chinese business culture to embrace strategic CSR will be heavily influenced not only by market institutions, but also by formal legal institutions and existing informal norms; all of which are interrelated, mutually influencing, and together form the institutional environment in which firms operate.\textsuperscript{13} The argument here is not that formal legal institutions are essential preconditions to the emergence of markets or a market economy—this position has already been refuted by other commentators and by the Chinese experience itself.\textsuperscript{14} Instead, the claim is that the presence or absence of formal legal institutions and how well they function have broad and often overlooked indirect effects on how firms define CSR, on the strength of stakeholder

those with investment from Hong Kong, Macau, and Taiwan, which are subject to somewhat different rules than other foreign-invested enterprises. However, the extent to which domestic legal institutions affect the CSR commitment of Chinese companies with significant foreign investment may also differ from their effect on domestic firms without foreign investment or control.

\textsuperscript{13} See \textit{NORTH, supra} note 10, at 3–10; Ruth V. Aguilera & Gregory Jackson, \textit{The Cross-National Diversity of Corporate Governance: Dimensions and Determinants}, 28 \textit{ACAD. MGMT. REV.} 447, 461 (2003); see generally Joseph M. Lozano, Laura Albareda & Tamyko Ysa, \textit{Governments and Corporate Social Responsibility: Public Policies Beyond Regulation and Voluntary Compliance} (2008) (describing various national models of CSR and their determinants); Cynthia A. Williams & Ruth V. Aguilera, \textit{Corporate Social Responsibility in Comparative Perspective, in THE OXFORD HANDBOOK OF CORPORATE SOCIAL RESPONSIBILITY} 452 (Andrew Crane, Dirk Matten, Abagail McWilliams, Jeremy Moon, & Donald S. Siegel eds., 2008) (presenting a comparative analysis of the legal, institutional, attitudinal, and behavioral factors that shape how CSR is defined and implemented).

\textsuperscript{14} See generally Donald C. Clarke, \textit{Economic Development and the Rights Hypothesis: The China Problem}, 51 \textit{AM. J. COMP. L.} 89, 109 (2003) (observing, in part, that alternatives to formal legal institutions abound and may be sufficient to ground economic development and even the emergence of markets). The author draws on the history of China’s legal and economic development to refute claims advanced most notably by La Porta, Lopez-de-Silanes, Shleifer & Vishny (LLSV) in a series of articles. \textit{Id.}
influence, and on other market drivers of responsible business practice.

This article observes that the evidence for the business case in China is currently mixed and that many of its observed limits are directly or indirectly linked to specific features of the Chinese legal institutional environment that limit the salience of stakeholders in managerial decision-making. These findings therefore suggest that recent policy initiatives of the Chinese government and other emerging markets that depend on market forces to drive CSR and broader legal compliance may face substantial constraints. They also suggest that the potential for Chinese firms to move toward next generation, strategic CSR may depend heavily on the state’s resolve to strengthen legal institutions and leverage the role of the state as a primary stakeholder for Chinese firms.

II. STRATEGIC CSR AS INSTITUTIONAL CHANGE

Prior scholarship has observed that variations in firm CSR practices are, in part, a function of a firm’s local and global institutional context. Institutions are the “rules of the game” or the constraints that structure incentives in social interactions. They include formal legal rules, as well as informal constraints like conventions, norms, codes of behavior, and cultural frameworks. Institutions also include the crucial mechanisms and incentives of enforcement that determine the effectiveness of institutional constraints. Business culture is also an informal institution that affects firms’ incentives to act in a responsible manner beyond the

\[15\] See North, supra note 10, at 3; Aguilera & Jackson, supra note 13, at 461-62; see generally Lozano, Albareda, & Ysa, supra note 13 (describing various national models of CSR and their determinants); Williams & Aguilera, supra note 13, at 452-53 (presenting a comparative analysis of the legal, institutional, attitudinal, and behavioral factors that shape how CSR is defined and implemented).


\[17\] See North, supra note 10, at 3; See also John L. Campbell, Institutional Change and Globalization I, 18 (2004); March & Olsen, supra note 16, at 17.

\[18\] See Campbell, supra note 17, at 3-4; March & Olsen, supra note 16, at 17.
incentives created by formal law and regulatory enforcement. Other sources of informal norms may come from the external economic and cultural environment, as well as from markets; all of these institutions are overlapping and interrelated.

Why firms in China and other emerging markets might embrace strategic CSR is at base a question about the prospects for institutional change. Business culture is an informal institution; dominant business norms that support or undermine a stakeholder orientation may be ultimately internalized within firms and direct corporate behavior. Therefore, a central question from an institutional perspective is whether the business case for CSR can drive a transformation of firms’ informal institutional environment. This part explains why the business case matters for institutional change and assesses the evidence for the business case based on empirical work in developed, largely Western markets. Part III then explores the evolution of CSR in China, evidence of the business case for Chinese firms, and how legal institutions affect the prospects for strategic CSR to take root.

A. UNDERSTANDING INSTITUTIONAL CHANGE

Institutional theory has identified several mechanisms for institutional change. The first mechanism is path dependence. Path dependence has been highly influential in explaining the evolution of corporate law and CSR in different legal systems. This mechanism

---

19 See Frederick, supra note 1, at 528–29.


21 See generally Frederick, supra note 1, at 528–29 (discussing global CSR and the importance of culture in shaping CSR practices).


refers to the “process whereby contingent events or decisions result in the establishment of institutions that persist over long periods of time and constrain the range of actors’ future options, including those that may be more efficient or effective in the long run.”

This literature suggests that the ease with which responsible business practice is accepted as a normative goal within a business community may be constrained by deeply entrenched patterns and practices. At the same time, institutional change can also arise when actors innovate using existing principles and practices and combine them in new ways.

The concept of norm diffusion within institutional theory is also useful in explaining its spread as a set of new institutional principles, or practices, among organizations or communities. Norm diffusion aligns with the comparative law concepts of convergence among formal and informal legal rules and the theory of legal transplants. This literature observes that the success of a legal transplant, or alternatively, the diffusion of a new norm, often depends on the underlying institutional context. Moreover, organizations operate amid multi-layered and mutually influencing social, economic, political, and legal institutions at the national, subnational, and transnational level that may initiate and facilitate norm diffusion. Since CSR as a business concept has been introduced to many emerging markets largely by multinational enterprises and other global actors, including multilateral and international organizations, these concepts are particularly helpful in understanding how informal norms within a given business culture might become more receptive to strategic CSR over time.

While institutional change is often incremental and path dependent, it may also be explained as a punctuated equilibrium where radical change is spurred by external factors that disrupt

---

24 CAMPBELL, supra note 17, at 65; see NORTH, supra note 10, at 93–95.
25 See CAMPBELL, supra note 17, at 65.
26 See CAMPBELL, supra note 17, at 69 (describing the principle of “bricolage”); see also MARCH & OLS N, supra note 16, at 166–71 (discussing the use of existing principles and practices to create new solutions).
27 See CAMPBELL, supra note 17, at 77–89.
28 See generally AGUILERA & JACKSON, supra note 13, at 461 (explaining the mediating effect of subnational and national characteristics on transnational norm diffusion and institutional change generally).
29 See NORTH, supra note 10, at 8, 90; CAMPBELL, supra note 17, at 13, 33–35.
stasis. Examples of exogenous shocks to the system that have led to rapid institutional change in favor of CSR include the Bhopal and BP Deepwater Horizon disasters.

Another key factor in understanding how institutional change occurs is the “symbiotic relationship” between law and other institutional constraints and organizations such as firms, universities, and regulatory agencies, all of which may also be influenced by individual change agents. Institutional scholars have emphasized the importance of organizational learning, imitation, and adaptation as sources of change in the behavior and development of firms and other organizations, which can, in itself, lead to institutional convergence or “isomorphism”; notwithstanding the diverse contexts in which firms operate. Therefore, organizations themselves contribute to institutional change and their interactions, as well as the interactions among individuals and organizations, over time can motivate change in the underlying beliefs or “institutional logics” that come to define formal and informal institutions. These observations suggest that firms’ own support for, or resistance to CSR may influence the social, economic, political, and legal institutions that make up their environment; even as these institutions support or constrain firms’ commitment to responsible business. Individual leaders may also innovate in ways that inspire others to follow.

A final question that institutional theory has addressed concerns the sequencing and direction of institutional change. Some studies note that because certain institutions such as cultural norms and values change slowly, changes in formal rules may, at times, be adopted faster, sometimes even leading a shift in the underlying

30 See Campbell, supra note 17, at 34–35 (surveying the literature).
31 See March & Olsen, supra note 16, at 74–77 (“[A]n institution is the] intermeshing of three systems: the individual, the institution, and the collection of institutions that can be called the environment.”); see also Campbell, supra note 17, at 74–77 (describing change agents).
cultural institutions. However, resistance to the implementation of the new rules may also arise where social norms are not already aligned with the reform direction. At other times, informal normative and cultural changes in industry precede formal institutional changes in an industry’s governance structure or in the regulatory environment. Both patterns of institutional change can be seen in the evolution of regulatory rules and business practices. For example, environmental standards and the potential risk of formalizing regulation too soon has led many governments to encourage voluntary CSR commitments or defer to market forces as an alternative or precursor to legislation.

B. THE BUSINESS CASE & INSTITUTIONAL CHANGE

The business case for CSR posits that better corporate social performance (CSP), that is, firms’ efforts to affirmatively benefit the firms’ diverse stakeholders or reduce negative impacts on stakeholders, leads to better financial performance over time. Theoretical and empirical research on the business case for CSR have identified a number of market actors and mechanisms that may support the business case for CSR, many of which are linked to the interests of the firms’ diverse stakeholders. In the labor markets, for example, firms with better labor and employment practices or a reputation for operating sustainability may better attract and retain employees and executives. In the capital markets, firms with better CSR practices and greater transparency may be able to access debt

---

34 See NORTH, supra note 10, at 89–91 (Arguing that “formal dimensions, such as property rights . . . change more rapidly than informal dimensions, such as cultural norms and values.”).

35 A well-known example of this challenge is the history of desegregation in the U.S.

36 See CAMPBELL, supra note 17, at 60.

37 Harper Ho, supra note 8, at 429.


40 See Carroll & Shabana, supra note 2, at 98.
and equity capital more cheaply or may be more attractive to long-term investors.\footnote{Id.} In more visible product markets, firms known for responsible business practice may enjoy higher reputational capital among consumers who may be willing to pay a premium for their products or reward firms with stronger brand loyalty.\footnote{Id. at 94, 98, 102.} Firms that embrace CSR may also be better able to manage and mitigate operational risk, including business, legal, and financial risk, making them better able to generate and preserve firm value.\footnote{See Marc Orlitzky & John D. Benjamin, Corporate Social Performance and Firm Risk: A Meta-Analytic Review, 40 BUS. & SOCI’Y 369, 372–373 (2001) (finding that firms with low corporate social performance often are the target of legal and criminal liability, while firms with high corporate social performance do not have the same legal burdens); see also Marc Orlitzky et al., Corporate Social and Financial Performance: A Meta-analysis, 24 ORG. STUDIES 403, 406–407 (2003) (finding that corporate social performance enhances firm reputation and goodwill with external stakeholders).}

The empirical question of whether or not the business case holds true has direct implications for institutional change in broader business culture. This is one reason for the issue’s sustained scholarly attention. The evidence demonstrates how market forces (and therefore market institutions) affect the diffusion of CSR friendly norms throughout business culture and can, in itself, stimulate institutional change if it motivates other firms to follow earlier innovators and change agents.\footnote{See generally Williams & Aguilera, supra note 13 (analyzing broadly the legal, institutional, attitudinal, and behavioral factors that shape how CSR is defined and implemented).} In the U.S., for example, where shareholder wealth maximization is a dominant norm within business culture,\footnote{See JONATHAN R. MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 4, 7 (2008).} a shift in norms toward acceptance of “shared value” or strategic CSR as an appropriate or expected goal of economic activity can only occur if most firms believe that markets reward CSR leaders and punish CSR laggards—in other words, that the business case holds.

A transformation of these informal rules often begins when leading firm managers and influential stakeholders, such as consumer groups, NGOs, and investors, start to emphasize responsible business
practice. These efforts spur changes in market behavior that provide new incentives for responsible business practices that can lead more firms and managers to embrace CSR principles. More stakeholders are attracted by the “value proposition” of supporting responsible firms, which ultimately creates a virtuous cycle. These mutually influencing trends may ultimately bring about broader institutional changes in business culture so that dominant business norms begin to facilitate, rather than impede, a strategic understanding of CSR. External shocks (such as an environmental crisis) or changes in formal institutions (such as legislative reform) might expedite this process. However, firm innovation and individual leadership may face resistance if innovation around CSR proves too costly to the firm; this resistance may come from weak support or opposition from existing legal regimes, or because first adopters are less competitive in the near term. In these contexts, early leaders in strategic CSR may face an uphill battle, and institutional change may proceed slowly, if at all.

Whether or not the business case holds is also an important question because it directly affects the force of formal institutions. A starting point here is the observation that responsible business practice, whether through companies reducing their negative stakeholder impacts or positively contributing to societal welfare, is likely to align with public regulatory goals. Governments may therefore benefit from directly supporting or facilitating CSR practices and encouraging firms to identify opportunities to create “shared value.” In addition, if the business case holds, market incentives can alleviate the need for top-down regulatory enforcement allowing governments to use fewer carrots and sticks to incentivize compliance. If, however, the business case for CSR is weak, then market incentives may drive companies to see formal legal compliance as value-reducing and the state will be unable to

---

46 See Jonathan P. Doh & Terrence R. Guay, Corporate Social Responsibility, Public Policy, and NGO Activism in Europe and the United States: An Institutional Stakeholder Perspective, 43 J. MGMT. STUDIES 47, 55–56 (2006) (stating that stakeholders are the individuals in the firm with the most influence to operate with social responsibility).

47 See id. at 57.

48 See id.

49 See id. at 59–64.

50 See Carroll & Shabana, supra note 2, at 100.

51 See generally id. at 91–92 (discussing the business case and its incentives).
defer to market forces or self-regulation, making public regulation both more necessary and more costly. In such a context, any direct state policies to encourage CSR practices are unlikely to bear fruit. By facilitating a shift in business culture, the business case will also affect the evolution and effectiveness of formal legal institutions.

C. EVIDENCE FOR THE BUSINESS CASE

Whether firms can do better financially by adopting a strategic vision of CSR (or, more narrowly, certain CSR practices) depends on the relative costs and benefits involved. One hypothesis is that these efforts impose a cost burden or may result in lost business opportunities because the company is unwilling to accept certain risks, consequently rendering the company less competitive. An alternative view is that CSR might contribute to financial performance by helping the firm identify areas of comparative advantage; identifying new opportunities; or by reducing costs or risks to the business that would otherwise be value-reducing. Firms that embrace CSR, particularly those that see CSR as integrated within their organization, may therefore outperform their peers in generating and preserving firm value while at the same time advancing broader social welfare. What, then, is the evidence for the business case?

Over the past several decades, a deep empirical literature has developed that tests the business case using a range of methodologies. Most of these methodologies measure financial success using standard market or accounting measures of financial performance. Additionally, a separate stream of research has looked at how responsible business practice may affect firms’ financial risk. Although many earlier studies focus on a single dimension of CSR, such as environmental performance, more recent research looks

---

52 See id. at 100–101.
53 See id. at 101.
54 See Kurucz et al., supra note 38, at 88–89.
56 See Gordon L. Clark et al., From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance 11–19 (2015) (conducting a meta-study of over 200 studies); see also Harper Ho, supra note 55 (analyzing studies that focus on financial risk effects of sustainability).
at a range of factors; this research often draws on large-scale datasets that contain multiple metrics for a wide range of CSR indicators and utilize self-reported and external sources of information.\textsuperscript{57} Also, a subset of the literature focuses on the quantity or quality of sustainability disclosures under recognized reporting standards, which are seen as a proxy for, or driver of, CSR.\textsuperscript{58}

While the evidence for the business case from over nearly four decades remains mixed, most studies, over eighty percent by some recent estimates, show that firms with strong CSR practices or lower negative stakeholder impacts enjoy higher profitability and lower financial risk; these results translate to a lower cost of debt and equity capital.\textsuperscript{59} These same firms benefit financially from improved operational performance and transparency.\textsuperscript{60} A substantial amount of the evidence also indicates that incorporating nonfinancial indicators of risk and return that align with portfolio firms' corporate social

\textsuperscript{57} Common data collections include the KLD 400 Social Index, the ASSET4 index (from Thompson Reuters), and Bloomberg’s ESG data.

\textsuperscript{58} Widely used standards include those developed by the Global Reporting Initiative (GRI), the Climate Disclosure Standards Board (CDSB) (formerly, the Carbon Disclosure Project (CDP)), the Sustainability Accounting Standards Board (SASB), and the International Integrated Reporting Council (IIRC). See U.N. Env’t Programme, \textit{Frequently Asked Questions on Corporate Sustainability Reporting}, 7–10. U.N. Doc. DTI/1641/PA (2013) (by Louis Guthrie, Mardi McBrien & Dr Jarlath Molloy), available at http://www.unep.org/resourceefficiency/Business/SustainableandResponsibl eBusiness/CorporateSustainabilityReporting/GroupofFriendsofParagraph47/ FAQsonSustainabilityReporting/tabid/106320/Default.aspx (surveying the types of data that are used in corporate sustainability reporting).

\textsuperscript{59} See CLARK ET AL., supra note 56, at 9 (reporting that nearly ninety percent of fifty-one studies over the past twenty years show a positive relationship between sustainability and firm operational performance, and eighty percent of forty-one studies over s similar time period show a positive relationship between sustainability and financial performance); see also Joshua D. Margolis, Hillary Anger Elfenbein & James P. Walsh, Does it Pay to Be Good...And Does it Matter? A Meta-Analysis of the Relationship between Corporate Social and Financial Performance 1, 23 (March 1, 2009) (unpublished manuscript), available at www.ssrn.com/abstract=1866371 (surveying 251 studies from 1972 through 2007); Orlitzky et al., supra note 43, at 413–17 (surveying fifty-two studies from 1970 to 2003).

\textsuperscript{60} See, e.g., Robert G. Eccles, Ioannis Ioannou & George Serafeim, \textit{The Impact of Corporate Sustainability on Organizational Processes and Performance}, 60 MGMT. SCI. 2835 (2014).
performance has either a neutral or positive effect on portfolio risk-adjusted returns to diversified shareholders, particularly, over the medium to longer term.\footnote{See generally Harper Ho, supra note 55 (surveying the literature).}

On the whole, the few studies examining the business case across jurisdictions found that stronger CSR indicators are associated with larger firm size; public or state ownership; higher expenditures on research and development; and corporate governance or capital structures that give managers greater flexibility in allocating resources.\footnote{See generally Ioannis Ioannou & George Serafeim, What Drives Corporate Social Performance? The Role of Nation-Level Institutions, 43 J. INT’L BUS. STUDIES 834, 842–47 (2012) (analyzing various factors and their impact on firms’ CSP across different nations).} Similar factors appear to affect the level of sustainability reporting as well.\footnote{See id. (finding, for example, that firms in polluting industries and those cross-listed on a leading stock exchange are more likely to produce sustainability reports).} Because reliable publicly reported data is easiest to obtain, most studies testing the business case focus on publicly traded companies and primarily analyze firms listed in Western capital markets.\footnote{See generally id.}

Some of the diversity in the empirical findings can be traced to the particular measures used to capture CSR, which is generally understood to include both corporate commitments to avoid causing harm (i.e. negative CSR) and efforts to positively impact a range of corporate stakeholders (i.e. positive CSR). In general, studies focusing on a single aggregate CSR measure based on firm reputation or corporate philanthropy (positive CSR) find that firms who attain an optimal level of CSR outperform those with either very low or very high CSR measures; this outcome reflects the possibility that firms may sacrifice profit by over-investing in contributions to broader stakeholder or societal well-being.\footnote{See, e.g., Paul C. Godfrey et al., The Relationship Between Corporate Social Responsibility and Shareholder Value: An Empirical Test of the Risk Management Hypothesis, 30 STRATEGIC MGMT. J. 425, 436–39 (2009) (identifying an optimal level of reputational benefits that cushion firms in the event of potential legal liability); see also Michael L. Barnett & Robert M. Salomon, Beyond Dichotomy: The Curvilinear Relationship Between Social Responsibility and Financial Performance, 25 STRATEGIC MGMT. J. 1101, 1112–16 (2006) (finding the strongest financial returns to low and high levels of sustainability based on an analysis of socially screened mutual
focusing on the effect of firm efforts to reduce negative impacts on core stakeholders or efforts to better manage and mitigate their risk of liability generally find a strong positive influence on firm financial performance.66

A growing number of studies suggest that the relationship between firm-level CSR and CFP is in fact bidirectional and therefore that CSR and financial performance may be mutually reinforcing.67 The studies find that firms with strong CSR enjoy better financial performance in later periods and find that firms with strong financial performance exhibit stronger CSR in later periods relative to their peers; perhaps this result occurs because they have more resources to invest in improving CSR or have greater visibility in the market.68 Similarly, larger and more profitable firms are those most likely to have strong sustainability or nonfinancial disclosure practices.69

In sum, the evidence shows that for many firms across a range of sectors, responsible business practice and attention to stakeholder impacts brings financial reward. Of course, the aggregate evidence does not indicate that all CSR practice will generate or maximize value to every firm and its shareholders; some evidence indicates that CSR practices can be profit-sacrificing, even over longer time horizons. Nevertheless, market drivers are a key reason why the largest listed firms in the U.S., as well as a number of

69 These variables are common controls in studies on the business case for CSR and this conclusion is supported by numerous studies, see Orlitzky, Schmidt & Rynes, supra note 43; Orlitzky & Benjamin, supra note 43, and in more recent meta-studies, see CLARK ET AL., supra note 56.
the largest investors and many advocacy organizations, endorse the business case and see generating “shared value” through responsible business conduct as an important or even essential goal of economic activity.70 While they may not yet be indicative of fundamental institutional change, these trends already mark a shift in the dominant business culture, particularly for firms in the U.S. and U.K. markets that have traditionally adhered to the shareholder wealth maximization norm and viewed CSR practices as at odds with that goal.

III. CHINESE FIRMS & STRATEGIC CSR

As it happens, the question of whether the business case holds—whether markets reward “good” business practice or not—is not only a critical empirical question for Western firms, investors, and academics, but is a question that lies at the heart of some of the most pressing policy choices confronting China and other emerging markets. In 2008, China’s State Environmental Protection Agency (SEPA), now known as the Ministry of Environmental Protection (MEP), joined with several other administrative agencies to promote better environmental compliance by large Chinese firms under a series of green finance policies.71 Among these policies, there was a green securities policy adopted by the China Securities Regulatory Commission (CSRC) and the MEP that required environmental disclosures and performance assessments for listed firms.72 This policy also included a Green Initial Public Offering (IPO) component that required companies in fourteen highly-polluting industries that wished to launch an IPO, or make a later offering of securities, to pass an environmental assessment by the MEP, including solicitation

---

70 Voluntary sustainability reporting practices and support for responsible investment are two indicators of these trends. See, e.g. KPMG INT’L COOP., THE KPMG SURVEY OF CORPORATE RESPONSIBILITY REPORTING 2013 (8th ed. 2013); Harper Ho, supra note 8 (discussing trends among investors).


of public opinion. While it was in effect, the CSRC aggressively enforced the Green IPO Policy to block listings of polluting firms. However, in late 2014, the MEP issued a policy document that discontinued the Green IPO policy and indicated that this shift was intended to remove government interference and defer to the market.

Not long after this policy shift, the Chinese governments’ Green Finance Task Force (which was headed by the People’s Bank of China; the China Banking Regulatory Commission; the Ministry of Finance; and some other industry players, academics, and advisors) released a blueprint for a new series of Green Finance initiatives that will include a revised Green IPO Policy as well as a range of new policies spanning banking, insurance, and finance. Nearly all of the proposed measures rely on market incentives to motivate environmentally sustainable development and responsible business practice across the Chinese economy, and these policies are expected to play a part under China’s next Five-Year Plan, which will confirm its policy direction for 2016–2020.

But can market forces really drive legal compliance and responsible business practice? Viewed pessimistically, the Green IPO policy shift simply signals a lack of interest in environmental screening for firms that are going public. On the other hand, taken at face value, “deferring to the market” is very much in line with the Chinese government’s growing emphasis on market-based policy

---


76 GREEN FIN. TASK FORCE, ESTABLISHING CHINA’S GREEN FINANCIAL SYSTEM (2015).

77 See id. at ix.
tools and self-regulation. Yet for markets to do their job, and for new informal compliance-oriented norms to emerge, either formal enforcement mechanisms that can substitute for regulatory oversight must exist, or environmental compliance must be in firms’ own economic interest. The same is true for CSR. Taking a closer look at the strength of the business case in China is therefore a critical step toward understanding the potential for institutional change that can affect not only how firms approach CSR but also legal implementation. This part briefly describes the diffusion of CSR concepts in China and then surveys the empirical evidence supporting the business case for CSR.

A. THE EVOLUTION OF CSR IN CHINA

The fact that China introduced its green finance policies and conditioned public listing on environmental performance as early as 2008 is quite astonishing. Even in the U.S., policies that recognize the potential role of financial institutions and debt and equity markets in advancing or impeding sustainability are still in their infancy. China’s green finance policies point to the growing importance of environmental concerns in China’s development policy and to the role governments across China have played over the past decade in promoting various forms of CSR. However, institutional change in broader business culture toward an embedded, strategic view of CSR is still in its early stages.

---

78 The Decision of the Third Plenum of the Central Committee of the Communist Party of China was considered a watershed in its commitment to use market incentives to direct capital into environmental protection and to incentivize sustainable resource use. See Decision on Major Issues Concerning Comprehensive Deepening Reforms (promulgated by the Cent. Comm. Communist Party China, Nov. 12, 2013) (China), translated at http://www.china.org.cn/china/third_plenary_session/2014-01/16/content_31212602.htm [hereinafter Third Plenum Decision].

79 See NORTH, supra note 10, at 4.

80 It is important to note that the line between CSR (the “spirit of the law”) and legal compliance with the letter of the law blurs in a regulatory environment like China’s, where formal enforcement is inconsistent.

81 See generally Wang & Bernell, supra note 74, at 340 (noting background events leading up to disclosure requirements).

82 See generally Frederick, supra note 1 (exploring the stages and historical development of CSR).

83 See generally Porter & Kramer, supra note 5.
The origins of early CSR concepts in China can be traced to the market reforms of the late 1980s and early 1990s that expanded foreign investment and the corresponding sweatshop labor practices that sparked global consumer movements throughout the mid-1990s.\(^{84}\) In response, global brands began to implement supply chain labor and environmental audits and, for the first time, Chinese suppliers faced demand for practices that met or exceeded local legal standards and certainly for practices that exceeded the level of compliance set by the local enforcement.\(^{85}\) At the same time, multinational companies’ sourcing practices were often at odds with the stated goals of the standards they imposed through supply chain audits and local governments had few incentives to worry about firms’ social impact beyond job growth, economic development, and investment targets. As a result, prior to the mid-2000s, CSR concepts faced resistance from Chinese firms and policymakers who saw CSR largely as an externally imposed foreign transplant.\(^{86}\)

Over the past decade, the institutional environment for Chinese firms has been radically transformed by labor unrest, public outrage over product safety scandals, and environmental disasters.\(^{87}\) Consistent with the literature on punctuated equilibria, these external policy shocks have motivated the central government to emphasize sustainable development and have stimulated increasingly tough legislation.\(^{88}\) China’s current emphasis on sustainability can be traced to high-level policy statements by then-President Hu Jintao in 2005, which have been carried through into China’s current (2011–2015) Five-Year Plan.\(^{89}\) That same year, China’s Company Law was amended to state that companies shall “abide by the laws and administrative regulations, observe social morals and commercial

---

\(^{84}\) See Harper Ho, \textit{supra} note 8, at 398.

\(^{85}\) During this period, China’s development model depended almost exclusively on high economic growth driven by foreign direct investment that was attracted by low labor and production costs.

\(^{86}\) See Harper Ho, \textit{supra} note 8, at 398 (discussing the history of CSR in China).

\(^{87}\) See \textit{id.} at 398–401.

\(^{88}\) See \textit{generally id.} at 406–07 (discussing mandatory CSR requirements in China).


91 These themes are reflected in more recent policy statements as well. See, e.g., Third Plenum Decision, supra note 78, at part VIII (emphasizing “social innovation,” new “social governance systems” and “social fairness and justice”).

92 See Harper Ho supra note 8, at 420.

93 See id. at 401–17 (detailing a more complete survey of these initiatives).


95 See id.
voluntary commitments for banks engaged in project finance lending, and the Global Compact.\(^{96}\) All of these efforts draw continued support from the Chinese Communist Party’s emphasis on sustainability and its explicit references to the public accountability and social responsibility of companies in its policy directives.\(^{97}\)

Many of these developments have raised public awareness of CSR concepts within China, and expectations of how leading firms should do business may be shifting.\(^{98}\) For example, a recent survey by the Conference Board of over 470 firms (around seventy-five percent domestic Chinese firms) showed that employer branding, attracting, and retaining talent are becoming important drivers of CSR for leading firms.\(^{99}\) The same study confirms other research showing that adoption of “early stage corporate sustainability practices,” such as business codes of conduct, health and safety standards, and other policy guidelines, are quite common.\(^{100}\) The number of firms producing voluntary sustainability reports, some through international voluntary regimes like the Global Compact, continues to rise; these firms are led by state-sector firms and certain listed firms that are subject to mandatory environmental or CSR

\(^{96}\) See Harper Ho, \textit{supra} note 8, at 403 (surveying these developments).

\(^{97}\) See \textit{Five-Year Plan}, \textit{supra} note 89. See also Zhonggong Zhongyang Guanyu Quanmian Tuijin Yifa Zhiguo Ruogan Zhongda Wenti Jueding (中共中央关于全面推进依法治国若干重大问题的决定) [Decision of the CPC Central Committee Concerning Some Major Questions in Comprehensively Moving Governing the Country Forward According to Law] (promulgated by the Cent. Comm. Communist Party China, Oct. 23, 2014) Part V, ¶ 1 (China) (emphasizing the role of law in “guiding the people to consciously carry out their statutory duties [and] social responsibilities”).


The expansion of philanthropy, for example, has led some observers to identify ties between responsible business practice and aspects of the Confucian tradition with its emphasis on collective well-being. See, e.g., Geoffrey K.H. See, \textit{Harmonious Society and Chinese CSR: Is There Really a Link}, 89 J. BUS. ETHICS 1, 3 (2009).

\(^{99}\) See \textit{Anke Schrader et al., Conference Bd., Business and Sustainability in China: Company Responses to a National Priority} 9 (2011).

\(^{100}\) \textit{Id.} at 15–16, 29 (finding that over sixty percent of respondents had a formal CSR policy statement and that around thirty percent had a specific budget allocated to CSR initiatives).
reporting requirements. The number of firms adopting the internationally used Global Reporting Initiative (GRI) standards as the basis of their disclosures has also risen dramatically to around twenty percent of Chinese companies issuing a sustainability report.

However, CSR is not yet widely embraced by firms or well-understood by policymakers, state agencies, and other stakeholders. Although public expectations of firm CSR practice may be growing, public stakeholders, such as local or foreign NGOs, customers, suppliers, trade associations, and even the media wield relatively weak influence over corporate sustainability decisions for Chinese firms. Studies of Chinese business leaders and the broader public confirm that both tend to define CSR as “ad hoc public philanthropy, strategic philanthropy, and ethical business practices.”

Consistent with these observations, empirical studies find limited adoption of strategic CSR by Chinese firms, even by CSR leaders; most firms view CSR primarily as a cost and do not have robust internal oversight systems for assessing their social performance. Many companies who responded to the Conference

---

101 See ANKE SCHRADER, CONFERENCE BD., CORPORATE SUSTAINABILITY DISCLOSURE IN CHINA 6 (2013).
103 See, e.g., Bala Ramasamy & Matthew Yeung, Chinese Consumers’ Perception of Corporate Social Responsibility (CSR), 88 J. BUS. ETHICS 119 (2009) (finding a higher level of consumer support for CSR in mainland China than in Hong Kong).
104 See SCHRADER ET AL., supra note 99, at 24, fig. 6b.
106 See SCHRADER ET AL., supra note 99, at 21, fig. 5; Johan Graafland & Lei Zhang, Corporate Social Responsibility in China: Implementation and Challenges, 23 BUS. ETHICS: A EUR. REV. 34, 44 (2014) (finding that sixty-three percent of the sample firms identified competitive pressure as a key obstacle to CSR, and forty-seven percent cited CSR’s high cost); SCHRADER, supra note 101, at 41, fig. 18 (finding that despite national and local measures to curb pollutant emissions and reduce energy and water
Board survey cited above did not associate compliance practices, codes of conduct, and the like with sustainability, and that study concluded that CSR initiatives “often remain isolated, without being tied into a comprehensive, enterprise-wide approach.” 107 Responsibility for CSR reporting and monitoring is often allocated to the government relations or public relations departments, 108 and, despite widespread adoption of sustainability policies, at least by larger firms, few disclose metrics on implementation. 109 CSR reporting is seen by many firms as a public relations exercise, and the quality of disclosure remains poor even as the level of reporting continues to rise. 110 Few companies disclose quantitative indicators, and few sustainability reports are externally audited. 111 In sum, the diffusion of CSR concepts in China appears to be following a similar pattern as in many Western markets; in these markets, CSR was first limited to direct philanthropy and isolated programs. Informal norms of business practice have only recently begun to shift toward a broader expectation that firms’ CSR commitments will extend throughout their operations.

B. EVIDENCE FOR THE BUSINESS CASE IN CHINA

Despite the many advances that have been made, a key reason why institutional change in the normative expectations of the role of business in Chinese society has only been modest to date has
to do with the widely held view that the business case does not hold in the Chinese market. This is borne out by the Conference Board survey cited earlier; this study found that over half of the Chinese firms responding identified an “undeveloped or missing business case” as one of the key obstacles to improving their commitment to sustainability. This finding supports the conclusion that the business case can be an important driver of CSR diffusion and institutional change, but whether this perception reflects reality or not has yet to be explored by comparative scholars. However, empirical studies could also shed light on the reasons behind the strength or weakness of the business case.

From a comparative standpoint, the evidence might be expected to support one of two competing hypotheses. The first is that in contrast to Western markets where Friedman famously claimed that CSR is just good business and nothing more, CSR may not actually be “good business” in China; perhaps this could be the case because the business case does not hold, the business environment is highly competitive, market mechanisms are inefficient, or formal legal institutions remain weak. For many companies, CSR commitments may not be valued by market actors; however, the evidence discussed above suggests that normative expectations by domestic consumers and employees may be changing. Alternatively, the business case may hold, suggesting that market mechanisms may be effective enough, that informal norms may be emerging to fill gaps in formal institutions, or that aspects of traditional Chinese culture or business context align with CSR concepts. In either case, comparative studies on CSR practice confirm the path dependency and interaction of existing

---

112 See generally Schrader et al., supra note 99 (examining the business case in the Chinese market).

113 Id. at 21, fig. 5.

114 Milton Friedman, The Social Responsibility of Business is to Increase its Profits, N.Y. Times Mag. (Sept. 30, 1970); see also Ribstein, supra note 39 (further developing this view).

115 See Ioannou & Serafeim, supra note 62 (finding, based on a multi-year, multi-jurisdictional comparison, that the level of encouraged strong competition; the level of corruption; and whether the country has a credit-based rather than a capital-market-based corporate finance model are all factors that lower the level of firms’ corporate social performance (CSR)).

116 See id.

117 See, e.g. See, supra note 98 (suggesting Confucian thought as a CSR driver).
formal and informal institutions which have been found “to explain differences in [CSR] practices across advanced economies.”\textsuperscript{118} For China, important dimensions include its centrally controlled political system; its insider corporate governance model, which preferences controlling shareholder interests; and the dominant presence of the state sector in the economy.\textsuperscript{119}

Before proceeding further, it is important to respond to a potential objection to this investigation: looking at market-based drivers for strategic CSR is the wrong approach for the Chinese context. Because of the continued direct and indirect influence of the state in the Chinese economy—or so the argument goes—looking for market-based drivers of institutional change is misguided and futile. Of course, any comparative project must be aware of important features of the economic, social, or legal institutions being examined. Additionally, it is also important for such projects to be sensitive to the limitations of available data and methodologies and wary of applying a Western lens to non-Western contexts. However, as discussed above, Chinese policymakers and regulators are frequently quite explicit in their use of market-based incentives to motivate firms and their management.\textsuperscript{120} CSR advocates within state agencies and beyond also draw normative support for their efforts from the business case for CSR; consequently, an understanding of the evidence for the business case in China becomes doubly necessary to comparative scholars.

Over the past decade, a growing body of empirical work has sought to test the business case for CSR using data from Chinese firms. This research is part of a larger body of research by both Chinese and Western scholars examining CSR and sustainability issues in the Chinese context.\textsuperscript{121} This discussion relies on studies published in Western journals that empirically test the business case

\textsuperscript{118} Na Ni, Patterns of Corporate Responsibility Practices for High Financial Performance: Evidence from Three Chinese Societies, 126 J. BUS. ETHICS 169, 174 (2015) (citations omitted); see also Ioannou & Serafeim, supra note 62 (supporting this conclusion).

\textsuperscript{119} See Na Ni, supra note 118, at 169, 174.

\textsuperscript{120} Indeed, the Chinese Communist Party itself appears to be embracing market incentives within its own ranks. See Patricia M. Thornton, The New Life of the Party: Party-Building and Social Engineering in Greater Shanghai, 68 CHINA J. 58 (2012).

for CSR. With limited exceptions, these studies look at CSR practice or disclosure rather than measuring firm outcomes. Most use standard accounting measures of financial performance (ROA & ROE), although a few also use market measures of profitability, such as stock market returns. CSR measures are derived in some cases from survey-based indicators, but most of the studies used one-dimensional CSR measures such as the level of corporate philanthropy, the issuance of a CSR or sustainability report, or the adoption of a code of conduct or compliance management system. Only one study used a Chinese multi-indicator, multi-year database analogous to the KLD CSR ratings that have been most commonly used in research on Western firms.

To date, most of the empirical studies on the business case in China published in Western journals support the broader literature on the business case that finds a positive relationship between CSR and financial performance. In contrast, the study by Wang et al.

---

122 A search conducted in May 2015 on Google Scholar identified fifteen to twenty such articles, while a comparable search on a Chinese database found over 300 in the past ten years. This discussion does not reflect the findings of studies published in Chinese journals, which will be analyzed in a separate article.

123 For example, one study assesses whether adoption of CSR standards affects environmental performance. See Johan Grafland & Hugo Smid, Does CSR Really Make a Difference? An Explorative Analysis for Chinese Companies, 22 CHINA & WORLD ECON. 102 (2014).


125 See Shuo Wang et al., Can Socially Responsible Leaders Drive Chinese Firm Performance?, 36 LEADERSHIP & ORG. DEV. J. 435 (2015). This database (RLCCW) relies on a content analysis of annual sustainability reports using a framework that is based on the international CSR guidelines and ISO26000, and it measures across nine CSR dimensions. See id. at 441.

126 One study using data from firms in Guangdong found, consistent with findings in developed markets, that this relationship is bi-directional such that strong CSR performance improves later period financial performance and vice versa. See Chen Honghui & Wang Xiyang, Corporate Social Responsibility and Corporate Financial Performance in China: an Empirical Research from Chinese Firms, 11 CORP. GOV. 361 (2011) (surveying 141 Guangdong firms from 2007–2008). However, further research is needed, as conclusions from this study are limited by a low
found a negative relationship between CSR and accounting measures of financial performance over a two-year period. Additionally, another study, though hampered by a limited data set, found no significant relationship at all. Yet another study that examined the relationship between philanthropic contributions and the cost of debt financing found that debt capital was more expensive for firms with either extremely high levels of charitable contributions or extremely low levels. While this is consistent with findings regarding the declining marginal returns on investments in reputational capital and corporate philanthropy, studies using broader CSR measures may not exhibit the same pattern. One such study was noteworthy, however, as the only one in the sample to look at financial performance in terms of the cost of debt financing, which most research in Western markets has been shown to be lower for firms with better CSR. A number of studies also find that ethical or responsible leadership has a positive effect on firm financial performance. Although these studies fail to explore in more depth the reasons for these findings, it is likely that strong leadership commitments to CSR or ethical behavior reflects overall management quality as well as indirect reputational benefits.

Reflecting the early stage of CSR in China, a number of studies measure CSR based on whether firms issue sustainability reports, hypothesizing that firms with better disclosure may also be better at monitoring and managing CSR-related risk. One such study comparing the financial performance of a sample of firms listed on

survey response rate, potential concerns about the unrepresentativeness of the sample, and a lack of clarity of some of the variables. See id.

127 See Wang et al., supra note 125.
128 See Denise Luethge & Helen Guohong Han, Assessing Corporate Social and Financial Performance in China, 8 SOC. RESP. J. 389 (2012) (testing effects only with a small sample size of PRC companies listed on the Hong Kong stock exchange in a single year (2008)).
130 See, e.g., Godfrey, supra note 65.
131 See Clark et al., supra note 59 (surveying the literature).
132 See Yan Zhu et al., Corporate Social Responsibility, Firm Reputation, and Firm Performance: The Role of Ethical Leadership, 31 ASIA PAC. J. MGMT. 925 (2014) (surveying the general managers and vice general managers of 208 companies in the tourism sector in Guangdong Province); Wang et al., supra note 125 (using ROE as a measure of operational performance).
the Shenzhen, Shanghai, and Hong Kong stock exchanges found that sustainability reporting “influence[d] both environmental and financial performance” of the sampled firms.\textsuperscript{133} This finding has been supported by other studies as well.\textsuperscript{134} Those same studies also find that firms with high financial performance are more likely to issue a separate CSR report in a later period.\textsuperscript{135} Others find, however, that reporting may not be as directly linked to actual operational practice, because few companies set specific targets or report on the progress and attainment of those goals.\textsuperscript{136} 

Consistent with the literature on path dependency, many features of the domestic institutional context appear to affect the strength of the business case and how it is tested. For example, the introduction of SASAC’s 2008 CSR guidelines, which encouraged sustainability reporting and were followed by mandates for certain state-owned enterprises (SOEs), help explain why the vast majority of sustainability reports are issued by SOEs and publicly traded companies.\textsuperscript{137} Several studies also find that competitive advantage, innovation, and reputational concerns are key drivers of CSR adoption for Chinese firms.\textsuperscript{138} Other key drivers include compliance, labor market competitiveness, cost saving, and risk management.\textsuperscript{139} A number of studies find that the adoption of CSR standards, the quality and level of sustainability disclosure, and the depth and breadth of CSR practice is higher for larger firms and, in some cases, for firms with state or foreign ownership.\textsuperscript{140} The relative weight or

\textsuperscript{133} See Weber, supra note 98, at 306.

\textsuperscript{134} See, e.g., Cheng et al., supra note 102.

\textsuperscript{135} See id.

\textsuperscript{136} See Graafland & Zhang, supra note 106.

\textsuperscript{137} See Schrader et al., supra note 99, at 34.

\textsuperscript{138} See Graafland & Zhang supra note 106 (finding, based on an 100 company survey, that respondents’ CSR focus centered on competitiveness, business practice, and process innovation); id., at 14, fig. 1 (reporting that competitive advantage was a key driver of sustainability for over 75 percent of respondents to an online survey, followed closely by brand recognition, and reputation).

\textsuperscript{139} See Schrader et al., supra note 99, at 14, fig. 1.

\textsuperscript{140} See, e.g., Cheng et al., supra note 102 (finding size effects); Zheng et al., supra note 110 (finding from a survey of 5,344 listed firms that central SOEs are more likely to issue CSR reports, while firms owned by block holders are less likely to do so); Graafland & Zhang, supra note 106, at 44 (finding use of CSR instruments positively related to size and foreign ownership); Schrader, supra note 101, at 6 (finding firm size affected the
“salience” of different stakeholders for firms in Mainland China has also been found to differ from the views of their counterparts in Hong Kong and Taiwan.\textsuperscript{141} For example, the study found that in China, firms with high financial performance exhibited lower levels of attention to community and environmental interests, while this was not the case for similar firms in Hong Kong.\textsuperscript{142} One of the most significant features of the PRC institutional context is that local and central authorities are key stakeholders in PRC firms. Additionally, one study on corporate philanthropy measured the effect of “government-oriented” CSR on financial performance, which it defined as cash or in-kind contributions to the government or its agencies.\textsuperscript{143} Interestingly, the study found a correlation between government-related contributions that was not evident for other types of charitable contributions and financial performance.\textsuperscript{144} As discussed below, the fact that these contributions are considered philanthropy at all is itself indicative of the complexity of CSR concepts and the role of the state in the PRC context.

In sum, this early evidence suggests that market drivers of CSR exist for some PRC firms. However, because of data limitations or the approaches firms adopt, many of the studies to date define CSR rather narrowly in terms of charitable contributions, sustainability disclosure, or CSR standard adoption that may not translate into actual changes in firm conduct.\textsuperscript{145} The diversity of data;
methodologies; indicators used for measuring CSR and CFP; and precise research questions means that more research is needed before clear conclusions can be drawn. Generalizable results are also difficult to make from some of the studies reviewed here due to small sample sizes and methodological weaknesses; these weaknesses include incomplete discussion of survey implementation methods and timeframes, as well as a failure to include control variables that are established in the literature as potentially affecting the business case, such as the amount of firm leverage and industry or jurisdictional differences. Analyses of ratings of corporate responsibility drawn from public reporting or other forms of self-disclosure may also over- and under-represent actual practice. In addition, sustainability reporting and CSR data have only been produced by a sizeable number of Chinese public companies and by SOEs for less than a decade, so the body of empirical evidence from which conclusions can be meaningfully drawn in the Chinese context is still relatively small, albeit growing rapidly. Given the time required for the publication process, several recent studies necessarily rely on only a few years of data from time periods in the mid-2000s when sustainability practices and disclosure were relatively new for Chinese firms.

Future research should deepen the analyses presented in these studies and draw on some of the cautions they suggest. For example, using corporate philanthropy as a proxy for CSR may be misleading. One extensive study of family-owned firms in eighteen industries found that philanthropy was significantly and positively correlated with environmental misconduct. This suggests that firms were using “greenwashing” to distract from poor environmental practice. One critical question not addressed by the studies themselves is the question of how extensively the early empirical evidence supporting the business case for CSR among domestic firms has been disseminated in China, beyond diffusion of strategic CSR

---

146 See David Gelles, Social Responsibility that Rubs Right Off, N.Y. TIMES, Oct. 18, 2015, at BU3 (defining and discussing “greenwashing”).

147 Even more troubling, the effects were weaker for politically connected family-owned firms, possibly because their political connections made the buffer provided by corporate philanthropy less necessary. See Du Xingqiang, Is Corporate Philanthropy Used as Environmental Misconduct Dressing? Evidence from Chinese Family-Owned Firms, 129 J. BUS. ETHICS 341, 342, 354 (2015) (using nation-wide data from over 3,000 small and medium-sized enterprises).
concepts more generally. Despite these limits, these studies offer an early indication of the potential, as well as the challenges confronting any transformation of the informal norms that shape Chinese business culture and practice.

C. *Why Legal Institutions Matter*

Because the vast literature on the business case is largely based on data from Western capital markets, it proceeds from the assumption that legal institutions and markets function efficiently. The Chinese context offers an important opportunity to more directly examine how the presence and function of legal institutions grounds the business case. As discussed before, not only do legal institutions undergird markets themselves (and hence the drivers of the business case), but they also affect the salience of particular stakeholders to firm decision-making, define CSR and its potential scope, and directly facilitate or limit the extent to which informal institutions, like the business culture in which firms operate, encourage strategic CSR. Domestic norms and rules may reflect the diffusion of international standards, and the institutional context for many Chinese companies is in fact global; however, a discussion of foreign legal institutions is beyond the scope of this article. With this caveat in mind, the analysis here of how law matters in the domestic context may shed light on the prospects for informal institutions to support strategic CSR in China and on the limits of CSR diffusion in contexts where formal institutions are still evolving.

1. **Law & Markets**

An obvious starting point when looking at how formal institutions, like legal rules and enforcement mechanisms, matter to the business case is the relationship between law and markets. It is uncontroversial that one important function of legal institutions is to set the rules of the game for markets. As Pistor and Xu have noted with respect to China, administrative governance can substitute for legal institutions, but formal institutions in some form are nonetheless important, if not always necessary, to facilitate market transactions. Some commentators have suggested that the core rules of the game are those that are necessary to protect fair competition, deter fraud and self-dealing, and reduce information asymmetry. Ensuring market players’ access to information is particularly important to the business case because lack of access to information
prevents market actors, like consumers or investors, from communicating their preferences to firms through the product or capital markets. The strength or weakness of formal legal institutions can therefore facilitate or impair the business case insofar as it depends on these pressures.

In fact, all of the market drivers of CSR, such as consumer, employee, or investor demand, require certain conditions to be met in the institutional context of markets themselves in order for market pressure to set new expectations for firms. First, market actors’ own preferences must value companies that embrace CSR. Information on where these preferences align must be efficiently communicated to firms. In addition, markets must reward firms who align their operations with those preferences and punish those who do not. These consequences must be financially material to firms in order for them to take notice, making the availability of meaningful legal remedies, reputational sanctions, and formal enforcement mechanisms important. Finally, firms must have the power and capacity to respond. As it happens, all of these elements, and therefore the business case itself, depend to some extent on the existence, nature, and relative strength of formal legal institutions.

Most critically, corporate stakeholders must have access to reliable information that can help them distinguish firms with strong or weak nonfinancial (i.e. CSR) performance. For example, formal law directly affects the quality and quantity of information by mandating the extent to which state agencies release information on firm regulatory violations; the extent to which firms are required to produce sustainability disclosures; the strength of anti-fraud and consumer protection laws that govern firm communications with the public and investors; the potential for external monitoring by other organizations and the public; and access to reliable “reputational intermediaries,” like lawyers, accountants, and auditors, who prepare or attest to the quality of disclosed information. Whether firms’ CSR practice has any financial effect therefore may depend indirectly on whether legal institutions permit or restrict press freedom, civil society activity, and other forms of public oversight and whether regulation of market intermediaries makes them credible monitors and gatekeepers. All of these factors present challenges in the Chinese context.

Equally important to the business case is whether market actors can communicate their preferences to firm managers. Stakeholders’ ability to exercise voice also affects which stakeholders matter to firms. For listed firms, share price is a
primary signal to managers of shareholders’ response to new information about the company. However, China’s markets are not efficient and formal remedies for investors are weak, thus limiting the influence of outside investors. In systems like China’s, where banks are a more important source of finance than equity markets, the efficiency of market prices and potential for minority investor voice are also of less importance. Public stakeholders, for their part, have a number of avenues to influence firms directly and indirectly. Many local governments have hotlines to report regulatory violations or illegal conduct, and social media has proven to be a powerful force in China’s justice system. Aggrieved citizens can also petition courts, state agencies, and party offices through “letters and visits” in person and online, in addition to taking legal action. Media reports on corporate violators can lead in some cases to intervention by the relevant authorities. However, restrictions on media and civil society organizations; corruption and local protectionism; and gatekeeper conflicts of interest may limit the extent to which stakeholder preferences and demands reach corporate decision-makers.

In addition, many of the arguments in support of the business case rest on the potential costs and risks of negative CSR, that is, the penalties firms incur when they harm stakeholders. What is often overlooked in the Western literature on the business case is that whether these penalties exist at all and whether they are financially material to firms almost completely depends on the perceived and actual risk and severity of legal or administrative liability. Private enforcement by employees, consumers, or investors through litigation, public protest, and media exposure may also create a risk of economic loss to the firm. However, if these enforcement mechanisms are weak, the business and financial risk of the firm’s poor social performance will be too small to be relevant from a financial standpoint, or can be easily externalized.

In China, the limits of regulatory enforcement in areas as diverse as product safety; labor and employment; and environmental regulation combined with the extent of corruption and the procedural and practical limits on private litigation together reduce the risk of significant liability to firms and their managers. As one recent survey of CSR perceptions and practice recently reported, “[t]he main impediments [to CSR in China] are no longer monetary or even legislative.” Rather, “they have to do with institutional and structural change and efficient use of government resources, accompanied by effective implementation of legislation.” Indeed, “without adequate
oversight and enforcement, proactive compliance can thus become a disadvantage for companies.”

Of course, CSR diffusion is typically achieved through norm formation, firm voluntary commitments, self-regulation, and other forms of “soft law” that may drive deeper internal changes in corporate organizations than formal law. However, prior work observes that the enforcement of informal norms and soft law depend on many of the same underlying processes and institutions as hard law. For example, the reliability of voluntary sustainability reporting depends on the authority and credibility of third-party standard-setting organizations and external auditors. Within the firm, enforcement of codes of conduct depends on the same internal oversight tools as are necessary for formal legal compliance. Because hard law and voluntary CSR practices are often mutually reinforcing, weaknesses in legal institutions constrain the potential of voluntary commitments and self-regulation.

Finally, formal rules matter to the business case because law can be used, as the Green Finance initiatives contemplate, to create markets or market incentives that essentially price positive and negative externalities of firm operations that are linked to stakeholder impacts. Cap-and-trade systems designed to make firms internalize the cost of greenhouse gas emissions are a prominent example. Market intervention through the use of tax incentives or levies to raise the market price of negative behavior, or lower the cost of positive investments is another common example of how legal rules (in other words, legal institutions) can harness markets in order to ultimately promote institutional change in business culture and practice. Again, many of China’s recent reform initiatives, particularly in the environmental space, draw on these tools and, if successful, could strengthen the business case for firms to attend to these issues.

2. STAKEHOLDER SALIENCE

Another way in which law grounds the business case is through its impact on stakeholder salience. As Aguilera and Jackson have noted, formal and informal “[i]nstitutions shape the social and political processes of how stakeholders’ interests are defined . . . aggregated, and represented with respect to the firm.” Archie Carroll, the author of the famous CSR pyramid model, defines stakeholder salience in terms of the legitimacy and power of particular stakeholders, which can change over time as the external business
context changes. For example, wages and working conditions were key issues for firms in China from the 1990s through the early 2000s when tightening labor markets and a rise in labor litigation prompted shifts in firm practice. Legal rules can affect stakeholder salience by legitimizing or prioritizing certain stakeholders and creating or restricting avenues for stakeholder voice. In the case of organizational stakeholders, law can also set the conditions for their existence and scope of influence. In short, the content of legal standards, applicable procedural rules, and how well formal legal institutions function all affect whether firms consider stakeholder impacts material to their core business. Therefore, all of these rules directly affect the cost-benefit analysis that underlies the business case for CSR.

As a starting point, corporate governance rules determine, in part, the degree of influence that key stakeholders (i.e. laborers, creditors, and shareholders) have on firm-level decision-making. For example, under the corporate law of nearly every U.S. state, corporations are permitted to be formed for “any lawful purpose,” and directors and officers are generally permitted to consider stakeholder interests in corporate decision-making. However, limits on the governance rights of non-shareholders support a focus on shareholder interests. Under U.K. Company Law, in contrast, fiduciary duties require directors to consider a range of stakeholder interests. Article 5 of China’s Company Law urges companies to consider stakeholders (as well as other corporate governance rules, modeled partly on German law); create a dual board structure; and require listed companies to ensure at least one-third employee representation on the supervisory board. Taken together, these provisions are generally supportive of stakeholder concerns; however, they must be weighed against the context of controlling shareholder dominance in most Chinese companies, shareholder-centric enforcement rules, and the relative weakness of supervisory boards.

The fact that local governments are key stakeholders for most businesses also means that state priorities can also affect companies’ incentives more directly and through more avenues than is perhaps the case for Western firms; it can also increase diffusion of CSR norms if these goals are supported by local governments. For example, many Chinese companies report that they are influenced by competitors’ CSR practices and may pursue sustainability goals in order to avoid being seen as laggards by local authorities. In addition, studies of media perspectives on CSR also report that how the media covers companies, as well as the emphasis that different stakeholders
receive, are related to government priorities, in part because Chinese media outlets rely heavily on government sources. Because Chinese central and local government actors may engage with firms as regulators; stakeholders; and, at times, shareholders the state plays a particularly important role in shaping the relative salience of various stakeholders in terms of their legitimacy and visibility.

At the same time, legal rules can also limit the ability and power of some stakeholders to influence firms. Some of these, such as the limits on private litigation by shareholders or other stakeholders have been mentioned above. In addition, China maintains tight restrictions on independent labor unions and grassroots NGOs in China have long been restricted, controlled, or coopted to varying degrees by the central and local state. Public interest advocacy is heavily restricted by practical and formal limits on legal representation of politically sensitive cases. All of these limits weaken the legitimacy, power, and voice of domestic civil society organizations that could advocate for stakeholder interests.

Beyond the direct effect of weak legal regimes on business culture; incentives; and the perceived low costs of violations, which may outweigh any benefits of CSR practices, firms are also unlikely to see stakeholders’ demands as salient in economic terms without the threat of significant legal or administrative penalties to back them up. Limits on judicial remedies and available penalties therefore have an additional impact by weakening stakeholder voice. A prime example of this phenomenon is the materiality of human rights issues in the U.S. Before the mid-1990s, firms gave little heed to the human rights impacts of their operations, particularly in far-flung markets run by foreign subsidiaries. This practice changed when corporations began to be haled into court under the Alien Tort Claims Act for facilitating violations of international human rights law by their foreign affiliates. Although the trend has been curtailed by the Supreme Court’s decision in Kiobel, the size of the potential settlements pre-Kiobel made human rights issues financially material to multinational firms. Similarly, the Chinese central government’s current focus on environmental sustainability, tougher penalties under China’s amended Environmental Protection Law, and new enforcement campaigns may make environmental issues more salient to firms.
3. DEFINING, DRIVING, OR DISCOURAGING CSR

As the previous section already suggests, legal rules affect the business case, not only by impacting how market pressures influence firms, but also by shaping how CSR is defined and incentivized. Governments may define CSR directly by mandating specific CSR or sustainability practices, or indirectly by enacting legislation that shapes informal norms and sets the foundation on which voluntary CSR practice builds.

To begin from the common understanding of CSR as going beyond legal compliance, it remains the case that, by establishing minimum legal standards for firms, governments define what “going beyond” compliance actually means. For example, firms that offer better working environments than the law requires or pollute less than the law allows may be considered to be engaging in CSR. And again, the corporate law of a given jurisdiction is particularly important in defining the space for CSR because it determines whether companies formed in that jurisdiction are generally permitted, required, or prohibited from using the corporate form to advance public or stakeholder interests. Laws also indirectly define what responsible business conduct includes, often reflecting dominant social norms. For example, labor legislation might seek to benefit women by restricting them from certain jobs while federal labor law in the U.S. requires equal access to employment opportunities; still other systems may make no special provisions for women or other traditional minorities. Laws that governments pass to encourage CSR “have a strong influence on establishing social expectations about responsible corporate behavior.” By endorsing certain stakeholders over others, the state can give their interests greater legitimacy and salience.

Governments may also adopt specific policies that may strengthen the business case for firms to adopt CSR in some form. The World Bank, the United Nations, and a number of governments have identified four key roles for governments, and therefore, potentially for legal institutions, in advancing CSR: (1) explicit CSR mandates, such as mandatory sustainability reporting; (2) facilitating, for example by setting standards for voluntary CSR reporting; (3) endorsing CSR or particular standards and practices; and (4) by partnering with firms and other organizations to promote CSR practices. Official acknowledgment of the importance of CSR itself signals that the state permits and encourages firms to account for stakeholder interests. Governments in many emerging markets,
including Thailand, Vietnam, Brazil, India, Egypt, Chile, South Korea, Nigeria, and South Africa have also established public policies to promote (and in some cases mandate) CSR, and China is no exception.

As described earlier, a number of national and subnational government actors in China see CSR policies as innovative and as a potential source of competitive advantage in relation to other local governments or agencies and many have adopted measures that encourage or mandate certain CSR practices or establish audit systems to evaluate and rank corporate social performance. Many of these measures explicitly define CSR and state that endorsement or facilitation of CSR is especially important in China because local and central governments are key stakeholders of Chinese firms whose priorities affect CSR decisions. For example, these programs demonstrate a lack of state support for some dimensions of CSR, such as human rights, which means that these issues are less likely to be salient to Chinese firms. At the same time, the Chinese Communist Party has additional tools at its disposal through its personnel evaluation system that can motivate local officials to follow state priorities, which are at the present increasingly emphasizing the implementation of environmental law. While the possibility of mandatory CSR may strike Western observers as a misnomer, in China, and in India as well, mandatory approaches are increasingly common. At the same time, the voluntary-mandatory distinction may itself be less useful in weak enforcement environments, and in China, CSR is often seen as the voluntary actions companies take to reach the aspirational target that law establishes relative to the actual legal requirements set by local enforcement priorities and capacity. All of these initiatives, whether voluntary or mandatory, explicitly define and incentivize CSR.

Consequently, a related limit of the business case for CSR is that how governments define CSR may in fact undermine its legitimacy and normative force, and thus hinder a shift in the norms of business culture toward strategic CSR, which sees CSR as embedded in the core of how companies do business. In India, for example, legal mandates in the Company Law have actually narrowed the definition of CSR by mandating corporate philanthropy and equating it with CSR. This implies that charitable contributions are the most important aspect of CSR, when in fact corporate philanthropy is one form of CSR that is most likely to be isolated from the rest of corporate operations. Similarly, in China, a problematic development is that local governments often undertake
philanthropy drives to demand corporate support for various local development goals or other causes. This practice does not only discourage companies from embracing CSR, but it is unpredictable and potentially costly, opens the door to corruption, and ultimately perpetuates the view that CSR is value-reducing. Despite official support for many dimensions of CSR, these kinds of practices at the local level may discourage firms and their stakeholders from embracing a deeper, strategic understanding of CSR.

As this discussion shows, the market drivers of the business case rest on both formal and informal institutions that are interrelated and mutually reinforcing. Although governments at multiple levels are important stakeholders for Chinese firms and many formally endorse or promote CSR, the normative force of these policies and programs is undercut by the weak support legal institutions offer to stakeholders themselves. Although further research is needed to confirm how these limits affect the strength of the business case for particular firms or sectors, these constraints may explain the narrow focus of Chinese firms on discrete CSR practices such as corporate philanthropy and sustainability reporting, as well as the mixed conclusions presented by the empirical studies to date.

IV. CONCLUSION

This article has examined how market drivers might influence the informal norms of business culture in favor of strategic CSR, and how legal institutions affect the potential for institutional change. These questions are particularly critical as China’s leadership is looking to market-based tools to advance its sustainability agenda, raise the level of voluntary legal compliance, and encourage companies to support broader public policy goals.\textsuperscript{148} These efforts complement diverse government-led initiatives to expand understandings of CSR and commitment to CSR practices among Chinese firms. Examining how market forces might drive CSR diffusion among Chinese firms is also important because Chinese companies are expanding to both developed markets like the U.S., Australia, and the E.U., and to emerging markets in Africa, South America, and the Middle East who may seek to draw lessons from China’s development model.\textsuperscript{149}

\textsuperscript{148} See id. at 200–08.
\textsuperscript{149} See id. at 227.
The early empirical work on the business case for CSR in the Chinese context suggests that embracing some forms of CSR may improve financial performance for some Chinese firms. However, the early literature surveyed here is based on limited definitions of CSR and does not yet demonstrate that market-based incentives are sufficiently strong to motivate deep changes in firm behavior across the economy. Future research could usefully test the business case using more comprehensive measures of CSR in order to assess how actual firm practice compares to firms’ stated CSR practices. Furthermore, more studies are needed to substantiate these early findings.

This article has also shown that the limits of the business case in China are tied in large part to the limits of formal legal institutions. Although this suggests that voluntary CSR practices are unlikely to effectively substitute for better regulatory enforcement, more consistent legal implementation may lend support to the business case and encourage firms’ voluntary commitments. In the meantime, ethical leadership and modeling by industry leaders may play an important role. Given the state’s dominance as a stakeholder and as regulator, governments in China might lay a foundation for market-based incentives to work by facilitating strategic CSR, not only through direct state-led CSR policies, but by strengthening formal institutions, promoting transparency across markets, and by strengthening avenues for stakeholders to monitor firm behavior. If these efforts succeed, market drivers might more clearly align with strategic CSR, as well as the state’s broader public policy goals.